



Rewarding Learning
ADVANCED
General Certificate of Education
2009

Economics

Assessment Unit A2 3

assessing

Module 5: Economic Development
and the Environment and
Module 6: Financial Economics

[A2E31]



A2E31

WEDNESDAY 3 JUNE, AFTERNOON

TIME

1 hour 20 minutes.

INSTRUCTIONS TO CANDIDATES

Write your Centre Number and Candidate Number on the Answer Booklet provided.
Answer **either** Section A on Module 5 **or** Section B on Module 6.
From the Section which you select answer Question 1 and **either** Question 2 **or** Question 3.
Indicate clearly on your Answer Booklet which Section you have answered.

INFORMATION FOR CANDIDATES

The total mark for this paper is 60.
Section A: Quality of written communication will be assessed in parts (a), (c)(ii) and (d) of Question 1 and all parts of Questions 2 or 3.
Section B: Quality of written communication will be assessed in parts (b), (c), (d) and (e) of Question 1 and all parts of Questions 2 or 3.
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.

Section A: Module 5 – Economic Development and the Environment

Answer Question 1 and **either** Question 2 **or** Question 3.

1 You **must** answer this question

The passage below was written in August 2008.
Study it carefully and answer the questions which follow.

Good Intentions, Bad Ideas!

Ethical consumption may allow prosperous shoppers to feel good, but it doesn't do much for the planet or for the world's poor. Protecting the environment and ending world hunger are such vital priorities that we must not treat them lightly. However, campaigns for organic food or fair trade may be doing precisely that.

1

One of our great myths is that farming is an environmentally-friendly activity. For thousands of years we've been converting forests into fields. Thomas Malthus predicted in the 19th century that food production could never keep pace with the world's increasing population. It has been our ingenuity in science and technology that postponed such disaster. Reverting to land-intensive organic cultivation would reduce agricultural productivity, slash crop yields and mean more rapid clearance of the remaining rainforests.

2

Another myth is that all farmers in every less economically-developed country would prosper if only the rich nations would end unfair subsidies to their own farmers. The wickedness of such practices is not in dispute. However, alongside American rice "dumped" into many African markets, there is rice from Thailand and Vietnam. This does not receive subsidy, but still costs less than the locally-produced crop. Protect all rice-growers in Africa with tariffs and we merely reward them at the expense of Asian growers who use scarce resources more efficiently.

3

The aim of the Fairtrade movement is to give a better deal to farmers in LEDCs. Importing firms can label their products as "Fairtrade" by paying producers an amount above the going rate. This premium may be far less than the additional mark-up charged to consumers in the developed country. A famous example of this was when Costa Coffee charged customers an extra 10 pence for "Fairtrade coffee". Of this 10 pence, less than a penny went to coffee producers in the LEDCs. Moreover, the system encourages producers to increase output of such commodities rather than diversify. This increases supply, keeps market prices low, and worsens the situation of those not lucky enough to have secured a fairtrade deal.

4

Some non-government organisations have been promoting the idea of "managing supply" of certain crops, notably coffee, by establishing an international cartel of coffee producers. If successful, it could bring about an increase in world prices, but there are ethical and practical difficulties. Regulation would be difficult and, depending on the elasticities of demand and supply, massive production cuts might be required in order to drive up price. This would be particularly damaging to countries in which a high proportion of farmers depend on coffee exports.

5

However, supporters of the Fairtrade movement argue that education, diversification and improvements in quality only become possible if producers in poor countries are enabled to earn more than markets currently allocate to them. Additionally, even critics of “gesture consumption” accept that consumers’ behaviour **does** influence the policies of governments, and that just may be how they can save the world.

Source: Adapted from a variety of sources.

- (a) Explain why organic farming may actually harm the environment. [6]
- (b) Explain how farmers in Africa might not necessarily benefit from governments in rich countries abandoning subsidies to their own producers. [4]
- (c) (i) Explain what is meant by “an international cartel”. [2]
- (ii) Analyse how a cartel of coffee-producing nations might influence the world price of coffee. [8]
- (d) Evaluate the view that “Fairtrade” is no more than a marketing ploy by retailers and brings no real benefits to producers in less economically-developed countries. [10]

Answer **either** Question 2 **or** Question 3.

- 2 (a) Explain what is meant by environmental externalities.
- (b) Analyse some of the measures which might be taken to reduce negative environmental externalities. [12]
- (c) Evaluate the view that UK governments should place more emphasis on protecting the environment from the adverse effects of economic activity. [12]
- 3 (a) Explain what is meant by economic development. [6]
- (b) Analyse **two** economic models which seek to explain how economic development may take place. [12]
- (c) “The most serious barrier to sustainable economic development is ‘bad government’.” Critically examine this view. [12]

Section B: Module 6 – Financial Economics

Answer Question 1 and **either** Question 2 **or** Question 3.

Quality of written communication will be assessed in parts (b), (c), (d), and (e) of Question 1 and in all parts of Questions 2 and 3.

1 You **must** answer this question.

The following article was written in August 2008.
Study it carefully and answer the questions which follow.

“Government Borrowing Soars.”

Year to End March	Public Sector Net Debt as Percentage of GDP
2004	32.6
2005	34.7
2006	36.0
2007	36.7
2008	38.3

Table 1

The latest figures on government finances paint a bleak picture. Public sector net borrowing for the first 3 months of the financial year was £24.4 billion, the biggest quarterly figure since records began in 1946. Tax receipts rose by £2.8 billion but government spending rose by £8.8 billion. This trend of increasing deficits can only worsen as the economy slows down.

1

This is particularly bad news for Gordon Brown who as Chancellor established two fundamental principles for public finance. Firstly, there was the golden rule that over the course of an economic cycle the Treasury should only borrow for investment purposes. Secondly, there was the sustainable investment rule that total public sector debt should not exceed 40 per cent of GDP. If the cost of the rescue package for Northern Rock is included in government borrowing then the second rule has already been broken.

2

Of course, politicians can fudge these figures in a variety of ways and claim to have met the two targets even when it was obvious to most observers that they had been breached. For example, they could redefine the start and the end of the economic cycle and blur the distinction between current and capital expenditure. This enables politicians to put a positive spin on even the worst of figures.

3

However, the most recent figures for public finances are so bad that no amount of manipulation could put them within Gordon Brown’s two rules. So Chancellor Alistair Darling has a tough decision to make. He must either tighten fiscal policy or abandon the cornerstones of public spending on which so much of Gordon Brown’s reputation for sound economic management was based.

4

Most observers believe that the two rules are likely to be amended and the Treasury has already stated that they will be re-examined at the end of the current economic cycle. The prospect of even higher levels of government borrowing sent jitters through the currency markets with the pound falling against both the dollar and the euro. For some, it brought back memories of the 1970s when a previous Labour government spent so much that it simply ran out of money and had to endure the humiliation of borrowing from the International Monetary Fund.

Not surprisingly, Labour's political opponents were quick to accuse it of incompetence. Liberal Democrat Treasury spokesman, Vince Cable, called for fiscal policy to be totally removed from political control in much the same way as monetary policy has been. He said, "The assessment of fiscal policy must be made by an independent body in the same way interest rates are determined."

Source: Adapted from a variety of sources during August 2008

- (a) Using the data in **table 1**, outline over the period shown what has happened to public sector debt as a percentage of GDP. [3]
- (b) Analyse how an economic slow down would be likely to affect government finances. [6]
- (c) Explain the two principles which Gordon Brown established for controlling government finances. [6]
- (d) Explain some of the ways in which politicians might manipulate statistics in order to be able to claim that these two principles had not been broken. [6]
- (e) Critically examine Vince Cable's proposal that fiscal policy should be removed from government control and placed in the hands of an independent body. [9]

Answer **either** Question 2 **or** Question 3.

- 2 (a) Explain the difference between ordinary shares and gilt-edged securities.
- (b) Analyse the role of the Stock Exchange in the UK economy. [12]
- (c) Critically examine the view that the prices of stocks and shares are a good indicator of the state of the UK economy. [12]
- 3 (a) Explain the difference between narrow money and broad money. [6]
- (b) Explain the process by which the banking sector can create money. [12]
- (c) Critically examine the decision of the UK government in 2008 to use taxpayers' money to support the banking system when it faced financial difficulties. [12]

THIS IS THE END OF THE QUESTION PAPER

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