



Rewarding Learning
ADVANCED
General Certificate of Education
2022

Economics

Assessment Unit A2 2
assessing
Managing the Economy in a Global World



AEC21

[AEC21]
MONDAY 6 JUNE, AFTERNOON

TIME

2 hours.

INSTRUCTIONS TO CANDIDATES

Write your Centre Number and Candidate Number on the Answer Booklet provided.
Answer **all** questions in Section **A** and **B** and **one** question in Section **C**.
You are permitted to use a calculator in this paper.

INFORMATION FOR CANDIDATES

The total mark for this paper is 90.

- Section A: 20 marks
- Section B: 40 marks
- Section C: 30 marks

Figures in brackets printed down the right-hand side of pages indicate the marks awarded to each question or part question.

ADVICE TO CANDIDATES

You are advised to take account of the marks for each part question in allocating the available examination time.

Quality of written communication will be assessed in Questions **5**, **6(b)**, **(c)** and **(d)**, **7** and **8**.
Quantitative skills will be assessed where appropriate.

Section A (20 marks)

Answer all questions

- 1 Two countries, Highland and Lowland, are producing apples and pears under the conditions assumed by the theory of comparative advantage. The table below shows the production possibilities if both countries divide their resources equally between the production of apples and pears.

Country	Apples (tonnes)	Pears (tonnes)
Highland	3000	3000
Lowland	1500	500

Using the information in the table above, calculate what the total output of pears would be if both countries specialised completely according to their comparative advantage. [2]

- 2 Ten years after the financial crisis of 2008, Bank of England governor Mark Carney stated that “despite numerous reforms to the financial system, some UK banks are still considered to be too big to fail”.

With reference to the example above, explain the term moral hazard. [4]

- 3 The table below gives estimates of the long-run price elasticity of demand of UK exports to the Eurozone for selected sectors.

Sector	Price elasticity of demand
Agricultural products	-0.20
Foodstuffs	-0.65
Pharmaceuticals	-0.70
Textiles and footwear	-0.46
Machinery and equipment	-1.20
Aerospace	-0.16

Using the information in the table above, explain which sector is likely to benefit most from a 15% reduction in the value of sterling against the euro. [4]

- 4 The table below shows selected components of a country's balance of payments accounts for 2019 and their relationship to the country's gross domestic product (GDP).

Balance of trade in goods (\$bn)	Balance of trade in services (\$bn)	Net secondary income (\$bn)	Current account balance (\$bn)	Current account balance as a % of GDP
105.6	-32.4	-14.6	39.3	6.0

Using the information in the table above, calculate:

- (a) The primary income balance for this country in 2019. [2]
- (b) The country's gross domestic product (GDP) in 2019. [2]
- 5 The European Central Bank (ECB) has stated recently that it is ready to restart its quantitative easing programme amid concerns of low growth and deflation in Eurozone countries such as France and Germany.

With the aid of an appropriate diagram, analyse the likely impact on the German economy of a decision by the ECB to relaunch a quantitative easing programme. [6]

Section B (40 marks)

Answer all questions

The following passages were compiled in August 2019. Read them carefully and answer the questions which follow.

6 Case study: “From trade war to currency war”

Source 1: Markets increasingly volatile

On 5 August 2019, the Chinese authorities allowed the yuan to plunge against the US dollar to a level not seen since the financial crisis of 2008, as shown in **Fig. 1** below. The move was seen by many as an attempt by the Beijing authorities to lessen the impact of US tariffs on Chinese exporters and to send a warning to Washington that they are willing to use their currency as a weapon in the so-called trade war.

Currency traders are worried that this move could significantly increase the volatility of the foreign exchange market. One of their fears is that governments of other countries might try and weaken their currencies in an attempt to shield their economies from a global slowdown.

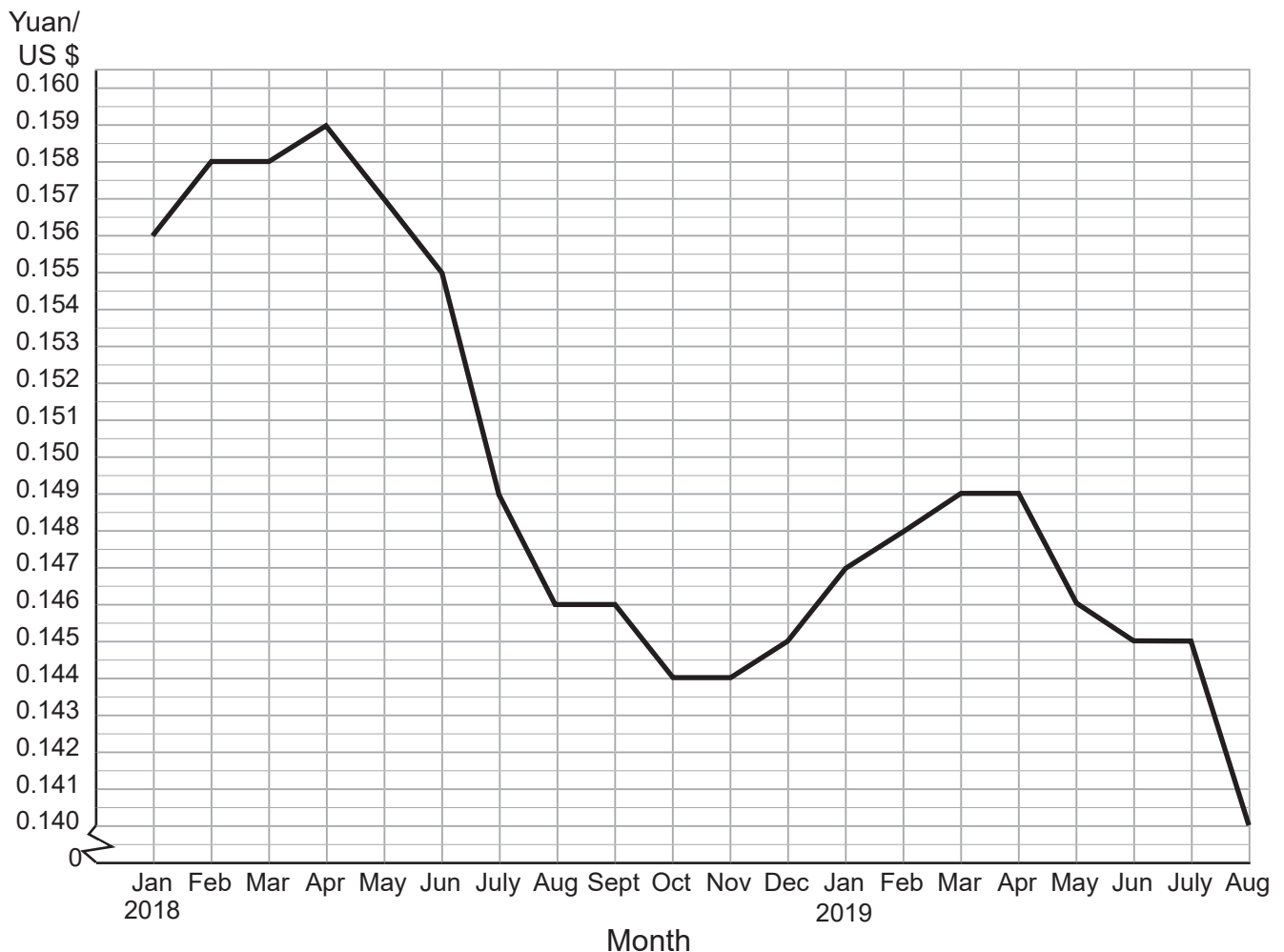


Fig. 1: Value of the yuan against the US dollar, January 2018–August 2019

The fall in the value of the yuan has led to steep rises in “safe haven” currencies such as the Japanese yen and the Swiss franc. In response, the Swiss National Bank began buying foreign currency and the Japanese authorities issued a warning to investors that they were ready to intervene if excessive gains threatened to hurt their export-reliant economy.

Source 2: Washington labels Beijing a currency manipulator

The US has officially named China as a currency manipulator in a statement which will intensify tensions between the world’s two major economies. The US Treasury defines currency manipulation as countries deliberately influencing the exchange rate between their currency and the US dollar to gain an “unfair competitive advantage in international trade”.

In its announcement, the US Treasury said: “China has a long history of facilitating an undervalued currency through protracted, large-scale intervention in the foreign exchange market. In recent days, China has taken significant steps to devalue its currency, while maintaining substantial foreign exchange reserves.”

However, China rejected the charge, and actually moved to contain the yuan’s slide in the foreign exchange markets. In a statement, the Chinese authorities claimed that the fall in the yuan was natural and entirely predictable given the tariffs imposed by Washington on Chinese goods.

This claim has been backed up by currency trader Maria McEvoy, who stated: “Despite claims from Washington of currency manipulation, the fall in the value of the yuan against the dollar since the beginning of 2018 has more fundamental causes. The main reason is the strong dollar; the US economy has been growing strongly in recent years and as a result the Federal Reserve has increased interest rates five times since the beginning of 2018. At the same time, the Chinese economy has slowed and the Chinese stock market has lost almost 20% of its value since the beginning of the year. This has spooked investors who are actively seeking safer currencies. If you add in the tariffs imposed by the Trump administration and the resulting reduction in demand for Chinese goods in the US, it is not hard to see why the yuan has fallen.”

Source 3: President Trump calls on the Fed to cut interest rates

Donald Trump has stepped up the pressure on the Federal Reserve to cut interest rates with a personal attack on Jerome Powell, the man he handpicked to run the US central bank. The US president has taken to Twitter to insult Mr Powell and said he had let the country down by refusing to cut interest rates in response to what he sees as currency manipulation by the Chinese.

Some of President Trump's more vocal supporters have gone even further. They suggest that the Federal Reserve should intervene directly in the currency markets to buy yuan in order to raise its value against the dollar.

However, Maria McEvoy has warned against such a move, and pointed to the fact that it would be difficult for the US to influence the value of the yuan by purchasing it. In a report to investors, she argued that there were far more effective policies available to the US authorities if they wished to reduce the negative impact of the yuan's fall in value. "If the US really wants to put pressure on the Chinese authorities, they could increase the level of tariff from the current average level of 10% to at least 25%", she said. "They could support struggling US firms by mirroring the subsidies given to Chinese firms by the Beijing authorities, and they could prohibit US financial institutions from investing in Chinese equity and bond markets, and hence make it more difficult for Chinese firms to raise finance. Alternatively, they could take the opposite approach and engage directly with the Chinese authorities in an attempt to negotiate a mutually beneficial free trade agreement."

- (a) Using the information in **Fig. 1**, describe the trend in the value of the yuan against the US dollar between January 2018 and August 2019. [4]
- (b) With the aid of an appropriate diagram, analyse the possible causes of the fall in the value of the yuan against the dollar since January 2018. [9]
- (c) Examine the likely impact on the US economy of a fall in the value of the yuan against the US dollar. [12]
- (d) Evaluate some of the steps the US government might take to deal with the fall in the value of the yuan against the US dollar. [15]

Section C (30 marks)

Answer one question

- 7 In 2019 the Turkish Foreign Minister stated that joining the European Union (EU) was still top of the Turkish government's agenda, and he called on the EU to help Turkey remove the difficulties it faced in its bid to join the bloc. He also claimed that Turkish membership of the EU would benefit the EU just as much as it would benefit Turkey.

Evaluate the advantages and disadvantages to Turkey of joining the EU. [30]

- 8 Economists have long argued that globalisation benefits individuals, businesses and national governments through the international exchange of money, ideas and culture. However, some critics claim that it adversely affects both developed and developing economies and adds to the destruction of the earth's fragile ecosystem.

Critically examine the view that globalisation has been bad for both more developed and less developed countries. [30]

THIS IS THE END OF THE QUESTION PAPER

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