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General Certificate of Education

2019

Economics

Assessment Unit A2 2

assessing

Managing the Economy in a Global World



AEC21

[AEC21]

THURSDAY 23 MAY, MORNING

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**.

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. In questions involving calculations, you are advised to show your workings. 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

Answer all questions (20 marks)

- 1 The table below shows the money supply, the average price level and the number of transactions for an imaginary economy.

Average price level	£300
Money supply	£150,000
Number of transactions	1000

Using the information in the table, calculate the velocity of circulation for this economy. [2]

- 2 On 23rd August 2018, the UK pound was trading on the foreign exchange markets at a rate of £1 to €1.12 and £1 to US\$1.31.

Using the information above, calculate the value of the US dollar in euros. [2]

- 3 The table below shows the production levels of apples and bananas in two countries, if both countries aim to be self-sufficient and divide their resources equally between the production of apples and bananas.

Country	Apples (millions)	Bananas (millions)
Samland	30	30
Masland	15	5
Total	45	35

- (a) With reference to the information in the table above, explain the difference between an absolute advantage and a comparative advantage. [4]

- (b) Using the information in the table, explain why Samland would be happy to trade with Masland at a rate of two apples to one banana. [2]

4 In the second quarter of 2018, Foreign Direct Investment (FDI) in the UK was £22,199 million. This figure, which represented 4.24% of UK GDP, meant that the UK maintained its position as the EU's most favoured destination for FDI.

(a) Explain what is meant by Foreign Direct Investment (FDI). [2]

(b) Using the information above, estimate UK GDP for the second quarter of 2018. [2]

5 The Global Sugar Alliance has called on the Pakistan government to remove the subsidies it pays to domestic sugar producers. They claim that the subsidies restrict the ability of foreign producers to access Pakistani markets and distort the world price of sugar.

With the aid of an appropriate diagram, analyse the likely impact of removing domestic subsidies on the Pakistani sugar market. [6]

Section B: Case study

Answer all questions (40 marks)

The following passages were compiled in August 2018. Read them carefully and answer the questions which follow.

6 World economy teeters on the brink of trade war

Source 1: Trade war declared between the United States of America and China

On 6th July 2018 the US officially entered into a trade war with China. The US slapped 25% tariffs on more than 800 Chinese products ranging from dishwashers to aircraft tyres with an estimated value of \$34 billion. China immediately responded with tariffs of its own, insisting Donald Trump had started the “biggest trade war in economic history”.

In the classic “tit for tat” response, the US promptly issued a list of additional products it was considering imposing tariffs on, this time to a value of \$200 billion dollars, with President Trump even tweeting that he was “ready to go to 500” – a reference to the total \$500 billion value of US imports of Chinese goods.

The imposition of the tariffs is in response to what Mr Trump sees as the unfair and unsustainable trade in goods position between the US and China, which is illustrated in **Fig. 1** below.

Fig.1 removed due to copyright issues

Fig. 1: US–China trade in goods balance 2006–2017

The declaration of a trade war with China poses significant problems for the rules-based system of world trade, which is overseen by the World Trade Organization (WTO), coming as it does so soon after the imposition by the US of tariffs of 25% and 10%, respectively, on all imports of steel and aluminium.

China regards the first wave of American tariffs as a unilateral violation of global trading rules and has lodged a complaint with the WTO. However, Mr Trump believes that China started the conflict by stealing US intellectual property. He is unafraid of escalating the dispute as he believes he has the upper hand in terms of economic power and is no fan of the world trading system. Indeed, he believes that the US may well be better off withdrawing from the WTO and negotiating trading agreements independently.

Source 2: Could trade war become a currency war?

The trade war raging between China and the US shows signs of spiralling over into a currency war after US president Donald Trump accused Beijing's Central Bank of devaluing the yuan against the US dollar. His comments come after data showed that the yuan had fallen by 5% against the US dollar in the last four weeks. In a tweet, President Trump said, "China, the EU and others are manipulating their currencies and interest rates down while the US dollar strengthens, eroding our big competitive advantage."

The Chinese authorities have denied that they are purposely manipulating the yuan downwards, claiming that its fall in value reflects market forces rather than direct intervention. A Beijing spokesman stated that "the fall in the value of the yuan against the dollar reflects the predicted negative impact to our economy of trade restrictions in the US. As well as this, markets are expecting US monetary authorities to continue the policy of raising interest rates. Indeed, one could argue that it is not the actions of the People's Bank of China that has devalued the yuan, but rather the actions of the US authorities".

The accusation of currency manipulation by the Chinese government comes amid threats by the US president to impose tariffs on all Chinese imports into the US and begin a full-scale trade war.

The game being played out by Washington and Beijing is like a high-stakes poker game! Each time the US raises its stake by adding new tariffs, China responds with an equal amount of import duties on American goods. Both sides want the other to blink first. However, the difficulty for Beijing is that while the US bought \$505 billion of goods from China last year, the Chinese only bought \$130 billion worth of US goods. This means that Beijing will run out of imports to tax long before Washington does.

An obvious alternative to further tariffs is to make Chinese goods more competitive by weakening the yuan and so counteracting the impact of US tariffs. It is little wonder then that the Beijing authorities are actively considering such an option, even if there is no solid proof that they have already initiated the policy.

Source 3: Who gains and who loses from a trade war?

While the rhetoric of a trade war may be popular with many of those who voted for Mr Trump, it is much less popular among economists. Indeed, many in Trump's own Republican Party have traditionally favoured free trade.

Supporters of Mr Trump point out that the US trade deficit is unsustainable and represents a huge leakage from the US economy. They argue that the US is such a large free trade area itself that it does not need to trade internationally in the same way as smaller economies do and, as such, a trade war will be easy for the US to win.

However, analysis of the tariffs on steel and aluminium by the consultancy firm Trade Solutions has estimated that while the tariffs might create as many as 33 000 additional jobs in metal production, they will destroy 179 000 jobs in industries which use these metals in their production processes. They also point out that the tariffs will ultimately lead to higher prices for consumers and put pressure on the Federal Reserve to raise interest rates, which in turn could knock as much as 1% off GDP growth over the next few years.

Sinead Douglas, chief economist at Trade Solutions, stated: "The US has long been the engine of global trade and growth, but in Mr Trump they have a dangerous driver. His reckless actions and total disregard for the hard-fought world trading order risks harming not only the US's trading partners but also US consumers, producers and ultimately the government itself."

- (a) Describe the trend in the balance of trade in goods between the US and China from 2006 to 2017. [4]
- (b) With the aid of an appropriate diagram, analyse how the imposition of "trade restrictions in the US and an expectation that US monetary authorities will continue the policy of raising interest rates" could cause a fall in the value of the yuan against the US dollar. [9]
- (c) Critically examine the likely impact on the Chinese economy of a policy of suppressing the value of the yuan against the US dollar. [12]
- (d) Evaluate the view that a trade war is bad for US consumers, producers and ultimately the government itself. [15]

Section C: Essay section

Answer one question (30 marks)

- 7 While once considered a byword for economic and social progress, and deemed to be an unstoppable force for good, the term globalisation has become tarnished in recent years. In fact, it is increasingly blamed for a wide range of economic problems including income inequality, cultural erosion and political instability.

Critically examine the impact of globalisation on the UK economy. [30]

- 8 A 2018 report by the Institute for Fiscal Studies claimed that the Chancellor would have to impose tax rises of approximately £41 billion per year to meet his target of balancing the public finances by 2025. The report came at a time when there was growing pressure on the Chancellor to abandon his target for a balanced budget and increase the money allocated to key public services such as health, policing and education.

Critically examine the view that governments should always run balanced budgets. [30]

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