Economics Questions By Topic:

Role of the State in the Macroeconomy (4.5)

A-Level Edexcel Theme 4

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SECTION A

Write your answers in the spaces provided.

1 After the Global Financial Crisis of 2008, the US President introduced expansionary fiscal policies of $800 billion. The International Monetary Fund estimated that the multiplier at the time was approximately 1.5.

(Source adapted from: https://www.economist.com/the-economist-explains/2016/09/07/what-is-the-keynesian-multiplier)

Explain the impact of annual fiscal deficits on the US national debt. **(2)**

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(Total for Question 1 = 2 marks)

2 The UK Government is planning to cut the rate of corporation tax on all pre-tax profits of companies to 17% by 2020.

(Source: adapted from https://www.ft.com/content/7579f124-5742-11e7-9fed-c19e2700005f)

Explain **one** possible reason why the revenue from corporation tax could increase if the government cuts the rate of tax. **(2)**

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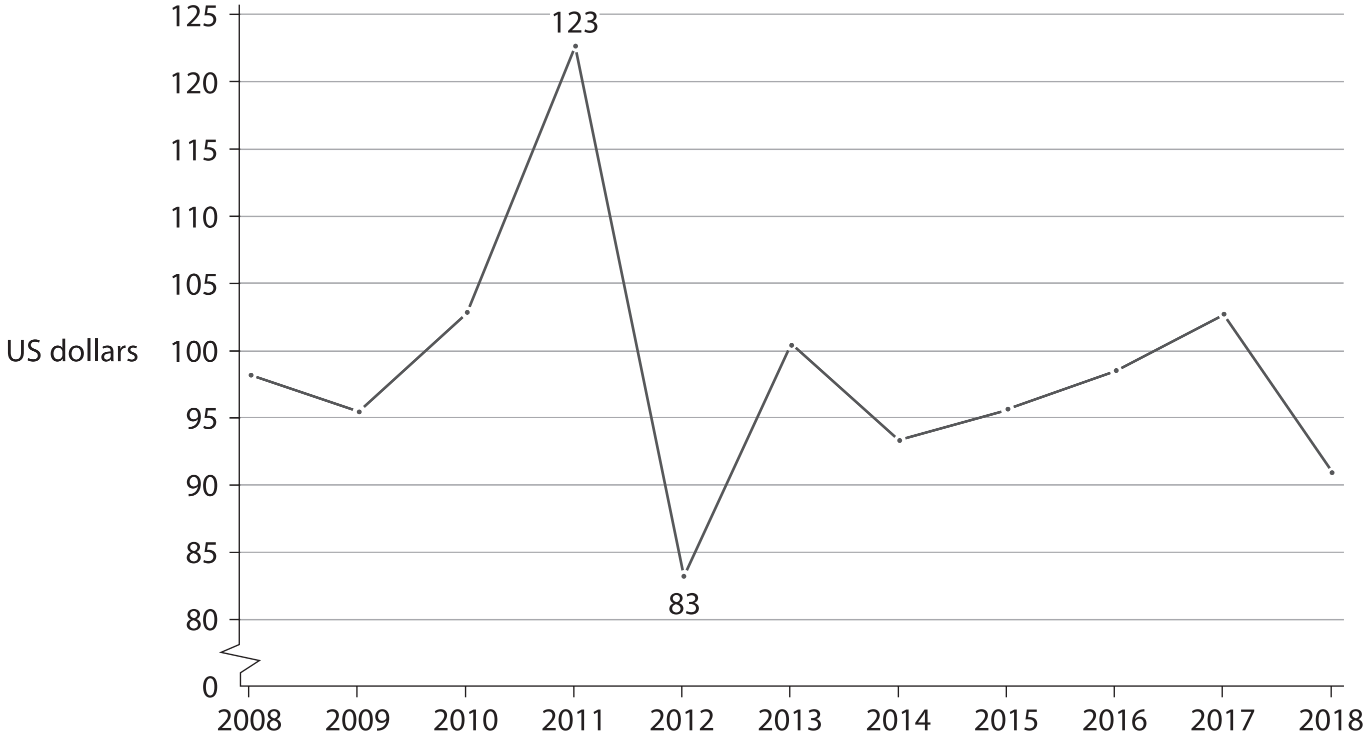
(Total for Question 2 = 2 marks)

Question 3

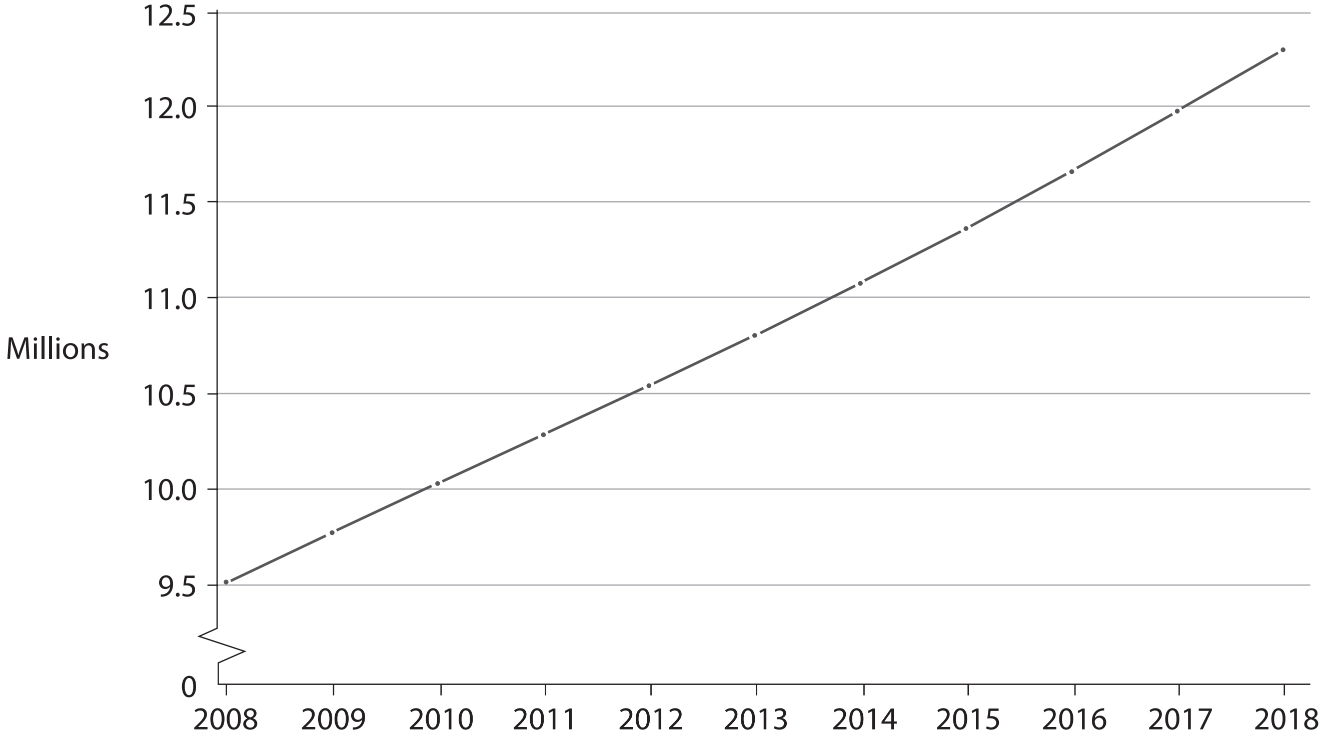
Trade and aid in Rwanda

Figure 1: Aid funding received by Rwanda (per capita, US dollars), 2008 to 2018



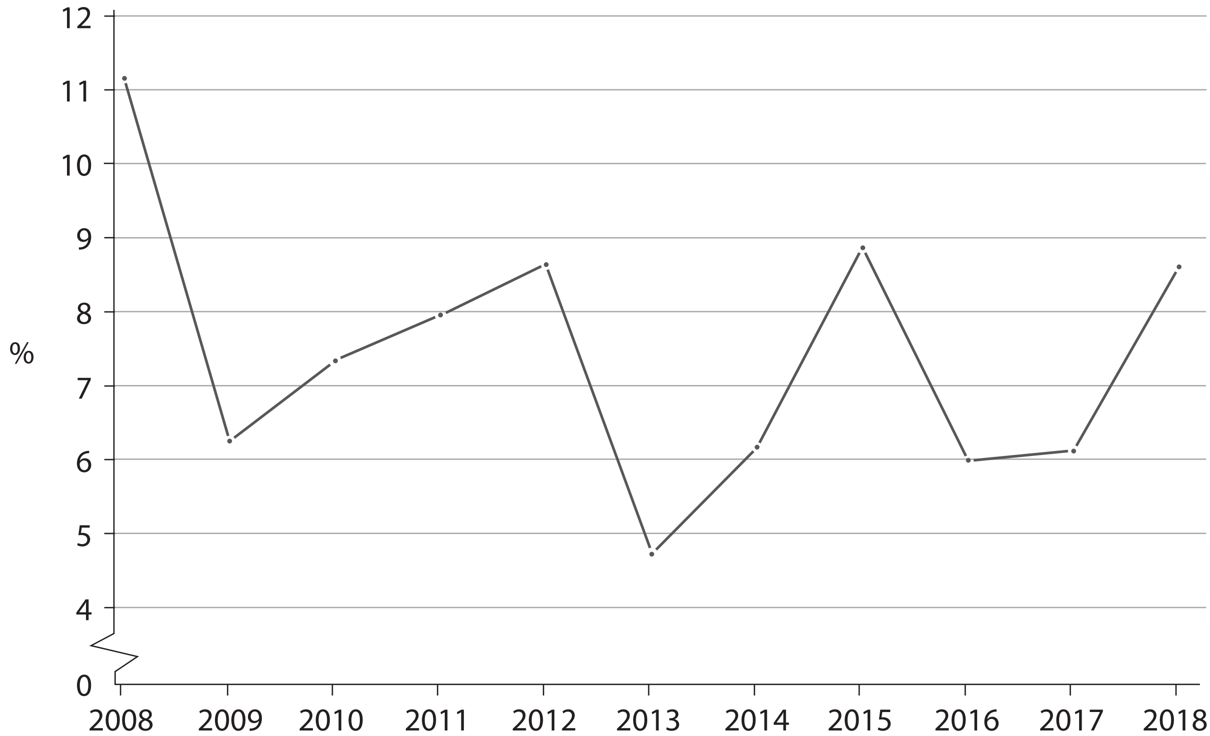
(Source adapted from: data.worldbank.org)

Figure 2: Population of Rwanda (millions), 2008 to 2018



(Source adapted from: https://tradingeconomics.com/rwanda/population)

Figure 3: Rwanda real GDP annual percentage growth rate, 2008 to 2018



(Source adapted from: African Development Bank Statistics accessed April 2020)

Extract A

Rwandan tariffs on imports of used clothing

In a market in Kigali, Rwanda's capital, an auction is under way. Sellers offer crumpled T-shirts and faded jeans; traders argue over the best picks. Everything is second-hand. A Tommy Hilfiger shirt sells for 5 000 Rwandan francs ($5.82); a plain one for a tenth of that. Afterwards, a trader sorts through the purchases he will resell in his home village. The logos hint at their previous lives: Kent State University, a rotary club in Pennsylvania, Number One Dad.

These auctions were once twice as busy, but in 2016 Rwanda's government increased import tariffs on a kilo of used clothes from $0.20 to $2.50. Now many traders struggle to make a profit. The traders are not the only ones who are unhappy. Exporters in the US claim the tariffs are costing jobs there. In March, the US President warned that he would suspend Rwanda's tariff-free access to US markets for its clothing exports after 60 days if it did not remove the tariff.

Globally, about $4 billion of used clothes crossed borders in 2016. The share from China and South Korea is growing, but 70% still come from Europe and North America. Many go to Asia and eastern Europe, but Africa remains the largest market. The trade enables poor people to afford clothes and creates retail jobs. However, governments worry that the trade undercuts their own clothing manufacturers.

Second-hand imports of clothing now dominate African markets. Researchers at the Overseas Development Institute, a British think-tank, estimate that Tanzania imports 540 million used items of clothing and 180 million new ones each year, while producing fewer than 20 million itself. African manufacturing is weak for many reasons, from ineffective privatisations to collapsing infrastructure. But second-hand clothing imports are a major factor: it is estimated that they accounted for half of the fall in employment in the African clothing industry between 1981 and 2000.

For example, a clothing factory in Kigali is operating at only 40% of capacity and employs 600 workers, down from 1 100 in the 1990s. It is hard to compete, says Ritesh Patel, its manager, when a used imported T-shirt sells for the price of a bottle of water. Instead, the company specialises in uniforms for police, soldiers and security guards, which cannot be bought second-hand.

The threatened suspension of tariff-free access to the US market would hurt Rwanda, but not very much. Last year Rwanda sold just $1.5 million of clothing to the US. Nor, with about 12 million people, is Rwanda a big market for US exports.

(Source adapted from: https://www.economist.com/finance-and-economics/2018/05/31/rwanda-refuses-to-remove-tariffs-on-imports-of-used-clothing)

Extract B

Development in Rwanda

Rwanda's strong economic growth has been accompanied by substantial improvements in living standards, with a two-thirds drop in child mortality and near-universal primary school enrolment. A strong focus on policies to encourage industrialisation and poverty reduction initiatives have contributed to significant improvements in access to services and human development indicators. Absolute poverty declined from 59% to 39% of the population between 2001 and 2014 but was almost stagnant between 2014 and 2017. The official inequality measure, the Gini index, declined from 0.52 in 2006 to 0.43 in 2017.

(Source adapted from: https://www.worldbank.org/en/country/rwanda/overview)

3 Discuss policies, other than import tariffs, that the Rwandan government could use to develop its manufacturing industries.

(15)

(Total for Question 3 = 15 marks)

Question 4

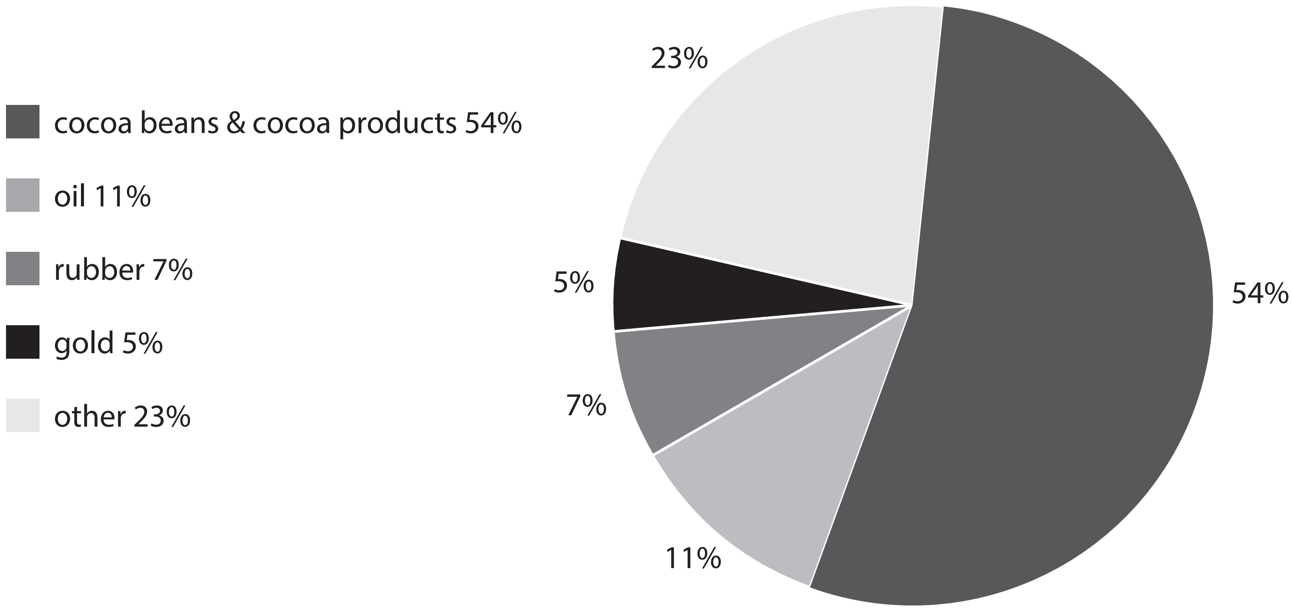
Trade and Development Issues in Africa

Figure 1: The Fairtrade scheme in the cocoa industry. How the additional revenue is spent by cocoa farmers.

Improving business administration and infrastructure	44%
Investing in farm equipment, training and funding	45%
Supporting social services for the community	10%
Other	1%

(Source: https://www.fairtrade.org.uk/~/media/FairtradeUK/What%20is%20Fairtrade/Documents/Policy%20and%20Research%20documents/Monitoring%20reports/Fairtrade%20Monitoring%20Report_9thEdition%202016.pdf)

Figure 2: Ivory Coast exports – relative share of main products (%), 2016



(Source: https://atlas.media.mit.edu/en/visualize/tree_map/hs92/export/civ/all/show/2016/)

Extract A

Cheap cocoa is costing farmers dear

The median annual income of cocoa farmers in the west African country, Ivory Coast, is just US$2 600. Research suggests that an annual income of US$6 133 is needed for this country's farmers to have a decent, living income. This situation is even worse for farmers who are not part of a Fairtrade scheme.

World cocoa prices fell by more than a third in 2017. Cocoa farmers have to accept all the risk from price volatility, putting a significant strain on their fragile incomes. On the other hand, cocoa processors and chocolate manufacturers are able to adapt or even make high profit and consumers continue to enjoy their chocolate.

This is still happening despite considerable investment in agriculture to build a sustainable cocoa sector. The focus has been on raising productivity and diversifying crops. The average cocoa farm in the Ivory Coast produces only around half of the output that could be achieved with training and resources such as fertilisers, equipment and replanting. If farmers diversify into other crops, livestock or non-farm activities, they lower the risk they face of fluctuating world cocoa prices.

Even tripling farm output would not provide the average cocoa farmer with a living income. Diversification alone will not always make farms more profitable. If we want farmers to earn a living income, we must also be willing to pay farmers more.

(Source adapted from: https://www.fairtrade.org.uk/Media-Centre/Blog/2018/October/Cheap-cocoa-is-costing-farmers-dear)

Extract B

Sub-Saharan Africa is becoming more integrated

After two years of negotiations, representatives of a large number of African countries signed the African Continental Free Trade Agreement (AfCFTA) in Kigali on March 21, 2018. This created a trading bloc of 1.2 billion people with a combined gross domestic product of more than US$2 trillion. The agreement committed countries to removing tariffs on 90% of goods and to liberalise services.

This can be seen as a sign of rapid and steady regional integration. Sub-Saharan Africa in particular is much more integrated today than in the past. The level of integration in sub-Saharan Africa is now similar to that in the world's other developing and emerging market economies.

However, the two largest African economies, Nigeria and South Africa, refused to sign the agreement. Nigeria's manufacturers and trade unions are concerned about the potential negative impacts of becoming more open to imports from other African countries with lower labour costs.

Greater interdependence can expose small economies to their partners' recessions. After nearly 20 years of strong economic activity, sub-Saharan Africa experienced the downside of integration in 2015. The collapse in commodity prices and the slowdown in economic activity in Nigeria and South Africa contributed to sub-Saharan African growth slowing sharply. Since 2017 growth has begun to recover. The recovery is mixed, though, and it is unclear to what extent the slow recovery of the larger economies is still affecting the rest of sub-Saharan Africa.

(Source adapted from: https://www.imf.org/ and https://www.pulse.ng/)

4 Nigeria is considering joining the African Continental Free Trade Agreement. Assess policies the Nigerian government could use in response to the concerns of the country's 'manufacturers and trade unions' (Extract B paragraph 3) if they join this trading bloc.

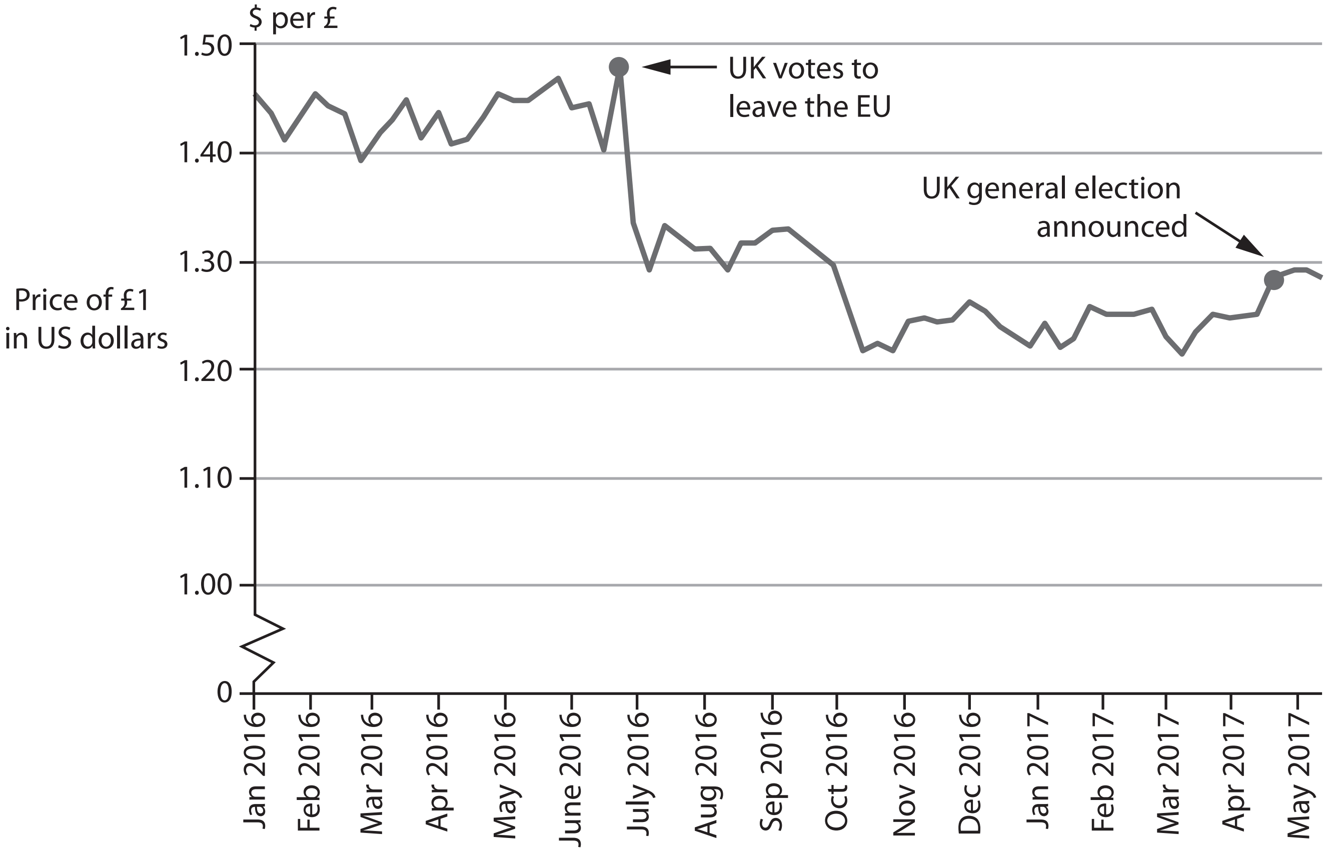
(10)

(Total for Question 4 = 10 marks)

Question 5

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)

5 Discuss whether providing substantial government financial support to banks is the best policy response during a financial crisis.

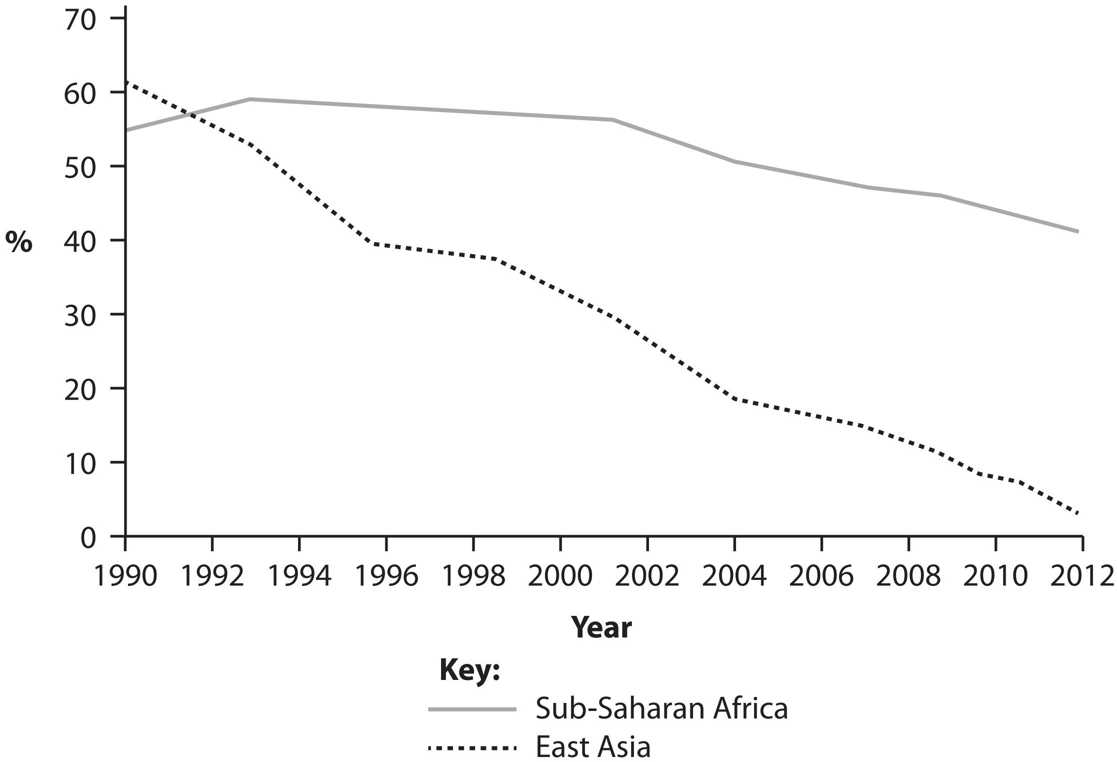
(15)

(Total for Question 5 = 15 marks)

Question 6

Globalisation and Inequality

Figure 1: Proportion of population in absolute poverty (US$1.90-a-day 2011 PPP)



(Source: https://openknowledge.worldbank.org/bitstream/handle/10986/25078/9781464809583.pdf)

Extract A

Lessons from globalisation

The past 25 years have seen a freeing up of trade. Capital has been free to move around the world. Formerly closed economies in Asia have been opened up and tariffs cut. In emerging economies, a billion people have been taken out of absolute poverty, but relative poverty remains a problem.

In many advanced economies globalisation has come to mean, according to the Governor of the Bank of England, "low wages, insecure employment, stateless corporations and striking inequalities". His solution to these problems is threefold: an acceptance by economists that not everybody has gained from trade and technology; a better mix of monetary policy, fiscal policy and structural reform to boost growth; and more inclusive growth. In essence, this is the same conclusion that was reached in the past when there was a fear that market forces had to be moderated to prevent capitalism from destroying itself.

The good news is that this moderation of capitalism included real policy changes: an extension of the right to vote, the growth of trade unions, the creation of welfare states, a move to more progressive tax policies, nationalisation of key sectors of the economy, and more activist demand management.

The bad news is that this process took about 100 years and was not completed until the end of the Second World War. What's more, protectionism seems to be on the increase as countries seek to protect themselves from inequalities caused by rapid globalisation.

(Source: adapted from https://www.theguardian.com/business/2016/dec/05/mark-carney-globalisation-bank-of-england-capitalism)

Extract B

Tackling inequality

Despite decades of substantial progress in boosting prosperity and reducing absolute poverty, the world continues to suffer from substantial inequalities. For example, the poorest children are four times less likely than the richest children to be enrolled in primary education across developing countries. Among the estimated 780 million illiterate adults worldwide, nearly two-thirds are women. Poor people face higher risks of malnutrition and death in childhood and lower chances of receiving key healthcare. Such inequalities result in high financial costs, limit economic growth, and generate social and political burdens and barriers.

These consequences highlight the importance of directing attention to the problem of inequality. There are other reasons to tackle inequality. Most economies are struggling to recover from the global financial crisis that started in 2008 and the subsequent slowdown in global growth. The goal of eliminating absolute poverty by 2030 might not be achieved without accelerated economic growth or reductions in inequalities within countries, especially in those with large numbers of poor. Generally speaking, poverty can be reduced through higher average growth, a narrowing in inequality, or a combination of the two. Achieving the same poverty reduction during a slowdown in growth therefore requires a more equal income distribution.

Some level of inequality is desirable to maintain an appropriate incentive structure in the economy or simply because inequality also reflects different levels of talent and effort among individuals. However, the substantial inequality observed in the world today offers great scope for reducing the gap between rich and poor. Policies to redistribute income from higher-income and wealthy households to those on lower incomes can be achieved without compromising growth, if done effectively. A trade-off between efficiency and fairness is not inevitable.

(Source: adapted from https://openknowledge.worldbank.org/bitstream/handle/10986/25078/9781464809583.pdf)

6 With reference to Extract A, discuss **two** macroeconomic policies, apart from protectionism, that a government could use to reduce the negative effects of globalisation.

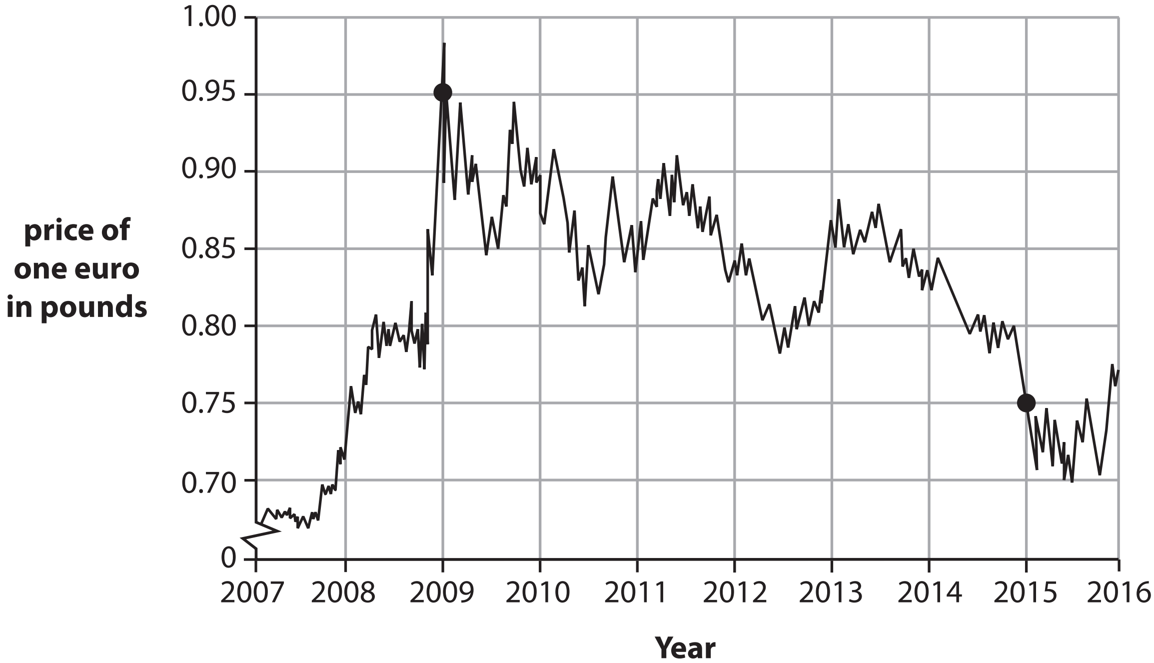
(12)

(Total for Question 6 = 12 marks)

Question 7

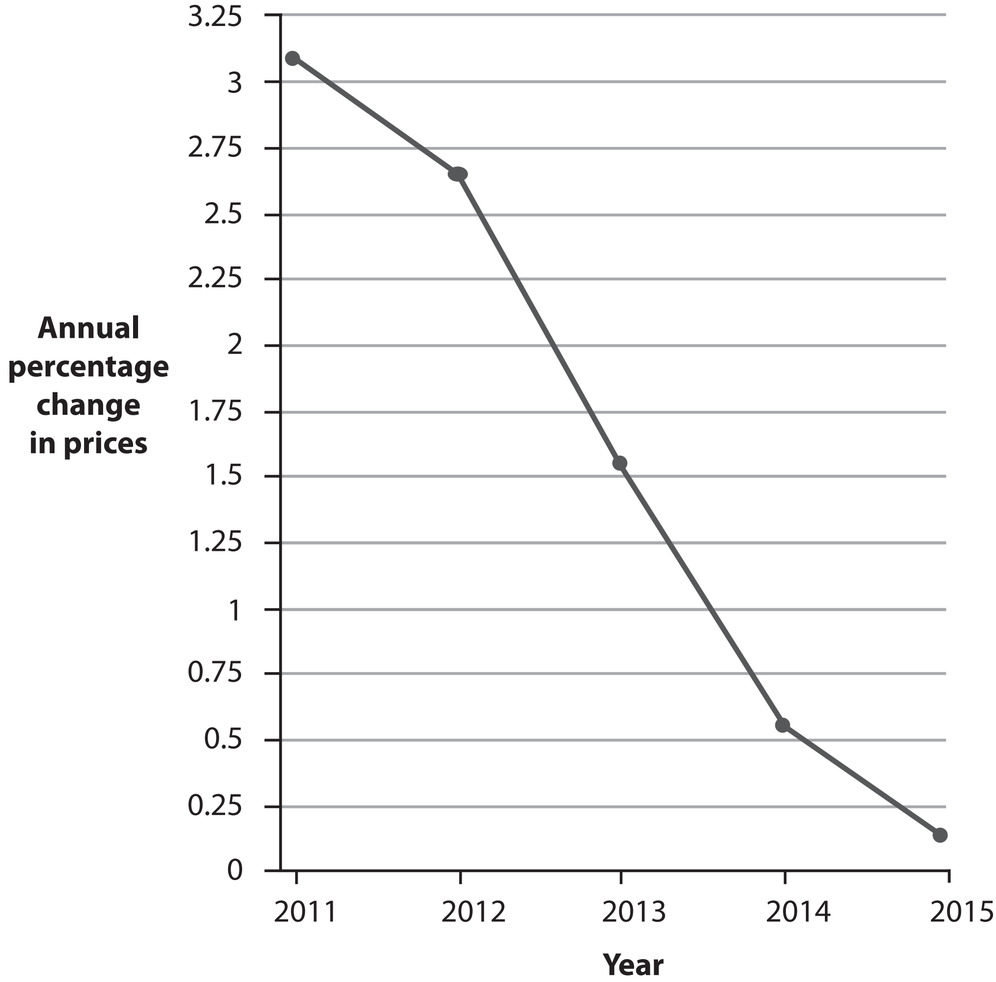
The Eurozone economy

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)

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)

(a) Discuss the likely success of the ECB's quantitative easing programme in moving Eurozone inflation closer to 'the central bank's ceiling of 2%' (Extract A, line 17).

(12)

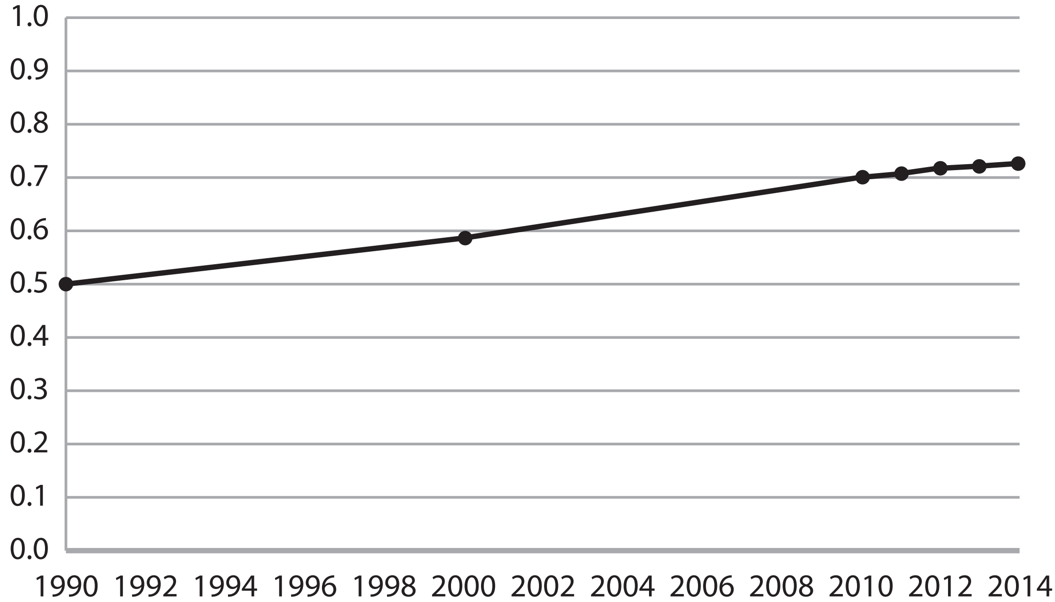
(b) Discuss 'looser fiscal policy' and 'supply-side reforms' (Extract A, lines 20 and 21) that may be used by governments of Eurozone countries to increase economic growth.

(15)

(Total for Question 7 = 27 marks)

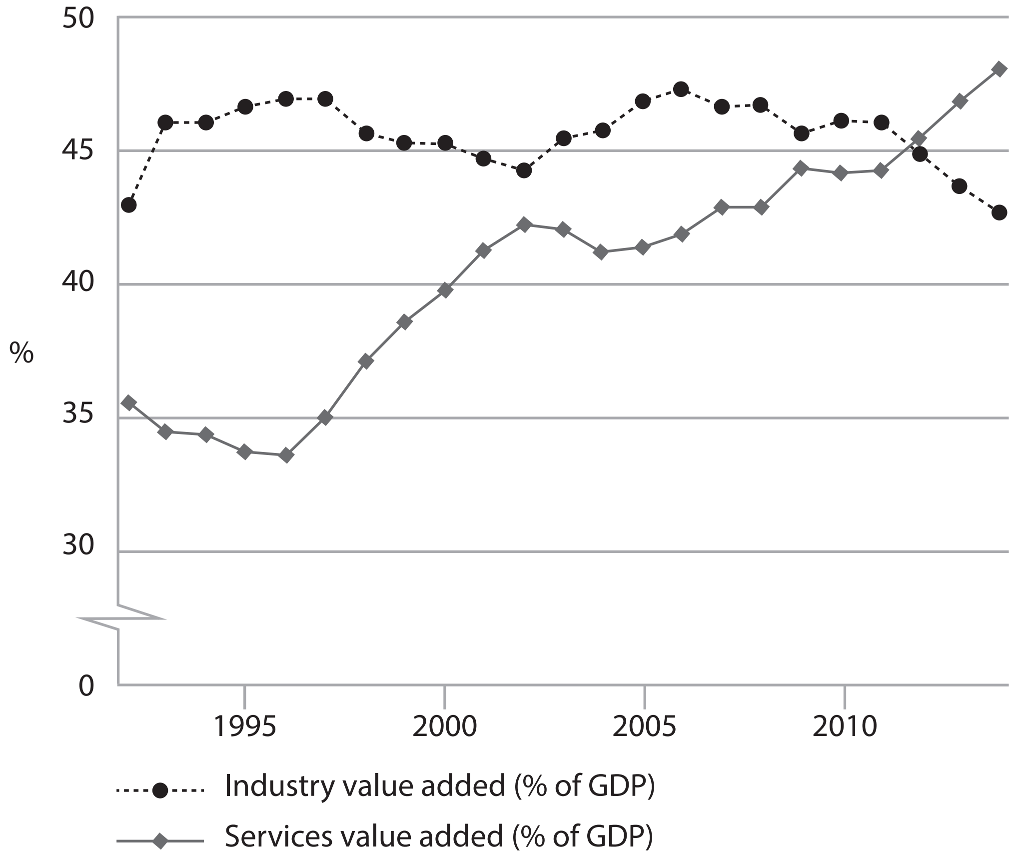
8 China's economy

Figure 1 China's human development index (HDI), 1990–2014



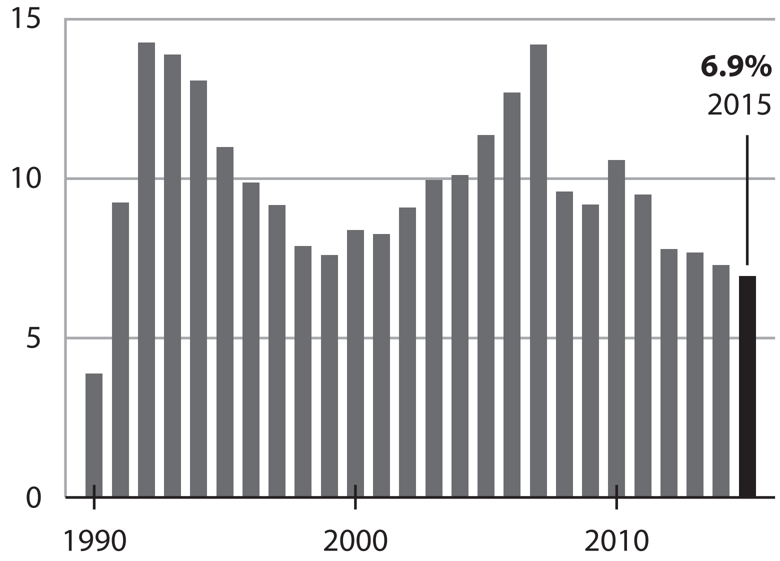
(Source: http://hdr.undp.org/en/countries/profiles/CHN)

Figure 2 China's industry and services sectors, as a proportion of GDP, 1992–2014



(Source: adapted from http://www.cnbc.com/2016/01/17/how-chinas-economy-has-evolved-in-charts.html)

Figure 3 China's real GDP growth, year-on-year percentage change, 1990–2015



(Source: adapted from http://i.dailymail.co.uk/i/pix/2016/01/19/11/305438200000578-3406224-image-m-6_1453201350106.jpg)

Extract 1 China's economic growth

In 2015, China recorded a significant fall in its rate of economic growth to 6.9%, the weakest for 25 years. If any other major economy grew by nearly 7% a year, it would be seen as a triumph. However, it is being seen as evidence of deep problems in the Chinese economy.

With growing debt and too much housing and factory capacity, economists predict a tougher year ahead. Share prices have fallen and there is a danger of a house price crash. Fears over slowing momentum in China and the Government's handling of the economy have combined with concerns over plunging oil and commodity prices to pull down global stock markets since the start of 2016.

During the economic slowdown, China's economy has diverged along two tracks, with the manufacturing industries that powered it for so long being hit harder while services and household consumption are booming. Service industries last year managed to absorb job losses from manufacturing. In 2015, services made up 50.5% of GDP, considerably higher than the manufacturing sector. Consumption's contribution to the economy also grew strongly, accounting for 66.4% of GDP, more than 15 percentage points higher than in 2014.

The trend to greater reliance on consumption rather than investment is one the Government has long said it wants to encourage. But as the rate of economic growth falls further, economists expect more companies to fail and unemployment to rise. Therefore, it is expected that the Chinese Government will adopt further expansionary economic policies in 2016. The Chinese Government has traditionally used budget deficits to fund infrastructure spending coupled with lower interest rates and measures to boost exports to revive growth. However, these policies appear increasingly ineffective. For example, higher spending on infrastructure in 2015 only led to a short-term increase in investment. Meanwhile, exports, which accounted for 34.9% of GDP in 2007 but only 22.6% as of 2014, are unlikely to promote growth given weak demand from developed economies.

Even as the economy slowed, consumer debt increased by 18.2% in 2015. Total debt equals almost 260% of annual economic output, up from less than 160% in 2007. Increasingly, new lending is being used to service debt rather than fund new ventures and energy-saving technologies. Households and companies now spend the equivalent of 20% of GDP on interest payments, more than the US, Japan and the UK. As the economy slows and the yuan (the Chinese currency) weakens, the Chinese are moving their money out of the country, contributing to a fall in investment.

The Government finds itself in a dilemma: if it cuts interest rates, there will be more capital flight. If it raises interest rates then companies with large debts are likely to go bankrupt causing an increase in unemployment.

(Sources: adapted from http://www.wsj.com/articles/china-economic-growth-slows-to-6-9-on-year-in-2015-1453169398 and http://www.afr.com/news/economy/chinese-gdp-growth-falls-to-new-low-of-7-percent-20160119-gm8xi2#ixzz3yAGy1elJ)

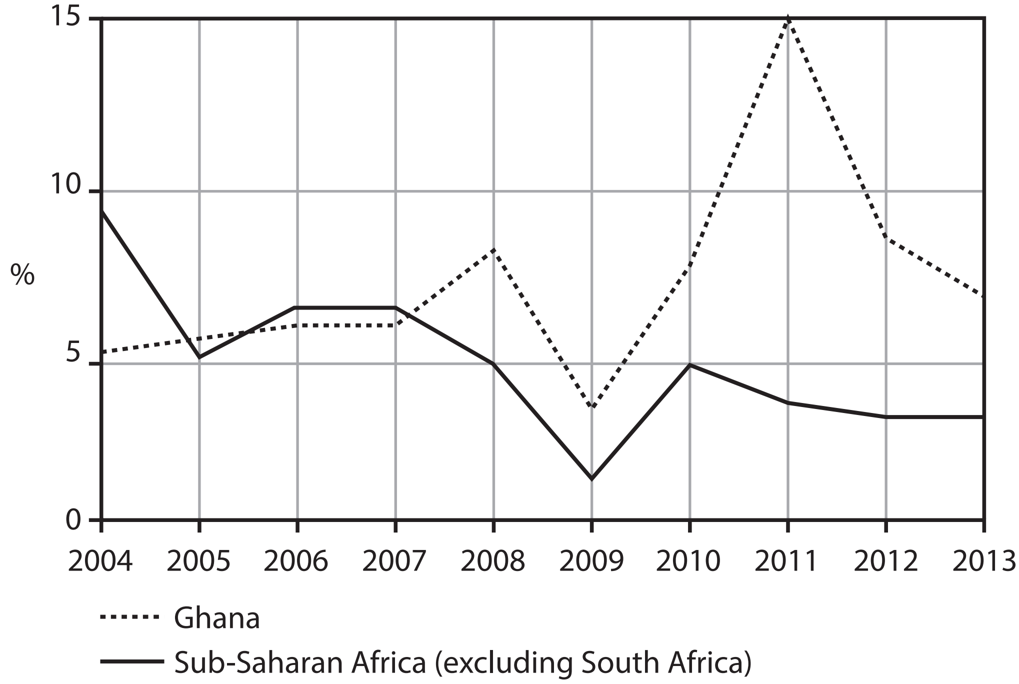
***8** With reference to Extract 1, evaluate the likely impact of 'further expansionary economic policies' (Extract 1, lines 20–21) on the Chinese economy.

(15)

(Total for Question 8 = 15 marks)

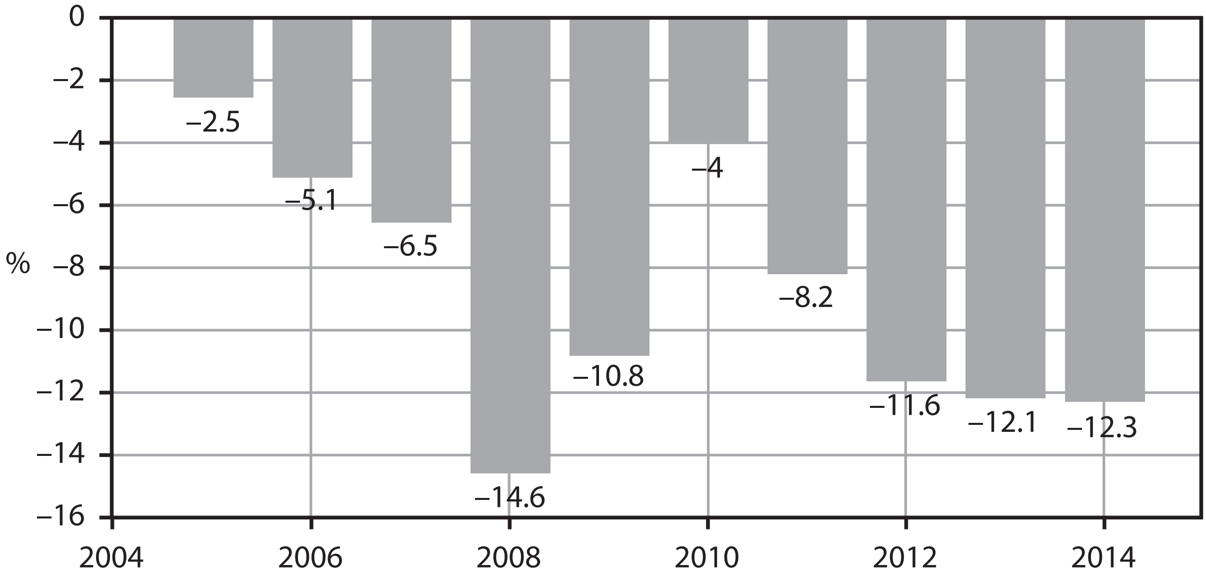
9 Ghana's Economy

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



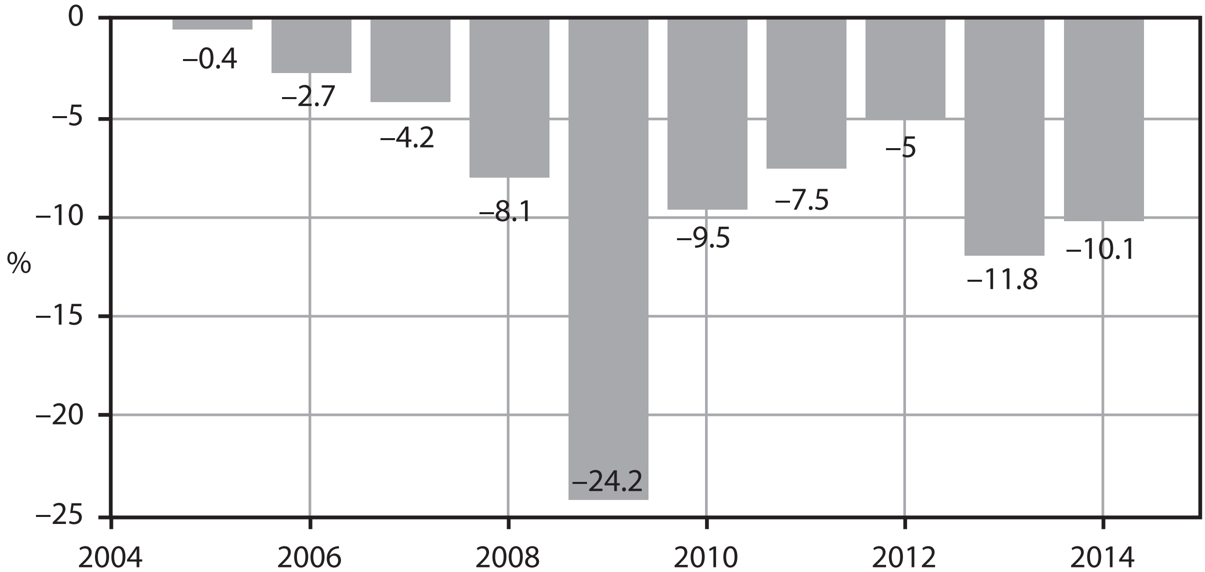
(Source: http://www.worldbank.org/en/country/ghana)

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



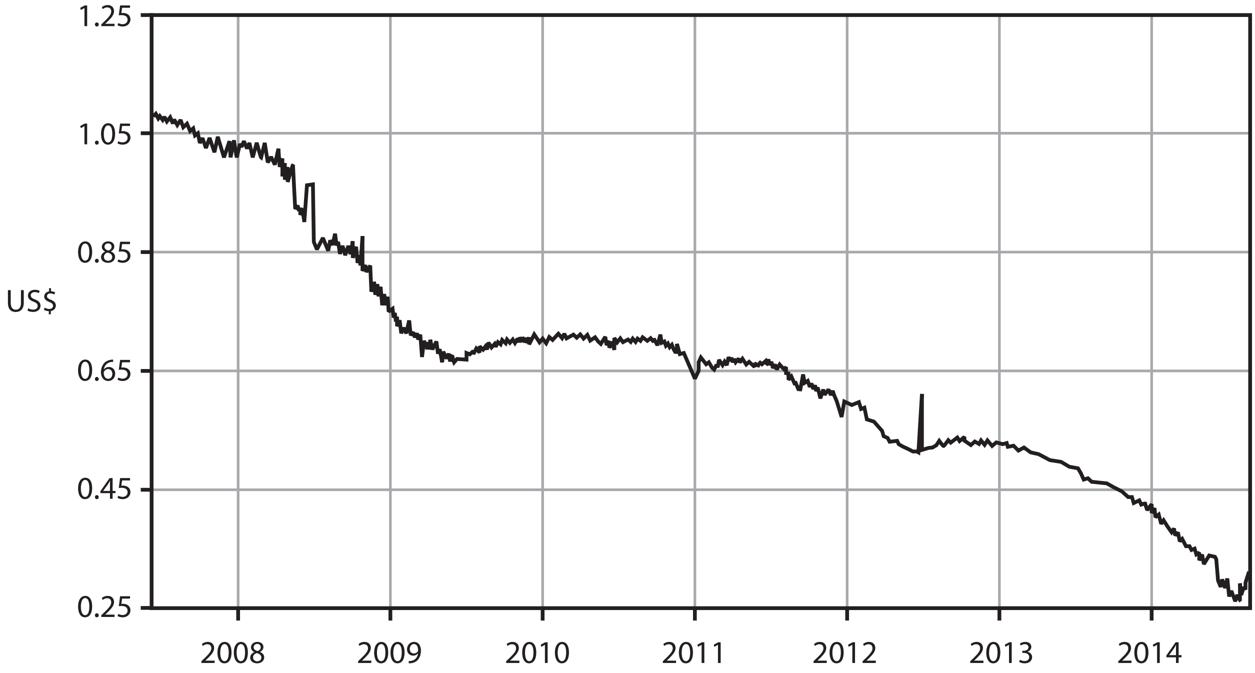
(Source: http://www.tradingeconomics.com/ghana/current-account-to-gdp)

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 fourth paragraph of Extract 1, explain **two** measures which the Government could take to reduce Ghana's deficit on the current account of the balance of payments.

(8)

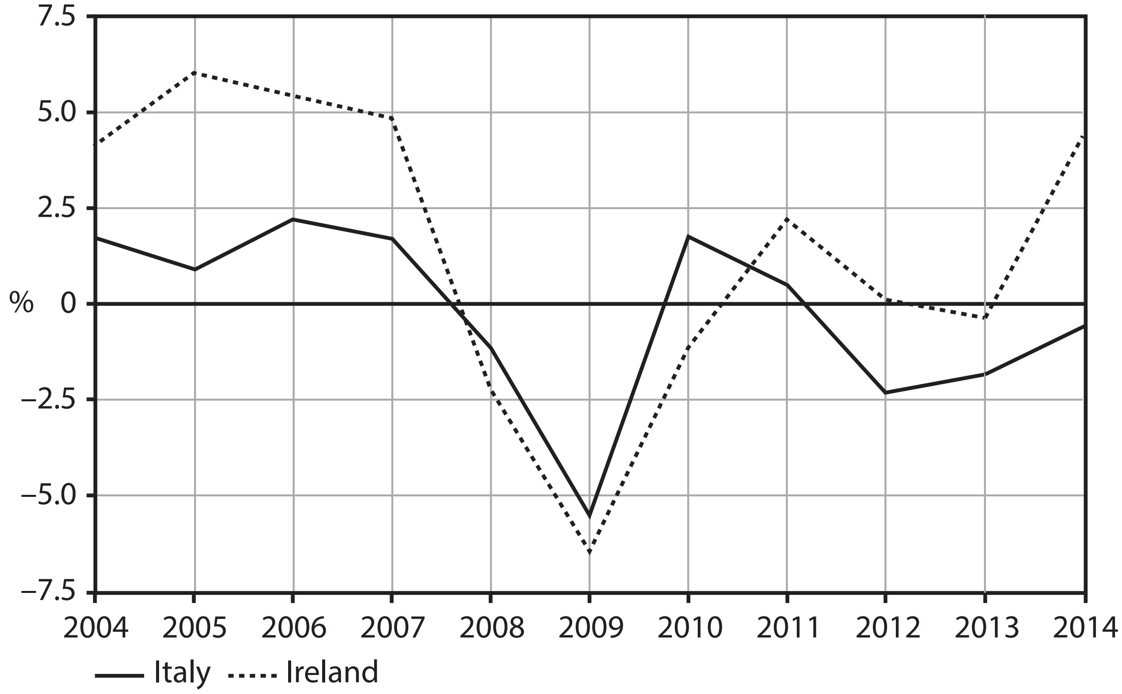
*(b) With reference to the information provided, evaluate measures by which Ghana's Government could reduce its fiscal deficit.

(15)

(Total for Question 9 = 23 marks)

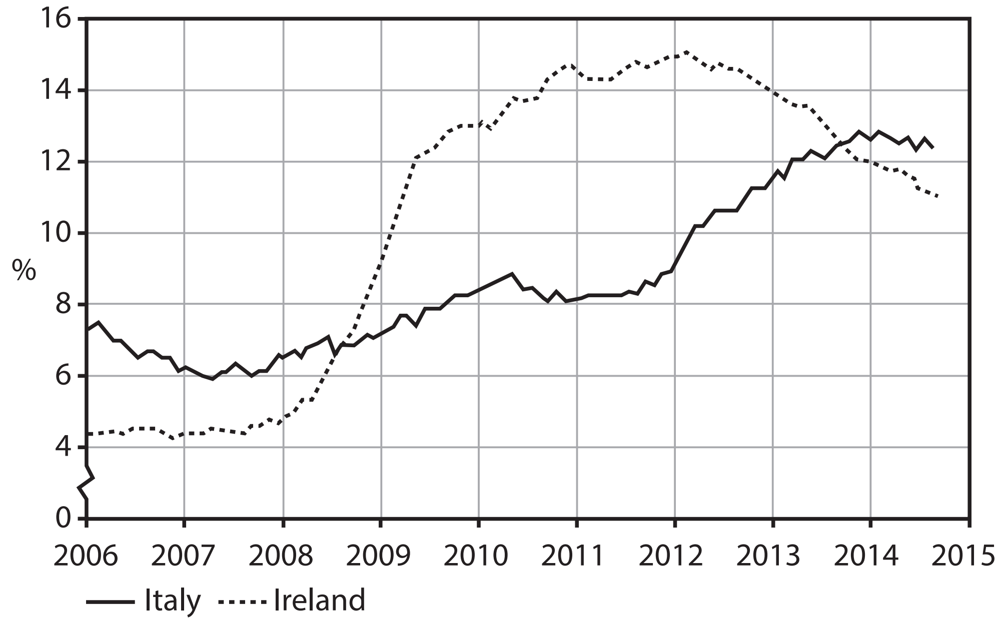
10 Eurozone: Italy and Ireland

Figure 1 GDP growth rate in Italy and Ireland (annual % change in GDP)



(Sources: http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG/countries/IT?display=graph and http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG/countries/IE?display=graph)

Figure 2 Italy and Ireland: ILO unemployment rates (%)



(Sources: http://www.tradingeconomics.com/italy/unemployment-rate and http://www.tradingeconomics.com/ireland/unemployment-rate)

Extract 1 Italy's debt burden

The biggest question facing the economic stability of Europe is what happens if Italy continues to stagnate as it has done for the past 15 years. Unless there is a significant increase in economic growth, Italy's economic position is unsustainable and will result in eventual debt default. At that point, Italy's future in the eurozone would also be in doubt – and the future of the euro itself.

The fall in the general price level in Italy is raising the real value of debt. Between 2007 and 2013, the ratio of public sector debt to gross domestic product (GDP) rose from 103.3% to 132.6%. If Italy's economy continues to stagnate in 2015 and 2016, the debt-to-GDP ratio will be heading towards 150% of GDP. The problem is not the number but the trend which could ultimately result in Italy becoming insolvent. However, Japan is still solvent at a debt-to-GDP ratio more than 200%. But Japan, unlike Italy, has its own central bank. If investors believe that the country's debt can be stabilised at any given level, they will continue to refinance its debt.

The main reason for the explosion in the debt ratio has been the fall in nominal GDP. The only way out of this trap is for nominal GDP to rise faster than debt. But Italy, as a member of the eurozone, lacks the policy instruments.

Economic reforms may help to generate some growth but only in the long run. For example, measures to enable companies to make workers redundant more easily are unlikely to have an immediate impact. Italy needs to bring its taxes down to the eurozone average, and to improve the quality and efficiency of the public sector. Other possible remedies include a programme of European Central Bank (ECB) asset purchases (quantitative easing) and higher growth in the other eurozone economies.

(Source: adapted from http://www.ft.com/cms/s/0/02cb9932-3ff0-11e4-936b-00144feabdc0.html#axzz3E2evoa3V
September 21, 2014 'Italy debt burden is a problem for us all' by Wolfgang Münchau)

Extract 2 Ireland leaves eurozone behind as exports boom

Ireland's economy is growing at an explosive pace creating great demand for property. In its capital Dublin, house prices have risen 24% in the year to August 2014, though they are still far below their peak and 135 000 households are still in arrears from the last crisis. GDP surged 7.7% in the year to June 2014 as rising exports to the US, Britain and China transform the former crisis-state into the eurozone's star economy. Meanwhile, the rest of the eurozone remains in a slump. The turnaround comes less than a year after Ireland regained economic sovereignty as it is no longer subject to the ECB-IMF bail-out conditions. The collapse of the banking system in 2008 and the country's €67 billion rescue already seems like a long time ago.

Ireland has been held up as an excellent example of what can be achieved if a country adopts austerity measures and regains competitiveness through an "internal devaluation". For example, the Government cut public sector wages by 20%.

The Irish economy is unique, with an export industry of pharmaceuticals and computer software, led by US transnational companies exploiting Ireland's 12.5% corporation tax. The country has an export to GDP ratio of 108%, compared with 30% for Italy. Irish exports rose 12% between 2013 and 2014 at a time when world trade was stable. Ireland's biggest export earners are Google (€17 billion), Microsoft (€15 billion), Johnson and Johnson (€10.5 billion) and Pfizer (€5 billion).

However, unemployment is still 11.2% despite large scale emigration. Investment has stopped falling but only after reaching the lowest level in Irish history in 2013 as a share of GDP. Credit is contracting. Ireland's public sector debt has risen sharply to 124% of GDP in 2014 from 25% in 2007. The IMF expects the debt ratio to drop to 111% by 2018.

(Source: adapted from *The Daily Telegraph* 18 Sept 2014 By Ambrose Evans-Pritchard http://www.telegraph.co.uk/finance/economics/11107507/Ireland-leaves-eurozone-behind-as-exports-boom.html)

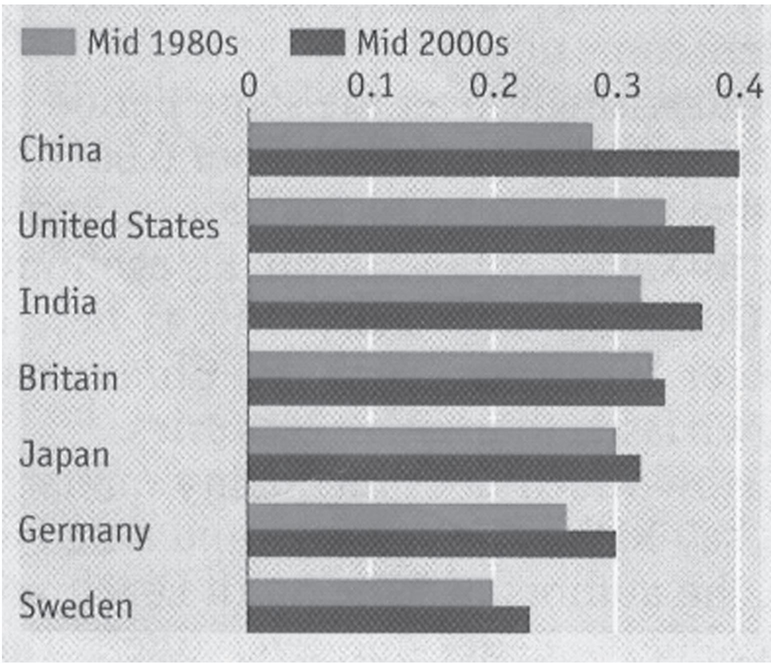
***10** To what extent might a high public sector debt to GDP ratio be a cause for concern? Refer to the information provided in your answer.

(15)

(Total for Question 10 = 15 marks)

11 Inequality

Figure 1 Inequality within selected countries as measured by the Gini Coefficient



(Source: © *The Economist Newspaper* Special report on global leaders, 22 January 2011 page 8)

Extract 1 Changes in income inequality

Globally, the income gap *between* the rich and poor countries has been narrowing as some poorer countries are achieving faster rates of economic growth. However, the gap between the rich and the poor has increased *within* many emerging economies (notably India and China) as well as *within* many rich countries. This is true not only in the United States, but also in countries with a reputation for being more focused on equality, such as Sweden.

In China increased inequality has been associated with the drive towards capitalism, helping to enrich the growing entrepreneurial class. The continued industrialisation of regions bordering the sea has helped to increase incomes of urban workers. Consequently relative poverty is increasing. Poverty is becoming increasingly difficult to address, as the rural poor are now concentrated in remote regions with difficult natural conditions.

However, at the same time, China's rapid economic development in the past two decades has generated the most rapid decline in absolute poverty ever witnessed. It has already achieved the goal of halving the number of people in extreme poverty by 2015, set by the UN as one of eight Millennium Development Goals.

In the United States, income inequality began to widen in the 1980s largely because the poor fell behind those in the middle income group. More recently, the shift has been overwhelmingly due to a rise in the share of income going to the very top – the highest 1% of earners and above – particularly those working in the financial sector.

Analysis by The Economist suggests that the gap between poorer and richer regions of a country increased during the recession of 2008–09 in some developed economies. In Britain, the income gap between richer and poorer regions is likely to widen further as government spending cuts fall disproportionately on less prosperous parts of the country. GDP per head in the poorest quarter of Britain's regions is now lower than the richest region of China.

Extract 2 Attempts to reduce inequality

The European Union's "structural funds", more than a third of the EU's budget, are designed to shift cash from the richer to the poorer regions of the single market. The United States Government has invested federal dollars into deprived regions such as West Virginia.

Unfortunately, the regional development strategies have a poor record. Despite massive transfers, the gap in participation rates between Italy's richer north and its poorer south is still huge: only 40% of people in Calabria have a job compared with 65–70% in Lombardy and Bolzano. Even policies that, in principle, should be helpful, such as improving infrastructure, provide no simple solutions. West Virginia now has an extensive road network, but is still poor.

The best ways to combat inequality are as follows. First, governments should invest in and remove barriers to education, and refocus government spending on those that need it most. Oddly, the urgency of these kinds of reform is greatest in rich countries, where prospects for the less-skilled are poor and falling. Second, governments should eliminate subsidies for uncompetitive industries. In the emerging economies the policies should be aimed at eliminating monopolies and reducing trade barriers. Third, governments should make it easier for people to move from declining regions to prospering regions.

(Source for Extract 1 and Extract 2: © *The Economist Newspaper*, 22 January 2011 page 11 and 12 March 2011 pages 14–15)

*11 Evaluate policies which a government could employ to reduce inequality within its country.

(15)

(Total for Question 11 = 15 marks)

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

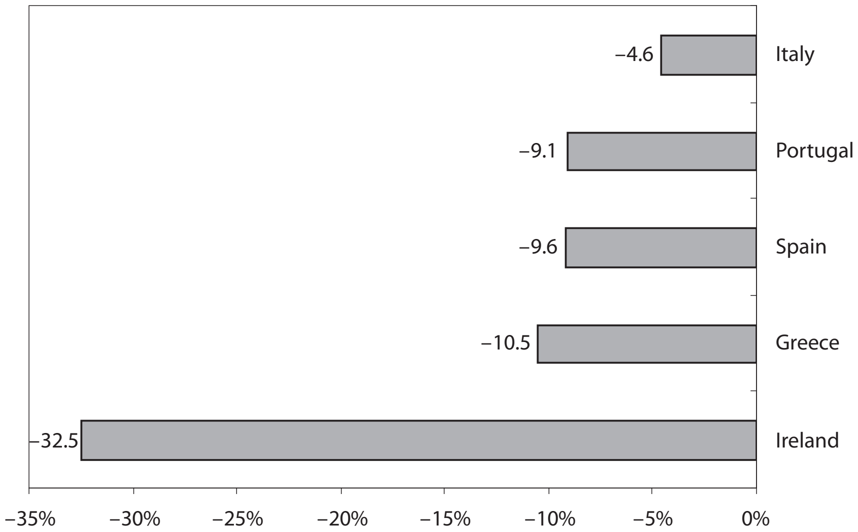
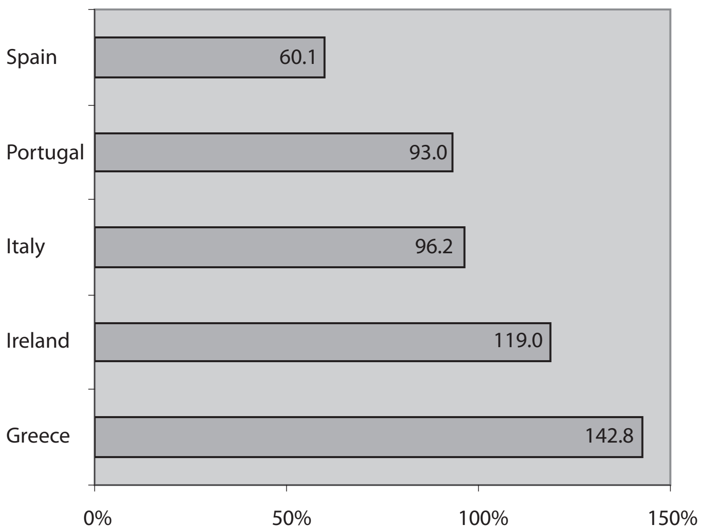
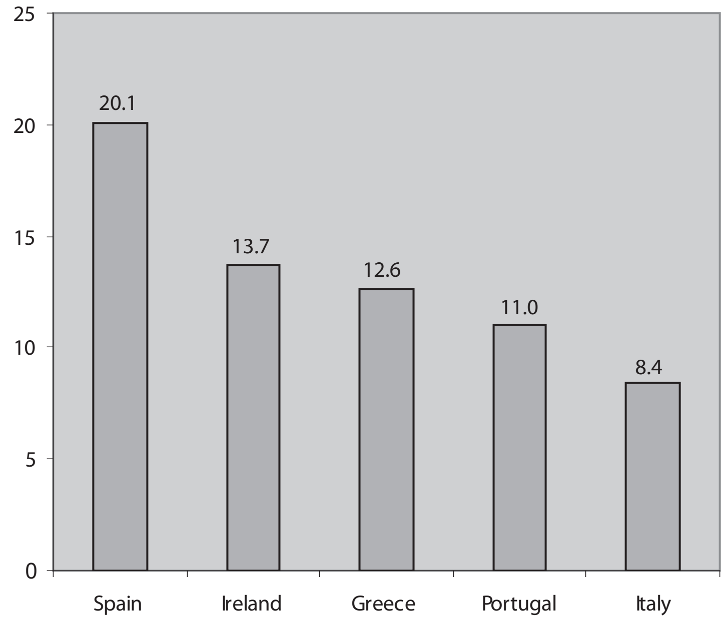


Figure 2: National debts as a percentage of GDP of selected Eurozone countries (2010)



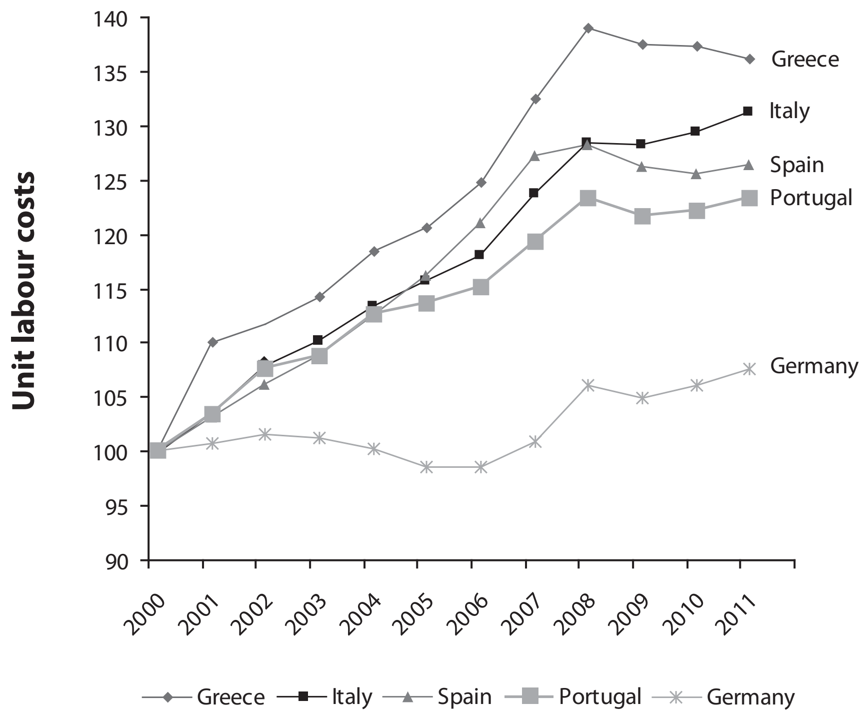
(Source for Figures 1 & 2: Eurostat © European Union http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/2-26042011-AP/EN/2-26042011-AP-EN.PDF)

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)

(a) With reference to Figures 1 and 2, explain the difference between a budget deficit and the national debt of a country.

(5)

(b) With reference to Extract 1, explain why 'weak growth and high unemployment could cause serious problems for countries that already have high levels of national debt' (Extract 1, lines 19–20).

(8)

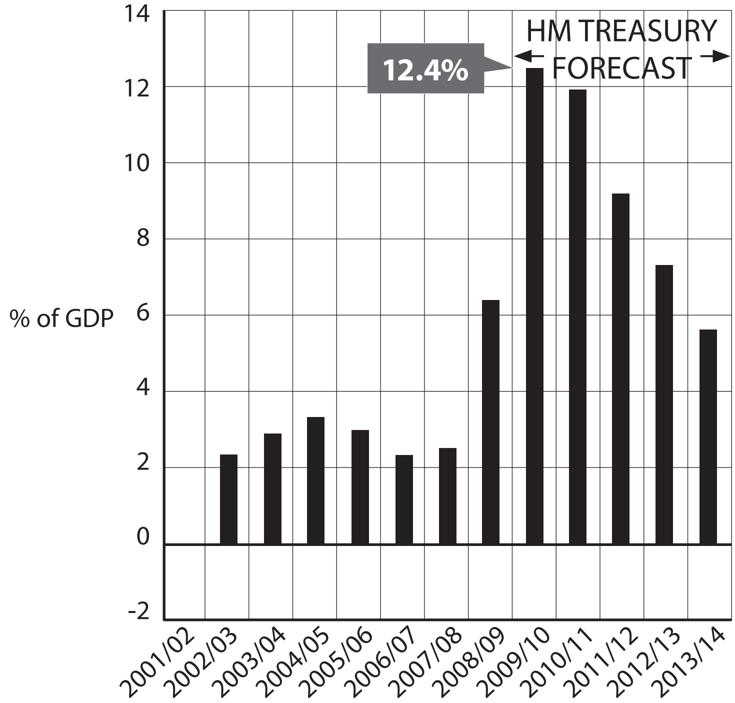
* (c) Discuss the view that governments of countries with large budget deficits should take measures to reduce them as quickly as possible.

(15)

(Total for Question 12 = 28 marks)

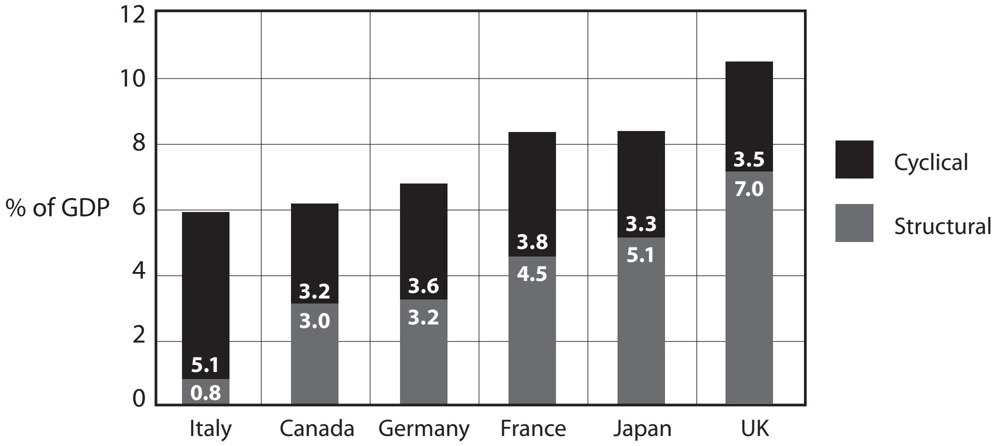
13 Public Finance

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



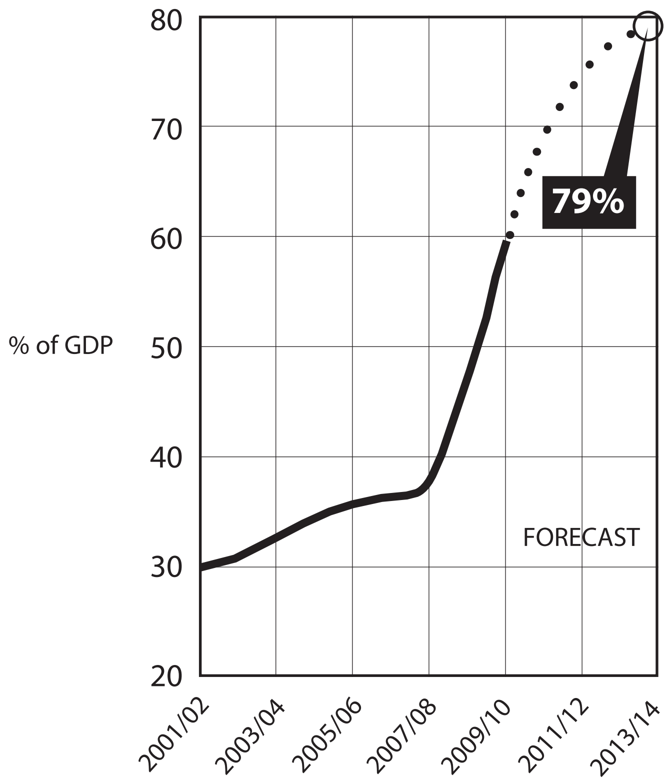
Source: *The Independent*, 23 April 2009 Sean O'Grady 'So much for balancing the books: this is worse than we ever imagined'

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



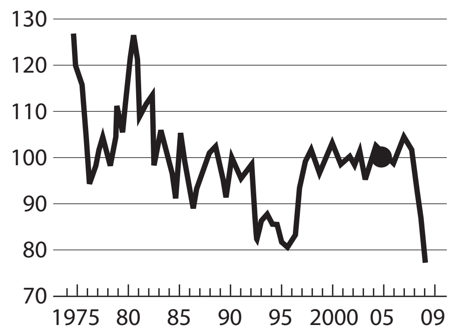
Source: *The Independent*, 23 April 2009 Sean O'Grady 'So much for balancing the books: this is worse than we ever imagined'.

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'.

(a) With reference to Figure 1, how might the expected change in the UK's fiscal deficit **between 2007–08 and 2009–10** be explained?

(5)

(b) With reference to the information provided, explain the problems resulting from the deterioration in the public finances for the UK **or** any country of your choice.

(8)

(c) Evaluate the reasons why the UK economy was in a weak state following the financial crisis in autumn 2007.

(10)

*(d) Evaluate the likely effectiveness of monetary policy in the management of the economy in the light of the information provided.

(12)

(Total for Question 13 = 35 marks)

14 The European Central Bank introduced a new round of quantitative easing (QE) in March 2020, purchasing up to €750 billion of assets. The objective of this QE was to reduce the serious risks to the effectiveness of monetary policy resulting from a significant recession. The European Central Bank's target for inflation remains at 'below but close to 2%'.

(Source adapted from: https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200318_1~3949d6f266.en.html)

Evaluate the effectiveness of quantitative easing during 'a significant recession'. ( )

(Total for Question 14 = 25 marks)

15 In 2018, the United States Government cut the corporation tax rate (tax on company profits) from 35% to 21%. Income tax rates for US citizens were also reduced: for example, the top rate of income tax was cut from 39.6% to 37%.

(Source adapted from: https://www.nytimes.com/)

Evaluate the likely impact of cutting tax rates as a policy to increase economic growth. ( )

(Total for Question 15 = 25 marks)

16 Japan's budget deficit for 2017/18 is expected to be 4.6% of GDP. Its national debt is forecast to increase to above 250% of GDP by 2019.

Evaluate the impact of a large fiscal deficit and national debt on a country's economy. ( )

(Total for Question 16 = 25 marks)

17 In 2016 the UK Chancellor of the Exchequer announced that the government would spend an extra £23 billion on innovation and infrastructure over the following five years.

Evaluate the likely economic effects of this planned increase in government expenditure. ( )

(Total for Question 17 = 25 marks)

18 In 2012, it was estimated that Japan's national debt was equal to 214.3% of its GDP, and Greece's national debt was equal to 161.3% of its GDP.

Evaluate the likely impact of measures which a government could take to reduce the economy's national debt. Refer to a developed economy of your choice in your answer. ( )

(Total for Question 18 = 25 marks)

*19 (a) The national debt of countries in the European Union (EU) increased on average from 62.2% to 85.2% of GDP between 2008 and 2012.

To what extent might the rise in the national debt of an EU country be a cause for concern?

(20)

(b) Between 2008 and 2013, the average VAT (sales tax) rate in the European Union increased by 2 percentage points. Many EU countries also made significant cuts in welfare payments.

Evaluate the economic impact of increases in indirect taxes and cuts in welfare payments as measures to improve public finances.

(30)

19 0

***20** (a) The budget deficits of many countries including France, Greece, Ireland and the UK fell between 2009 and 2013.

Assess the likely causes of such a decrease in the budget deficit of a country of your choice.

(20)

(b) In 2012, France announced its intention to increase its top rate of income tax from 46.7% to 75%.

Evaluate the likely economic effects of such an increase in the marginal rate of income tax.

(30)

20 50

*21 In 2012, EU agricultural subsidies amounted to €76 billion ($94 billion) and US agricultural subsidies were €138 billion ($172 billion).

Evaluate the economic effects of such agricultural subsidies on the global economy.

(30)

21 30

*22 To what extent is monetary policy the most effective way of stimulating economic growth? Refer to at least one example of a developed economy in your answer. **(30)**

22 30

***23** (a) Many countries have experienced a substantial rise in their fiscal deficits since 2008. Assess the factors which might explain this trend in the public finances of a country of your choice. **(20)**

(b) Evaluate the case for cutting public expenditure rather than raising taxes as a means of reducing fiscal deficits. **(30)**

23 50

***24** In the 2009 budget the UK government announced that a new 50% rate of income tax would be introduced in 2010. This creates three marginal tax rates of 20%, 40% and 50%, instead of two. Evaluate the likely economic effects of this change in the tax structure. **(30)**

24 30