

372/01

ECONOMICS – EC2

A.M. WEDNESDAY, 18 January 2006

(1 hour)

ADDITIONAL MATERIALS

In addition to this examination paper, you will need an 8 page answer book.

INSTRUCTIONS TO CANDIDATES

This paper contains **one** compulsory question.

INFORMATION FOR CANDIDATES

The number of marks is given in brackets at the end of each question.

You are reminded of the necessity for good written communication and orderly presentation in your answers.

MANAGING A STABLE ECONOMY

In the Pre-Budget Report of December 2004 the Government forecast that:

- the economy would grow by 3.25% in 2004 and by 3% to 3.25% in 2005. This continued economic growth would help to maintain tax revenues;
- inflation would remain low and stable;
- 5 • there would be a budget deficit but no need to raise taxes. In any case a rise in the rate of income tax would not necessarily raise tax revenue.

The world economy strengthened in 2004 following downturns in many countries in the previous four years. The global economy is experiencing a period of far-reaching and fundamental change, driven by advances in technology, greater international trade and investment and rapid growth in many emerging markets particularly China and India. These changes have the potential to bring great increases in global prosperity.

The Government is committed to long term supply side reforms aimed at ensuring that the UK is well-placed to prosper in the changing global economy by promoting a stable economy which is flexible, enterprising and strong in innovation and skills. The Pre-Budget Report also announced:

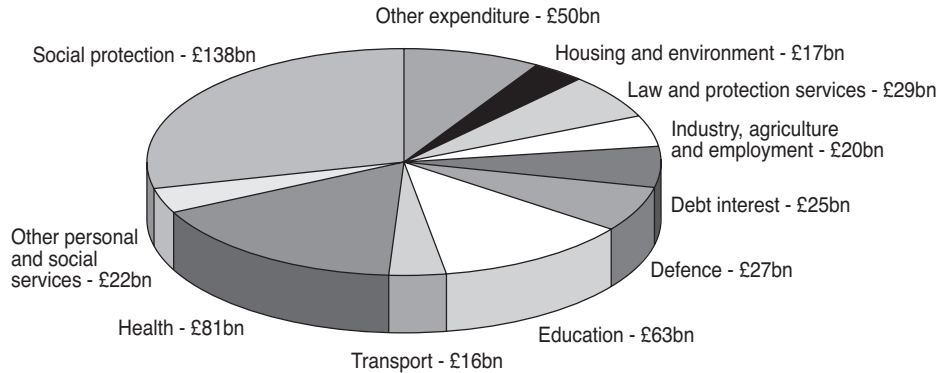
- 15 • **a Learning Allowance** that will allow benefit claimants to participate in full-time training;
- **a National Employer Training Programme** providing free and flexibly delivered training for low-skilled adults in work;
- **the implementation of the ten-year Science and Innovation Investment Framework**, by strengthening the partnership with business on raising investment in UK Research and Development, and improving business-university collaboration.
- 20

Forecast Government Expenditure 2004-2005

Total public spending is expected to be around £488 billion in 2004-05, around £8,000 for every man, woman and child in the UK. It is set to rise to £520 billion in 2005-06 and to £549 billion in 2006-07.

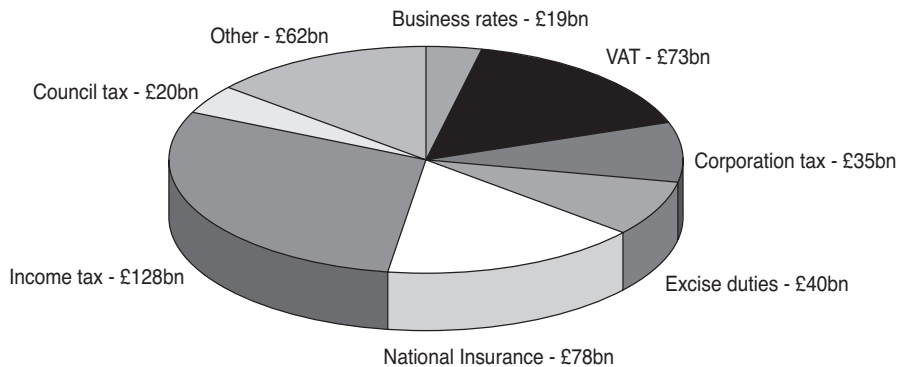
Where the money is spent

Total expenditure - £488 billion



Where the money comes from

Total receipts - £455 billion



Source: HM Treasury (adapted)

- (a) (i) From the above data identify a direct tax and an indirect tax. [2]
- (ii) With reference to the government expenditure in the data, distinguish between current and capital expenditure. [4]
- (b) With the aid of a diagram, explain why 'a rise in the rate of income tax would not necessarily raise tax revenue'. (Lines 5 and 6.) [6]
- (c) Using economic analysis, explain why the Government is responsible for so much expenditure on health, education and defence. [6]
- (d) Using the data, explain how the Government uses its expenditure and taxation policies to implement supply side reforms in the UK economy. [8]
- (e) Calculate the Government's expected budget deficit in 2004-2005 and evaluate its likely impact, with the use of diagrams, on output, employment and the price level. [14]