Economics Questions By Topic:

Balance of Payments, Exchange Rates & International Competitiveness (4.1.7, 4.1.8, 4.1.9)

A-Level Edexcel Theme 4

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SECTION A

Write your answers in the spaces provided.

1 British pound to US dollar exchange rate (value of one pound in dollars), June 2017 to June 2019.

(Source adapted from: https://www.xe.com/currencycharts/?from=GBP&to=USD&view=2Y)

(a) Which **one** of the following has been the overall change in the British pound to US dollar exchange rate from 1st January 2018 to 1st January 2019?

(1)

☒ **A** Appreciation

☒ **B** Depreciation

☒ **C** Devaluation

☒ **D** Revaluation

(b) Explain the likely impact of the change in the exchange rate of the pound shown in the graph from 1st January 2018 to 1st January 2019 on the UK current account of the balance of payments.

(4)

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(Total for Question 1 = 5 marks)

2 Unit labour costs for selected European countries, 2017, base year 2010 = 100.

Country	**Unit labour costs**
Austria	113
Hungary	120
Estonia	129
France	107

(Source: http://www.oecd-ilibrary.org/economics/data/labour/unit-labour-cost-quarterly-indicators-early-estimates_data-00607-en)

(a) Explain **one** likely reason for Estonia's unit labour costs rising faster than in other European countries.

(2)

(b) Explain how Estonia's competitiveness could be affected by rising unit labour costs.

(2)

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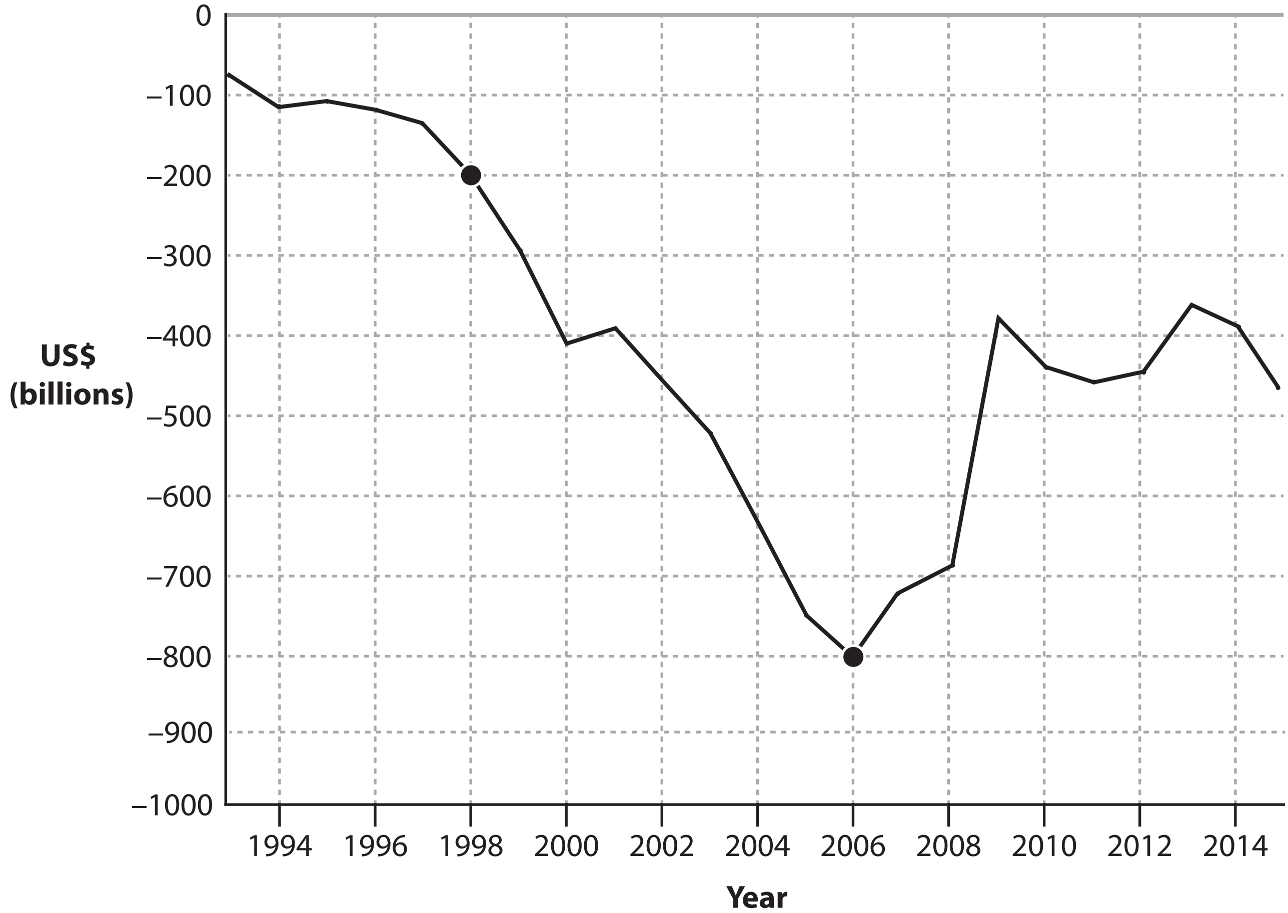
(Total for Question 2 = 4 marks)

3 United States current account of the balance of payments, 1993–2015



(Source: http://data.worldbank.org/indicator/BN.CAB.XOKA.CD?end=2015&locations=US&start=1993)

(a) Calculate the percentage change in the United States current account deficit on the balance of payments between 1998 and 2006.

(2)

(b) Explain the term 'current account of the balance of payments'.

(2)

(c) Using the chart on page 6, which **one** of the following may be inferred about the United States balance of payments?

(1)

☒ **A** The current account deficit decreased between 2001 and 2006

☒ **B** The current account surplus increased between 2001 and 2006

☒ **C** There was a current account deficit for the entire period shown

☒ **D** There was a current account surplus for the entire period shown

(Total for Question 3 = 5 marks)

END OF SECTION A

SECTION B

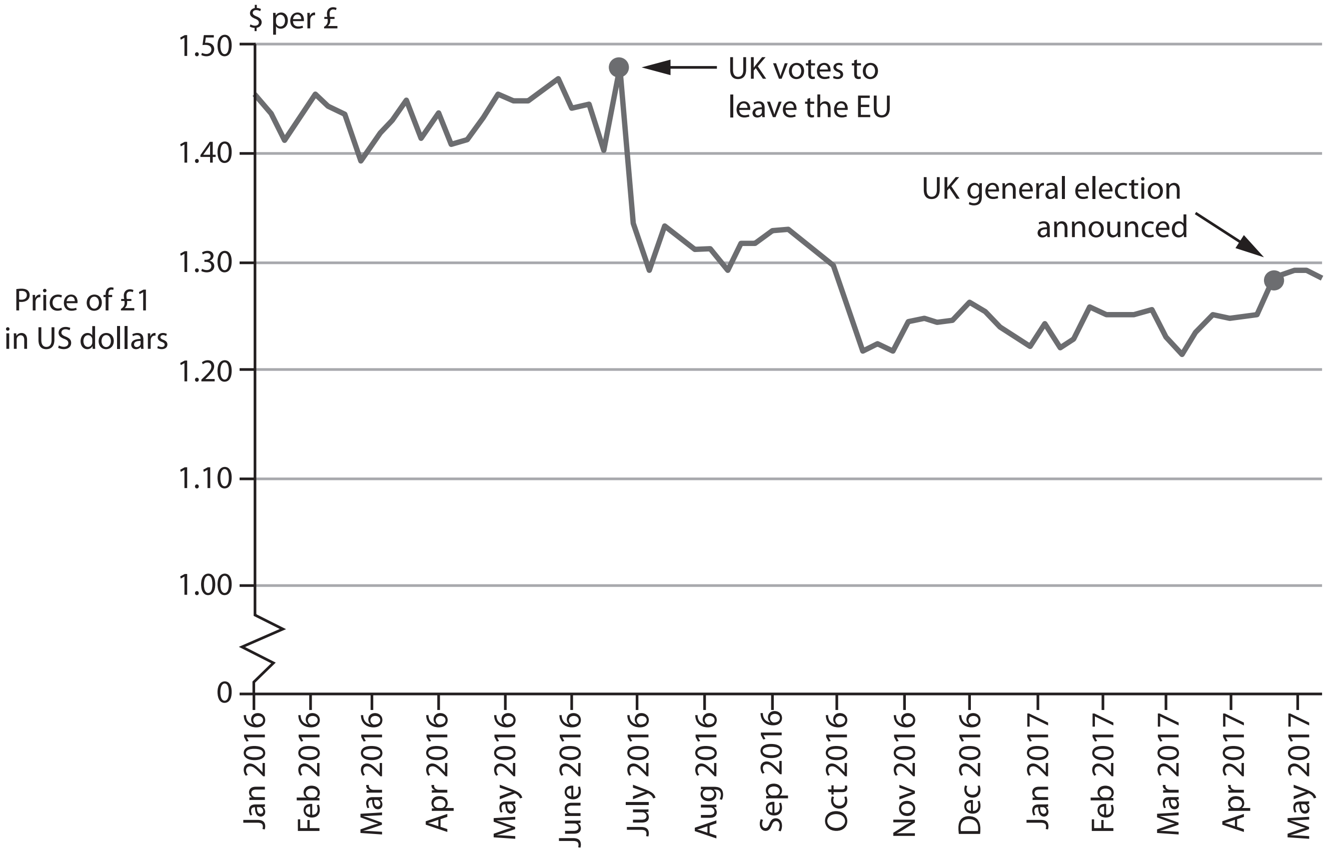
Read all extracts/figures before answering.

Write your answers in the spaces provided.

Question 4

The UK economy since the financial crisis

Figure 1: Pound sterling to US$ exchange rate, 2016-17



(Source: adapted from https://www.ft.com/content/d50ce580-3968-11e7-ac89-b01cc67cfeec)

Extract A

UK companies use forward currency market

The Norfolk-based picture frames maker Nielsen Bainbridge recently made forward contracts in the foreign exchange market to reduce the impact of currency fluctuations. The pound's post-Brexit referendum depreciation has been a test of nerve for Nielsen Bainbridge and many other importers. At present the company's suppliers are located in Europe or China. "Currency therefore has a big impact on our business and the margins we can obtain," says Ms Burdett, the Finance Director. Forward contracts enable institutions, businesses and individuals to lock in an exchange rate over a certain period of time regardless of how the rate moves during that time. Ms Burdett buys currency as soon as Nielsen Bainbridge confirms a large order as a way to fix costs. One third of UK business managers are considering shifting from EU to UK suppliers.

(Source: adapted from 'UK companies use pound strength to hedge forex risk' by Roger Blitz, Markets, © FT.com, 16 May 2017. https://www.ft.com/content/d50ce580-3968-11e7-ac89-b01cc67cfeec)

Extract B

Bank of England seeking to prevent future bank bailouts

The Bank of England has ordered big lenders in the UK to find £116 billion of funding to ensure that taxpayers will never again have to bail out the banking sector. The Bank intends to publish details of how each of the big lenders would cope in the event they find themselves in a situation similar to Royal Bank of Scotland and Lloyds Banking Group, which needed £65 billion of taxpayer bailouts during the 2008 Global Financial Crisis. This had a significant negative impact on the UK government's national debt and, many would argue, increased the need for contractionary fiscal policy. Having said that, the UK government sold all its shares in Lloyds Banking Group in 2017 and, according to the Chancellor of the Exchequer, "recovered every penny of its investment in Lloyds".

Sir Jon Cunliffe, the deputy governor at the Bank responsible for financial stability, said regulators needed to let banks fail in a similar way that traditional companies collapse. This has not been possible in the past because of the risk that savers lose their money and because a system did not exist to allow banks to be put into insolvency.

"Just like when other businesses fail, losses arising from bank failure would be imposed on shareholders and investors. This protects the public from loss and incentivises banks to operate more prudently," said Cunliffe.

(Source: adapted from 'Bank of England tells lenders to find £116bn to help prevent bailouts', by Jill Treanor, 02 October 2017, Copyright The Guardian News and Media Ltd https://www.theguardian.com/business/2017/oct/02/bank-of-england-bailouts-rbs-lloyds and 'Lloyds bank bailout repaid in full, Philip Hammond claims', by Jill Treanor, Larry Elliott, 21 April 2017, Copyright Guardian News & Media Ltd 2017 https://www.theguardian.com/business/2017/apr/21/lloyds-bank-bailout-repaid-in-full-philip-hammond-claims)

Extract C

Bank of England tells lenders to increase capital reserves

The Bank of England has told lenders they will need to build a special reserve worth £11.4 billion by the end of 2018 as it tries to make banks more resilient to the risk posed by mounting consumer debt. This reserve of assets that can be readily turned into cash is a way of forcing banks to set aside capital reserves in good times in order to keep lending to the wider economy at a steady level, even during an economic downturn. In 2017 the Bank of England told UK banks it would raise the reserve ratio, relative to all assets, from zero to 0.5% and also forecast a further increase to 1% by the end of 2017.

The move is not intended to directly reduce consumer demand for credit, which in 2017 grew by 10.3% on an annual basis, but it may well lead to banks becoming less willing to lend to consumers. Since the Bank of England has recently become increasingly concerned about consumer borrowing, including rising car loans and credit card debt, this may be no bad thing as far as the Bank of England is concerned, even if it does have a negative impact on the wider economy.

Analysts are concerned about the impact on consumer confidence of rising inflation, partly caused by a falling pound. With falling real incomes consumers could become more vulnerable to falling behind with their credit card and personal loan repayments. Despite these concerns the UK economy recently recorded the lowest rate of unemployment since 1975.

(Source: adapted from 'Bank of England tells lenders to increase capital buffers by £11.4bn' by Caroline Binham, Gemma Tetlow and Martin Arnold © Financial Times 2017 https://www.ft.com/content/9bc99294-5b1b-11e7-9bc8-8055f264aa8b)

4 With reference to Extract A and Figure 1, examine the likely impact of the change in the sterling exchange rate on the UK economy.

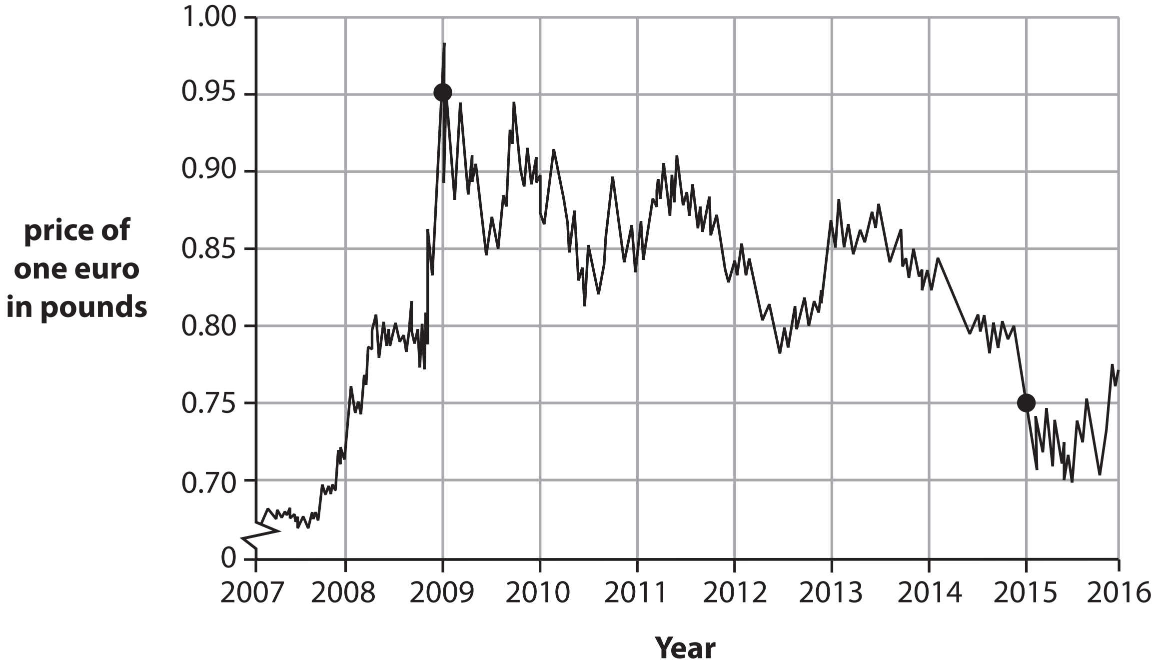
(8)

(Total for Question 4 = 8 marks)

Question 5

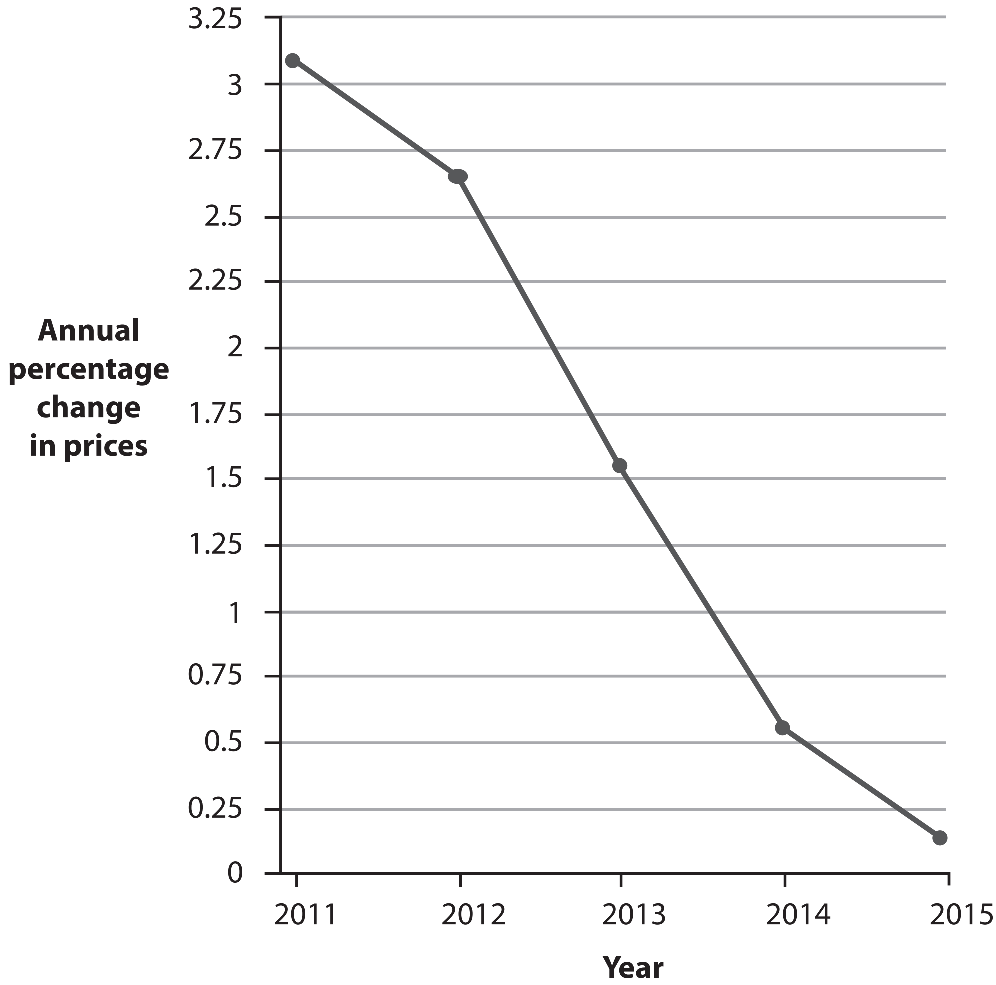
The Eurozone economy

Figure 1: Exchange rate of the euro (€) to the British pound (£)



(Source: https://www.ecb.europa.eu/stats/exchange/eurofxref/html/eurofxref-graph-gbp.en.html#)

Figure 2: Eurozone inflation rate as measured by the Consumer Prices Index (CPI)



(Source: adapted from http://www.imf.org/external/pubs/ft/weo/2015/02/weodata/download.aspx)

EXPERT TUITION

Extract A

European Central Bank disappoints markets with weaker than expected stimulus

Mario Draghi, president of the European Central Bank (ECB), surprised financial markets in November 2015 with a less ambitious package of monetary stimulus than many had anticipated.

The ECB cut its base interest rate by 0.1% to minus 0.3% in order to encourage private banks to lend funds to companies and households rather than deposit them at the central bank. The central bank agreed to extend its €60 billion (£45 billion) monthly bond-buying quantitative easing (QE) programme for a further six months. The ECB's €1.1 trillion QE scheme had originally been due to end in September 2016.

"We are doing more because it works," Mr Draghi said. Yet the ECB did not increase the size of its monthly asset purchases and also disappointed those expecting that it would cut interest rates more aggressively.

The euro rose almost 3% against the dollar to $1.08 after the announcement. Italian and Spanish bond yields both jumped by 0.27% to 1.62% and 1.72% respectively.

The ECB's economists reduced their inflation forecasts for the next two years. They now predict consumer prices in the Eurozone rising by just 1% in 2016 and 1.6% in 2017 – still below the central bank's ceiling of 2%. In November 2015, the inflation rate was just 0.1% and core inflation, excluding volatile items such as fuel and food, dropped to 0.9%.

Mr Draghi stressed again that monetary policy alone could not restore the Eurozone to economic health. He called for looser fiscal policy among member states to support aggregate demand and more rapid implementation of supply-side reforms. "In order to reap the full benefits from our monetary policy measures, other policy areas must contribute decisively," he said.

(Source: http://www.independent.co.uk/news/business/news/ecb-disappoints-traders-with-weaker-than-expected-stimulus-a6759786.html, 4th December 2015)

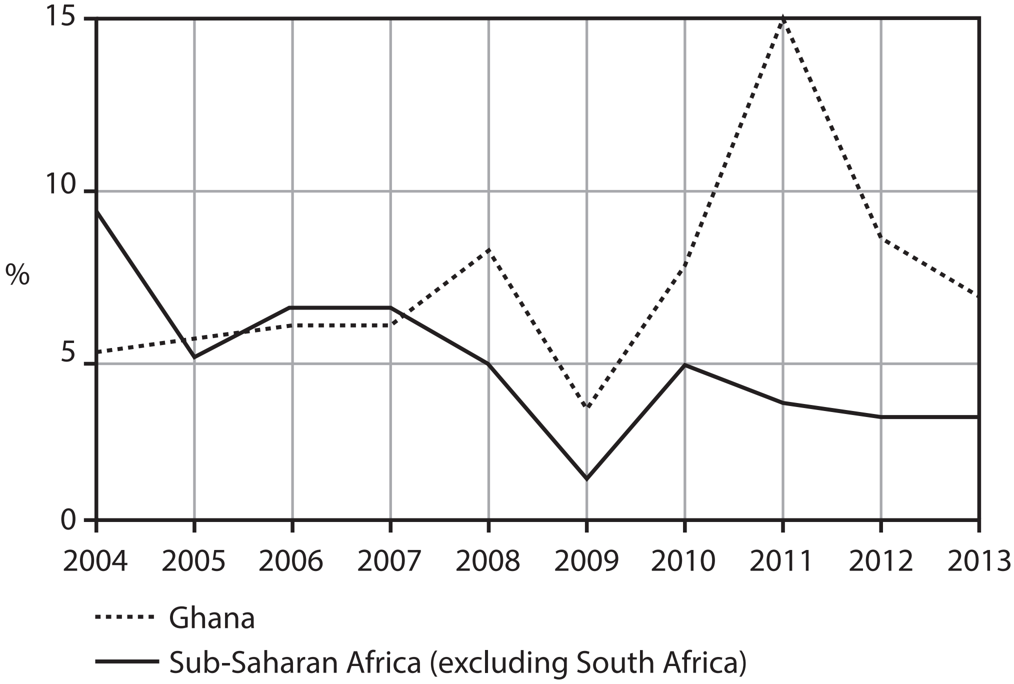
5 Since mid-2015 the euro has appreciated. Assess the likely impact of an appreciation of the euro on the current account of the balance of payments for Eurozone countries.

(10)

(Total for Question 5 = 10 marks)

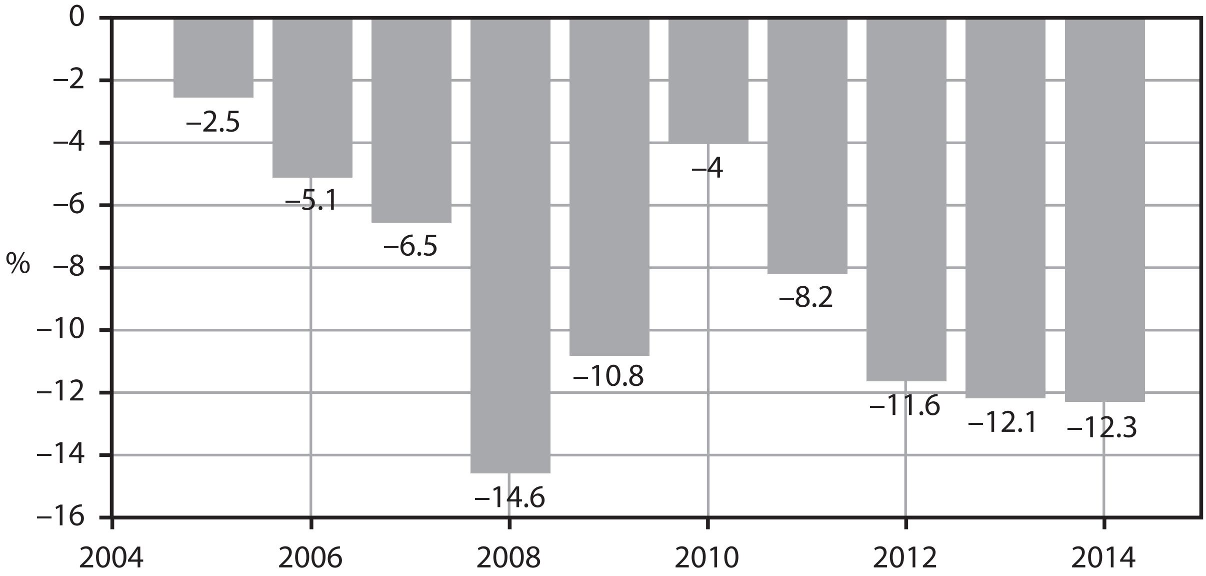
6 **Ghana's Economy**

Figure 1 GDP growth rate 2004–2013 (annual % change in GDP)



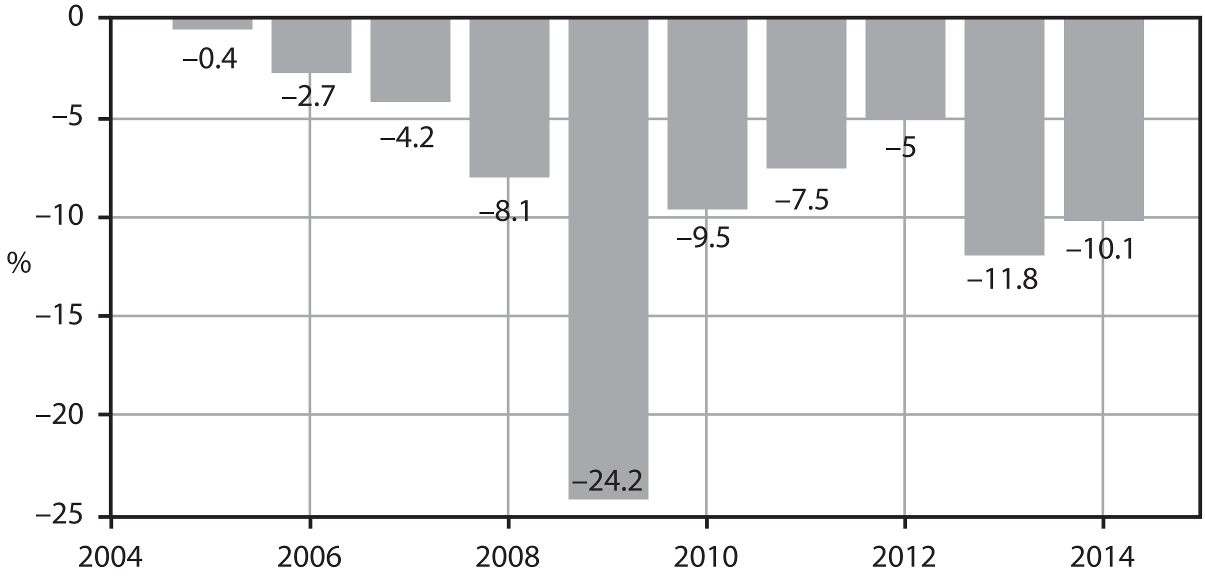
(Source: http://www.worldbank.org/en/country/ghana)

Figure 2 Ghana's current account of the balance of payments as a proportion of GDP, 2005–2014



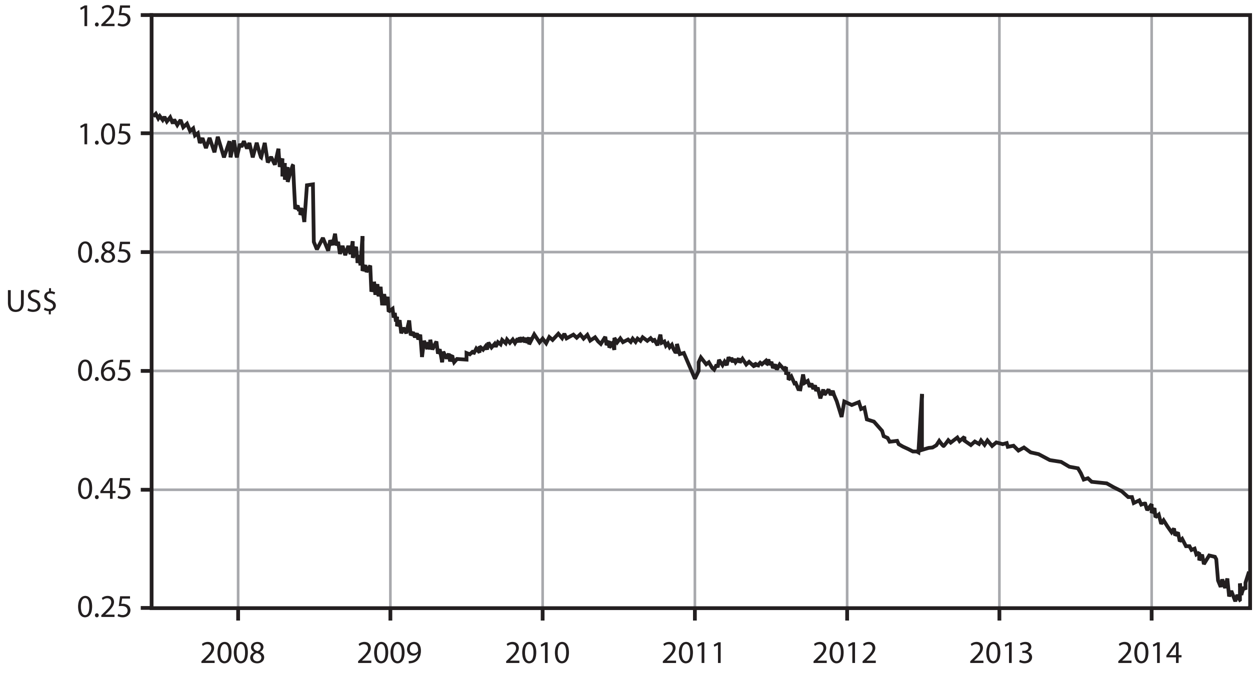
(Source: http://www.tradingeconomics.com/ghana/current-account-to-gdp)

Figure 3 Ghana's government budget balance as a proportion of GDP 2005–2014



(Source: http://www.tradingeconomics.com/ghana/government-budget)

Figure 4 Exchange rate: US dollars per 1 Ghana cedi, July 2007 to September 2014



(Source: http://www.xe.com/currencycharts/?from=GHS&to=USD&view=10Y)

Figure 5 Central Government expenditure, 2009-2014 (% of GDP)

	2009	**2010**	**2011**	**2012**	**2013**	**2014**
Total Government expenditure of which:	**24.8**	**25.7**	**25.1**	**33.1**	**31.8**	**31.1**
Wages and salaries	6.8	8.7	7.5	10.0	10.4	9.7
Interest payments	2.7	3.0	2.7	3.4	4.7	6.8
Transfers to other Government units	3.5	4.2	4.2	6.0	4.9	4.6
Capital expenditure	6.8	6.7	6.2	6.6	5.1	4.8
Other	5.0	3.1	4.5	7.1	6.7	5.2

(Source: http://ifsghana.org/images/pdfs/ghana_a_review_of_the_2015_national_budget_final.pdf)

Extract 1 Ghana seeks International Monetary Fund (IMF) help after its currency depreciates by 40%

Ghana, the country that was the prime example of the 'Africa rising' story of strong economic growth and improved governance, is to seek help from the IMF. The reversal of fortunes underlines the challenges the continent still faces. The West African nation will turn to the IMF for financial assistance after its currency (the cedi) plunged by 40% in value against the US dollar, making the cedi the worst performing currency in the world in 2014. Ghana is the second sub-Saharan African country to turn to the IMF for help in 2014, after Zambia announced its intention to do so in June.

Ghana's request for a bailout is likely to shake some investors, as Ghana was seen as a model of economic and political development in the continent. In 2007 it became the first country in sub-Saharan Africa, apart from South Africa, to raise $750 million through the issue of 10-year government bonds.

Although the continent still has some of the world's fastest-growing economies, issues including conflict, strikes, overspending by the state and the slow pace of reforms have put a brake on expansion.

The opening of talks with the IMF about a financial rescue is a policy reversal for John Mahama, Ghana's president, who has long insisted that his country would resolve its economic problems using home-grown solutions. Critics said Mr Mahama's government has been slow to cut public spending to bring down the double-digit fiscal deficit, although some of its policies have also been praised. For example, the President said that the Government had introduced new taxes to increase revenues. Further, to reduce the current account deficit, Mr Mahama plans to provide "stimulus and incentives" such as investment grants and the removal of export taxes to encourage agricultural businesses to produce foodstuffs domestically – including rice, sugar and poultry – that currently cost the country $1 billion per year to import. He also said he wanted to create a system to incentivise cocoa traders through subsidies to process more beans within the country into raw materials for chocolate production such as cocoa powder, rather than simply exporting the commodity.

Seth Terkper, Ghana's finance minister, said the president had "directed [the government] to open discussion with the IMF" to support the country's growth programme, adding that the most immediate concern was "to stabilise the cedi and reduce the [fiscal] deficit".

Nearly three years after the start of oil production in Ghana, which was meant to strengthen the country's fiscal position, the country faces a double-digit fiscal deficit after a 75% increase in public sector salaries over two years. Inflation is rising rapidly as the cedi plunges.

Ghana ran a fiscal deficit equal to 11.8% of gross domestic product in 2013. The Government has promised to cut the deficit to 8.5% in 2014 but observers believe it would struggle to reduce it below 10%. The IMF warned, in its annual review of the Ghanaian economy in May 2014, that under current policies the fiscal deficit would stay at about 10.2% this year and 9.3% in 2015.

Mr Terkper said: "We would like to have a complementary plan with the World Bank and the African Development Bank [in addition to the IMF programme] to achieve our objective to become an upper- middle-income economy."

(Source: adapted from www.ft.com/cms/s/0/195ce3ec-1a5f-11e4-8131-00144feabdc0.html#axzz3EgzRL7Xqid Last updated: August 3, 2014 3:16 pm By Javier Blas in London and from http://www.ft.com/cms/s/0/3c9d1018-97d1-11e3-8dc3-00144feab7de.html#axzz3H4SBcfSN 'Mahama vows to diversify economy as Ghana tackles fiscal turmoil' 17 February 2014)

(a) With reference to the information provided, examine **two** factors which might have caused the depreciation of Ghana's currency, the cedi.

(10)

*(b) Assess the likely effects of the fall in the external value of the cedi on Ghana's economy.

(12)

(Total for Question 6 = 22 marks)

7 India's Economy

Figure 1 GDP growth 2003–2012

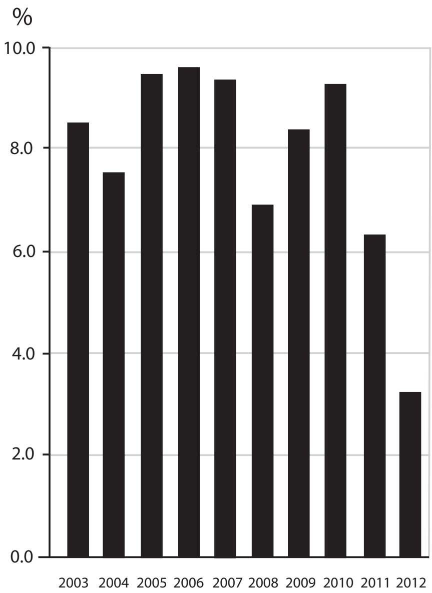


Figure 2 Net investment as a proportion of GDP, 2003–2012

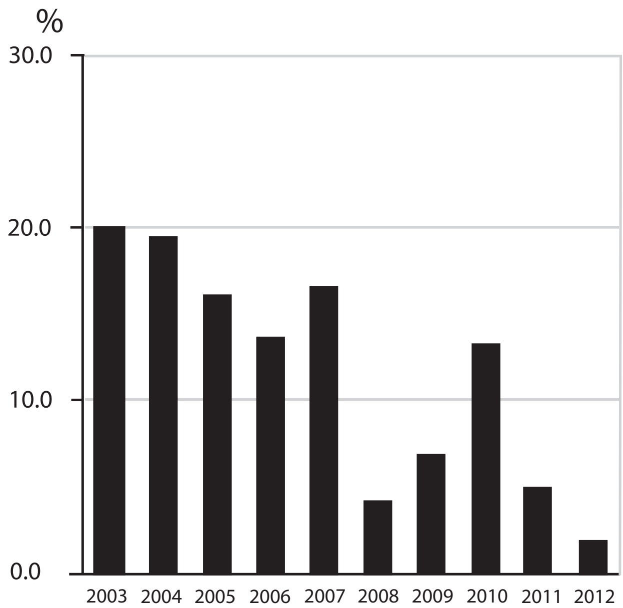
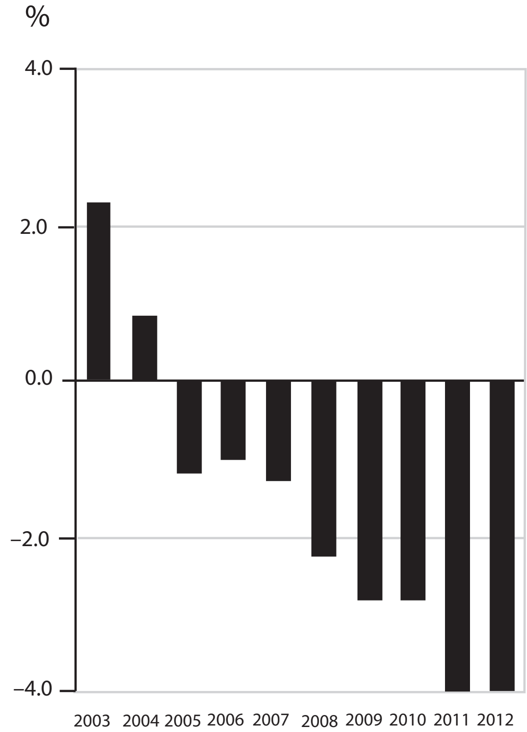
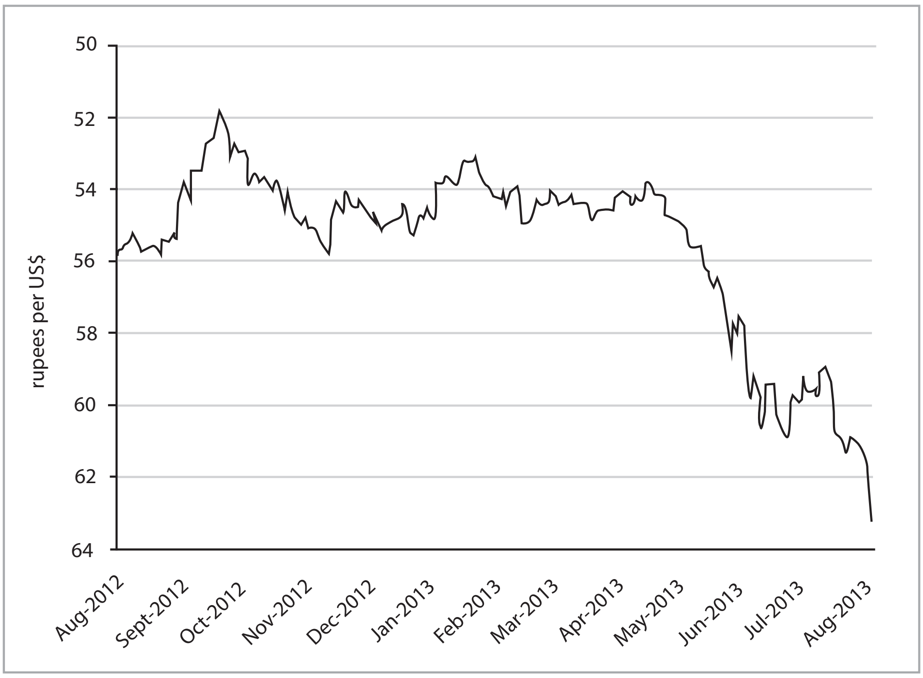


Figure 3 Current account of the balance of payments (% of GDP) 2003–2012



Source: (Figures 1–3 www.focus-economics.com/en/economy/reports/economic.../India)

Figure 4 Indian rupee against the US dollar, August 2012 to August 2013



Extract 1 Why India's economy is still in trouble

The currencies of several developing economies fell rapidly between May and August 2013 following the announcement that the USA's Federal Reserve Bank is to run down its programme of quantitative easing. Among them was India's rupee, which fell more than 20% to a record low, causing observers to declare a crisis. Although the rupee regained a little value after August 2013, this did nothing to fix the underlying problems plaguing India's economy.

India's rapid growth since the early 1990s has obscured the fact that India has very low literacy rates and poor nutritional standards. While the rupee's rapid depreciation is perhaps the most visible sign of the country's problems, there are other alarming indicators: India's GDP only grew 3.2% in 2012 compared with 7.8% in China. Some scholars, such as the Harvard economist Amartya Sen, have urged India's government to invest more in programmes to improve health care and alleviate poverty. Equally important is the need for the country to provide work for the hundreds of millions of poor, unskilled people who were left behind during the growth surge of 1990–2009. The most promising way to accomplish that is to re-engineer the 1991 economic development programme to emphasise more sustainable growth.

However, the government's reforms of the early 1990s did not go nearly far enough. First of all, its economy is still suffering from restrictive regulations. For example, labour laws make layoffs difficult, discouraging many foreign manufacturers from opening factories. The government has also failed to complete reforms allowing foreign investors to take profits out of the country. Further, crucial measures such as competitive tendering have not been implemented.

The country has also neglected to use policies to stimulate domestic manufacturing, instead focusing on the service sector. The service economy grew by almost 10% in the 1990s, but India's already undersized manufacturing sector grew by only 5.7%. A country like India, with a huge and unskilled population, needs a manufacturing base to employ its people and pay for its imports. But India manufactures too little and imports too much. The contribution of India's manufacturing to GDP is only around 15% whereas manufacturing contributes about 40% to GDP in China.

India also failed to deal with problems such as corruption and a poor energy grid. Frequently, scarce electricity is diverted to the offices and workshops of bribe-payers or the politically connected. Misplaced government intervention has, for instance, provided subsidies to fertiliser producers instead of improving farmers' ability to buy the fertiliser.

(Source: http://www.newyorker.com/online/blogs/currency/2013/09/why-indias-economy-is-still-in-trouble.html)

Extract 2 India's economic slowdown forces middle classes to put dreams on hold

A decade of rapid growth propelled tens of millions of Indians from poverty into a middle class that now numbers over 200 million, an extraordinary social transformation in a nation of 1.2 billion. Economic reforms and a boom in India's IT and business-services industries fuelled expansive growth of the economy – 8% on average per year from 2003 to 2012.

But these days, the optimism that once inspired slogans such as "India Rising" is fading. The economy is expected to grow by only 4%–5% in 2013, not enough to create the salaried jobs needed for the country's growing workforce nor to enable millions of people to escape poverty in the next few years.

Following the fall in the value of the rupee, prices for staple products such as fuel and onions have increased rapidly. Further, a sharp increase in inflation, high interest rates and infrastructure problems have caused the economy to slow down. Many of the country's new consumers say that the rising costs of fuel and food, combined with the weak rupee, have forced them to put off major purchases such as homes and cars and to cancel holidays.

(Source: Annie Gowen in Ghaziabad for the Washington Post Guardian Weekly, Tuesday 12 November 2013 http://www.theguardian.com/world/2013/nov/12/india-delhi-economic-slowdown-middle-class)

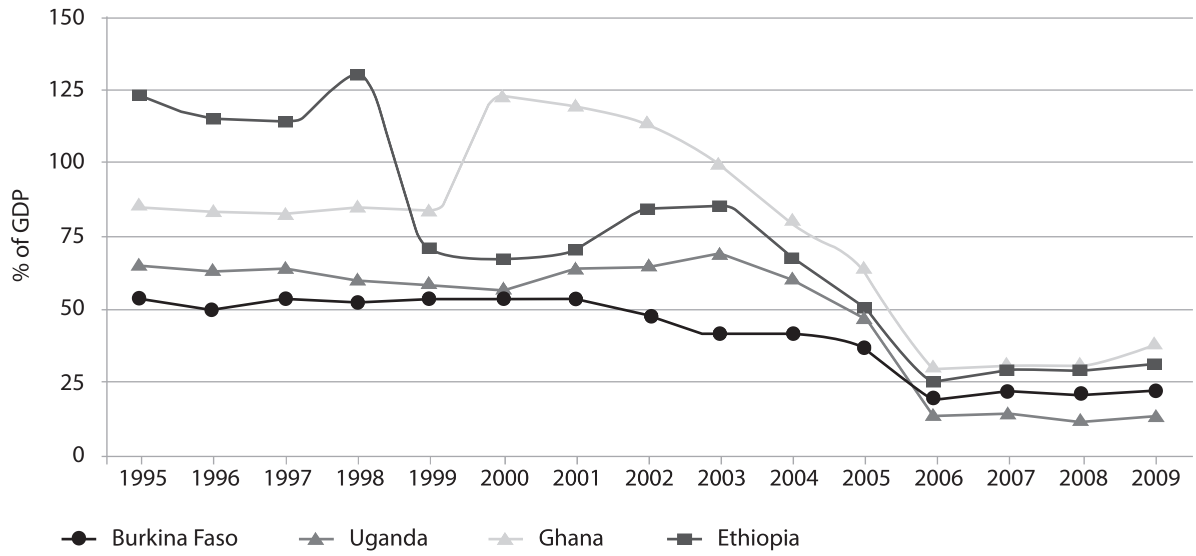
*7 Assess the possible effects of the fall in the external value of the rupee on the Indian economy.

(12)

(Total for Question 7 = 12 marks)

8 The Lion Kings

Figure 1 External debt of selected African countries as a % of Gross Domestic Product (GDP), 1995-2009



(Source: © 2012 African Economic Outlook)

Figure 2 The World's Fastest-Growing Economies 2001-2010: Annual Average GDP Growth (%)

Angola	11.1
China	10.5
Myanmar	10.3
Nigeria	8.9
Ethiopia	8.4
Kazakhstan	8.2
Chad	7.9
Mozambique	7.9
Cambodia	7.7
Rwanda	7.6

(African countries in bold italics)

Figure 3 Forecast Annual Average GDP Growth (%), 2011-2015

China	9.5
India	8.2
Ethiopia	8.1
Mozambique	7.7
Tanzania	7.2
Vietnam	7.2
Congo	7.0
Ghana	7.0
Zambia	6.9
Nigeria	6.8

(African countries in bold italics)

Extract 1 Africa on the point of take-off

The World Bank says Africa "could be on the brink of an economic takeoff much like China was thirty years ago". Jeffrey Sachs, one of the leading experts on developing countries, says the continent could become "the surprise winner of the coming decade". The scale and extent of Africa's economic boom is unprecedented: from 2001 - 2010 six out of the ten fastest growing countries were African. In eight of the last ten years, Africa's lion states have grown faster than Asia's tigers. The fastest-growing economy in the world in 2011 was Ghana at 13%, compared with barely 1% in most European countries and just over 1% in America. Thanks to external debt relief in Africa and the massive increase in borrowing in Europe, many European countries are now more indebted than African nations.

New African billionaires and multi-millionaires are being created at an astonishing rate and the wealth is trickling down. Some 313 million people, 34% of the continent's population, spend \$2.20 a day, a 100% rise in less than 20 years, according to the African Development Bank Group (AfDB).

Some African firms are now so big they are buying global rivals. South African Breweries has bought America's Miller, to become SAB Miller, the world's second largest brewer. The world's leading multinationals are rushing to invest in Africa. For example, America's Walmart, the world's biggest retailer, recently spent \$2.4 billion acquiring a majority stake in South African firm Massmart. Overall foreign investment in Africa has grown more than 600% in the last decade.

Why is Africa suddenly shaking off decades of decline? Traditional industries of mining and agriculture are now more valuable and more productive. Africa has about half of the world's gold deposits, 10% of its oil reserves, and a third of its diamonds, copper, platinum and "rare earth" minerals used in smartphones, tablet computers and flat-screen TVs. Prices for these commodities are high, having risen significantly over the last decade. Furthermore, some of the old problems which have held Africa back are easing: the birth rate is falling and infrastructure is slowly improving, largely thanks to investment from China. Thousands of miles of roads and railways, oil and gas pipelines and new ports are being built in Kenya, Ghana, Nigeria and Mozambique.

While many macro factors are creating the right conditions for growth, micro factors, such as technology, are also generating prosperity. Until as recently as 2005, Africa was almost isolated from a technological perspective with most countries only having a few ancient landline telephone systems. Today, thanks to vast new underground fibre-optic cables that run from the east and west coasts of Africa, and millions of mobile phone masts, the continent is plugged into the world. The 400 000 landline subscribers in Nigeria have become 60 million mobile phone subscribers. The continent is the world's fastest-growing mobile phone market, expanding by 20% per year since 2006. Internet speeds have risen 100-fold in the last few years while connection costs have fallen 40-fold. Internet usage grew by 2 527% between 2000 and 2011. The real effects of the technological boom are felt beyond the high-tech companies themselves. These improvements in communication have created the one thing Africa lacked: a consumer society. In Kenya, for example, around 41% of the population use mobile phones to pay for goods by transferring credits from one handset to another in seconds. McKinsey & Company, a research consultancy, predicts that African consumer spending will rise from \$869 billion in 2008 to \$1.3 trillion by 2020.

Nevertheless, Africa is still the poorest continent on earth. Most of its one billion population live on less than \$2 a day and average life expectancy in some countries is as low as 46. Education may have improved but is very weak by international standards. Deforestation and desertification are rising, causing conflicts over access to land and water. South Africa, which used to be a model for the continent, is tainted with corruption – a problem common in many other African countries. Despite all the advances in technology, only 12% of Africans are regular internet users, compared with a world average of 30%. All the new infrastructure has done little to overcome the problems of excessive bureaucracy, congested roads and over-crowded ports and airports. Basic services, such as power supplies, are inadequate with power cuts a common occurrence. Internal security is a major problem in countries such as Nigeria.

(Source for Extract 1 and Figures 2 and 3: © The Sunday Times 26 February 2012)

8 With reference to Figure 1 and the first paragraph of Extract 1, outline the effect of 'external debt relief' (line 8) on a country's balance of payments.

(5)

(Total for Question 8 = 5 marks)

9 Brazil

Figure 1 Brazil's Gross Domestic Product (GDP) per capita (PPP) in US dollars ($)

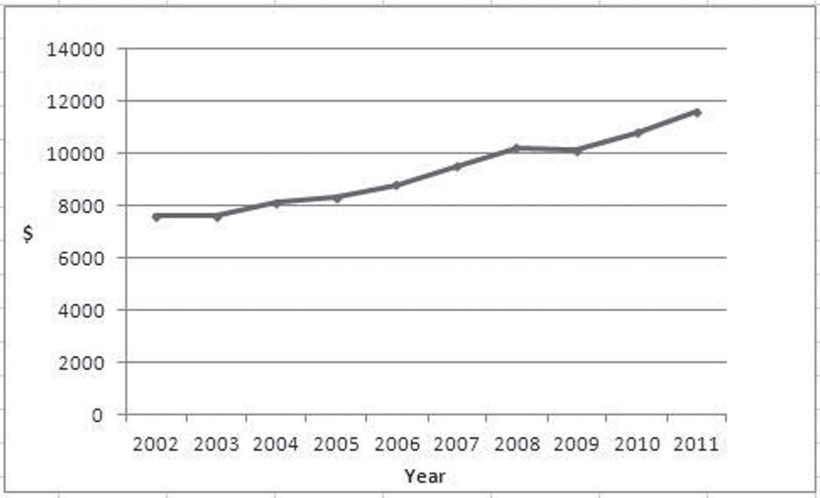
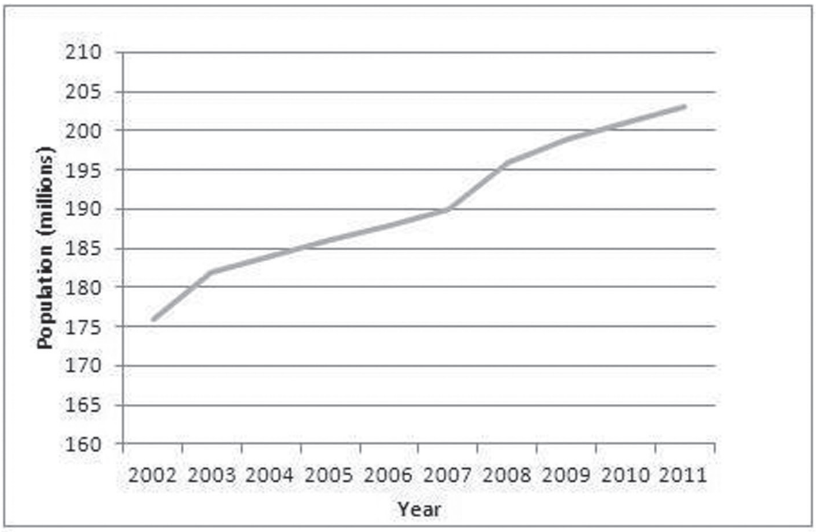
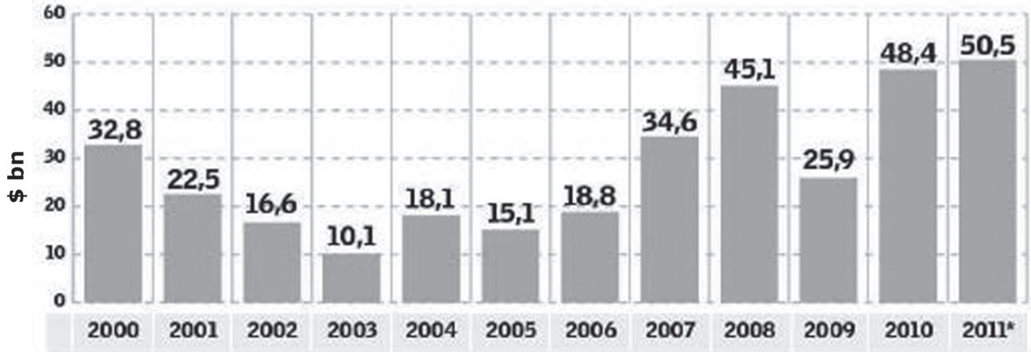


Figure 2 Population of Brazil (millions)



(Source for Figure 1 and Figure 2: © Index Mundi)

Figure 3 Annual Foreign Direct Investment in Brazil (billion US$)



*estimate

(Source: © Brasmari)

Extract 1 Brazil's economy overtakes UK

Brazil has claimed the UK's spot as the world's sixth largest economy after official figures showed its economy grew 2.7% in 2011 against the UK's 0.8%. France remains in fifth place behind Germany, Japan, China and the US. The per capita income of Brazilians remains less than a third of that enjoyed in the UK at approximately \$11 900 (£7 400) per head, but the gap is narrowing all the time while developed economies largely stagnate.

Brazil's dash for growth can be traced back to the mid-1990s when a series of privatisations ended the state's dominance of commercial life. China became a big customer, with a particular liking for soya beans and iron ore. The US also began to invest heavily in the country. Top of the list of economic attractions is agriculture and the processing of foodstuffs, which account for about a quarter of Brazilian GDP and 36% of exports. In the last 20 years it has become the world's largest producer of sugarcane, coffee and tropical fruits. It also has the world's largest commercial cattle herd (50% larger than that of the US) at 170 million animals, according to official figures. Oil is expected to become the next big commodity for export, especially if a way can be found to drill safely in the Atlantic's deep waters. Reserves are believed to equal those shared by Norway and the UK in the North Sea.

President Lula da Silva brought in social policies to raise the incomes of Brazil's poorest people after his election in 2002. Dilma Rousseff, his successor, oversees a country where most people are considered middle class. Absolute poverty has dropped dramatically from 10% of the population in 2004 to 2.2% in 2009 and inequality, as measured by the Gini coefficient, has fallen to a 50-year low of 0.519. Key factors in these trends have been low inflation, consistent economic growth, social programmes and real increases in the minimum wage.

Rousseff is a strong advocate of tackling corruption and increasing transparency in government. Within the first year of her government, several cabinet ministers resigned after accusations of bribery in awarding contracts. Yet bribery and the politicisation of the civil service continue to cause problems, with many overseas companies complaining that contracts are only signed and completed after bribes have been paid to civil servants.

The combination of huge natural resources and significant growth in manufacturing and services has attracted foreign direct investment while high interest rates have meant Brazil is one of the most attractive places for the world's super-rich to save their money. One of the knock-on effects has been to push up the value of the *real*, Brazil's currency, which has appreciated 40% since the financial crisis of 2008. For Brazil's wealthy it is a bonus because it increases their wealth and foreign buying power. It has also allowed the government to embark on a spending spree.

But for exporters it is a huge headache because if the commodity boom ends, the high value of the *real* could mean the country has little in the way of business to fall back on. Guido Mantega, Brazil's finance minister, blames the US, UK and continental Europe for driving investors towards Brazil. He argues that quantitative easing schemes have cheapened the world's major currencies, leaving his as one of the few attractive ones around. However, he is trapped because domestic savings are not sufficient to sustain long-term high growth rates. That means Brazil must continue to attract foreign investment, especially as the government plans to cover the cost of oil extraction, nuclear power and other infrastructure sectors over the next few years.

(Source: Adapted from Philip Inman, © Guardian News and Media Limited, 6 March 2012 and © World Bank)

(a) With reference to Extract 1, analyse **two** reasons why the value of the *real*, Brazil's currency, has appreciated.

(8)

(b) Examine the likely effects of the appreciation of the *real*, Brazil's currency, on its Balance of Payments accounts.

(10)

(Total for Question 9 = 18 marks)

10 Crisis in the Eurozone

Figure 1: Budget deficits as a percentage of GDP of selected Eurozone countries (2010)

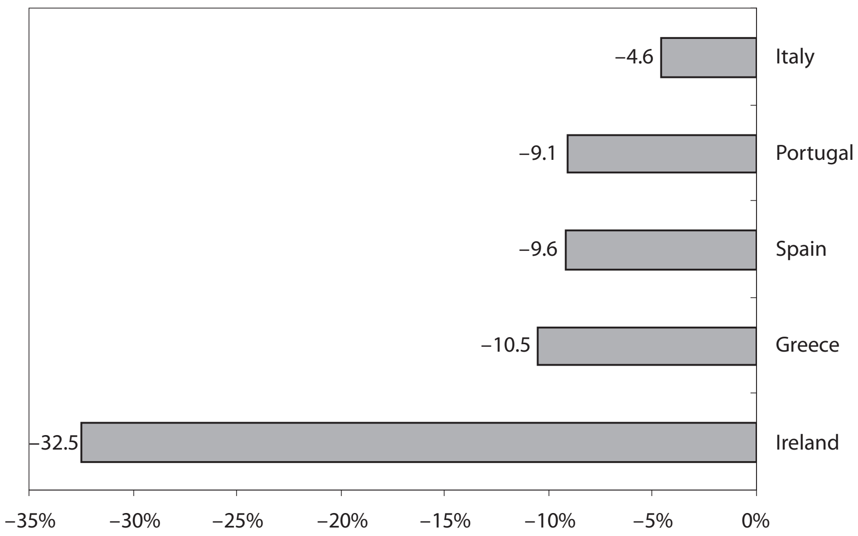
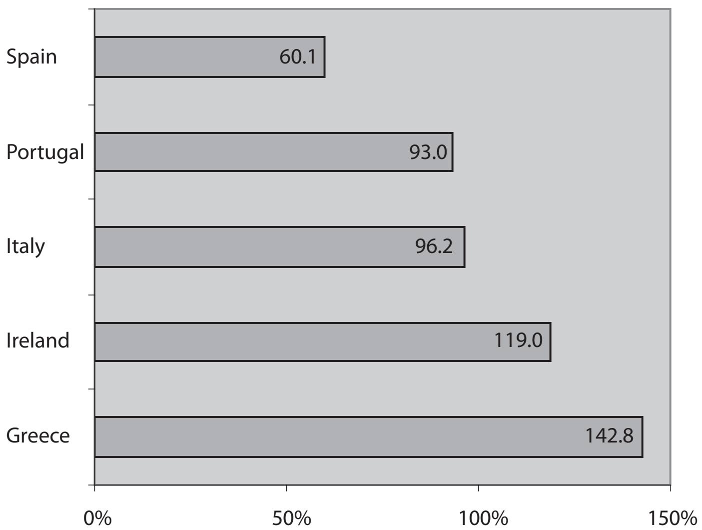
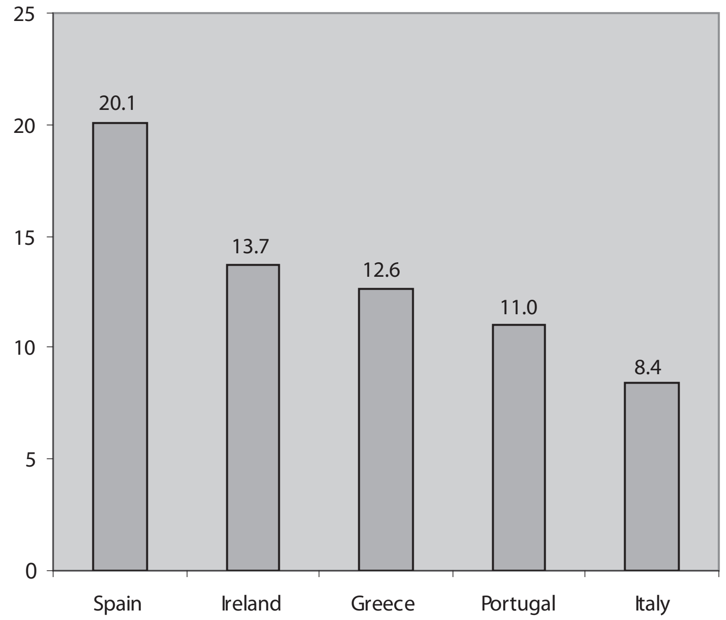


Figure 2: National debts as a percentage of GDP of selected Eurozone countries (2010)



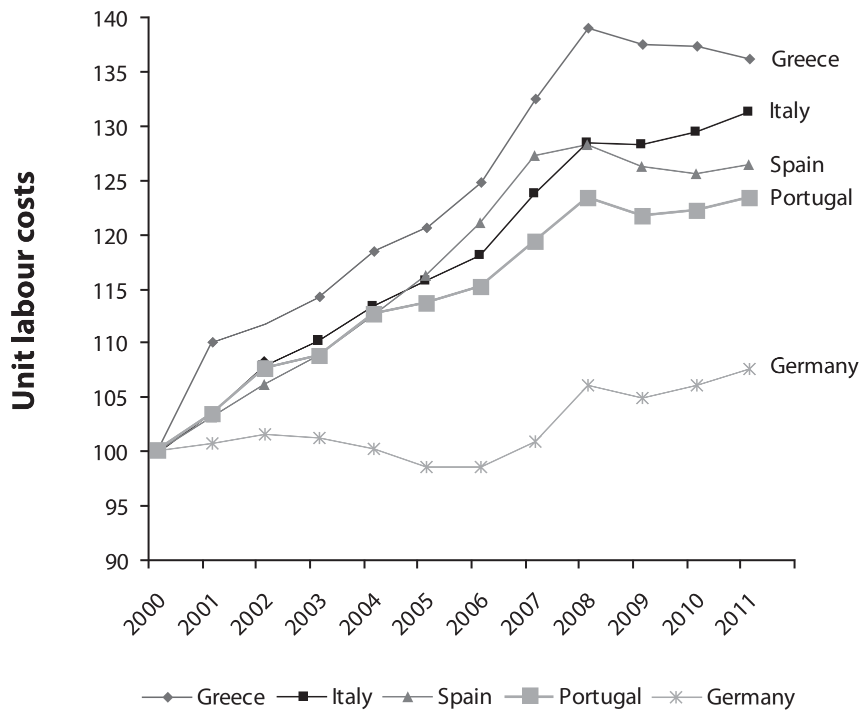
(Source for Figures 1 & 2: Eurostat © European Union http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/2-26042011-AP/EN/2-26042011-AP-EN.PDF)

Figure 3: Unemployment in selected Eurozone countries, per cent (2010)



(Source: Eurostat © European Union http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Unemployment_statistics#A_detailed_look_at_2010)

Figure 4: Unit Labour Costs in selected Eurozone countries (2000 = 100)



(Source: Eurostat © European Union http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=nama_aux_ulc&lang=en)

Extract 1: Differences in performance in Eurozone economies

The fear that Greece's debt crisis might be the first of similar problems elsewhere in the Eurozone has been borne out. In November 2010, Ireland joined Greece in being forced to apply for funds from the European Union (EU) rescue scheme and the International Monetary Fund (IMF). A few months later in April 2011, Portugal became the next country to seek substantial financial support.

Although economic growth picked up in most EU countries in 2010, there were marked differences in performance. Germany's economy is booming, with Gross Domestic Product (GDP) increasing 3.5% but the Irish economy contracted by 1.6% in the final quarter of 2010 and is forecast to grow by less than 1% in 2011. The outlook for Greece is worse: GDP fell by 3.9% in 2010. It is notable that GDP in countries outside the Euro such as Britain, Poland and especially Sweden grew at a rate faster than the Eurozone average in the first nine months of 2010.

In many countries unemployment has not risen by as much as might be expected given the depth of the financial crisis of 2008-9. Germany now has lower unemployment than before the crisis, thanks in part to short-time working and flexible time arrangements in its manufacturing sector. The worst affected countries include Ireland and Spain, where a collapse in construction activity has caused a sharp rise in unemployment.

Weak growth and high unemployment could cause serious problems for countries that already have high levels of national debt. That explains why Greece was first to lose the confidence of the markets with a national debt to GDP ratio of 127% and a budget deficit of 15.5% of GDP in 2009. Both Ireland and Spain had low national debt to GDP ratios before 2008, but a combination of recession and a collapse in their housing markets resulted in a massive fall in tax revenues.

(Source: © *The Economist* Newspaper, 6 April 2011)

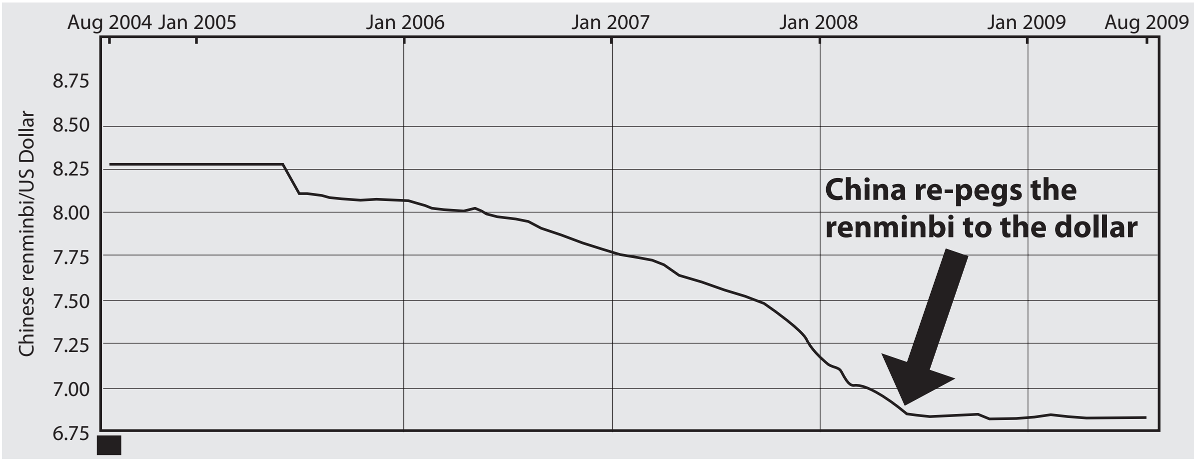
***10** Examine policies which might improve the competitiveness of the goods and services produced by Greece, Italy and Portugal.

(12)

(Total for Question 10 = 12 marks)

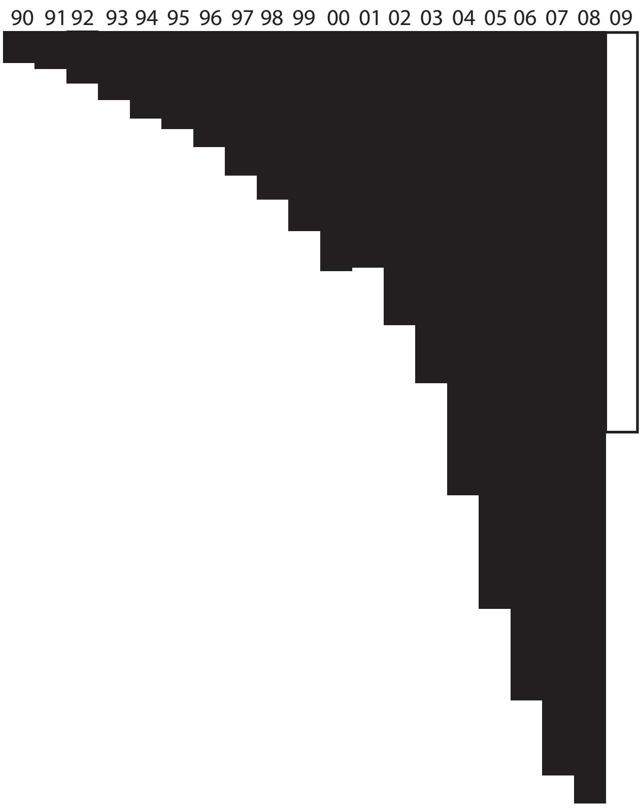
11 Trade Imbalances

Figure 1: Value of Chinese renminbi against the US Dollar



Source: http://www.marketskeptics.com/2010/04/cracks-appearing-in-us-financial-system.html

Figure 2: US trade deficits with China since 1990



1990: $10 billion.
1991: $13 billion.
1992: $18 billion.
1993: $23 billion.
1994: $30 billion.
1995: $34 billion.
1996: $40 billion.
1997: $50 billion.
1998: $57 billion.
1999: $69 billion.
2000: $84 billion.
2001: $83 billion.
2002: $103 billion.
2003: $124 billion.
2004: $162 billion.
2005: $202 billion.
2006: $234 billion.
2007: $259 billion.
2008: $268 billion.
2009 (until August): $144 billion.

TOTAL: $2,009 billion

Source: http://www.census.gov/foreign-trade/balance/c5700.html

Extract 1 US trade disputes

President Obama has promised that two million of the jobs which America needs to create in the next five years are to come from doubling US exports. The US is to have a National Export Initiative which will include an export promotion cabinet and a policy of getting tough with trading partners who "have not played by the same set of rules" as the US. A major problem is the undervaluation of China's currency, the renminbi, against the dollar.

President Obama will also have to settle several trade disputes, especially the one with Mexico. Mexico imported $129 billion in American exports in 2009. In response to trade union pressure, the US Congress cancelled a trial programme that allowed Mexican trucks to travel more freely into the US. In retaliation, Mexico imposed $2.4 billion in tariffs on a variety of American goods, resulting in a loss of $2.6 billion in US exports and 25 000 jobs.

Additionally, in 2009, Brazil persuaded the World Trade Organisation (WTO) that American government subsidies and loan guarantees to cotton growers violated WTO rules. This ruling allows Brazil to impose $560m in retaliatory tariffs on cotton goods, beauty products and cars. More importantly, Brazil is free to impose other penalties, most notably ignoring US patents in the media, pharmaceutical and technology industries. This retaliation by Brazil could result in thousands of American workers losing their jobs.

Source: *The Sunday Times*, 14 March 2010 and the *Financial Times*, 12 March 2010.

Extract 2 The Chinese currency

The undervaluation of China's currency, the renminbi, against the dollar has been a source of tension between the US and China for some time. The Chinese government has kept the renminbi at 6.83 per dollar since mid-2008 to protect its exporters from the global recession and a contraction in world trade. China has accumulated a record $2.4 trillion of reserves and $889 billion of US government debt, partly as a result of its exchange rate policy. Global growth would be about 1.5% higher if China stopped undervaluing its currency and running trade surpluses, according to Paul Krugman, a leading economist. If China did not start to appreciate the renminbi over the next few weeks, there was a good chance that the US would label China a 'currency manipulator'. That could allow the US to impose new tariffs on Chinese products.

Stephen Roach, Chairman of Morgan Stanley Asia said Paul Krugman's call for a stronger renminbi is "very bad" advice because the US trade deficit is due to a low level of savings in the US. Boosting Chinese spending and increasing savings in the US is a better way of reducing trade imbalances, according to Roach.

Source: http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aaDhEg_mZprU

(a) With reference to Figures 1 and 2 and to Extract 2, analyse the effects of an undervaluation of the Chinese currency, the renminbi, for the US economy.

(8)

(b) To what extent might a higher level of savings in the USA be sufficient to eliminate trade imbalances between China and the USA?

(10)

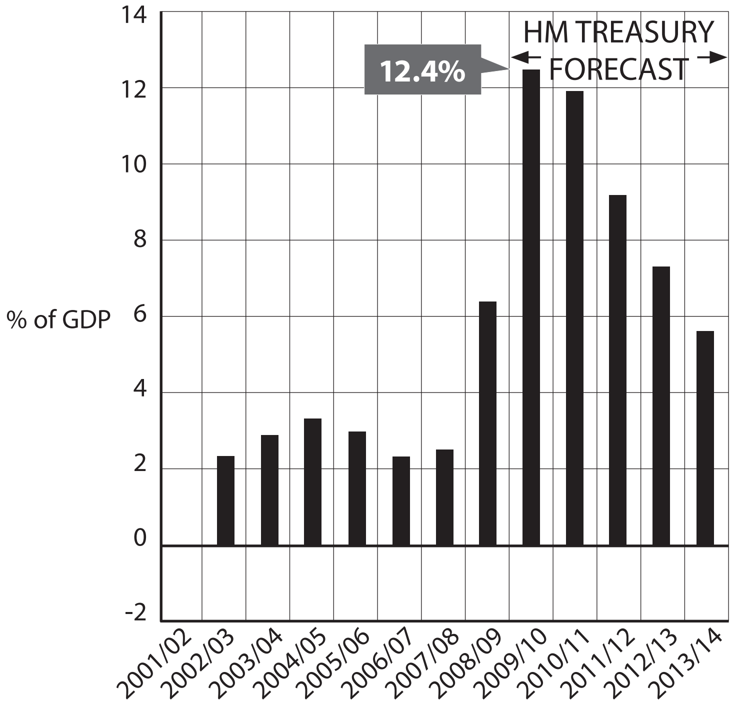
*(c) To what extent are large trade imbalances a cause for concern?

(12)

(Total for Question 11 = 30 marks)

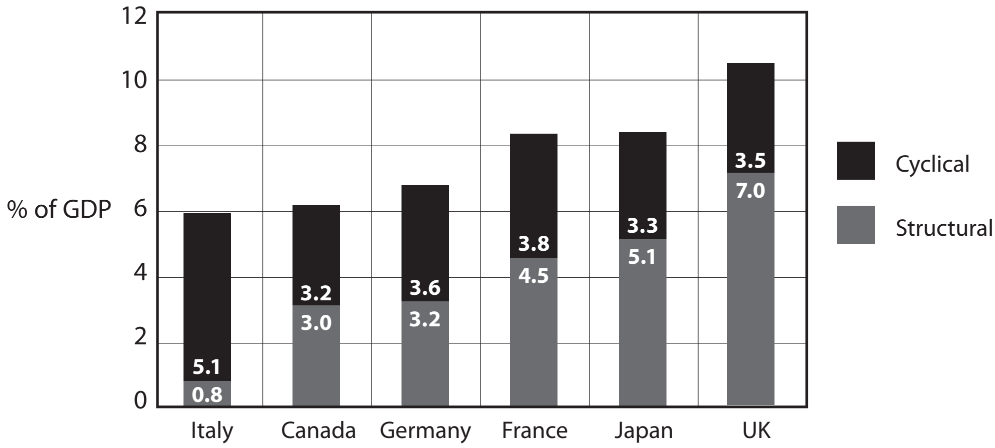
12 Public Finance

Figure 1: The UK's fiscal deficits 2001/02–2013/14 (% of GDP)



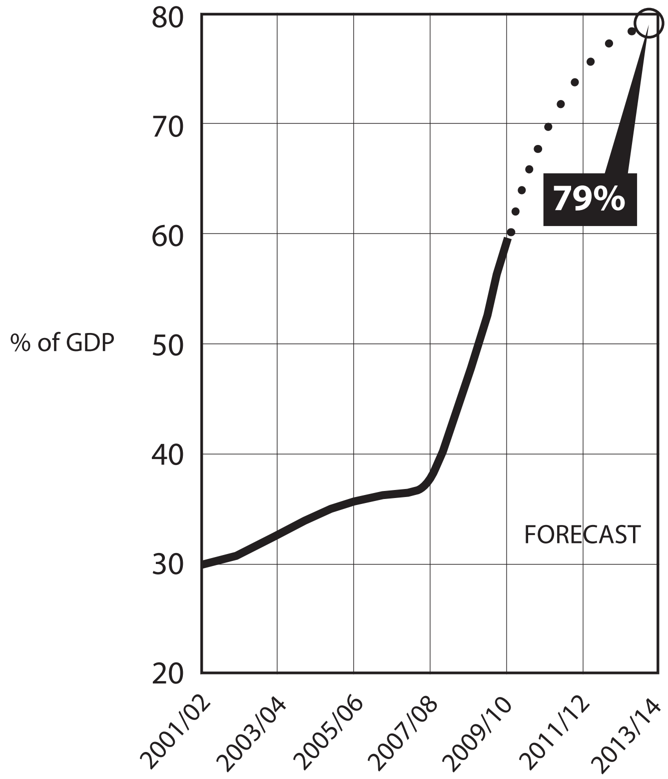
Source: *The Independent*, 23 April 2009 Sean O'Grady 'So much for balancing the books: this is worse than we ever imagined'

Figure 2: Fiscal deficits in selected countries as a percentage of GDP 2009/10 (OECD forecasts)



Source: *The Independent*, 23 April 2009.

Figure 3: UK Public Sector Net Debt (the National Debt) as a percentage of GDP: 2002–2014



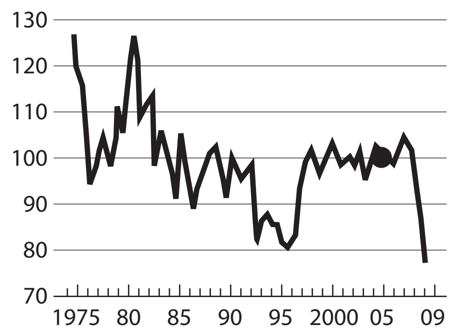
Source: *The Independent*, 23 April 2009 Sean O'Grady 'So much for balancing the books: this is worse than we ever imagined'.

Figure 4: Public Sector Net Debt as a percentage of GDP in Selected countries (2008 forecasts)

Country	% of GDP
Italy	105
Canada	58
Germany	77
France	67
Japan	201
UK	44
USA	65

Source: http://www.imf.org/external/pubs/weo

Figure 5: Sterling's (£) trade-weighted index; 2005 = 100



Source: *The Economist*, 25 April 2009 'Hubris and nemesis'.

Extract 1 Fiscal deficits

The UK Budget is traditionally thought of as an exercise in showing how the nation's books can be balanced. In this case, it is more a case of demonstrating to the world how difficult, if not impossible, it will be to pull public finances back into balance. The fiscal deficit for 2008–09 was £90bn. It is predicted that in 2009–10 it will soar to £175bn or 12.4% of GDP, one of the highest in the western world. Nor will it decline very rapidly. It will still be £173bn in 2010–11 and £97bn in 2012–13.

The annual growth in public spending will be limited to just 0.7% in real terms for the five years after 2010. Given the inevitable rise in the bill for unemployment benefits, plus an additional £2bn for training, announced in the 2009 budget, and the rise in the cost of servicing a national debt, such a small increase in public spending can only mean deep cuts in other government departments. Other countries have tackled similar problems in the past. For example, Canada had a budget out of control in the 1990s. It faced the need to cut public expenditure by around 20% in real terms. It now has one of the best records in coming through the global recession. At the same time, it has kept its position near the top of the Human Development Index ranking.

Sources: adapted from *The Independent*, 23 April 2009 Sean O'Grady 'So much for balancing the books: this is worse than we ever imagined' and *The Independent*, 6 May 2009 'The huge experiment that failed' by Hamish McRae.

Extract 2 The UK economy and recession

Since the financial crisis broke in 2007, the UK economy has looked weak. It was at the Northern Rock bank, after all, that depositors lined up in the streets to withdraw their money – the first run on a bank since 1866. The UK appeared vulnerable for three reasons. First, the economy was exposed to the credit crisis through its own big banks and London's importance as an international financial centre. Second, during the housing boom, UK households had run up the biggest debt, relative to disposable income, in the G7 (the world's richest countries). Thirdly, the rise in UK house prices had been among the most extreme internationally.

Although the UK economy looked set to suffer a severe recession, other big economies, notably Japan and Germany, were falling further: their export driven economies were particularly exposed to the global downturn that followed the financial panic resulting from the collapse of Lehman Brothers in late 2008. The UK has been less affected because manufacturing makes up only 13% of the economy, compared with around 20% for Germany and Japan.

Further, a fall in sterling caused by a general loss of confidence in the UK is now helping to stabilise the economy. However, the collapse of foreign markets has limited the impact of the 27% decline in sterling's trade-weighted index, measured against other leading currencies, between July 2007 and March 2009. UK exports fell in volume by almost 14% in the year to February 2009. But other countries have suffered far more: in Japan the volume of exports fell by 45% over the same period. As important, the falling pound is helping to guard the UK against deflation which could be lethal in an economy in which household debt and public sector debt is very high.

The economy is also getting a lot of help from a looser monetary policy. First, the Bank of England cut the interest rate progressively from 5% in early October 2008 to 0.5% in March 2009. Second, it used quantitative easing – buying assets (mainly gilt-edged securities) – to boost the money supply and encourage lending. By contrast, the UK is getting a smaller discretionary fiscal stimulus than other countries to fight the recession. However, automatic stabilisers are also supporting the economy.

Source: *The Economist*, 25 April 2009 'Hubris and nemesis'.

*12 Assess the likely economic implications of 'the 27% decline in sterling's trade-weighted index... between July 2007 and March 2009' (*Extract 2, lines 17–18*).

(15)

(Total for Question 12 = 15 marks)

END OF SECTION B

SECTION C

Write your answers in the spaces provided.

13 The British pound fell by over 10% to a 30-year low against the US dollar after the UK voted to leave the European Union.

To what extent will this depreciation impact on future economic growth in the UK? **(25)**

(Total for Question 13 = 25 marks)

***14** The trade-weighted exchange rate of the US dollar appreciated by over 20 percentage points between January 2013 and January 2016.

(a) Assess the possible causes of this increase in the exchange rate of the US dollar. **(20)**

(b) Evaluate the possible economic effects of the appreciation of the US dollar. **(30)**

(Total for Question 14 = 50 marks)

***15** In 2015 Switzerland was ranked first in the Global Competitiveness Index while the UK was ranked tenth, Portugal was ranked thirty-eighth and Greece eighty-first.

(a) Assess the factors influencing a country's competitiveness.

(20)

(b) Evaluate measures by which the competitiveness of the goods and services produced by the UK, Greece and Portugal might be increased.

(30)

(Total for Question 15 = 50 marks)

***16** UK productivity, as measured by output per worker, was 25 percentage points below the average for the rest of the major G7 economies in 2012, the widest gap since 1992.

(a) Assess the view that productivity is the most significant factor influencing the international competitiveness of an economy's goods and services.

(20)

(b) Evaluate the impact of a fall in productivity on an economy. **(30)**

(Total for Question 16 = 50 marks)

***17** (a) In 2011, Germany recorded a trade in goods surplus of €146.1 billion whereas the USA recorded a trade in goods deficit of $737 billion and the UK a deficit of £99.7 billion. Assess the possible causes of such differences in trade balances.

(20)

(b) Evaluate means by which trade imbalances could be reduced.

(30)

(Total for Question 17 = 50 marks)

18 *(a) The UK fell from 9th to 12th place in The Global Competitiveness Index between 2007 and 2008. Examine the factors which might have caused a decrease in the international competitiveness of the UK's goods and services.

(20)

*(b) Evaluate strategies which may be used by businesses **and** governments to improve the competitiveness of a country's goods and services.

(30)

END OF SECTION C **(Total for Question 18 = 50 marks)**