General Certificate of Education
Advanced Level Examination
June 2014

Economics ECON4

Unit 4 The National and International Economy

Tuesday 10 June 2014 1.30 pm to 3.30 pm

For this paper you must have:
- an AQA 12-page answer book
- a calculator.

Time allowed
- 2 hours

A

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: UK Inflation (%) as measured by the Retail Prices Index (RPI) and the Consumer Prices Index (CPI), 2004–2011

Year	RPI	CPI
2004	3.0	1.3
2005	2.8	2.1
2006	3.2	2.3
2007	4.3	2.3
2008	4.0	3.6
2009	–0.5	2.1
2010	4.6	3.3
2011	5.2	4.5

Source: ONS, accessed on 8 August 2012

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

Extract C: Is money the root of all evil in the UK?

In September 2011, UK inflation, as measured by the CPI, was 5.2%. By June 2012, it was down to 2.4%. This fall has resulted from reductions in global energy and food prices, as well as a stronger pound and significant price reductions by retailers. The fear of some economists is that these factors will be of a temporary nature, especially when recovery gets under way nationally and globally, and inflation will prevail once more.

Such fears have led these economists to criticise the Bank of England for continuing with its loose monetary policy of low interest rates and quantitative easing. They accept that this policy was pursued in good faith in order to generate economic recovery and prevent deflation, but point to continuing disappointing performance. They fear that the main consequence will be inflation and point to the Bank's own view in its Inflation Report of August 2012 that 'considerable uncertainty surrounds the inflation outlook'.

The Quantity Theory of Money is relevant here. It predicts a direct relationship between increases in the money supply and increases in the price level. Increases in the money supply can begin to influence such factors as interest rates and the exchange rate, as well as business and consumer confidence. When the feared impact of increases in the money supply is added to the anticipated global inflationary forces, it is argued that UK inflation will inevitably rise. As for the global economy, rising inflation could also be a major obstacle to any UK economic recovery.

Source: news reports, 2012

0 1 Using **Extract A**, calculate the difference between the annual average value of RPI and the annual average value of CPI for the years 2005 to 2008, and identify **one** other significant comparison between the RPI and the CPI for the period 2004 to 2011.

[5 marks]

0 2 **Extract C** (lines 12–13) states that the Quantity Theory of Money 'predicts a direct relationship between increases in the money supply and increases in the price level'.

Explain the term 'price level' **and** analyse how increases in the money supply of an economy may bring about increases in the price level in that economy.

[10 marks]

0 3 **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]

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: GDP at current prices ($US billion) for selected European countries, 2008 – 2011

Country	2008	2009	2010	2011
France	2191	2171	2220	2290
Germany	3048	2952	3060	3205
Norway	293	264	280	306
UK	2203	2131	2222	2223

Source: OECD, accessed on 8 August, 2012

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

Extract F: Should the UK envy Norway?

Critics of the EU point to the experience of Norway which has twice rejected EU membership. Instead, along with Iceland and Liechtenstein, Norway joined the European Economic Area (EEA). This is an association of these three countries and all 27 EU members. It means that Norway is subject to just one third of the EU regulations faced by full members. It is governed by the so-called “four freedoms”. These are the free movement of goods, services, people and capital between members of the EEA. These freedoms form the essence of the EU Single Market.

Despite Norway enjoying the “four freedoms” within the EEA, one of the main disadvantages of non-membership is that the EU common external tariff applies to Norwegian exports to the EU. Norway’s important processed fish exports, for example, face EU tariffs of up to 12%. In turn, Norway imposes duties on goods from the EU such as a 400% tariff on French cheese imports. Clearly, Norway does not benefit from free trade to the extent that full members of the EU enjoy.

Those opposing full membership point to Norway’s non-participation in the CAP, allowing it to have its own policy on agriculture and food prices. They point also to low unemployment and annual average GDP growth of 2.75% over the past 40 years. One recent estimate gives Norway’s GDP per head as £40 000, the UK’s as £23 000, and an EU average of £21 150. Would such a favourable picture continue within the EU? Of course, conclusions are difficult to reach because it cannot easily be judged how Norway would have fared had it been a full member of the EU. Other factors, such as its significant benefits from oil and gas reserves, would need to be considered in any assessment.

Source: news reports, 2012

0 4 Norway’s annual average GDP growth rate has been 2.75% over the past 40 years. Using **Extract D**, calculate in $US billions, to the nearest whole number, what Norway’s GDP at current prices would be in 2012, assuming an annual growth rate of 2.75%, and identify **one** significant feature of the data in **Extract D** for the period 2008 to 2011.

[5 marks]

0 5 **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.

[10 marks]

0 6 **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]

Turn over for Section B

Turn over ▶

Section B

Answer **one** essay from this section.

Each essay carries 40 marks.

EITHER

Essay 1

In July 2012, the Office for Budget Responsibility concluded that UK Government measures to cut the budget deficit have improved the UK's long-term economic prospects.

0 7 Explain possible economic reasons why a government might prefer to cut government spending to reduce a budget deficit rather than raise taxes.

[15 marks]

0 8 To what extent do you agree, if at all, that the implementation of a budget deficit reduction programme will improve the UK's long-term economic prospects? Justify your answer.

[25 marks]

OR

Essay 2

'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.'

0 9 Explain **three** possible determinants of a country's exchange rate against other currencies.

[15 marks]

1 0 Assess the importance of a floating exchange rate to a country trying to achieve macroeconomic stability.

[25 marks]

OR

Essay 3

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

1 1 Using at least **one example of each**, explain how demand-side and supply-side shocks might harm a country's economic growth.

[15 marks]

1 2 Evaluate the likely impact of world economic growth **both** on the UK economy **and** on individuals in the economy.

[25 marks]

END OF QUESTIONS

There are no questions printed on this page

There are no questions printed on this page