AQA A-LEVEL ECONOMICS · 7136

ECONOMICS



EXAM QUESTION PACK

3.2.6.3 THE BALANCE OF PAYMENTS

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1. ‘The UK economy has recently been in the grip of its worst recession for 60 years.’

Explain possible reasons for an economy moving from a period of prosperity to one of recession.

[15 marks]

2. ‘Failure to get a new trade deal would put another dark cloud over the world economy.’

Source: PETER MANDELSON, EU Trade Commissioner, July 2008

Evaluate the significance for the UK balance of payments on current account of increased use of protectionist policies around the world.

[25 marks]

3. The formation of single markets by countries in various parts of the world, including within Europe, has shown that much is to be gained from increased economic cooperation.

Evaluate the possible economic costs and benefits to an EU member state, such as the UK, of being part of the EU single market.

[25 marks]

4. ‘It is better to do everything you can to prevent deflation before it begins, even if there is only a small chance of it occurring.’

Assess the impact on UK macroeconomic performance of a prolonged period of deflation.

[25 marks]

5. Weaknesses in the UK balance of trade in goods persist, with a deficit of £27.6 bn in the third quarter of 2011, compared, for example, to £23.3 bn in the same quarter in 2010.

Discuss the possible contribution of supply-side reforms to achieving an improvement in the UK balance of trade in goods.

[25 marks]

6. **The Global Context Extract B** (lines 35–37) concludes: ‘Globalisation must surely have played its part in the success of the UK economy…whatever problems it may also have created.’

Using the data and your economic knowledge, to what extent do you agree with the view that globalisation has been of benefit to UK macroeconomic performance?

[25 marks]

7. **The Global Context Extract B** (lines 5–8) argues: “It now seems unlikely that economic ‘powerhouses’ such as India and China will provide support for the global economy through trade and investment. Such support might have helped avoid world recession and restored economic growth.”

Explain the term ‘world recession’ **and** analyse how **both** trade **and** investment can help to bring about economic growth.

[9 marks]

8. An economy which is enjoying rapid economic growth experiences a significant rise in the external value of its currency within a floating exchange rate system.

Explain the factors which may lead to a rise in the exchange rate of a currency within a floating exchange rate system.

[15 marks]

9. **The Global Context Extract B** (lines 4-5) refers to global investment undertaken by China.

Explain the term ‘global investment’ **and** analyse **two** economic consequences for an economy receiving such investment.

[9 marks]

10. An economy which is enjoying rapid economic growth experiences a significant rise in the external value of its currency within a floating exchange rate system.

Evaluate the possible macroeconomic consequences for an economy of a rise in the exchange rate of its currency.

[25 marks]

11. **The Europena Union Context Extract Extract D** (lines 27−28) states that ‘the impact of the increased government borrowing arising from budget deficits across the EU is of concern amongst some economists’.

Using the data and your economic knowledge, assess the impact on the UK economy of increased government borrowing by EU governments.

[25 marks]

12. **The Global Context Extract B** (lines 33−34) argues that ‘the living standards of developed countries, including the UK, will be affected by economic growth in Africa’.

Using the data and your economic knowledge, assess the view that living standards in the UK are likely to benefit from sustained economic growth in the economies of Africa.

[25 marks]

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13. THE EUROPEAN UNION CONTEXT

Extract D: Is EU unity threatened?

Europe, and indeed much of the world, was shaken by the depth of the economic downturn from 2008. Many countries, including the UK, saw the solution to be a return to Keynesian economics and, therefore, tolerance of large budget deficits. This was coupled with significant monetary expansion, so that, in the UK for example, the Bank of England Bank Rate was cut to 0.5% in 2009, accompanied by a policy of 'quantitative easing' (increases in the money supply).

The UK pressed other EU governments to embark on fiscal expansion. Not all shared the UK's enthusiasm and, at best, wanted only a much more modest fiscal stimulus than was the case in the UK. However, events sometimes overtook such wishes. Ironically, given the scale of the UK fiscal stimulus, until the latter part of 2009 the UK was the only major economy to remain in recession. This may reflect the greater significance of the housing and financial sectors in the UK compared to other EU countries.

The fiscal position of many EU countries has given rise to concern. Italy, for example, now has a national debt (the total outstanding debt of central government) of around 120% of GDP, even though its annual budget deficit is not exceptionally large. Some countries have shown a greater determination than Italy to cut their deficits. In December 2009, for example, Ireland announced sharp cuts in public sector wages. But it is certainly not just Italy which has shown complacency. The EU's Stability and Growth Pact limits annual borrowing to 3% of GDP. EU governments are under increasing pressure to return to this target by 2014.

The short- to medium-term benefits of fiscal expansion during downturns cannot be denied. Government spending can initiate a powerful stimulus to an economy through the multiplier process. Aggregate demand therefore rises. The UK Pre-Budget Report put government spending at £676 billion. Tax cuts will give households more spending power. Coupled with cheap credit and retail price discounts, recovery can therefore be helped through increased consumption.

However, the impact of increased government borrowing arising from budget deficits across the EU is of concern amongst some economists. It may eventually force the authorities to increase interest rates, lead to 'crowding-out' of private sector activity and make public spending cuts and tax increases an inevitability. In the UK, for example, a VAT rate of 17.5% was restored in January 2010 following a temporary cut to 15%. Equally, the 2009 Pre-Budget Report announced an increase in National Insurance contributions.

The problem in trying to assess the impact of fiscal expansion is, of course, not knowing what might have happened without it. Certainly, some economists are quick to attribute the end of recession in France and Germany in 2009 to such fiscal loosening. Indeed, it is difficult to argue that, for any country in the EU, economic growth and employment cannot be beneficial to some extent at a time when business and consumer confidence are both at a low level.

Whether such a policy eventually causes inflation to make an unwelcome return remains to be seen. At that point, EU members may experience a greater urgency to balance budgets and reduce monetary expansion.

Source: various sources, 2010

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14. ‘While it is necessary to have macroeconomic policy objectives, such as price stability and full employment, they can sometimes prove difficult to reconcile.’

Explain the various macroeconomic policy objectives **and** their importance to an economy.

[15 marks]

15. **THE GLOBAL CONTEXT**

Extract B: Living standards

Economists can generally agree on the causes of economic growth such as investment, innovation and improvements in productivity. There is greater disagreement over the consequences. An important part of the debate is the impact of economic growth on living standards. The debate has become more complex as measurement of living standards has taken on greater sophistication. GDP per capita (income per head) remains one of the basic measures.

Supporters of continued economic growth point to increased consumption possibilities, greater welfare, more support for the disadvantaged and more resources for health, education and infrastructure.

Opponents of unlimited economic growth point to the rapid depletion of exhaustible natural resources and environmental deterioration. The Copenhagen Summit of December 2009 brought the latter issue into sharp focus once again.

Various indices, such as the Human Development Index, incorporate a number of factors into their calculations in order to give as comprehensive a view of living standards as possible and to allow more accurate international comparisons. Factors include life expectancy, infant mortality and nutritional levels.

The Legatum Institute publishes a global survey annually, popularly known as a ‘prosperity index’. It brings together data on, for example, economic growth, welfare, happiness, crime and healthcare. This data is then used to rank countries.

The 2009 index ranked 104 countries. The UK was placed 12th (its best position for three years). Low scores for key public services kept it out of the top ten. All African countries were in the bottom half of the index.

However, the continent of Africa is undergoing economic change. The World Bank points to a rapid transformation in some countries. Mozambique has seen annual average growth of 8% in the last decade, Kenya has emerged as a major global supplier of cut flowers and Rwanda is developing tourism very successfully. While Lesotho is developing its clothing industry, Ethiopia is starting to manufacture footwear. Can we look to Africa for the next wave of ‘emerging economies’, to follow India and China? In 2009, Africa as a whole had the world’s third highest rate of growth behind India and China. Africa’s role as a major supplier of raw materials to China also illustrates its increasing economic links with the rest of the world.

As a result of this economic change, living standards in Africa will no doubt improve. Additionally, the living standards of developed countries, including the UK, will be affected by economic growth in Africa. Export markets for both goods and services will strengthen, as will investment opportunities, and natural resources will become more accessible.

But how long before the UK faces stiff competition from Africa in agriculture, manufacturing and service activities? No one can accurately predict the impact on the UK economy but the careful monitoring of developments in Africa will become increasingly necessary.

Source: various sources, 2010

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16. The deficit on the UK balance of trade in goods and services rose from £26 billion in 2003 to £44 billion in 2008.

Explain the main factors which might help determine the volume of UK exports and imports.

[15 marks]

17. **The European Union Context Extract D** (lines 35-36) argues that 'a more ambitious set of common macroeconomic policies would help speed recovery in the EU'.

Using the data and your economic knowledge, assess the impact on the UK economy of a recovery in the EU as a whole.

[25 marks]

18. 'Oil, as a form of energy, reigns supreme but it has brought significant problems to economies in terms of inflation in particular, and the potential for economic instability in general.'

Discuss how rising oil prices might affect the macroeconomic performance of an economy.

[25 marks]

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19. THE EUROPEAN UNION CONTEXT

Extract D: Is European Union (EU) unity threatened?

In March 2009, the Hungarian Government asked Germany for €190 billion to prevent what it saw as a new economic 'Iron Curtain' from going up across Europe. The term 'Iron Curtain' was intended to remind Europeans of the Soviet-era divide between the poorer Communist East and the more prosperous, free, democratic West. Hungary argued that, without such help, the contrast between the richer and poorer members of the EU would only widen further. Germany's refusal of Hungary's request symbolised, for many, the deepening divide between the EU's richer and poorer members.

The contrast in fortunes is seen by newer members of the EU, such as Latvia, Lithuania and Hungary, as one which can only worsen during the recession and which may threaten the EU's existence in the long term. On the other hand, some people in the more−established members of the EU, such as the UK and France, have become increasingly disillusioned with the EU and especially with the level of assistance now expected from these more-established members by the newer members.

At the Brussels Summit of March 2009, the Czech Prime Minister warned of 'the greatest crisis in the history of European integration'. Gordon Brown, for the UK, spoke of the need for unity and common policies. The Single European Market, for example, is seen as an evolving policy which can foster prosperity for all and bring closer integration.

Cyclical unemployment is now widespread, however, and has been growing faster in the Eastern members of the EU than in those of the West. This could increase tensions between Eastern and Western members of the EU. The impact of cyclical unemployment on both individuals and whole economies can be serious, as incomes and output fall and welfare-dependency becomes more widespread.

Nevertheless, it would be wrong to argue that the wealthier members of the EU have been totally immune to the problem. The Netherlands, the worst affected Western member, experienced a 34% rise in unemployment between January 2008 and March 2009. There was a much greater rise in Latvia and Lithuania, both in the East.

During a recession, questions are likely to be asked about the future of the EU as policy disagreements emerge. Supporters claim that the EU is a force for good and needs to be strengthened, rather than weakened or abandoned. In this way, it is argued, East-West tensions can be kept at bay.

Such supporters feel that an enlarged EU, with open markets based on the Single European Market policy, helps spread benefits of membership across the whole organisation and offers the best chance of rapid recovery. In the UK, however, many see openness as a threat to jobs and to living standards.

In the current climate, it has also been argued that a more ambitious set of common macroeconomic policies would help speed recovery in the EU. Fiscal and supply-side policies come into this category, as well as monetary policy, even though only 16 members of the 27-member EU have adopted the euro. Even so, limited agreement on monetary policy, such as interest rates, could be of benefit.

The UK has not had the leading role in EU recovery policies that it has had globally, but it has shown a willingness to play its part in fostering unity and economic revival so that Europe can make a vital contribution to international recovery. Talk of disunity and the break-up of the EU can only cause instability and hinder economic recovery. This is something that members can ill-afford, particularly the UK. Growth, jobs and stable prices are desperately needed.

Source: various sources

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20. In 2009, the World Bank described the Chinese economy as a “relative bright spot in an otherwise gloomy global economy” (**The Global Context Extract B**, lines 34-35).

Using the data and your economic knowledge, assess the consequences for the UK economy of China’s continued economic growth during a global recession.

[25 marks]

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1. ‘When the exchange rate of a country’s currency causes problems, it may be down to free market orces, but government intervention might be to blame.’

Assess the importance of a floating exchange rate to a country trying to achieve macroeconomic stability.

[25 marks]

2. ‘The long-term progress made towards a free-trade world must be maintained. Calls for greater protectionism would lead to a disastrous collapse of global economic activity.’

Assess the view that the progress made towards free trade has brought significant economic benefits **both** to the UK **and** to the rest of the world.

[25 marks]

3. THE GLOBAL CONTEXT

Extract B: China: a bright spot in a gloomy world

China, despite its recent rapid growth, has not remained immune to the economic downturn as some economists had hoped. However, it remains an economy which is looking to the future with some optimism. It continues to invest in the production of raw materials and resources in other countries. The consequent increased global investment should give a much-needed boost to jobs and growth in countries benefiting from it. Despite this investment, growth in demand from China is likely to continue to push up world raw material prices in the long term.

Certainly, China has shown an increased recognition of the need to play its part in bringing about global recovery. For example, in a recent international agreement to boost the funds of the International Monetary Fund (IMF) by $500 billion, China has agreed to contribute $40 billion, compared to the UK's $15 billion. The IMF can now fulfil its promise of loans to such countries as Poland and Mexico, which should contribute to the greater global stability needed for recovery.

Nevertheless, China, fearing inflation, has expressed its concern about the policy of some leading central banks, including the Bank of England, of quantitative easing (increasing the money supply) in order to bring about economic revival by increasing aggregate demand. China also knows that its policy of holding down the external value of its currency in order to boost export-led growth is only likely to be successful if a global revival of demand is achieved. For example, China saw a 25% decline in exports in 2008. The depressed UK market will have contributed to this decline.

The other major world economies are keen to keep talking with China and win its approval for a host of measures to bring about recovery. They want to engage China in more long-term talks as well. These will include international financial reforms and environmental policies, especially as China's industrial growth continues to create negative externalities.

China has every reason to be optimistic about its future prospects. In June 2009, the *Organisation for Economic Co-operation and Development* (OECD) forecast growth for that year of 7.7% and 9.3% for 2010. To a country used to double-digit growth figures, this may seem like a recession. However, such figures are a far cry from the negative growth seen in many parts of the global economy, including the UK economy.

Nevertheless, the ongoing concern of the Chinese Government is reflected in the decision to give a $565 billion fiscal stimulus to its economy in 2009. It is also considering protectionist policies, which may impact on those countries hoping to increase exports to China. For the World Bank, however, the Chinese economy remains a 'relative bright spot in an otherwise gloomy global economy' and countries such as the UK are keen to see China help pull the global economy out of recession.

China has reacted coolly to suggestions that a solution to the world's economic problems lies in the hands of two powers: itself and the US. Although the UK has played a leading role in international discussions on recovery, such an assertion may yet prove to have a ring of truth. What is certain is that co-operation is vital in ensuring that appropriate policies are followed to bring about a new era of sustained growth.

Source: various sources, 2009

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4. **THE EUROPEAN UNION CONTEXT**

Extract D: Turkey − gateway to Asia

Turkey has been in talks since 2005 regarding possible membership of the European Union (EU). While further enlargement of the EU causes some concern, serious consideration needs to be given to Turkey. Its geographical position links Europe and Asia. Since Asia is currently driving world economic growth, Turkey can be an important strategic gateway to Asia for the EU.

The UK Government supports Turkey's application for EU membership but questions still persist. If Turkey joins the EU, can the UK successfully take up the resulting trade and investment opportunities? Will the UK be overwhelmed by imports and cheap migrant labour? Will UK businesses be determined enough to grasp any opportunities?

Turkey has a population of 75 million, which is expected to rise to 100 million by 2020. The average age is just 27 and it has vast economic potential. Turkey's GDP is ranked 18th in the world, and GDP per capita is £7163. Like the UK, there has been some negative growth in recent years but the economy recovered to achieve 11% growth in the first quarter of 2010. Between 2002 and 2007, Turkey's annual average economic growth of 7% was far greater than that of the UK.

About 50% of Turkey's exports are to Europe, with textiles being particularly important. Machinery and semi-manufactured goods are major imports. The UK does not yet rank alongside countries such as Germany, Italy, China and the US as important exporters to Turkey, but opportunities certainly exist.

Turkey has had a reputation for economic instability. Since 2005, for example, inflation has been between 5% and 12%. Unemployment has remained in double figures: 10% of the labour force in 2005 and 14% currently. However, Turkey now boasts a relatively modest budget deficit of between 4% and 5% of GDP.

Despite a degree of instability, Turkey is seen as an attractive centre for investment. For example, the country received £115 bn in foreign direct investment in 2009. However, Turkey's infrastructure still leaves much to be desired.

UK businesses need to consider the potential economic opportunities. Lord Digby Jones, formerly of the *Confederation of British Industry* (CBI), points out that Turkey's recent economic growth is from a low base. According to Lord Jones, "Whereas a little bit of growth in a prosperous country such as Germany does not make much difference, in a developing country such as Turkey millions of people get richer". This is perhaps an exaggeration, especially in the short run, but a valid point is being made.

The UK must not be blind to the potential problems of Turkey's possible membership of the EU and must also be in a position to grasp the opportunities which are sure to appear.

Source: news reports, 2010

5. 'The long-term progress made towards a free-trade world must be maintained. Calls for greater protectionism would lead to a disastrous collapse of global economic activity.'

Explain **three** protectionist policies that a government could introduce to reduce a deficit on the current account of the balance of payments.

[15 marks]

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6.

The European Union Context Extract D (lines 33 −34) argues that the 'UK must not be blind to the potential problems of Turkey's possible membership of the EU and must also be in a position to grasp the opportunities which are sure to appear'.

Using the data and your economic knowledge, assess the potential economic consequences for the UK if Turkey joined the EU.

[25 marks]

7.

The global economic slowdown in recent years saw UK unemployment, as measured by the claimant count, rise from 870 000 in 2004 to 1.5 million in 2009.

To what extent would a significant fall in the exchange rate of the pound sterling achieve a sustained reduction in unemployment in the UK?

[25 marks]

8.

The global economic slowdown in recent years saw UK unemployment, as measured by the claimant count, rise from 870 000 in 2004 to 1.5 million in 2009.

As unemployment rises, explain **two** possible economic problems which might affect individuals in the UK **and two** possible economic problems which might affect the UK economy as a whole.

[15 marks]

9.

UK exports of goods which, in 2002, were valued at £187 billion, had risen to £228 billion in 2009.
The deficit on the UK balance of trade in goods rose from £48 billion in 2002 to £82 billion in 2009.

Evaluate the view that an increasing deficit in UK trade in goods is a major problem for the UK economy.

[25 marks]

10.

UK exports of goods which, in 2002, were valued at £187 billion, had risen to £228 billion in 2009.
The deficit on the UK balance of trade in goods rose from £48 billion in 2002 to £82 billion in 2009.

Explain **three** possible reasons for growth in the value of an economy's exports of goods.

[15 marks]

11.

The formation of single markets by countries in various parts of the world, including within Europe, has shown that much is to be gained from increased economic cooperation.

Evaluate the possible economic costs and benefits to an EU member state, such as the UK, of being part of the EU single market.

[25 marks]

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12. THE EUROPEAN UNION CONTEXT

Extract D: The fiscal remedy for recession

The recession of 2009 brought renewed interest amongst EU governments in a so-called Keynesian approach to spending their way out of recession. They were desperate to avoid a prolonged period of negative growth and the accompanying mass unemployment.

In the UK, as well as within the eurozone, fiscal rules were abandoned as the fight for economic recovery began. The Stability and Growth Pact of the eurozone, to which the UK had also adhered in an informal way before the recession, limited budget deficits to 3% of GDP and a nation's debt to 60% of GDP. Such constraints were often far exceeded and increasing concerns were being expressed. In May 2010, the new UK Government became a prominent voice within Europe for a reversal of fiscal policy, with public spending cuts and tax increases.

The UK Government's policy was given some support by the economic crisis unfolding in Greece, a member of the eurozone. The Greek Government needed to be 'bailed out' by fellow member states if it was not to default on its debts. It had a budget deficit of 14% of GDP and a national debt of 115% of GDP in 2009, a year when its GDP also fell by 2%.

There was concern in the EU that such a situation had been allowed to develop, with increasing calls for EU-wide controls. France and Germany were pressing for an EU institution such as the European Commission to provide such a role, with the power to impose an EU-wide fiscal policy on all member states and not just the eurozone.

The UK Government opposed any such powers over member countries. However, it had gone as far as to establish an Office for Budget Responsibility (OBR), intended to keep the Government's tax and spending plans under control by providing a reality check on the state of the nation's finances. The OBR, however, does not have the powers that some were envisaging for the EU.

In a climate of greater stability in 2010, some still believed that an EU-wide fiscal policy needed to be a key part of the evolution towards a federal state. It cannot be denied that the best way forward must be that which delivers macroeconomic stability across the EU. Whether this comes about through member governments each developing a policy of fiscal responsibility or through a fiscal policy imposed by the EU on all member states remains open to debate.

Source: various sources, 2010

13.

The European Union Context Extract D (lines 16−18) suggests that France and Germany would like the EU to have 'the power to impose an EU-wide fiscal policy on all member states and not just the eurozone'.

Using the data and your economic knowledge, assess the possible economic consequences for the UK economy of an EU-wide fiscal policy requiring all member states to balance their budgets.

[25 marks]

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14. **The Global Context Extract B** (lines 2−3) states that ‘India’s economic success could help to bring some relief to the UK economy and speed the recovery process through increased exports’.

Using the data and your economic knowledge, assess the importance to the UK economy of continued economic growth in India.

[25 marks]

15. Weaknesses in the UK balance of trade in goods persist, with a deficit of £27.6 bn in the third quarter of 2011, compared, for example, to £23.3 bn in the same quarter in 2010.

Explain **three** reasons for a country such as the UK experiencing persistent deficits in the balance of trade in goods.

[15 marks]

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16. THE GLOBAL CONTEXT

Extract B: A passage to India

In July 2010, the UK Prime Minister led a Government delegation to India. The hope was that India's economic success could help to bring some relief to the UK economy and speed the recovery process through increased exports.

India's growth in 2010 is expected to be about 9%. Its GDP per capita is $3100, although over 400 million Indians live below the international poverty line of $1.25 per day. It has a labour force of almost 500 million but an official rate of unemployment of 11%. Quarterly sector growth is impressive: 1.8% in services, 2.2% in manufacturing and 1.7% in agriculture between January and March 2010.

For the Indian Government, inflation and economic growth are top of the agenda. Unfortunately, there is often a trade-off between these two macroeconomic indicators. Inflation jumped from 1.3% in October 2009 to almost 5% in November 2009. However, food inflation was 19%. As in other countries, rising oil costs are also amongst the causes of inflation for the Indian economy.

The UK Government still hopes to promote increased UK economic involvement in India. Certainly Indian business has become more involved in the UK. *Tata*, one of India's oldest companies, is now the UK's leading manufacturer through its ownership of *Corus Steel and Jaguar Land Rover*. India is now more likely to be creating jobs in the UK through direct investment rather than 'stealing' them, for example through call-centre activity relocated from the UK. UK business needs to rise to the challenges and opportunities presented in India. Companies such as *Vodafone* (telecommunications) and *BAE Systems* (defence and aerospace) are amongst the recent success stories and it is widely believed that India's increased demand for world-class services, for example financial and legal, can be met by the UK.

Infrastructure investment is urgent. Each year, about 40% of India's agricultural produce rots before arriving at market because of inadequate storage facilities and poor road and rail links. The Indian Government's plans to spend $500bn between 2010 and 2013 on new ports, roads, rail links and airports will help to improve the situation. This investment is an export opportunity for UK firms specialising in infrastructure projects. The growth of the Indian economy will also help UK service exporters such as banking, education and health-care businesses. Currently, India accounts for only 1% of UK exports.

However, India remains fiercely protective, and investment and trade flows from the UK could remain limited. Progress will depend on whether a long-awaited EU-India trade deal becomes a reality and on the outcome of the *World Trade Organization's* global trade talks. Many argue that India can only benefit from increased international trade.

The UK Government said at the time of the Prime Minister's July 2010 visit to India that the UK had a vital stake in India's rise to becoming a global power and in its future prosperity. At the same time, a view was also expressed that the UK needs India much more than India needs the UK. It is hoped that all aspects of the UK's macroeconomy can eventually benefit as India develops further.

Source: news reports, 2010

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17. Weaknesses in the UK balance of trade in goods persist, with a deficit of £27.6 bn in the third quarter of 2011, compared, for example, to £23.3 bn in the same quarter in 2010.

Discuss the possible contribution of supply-side reforms to achieving an improvement in the UK balance of trade in goods.

[25 marks]

18. **The Global Context Extract B** (lines 36–37) states that, if other MENA economies were to follow Jordan's lead, there would be a 'significant strengthening of MENA's economic importance in the global economy'.

To what extent, if at all, should developed countries such as the UK be concerned about a significant strengthening of the economic importance of MENA countries in the global economy? Justify your answer, using the data and your economic knowledge.

[25 marks]

19. In November 2011, the UK inflation rate was 4.8%, the rate of unemployment was 8.3%, while Bank Rate remained at 0.5%.

Explain **two** economic consequences for an individual **and two** economic consequences for an economy of an increase in its price level.

[15 marks]

20. 'Globalisation has made many economies more prosperous, but all economies have been made more vulnerable to economic shocks.'

To what extent, if at all, have the economic consequences of globalisation differed between developed and developing countries?

[25 marks]

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21.

THE GLOBAL CONTEXT

Extract B: A decade of change, challenge and opportunity

This year, ten years will have passed since the downfall of Saddam Hussein in Iraq. Over these years the Middle East and North African countries (MENA) have continued to witness economic and political instability, culminating in the recent so-called 'Arab Spring' uprisings in countries such as Egypt, Libya and Syria.

The *Organisation for Economic Cooperation and Development (OECD)* distinguishes two groups within the MENA region. The resource-rich economies, such as Iraq, Saudi Arabia and Dubai, are recognised as being different from those seen as resource-deficient, such as Egypt and Jordan. For both groups, however, and despite the political problems for some, the OECD is optimistic about future growth.

The OECD argues that, as the global economy recovers, demand for goods and services from European and emerging markets in particular will encourage development of MENA's manufacturing and service sectors. Just as the UK, for example, enjoys a comparative advantage in financial services, some MENA economies are now developing attractively priced manufactured goods. Tourism is also ripe for further development.

However, although the OECD points to economic progress having been made, recent years have highlighted challenges which need to be faced in the MENA economies if there is to be further progress. Improvements in labour productivity and hence competitiveness are essential for increased trade with the rest of the world. More foreign investment in infrastructure and manufacturing plant is desperately needed, with advanced countries such as the UK having a role to play here. Unemployment remains persistently high in some MENA countries, as does inflation.

Jordan is beginning to show what can be done to bring about a more successful economy. Through productivity improvements, it is now one of the most competitive MENA countries. This has helped it to negotiate a number of significant free trade agreements, including those with the EU and the US. Exports have brought increased economic growth to Jordan, as has domestic investment.

One of the benefits of economic success can be a higher standard of living. The Human Development Index (HDI) allows international comparisons of living standards. The Arab states of the Middle East have seen an improvement in the index from 0.444 in 1980 to 0.641 in 2011. The latter figure can be compared with 0.862 for the UK.

Income per head, access to healthcare and education, life expectancy, the quality of the environment and a fair distribution of income are key factors in any assessment of living standards. The UK and other developed countries need to remember that higher living standards can mean bigger markets for goods and services.

In many of the MENA economies, there is still much to be done to achieve sustained economic success. But, where Jordan leads, others will begin to follow. To do so would see a significant strengthening of MENA's economic importance in the global economy.

Source: news reports, 2012

22.

The European Union Context Extract D (lines 28–29) states that it 'is difficult to predict what the economic impact on the UK might be should there be a break-up of the eurozone'.

Using the data and your economic knowledge, assess the possible impact on the UK economy if a number of countries leave the eurozone.

[25 marks]

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23. ‘Economic shocks can bring with them significant consequences for macroeconomic performance, as the UK knows only too well.’

Using at least **one example of each**, explain how demand-side and supply-side shocks might harm a country’s economic growth.

[15 marks]

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24. THE EUROPEAN UNION CONTEXT

Extract D: Can the eurozone survive?

Before the global recession of 2008, the euro had emerged as a successful major currency, making travel and trade for member countries much easier. Those countries traditionally with weaker currencies, such as Italy, Greece and Spain, were given a degree of stability which fostered economic growth. Some leading economists and politicians were urging the UK to adopt the euro, seeing it as a major step towards the full integration of the UK into the European Union (EU).

The global recession changed everything. By 2011, there were many in the UK relieved that we were still outside the eurozone. The growing debt crisis in the eurozone has inevitably had repercussions for the euro. Stronger members found themselves being called upon to offer financial support to those economies in trouble. Media reports began to suggest that the ultimate outcome of the debt crisis would be the break-up of the eurozone, with some of the weaker members such as Spain, Italy and Greece re-adopting their former national currencies.

The UK Government has adopted a policy of fiscal restraint in order to reduce annual borrowing and to try to limit the growth of the National Debt (the total outstanding debt of the government). It urged the weaker members of the eurozone in particular to adopt a similar policy if they were to retain membership.

However, the potential benefits of leaving the eurozone are not lost on some politicians and economists within the weaker economies. One such benefit is the absence of the same 'one-size-fits-all' interest rate. For example, some countries still in recession in the eurozone saw their interest rates, as set by the European Central Bank, rise to 1.25% in July 2011. This was at a time when the Bank of England kept the UK Bank Rate at 0.5%. Countries could also restore an exchange rate for their own currencies which would give them a competitive edge, rather than being forced to cut wages and jobs. They would also not be obliged to follow such a strict policy of fiscal restraint which remaining members would have to follow.

There are others, however, both within these countries and beyond, who warn against departure from the eurozone. It is difficult to predict what the economic impact on the UK might be should there be a break-up of the eurozone. The impact would depend on a number of factors, including how many countries left and which countries these were. It might also depend on the degree of economic instability which departure from the eurozone might cause in those countries as they restored their national currencies, and the impact on the stability of the remaining members of the eurozone. It has to be borne in mind, however, that the EU would still exist.

The UK might expect disruption to trade, at least in the short term, with consequences for the balance of payments. Another banking crisis could also emerge. International money, seeking a safe haven, might favour the pound sterling and thus strengthen its external value. These potential developments have implications for UK growth and employment and pose yet another threat to the current recovery. The UK might be relieved to be outside the eurozone. However, the UK is certainly not immune from the possible consequences of its break-up.

Source: European Central Bank, 2012

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25. Using **The European Union Context Extract C**, calculate the price in dollars of a good exported from the eurozone to the US at the start of 1999 priced at 20 euros **and** identify **one** significant feature of the dollar/euro exchange rate for the period 1999 to 2011.

[2 marks]

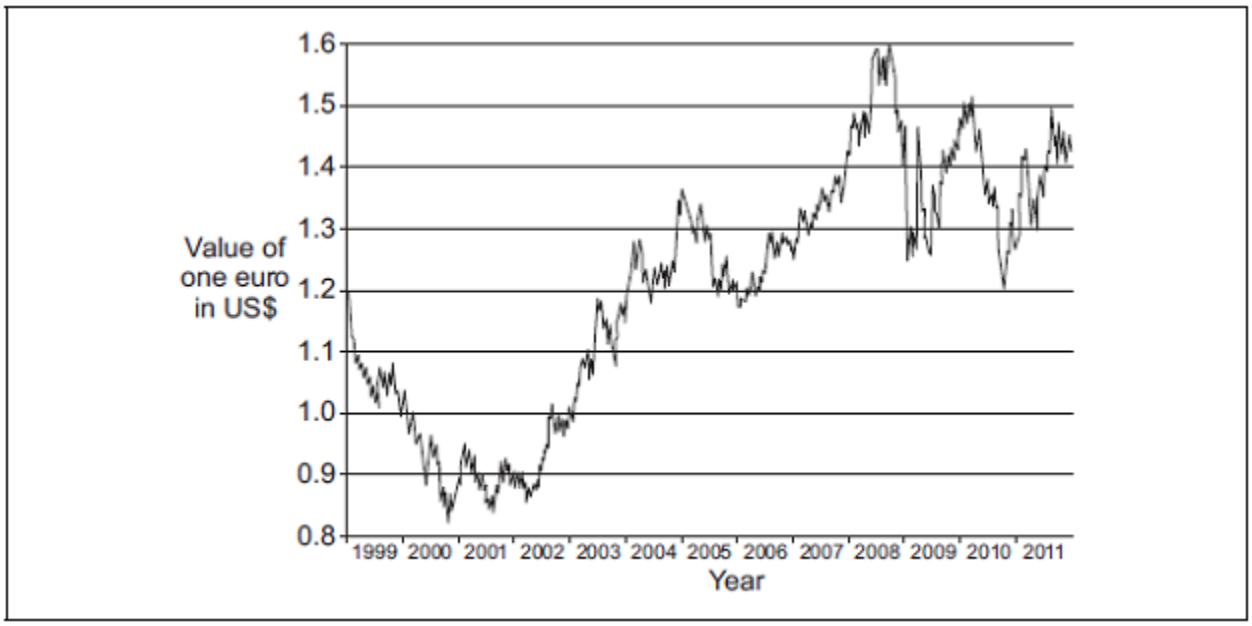
26. 'When the exchange rate of a country's currency causes problems, it may be down to free market forces, but government intervention might be to blame.'

Explain **three** possible determinants of a country's exchange rate against other currencies.

[15 marks]

27. **THE EUROPEAN UNION CONTEXT**

Extract C: The US$/euro exchange rate, 1999 to 2011



Source: European Central Bank, 2012

28. **The European Union Context Extract E** (lines 1−2) states: 'In recent years, growing disenchantment with the EU has led to calls for the UK to leave the organisation.'

Do you agree with the view that the UK economy would benefit if the UK left the EU? Justify your answer using the data and your economic knowledge.

[25 marks]

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29.

THE EUROPEAN UNION CONTEXT

Extract E: Would the UK be left out in the cold by saying goodbye to the EU?

In recent years, growing disenchantment with the EU has led to calls for the UK to leave the organisation. Supporters and opponents of UK membership have presented coherent arguments.

A study by the so-called Bruges Group, which opposes the EU, estimated the annual cost of UK membership to be £65bn. This included an estimated cost to businesses of £28bn to comply with EU regulations and an annual net contribution to the EU Budget of £14.6bn. A member of the EU Commission in 2011 estimated that the Common Agricultural Policy (CAP) causes the UK consumer to pay up to three times as much for food than if the CAP did not exist. The common external tariff raises prices of imports into the EU, including the prices of consumer goods and resources used by businesses. It also protects inefficient, high-cost EU producers.

Those supporting UK membership point, for example, to the 3.5 million UK jobs created from trade with the EU, either within the export sector or, more widely, through the operation of an export-led multiplier. The Single European Market has helped trade creation and has allowed EU labour to move to the UK, to the benefit of UK businesses. Despite not being in the eurozone, the UK has continued to attract a large share of the world's investment funds so that it is now the third largest recipient internationally. It is claimed that a large part of this is due to EU membership. The EU as a whole has also exerted much greater influence than could any individual EU country in negotiations to further global free trade. One business organisation has argued that non-membership would be like 'sitting outside in the corridors rather than at the decision table'.

Sources: various, 2012

30.

The European Union Context Extract E (lines 12−14) points out that UK trade with the EU has created 3.5m jobs in the UK 'either within the export sector or, more widely, through the operation of an export-led multiplier'.

Explain the term 'export-led multiplier' **and** analyse **two** possible economic reasons for an increase in UK exports to the EU.

[9 marks]

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1. The Balance of Payments

Extract D: UK trade figures and real GDP growth 2006 - 2012

	UK trade balance			Real GDP (% change on previous year)
	Trade in goods (£ million)	Trade in services (£ million)	Balance of trade in goods and services (£ million)	
2006	-76 842	41 643	-35 199	2.8
2007	-90 535	53 802	-36 733	3.4
2008	-94 261	61 689	-32 572	-0.8
2009	-82 933	59 560	-23 373	-5.2
2010	-98 585	65 733	-32 852	1.7
2011	-100 092	76 832	-23 260	1.1
2012	-108 700	75 319	-33 381	0.3

Source: news reports 2014

2.

THE GLOBAL CONTEXT

Extract B: Inflation never quite goes away

Governments around the world seeking a cure for inflation accept that such a cure may never be achieved. They recognise, therefore, that the next best thing is effective control in order to secure economic stability and sustained economic growth. Even then, past experience suggests that inflation will never be fully under control. Governments recognise that there may be both national and international forces at work which have a bearing on prices. International causes of inflation are inevitably going to be more difficult, or impossible, for a country to control than those whose origins are from within that country.

Some economists might argue that a weak global economy can help to suppress inflation but this weakness, if it persists, will have costs in terms of jobs and living standards. In any case, there may still be pessimism about inflation in the long term. As growth strengthens both in emerging and advanced economies, consumer demand, energy costs, primary commodity prices and wage costs are certain to rise. Agricultural commodity prices, for example, have fallen in recent decades but a significant upward trend could occur. Such a trend will be reinforced by the growth of a global population, now over 7 billion. An increasing global inflation problem could have serious consequences for all aspects of UK macroeconomic performance, including the balance of payments and employment. It breeds uncertainty for government, consumers and businesses and raises expectations of future inflation. Because it affects competitiveness and can disrupt trade and investment flows, the impact on both the current and the capital accounts of the balance of payments needs to be assessed. It is also likely that worsening inflation can halt any hesitant recovery. Overall, economic instability can be expected.

Source: news reports, 2012

3.

The Global Context Extract B (lines 15−16) argues: ‘An increasing global inflation problem could have serious consequences for all aspects of UK macroeconomic performance, including the balance of payments and employment.’

Using the data and your economic knowledge, discuss the possible impact on the UK balance of payments of an increasing rate of inflation throughout the global economy.

[25 marks]

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4.

THE GLOBAL CONTEXT

Extract C: Incentives and economic performance

Could inequality be adversely affecting economic performance? According to some economists, capitalism is not working effectively. Reducing trade union power and creating more flexible labour markets have created greater income inequality. Successive governments have also reduced taxation on companies and high earners (such as the cut in income tax for those earning over £150 000 from 50% to 45%) in order to promote incentives and wealth generation, as well as focusing much of the UK's hopes on the financial services industry. These policies, however, have created greater divides in terms of the 'haves' and 'have nots' which may have consequences for the UK's macroeconomic performance.

There has been a shift, over the last generation, in the share of GDP from the workforce to shareholders of between 5% −7%, with many low earners finding it difficult to get onto the property ladder. Neo-classical economists cite the trickle-down effect as a way of improving the living standards of all by cutting taxes for upper income groups and business, stating that economic progress depends on saving and innovation which, in turn, depends on the ability to make high profits. However, research by the Tax Justice Network claims that, when there are high levels of inequality, to avoid tax, financial capital often leaves the country, rather than staying in the domestic economy.

It has been argued that other policies such as public sector pay rise limits of 1%, benefits rising at 1% rather than inflation-linked increases, and the removal of some housing benefit, as well as the culture of bankers' bonuses, have all contributed to growing inequality. This is likely to have consequences for consumer spending power, but may also help to contribute to reduced inflationary expectations. There has also been criticism of the UK banking system, in that it has been too focused on making quick financial returns rather than long-run investment. Ultimately, these factors may damage the UK's ability to achieve its macroeconomic targets.

Source: News reports, 2013

5.

Globalisation and outsourcing of manufacturing provides several potential benefits to economies. However, some countries, such as the UK, continue to suffer persistent trade deficits but are unable to resort to import controls.

Assess the view that, for the UK, the economic benefits of globalisation outweigh the costs.

[25 marks]

6.

Globalisation and outsourcing of manufacturing provides several potential benefits to economies. However, some countries, such as the UK, continue to suffer persistent trade deficits but are unable to resort to import controls.

Explain how the UK Government could reduce a balance of payments deficit on the current account, other than through the use of import controls.

[15 marks]

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7.

The European Union Context Extract F (line 1) states: 'Deflation is the new economic menace threatening European economies including the UK.'

Using the data and your knowledge of economics, evaluate the view that deflation in the EU's economies would inevitably be damaging to the UK's macroeconomic performance.

[25 marks]

8.

Since the start of the financial crisis of 2007−2008, the UK, the Eurozone and the USA have adopted quantitative easing (QE) in an attempt to stimulate their economies.

To what extent do you agree that maintaining inflation at the target rate of 2% should be the top priority of UK macroeconomic policy? Justify your answer.

[25 marks]

9.

THE EUROPEAN UNION CONTEXT

Extract F: Is deflation a bad thing?

Deflation is the new economic menace threatening European economies including the UK. In the Eurozone in particular, the European Central Bank is considering the use of quantitative easing to help avoid deflation; but why is it such a problem? Firstly, there is the argument that deflation delays spending. However, this does not relate to all forms of consumption. Another reason is the effect on debtors. Prices and perhaps incomes may fall, but the real value of debt increases. For firms experiencing falling revenues, and households with declining incomes, debt repayments become more of a burden. Governments can be caught in the same trap, because if prices and incomes fall, so does tax revenue.

There is an alternative view that moderate deflation is not a bad thing, especially if it is the result of innovation that reduces production costs. Also, some comfort is to be had from falling or barely rising prices as this goes some way to improve competitiveness. Some of the Eurozone's economies desperately need to become more competitive and they need to either reduce costs or increase productivity. However, falling prices deter investment, which makes productivity improvements far more difficult.

Source: news reports, 2014

10.

There are several countries, such as Iceland, Serbia and Turkey, which may join the European Union in the future and so become members of the single market.

Evaluate the view that further enlargement of the European Union would be beneficial for the UK economy.

[25 marks]

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11. **The European Union Context Extract F** (lines 14−18) states: 'The EU introduced the Stability and Growth Pact …in order to prevent individual economies from creating instability across the EU. However, EU member countries have struggled to keep to the pact, with only four member countries not breaking the rules.'

Using the data and your knowledge of economics, evaluate the likely impact on the UK economy of other EU countries attempting to reduce their public sector debt at the same time.

[25 marks]

12. **THE EUROPEAN UNION CONTEXT**

Extract F: Ireland emerges from bailout

Whilst many of the Eurozone members still face instability in their own economies, Ireland became the first economy to emerge from its bailout since the Eurozone crisis began. In its final report on Ireland's progress under the rescue scheme, the European Commission said: 'With public sector debt at 122% of GDP in 2013, Ireland needs to continue with its fiscal reduction programmes, reduce private-sector debt and improve bank profitability to revive lending.'

Of the UK's top ten European trading partners, Ireland is the only one with which the UK has a current account surplus. The importance of trade with Ireland is therefore of great significance. The Irish and UK economies are highly integrated and it is not yet clear how further cuts in Ireland might impact on the UK's macroeconomic performance.

Public sector debt across many European nations is still at very dangerous levels and Ireland's debt to GDP ratio is the second highest in the EU. Higher national debts may lead to problems such as crowding out, where private sector investment is reduced due to increased public sector borrowing. The EU introduced the Stability and Growth Pact (limiting total debt as a percentage of GDP to 60% and annual deficits to 3% of GDP) in order to prevent individual economies from creating instability across the EU. However, EU member countries have struggled to keep to the pact, with only four member countries not breaking the rules. Both Ireland and the UK have breached the pact since 2008. No doubt more problems lie ahead for the Eurozone.

Source: News reports, 2013

13. **The Global Context Extract B** (lines 1−3) states: 'some economists are predicting that the US will play a leading role in driving world economic growth and, as the country which is the UK's main export partner, this may provide an injection into the UK's circular flow of income.'

Explain the term 'circular flow of income' **and** analyse how economic growth in the US may lead to increased national income in the UK.

[9 marks]

14. **The Global Context Extract C** (lines 7−9) states: 'These policies, however, have created greater divides in terms of the 'haves' and 'have nots' which may have consequences for the UK's macroeconomic performance.'

Using the data and your knowledge of economics, assess the importance for UK macroeconomic performance of increasing income inequality, **both** domestically **and** in other economies.

[25 marks]

15. THE GLOBAL CONTEXT

Extract B: Will growing inequality damage the US economy?

Some economists are predicting that the US will play a leading role in driving world economic growth and, as the country which is the UK's main export partner, this may provide an injection into the UK's circular flow of income. However, since the 2008 financial crash, there has been debate in the US over whether or not economic growth can be strengthened and, if so, how best to achieve this. Within this debate, there are growing concerns about the specific issue of income inequality. The top 1% of earners have received 95% of the increase in income since the financial crisis. Since 2009, the top 1% have seen their incomes rise on average by 31.4%, whereas the rest of the population has seen a rise of only 0.4%.

The economist, Joseph Stiglitz, has highlighted inequality as one of the prime reasons why the US has continued to struggle to recover. His basic argument is that the rich have a lower marginal propensity to consume (the proportion of any increase in income spent) and a higher marginal propensity to save (the proportion of any increase in income not spent) than the poor.

Such inequality also creates unsustainable 'property-price bubbles' as wealthy individuals increase the demand for property to let out on the rental market which further fuels inflation. Tax receipts, which could be injected into the economy, also end up being reduced, as the rich are able to exploit loopholes to avoid payment of tax. For this reason, Stiglitz argues that it is necessary for the US Government to intervene to deal with inequality. If the incomes of the poor were raised, increased consumption would occur. This argument is refuted by Paul Krugman, who states that there are some European economies with much lower income inequality which are also in a mess.

Source: News reports, 2013

16. The National Minimum Wage after 15 years

Extract D: Calls for employers to commit to paying the Living Wage as the pay gap widens

The TUC, the Archbishop of Canterbury and Boris Johnson, the Mayor of London, are just a few of those who have called on employers to pay their workers a living wage. The Living Wage is defined as 'the wage that can meet the basic needs to maintain a safe, decent standard of living within the community'. The Living Wage differs from the minimum wage in that the latter is set by law and may fail to provide people with enough income to have a reasonable quality of life. It has been claimed that five million people are paid less than the Living Wage, which is estimated at £8.80 an hour in London and £7.65 elsewhere.

Proponents argue that paying the Living Wage means workers can live with dignity and not just exist. By paying the Living Wage, employers can lift their employees out of poverty, debt, and illness, which will improve family life. Employers benefit because it is easier to recruit and retain staff, productivity increases, and there is a reduction in sickness and absenteeism. Government spending on welfare is also reduced. Everyone is a winner.

Source: News Reports accessed May 2104

17. It has been suggested that the NMW should be increased so that it is the same as the Living Wage.

Using **The National Minimum Wage After 15 Years**, explain the possible effects on individuals and the economy if the government were to adopt this suggestion.

[15 marks]

18. **The National Minimum Wage after 15 years**

Extract E: The National Minimum Wage: silver bullet or poisoned chalice?

Since its introduction in 1999, the NMW has increased by 75%, whilst average earnings have risen by 61% and the Retail Price Index by 53%. A new report, published by the Institute of Economic Affairs, argues that the NMW should be abolished for apprentices and under 18-year-olds in the UK to tackle persistently high youth unemployment. The rate for 16 and 17 year olds is due to rise to £3.79 per hour in October 2014 and to £2.73 per hour for apprentices. The authors of the report also believe that setting a single NMW is likely to have adverse effects on private sector employment in the regions. In Wales, for example, the NMW is 70% of median hourly earnings in the private sector, compared to just 42% in London. The report recommends that the minimum wage should be regionalised. When determining the minimum wage for each region, differences in productivity and economic conditions should be taken into consideration.

Source: News Reports accessed May 2104

19. **The National Minimum Wage after 15 years**

Extract B: The National Minimum Wage to rise to £6.50 in October 2014

Will a rise in the National Minimum Wage (NMW) damage the competitiveness of the UK economy? Representatives of businesses in the UK have claimed that the recently announced 3% increase in the National Minimum Wage is 'unwelcome in today's economic climate'. Critics of the increase maintain that 'it is essential that businesses remain competitive and that the above inflation increase in the NMW will add significantly to business costs'. Yet competitiveness is not just about wages, it also, for example, depends on productivity, the exchange rate and innovation.

Source: News Reports accessed May 2104

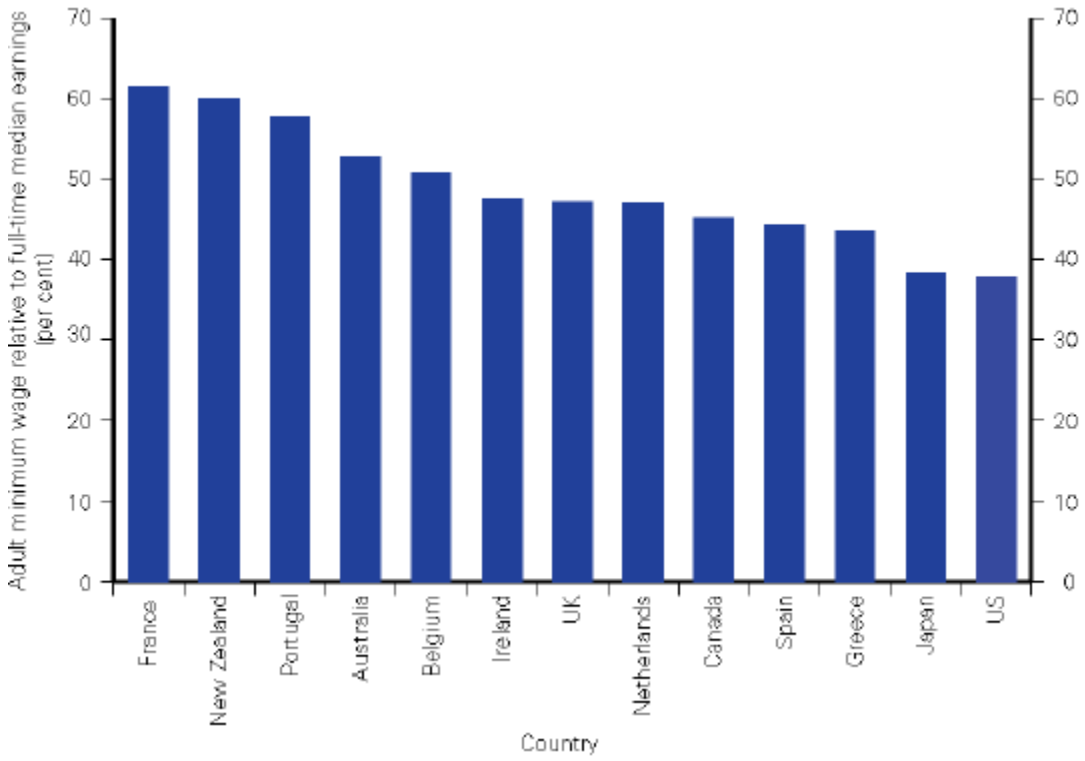
20. **The National Minimum Wage after 15 years**

Extract C: International comparison of adult minimum wages by country, December 2013

Country	**Minimum wage in UK £s, using purchasing power parity exchange rates**
Australia	7.79
France	7.77
Belgium	7.02
Netherlands	6.97
Ireland	6.80
New Zealand	6.35
UK	6.31
Canada	5.89
USA	5.31
Japan	4.80
Spain	3.48
Greece	3.40
Portugal	2.91

Source: Extracted from National Minimum Wage – Low Pay Commission 2014

Adult minimum wages relative to full-time median earnings, by country, 2012



Source: The Future Path of the National Minimum Wage - Low Pay Commission 2014

Some countries, such as China and India, do not have a single national minimum wage. In China, each province sets its own minimum wage to reflect local conditions. In November the hourly rate in Beijing was equivalent to approximately £1.74, whereas in Hunan it was around £0.93.

International comparisons of productivity, final estimates for 2012

Current price GDP per hour worked

UK = 100

Canada	105
France	132
Germany	131
Italy	111
Japan	89
UK	100
USA	135
G7 average	120

Source: ONS 20 February 2014

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21.

The Balance of Payments Extract F (lines 21−22) states: 'The UK's large current account deficit cannot be ignored easily, and research shows that such deficits are reduced eventually through some combination of slower growth and currency depreciation'.

Using the data in the extracts and your knowledge of economics, evaluate the significance of a large and persistent deficit on the current account of the balance of payments for the UK economy.

[25 marks]

22.

The National Minimum Wage after 15 years

Extract A: The role of the National Minimum Wage

The purpose of the NMW is to provide a wage floor, in order to protect low-paid workers against exploitation, without causing job losses. Many economists have been wary of statutory minimum wages: unless they raise the price of labour at the bottom of the wage distribution above what it would otherwise be they are pointless; but if they raise it then the fear is that they will curb demand for labour, and curb it to the particular detriment of the least skilled.

However, others have pointed out that labour markets are not perfectly competitive. There are costs and risks for workers who want to change jobs, and some employers enjoy a degree of monopsony power in local labour markets. As a result workers may be paid at levels below the market-clearing rate. The implication is that a statutory wage floor may raise the pay of the lowest earners without adverse employment effects. The challenge is to set the level as high as possible short of causing people to lose jobs.

Source: The Future Path of the National Minimum Wage - Low Pay Commission 2014

23.

The data below shows the data for the balance of payments for a country in £bn.

Year	Balance of trade in goods	Balance of trade in services	Primary income balance	Secondary income balance
1	–80	+50	+5	–10
2	–90	+40	+10	–15

Between Year 1 and Year 2 the

A surplus on the Current Account fell by £20bn. ⬭

B deficit on the Current Account fell by £20bn. ⬭

C deficit on the Current Account rose by £20bn. ⬭

D surplus on the Current Account rose by £20bn. ⬭

[1 mark]

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24. Although international trade has benefited UK consumers greatly over the last century, improvements in transport mean it is becoming more difficult for UK firms to compete against low-cost foreign producers.

Discuss the view that protectionist policies should be introduced to protect UK firms.

[25 marks]

25. Although international trade has benefited UK consumers greatly over the last century, improvements in transport mean it is becoming more difficult for UK firms to compete against low-cost foreign producers.

Explain why international trade has benefited UK consumers.

[15 marks]

26. **The Balance of Payments Extract E** (lines 8−10) states that: 'The hope was that with sterling having lost about a quarter of its value since the financial crash five years previously, this depreciation would have boosted exports …'
With the help of a diagram, explain how a boost to exports would help the recovery of the UK economy.

[9 marks]

27. Explain how the data in **The Balance of Payments Extract D** show that increasing growth in real GDP frequently leads to an increased deficit in the balance of trade in goods and services.

[4 marks]

28. Assume that in 2012 the net primary income balance was a deficit of £2,154 million and the net secondary income balance was a deficit of £23,055 million. Using the data in **The Balance of Payments Extract D**, calculate the current account balance for the UK for 2012.

[2 marks]

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29. The Balance of Payments

Extract F: Warning on UK's current account deficit

The UK is one of only eight countries to see its current account deficit increase since 2008, and its deficit has increased the most. Should overseas investors be worried? The UK has lived with large current account deficits for decades. From the 1940s to the early 1970s, when the country was operating a fixed exchange rate system, the UK was forced to use contractionary policies to keep the balance of payments in check and had to devalue the pound sterling in 1949 and 1967. From the 1980s onward, with the exchange rate floating, persistent current account deficits stopped being a cause for concern.

In the boom years before the global financial crisis, the current account deficit remained large, exceeding 3% of GDP in 2006. With hindsight, this should have rung alarm bells that the economy had become seriously unbalanced, with foreign money flowing into the UK to fund unsustainable public and private sector consumption rather than investment. After the crash, it was widely assumed that the UK economy would recover through higher exports and higher business investment. Indeed, the government's 2010 budget forecasted a current account surplus of 0.9% in 2013, driven by a surge in exports. This forecast proved highly inaccurate as the current account deficit increased.

Although surveys show that business confidence is high, investment fell in the year to the end of September 2013, and the UK's export performance has been poor, despite the depreciation of sterling by approximately 25% in the immediate aftermath of the financial crisis. In contrast, other European economies have seen strong export growth.

The UK's large current account deficit cannot be ignored easily, and research shows that such deficits are reduced eventually through some combination of slower growth and currency depreciation.

Source: news reports, February 2014

30. The Balance of Payments

Extract E: Re-balancing the UK economy

The UK government wants to re-balance the economy more towards investment, manufacturing and exports, and away from consumption and government spending. Manufacturing only accounts for around 11% of what is produced in Britain, while the service sector accounts for over three-quarters of UK GDP.

Britain, which until recently exported more to Ireland than to the combined BRIC economies (Brazil, Russia, India, and China), wants to export more to emerging economies and help its companies access the fastest-growing markets in the world.

In 2012, Britain’s trade deficit hit its highest level since 2007. The hope was that with sterling having lost about a quarter of its value since the financial crash five years previously, this depreciation would have boosted exports in the same way that it did during the early 1990s, when the pound depreciated after a sterling crisis. The last time that Britain had a trade surplus was towards the end of that decade, in 1997.

Source: news reports, February 2014

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1. **Extract F** (lines 10–12) states 'The Austrian economist, Friedrich Hayek, highlighted artificially low interest rates and excessive credit creation as being the main causes of cyclical instability.'

Using the data in the extracts and your knowledge of economics, evaluate the view that maintaining low interest rates for a sustained period of time may be damaging to the UK's macroeconomic stability.

[25 marks]

2. Using **Brazil: The Hot 'BRIC'**, explain how Brazil is likely to benefit from inward investment by a UK car manufacturer.

[15 marks]

3. In 2013 Ethiopia had a relatively high real GDP growth rate of 7% but only 42% of its population had access to improved water sources and life expectancy was only 63 years.

Discuss the view that free trade is more effective than aid in promoting economic development in developing countries such as Ethiopia.

[25 marks]

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4.

Brazil: The Hot ‘BRIC’

Extract D: News report – Is Brazil in trouble?

In June 2013, more than a million citizens across Brazil took to the streets to protest against political corruption, poor healthcare, inadequate schools, substandard public transport and crumbling infrastructure. This is in a country which is reported to be spending $13.3 billion to host the 2014 World Cup and $18 billion to host the 2016 Olympic Games.

In February 2014, the Brazilian currency, the real, is also making the headlines. In recent months it has collapsed against the pound. A year ago, visitors to Brazil would have got 2.70 real for £1 but now the rate stands at 3.61 to the pound. The fall in the value of the real is in response to a widening budget deficit and fears that the government's credit rating will be reduced. In response, the central bank has raised its base interest rate to 10.75%.

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5.

Brazil: The Hot 'BRIC'

Extract C: How does Brazil compare with the UK?

Selected data for the UK and Brazil (2013 unless otherwise stated)

	UK	Brazil
GDP (PPP)	$2.39 trillion	$2.42 trillion
Real GDP per head (PPP)	$36,600	$12,100
Real GDP growth per capita (2000–2012)	1.14% per annum	2.27% per annum
Average growth (2000–2012)	1.72% per annum	3.41% per annum
Human Development Index (HDI)	0.875 (World ranking 26)	0.730 (World ranking 85)
Unemployment	7.7%	5.5%
Inflation	2.7%	6.2%
Current account of the balance of payments (%GDP)	–2.41%	–3.83%
Public sector debt (%GDP)	91.1%	59.2%
Budget balance (%GDP)	–7.4%	+1.6%
Industry %GDP	20.5%	26.4%
Services %GDP	78.9%	68.1%
Gini coefficient	34.0	54.7
Share of income of the poorest 10% of the population	2.1%	0.8%
Share of income of the richest 10% of the population	28.5%	42.9%
Years of schooling	16 yrs	14 yrs
Literacy rate	99%	90.4%
Life expectancy	80.3 yrs	73.0 yrs
Infant mortality rate	4.5 per thousand live births	19.8 per thousand live births
Population	63.4 million	201.0 million

Population, % over 65	17.3%	7.3%
Population, % under 15	17.3%	24.2%

Source: The World Factbook 2013–14. Washington, DC: Central Intelligence Agency, 2013.

Note: PPP = purchasing power parity

6.

International trade Extract C (lines 10−11) suggests that 'Increased protectionism could be damaging as the UK is placing much of its hopes for export success on the growing Chinese market.'

Using the data in the extracts and your economic knowledge, evaluate the view that the use of protectionism is inevitably damaging to economies.

[25 marks]

7.

Brazil: The Hot 'BRIC'

Extract B: Brazilian economy

Brazil has a mixed economy with abundant natural resources. It has been the world's largest producer of coffee for the last 100 years and it will shortly become one of the world's top ten oil producers. Brazil also has a strong manufacturing sector. For example, it is a likely source of the A4 paper you use in your printer, and its Bandeirante Corporation has long competed with aerospace giants as a world-class manufacturer in the niche market of short-haul commuter aircraft. By value, it ranks as the 23rd largest exporter in the world. However, the discovery of oil off the coast of Brazil has led to an appreciating currency; this makes life more difficult for domestic manufacturers.

Brazil is the world's fifth largest country by both population and total area. It has grown rapidly over the last thirty years and is now the world's seventh largest economy. It has the fourth largest car market in the world. From 1980 to 2011, Brazil's Human Development Index increased by 30.8%. However, Brazil is also well known for its inequality, and there is much rural and urban poverty. Many of its large cities contain crowded and deprived slum districts known as favelas. Brazil's health care system ranks 125th out of 190 countries.

Brazil currently dominates Foreign Direct Investment (FDI) into Latin America and in 2011 it attracted about one third of all the FDI into the region. FDI creates jobs and contributes to improvements in human capital as foreign companies often invest in their workforce. New investment has a multiplier effect and the resultant growth in GDP generates higher tax revenues for the Brazilian Government. However, there are also the environmental effects to consider. Many overseas companies that are located in Brazil export part of their output but some of their profits are sent abroad.

Source: News reports, October 2013

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8. **International trade Extract B** (lines 12−13) states ‘The Government last night released research suggesting a US-EU agreement sweeping away trade barriers would particularly benefit the automotive, financial and chemical sectors.’

With the help of a diagram, explain the extent to which the removal of a tariff might affect the volume of imports into the UK.

[9 marks]

9. Using the data in **International trade Extract A**, calculate, to one decimal place, the percentage change in the total net trade balance in goods with the UK’s top five trade partners from February−April 2012 to February−April 2013.

[2 marks]

10. **International trade**

Extract C: China and Europe risk trade war

China this week responded to EU anti-dumping tariffs on solar panels with a levy on European wine. However, by attacking wine producers, Beijing has potentially turned a straightforward dispute over state subsidies between Germany and China into a full-blown European trade war.

France has effectively been targeted in retaliation for a levy designed to protect German manufacturers in what appears to be a deliberate attempt to increase tensions within the EU. In doing so, experts said that China, which is relatively new to the politics of global trade, has demonstrated smart tactics.

The danger is that China may decide to target other seemingly innocent parties if the row escalates, and that might mean the UK. Increased protectionism could be damaging as the UK is placing much of its hope for export success on the growing Chinese market.

In the last five years, UK goods exports to China have virtually doubled to £15.9bn and, three years ago, David Cameron set a $30bn (£20bn) target by 2015 as part of a bilateral deal with Beijing. Including Hong Kong, China is now the UK's fifth largest net trading partner.

However, China's influence in the UK stretches wider. At the end of 2011, foreign direct investment into the UK from China totalled £1.3bn, the second largest in the EU after Germany. In the last six months alone, China's telecoms giant Huawei has announced plans to invest £1.3bn in a new plant while ABP (a large Chinese investment group), plans to spend £1bn developing the Royal Albert Dock in London.

The Government also hopes to attract Chinese money to invest in UK infrastructure as part of George Osborne's 'Plan for Growth'. In other words, China is a key part of the Government's economic recovery plan.

Source: ©Telegraph Media Group Ltd 2013

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11. **International trade**

Extract B: Transatlantic free trade?

David Cameron today confronted his critics by making the positive case for continuing European Union membership as he held talks with President Barack Obama over a giant US-EU trade deal that could provide a £10bn annual boost to the UK economy.

With his party in renewed turmoil over Europe, the Prime Minister sought to reassure the White House (where senior figures in the Obama administration have insisted they regard the UK as a crucial member of the union) that the UK are not looking to leave the EU.

The planned agreement would establish a free trade area between the world's two largest trading blocs, creating a transatlantic market of 800 million consumers.

Writing in today's Wall Street Journal, Mr Cameron says: "This deal could add as much as £10bn to the UK economy and £63bn to US GDP. But the rest of the world would benefit too, with gains that could generate €100bn (£84bn) worldwide".

The Government last night released research suggesting a US-EU agreement sweeping away trade barriers would particularly benefit the automotive, financial and chemical sectors. It claimed the deal could be worth £380 a year for each British family.

Karel de Gucht, the European Commissioner for Trade, has cited the deal as a prime reason for the UK staying in the EU, telling The Independent last week that it would be "clear madness" for the UK to leave in light of such a deal.

Source: Adapted from: © www.independent.co.uk 13 May 2013

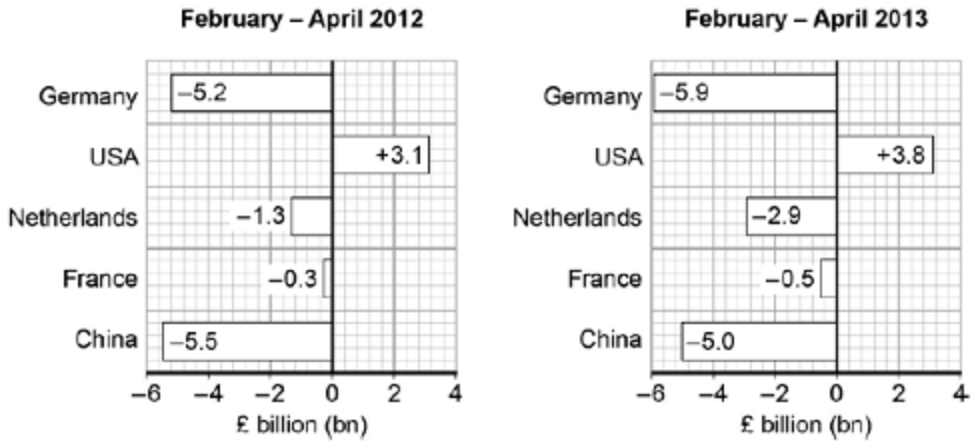
12. In 2014, the UK's contributions to the European Union (EU) budget rose by £2.7bn, making it the second largest net contributor. However, it is argued that the UK benefits much more from the trade and the job creation that EU membership brings.

Evaluate the extent to which individuals and firms in the UK benefit from membership of the EU.

[25 marks]

13. **International trade**

Extract A: UK's trade balance in goods with significant trading partners* 3 monthly balance (£billion)



* Significant trading partners defined as top 5 combined export & import sources 2012

Source: Contains public sector information licensed under the Open Government Licence v. 1.0

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14. In 2014, the UK's contributions to the European Union (EU) budget rose by £2.7bn, making it the second largest net contributor. However, it is argued that the UK benefits much more from the trade and the job creation that EU membership brings.

Explain how membership of a customs union, such as the EU, affects the pattern and volume of trade between countries.

[15 marks]

15. 'George Osborne talks about boosting exports and rebalancing the economy, but the Chancellor is not nearly as worried about the trade deficit as he is about the budget deficit.'

To what extent do you agree that a persistent trade deficit is more damaging to the UK's macroeconomic performance than a persistent budget deficit? Justify your answer.

[25 marks]

16. Explain the phrase 'devaluation of the exchange rate' (**Extract B**, line 12) **and**, with the help of a diagram, analyse how a devaluation of the Chinese currency (the yuan) may affect economic growth in the UK.

[9 marks]

17. **Extract C** (lines 2 – 4) asks: 'Is it time the UK considered manipulating its currency directly and managing its exchange rate in order to reduce the ever-increasing trade deficit and to help improve its performance?'

Using the data and your knowledge of economics, evaluate the view that the UK should focus its monetary policy on managing the exchange rate in order to improve macroeconomic performance.

[25 marks]

18. In January 2009, £1 could buy approximately 1.04 euros on the foreign exchange market. By July 2015, £1 could buy approximately 1.44 euros.

Evaluate the impact on the UK's macroeconomic performance of a sustained rise in the value of the pound sterling against the euro.

[25 marks]

19. Between 2011 and 2016, UK unemployment fell from a high of 8.5% to 4.8%. Some argue that government attempts to reduce unemployment inevitably lead to trade-offs with other macroeconomic policy objectives.

Discuss the view that falling unemployment will inevitably lead to trade-offs with other macroeconomic policy objectives.

[25 marks]

20. **Extract C** (lines 21 – 22) states: 'Any kind of deal between the EU and ASEAN economies is still a long way off, and the UK must wait to see how new trade deals affect its macroeconomic performance.'

Using the data and your knowledge of economics, evaluate the extent to which international agreements to increase free trade are likely to be beneficial to the UK's macroeconomic performance.

[25 marks]

21. The UK has seen significant changes in its pattern of trade with the rest of the world in terms of what we trade and with whom. The UK's current account deficit widened from £29.1bn in 2011 to £100.2bn in 2015. The deficit in 2015 was 5.4% of GDP, the largest annual deficit as a percentage of GDP since records began in 1948.

Evaluate the measures that might be taken to reduce a deficit on the current account of the UK's balance of payments.

[25 marks]

22. The UK has seen significant changes in its pattern of trade with the rest of the world in terms of what we trade and with whom. The UK's current account deficit widened from £29.1bn in 2011 to £100.2bn in 2015. The deficit in 2015 was 5.4% of GDP, the largest annual deficit as a percentage of GDP since records began in 1948.

Explain the possible reasons for changes in the pattern of trade between the UK and the rest of the world.

[15 marks]

23. The table below shows selected components of the UK balance of payments on current account as a percentage of GDP between 2011 and 2014.

Year	Balance of trade in goods and services	Primary income balance	Secondary income balance	Current account balance
2011	−1.6	1.3	−1.3	−1.6
2012	−2.0	0.1	−1.3	−3.2
2013	−2.0	−1.0	−1.5	−4.5
2014	−1.9	−1.8	−1.4	−5.1

It can be concluded from the data that between 2011 and 2014 the main reason for the rise in the current account deficit as a percentage of GDP was

A GDP growing faster than the deficit on the current account. ⬭

B the deficit on trade in goods increasing by more than the surplus on trade in services. ⬭

C the deterioration in the primary income balance. ⬭

D the growth in the deficit on the secondary income balance. ⬭

[1 mark]

24. **Extract B** (lines 21) states 'Although some argue that a current account deficit is not a problem, others point to the worryingly large and persistent nature of the deficit.'

Using the data in the extracts and your knowledge of economics, assess the impact of a persistent current account deficit on the macroeconomic performance of the UK economy.

[25 marks]

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25. **Extract B** describes the trade figures as ‘disappointing’.

Explain how the data in **Extract A (Figure 2)** show that the UK’s trade performance has been ‘disappointing’ given the fall in the value of the pound since November 2015.

[4 marks]

26. **Extract C** (lines 8–9) states ‘Trade deficits and surpluses may be self-correcting in a floating exchange rate system.’

With the help of a diagram showing the supply of and demand for a currency, explain how a floating exchange rate may help to correct a trade surplus.

[9 marks]

27. Which one of the following is an expenditure switching policy that would help to reduce a deficit on the balance of payments on current account?

An increase in

A government expenditure on public goods. ⬭

B income tax to reduce consumer expenditure. ⬭

C quotas on exports of demerit goods. ⬭

D tariffs to raise the price of imports. ⬭

[1 mark]

28. A country experiences a large net capital outflow. All other things being equal, the most likely consequence of this in the short run will be a decrease in

A its exchange rate. ⬭

B its net income from overseas investments. ⬭

C its rate of interest. ⬭

D the value of exports and imports. ⬭

[1 mark]

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29. The table below contains selected data on a country's macroeconomic performance over a 20 year period.

Year	Unemployment (%)	Rate of inflation (%)	Balance of trade on current account ($ bn)
1998	6.0	3.5	−20
2003	5.8	3.0	−19
2008	5.5	2.5	−12
2013	5.2	2.0	−2
2018	5.0	1.5	+3

All other things being equal, which one of the following, **A**, **B**, **C** or **D**, can be inferred from the above data?

A The natural rate of unemployment is falling ⬭

B The price level is increasing more slowly ⬭

C The volume of exports is increasing ⬭

D There is an inverse relationship between unemployment and inflation ⬭

[1 mark]

30. **INVESTIGATION**

Scenario

You are an economist working for an organisation which investigates ways to improve the standard of living of UK citizens.

You have been asked to review changes in living standards and inequality since the 2007–2008 financial crisis.

As part of this investigation, you are to provide answers to the following question.

Study **Extracts A**, **B** and **C**, and then use these and your knowledge of economics to help you answer this question.

Explain how a sustained slowdown in the world economy is likely to affect living standards in the UK.

[15 marks]

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31. Between 2014 and 2018, the pound fell by more than 20% against the dollar and euro. Some argued that this would benefit the UK's macroeconomic performance, but others claimed that a lower exchange rate will cause problems.

Assess the view that a depreciation of the pound against other currencies is likely to improve the UK's macroeconomic performance.

[25 marks]

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