AQA

A-level ECONOMICS

Paper 2 National and international economy

Tuesday 12 June 2018 Afternoon Time allowed: 2 hours

Materials

For this paper you must have:
- an AQA 12-page answer book
- a calculator.

Instructions
- Use black ink or black ball-point pen. Pencil should only be used for drawing.
- Write the information required on the front of your answer book. The **Examining Body** for this paper is AQA. The **Paper Reference** is 7136/2.
- In **Section A**, answer **EITHER** Context 1 **OR** Context 2.
- In **Section B**, answer **one** essay.

Information
- The marks for questions are shown in brackets.
- The maximum mark for this paper is 80.
- There are 40 marks for **Section A** and 40 marks for **Section B**.
- You will be marked on your ability to:
  - use good English
  - organise information clearly
  - use specialist vocabulary where appropriate.

Advice
- You are advised to spend 1 hour on **Section A** and 1 hour on **Section B**.

Section A

Answer **EITHER** Context 1 **OR** Context 2.

EITHER

Context 1 **Total for this context: 40 marks**

The UK's trade balance

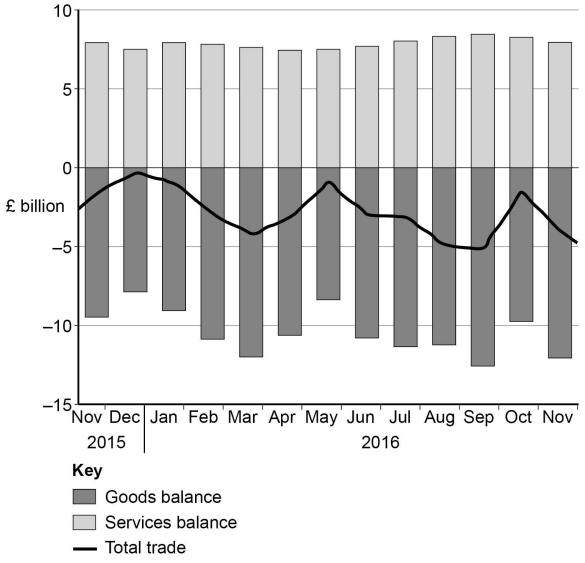
Study **Extracts A, B and C** and then answer **all** parts of Context 1 which follow.

Extract A

Figure 1: Sterling effective exchange rate index, November 2015 to November 2016



Figure 2: Balance of UK trade, November 2015 to November 2016



Source: ONS

Extract B: The UK's trade deficit

In September 2016, the UK's trade deficit with the rest of the world widened unexpectedly. Exports fell, despite a sharp fall in the value of the pound. The trade deficit in goods alone rose to £12.7bn. The value of imports increased by £1.3bn to £38.8bn, while exports fell by £0.2bn to £26.1bn. The rebalancing of the UK economy to achieve export-led growth has not happened yet.

The disappointing trade figures suggest that the 16% fall in the value of the pound since the EU referendum in June 2016 has failed to lift exports significantly. An economist at Scotiabank, said "If we are lucky, the weak pound may boost exports, but export growth tends to be driven more by the strength of overseas demand, rather than the exchange rate." Others point to a lack of competitiveness and low productivity as being central to the UK's poor export performance.

In Quarter 3 of 2016, the UK economy grew much faster than many economists had initially expected, with signs that the growth had been supported by rising consumer spending. This may be one of the reasons why imports of goods have increased. A statistician at the ONS, said that "In this first full quarter since the EU referendum, there is little evidence of the lower pound feeding through into trade volumes or prices."

In recent years, the UK's earnings on assets overseas have fallen relative to the earnings of foreign investors in the UK. This contributed to the deterioration in the

current account balance, leading to a record deficit of 5.4% of GDP in 2015. Although some argue that a current account deficit is not a problem, others point to the worryingly large and persistent nature of the deficit. The effects on employment, the need to attract inward investment and the possible negative effects on growth and living standards are among the causes for concern.

Source: News reports, 2016

Extract C: Germany's trade surplus

Germany's surplus on the current account of its balance of payments surged to a record level in 2015, at 8.5% of GDP. It has now overtaken the Chinese surplus as the largest imbalance in the world. This imbalance is clearly causing problems inside the eurozone and globally. If the German current account is in surplus, it implies that other nations are in deficit.

Although the German government views the surplus as evidence of economic success, there is growing pressure from other countries and the European Commission for Germany to take steps to reduce the surplus. Trade deficits and surpluses may be self-correcting in a floating exchange rate system, but as Germany is part of the eurozone, its currency does not fluctuate against those of other member countries, since they all use the euro.

Germany's surplus has been increased by low oil prices and the relatively low value of the euro. Healthy growth in other European nations has also contributed to strong demand for German exports. Whatever the reason for Germany's surplus, the UK may only look on in envy.

Source: News reports, 2016

0 1 Using the data in **Extract A (Figure 1)**, calculate the change in the effective exchange rate index, as a percentage, between November 2015 (point A) and November 2016 (point B). Give your answer to **two** decimal places.

[2 marks]

0 2 **Extract B** describes the trade figures as 'disappointing'.

Explain how the data in **Extract A (Figure 2)** show that the UK's trade performance has been 'disappointing' given the fall in the value of the pound since November 2015.

[4 marks]

0 3 **Extract C** (lines 8–9) states 'Trade deficits and surpluses may be self-correcting in a floating exchange rate system.'

With the help of a diagram showing the supply of and demand for a currency, explain how a floating exchange rate may help to correct a trade surplus.

[9 marks]

0 4 **Extract B** (lines 19–21) states 'Although some argue that a current account deficit is not a problem, others point to the worryingly large and persistent nature of the deficit.'

Using the data in the extracts and your knowledge of economics, assess the impact of a persistent current account deficit on the macroeconomic performance of the UK economy.

[25 marks]

Do **not** answer Context 2 if you have answered Context 1.

OR

Context 2 **Total for this context: 40 marks**

Monetary policy and stability

Study **Extracts D, E and F** and then answer **all** parts of Context 2 which follow.

Extract D

Figure 3: UK household gross debt to income, 2006 to 2020

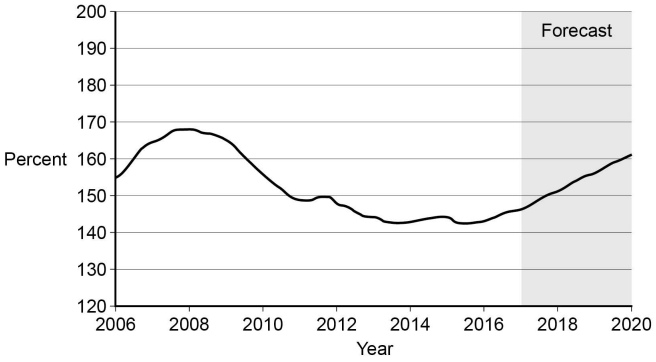


Figure 4: Household saving ratio, 2006 to 2016

Year	Saving ratio (%)
2006	7.6
2008	7.5
2010	11.2
2012	9.3
2014	8.4
2016	7.1

Source: ONS

Extract E: Financial regulation and monetary policy

In response to the lessons learned from the global financial crisis of 2007/08, the government of the UK has introduced major reforms to financial markets. The government recognised that systemic risk, moral hazard and imperfect information had all contributed to the credit crunch and subsequent recession in the UK. As a result, changes have been made to try to avoid a recurrence of failing banks and expensive state-backed bailouts.

The Prudential Regulation Authority (PRA) was established to ensure the stability of firms offering financial services and the Financial Conduct Authority (FCA) was set up to regulate the industry. Also, the Bank of England is responsible for supervising the whole financial system through the Financial Policy Committee (FPC). The FPC identifies and attempts to reduce risks in the system. The new framework is seen as the biggest change for the Bank of England since it was given operational independence for the conduct of monetary policy in 1997.

Since 2013, the Treasury has required the Bank of England to place more emphasis on helping the government to achieve its objectives for growth and employment, in addition to its central objective of maintaining price stability. However, some argue that trying to maintain stable prices and low unemployment could create trade-offs.

The Monetary Policy Committee's decision to lower Bank Rate to 0.5% in 2009, and the subsequent decision to lower it to 0.25% in 2016, have been instrumental in the UK's sustained recovery and return to low levels of unemployment. The Bank of England has also used quantitative easing (QE) to boost consumption and investment. Maintaining low interest rates is considered by many to be vital for both consumer and business confidence.

Source: News reports, 2016

Extract F: A new financial crisis?

Has increased regulation worked or could the UK be on the verge of another financial crisis? The Bank of England is keeping a close watch on consumer spending amid signs that households are reducing their savings and building up debts. The Governor of the Bank, Mark Carney, said that consumption has been high in recent times, helping the economy, but he repeated the warning that living costs were likely to rise on the back of a weak pound and put a strain on households' real incomes. He also stated: "The saving ratio has fallen towards its pre-crisis lows, and consumer borrowing has accelerated noticeably."

It can be argued that rising borrowing has been caused by Bank Rate being kept too low for too long. The Austrian economist, Friedrich Hayek, highlighted artificially low interest rates and excessive credit creation as being the main causes of cyclical instability, damaging both investment and confidence. Asset price bubbles occur, including unsustainable rises in house prices, and eventually boom turns to bust. A major cause of the financial crisis in 2007/08 was arguably the unsustainably high level of debt that had been accumulated, but total world debt is now far in excess of the 2008 level.

Some form of financial crisis appears to occur every 7 to 10 years. As inflation rises, there will come a time when the Monetary Policy Committee decides to increase Bank Rate. This will affect many people who have become accustomed to cheap credit and who are tied into mortgages where the monthly repayments vary with interest rates.

Source: News reports, 2016

0 5 Using the data in **Extract D (Figure 4),** calculate the average amount saved per household in 2016 if average household income was £26 300. Give your answer to the nearest pound.

[2 marks]

0 6 Explain how the data in **Extract D (Figures 3 and 4)** show that consumer confidence may have risen since 2014.

[4 marks]

0 7 **Extract E** (lines 16–17) states 'However, some argue that trying to maintain stable prices and low unemployment could create trade-offs.'

With the help of a diagram, explain why a trade-off between price stability and low unemployment might occur.

[9 marks]

0 8 **Extract F** (lines 10–12) states 'The Austrian economist, Friedrich Hayek, highlighted artificially low interest rates and excessive credit creation as being the main causes of cyclical instability.'

Using the data in the extracts and your knowledge of economics, evaluate the view that maintaining low interest rates for a sustained period of time may be damaging to the UK's macroeconomic stability.

[25 marks]

Section B

Answer **one** essay from this section.

Each essay carries 40 marks.

EITHER

Essay 1

An African Development Bank report showed that Angola received more direct foreign investment than any other African country in 2015. Angola is a less economically developed country (LEDC) that has had fluctuating economic growth in the past. Despite having suffered from a long civil war which ended in 2002, many multinational corporations (MNCs) are now investing heavily in Angola's growing economy.

0 9 Explain the main barriers that LEDCs face when attempting to achieve stable, long-term economic growth.

[15 marks]

1 0 Evaluate the view that MNCs play a positive role in the development of LEDCs.

[25 marks]

OR

Essay 2

In the 2016 Autumn statement, the UK Chancellor of the Exchequer, Philip Hammond, officially abandoned the government's policy of trying to achieve a budget surplus by 2020. While some criticise the government for failing to achieve its fiscal target, others argue that the government should be doing more to help the supply side of the economy.

1 1 Explain how fiscal policy can be used to try to improve the supply side of an economy.

[15 marks]

1 2 Evaluate whether achieving a budget surplus is a desirable objective of economic policy.

[25 marks]

OR

Essay 3

In July 2017, more people were employed in the UK than ever before. At the same time, the UK unemployment rate fell to 4.3%, the lowest rate for 40 years. Whilst this suggests that the government's policies for employment are working, some claim that zero-hours contracts, low real wages and temporary jobs have made many people worse off.

1 3 Explain the causes of cyclical **and** structural unemployment.

[15 marks]

1 4 Assess the view that falling unemployment will inevitably lead to an improvement in the standard of living for people in the UK.

[25 marks]

END OF QUESTIONS

There are no questions printed on this page

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