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General Certificate of Education  
2010

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## Economics

Assessment Unit A2 2

The Global Economy

[AE221]

WEDNESDAY 2 JUNE, MORNING

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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 for each part question in allocating the available examination time.

## Question 1

The extracts below were written in March 2009.

Study them carefully and answer the questions which follow.

### Source 1: Protectionism on the rise

Ask any political leader for views on protectionism and it will be immediately rejected as a policy option. This will often be accompanied by references to the mistakes of the 1930s and a determination not to repeat them. The infamous Hawley-Smoot tariff act, passed by the USA in 1930, will be cited as an example of what not to do.

This piece of legislation increased tariffs on 20,000 imports and led to massive retaliation from America's trading partners. In the opinion of most economists it was a cause of the collapse in world trade which led to the Great Depression of the 1930s. Automobile mogul, Henry Ford, called it an act of economic stupidity and more than a thousand of America's leading economists signed a petition against it.

Of course, what politicians say and what they do are not always the same thing! Many will pay lip service to free trade but then succumb to political pressure from powerful vested interests that do not wish to face international competition. This year (2009) is unlikely to see a repeat of Hawley-Smoot. The WTO is too well established to permit massive increases in tariffs and quotas, but the various stimulus packages being implemented by governments throughout the world contain some nasty pieces of economic nationalism. Subsidies for domestic manufacturers are just as much a trade barrier as tariffs on imports. This new wave of insidious protectionism is as dangerous for world trade as Hawley-Smoot.

Economists today, just like those in the 1930s, see protectionism as the worst policy option open to government. However, there is no guarantee that the politicians are listening, any more than they did in the 1930s.

*Adapted from a variety of sources March 2009*

### Source 2: Globalisation to blame

The process by which the world's markets have become increasingly integrated has been given the label "globalisation".

Many world leaders have used this phenomenon as a scapegoat for the world recession which started with the credit crunch. The rapid spread of the financial and economic malaise from the collapse of sub-prime mortgages in the USA to a recession affecting every country in the world, could only have taken place in a globalised world economy.

Now many politicians, with Gordon Brown leading the way, are calling for worldwide regulatory bodies to control the activities of international banks and multi-national companies.

In October 2008 Prime Minister Brown wrote to EU leaders saying, "Global financial markets present challenges which no one nation can solve in isolation. We must therefore strengthen global cooperation and build a new global financial architecture for the years ahead".

In March 2009 these sentiments were echoed by American President, Barack Obama. He said, "We are living through a time of global economic challenges that cannot be met by the isolated efforts of any nation. Once and for all, we have learnt that the success of the American economy is inextricably linked to the global economy. There is no difference between action that restores growth within our borders and action that supports it beyond. If people in other countries cannot spend, markets dry up – already we have seen the biggest drop in US exports in nearly four decades, which has led directly to American job losses".

*Adapted from a variety of sources March 2009*

### Source 3: The euro in danger

Just as world leaders are calling for greater international cooperation, an example of such cooperation is looking extremely fragile. The single European currency is in greater danger of fragmentation now than at any time since its formation.

The problem is that economic divergence within the eurozone has increased dramatically and the current accounts of member states are radically different.

The single interest rate for the entire eurozone is at the root of many of the problems. For some countries, notably Germany, it is too high and for others, such as Spain, Greece and Ireland it is too low. German labour costs have risen by a paltry 5 per cent in the last decade, whilst Italian and Spanish costs are up by a quarter and those of Greece by 35 per cent.

Unsurprisingly current account balances have moved in the same direction as shown in the table below.

Country	Balance of payments on current account as percentage of GDP	
	2001	2007
Germany	0	+8
Italy	0	-2.6
Spain	-4	-10
Greece	-7	-14

(minus figures indicate a deficit)

Not only do the weaker member states have deteriorating current accounts, they also have massive fiscal deficits which are undermining the confidence of investors in their governments. Two years ago Italy and Greece had to pay only 0.25 per cent more than Germany to attract buyers for a ten year government bond. Last month Greece was paying 2.2 per cent more than Germany and Italy 1.3 per cent more. When investors lose confidence in a nation's financial stability they require higher rates of return as compensation for the additional risks of lending. If these weaker economies remain in the eurozone there will have to be massive cuts in real wages to make them more competitive. The UK by contrast is already becoming significantly more competitive thanks to the depreciation of sterling against the euro.

It may be too early to start writing the obituary for the euro. There is a huge political commitment to protecting it but no-one can take its survival for granted. Milton Friedman predicted that the euro would not survive its first major economic crisis and he may well prove to be correct.

*Adapted from © "Eurozone is being stress-tested but will not break apart easily" by Hamish McRae, The Independent, 23 February 2009*

- (a) Explain what is meant by protectionism. [5]
- (b) Explain why most economists regard protectionist measures as undesirable. [10]
- (c) Source 2 refers to the global nature of the economic crisis. Analyse the role of globalisation in worsening the current economic crisis. [10]
- (d) Source 3 explains some of the dangers facing the euro. Critically examine Milton Friedman's view that the euro will not survive. [15]

**Essays:**

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

**2 “EU damages world trade”**

- (a) Explain how free trade areas and customs unions fall short of full economic union. [15]
- (b) Critically examine the view that customs unions such as the European Union distort international trade and damage economic welfare. [25]

**3 “Current account deficit proves difficult to correct”**

- (a) Explain the main features of the UK’s balance of payments on current account. [15]
- (b) Critically examine the main policy options open to national governments in trying to correct a balance of payments current account deficit. [25]

**4 “Foreign aid creates dependency and stifles innovation”**

- (a) Explain the main features which are shared by most Less Developed Countries (LDCs). [15]
- (b) Critically examine the view that free trade would do far more for economic development in LDCs than any amount of foreign aid. [25]