‘A’ level: Economics ‘B’

Paper 3 mini tests 2021: The UK Economy

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Contents

These final two mini-tests out of the six have the following key features:

1. Each is one hour long, and correspond to Section A and Section B of a conventional two hour paper. So the first mini test focuses on the broad context of the UK economy, while the second one looks at one particular industry within the general context.

2. Accompanying each test is a mark scheme, based around Edexcel’s own mark schemes. These both assist the teacher in marking students’ work, and helps students understand what they need to do to improve their mark.

3. Also accompanying each test is a set of suggested answers. These are rather longer than most students would have time to produce in an examination setting, and also contain more analysis and detail than students would be expected to know. They inevitably contain some points of view personal to the author. They should therefore be seen as an example of how the questions might be tackled rather than as definitive responses.

4. Pagination has been organised so individual questions can easily be photocopied. This is also true of the mark schemes and suggested answers.

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Write your name here

Surname	Other names

Centre Number	Candidate Number

Economics B

2021 Paper 3: The UK Economy

First Paper 3 mini test – broad context

Time: 1 hour

You do not need any other materials

Instructions

Write in black

Fill in the boxes at the top of this page

Answer all questions in the spaces provided

Information

Total marks: 50

This gives you one minute per mark plus 10 minutes' reading time

Use this to time your answers

Calculators are permitted

Advice

Read each question very carefully

Try to answer every question

Check over your answers if you have time at the end

Answer all parts of the question

Read the following extracts (A to C) and Figures 1 and 2 before answering the question

Extract A

Dangers of a global recession occurring in 2020

This year [2018] marks the tenth anniversary of the 2008 financial crisis, which led to the 2008-09 global recession. There are significant risks that, by 2020, the world will be in recession once again. What are some of the risks that could bring this about?
First, asset prices look dangerously high with the US stock market enjoying a lengthy run of increased share prices. A collapse of this bubble could bring about a general loss of wealth and confidence. Then the US President, Donald Trump, is making threatening noises towards Iran. The outbreak of hostilities in the Middle East could result in a supply-shock as oil prices soar in response to shortages.

Then of course rising inflation might lead to central banks responding with contractionary monetary policy, and history demonstrates how easy it is for policy to overshoot its target and cause a recession. Finally, the deterioration of relationships between the USA and China could end in a trade war, a lose-lose situation where all countries suffer as the gains from trade dwindle.

Sources: UK press reports, 2018

Extract B

The furlough scheme

In response to the spread of the highly infectious disease known as coronavirus or Covid-19, the UK government took unprecedented action in March 2020. Restaurants, pubs and cafes were ordered to close on 20th March and a few days later all shops deemed 'non-essential' also had to close while almost everyone was ordered to stay at home. Workers had to work from home where possible.
In order to prevent mass lay-offs, the Chancellor, Rishi Sunak, launched the 'furlough scheme'. Workers who were not needed at the moment by their employers were paid 80% of their normal wages by the government. By October the government had injected £40 billion into the economy through this scheme, which at its height supported over 8 million workers. Other additional costs associated with the coronavirus and paid for by government were estimated at a further £160 billion.

It is too early to judge how successful this scheme has been. It achieved its immediate objective of preventing unemployment from soaring. The unemployment rate went up from an historic low of 4% to just 5%. On the other hand, many of the jobs saved in the short-term may never come back whereupon unemployment may rise sharply in 2021. Then again, the government's tax authorities think at least 10% of the money paid out has been fraudulently claimed. For example, firms could say their workforce was not working and therefore claim the money whereas in reality they could still be doing some or all of their tasks.

Sources: UK press reports, autumn 2020

Extract C

The Bank of England's response to coronavirus (Covid-19)

We have cut our interest rate to 0.1%

Lower interest rates will mean cheaper loans for businesses and households. That will reduce the costs faced by businesses and households in the UK.

We are helping banks to cut interest rates on their lending

We're offering banks and building societies long-term funding at interest rates at, or close to, 0.1%. This will reduce the interest rates they charge you.

We are helping businesses pay their staff and suppliers

We're working closely with HM Government to support large businesses by offering them cash for their corporate debt. This will help them to keep paying wages and their suppliers, even if they have serious cash flow problems.

We are helping banks to expand lending

We have reduced the amount of financial resources (called capital) that banks and building societies need to set against their lending to UK businesses and households.

Source: Bank of England

Figure 1 Cumulative Asset Purchases (Quantitative Easing), 2009-2020, £ billion

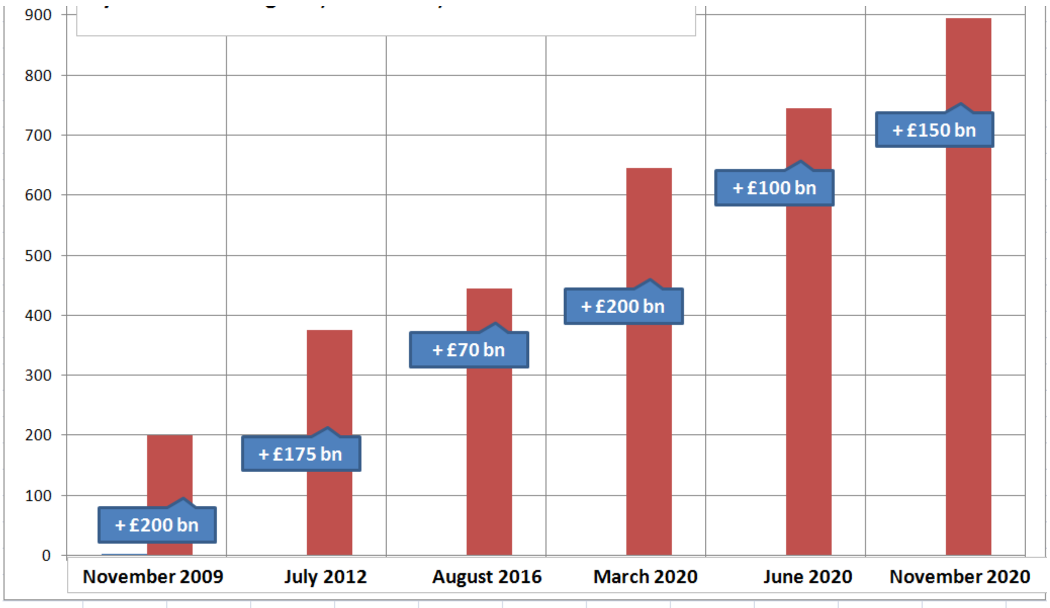
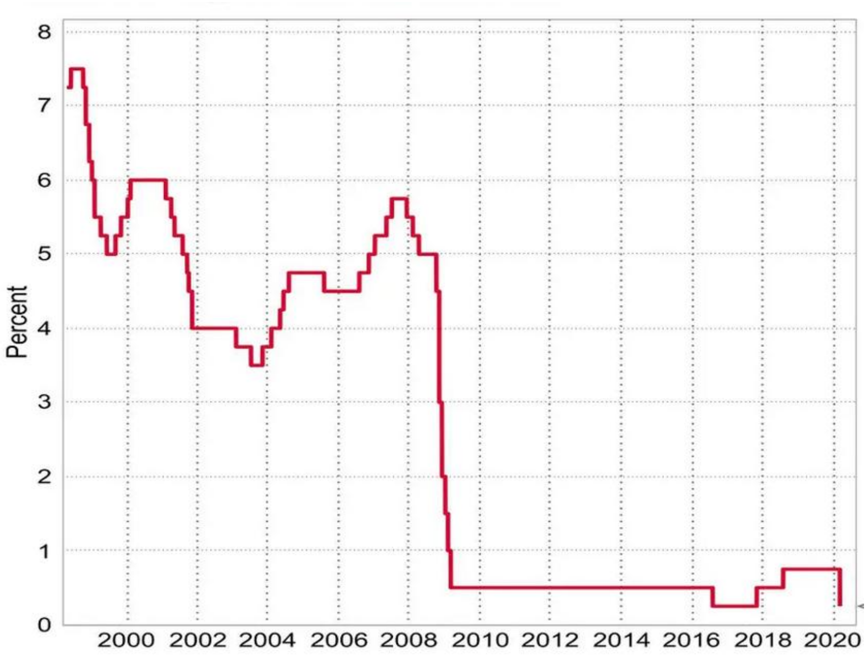


Figure 2 UK interest rates, 1998-2020



Questions

1a Discuss the main characteristics of a recession. **(8)**

1b With reference to Extract B, assess the impact of injections into the circular flow of income. **(10)**

1c ********************** **(12)**

1d ********************** **(20)**

First Paper 3 mini test, broad context – Mark scheme

General marking guidance:

1. The 'possible content' below gives suggestions for what a candidate might write. However, any relevant content should be rewarded.
2. Where a question directly mentions some of the stimulus material then this must be referred to in the answer in order to get full Application marks. Other references based on the candidate's own knowledge may also be rewarded.
3. Markers should use the full range of marks. They should not hesitate to give full marks for any question where the requirements of the mark scheme have been fully met. Equally, an answer that meets none of the criteria should always be given zero.

Question 1a	**Deciding on the correct level**	**Mark**
Level		**Max: 8**
	An answer with no merit.	0
Level 1	Occasional elements of knowledge, very little application, unconvincing arguments, no clear answer to question.	1-2
Level 2	Some knowledge and application, developed arguments, limited judgement.	3-5
Level 3	Convincing knowledge and application, well-developed arguments and balanced judgement.	6-8

Question 1a	Discuss the main characteristics of a recession.	**Mark scheme**
Level		
Knowledge	Definition of recession – two successive quarters over which real GDP falls. Recession officially ends when real GDP starts to rise; regardless of size of output gap.	2
Application	As in first half of 2020, caused by government-imposed shut-down of large sections of economy; first since 2008-09 recession caused by financial crisis.	2
Analysis	Normally rising unemployment: in 2020 largely prevented by furlough scheme (N rate rose from 4% to just 5%). Is a lagging indicator.	2
Evaluation	Often falling inflation – unless cause is supply-side shock as in 1974-75 and 1980-81. In 2020, inflation fell out of 1-3% pa band – hence letters from Bank to Chancellor. Impact on BOCA dependent on size of recession relative to that of our trading partners.	2

Question 1b	**Deciding on the correct level**	**Mark**
Level		**Max: 10**
	An answer with no merit.	0
Level 1	Occasional elements of knowledge, very little application, unconvincing arguments, no clear answer to question.	1-2
Level 2	Some knowledge and application, developed arguments, limited judgement.	3-4
Level 3	Convincing knowledge and application, well-developed arguments and some attempt at balanced judgement.	5-7
Level 4	Convincing knowledge and application, well-developed and evaluated arguments, impressive focus on question throughout, and an informed, personal and balanced judgement.	8-10

Question 1b	With reference to Extract B, assess the impact of injections into the circular flow of income.	**Mark scheme**
Level		
Knowledge	The three injections into the circular flow of income are investment, government spending and exports.	2
Application	Extract B refers to increases in government spending, notably the furlough scheme but also other spending associated with the government's response to Covid-19.	2
Analysis	Injections will increase the circular flow of income (i.e. nominal GDP) until they are matched by an equivalent increase in leakages (savings, taxes and imports). Put another way, the AD curve will shift outwards by the initial increase in injections times the value of the multiplier.	3
Evaluation	However, the increase in real GDP may be limited if the economy is already producing near potential output (Yp). In this case, injections may simply cause rising inflation instead.	3

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First Paper 3 mini test, broad context - suggested answers

1(a) *Discuss the main characteristics of a recession.* **(8)**
Answer: A recession is defined as a period where, for two successive quarters (i.e. three-month periods) real GDP falls. They are natural occurrences in the operation of the free market, a response to shocks of various kinds on either the supply-side or the demand-side of the economy. Recessions, therefore, are inevitably associated with falling real GDP because that is how they are defined in the first place.
Typically they are also associated with rising unemployment, specifically rising cyclical unemployment. As companies tend to wait a few months before going through the expense of making workers redundant unemployment is called a 'lagging indicator'. It starts to rise a few months after GDP starts falling and tends to go on rising for a few months or even years after GDP begins to recover. Firms weakened by a recession will often fold even after the first green shoots of a recovery have started to appear. The 2020 recession was unique in that very large falls in GDP in March and April were met with hardly any rise in unemployment – but this was due to the exceptionally generous furlough scheme which kept up to 8 million workers 'on leave' while paid by the government – and therefore not counting towards the unemployment total.
Recessions are often associated with falling inflation: certainly that took place in 2020 with inflation falling to 0.6% pa by the end of the year. However, this only takes place if the recession was caused by a demand-shock. If, alternatively, it is caused by a supply-shock as in the 1974-75 and 1980-81 recessions then 'stagflation' takes place. The SAS curve on the AS/AD model shifts inwards leading to rising inflation even while GDP (and therefore employment) falls – the worst of both worlds.
Another characteristic is an improving balance of payments on current account (BOCA). As GDP falls so demand for all sorts of goods fall – including imports. This leads to the improvement as BOCA equals Exports minus Imports. However, this positive impact only works if the recession is worse in Britain than it is with our trading partners. Otherwise Exports would fall as well, leading to no net improvement.

1(b) *With reference to Extract B, assess the impact of injections into the circular flow of income.* **(10)**
Answer: In the circular flow of income model the three injections are investment, government spending and exports. If any of these variables rise then the circular flow of income (i.e. GDP) will go on rising until the increase in injections is matched by an equivalent increase in leakages. The three leakages are savings, taxes and imports. The injection referred to in Extract B is an increase in government spending, in this case a vast increase of £200 billion representing an additional 10% of annual GDP in the space of six months (March to September 2020). This would normally cause a sharp increase in GDP and probably in inflation too. In this case it did not because the injection was timed to match the fall in consumption caused by 'locking down' large sectors of the economy to slow down the spread of the highly infectious coronavirus.
Another way of looking at the impact of an injection is to say that it will shift out the AD curve by the extent of the initial injection times the value of the multiplier. In the UK the value of the multiplier is fairly low: probably not more than two. This is because – being an open, high-tax economy – much of the initial injection expenditure immediately leaks out of the circular flow of income in the form of additional imports and additional tax revenue. And indeed the £200 billion additional expenditure was arguably not enough given that GDP still fell by 10% over the year.
On the other hand, reducing the public sector deficit has been a target of government policy since 2010. Having reduced the deficit to £55 billion in 2019, an additional £200 billion spend (combined with reduced tax revenue due to falling GDP), has blown all the government's progress on this metric out of the water. However, another way of looking at this is to say that the government's prior

progress in halting the rise of the National Debt as a percentage of GDP had put the public finances in a strong enough position to sustain this enormous, one-off injection.
In many circumstances an injection of this size would be inflationary. As potential output (Yp) approaches so additional spending feeds through into inflation as the SAS curve becomes increasingly steep. In this case there is no such danger as the lock-down measures have forced households to spend much less than normal, particularly in areas such as hotels and restaurants, travel and holidays. The increase in government spending has therefore been outweighed by a decline in consumption. Indeed, for much of 2020 inflation has fallen below the 1% pa lower boundary forcing the Governor of the Bank of England to write letters to the Chancellor explaining why the 2% pa target has been missed by more than 1%. In conclusion, the most significant impact of the 2020 government injection has been the remarkable slowing down of rising unemployment albeit at the cost of a vast increase in the public sector deficit.