



Rewarding Learning

ADVANCED
General Certificate of Education
2011

Economics

Assessment Unit A2 2

The Global Economy

[AE221]

FRIDAY 27 MAY, MORNING



AE221

TIME

2 hours.

INSTRUCTIONS TO CANDIDATES

Write your Centre Number and Candidate Number on the Answer Booklet provided.
Answer **Question 1** and **one** question from **Questions 2, 3 or 4**.

INFORMATION FOR CANDIDATES

The total mark for this paper is 80.

Quality of written communication will be assessed in **all** questions **except 1(a)**.

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 allocated for each part question in allocating the available examination time.

Question 1

The following passages were written in February 2010.

Please read them carefully and answer the questions which follow.

Case Study: Imbalances undermine economic recovery

Source 1: Greek debt threatens euro

A small country on the periphery of the European Union threatens to bring down the once powerful euro. Greece accounts for a mere 2.5% of Eurozone GDP yet its financial position has precipitated a run on the euro which has plummeted against the United States dollar. Many commentators even question the survival of the common currency.

International money markets took fright when it became clear that previously published figures for the size of Greek debt had totally underestimated the deficit. The government is now borrowing around 12.5% of GDP each year and has amassed a total public sector debt equal to 124 per cent of GDP.

Investors are concerned that Greece may default on its debt and are demanding sky high interest rates for any future borrowing. Of course, if the problem were confined to Greece then the rest of the Eurozone might be able to put together a rescue package.

However, Greece is not alone in having massive fiscal deficits as is shown in **Fig. 1** below.

Country	GDP (£ bn)	Public sector debt (£ bn)
Ireland	£143	£66
Spain	£912	£447
Portugal	£141	£107
Italy	£1333	£1533
Greece	£270	£335

Fig. 1

Investors are worried that Germany in particular would be unwilling to finance a rescue package for Europe's heavily indebted nations. A recent headline in German newspaper Bild said bluntly "No money for bankrupt Greeks!"

If these nations were not in the straightjacket of euro membership they could allow their currencies to depreciate. This would improve their balance of payments and reduce the value of their debt. Inside the Eurozone this is not possible, leading many economists to propose leaving the euro as the best solution for heavily indebted nations like Greece and Italy.

Economic strategist Albert Edwards takes a dim view of the future of the euro. He wrote, "Southern European countries are trapped in an overvalued currency and suffocated by low competitiveness, a situation which will lead to the break-up of the euro bloc."

“The problem for countries including Portugal, Spain and Greece is that years of artificially low interest rates have resulted in overheating and rapid inflation. The Eurozone is not an optimal currency area and a common interest rate is not suitable for all its members.

“Even if governments could slash their fiscal deficits, the lack of competitiveness within the Eurozone will require years of deflation to correct. Any help given to Greece merely delays the inevitable break up of the common currency area.”

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Source 2: Recession helps the balance of payments

It's an ill wind that does not blow someone some good and the same is true for the current credit crunch inspired recession. Whilst the slump has been disastrous for variables such as growth and unemployment, it has nonetheless helped the government to achieve one of its other macroeconomic objectives – that of reducing the deficit on the current account of the balance of payments. Recessions tend to cause wage cuts which reduce import demand and make exports more competitive. Quite often this is accompanied by a fall in the value of the pound which also helps to reduce the trade gap. 2009 saw the best trade performance by the UK since 2004. The gap between our exports of goods and services and what we import was £34 bn, down from £38 bn last year and £45 bn at its peak in 2007. A similar pattern was seen in previous recessions such as those in the early 1980s and early 1990s

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Source 3: China versus the world as trade war comes closer

With an 18 per cent jump in its exports in December, China passed Germany as the world's largest exporter. A 15 per cent increase in imports from China helped to drive the US trade deficit to the unexpectedly high level of \$40.2bn. Similarly, the EU has experienced a rise in imports from China with a jump of 10 per cent in December.

Both the EU and the USA have responded by imposing import restrictions on Chinese goods, the EU on shoes and the USA on tyres. China has retaliated by restricting imports of poultry and car parts from the USA and complaining to the World Trade Organisation (WTO) about the EU tariff on Chinese shoes.

The EU and the USA argue that trade with China is fundamentally unfair because the Chinese currency is kept at an artificially low level. Fred Bergsen, director of the Peterson Institute for International Economics, argues that China must allow market forces to correct the 25 per cent undervaluation of its currency.

American trade unionists have been urging President Obama to initiate a trade war with China in order to force a revaluation of the currency. They have been joined in this by a number of poorer nations which are also being swamped by a wave of imports from China. India, Brazil, Mexico and Indonesia have seen Chinese imports rise by between 30 and 50 per cent in recent months.

Such a trade war would undoubtedly be a vote-winner in the USA, but President Obama must be mindful of the fact that China is the largest single lender to an American government which is intent on a massive programme of public spending.

Trade wars, like their military counterparts, may seem attractive in theory but often produce outcomes very different from those envisaged by their instigators.

Adapted from: © China v world as trade war comes closer by Irwin Stelzer, The Sunday Times, 14 October 2011

- (a) Using the info in **Fig. 1**, compare the public sector debts of Ireland and [5]
- (b) Analyse the impact of the recession upon the UK current account balance.
- (c) Discuss how the high level of Greek public sector debt might be a threat to the continued existence of the euro. [10]
- (d) Evaluate the view of American trade unionists that President Obama should initiate a trade war against China. [15]

Essays:

Answer **one** question from **Questions 2, 3 or 4**.

2 “Rich nations must promote economic development in Less Developed Countries”

- (a) Distinguish between economic growth and economic development. [15]
- (b) Evaluate the main policies which rich nations could implement in order to promote economic development in Less Developed Countries. [25]

3 “Globalisation has affected every aspect of the UK economy”

- (a) Explain the main elements in the UK balance of payments accounts. [15]
- (b) Critically examine the impact of globalisation on the UK economy. [25]

4 “The Common Agricultural Policy is a cornerstone of the European Union”

- (a) Explain how membership of the European Union may result in both trade creation and trade diversion. [15]
- (b) Critically examine the view that the Common Agricultural Policy is a cornerstone of the European Union and is essential for the welfare of European food producers and consumers. [25]