



General Certificate of Education
Advanced Level Examination
January 2010

Economics

ECON4

Unit 4 The National and International Economy

Tuesday 2 February 2010 1.30 pm to 3.30 pm

For this paper you must have:

- a 12-page answer book.

You may use a calculator.

Time allowed

- 2 hours

Instructions

- Use black ink or black ball-point pen. Pencil should only be used for drawing.
- Write the information required on the front of your answer book. The **Examining Body** for this paper is AQA. The **Paper Reference** is ECON4.
- In **Section A**, answer **EITHER** Question 1 **OR** Question 2.
- In **Section B**, answer **one** question.

Information

- The maximum mark for this paper is 80.
- There are 40 marks for **Section A** and 40 marks for **Section B**.
- The marks for questions are shown in brackets.
- The paper is synoptic. It assesses your understanding of the relationship between the different aspects of Economics.
- You will be marked on your ability to:
 - use good English
 - organise information clearly
 - use specialist vocabulary where appropriate.

Advice

- You are advised to spend 1 hour on **Section A** and 1 hour on **Section B**.

SECTION A

Answer **EITHER** Question 1 **OR** Question 2.

EITHER

1 THE GLOBAL CONTEXT

Total for this question: 40 marks

Study **Extracts A and B**, and then answer **all** parts of Question 1 which follows.

Extract A: Exports of goods (\$bn, quarterly) for selected economies in 2007

	Q1	Q2	Q3	Q4
China	94	99	106	106
India	11	12	12	13
Japan	57	58	60	64
UK	35	36	37	39
USA	90	93	99	101

Source: official statistics, accessed on 27 May 2008

Extract B: Is trade the key to success?

There are few economists today who will argue against the importance of international trade in promoting economic growth and thereby improving living standards. This can be through both its impact on aggregate demand and the stimulus given to supply-side reforms. Undoubtedly, much progress has been made in achieving freer trade. 1
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A recent World Bank study concluded that the average incomes in 24 countries, which had reduced protectionist barriers and so had become much more open to trade, had risen by almost 70% in the period 1980 to 2000. More closed, protectionist, economies had seen their incomes per head rise by only 10%. Although other factors need to be considered in such an analysis, statistics such as these strengthen the argument that the benefits to growth and jobs, as well as to living standards, can be substantial. 10

Economic theory explains why trade might develop between countries. While absolute advantage might play a part, David Ricardo introduced the principle of comparative advantage. He argued that countries will specialise in the production of those items in which their comparative advantage is greatest; that is, where the opportunity cost of doing so is lower than that of another country or countries. 15

As trade develops, based on this principle, greater efficiency, lower prices, greater choice and economies of scale are among the benefits which might be experienced. But we cannot always be sure that comparative advantage is the most influential 20

factor in determining trade patterns. Both price and non-price factors, as well as protectionist policies such as tariffs, quotas and export subsidies, can be powerful influences. Some economists warn against what can be called a creeping protectionism, for example to protect jobs or to help new or declining industries, especially as world economic conditions deteriorate. 25

However, it may not be world economic conditions that encourage protectionism but simply survival against the stunning growth of individual economies. China, for example, growing by around 10% per annum, has seen an expansion of exports of 20% per annum.

Those in countries such as the US and UK who call for more protection need to bear in mind that, as China and others become richer, they will demand more and more of our goods and services. *The World Trade Organization (WTO)* works relentlessly to promote more free trade. The Doha trade talks began in 2001, providing a framework in which members agreed in 2004 and 2005 to cut substantially trade-distorting export subsidies, slash industrial tariffs and to consider freer trade in services. Emerging developing countries, such as India and Brazil, will, however, be opening their markets to a lesser extent. The WTO considered 2008 to be the ‘crunch’ year in trying to finalise such agreements. July of that year saw Doha end in failure. 30 35

Developed economies, such as the US and the UK, may be very concerned for their macroeconomic performance since these agreements could lead to greater openness of their economies to world markets. However, there is also widespread recognition of the actual benefits of free trade to developed economies. 40

Source: news reports, 2008

Question 1

1 (a) Using **Extract A**, identify **two** main features of the exports of goods in 2007. (5 marks)

(b) **Extract B** (lines 1-2) refers to the ‘importance of international trade in promoting economic growth’.

Explain the concept of economic growth **and** analyse **two** ways in which international trade can increase a country’s economic growth. (10 marks)

(c) **Extract B** (lines 40-42) suggests that the US and the UK may be ‘very concerned for their macroeconomic performance’ if free trade agreements lead to greater openness of their economies.

Using the data and your economic knowledge, assess the possible impact on the UK economy of greater openness to world markets. (25 marks)

Turn over ►

Do **not** answer Question 2 if you have answered Question 1.

OR

2 THE EUROPEAN UNION CONTEXT

Total for this question: 40 marks

Study **Extracts C and D**, and then answer **all** parts of Question 2 which follows.

Extract C: Real GDP growth (%), 2006-2009, selected economies*

	2006	2007	2008 <i>(forecast)</i>	2009 <i>(forecast)</i>
UK	2.8	3.0	1.0	-0.1
USA	2.8	2.0	1.6	0.1
Euro area	2.8	2.6	1.3	0.2
Major advanced economies (G7)	2.7	2.2	1.2	0.1
Newly-industrialised Asian economies	5.6	5.6	4.0	3.2

Source: official statistics, accessed on 20 October 2008

* The G7 is the Group of 7. These are the leading economies of the world and include France, the UK and the USA. The newly-industrialised Asian economies include Hong Kong, Singapore and Korea.

Extract D: Is an economic tidal wave about to roll over Europe?

As the storm clouds have gathered across the global economy, there is little reason for optimism when assessing the state of the European Union (EU) economy over the next few years. It is possible that the EU will enter recession in the last quarter of 2008, with unemployment hovering around 7% as economic growth slows or becomes negative.

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For most of 2007, Europe witnessed robust growth but signs of strain increased towards the end of the year. After that, falling consumer and business confidence, rising oil prices, together with a stronger euro, diminished growth expectations.

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Inevitably, there are variations across the EU. Spain, for example, has witnessed a dramatic fall in business confidence which will impact on GDP growth, while Germany, by squeezing wages, has gained 40% in labour cost competitiveness against Italy and 30% against Spain since the 1990s. Its current account balance is in stark contrast to the deficits in a number of other EU countries, but economic growth is forecast to be only 1% by 2009. The UK's economic future looks uncertain and recession is a strong possibility.

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It is difficult to predict what the impact of US economic weakness will be on the EU. Economic links between the US and the EU remain significant but EU trade (including that of the UK) with Asia, the Middle East and the emerging non-EU economies of Europe has increased markedly. Continuing revelations of losses to EU banks from the US housing market downturn have further undermined confidence and tightened credit.

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2008 has not brought about any revival of optimism across the EU. Further euro appreciation

is of concern (although, for the UK, the pound has shown signs of weakening), as is the continuing instability of the US economy. The world-wide ‘credit crunch’ has only served to generate greater pessimism. 20

Inflation has also been a major cause for concern. Both the Bank of England and the European Central Bank (ECB) know that, above all else, price stability has to be delivered. Hence interest rates remain relatively high, given UK inflation of over 4% and euro area inflation of 3.5%. High interest rates form part of the explanation for the strong euro which is causing problems for the EU aeronautic, automobile and textile industries in particular. But, even so, many UK exporters would like to see a further weakening of the pound. 25

It is hoped that less pressure on productive capacity, together with slower energy and food price inflation, will help reduce the inflation problem in 2009. There has even been talk of eventual deflation which will bring its own problems. 30

In the later part of 2008, interest rates began to fall, offering some hope to households and businesses. However, there may need to be greater reliance on a fiscal boost to bring recovery. The Stability and Growth Pact (to which the UK informally adheres) limits the fiscal deficit of each member of the euro area to a maximum of 3% of GDP. Given this limitation, one estimate suggests that in 2008 the euro area’s fiscal position would only allow for a widening of the deficit by just 0.5% of GDP. So, a relaxation of fiscal rules such as these would certainly be helpful. 35

It is likely, however, that the EU, including the UK, may need to rely on an external economic stimulus to improve macroeconomic performance. This could come from a sharp US recovery or from more rapid economic growth in Asia. 40

Source: news reports, 2008

Question 2

- 2 (a) Using **Extract C**, identify **two** significant points of comparison in real GDP growth between the economies shown for the period 2006 to 2009. (5 marks)

- (b) **Extract D** (line 3) suggests that it is possible that ‘the EU will enter recession’.

Explain the term ‘recession’ **and** analyse **two** possible causes of a recession. (10 marks)

- (c) **Extract D** (lines 39-40) concludes that ‘the EU, including the UK, may need to rely on an external economic stimulus to improve macroeconomic performance’.

Using the data and your economic knowledge, assess the possible effects on UK macroeconomic performance of an external economic stimulus, whether arising from other EU members or from other parts of the world. (25 marks)

Turn over for the next question

Turn over ▶

SECTION B

Answer **one** question from this section.

Each question carries 40 marks.

- 3 (a) Explain the concept of the natural rate of unemployment **and** the factors which might determine it. *(15 marks)*

- (b) In May 2008, the Governor of the Bank of England spoke of the need for the UK economy to move away from spending and importing, towards saving and exporting.

Evaluate the consequences for UK unemployment if this movement were to occur.

(25 marks)

- 4 (a) Explain how fiscal policy might be used to bring about supply-side improvements to an economy. *(15 marks)*

- (b) The level of UK public sector spending grew from 37% of GDP in 1997 to over 45% in 2008.

To what extent do you regard such an expansion of the public sector as beneficial to the UK economy?

(25 marks)

- 5 (a) Explain the factors which help determine the exchange rate of a currency. *(15 marks)*

- (b) In a floating exchange rate system, a currency may be subject to frequent fluctuations in its external value.

Discuss the possible economic consequences of such fluctuations for the achievement of a country's macroeconomic objectives.

(25 marks)

END OF QUESTIONS

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