THIS IS A LEGACY SPECIFICATION

OCR
RECOGNISING ACHIEVEMENT

ADVANCED GCE
ECONOMICS
Economics in a European Context

2888

Candidates answer on the Answer Booklet

OCR Supplied Materials:
- 16 page Answer Booklet

Other Materials Required:
None

Wednesday 23 June 2010
Morning

Duration: 1 hour 45 minutes

INSTRUCTIONS TO CANDIDATES

- Write your name clearly in capital letters, your Centre Number and Candidate Number in the spaces provided on the Answer Booklet.
- Use black ink. Pencil may be used for graphs and diagrams only.
- Read each question carefully and make sure that you know what you have to do before starting your answer.
- Answer **all** the questions.
- Do **not** write in the bar codes.
- A copy of the pre-issued stimulus material is included in the question paper. You must **not** bring your original copy into the examination.

INFORMATION FOR CANDIDATES

- The number of marks is given in brackets **[ ]** at the end of each question or part question.
- The total number of marks for this paper is **60**.
- You will be assessed on the quality of your written communication. All answers should be in continuous prose.
- This is the synoptic paper. You will, therefore, gain credit for demonstrating in your answers how individual aspects of the subject can be used to explain and evaluate economic issues and problems raised by the stimulus material.
- This document consists of **16** pages. Any blank pages are indicated.

DC (SHW (DJ) 00519 6/09) 18752/5

BLANK PAGE

Answer **all** questions.

1 **(a)** Using the data in Extract 1, compare:

- the trend in the EU price of gas and electricity for large industrial consumers over the period shown;
- the price of electricity for large industrial consumers in the UK and France over the period shown;
- the rate of inflation in Hungary with that in the euro zone over the period shown. **[6]**

(b) Analyse the case for deregulation and liberalisation of all EU energy markets. **[9]**

2 Comment on the extent to which government subsidies might encourage an increase in the supply of energy from renewable sources. **[10]**

3 Comment on the effectiveness of the EU's Emissions Trading Scheme in reducing the market failure created by the production of energy. **[15]**

4 Discuss whether membership of the EU's single currency would be in the interest of countries such as Hungary and the Czech Republic. **[20]**

Challenge of the three e's – energy, the environment and the euro

Introduction

Europe's energy markets, like other markets, have suffered from the downturn in economic activity in 2008 and 2009. But this has been welcome news for energy consumers and the environment as prices and production have both fallen. At the same time the European Commission (EC) renewed its efforts to increase the pace of deregulation and liberalisation of the European Union's (EU's) energy markets, launching an investigation into competition in the French electricity market amid concerns that government regulation of electricity prices continues to restrict competition. The EC sees significant benefits from deregulation and liberalisation and has the long term goal of extending the benefits of the single market to EU energy markets. However, the EC's faith in competition and market determined prices, such as those in the UK, is not shared by all.

The environmental benefits of reduced economic activity have not stopped the EC from pursuing further attempts to reduce the EU's dependence on forms of energy damaging to the environment. Yet in this respect, the EC appears to favour allowing member states to determine the choice of policy best suited to increase the supply of energy from renewable sources. So far, few member states have adopted radical measures such as tradable 'renewable energy certificates', preferring instead to achieve EU targets using other policy measures.

The downturn in economic activity has raised concerns about the effectiveness of the EU's flagship environmental policy – the Emissions Trading Scheme (ETS). Concerns centre around the impact of the recession on the price of the emissions permits which are now traded across the EU. Some have argued that the system is close to collapse as the price of permits has fallen dramatically in the early stages of recession.

The impact of the economic downturn has been felt with different degrees of severity across the EU. Some countries in Central and Eastern Europe have experienced challenging economic conditions, including unsustainable levels of foreign debt and a crisis of confidence in their currencies. Hungary, for example, has had to secure loans from the International Monetary Fund (IMF), the EU and individual European governments. In 2009, a leaked report from the IMF, suggested that Hungary and others should abandon their national currencies and adopt the euro in order to better survive the economic downturn. This brought almost unanimous disagreement from economists in Central and Eastern Europe, who argued that such a step would not be in the best interests of their economies.

In three key areas of economic integration, therefore, the EU continues to face challenges to its grand projects.

Pre-issued stimulus material

Extract 1 **Selected energy market data and macroeconomic indicators**
European Commission, Eurostat

Extract 2 **Energy pricing – regulated or free market?**

Extract 3 **EU renewable energy policy**

Extract 4 (a) **Draft emissions data is good news for EU carbon market**
EuroActiv, 7 April 2009

Extract 4 (b) **Draft emissions data bad news, not good news, for EU carbon market**
Bryony Worthington, Sandbag Climate Campaign, posted on EurActive blog, 8 April 2009

Extract 5 (a) **IMF urges Central and Eastern Europe to adopt euro**
Stephen Wagstyl, Financial Times, 5 April 2009

Extract 5 (b) **Early euro adoption 'bad idea' for Central and Eastern Europe**
EurActiv, 7 April 2009

Extract 1

Selected energy market data and macroeconomic indicators

Fig. 1.1 EU Natural gas prices for large industrial consumers

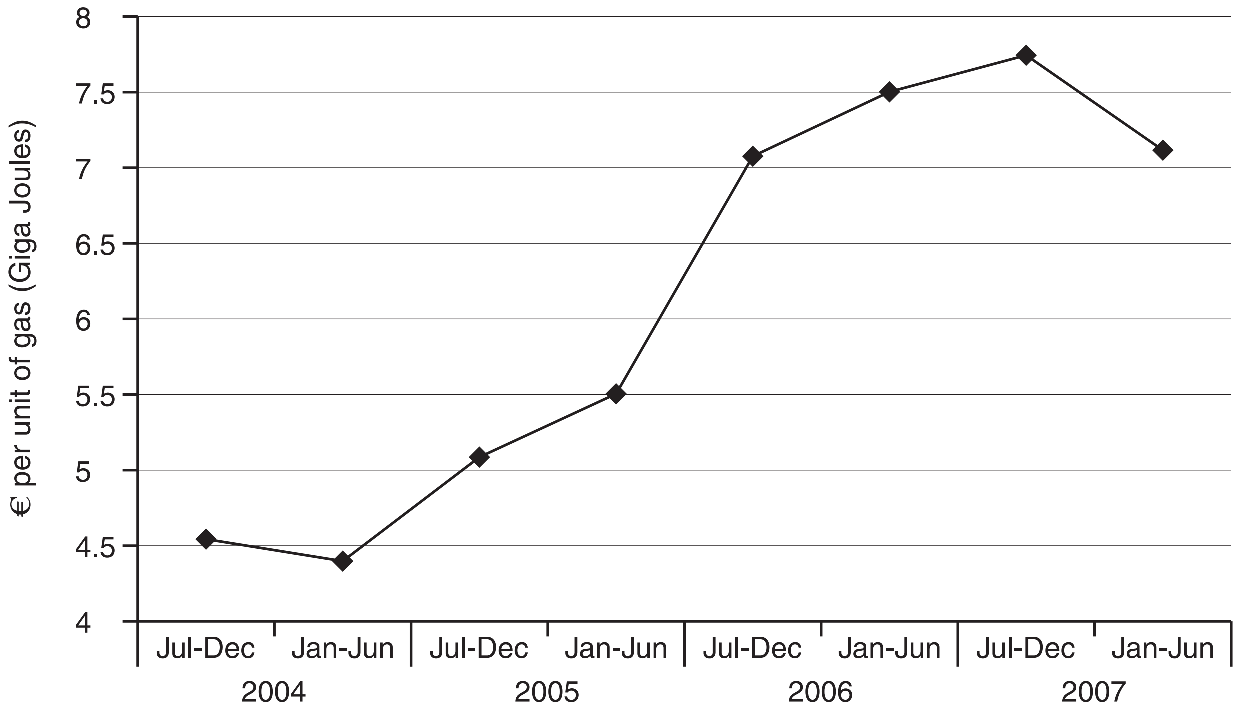


Fig. 1.2 EU Electricity prices for large industrial consumers

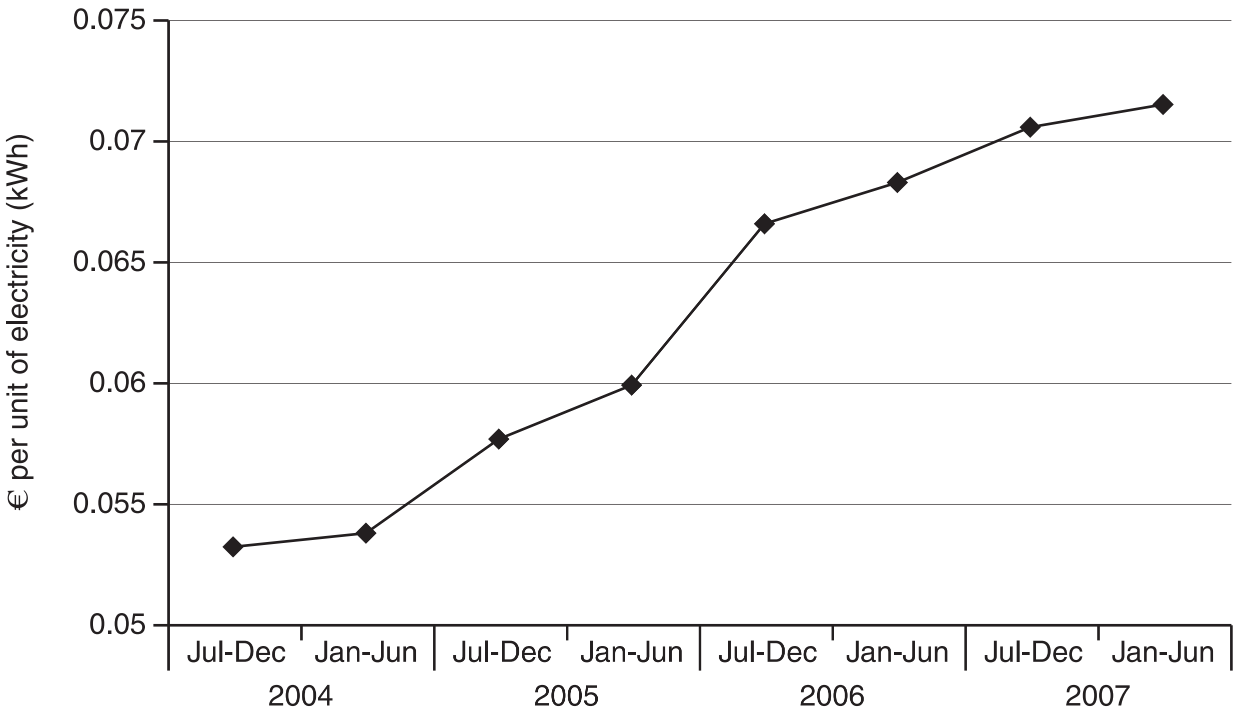


Fig. 1.3 Electricity prices for large industrial consumers in the UK and France

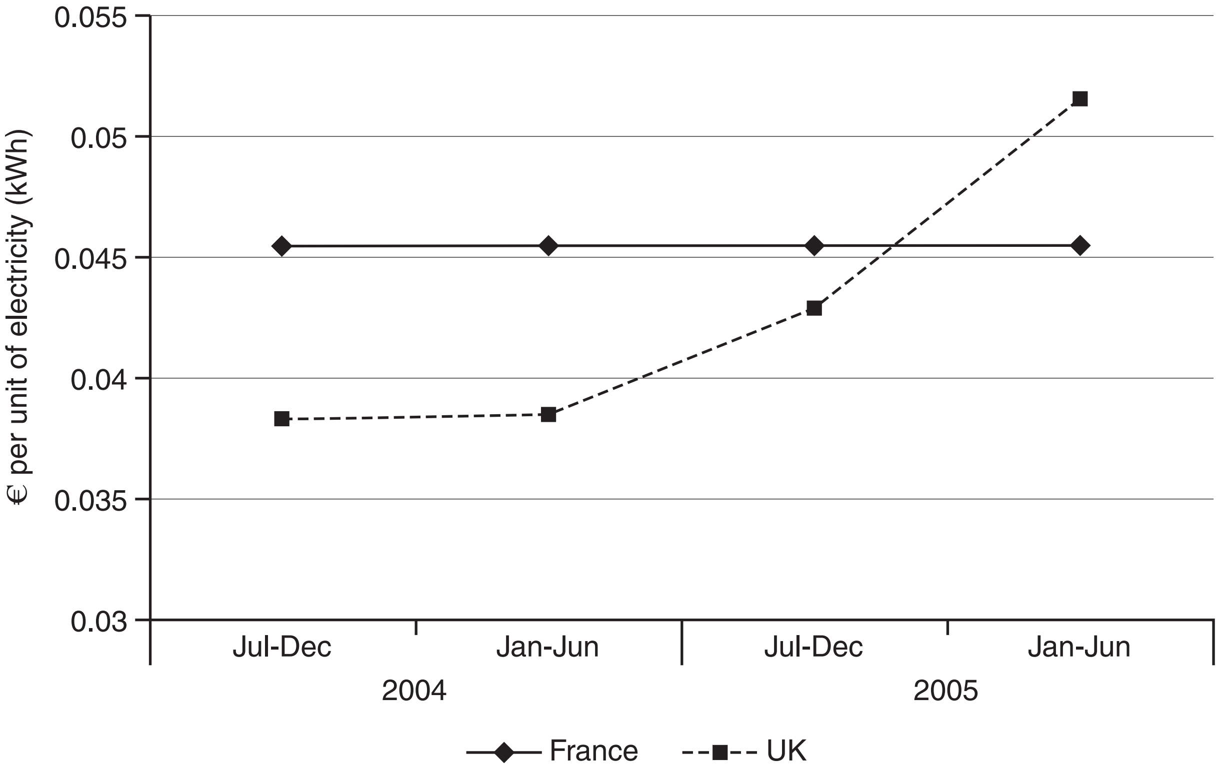


Fig. 1.4 Annualised growth of real GDP in eurozone, Czech Republic and Hungary

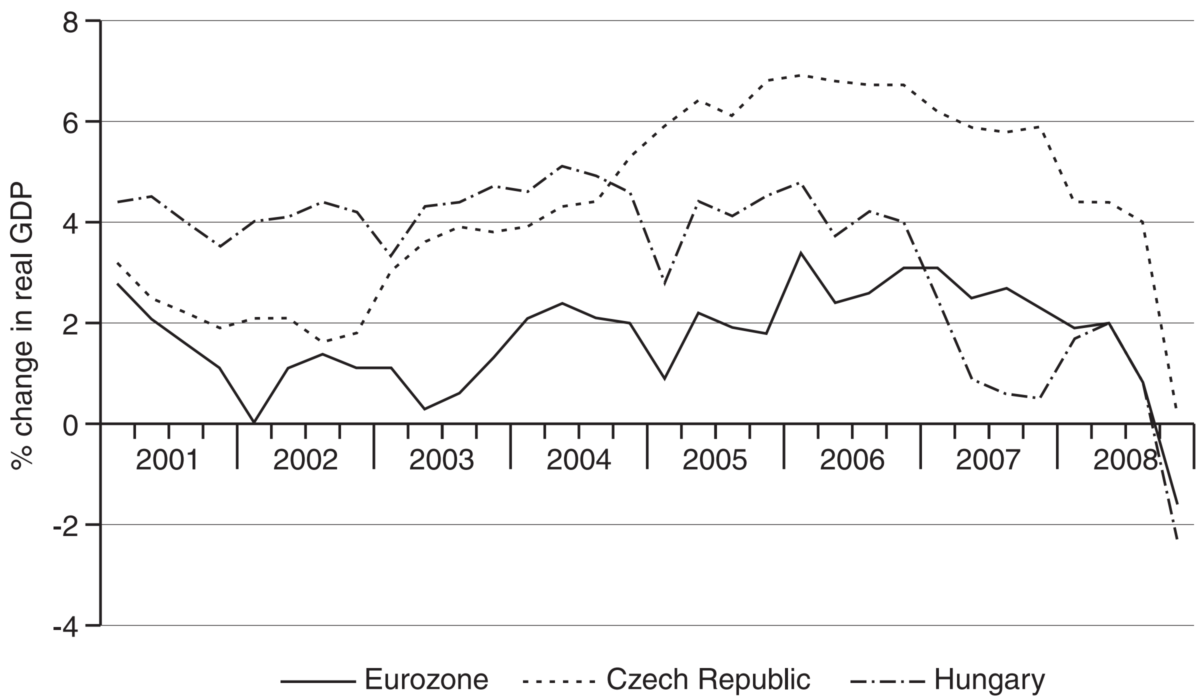
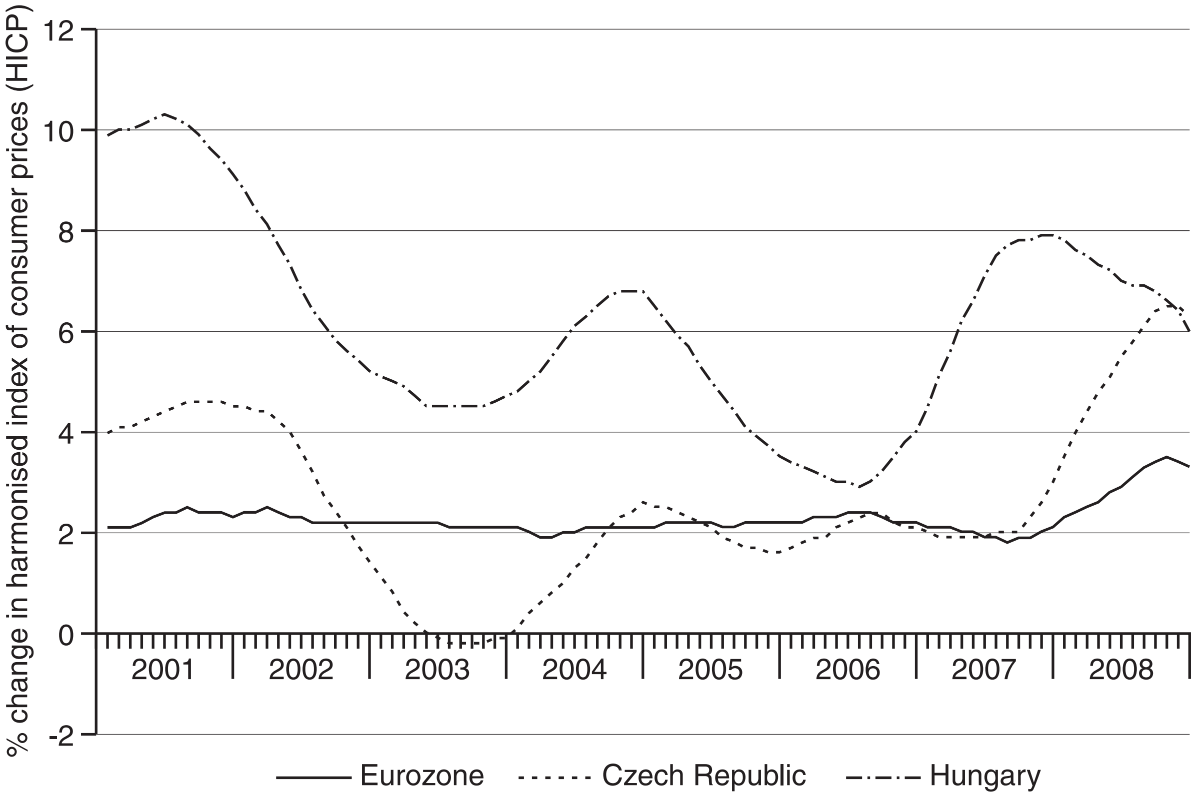


Fig. 1.5 Annualised inflation rate in eurozone, Czech Republic and Hungary



Extract 2

Energy pricing – regulated or free market?

The Single European Market has undoubtedly delivered benefits to members of the European Union. Yet in some member states energy prices are set by governments and not by the free market. There is now growing pressure on these countries to let market forces decide the price of electricity and gas in order to open these markets to competition.

In order to compete in energy markets in France and Spain, for example, new entrants would need to sell gas and electricity below the regulated prices. This, it is argued by the European Commission, is difficult as these prices are set artificially low.

Defenders of regulated prices in these countries argue that they protect industrial and household consumers of energy from wild swings in the prices of gas and electricity which would be experienced in a free market, as well as meeting social objectives. They point to the fact that, even in unregulated markets, large industrial users of electricity, for example, often enter into long-term contracts with the generators of electricity in order to reduce their exposure to volatile prices. These long-term contracts are of obvious benefit to the generators of electricity by reducing uncertainty about the demand for electricity.

The European Commission argues that regulated prices and long-term contracts restrict competition and prevent the market sending price signals to consumers. They would much prefer to see a liberalised and single EU energy market rather than one with fixed prices.

Extract 3

EU renewable energy policy

In March 2007, EU leaders agreed to a binding target to provide 20% of EU energy needs from renewable sources. A year later the European Commission set each member state an individual target based on its GDP per capita. The aim is to more than double the share of energy generated from solar, wind or hydro sources by 2020 in a bid to reduce the EU's greenhouse-gas emissions.

EU generators of electricity had favoured an EU wide system of trading in 'renewable energy certificates', similar to the EU's Emissions Trading Scheme (ETS). However, the European Commission has instead allowed member states the flexibility to decide on the policy or policies each will use to meet its target for green energy production.

So far, only the UK, Belgium, Italy and Sweden have adopted renewable energy certificates. These digital certificates record details of how a unit of electricity was made, by whom and finally who bought and used it. They are traded separately from the actual electricity itself, being sold by energy companies who have exceeded their green energy target and bought by those who have not achieved their target. The green energy targets or obligations are placed on either the suppliers or producers of energy.

Some economists have suggested that, until the EU addresses the issue of energy subsidies, measures such as 'renewable energy certificates' are likely to have little significant impact on the mix of energy production. A report by the European Environment Agency (EEA) in 2004 attempted to measure the subsidies given to the production of energy from different sources. This was complicated by the many different forms of energy subsidies in the EU, ranging from low interest loans to producers, grants to consumers, preferential tax treatment, government investment in energy infrastructure to a failure to impose external costs on producers. Nevertheless, subsidies to producers increase supply through reducing relative production costs. The EEA found that over 82% of subsidies in the EU went to energy produced from coal (45%), oil and gas (30%) and nuclear sources (7%) and only 18% to energy from renewable sources. A shift in subsidies towards renewable sources might, it is hoped, increase supply from such sources, although some economists are sceptical of whether this would be the case.

In a report in 2007, Greenpeace predicted that renewable energy could provide 50% of the world's energy needs by 2050 if governments put in place the right policies to encourage the production of green energy.

Extract 4 (a)

Draft emissions data is good news for EU carbon market

Early data for 2008 shows the EU's Emissions Trading Scheme (ETS) achieving its emissions reduction goals for the first time, boosting the bloc's morale as global negotiators try to hammer out a successor to the Kyoto Protocol later this year.

The preliminary data, released by the European Commission on 1 April, show a fall in recorded emissions of around 6% compared to 2007. Emissions stood at 1.981 billion metric tonnes (Mt), but the figure will be updated as the remaining installations disclose their data.

Poland tops the 'dirty thirty'

Poland had the questionable honour of being home to the most polluting installation. Elektrownia Bełchatów, a state-owned coal plant, emitted 30 Mt of CO_2 last year. The top ten polluting installations alone accounted for approximately 10% of all the emissions in the EU ETS, around 4-5% of the EU's total greenhouse-gas output, according to estimates by Point Carbon, a consultancy.

Germany had by far the biggest mismatch between the verified emissions and allocated allowances and emissions, with a difference of 84.8 Mt, followed by the UK and Italy. In fact, 11 of the 30 most polluting EU plants were under German ownership and four out of the top seven belonged to German energy company RWE.

Recession expected to reduce demand in 2009

According to estimates from Deutsche Bank and Point Carbon, around two billion European Emissions Allowances (EUAs) were used last year, enough to bring emissions into line with the EU's goal of reducing CO_2 by 20% by 2020.

The market expects the economic downturn to drive further reductions in demand for emission allowances in 2009, dragging down carbon prices. This has already proven to be the case for EU emissions allowances (EUAs), with industrial emitters selling their surplus credits to raise capital, sending prices plummeting to an all-time low in February 2009.

Extract 4 (b)

Draft emissions data bad news, not good news, for EU carbon market

Sir,

Your analysis of the 2008 greenhouse gas emissions data released earlier this month ('Draft emissions is good news for EU carbon market') is unfortunately overly optimistic.

The provisional data issued last week by the European Commission reveals that the EU's flagship climate policy – its Emissions Trading Scheme – has in fact just narrowly avoided hitting the rocks.

Due to the economic downturn in Europe, carbon emissions fell between 2007 and 2008 by roughly 5%. A significant reduction, but fortunately not big enough to throw the whole scheme into disarray by taking emissions below the level of allocated permits. If economic growth remains in negative figures, however, because allocations are the same each year, the situation in 2009 could be much worse.

Looking at the figures in aggregate also fails to tell the whole story. For example, two of the biggest countries in the scheme – Germany and the UK – only succeeded in creating a net demand for permits by handing out significantly reduced allocations to the power sector. Heavy industry was by and large given generous allocations based on anticipated growth projections.

The change in Europe's underlying economic performance now threatens the success of the ETS. Last week's near miss could, in future, turn into an even steeper price collapse and an unhelpfully low carbon price for many years to come.

Bryony Worthington
Sandbag Climate Campaign

Extract 5 (a)

IMF urges Central and Eastern Europe to adopt euro

Crisis-hit European Union states in Central and Eastern Europe should consider scrapping their currencies in favour of the euro even without formally joining the eurozone, according to the International Monetary Fund (IMF). The eurozone could relax its entry rules so countries could join as quasi-members, without European Central Bank (ECB) board seats, says the IMF.

Disclosure of the confidential report, prepared about a month ago, could reignite a fierce debate over strategies to assist Central and Eastern European economies.

Even though global leaders hailed last week's G20 summit as a success, Central and Eastern Europe's challenges remain. Amid deepening recession, Ukraine and Latvia, two states already in IMF programmes, have in recent days resisted proposed IMF reforms. A third, Hungary, is struggling to create a government capable of implementing the proposed IMF reforms.

Eurozone members oppose easing the eurozone's entry rules, as does the ECB.

Extract 5 (b)

Early euro adoption 'bad idea' for Central and Eastern Europe

Economists from Central and Eastern European countries have broadly rejected the idea, proposed by the IMF, of scrapping national currencies in favour of the euro as a quick response to the global economic recession.

A leaked IMF report, quoted by the Financial Times, stated that crisis-hit European Union states in Central and Eastern Europe should consider scrapping their currencies in favour of the euro, even without formally joining the eurozone.

But experts from the Central and Eastern European EU members appeared to be united in rejecting the idea. Jan Bures, chief economist at Poland's Poštovní Spořitelna Bank, said "You can eradicate exchange rate volatility by adopting the euro. However, this step will not be profitable for you unless you fulfill certain conditions".

In Hungary, György Barcza from K&H Bank said that adopting the euro before meeting the convergence criteria was unrealistic and would increase risks to both Hungary and the eurozone.

In Romania, Adrian Vasilescu, counsellor to the national bank governor, stated that abruptly scrapping the national currency would be a "big mistake". He warned that such a move could open new problems, boost inflation and hike prices.

Tomas Bartovsky, press spokesman for the Czech Ministry of Industry and Trade, said he had taken note of the report's publication, but added that he does not expect the conditions of the EU's Stability and Growth Pact to be changed.

For its part, the European Central Bank stressed that the implementation of the Maastricht Convergence Criteria remains the main condition for accession to the euro.

BLANK PAGE