Write your name here

Surname	Other names

Centre Number | Candidate Number

Edexcel GCE

Economics

Advanced
Unit 4: The Global Economy

Friday 25 June 2010 – Morning
Time: 2 hours

Paper Reference
6EC04/01

You do not need any other materials.

Total Marks

Instructions

- Use **black** ink or ball-point pen.
- **Fill in the boxes** at the top of this page with your name, centre number and candidate number.
- Answer **one** question from Section A and **one** question from Section B.
- Answer the questions in the spaces provided
  – *there may be more space than you need.*

Information

- The total mark for this paper is 100.
- The marks for **each** question are shown in brackets
  – *use this as a guide as to how much time to spend on each question.*
- Questions labelled with an **asterisk** (*) are ones where the quality of your written communication will be assessed
  – *you should take particular care on these questions with your spelling, punctuation and grammar, as well as the clarity of expression.*
- Calculators may be used.

Advice

- Read each question carefully before you start to answer it.
- Keep an eye on the time.
- You are advised to divide your time equally between Section A and Section B.
- Check your answers if you have time at the end.

Turn over ▶

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Section A: Answer ONE of the questions in this section

You are advised to spend a maximum of 60 minutes on this section.

1 *(a) Examine the causes of income and wealth inequality in the UK **or** any country of your choice.

(20)

*(b) 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)

2 *(a) To what extent is primary product dependency a constraint on economic growth and development in developing countries?

(20)

*(b) Evaluate **four** ways in which economic growth and development might be promoted in developing countries.

(30)

3 *(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)

Do not use pencil. Use black ink or ball-point pen.
Put a cross in the box indicating the question from Section A that you have chosen (☒).
If you change your mind, put a line through the box (☒) and then indicate your new question with a cross (☒).

Chosen Question Number: **Question 1** ☒ **Question 2** ☒ **Question 3** ☒

TOTAL FOR SECTION A: 50 MARKS

Section B: Answer ONE of the questions in this section.

You are advised to spend a maximum of 60 minutes on this section.

If you answer question 4 put a cross in this box ☒ .

4 The Global Financial Crisis

Figure 1: Real GDP: % Change on Previous Year

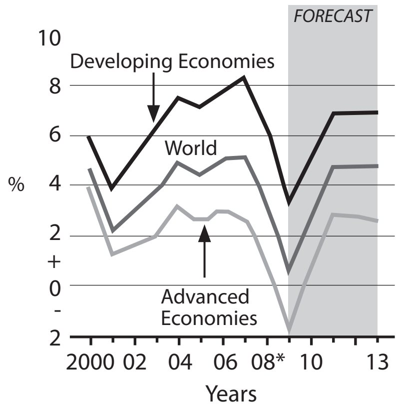
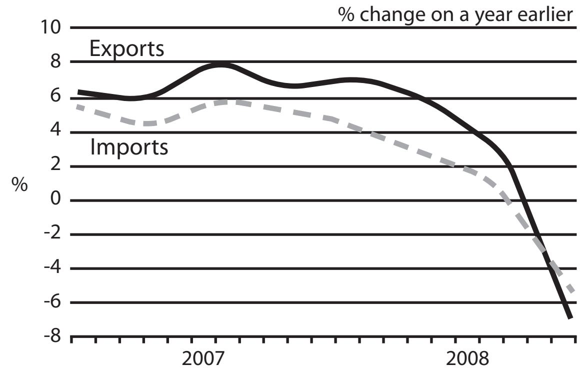
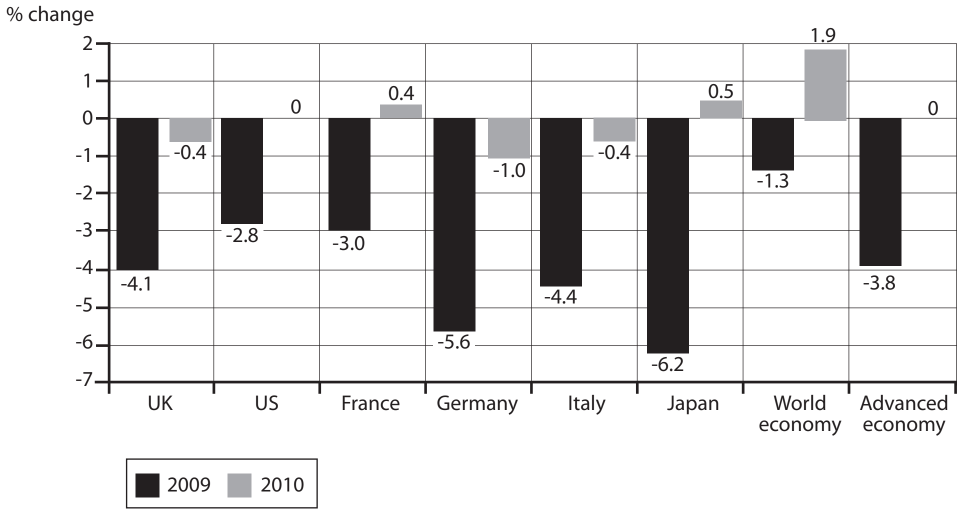


Figure 2: Value of World Exports and Imports: % Change on a Year Earlier



Source for Figure 1: *The Economist*, 21 February 2009 (Turning their backs on the world).
Source for Figure 2: *The Sunday Times*, 29 March 2009 (Export Giants sink most as World Trade Slumps by David Smith).

Figure 3: Real GDP Forecasts in 2009 and 2010, selected countries (% change)



Source: IMF.

Extract 1: Globalisation in retreat?

Between 2000 and 2008 the value of world trade in goods and services rose by 12% a year. Free trade has made the biggest contribution to more than 60 years of global prosperity. However, a golden age of global trade has come to an abrupt end. The economic meltdown has popularised a new term: deglobalisation. For the first time for many years, trade and investment flows are declining, but is globalisation really ending? At the end of 2008, the International Monetary Fund (IMF) said the world economy would grow at 2.2% in 2009, but by March 2009 it expected negative growth of between 0.5% and 1% over the year. Moreover, this recession appears to be affecting most economies simultaneously.

Falling trade has been the transmission mechanism from the financial crisis to the world's factories. In the second half of 2008 the value of trade fell: Pascal Lamy, the World Trade Organisation's (WTO) director-general estimates that world trade dropped by 5% in November 2008, by a further 7% in December and another 7% in January 2009.

The downturn has been sharpest in the countries which opened up most to world trade, especially East Asia's tiger economies. Singapore's exports are 186% of GDP; its economy shrank at an annualised rate of 17% in the last three months of 2008. Taiwan's exports are 60% of its GDP and its economy may fall as much as 11% this year. The downturn will also hurt rich countries which specialise in manufacturing: the IMF forecasts a contraction of about 2%, but Germany and Japan, who are big exporters of capital goods, cars and electronics are expected to shrink by much more (see Figure 3).

In contrast, the biggest emerging economies are doing less badly so far. In India, where exports are only around 15% of GDP, growth is expected to be 5% for 2009 and China was still growing by 6.8% in 2008.

There are several reasons why the banking system's problems have affected trade so quickly. First, the global recession is more severe than most thought possible. Secondly, according to the World Bank, global supply chains mean that a downturn quickly spreads. The trade interdependence of economies has rapidly transmitted the recession around the globe. Another problem is that trade finance has dried up. Firms have found it difficult to get export credits, without which they cannot do business.

A further issue is that the world recession is leading to protectionism. Lamy identifies several types, including import tariffs and subsidies to support industries which have faced difficulties.

Financial deglobalisation is hitting countries in a variety of ways. Foreign direct investment (FDI) fell by 21% in 2008 and is expected to fall a further 12%-15% in 2009. Rich countries seem to have suffered most so far. They have seen FDI falls of 33% on average and by 50% or more in Britain, Italy and Germany while Finland and Ireland have seen net outflows. FDI flows to developing countries were still growing in 2008, but by only 4%, after a rise of 20% in 2007. Flows to big South American countries were up by about 20% and those to India more than 100%.

Meanwhile, small countries that developed industries such as tourism, which grew as a result of globalisation, are also suffering. The WTO says international tourist numbers fell 1% in the second half of 2008, which may not sound bad, but this compares with growth of more than 5% per annum in the previous four years. In the Caribbean, visitors may fall by 33% this season: hotels are half empty, flights are being cancelled and fiscal deficits are rising.

Source: adapted from *The Economist*, 21 February 2009 'Turning their backs on the world' and *The Sunday Times*, 29 March 2009 'Export giants sink most as world trade slumps' by David Smith.

(a) Explain the characteristics of 'deglobalisation' (*Extract 1, line 4*).

(5)

(b) Explain why some countries may experience a more severe recession than others.

(8)

(c) Examine the possible effects of the global recession on countries with well-established tourist industries.

(10)

*(d) With reference to lines 26–34 of Extract 1, evaluate reasons why the banking crisis has hit world trade so severely.

(12)

*(e) In the light of the global recession, assess the likely economic effects of an increase in protectionism on the world economy.

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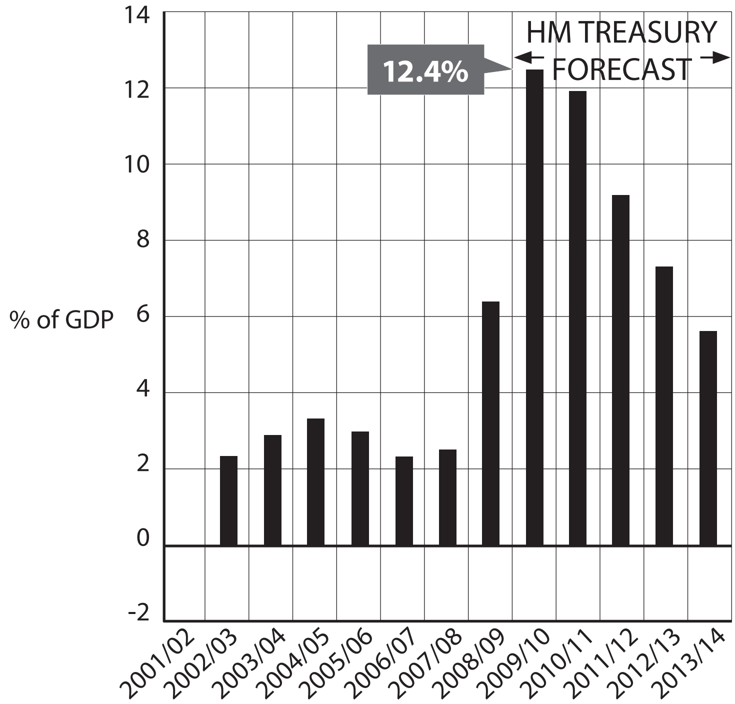
(15)

(Total for Question 4 = 50 marks)

If you answer question 5 put a cross in this box ☒.

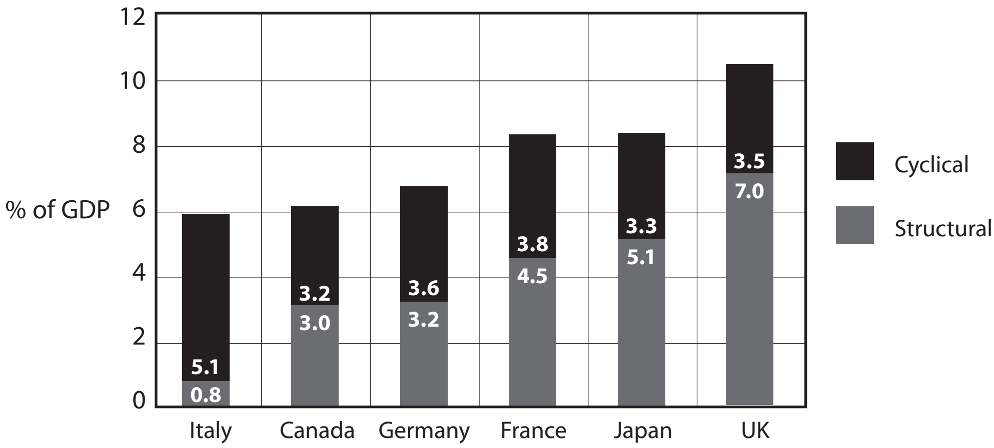
5 Public Finance

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



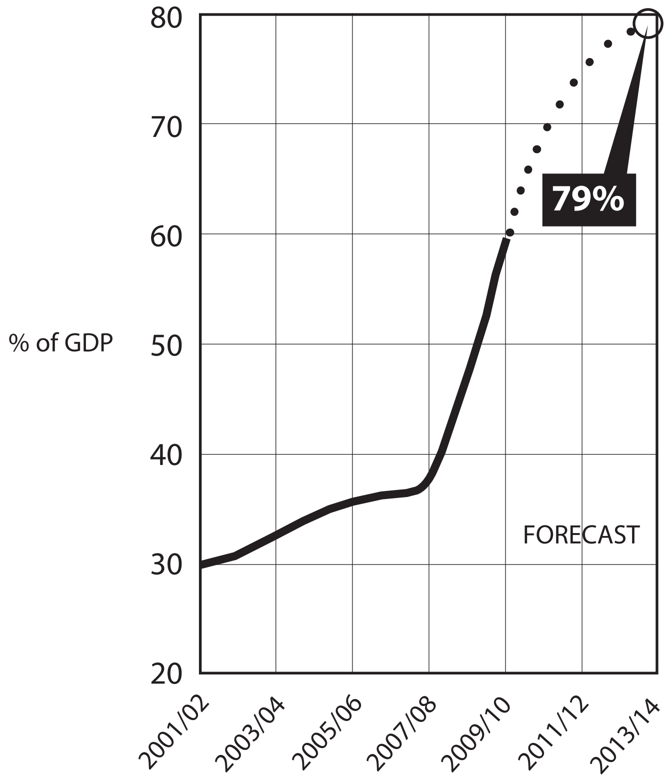
Source: *The Independent*, 23 April 2009 Sean O'Grady 'So much for balancing the books: this is worse than we ever imagined'

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



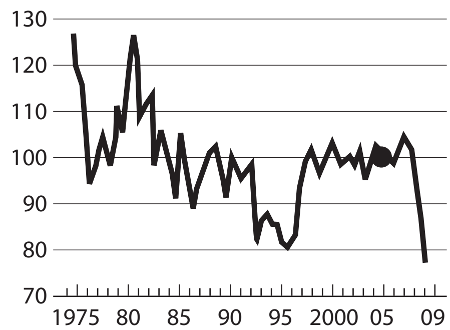
Source: *The Independent*, 23 April 2009 Sean O'Grady 'So much for balancing the books: this is worse than we ever imagined'.

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'.

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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)

*(e) 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)

(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)

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(15)

(Total for Question 5 = 50 marks)

TOTAL FOR SECTION B: 50 MARKS
TOTAL FOR PAPER: 100 MARKS

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