General Certificate of Education
June 2006
Advanced Level Examination

ECONOMICS **EC4W**
Unit 4 Working as an Economist: The European Union

Wednesday 14 June 2006 9.00 am to 10.40 am

For this paper you must have:
- an 8-page answer book

You may use a calculator.

Time allowed: 1 hour 40 minutes

Instructions
- Use blue or black ink or 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 EC4W.
- Answer the compulsory question.
- **At the very start of the examination,** tear along the perforations in order to detach the question on page 2 from the extracts.
- **The extracts** are printed on pages 3, 4, 5, 6 and 7, which can be unfolded.

Information
- The maximum mark for this paper is 84.
  4 of these marks will be awarded for Quality of Written Communication.
- You are reminded of the need for good English and clear presentation in your answer. The question should be answered in continuous prose.

Advice
- You are advised to spend the first 20 minutes reading the Case Study.

Answer the compulsory question.

You may detach this page by tearing along the perforations.

Case Study:

THE EUROPEAN UNION

You are advised to spend the first 20 minutes thoroughly reading the Case Study before writing the report. The instructions below set the scene of the Case Study and explain what you should include in your report. The whole report will be marked out of 84, including 4 marks for Quality of Written Communication.

Setting the scene

The European Commission has called an inter-governmental meeting in July 2006 to discuss the Stability and Growth Pact. This meeting will be attended by the finance ministers of all EU member states, and all governments will have equal voting rights, whether or not they belong to the euro. As an economist, you have been asked to write a report to advise the UK Chancellor of the Exchequer prior to the meeting.

When writing your report, you should make use of the information in **Extracts A to I**, together with any other relevant knowledge you possess.

Requirements of the report

You are to write a report entitled: 'The case for and against more flexibility in the Stability and Growth Pact'.

Your report should:

- explain how borrowing by EU governments can affect output, employment and inflation;
- suggest reasons why some EU governments might find it difficult to control their budget deficits;
- discuss whether the UK has been more successful than the rest of the EU in achieving sound economic performance;
- evaluate the costs and benefits to the EU of allowing more flexibility in the Stability and Growth Pact and make a recommendation, with justifications, as to whether the UK should support this greater flexibility.

Use economic concepts and principles where appropriate. You will be given credit for demonstrating your ability to analyse, comment critically on, and make effective use of, the data provided.

(84 marks)

Extract A: Stability and Growth Pact

At the Dublin summit of December 1996, Germany successfully pushed the other member states to approve a tough budgetary agreement, the Stability and Growth Pact, for the Eurozone, with near automatic penalties for countries running excessive budget deficits (above 3% of GDP). Germany had wanted automatic penalties to apply but softened its position slightly in the face of stiff French opposition. Nevertheless, Germany's finance minister claimed that the pact was a credible signal that the euro would be a 'hard' currency, a currency which markets trust.

Under the pact, euro countries running an excessive deficit will be exempt from penalties in the event of a natural disaster or if they experience a recession where GDP drops by at least 2% over a year. Penalties consist of an interest-free deposit of a fixed amount with Eurozone authorities, representing 0.2% of GDP, and a variable amount determined by the extent to which the offending country exceeded the 3% ceiling. If the deficit remains excessive, the deposit becomes a fine at the end of two years.

France resisted the pact before and during the Dublin summit because it reinforces the impression that European Monetary Union is imposing a 'fiscal straitjacket' that is destroying jobs.

Source: adapted from D DINAN, *Encyclopaedia of the European Union*, Macmillan Press Ltd, 2000

Extract B: Four to bust Eurozone deficit rules

Extract C: Following the golden rule

The Labour government in the UK has adopted a similar but not identical approach to the Stability and Growth Pact. Under its 'golden rule', the government pledges that over the economic cycle, it will borrow only to invest (e.g. in roads, hospitals and schools) and not to fund current spending (e.g. on wages, administration and benefits).

Investment is exempted from the zero borrowing rule because it contributes to the growth of GDP. Indeed, the government has announced a doubling of government investment expenditure as a percentage of GDP. The government has also committed itself to maintaining a ratio of public sector debt to GDP below 40%.

As with the Stability and Growth Pact, the argument is that by using an averaging rule over the cycle, budget deficits can be allowed to occur when the economy is in recession or when growth is sluggish, helping to stimulate the economy. In boom periods, budget surpluses can help to dampen the economy. A major possible criticism, however, is whether such a policy is too inflexible. Does it prevent the government using substantial discretionary boosts to the economy at times of serious economic slowdown?

Source: adapted from JOHN SLOMAN, *Economics*, Pearson Education Limited, 2003

Extract D: Borrowing exceeds Brown's forecast

Extract E: Reduced growth forecasts

The Confederation of British Industry (CBI) has reduced its growth forecasts for the UK economy in 2005, after the UK manufacturing index this month declined to its lowest ever level.

The CBI has reduced its forecast for British economic growth from 2.8% to 2.5%. This is below Chancellor Gordon Brown's forecast of 3.0 to 3.5%.

Source: *newratings.com*, accessed on 22 January 2005

Extract F: Inflation in the EU
(Harmonised index of consumer prices, 12 months to September 2004, percentage change)

Finland*	0.2
Denmark	0.9
Netherlands*	1.1
United Kingdom	1.1
Sweden	1.2
Belgium*	1.8
Cyprus	1.8
Austria*	1.9
Germany*	1.9
EU25	**2.0**
Eurozone	**2.1**
Italy*	2.1
Portugal*	2.1
France*	2.2
Ireland*	2.4
Czech Republic	2.8
Greece*	2.9
Lithuania	3.0
Luxembourg*	3.1
Malta	3.2
Spain*	3.2
Slovenia	3.4
Estonia	3.8
Poland	4.7
Slovakia	6.4
Hungary	6.7
Latvia	7.7
*Eurozone member	

Source: official figures, November 2004

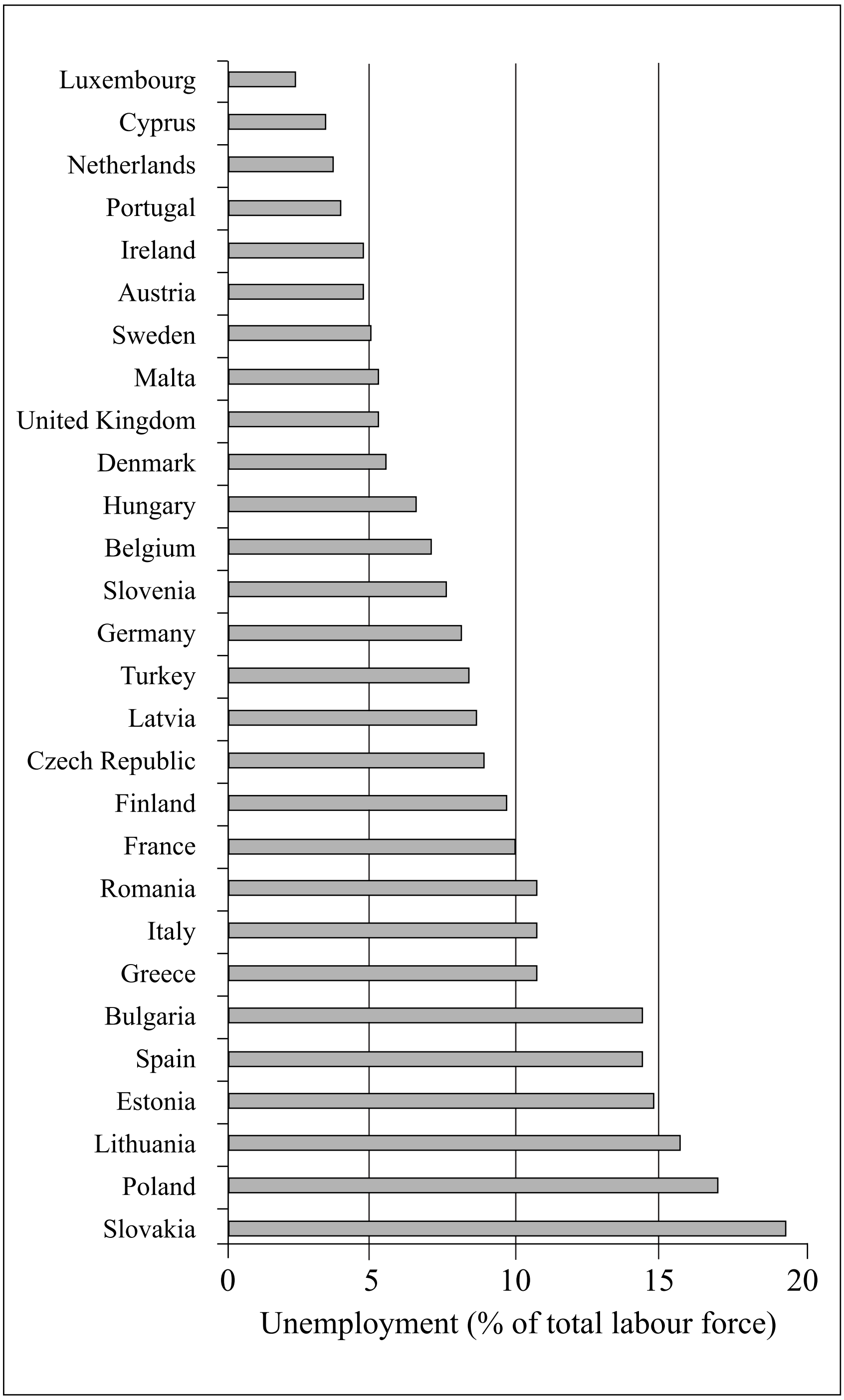
Extract G: Comparison of equivalent key interest rates

		12 months to 16 January 2005	
	Level (%)	**High (%)**	**Low (%)**
UK base rate	4.75	4.75	3.75
US Federal Funds	2.25	2.25	1.00
Euro base rate	2.00	2.00	2.00
Japan overnight call	0.00	0.00	0.00

Source: official figures, 16 January 2005

Turn over ►

Extract H: Unemployment in Europe
(EU member states, new members and applicant countries, 2001)



Source: official figures, November 2004

Extract I: Growth rates of real GDP, selected countries, 2004

Country	Growth rate (%)
Poland	5.6
Ireland	5.1
UK	3.2
Spain	2.6
France	2.1
Germany	1.7

Source: figures from *The World Factbook*, prepared by the US Central Intelligence Agency (CIA), *www.cia.gov*, accessed 4 May 2005

END OF EXTRACTS

There are no extracts printed on this page

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