

A-level ECONOMICS

Unit 4 The National and International Economy

Thursday 23 June 2016

Afternoon

Time allowed: 2 hours

Materials

For this paper you must have:

- an AQA 12-page answer book
- a calculator.

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 **Paper Reference** is ECON4.
- In **Section A**, answer **either** Context 1 **or** Context 2.
- In **Section B**, answer **one** essay.

Information

- The marks for questions are shown in brackets.
- The maximum mark for this paper is 80.
- There are 40 marks for **Section A** and 40 marks for **Section B**.
- This 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** Context 1 **or** Context 2.

Total for this Context: 40 marks

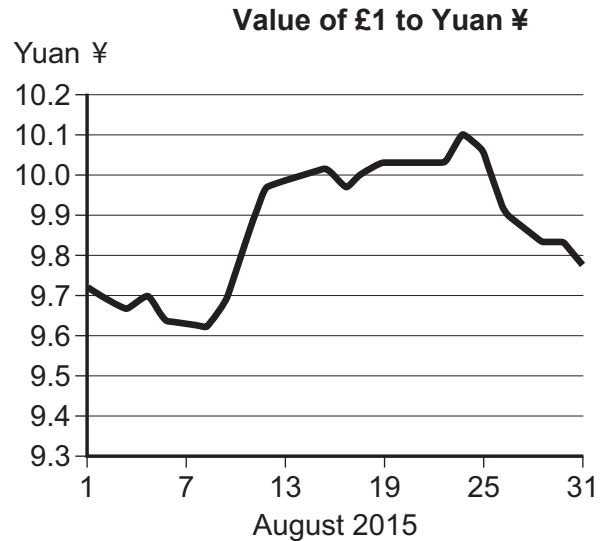
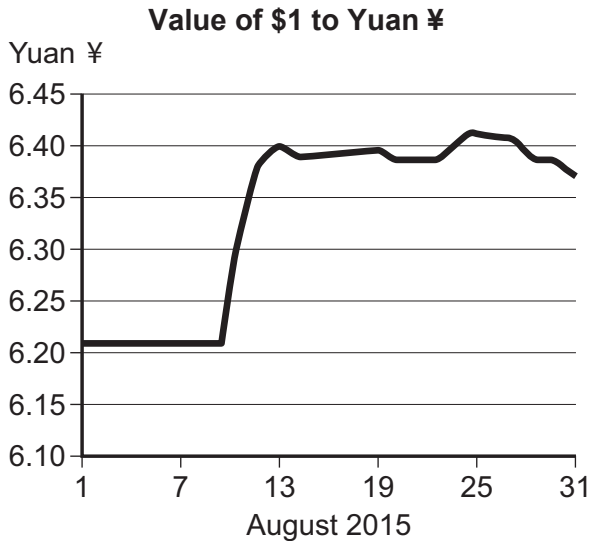
Either

Context 1

THE GLOBAL CONTEXT

Study **Extracts A, B and C**, and then answer **all** parts of Context 1 which follow.

Extract A: Value of US Dollar and UK Pound Sterling to the Chinese Yuan, August 2015



Source: Official statistics, 2015

Extract B: Currency wars

After China's recent devaluation of its currency (the yuan), several other emerging economies followed and reduced the value of their own currencies in an attempt to retain their international competitiveness. This sent shockwaves around global markets and increased fears of a currency war (nations engaging in successive devaluations in order to gain a competitive advantage). However, the most important change appears to be that caused by the Central Bank of China. The perception that the world's single biggest customer for raw materials is in economic difficulties has created fears for the stability of big commodity producing economies and damaged investor confidence. These economies include Kazakhstan, Russia, Brazil, South Africa and Malaysia.

1

"The appearance of China deliberately devaluing its exchange rate to boost growth has added urgency for policymakers elsewhere to do what they can to gain more export revenue", said an analyst. However, the devaluation of the exchange rate in China may also threaten the economic growth of many developed economies such as the UK and the USA. As these economies begin to reach their productive capacities, they are likely to increase their interest rates, which may appreciate their own exchange rates, thereby worsening the situation.

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The US government, in particular, has been angered. Although China claims to be trying to manage the yuan's value against a basket of currencies, the yuan is still, in practice, loosely pegged to the dollar. If the dollar appreciates, then so does the yuan. As a result, this may prompt China to peg the value of their currency at an even lower value against the dollar as a result. It is argued that the Chinese should float their currency freely to make global trade fairer, rather than manipulate its value. However, devaluation of the yuan has allowed Chinese exporters to further improve competitiveness and, by raising the price of imports, has also helped China to stave off deflation.

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Source: News reports, 2015

Extract C: Exchange rate systems

The UK has allowed market forces to determine its exchange rate for over 20 years but, in the face of growing global competition, this may be damaging to the UK's prosperity. 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? 1

Monetary policy has generally focused on the control of inflation using interest rates and, in recent times, quantitative easing has been used to help revive the economy. Much less attention has been paid to the exchange rate. If the UK did attempt to manage its exchange rate, it would not be the first European economy to do so. In 2011, Switzerland introduced what it called a 'currency ceiling' to try to block the steep appreciation of the Swiss franc, which had become a safe haven for investors frightened by the Eurozone debt crisis. The Swiss government realised that to allow the Swiss franc to appreciate might damage domestic exporters and plunge Switzerland into a long period of deflation. 5 10

To keep the value of the Swiss franc against the euro below the ceiling, the Swiss National Bank created new francs and sold them, accumulating foreign currency reserves. This was very costly to the Swiss government and some feared that it might ultimately lead to inflation. Managed currencies also make it difficult to use the other monetary policy instruments effectively, which is why most economies have moved to allowing their currency's value to be determined solely by market forces. That being said, when the Swiss returned to a freely floating system, their exchange rate increased by nearly 30% in one day. Having a managed exchange rate could, however, lead to more stability for the UK, boosting both trade and investment from abroad. This could help to improve the UK's macroeconomic performance, despite the growing global uncertainties. 15 20

Source: News reports, 2015

0 1

Using the data in **Extract A**, calculate (to one decimal place) the percentage change in the exchange rate between the **US dollar** and the **Chinese yuan** between 1 August 2015 and 13 August 2015, **and** identify **one** significant comparison between the exchange rates of the US dollar and the UK pound sterling with the Chinese yuan over the period shown.

[5 marks]

0 2

Extract B (lines 12–14) states: 'the devaluation of the exchange rate in China may also threaten the economic growth of many developed economies such as the UK and the USA.'

Explain the phrase 'devaluation of the exchange rate' **and** analyse how a devaluation of the Chinese currency (the yuan) may affect economic growth in the UK.

[10 marks]

0 3

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]

Turn over ►

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

Total for this Context: 40 marks

or

Context 2

THE EUROPEAN UNION CONTEXT

Study **Extracts D, E and F**, and then answer **all** parts of Context 2 which follow.

Extract D: Selected economic data for Spain

	2010	2011	2012	2013	2014
Population (millions)	46.6	46.7	46.8	46.8	46.5
Real GDP (€, bn)	1081	1075	1055	1049	1058
Unemployment Rate (%)	19.9	21.4	24.8	26.1	24.4
Current Account Balance (€, bn)	-42.4	-34.0	-3.0	15.1	8.5

Source: Official statistics, 2015

Extract E: Is the crisis over in Spain?

<p>The Spanish economy has been benefiting from an upturn in the economic cycle within the Eurozone. The European Central Bank's (ECB's) adoption of quantitative easing has given a boost to the Eurozone. The sharp fall in energy prices caused by the recent collapse in the price of oil has also acted like a tax cut, but Spain seems to have been doing much better than the single currency bloc as a whole, which grew at a much lower rate during this period.</p>	1
<p>The Spanish government claims that the recent recovery is partly due to the supply-side labour market reforms it has carried out since being elected in 2012. These reforms include: making it less expensive for employers to dismiss permanent workers; allowing firms to opt out of pay setting agreements within industries; allowing employers to set their own conditions of employment with their employees; and also reducing 'red tape'. At the same time, tax on firms' profits has been cut from 30% to 25%.</p>	5
<p>As a result of these and other measures, Spain has moved up the World Bank's 'ease of doing business' rankings from 52nd to 33rd during the last two years (in comparison, the UK has moved from 7th to 8th over the same period).</p>	10
<p>Economists' views on the impact of the reforms vary. Some suggest that they help to explain why Spain has been recovering better than other countries such as Italy and Portugal. Some estimates have suggested that unemployment would have peaked at 20%, rather than 26%, if the reforms had taken place earlier. However, others have argued that the source of the recovery has not been the structural reforms but rather the adjustments forced upon businesses and workers in coping with the severe recession, in particular through lower wages.</p>	15
<p>The Spanish economic recovery, however, needs to be put into perspective. Despite the improvement in growth and the decline in unemployment, Spain's unemployment rate is still the second highest in Europe, with only Greece having a higher rate.</p>	20
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Source: News reports, 2015

Extract F: Unemployment in the UK – as good as it gets?

The UK labour market is showing some healthy signs. A significant number of new jobs are continuing to be created and the unemployment rate stood at 5.7% at the end of 2014, in comparison to a Eurozone average of 11.1%. Economic growth has increased the demand for labour. However, some are now arguing that further improvements in the unemployment statistics can only be gained through improvements in the supply-side of the economy, rather than relying on demand.

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Wages are growing at their highest rate for over three years and inflation is at its lowest level on record. Consumers are in a much stronger position and the prospects for the UK economy have improved. At the same time, some European economies are showing signs of growth, which is likely to boost UK exports. However, further efforts to reduce the unemployment rate may prove difficult. Some argue that there are jobs out there, but some people are not willing or able to take them.

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Labour market programmes are in place in the form of training, subsidies for private employers and help for individuals to find work. However, the UK government has also embarked on a number of policy changes in an attempt to force the unemployed back to work and to deal with the rising costs of welfare. Measures such as the creation of the benefits cap (which limits the maximum amount that people of working age can receive in benefits) and restricting the uprating of Jobseeker's Allowance to the rate of inflation or 1% (whichever is lower) are all part of an attempt to encourage the unemployed to seek work. However, some would say that this is punishing the unemployed. The announcement of the introduction of a National Living Wage in the recent budget is claimed by the government to offset the effect of the changes to the benefits system.

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Source: News reports, 2015

0 4

Using the data in **Extract D**, calculate (to the nearest whole number) the real GDP per capita in Spain for 2014 **and** identify **one** significant comparison between the unemployment rate and real GDP over the period shown.

[5 marks]**0 5**

Extract E (lines 1–2) states: 'The Spanish economy has been benefiting from an upturn in the economic cycle within the Eurozone.'

Explain the term 'upturn in the economic cycle' **and** analyse why this may have caused Spain's unemployment rate to fall.

[10 marks]**0 6**

Extract F (lines 4–6) states: 'some are now arguing that further improvements in the unemployment statistics can only be gained through improvements in the supply-side of the economy, rather than relying on demand.'

To what extent do you agree that a further reduction in the UK's unemployment rate is most likely to be achieved by improvements in the supply-side rather than the demand-side of the economy? Use the data and your own knowledge of economics, to justify your answer.

[25 marks]**Turn over for Section B****Turn over ►**

Section B

Answer **one** essay from this section.

Each essay carries 40 marks.

Either

Essay 1

‘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.’

Source: The Guardian: Economics Blog, 30 June 2015

0 7 Explain the factors which are likely to cause a large budget deficit. **[15 marks]**

0 8 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]**

or

Essay 2

After a period of inflation below the target rate, the Consumer Price Index (CPI) inflation rate was recorded as –0.1% in early 2015. The Governor of the Bank of England wrote: ‘A temporary period of falling prices, driven by large adjustments in a few specific components of the CPI, is a fundamentally distinct phenomenon from ‘deflation’...The UK is not experiencing ‘deflation’.’

Source: Bank of England: Letter to the Chancellor, Mark Carney, 12 February 2015

0 9 Explain the possible causes of deflation in an economy. **[15 marks]**

1 0 Evaluate the possible consequences for the performance of the UK economy of the actual rate of inflation being below the Monetary Policy Committee’s (MPC’s) target rate. **[25 marks]**

or

Essay 3

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.

1 1 Explain how membership of a customs union, such as the EU, affects the pattern **and** volume of trade between countries. **[15 marks]**

1 2 Evaluate the extent to which individuals and firms in the UK benefit from membership of the EU. **[25 marks]**

END OF QUESTIONS

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