



GCE A level

374/01

ECONOMICS – EC4

P.M. FRIDAY, 6 June 2008

1¼ hours

ADDITIONAL MATERIALS

In addition to this examination paper, you will need a 12 page answer book.

INSTRUCTIONS TO CANDIDATES

Answer **one** of the questions.

INFORMATION FOR CANDIDATES

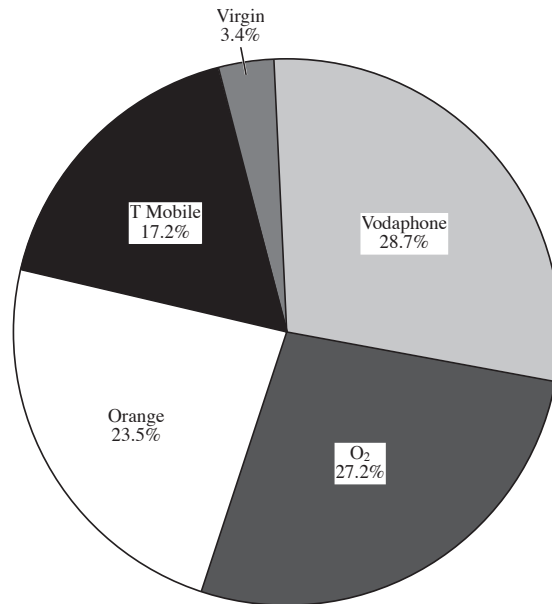
The number of marks is given in brackets at the end of each question.

You are reminded of the necessity for good written communication and orderly presentation in your answers.

Answer one question.

1. Study the following information and then answer the questions that follow.

Mobile phone network percentage market share 2007



Britain will fight EU vote to slash mobile phone charges

INTERNATIONAL MOBILE PHONE ROAMING CHARGES

	Charge to make a call to the UK from France, Spain and Germany (pence)	Charge to receive a call on 'roaming' in France, Spain and Germany (pence)
Vodafone	75	75
T-Mobile	55	55
Virgin	60	30
Orange	70	30
O₂	85	94

The European Commission (EC) yesterday backed plans to slash the cost of receiving mobile phone calls while abroad (known as 'roaming' charges). It has endorsed draft legislation that would prevent operators from charging more than 27p per minute for calls made abroad and 10p for those received.

- 5 The changes would result in huge savings to customers travelling abroad on holidays or business. A consumer pays an extra 40p a minute for receiving a roaming call, even though his operator only pays an extra 10p a minute for the added cost of roaming, the Commission said.

The European Commission (EC) estimates that mobile phone companies currently make up to £5.8 billion profit a year from international roaming charges. On average, these are four times higher than national mobile calls. The EC's proposed cuts would more than halve these profits which the EC views as occurring because of the mobile phone companies' market power.

But while the move promises big savings for holiday-makers and their families, British ministers, strongly backed by mobile phone companies, vowed to fight the price cuts, arguing that they are so severe that networks will have to raise domestic prices to recoup the losses.

The GSM Association, the trade association representing mobile phone operators, insisted that roaming charges had already fallen by 25 per cent since 2005, but politicians believe that there is still a huge mark-up on real costs. Anthony Ball, director of Onecompare.com, which contrasts prices, said that roaming rates were "a huge rip-off". However, the maximum price ceiling demanded by the European Parliament was so low that the companies were likely to impose higher charges for other mobile services, he predicted.

"We may see increases introduced in charges for UK domestic calling or messaging and also for new technologies, such as internet and video mobile TV."

The GSM Association cautioned that the ceilings would remove incentives for operators to invest and compete and would penalise a large number of mobile users. It objects in principle to the idea of government imposed maximum prices in a market economy.

In a statement, it predicted that the proposed price ceilings "will force European mobile operators to offer roaming services at below cost and give them no scope to compete with each other on price and on new services. At these price levels roaming customers will, in many cases, pay less than domestic customers for the same types of calls."

The GSM Association argues that the proposed price ceilings across Europe of 27p and 10p would particularly hurt operators providing cell phone services in difficult environments such as Austrian mountain resorts or the Greek islands.

"After years of expanding mobile coverage, this regulation could lead to a contraction in coverage, running counter to the European Union's aim of ensuring all its citizens have ready access to communications," said Rob Conway, the association's chief executive officer.

British Ministers will argue in favour of a higher maximum charge so that consumers who rarely travel abroad will have the option of lower-tariff deals. Of the 437 million mobile phone users in Europe, only about 147 million, or one-third, ever use phones abroad.

A spokesman for the British Government in Brussels said last night: "We are still concerned about the low ceiling because we think that, basically, mobile phone companies could seek to offset it by increasing the cost of domestic calls. We want to look at that. Some people think it is because we are trying to protect business. It is not. The small number of operators in the UK market is the best way of ensuring a good deal for the customer."

Adapted from The Times, 13 April 2007

- (a) Explain, using economic theory, the European Commission's case for forcing mobile phone companies to cut their 'roaming' charges. [8]
- (b) Explain, using the data, the main characteristics of the UK's mobile phone network market. [8]
- (c) Discuss the view that mobile phone operators need to make abnormal profits. [12]
- (d) "The small number of operators in the UK market is the best way of ensuring a good deal for the customer." (Lines 42-43)
To what extent do you agree with this statement? [12]

2. Study the following information and then answer the questions that follow.

Argentina - tucking in to the good times

The durability of economic recovery has surprised many. But is the government mortgaging the country's future?

Table 1 - Argentina selected economic indicators 1999-2004

	1999	2000	2001	2002	2003	2004
GDP (real annual % change)	-3.4	-0.8	-4.4	-10.9	8.8	9.0
Consumption (real annual % change)	-1.3	-0.5	-5.2	-12.8	7.0	8.3
Investment (real annual % change)	-12.6	-6.8	-15.7	-36.4	38.2	34.4
Unemployment (%)	14.3	14.7	18.3	20.4	14.5	12.1
Government budget balance (% of GDP)	-2.6	-2.4	-3.5	-1.3	0.5	2.5
Inflation percentage on a year ago	0.0	0.0	0.0	25.0	15.0	5.0

Figure 1 - Exchange rate of Argentine peso in \$ US

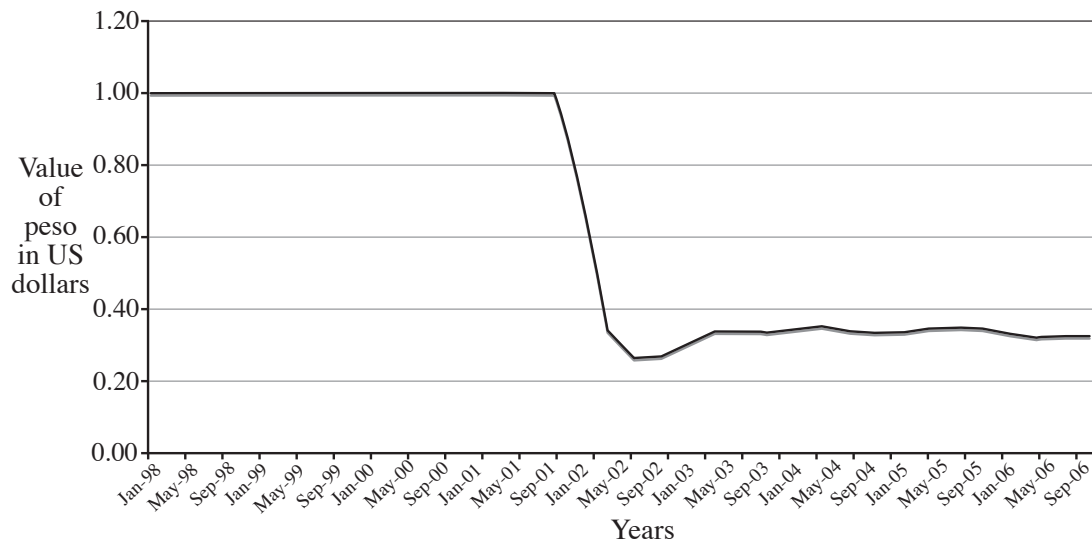
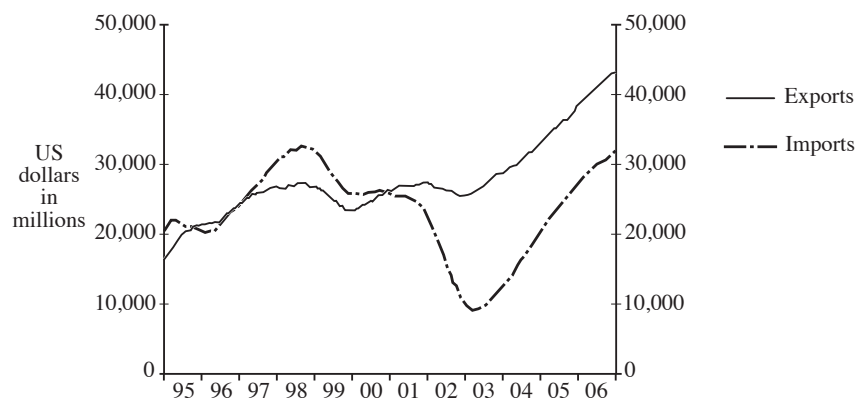


Figure 2 - Argentina imports and exports 1995-2006



In December 2001 crowds of Argentines angry at years of recession took to the streets of Buenos Aires and ousted the president. In what a century ago was the world's seventh-richest country, the economy shrank by 15% in the year to March 2002 and unemployment climbed to over 20%.

To the surprise of many, recovery from the national economic catastrophe in 2002 has been swift. Since the worst point in March 2002, Argentina's GDP has grown by 45%, an average of 8.6% a year. On the streets of Buenos Aires, the change is tangible. Cars and white goods are flying out of the showrooms thanks to cheap credit. Cinemas and restaurants are packed at weekends. Seaside resorts are heavily booked for the southern-hemisphere summer. Unemployment has fallen to 10.2%.

- 10 At a brutal cost, the 2002 collapse rebalanced the economy. A steep devaluation of the Argentinian peso turned deficits in the Government budget balance and the current account into surpluses. Roberto Lavagna, the finance minister from 2002 to 2005, kept spending under control. The government relied mainly on monetary policy to boost demand. The central bank stopped the peso from appreciating, issuing pesos to buy up exporters' dollars. The government has met its budget targets partly by taxing farm exports, which are unusually profitable because of the artificially cheap peso and high world prices.

IS ARGENTINA'S GROWTH SUSTAINABLE?

Table 2 – Argentinian economic forecasts 2006-11

	2006	2007	2008	2009	2010	2011
Real GDP growth (%)	8.5	7.5	5.0	4.0	3.9	3.8
Consumer price inflation (av; %)	10.9	9.7	12.2	10.3	8.2	6.7
Government Budget balance (% of GDP)	1.8	1.5	0.7	0.2	0.1	-0.2
Current-account balance (% of GDP)	2.9	2.0	1.4	0.8	0.8	0.6
Lending rate (average %)	8.6	10.5	12.0	11.5	10.0	9.0
Exchange rate (value of peso in dollars)	0.31	0.31	0.31	0.32	0.32	0.33

On economic policy, Prime Minister Kirchner's government has maintained an interventionist role for the state, especially regarding infrastructure and energy. Measures such as price controls have been used to achieve policy goals.

- 20 These policies have had the effect of supercharging growth. Their obvious drawback is inflation, which began to rise again, following a low of 5% in 2004, as spare capacity was used up. Mr Kirchner's response was to bully producers with "voluntary" price-freezes, outright price controls and export bans. Similar tactics caused several multinational investors in privatised utility companies to pack up and go.
- 25 Mr Kirchner's critics said these measures would halt investment. Anyway, they said, investment was of the wrong kind, in housing rather than factories. So far they have been wrong. Argentina does lack foreign investment but its own smaller companies have moved quickly to expand capacity in response to demand. The boom in construction and tourism has created many new jobs. Overall, investment has almost doubled as a percentage of GDP since 2002, from 11% to 21.4%, enough to sustain growth of 4% a year.

- 35 Some serious doubts remain. The biggest worry is energy. Because of the price controls, Argentines pay less than half as much for energy as their neighbours in South America. In this industry, the arguments of Mr Kirchner's critics ring true. Consumption has risen but investment has collapsed. Argentina has depleted its gas reserves, from 15 years' worth of production to fewer than 10. Industry sources warn of blackouts in 2007 if weather conditions are unfavourable. Fear of blackouts has suppressed investment in energy-intensive businesses, such as steel, aluminium and petrochemicals.

Other bottlenecks will make it harder to sustain growth even at a more modest pace. Now roads are again becoming congested. There are some shortages of skilled workers too. The World Bank has highlighted Argentina as an economic trouble spot, warning of “unsustainable rates” of growth and a lack of fiscal and monetary policy restraint. It expects Argentina’s economy to grow 7.7% this year and 5.6% in 2007.

“Unsustainably rapid growth in Argentina, boosted by a dangerously expansionary fiscal and monetary policy, has already strained capacity,” the World Bank said in its report, warning that the current account balances will fall sharply if the Argentinian government doesn’t take appropriate measures.

Since 2005 fiscal policy has become looser. Provincial governments are already running a deficit. On the other hand, the central bank is quietly tightening monetary policy. Many assume that Mr Kirchner will relax price controls and allow the peso to appreciate after an election next October at which he is likely to seek a second term.

The risk is that inflation might then take off, unless the authorities act to slow the economy. But officials remain bullish. “What do we have beyond two more good years?” the foreign minister, Jorge Taiana, asks. “We have higher investment than ever before. We have an extended commodity boom. We have a favourable exchange rate. We have trade and budget surpluses. Argentina’s growth can be sustained.” At what pace remains to be seen, but it has become harder to doubt the overall argument.

Adapted from The Economist, 19 December 2006

- (a) What evidence is there to suggest that “recovery from the national economic catastrophe in 2002 has been swift”? (Line 4) [8]
- (b) Explain how abandoning the fixed exchange rate for the peso affected the Argentinian economy after 2002. [8]
- (c) Discuss the arguments for governments, such as Argentina’s, maintaining “an interventionist role for the state”. (Line 17-18) [12]
- (d) To what extent can Jorge Taiana’s statement that “Argentina’s growth can be sustained”, (Lines 54-55), be regarded as realistic? [12]