



Rewarding Learning

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General Certificate of Education

2018

Economics

Assessment Unit A2 2

assessing

Managing the Economy in a Global World



AEC21

[AEC21]

TUESDAY 12 JUNE, AFTERNOON

TIME

2 hours.

INSTRUCTIONS TO CANDIDATES

Write your Centre Number and Candidate Number on the Answer Booklet provided.
Answer **all** questions in Section **A** and **B** and **one** question in Section **C**.

INFORMATION FOR CANDIDATES

The total mark for this paper is 90.

- Section A: 20 marks
- Section B: 40 marks
- Section C: 30 marks

Figures in brackets printed down the right-hand side of pages indicate the marks awarded to each question or part question.

ADVICE TO CANDIDATES

You are advised to take account of the marks for each part question in allocating the available examination time. In questions involving calculations, you are advised to show your workings. Quality of written communication will be assessed in Questions **3**, **4 (b)**, **(c)** and **(d)**, **5** and **6**. Quantitative skills will be assessed where appropriate.

Section A

Answer all questions (20 marks)

- 1 The table below shows outputs of computers and slaughtered beef cattle in two countries when each country allocates exactly half of its resources to each type of output.

A computer and a tonne of beef are of equal value in world markets.

Country	Computers	Beef (tonnes)
Carniva	200 million	300 million
Tronica	400 million	200 million

- (a) Using the information in the table above, explain what is meant by “absolute advantage”. [2]
- (b) Using the information in the table above, explain how both countries could benefit by specialisation and trade. [5]

- 2 Domestic demand and supply schedules for microwave ovens in a particular country are illustrated in the table below.

Price (\$)	Quantity demanded domestically (000s)	Quantity supplied domestically (000s)
60	1500	100
100	1300	300
140	1100	500
180	900	700
220	700	900

There has been no government intervention in the market, so microwave ovens have been selling within the country at the world price of \$100. Domestic output accounted for less than 25% of total sales, prompting the government to introduce a specific tariff of \$40 per microwave oven.

- (a) Calculate the revenue which this tariff will raise for the country’s government. [2]
- (b) With the aid of a diagram, analyse the impact of this tariff on community surplus in the country. [5]

- 3 A country's government is worried about a long-term deficit on the balance of payments on the current account. A few months ago, it began implementing policies to try to reduce the exchange value of its currency. The value of the trade-weighted exchange rate index of the country's currency (base 2008 = 100) has reduced from 97.00 to 87.30. In the same time period, imports into the country have fallen by 4%, and the country's exports have risen by 4%.

Assume that there are no other changes.

With reference to the Marshall-Lerner condition, analyse whether the government's policy is achieving its objectives in the short term. [6]

Section B

Answer all questions (40 marks)

The case study which follows was compiled in August 2016.
Read the articles carefully and answer the questions which follow.

Case study: “Interesting Times”

Source 1: Fears of deflation spark unprecedented measures

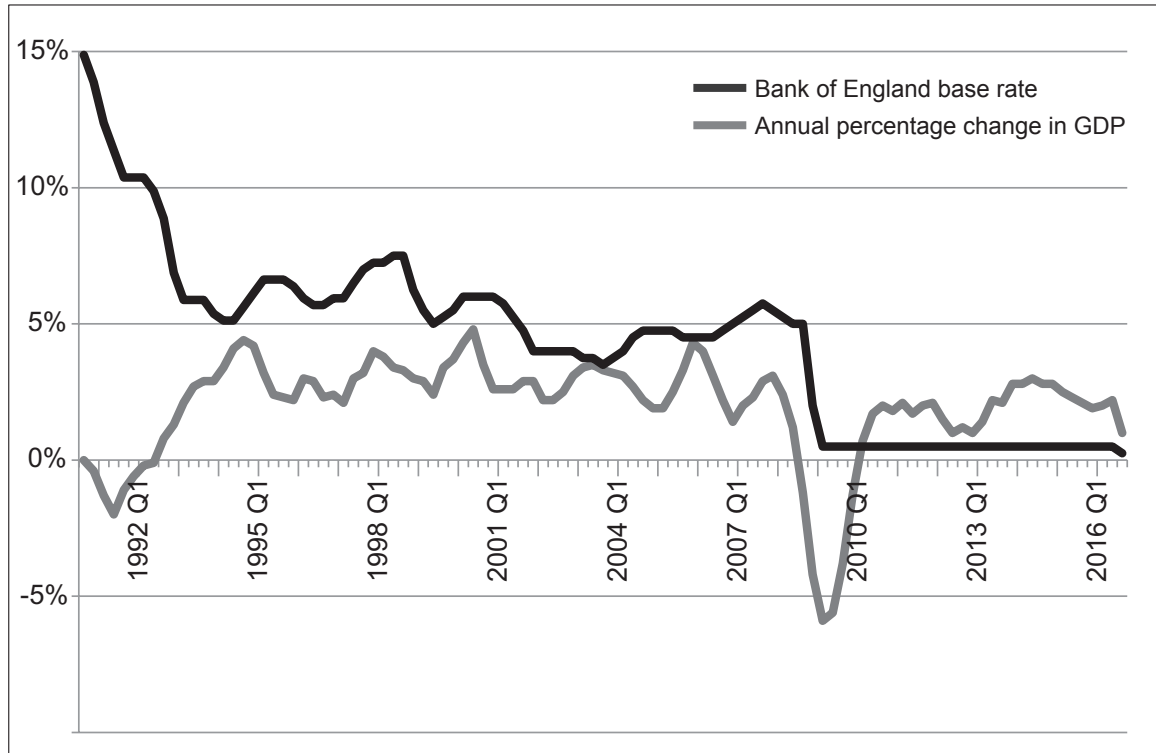


Fig. 1: Bank of England interest rate and annual change in GDP (1990–2016)

On 4 August 2016, the Bank of England reduced its base lending rate to a new record low level of 0.25%. Just over a quarter of a century earlier, that rate was 14.875%! Economic conditions and problems faced by policy-makers have changed considerably since the banking crisis of 2008–9. Mark Carney, Governor of the Bank of England, warned high-street lenders they must pass on cheaper borrowing costs to customers as part of a bigger-than-expected package of measures designed to prevent a post-Brexit recession. The Bank indicated that interest rates could be reduced further in coming months as the economic fallout from the vote to leave the EU becomes clearer. It had been forecasting slower growth in earnings and 250 000 job losses, even with these stimulus measures. Early economic indicators suggested that confidence among businesses and households slumped after the June referendum and that a slowdown in spending threatened to tip the UK into recession. Mr Carney rebuffed suggestions that the Bank was over-reacting to the Brexit vote. “There is a clear case for stimulus, and stimulus now, in order to have an effect when the economy really needs it,” he said.

Source 2: HM Treasury ready to be more flexible

The Bank's intervention to shore up confidence was backed by the Chancellor of the Exchequer, Philip Hammond. He also responded to assertions from Mr Carney and others that monetary policy had limited power to solve Britain's economic problems. "Alongside the actions the Bank is taking," he stated, "I am prepared to take any necessary steps to support the economy and promote confidence."

Markets are notoriously fickle, and the "liquidity trap" identified by John Maynard Keynes may result in growth being less than these measures are aiming for. The Bank's Monetary Policy Committee (MPC), chaired by the Governor, would almost certainly support a further interest rate cut, potentially taking official borrowing costs to as low as 0.1%, although Mr Carney said he was strongly opposed to negative interest rates.

The European Central Bank's introduction of charges to commercial banks for holding their cash was not a solution for stagnation in the Eurozone, and the Bank of Japan's introduction of negative rates in early 2016 had consequences scarcely anyone would have predicted. Instead of speculators selling the yen and triggering a beneficial depreciation of the Japanese currency, global uncertainties encouraged investors in Japan and abroad to invest in safe Japanese government bonds, despite their negative yield. The value of the yen on international currency markets actually rose, and the stimulus the Japanese monetary authorities were counting on did not happen!

The MPC was not unanimous in endorsing all the measures, which also included:

- plans to pump an additional £60bn in electronic cash into the economy to buy government bonds, extending the existing quantitative easing (QE) programme to £435bn in total;
- another £10bn in electronic cash to buy corporate bonds from firms "making a material contribution to the UK economy";
- as much as £100bn of new funding to banks to help them pass on the base rate cut. Under this new "term funding scheme", the Bank will create new money to provide loans to banks at interest rates close to the base rate of 0.25%. Banks which do not re-lend would be penalised.

The pound fell sharply against the dollar and euro after the Bank's announcement but the FTSE 100 share index rallied. Matthew Whittaker, economist at the Resolution Foundation think-tank, commented: "On the severe near-term economic cooling associated with the post-referendum uncertainty, the Bank can help. Longer-term, our economic performance rests on the post-Brexit picture on trade, competition and – crucially – productivity. Influencing those outcomes largely rests with politicians, not central bankers."

Source 3: Is the future dark – or just cloudy?

Philip Hammond's statement of intent was welcome to many who had argued that the policies of "austerity" followed by his predecessor, George Osborne, were unfair, divisive and inappropriate. The Treasury's reliance on monetary policy had been criticised as "obsessive". Mr Osborne's target of reaching a budget surplus by 2020 was dropped when Theresa May became Prime Minister.

David Farrow of the pressure group "Dikenomika" compared the national government to cautious companies in the private sector, which are afraid to borrow funds in difficult times, and end up with a more crippling ratio of debt to income than buoyant enterprises, which thrive by adopting bold strategies.

Doubts about expansionary monetary policy are not new. Economists generally agree that monetary policies can work to "pull down" the level of aggregate demand in an economy, but there is less agreement on their suitability for "pushing" aggregate demand upwards.

Ian MacParton, of the Pairat Investment Consultancy, told a conference of financial advisers: "We don't know how much worse things might be if the Bank of England had done nothing in 2009. We don't know if banks will find people who actually want to borrow, or if they might use their funds from sale of bonds to speculate outside the UK. It's even possible that quantitative easing might lead to a new asset price bubble, further increasing problems of inequality in the UK. The killer", he concluded, "is that we can't tell the future. If small firms and householders could be sure of markets and jobs, agonising about economic policy would be irrelevant!" Delegates at the conference upheld a motion declaring that the government's monetary policy was not working according to plan and needed to be replaced by a raft of tax cuts and subsidies for industrial investment.

- 4 (a)** Compare the trends in the Bank of England's interest rate and rate of change in GDP between 1990 and 2016 shown in **Fig. 1**. [4]
- (b)** Analyse the possible consequences to the UK economy of the cut in the Bank of England's base lending rate to 0.25% in August 2016. [9]
- (c)** Examine why the result of the referendum on Britain's withdrawal from the European Union might have led monetary authorities to expect negative consequences for the UK economy. [12]
- (d)** Evaluate the idea expressed in **Source 3** that expansionary monetary policy was not working and needed to be replaced by a package of fiscal measures. [15]

Section C

Answer one question (30 marks)

- 5** In 2015, the UK's deficit on the current account of the balance of payments was 5.4% of UK GDP, one of the highest figures on record. At the same time, figures published by the Office for National Statistics showed that 54% of the shares in British companies were in foreign ownership. Despite these figures, very few economists have been calling on the government to take action to reduce the current account deficit.

Critically examine the view that there is no need for concern about the UK's deficit on the current account of the balance of payments. [30]

- 6** Recent research suggests that there is little, if any, positive link between levels of foreign aid and economic growth in Less Developed Countries. Some of the fiercest critics of foreign aid programmes go as far as arguing that the main beneficiaries of foreign aid are the donor countries themselves. They argue that the only way to truly promote development is to change the rules regarding international trade.

Critically examine the opinion that financial aid is neither necessary nor sufficient to generate economic development in less prosperous countries. [30]

THIS IS THE END OF THE QUESTION PAPER

Sources

Source 1.....© Guardian News & Media Ltd 2019

Fig. 1.....© Bank of England and © Office for National Statistics. All content is available under the Open Government Licence v3.0

Source 2.....© Guardian News & Media Ltd 2019

Source 3.....Source 1: Reference from: OECD calls for less austerity and more public investment by Larry Elliott, Economics Editor.
Published by The Guardian, 18 February 2016.

<https://www.theguardian.com/business/2016/feb/18/oecd-calls-for-less-austerity-and-more-public-investment>

Source 2: Reference from: Osborne abandons 2020 budget surplus target. Published by BBC News, 01 July 2016

<https://www.bbc.co.uk/news/business-36684452>

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