

**ADVANCED SUBSIDIARY GCE
ECONOMICS**

2883

The National and International Economy

THURSDAY 17 JANUARY 2008

Morning
Time: 1 hour

Additional materials: Designated Answer Booklet [2883/AB]



INSTRUCTIONS TO CANDIDATES

- Write your name in capital letters, your Centre Number and Candidate Number in the spaces provided on the separate Answer Booklet.
- Read each question carefully and make sure you know what you have to do before starting your answer.
- Answer **all** the questions.
- Write all your answers in the separate answer booklet provided.
- The spaces should be sufficient for your answers but if you require more space use the lined pages at the end of the answer booklet.

INFORMATION FOR CANDIDATES

- The number of marks for each question is given in brackets [] at the end of each question or part question.
- The total number of marks for this paper is **45**.
- The quality of your written communication will be taken into account in marking your answer to the question labelled with an asterisk (*).

This document consists of **4** printed pages.

Answer **all** parts of this question in the accompanying answer booklet.

Iceland – Heating up or cooling down?

In 2006 there were concerns that the Icelandic economy was overheating and that the Icelandic government would not achieve all of its macroeconomic policy objectives. Inflation was rising rapidly, largely due to the combined effects of a consumer boom and a fall in the country's exchange rate. To counter these inflationary pressures, Iceland's Central Bank raised its interest rate from 11.5% to 12.3% in May 2006. This put its interest rate further out of line with that in many other countries (see Table 1).

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Table 1 Interest rates and inflation rates in selected countries in May 2006

	Rate of interest %	Rate of inflation (annual % change in consumer price index)
Iceland	12.3	7.6
Japan	0.2	0.4
Sweden	2.2	1.5
UK	4.7	2.0
USA	5.1	3.5

Iceland's government also introduced a number of supply-side policies and started to discuss whether it should apply for European Union (EU) membership. The aims behind both these moves, were not just to reduce inflation in the short run, but also to increase Iceland's long run rate of economic growth and to ensure greater economic stability.

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Time will tell whether Iceland's economic performance will improve and whether it will become an EU member.

- (a) Identify **three** macroeconomic policy objectives. [3]
- (b) (i) Using Table 1, describe the relationships between interest rates and inflation rates for the countries shown. [4]
(ii) Explain how a rise in the rate of interest may reduce the rate of inflation. [5]
- (c) Explain how a European country's pattern of trade might change if it joined the European Union. [2]
- (d) (i) Define the term 'exchange rate' (line 4). [2]
(ii) State and explain **two** factors which could cause a fall in a country's exchange rate. [6]
- (e) (i) Describe **two** benefits of economic growth. [4]
(ii) Comment on the effectiveness of **one** supply-side policy in promoting economic growth. [7]
- *(f) Discuss the benefits of a fall in the rate of inflation. [12]

[Total marks: 45]

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