



GCE A level

1134/01



S15-1134-01

ECONOMICS – EC4

A.M. FRIDAY, 19 June 2015

2 hours

1134
010001

ADDITIONAL MATERIALS

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

INSTRUCTIONS TO CANDIDATES

Use black ink or black ball-point pen.

Answer **one** question from Section A.

You are advised to spend no more than 1 hour and 15 minutes on Section A.

Answer **one** question from Section B.

INFORMATION FOR CANDIDATES

The number of marks is given in brackets at the end of each question or part-question. Section A has 40 marks and Section B has 20 marks.

You are reminded that assessment will take into account the quality of written communication used in answers that involve extended writing (Section B).

You are reminded that the essay questions in Section B are synoptic and so will test understanding of the connections between the different elements of the subject.

10 All new members of the EU are committed to eventually joining the single currency, the euro. Being part of economic and monetary union (EMU) and preparing to join the Eurozone means that countries have to meet five economic convergence criteria (Figure 2). Latvia joined the Eurozone in 2014. Only the UK and Denmark have 'opt-outs' from Eurozone membership. By 15 2014 18 of the 28 EU member states had joined the Eurozone, with Lithuania likely to join in 2015. By 2014 the euro had become an established reserve currency alongside the dollar and the yen but the financial crisis and the recession have put severe strain on the Eurozone in recent years.

Spain and Ireland suffered banking crises and Portugal and Greece have had government borrowing problems with their fiscal (budget) deficits and public sector debts over the last few 20 years. In June 2012 Spain became the fourth country in the 17-nation Eurozone to require a financial bailout from the EU after Greece, Ireland and Portugal. Mario Draghi, head of the European Central Bank, has said he will do "whatever it takes" to save the single currency. In October 2012 euro area finance ministers introduced a permanent lending facility for members in trouble. It may well be needed as the Greek public sector debt reached 175% of GDP by the 25 end of 2013, an unsustainable burden to the Greek economy.

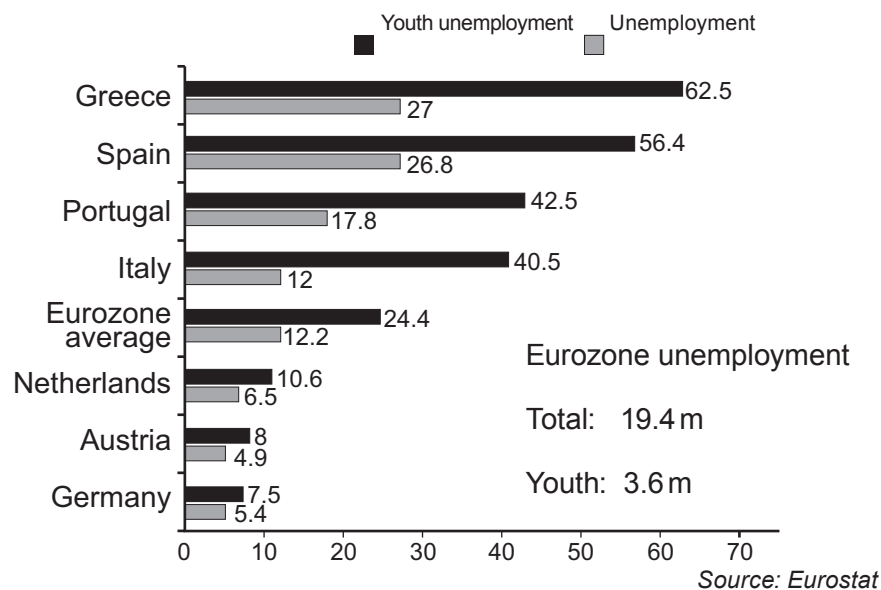
Figure 2 – The five convergence criteria for Eurozone members.

	1	2	3	4	5
What is measured:	Price stability	Sound public finances	Sustainable public finances	Durability of convergence	Exchange rate stability
How it is measured:	Consumer price inflation rate	Budget deficit as % of GDP	Government public sector debt as % of GDP	Long-term interest rate	Deviation from a central rate
Convergence criteria:	Not more than 1.5 percentage points above the rate of the three best performing member states	Not more than 3% of GDP	Not more than 60% of GDP	Not more than 2 percentage points above the rate of the three best performing member states in terms of price stability	Stable exchange rates against the euro for two years prior to entry

Source: European Commission.

Countries across the Eurozone have been trying to get their government finances back in line with the convergence criteria shown in Figure 2 by raising taxes and cutting government expenditure. These so-called austerity programmes have arguably made the already high unemployment across the Eurozone even worse, provoking protests on the streets in Spain and Greece. Many euro critics think that the euro is doomed and say that the 'one size fits all' 30 interest rate set by the European Central Bank (ECB), for 18 different economies with varying levels of unemployment is just plain crazy (Figure 3).

Figure 3 – Record breaking Eurozone unemployment (%) 2013.



35 Eurozone growth rates have been poor in recent years compared with other developed economies. Many supporters of the euro say that the low growth and high unemployment among Eurozone countries cannot be blamed solely on EMU. Instead inflexible labour markets, poor regulation of banking sectors and a fundamental lack of competitiveness in many countries is the real problem. The euro is arguably a politically driven project and its supporters will stop at nothing to preserve it, but for how long?

- (a) With reference to Figure 3 explain the costs of high unemployment to countries such as Greece and Spain. [8]
- (b) Explain why potential Eurozone members have to meet the convergence criteria described in Figure 2. [8]
- (c) 'Countries such as Greece should leave the euro if they want to boost economic growth and reduce unemployment.' Discuss. [12]
- (d) The 'enlargement of the EU benefits both new and existing members' (line 9). Discuss. [12]

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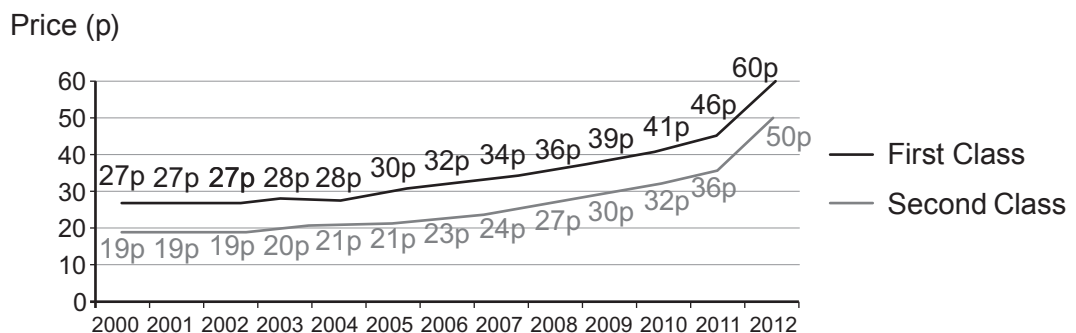
2. Study the information below and then answer the questions that follow.

PRIVATISATION OF THE ROYAL MAIL.

The Royal Mail traces its roots to a service founded by Henry VIII in 1516. Almost 500 years later, after several false starts, the Coalition Government has finally privatised the Royal Mail selling 60% of its ownership to private shareholders and another 10% being given in shares to postal workers. The sale of the company will raise around £2bn for the government helping to reduce the ever increasing public sector debt. The entry of the Royal Mail on to the Stock Exchange as a PLC in 2013 is the biggest privatisation for twenty years and is highly controversial. Even Mrs Thatcher, the architect of the 1980s privatisations of gas, electricity, water and the railways drew back from the privatisation of the Royal Mail.

The government argues that once the Royal Mail is in the private sector it will have better access to capital, enabling it to adapt to falling letter volumes and its growing parcels business. The government also say that the Royal Mail must continue to modernise so as to reduce its costs further. This is despite significant recent investment in new technology in the sorting process. Letter volumes have been hit by email, texting and social networking sites and not helped by the rise in price of a first and second class stamp (Figure 1).

Figure 1 – First and second class stamp prices from 2000-2012

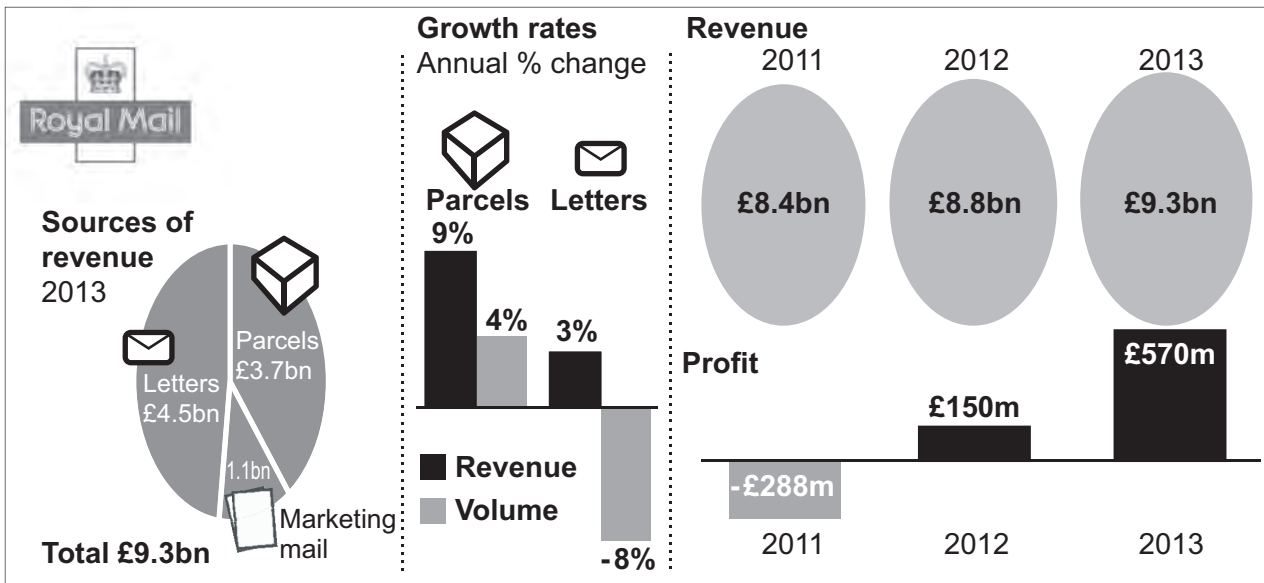


Source: RoyalMail

The privatised Royal Mail will still be obliged to provide the 'universal service obligation' which means every UK household is guaranteed a postal delivery on six days a week. Letters will also be priced the same whether they are being sent 2 miles or 200 miles in the UK. This is all overseen by the regulator, Ofcom. The problem for the Royal Mail is that it already has stiff competition from private firms in its letters business. In 2012 for instance, TNT handled 3.8 billion letters, compared with 1.1 billion in 2006 and UK Mail handled around 2.7 billion. These rivals can simply 'cherry pick' the best bulk mail contracts, such as those from banking giants, without ever having to worry about getting a loss making second-class postcard from Cornwall to Carlisle, for example. Many of Britain's biggest companies including Barclays, Tesco, Sky and TalkTalk use the services of the Royal Mail's competitors. The Royal Mail delivers around 18 billion letters a year but many of these are first collected and sorted by TNT and UK Mail.

With letter volumes falling it is the Royal Mail's parcels sector that is growing, fuelled in part by the popularity of online shopping. Indeed the Royal Mail is increasingly becoming a parcel delivery service and with its rivals DHL and UPS already in the private sector it seems logical for it to join them.

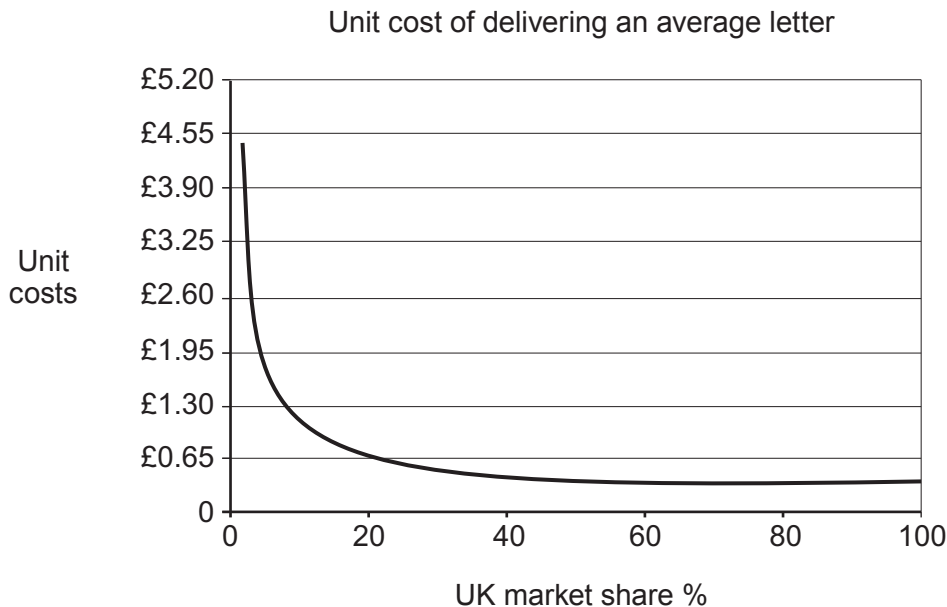
Figure 2 – Royal Mail (key data)



Source: Royal Mail

However, the sale of the Royal Mail is opposed by postal workers with their trade union, the CWU, threatening strike action. Postal workers being offered free shares in the new company leaves the union unimpressed fearing that the inevitable efficiency savings after privatisation will involve reducing the 150,000 strong workforce. In addition many believe that it will be hard to see the universal service obligation surviving although it could be subsidised from the parcels business. Critics also say that the privatisation of the Royal Mail threatens to repeat the mistakes of the sell-off of the railways: a natural monopoly sold off for the sake of a quick profit. The privatisation of mail services elsewhere in Europe does not inspire confidence for the Royal Mail sale according to *The Guardian* newspaper which reports that Holland has four different post companies competing to nobody's benefit.

Figure 3 – Economies of scale in postal deliveries



Is there a danger in the UK of having several different post boxes on our streets for competing mail companies who all deliver separately to our homes? In 2012 TNT embarked on a limited trial of delivering post to the doorstep using 400 delivery workers on bicycles to serve 250,000 households in West London.

- (a) With reference to the data and Figures 1 and 2 explain the changes to the Royal Mail's revenue and profit. [8]
- (b) With reference to the data explain why the Royal Mail's letter delivery service can be said to be a 'natural monopoly'. [8]
- (c) Evaluate the case for and against the privatisation of the Royal Mail. [12]
- (d) 'Once the Royal Mail is privatised and the UK market for letters and parcels is completely open to competition there will be no need for Ofcom to regulate the market.' Discuss this statement. [12]

SECTION B

Answer one question from this section.

- 3. How far do you agree with the view that the only cause of inflation is an excessive growth of the money supply? [20]
- 4. 'A current account deficit on the balance of payments should be a major concern to the government.' Evaluate this statement. [20]
- 5. Evaluate the different policies which can be used to achieve economic development in less developed countries. [20]

END OF PAPER