Cambridge Assessment International Education

Cambridge Pre-U

ECONOMICS **9772/01**

Paper 1 Multiple Choice, Short Answers and Data Response **May/June 2022**

INSERT **2 hours 30 minutes**

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INFORMATION

- This insert contains the case study.
- You may annotate this insert and use the blank spaces for planning. **Do not write your answers** on the insert.

This syllabus is regulated for use in England, Wales and Northern Ireland as a Cambridge International Level 3 Pre-U Certificate.

This document has **4** pages. Any blank pages are indicated.

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Case Study: The worst of both worlds?

Extract 35.1: Inflation

In the 1970s, significant government deficits, an oil price shock and spiralling wage demands drove inflation into double figures for many economies.

In 1975, the UK inflation rate hit an incredible 24%. Such rates seem unthinkable in 2020 at a time when central banks have been struggling to hit inflation targets of 2%, despite near-zero interest rates. Table 35.1 shows the UK Consumer Prices Index (CPI) between 2016 and 2020.

Table 35.1: UK Consumer Prices Index (CPI), 2016–2020 (2015=100)

Year	CPI value
2016	99.8
2017	101.5
2018	104.5
2019	106.4
2020	108.2

Source: tradingeconomics.com/united-kingdom/consumer-price-index-cpi

In 2020, with the coronavirus pandemic creating historically large decreases in gross domestic product (GDP), deflation is the more obvious threat. However, these conditions could quickly reverse as governments and central banks attempt to combat the pandemic with enormous fiscal stimulus packages far larger than those used in the aftermath of the 2008 global financial crisis.

In addition, in 2020, there may have been a turning point for globalisation. Instead of sending production offshore to cut costs, many firms could bring production back home, a process known as 'reshoring'. These trends could create supply chain constraints, reverse the previous cost-saving principles and drive up prices, triggering inflation.

In May 2020, warnings were taken a step further. Some economists argue that reshoring and reduced exports associated with deglobalisation, as well as the UK's biggest ever fiscal stimulus package, make stagflation inevitable. Stagflation is what happens when a stagnating economy with low or no economic growth simultaneously suffers high inflation; this represents the worst of both worlds.

Stagflation will lead to significant policy conflicts for a government seeking to achieve the objectives of an increase in economic growth, the control of inflation and a reduction in income inequality. Milton Friedman, who had argued during the 1960s that the Phillips Curve was built on doubtful assumptions and that stagflation was possible, rose to prominence when events in the 1970s proved him right. The search for a weapon to fight stagflation led in part to the rise of supply-side economic theories as an alternative to Keynesian economics.

In the current situation some economists take the view that central banks are not actually attempting to over-stimulate their economies, they are trying to save them from getting any worse. A widely held opinion is that the recovery will take a very long time and meantime aggregate demand will reduce further. Consumers will be put off buying expensive durable goods and firms will be reluctant to invest in capital or hire labour. Under these circumstances, it is difficult to predict inflation.

Extract 35.2: Income and wealth inequality

Whilst some central banks spent most of the past decade concerned that inflation was too low, fears amongst others that the steady fall in unemployment would enable workers to pursue inflationary wage claims have proved unfounded. However, a decade of quantitative easing and ultra-low interest rates have led to the price of assets – commodities, shares, bonds and property – inflating.

The aggregate wealth of UK households was reported to be £14.63 trillion in 2018 compared to £12.57 trillion in 2016. This amounts to a real increase of 13.1%. Furthermore, since 2008, there has been a real increase of 41% in the aggregate wealth of UK households. However, there has also been a significant increase in wealth inequality in the UK.

Over a longer term there has also been a higher mean value of disposable income relative to the median value in the UK. This is indicative of inequality in disposable income. This longer-term growth in the inequality of income has helped to exacerbate the ongoing wealth inequalities. Table 35.2 illustrates the relative extent of income and wealth inequality in the UK.

Table 35.2: Distribution of UK household disposable income and wealth, 2018

	bottom 10% of households	top 10% of households
% of total household disposable income	2.9	28.5
% of total household wealth	0.1	44.6

Source: https://www.ons.gov.uk/releases/wealthingreatbritainwave62016to2018

The Organisation for Economic Cooperation and Development (OECD) has suggested that reducing income inequality through Keynesian-style tax and transfer policies does not harm economic growth, so long as the chosen policies are well designed and implemented. It argues that redistribution efforts should focus on young people and families with children and include improvements in human capital investment through the promotion of skills development and learning.

Adapted from: thenational.ae 'Will the pandemic cause a surge in inflation?'
And: theguardian.com/business/2020/may/31/for-all-his-woes-at-least-sunak-does-not-need-to-worry-about-stagflation
And: ons.gov.uk/releases/wealthingreatbritainwave62016to2018

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