



GCE AS/A Level

2520U20-1 – **NEW AS**



S16-2520U20-1

ECONOMICS – Unit 2
Economics in Action

A.M. MONDAY, 23 May 2016

2 hours

ADDITIONAL MATERIALS

In addition to this examination paper, you will need:

- a calculator;
- a 12 page answer book.

INSTRUCTIONS TO CANDIDATES

Answer **all** questions.

Use black ink or black ball-point pen.

INFORMATION FOR CANDIDATES

The number of marks is given in brackets at the end of each question.

You are reminded of the necessity for good English and orderly presentation in your answers.

1. RECESSION TESTS RUSSIA'S RESILIENCE

Figure 1 Russian GDP Annual Growth Rate – July 2012 to July 2015

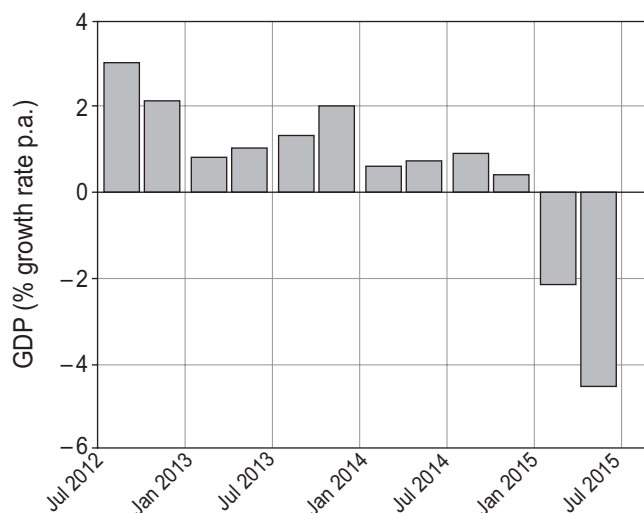


Figure 2 World price of oil – June 2014 to May 2015



Russia is one of the world's largest exporters of oil and natural gas. Since 2014, however, the country has been in economic crisis and in early 2015 it was plunged into recession. There are two major reasons for this recession:

1 – The fall in the world price of oil in 2014.

- 5 The world price of oil fell dramatically between June 2014 and January 2015. The causes of this price crash were falling demand for oil across the world as well as increased oil production in the United States. This fall in oil prices hit Russia hard as half of the Russian Government's revenue comes from its sale of oil and gas. If the price of oil had remained stable at \$100 per barrel throughout 2014 the government may well have balanced its budget that year – however, due to
- 10 the price crash, they were left with a significant budget deficit. The government announced there would have to be spending cuts of 10-15% in order to reduce the deficit.

2 – Economic sanctions.

- 15 Russia's military intervention in Ukraine, which began in 2014, has had a huge economic impact as well. In September of that year, a number of governments from other countries (including the UK) agreed to impose economic sanctions against Russia.

The sanctions included trade barriers such as:

- A full embargo on the trade of weapons and other technologies
- Large restrictions on exports to Russia of high-tech goods and energy sector services

Economic problems: Trade.

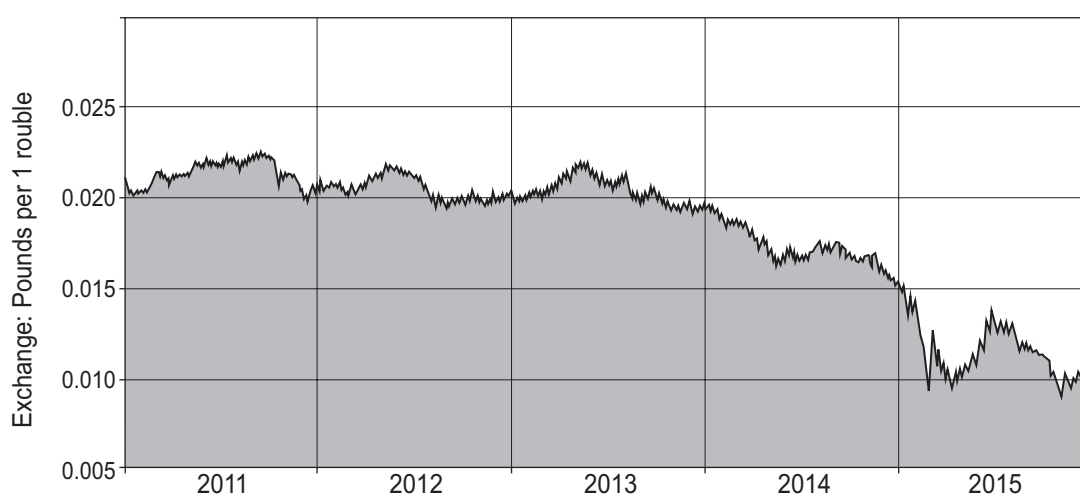
- 20 As a member of the World Trade Organisation, Russia is committed to the principles of free trade. However, the introduction of trade barriers means that free trade is not a realistic option at the moment. Prior to the trade barriers, EU countries imported approximately 80% of Russia's oil exports, and about 75% of its natural gas. The imposition of the trade barriers led to a fall of 25% in Russia's total exports between summer 2014 and summer 2015.

25 Russia has since responded with its own retaliatory trade barriers. For example, it imposed a year-long ban on the importing of certain agricultural goods from the EU; EU agricultural exports to Russia had previously been worth €11.8bn.

Economic problems: Decline of the rouble.

30 Both the fall in the price of oil and the introduction of trade barriers has led to a dramatic fall in confidence in the Russian economy and high levels of capital outflows. Businesses and individuals have been quick to sell off their assets at home and store money abroad – sometimes even buying property in the UK. The effect has been a near collapse of the Russian currency – the rouble (see Fig 3).

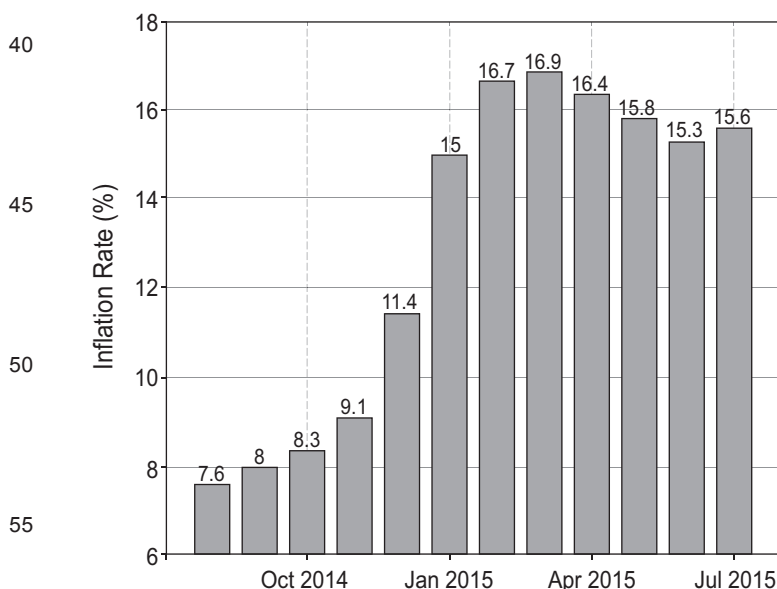
Figure 3 Exchange Rates: pounds per 1 rouble – 5 year history



35 The Central Bank of Russia has fought continually to try and support the currency by using monetary policy. In December 2014, the Central Bank increased interest rates from 10.5% to 17% – it was the sixth increase in interest rates that year. In addition, it was reported that the Central Bank had spent \$110bn of their country’s foreign currency reserves in buying roubles on currency markets. Perhaps a little surprisingly, however, it resisted the move to control outflows.

Economic problems: Inflation.

Figure 4 Russian Inflation Rates – August 2014 to July 2015



Whilst the UK is facing falling prices in the form of negative inflation, as a result of low oil prices, Russia’s inflation levels have soared to 15.6% due to the falling exchange rate. As a result, surveys have shown that Russian consumer confidence is at a record low. 18% of Russians now lack any sort of disposable income after buying food and other basic items. Poverty levels are now at their highest in 10 years with 1 in 6 people earning less than the minimum subsistence level. The Central Bank of Russia believes, however, that it can still reach its inflation target of 4% by 2017.

- (a) According to Figure 2, calculate the percentage fall in the world price of oil between 1st June 2014 and 1st January 2015. Show your workings. [2]
- (b) Using a demand and supply diagram, explain why 'the world price of oil fell dramatically between June 2014 and January 2015' (line 5). [4]
- (c) Discuss the view that consumers, workers and firms will always benefit if their country adopts free trade policies. [10]
- (d) Using an exchange rate diagram, explain why the Russian rouble collapsed between 2014 and 2015 (lines 32-33). [6]
- (e) Discuss the likely effectiveness of Russia's monetary policy in its attempt to support the rouble. [8]
- (f) To what extent should low inflation be the main macroeconomic objective for Russia? [10]

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2. WALES BOTTOM OF THE UK'S WEALTH TABLE

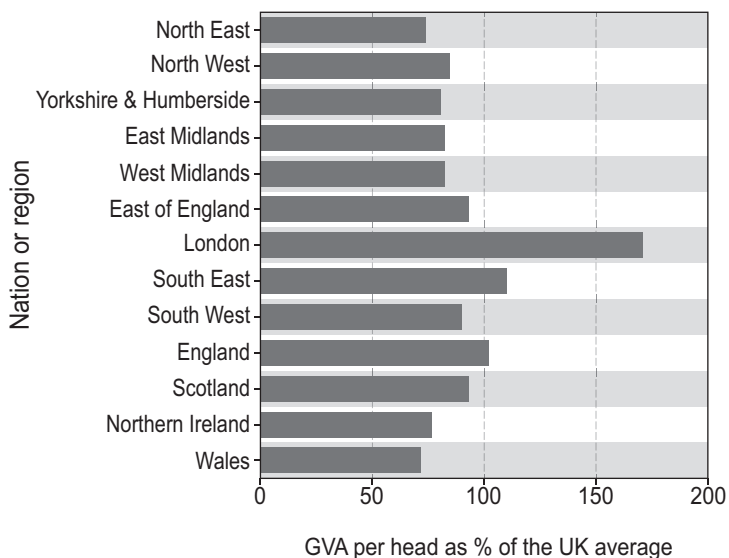
Wales saw strong growth in Gross Value Added (GVA) in 2013 but still remains the UK's poorest performing nation.

Gross Value Added (GVA) is used in the estimation of GDP and should be used as an approximation for GDP.

The Welsh economy: Facts and figures.

5 The latest figures from the Office for National Statistics (ONS) showed GVA per person in Wales growing by 3.4% between 2012 and 2013. It was a significantly faster rate of growth than the UK average of 2.6%.
 10 However, Wales still has the lowest GVA per person in UK at just £16,893 per person. Using an index figure of 100 for the UK as a whole, Wales scored just 72.2.

Figure 1



The Welsh economy: Opinions.

15 A Welsh government spokesperson said: "These figures are great news. Since devolution in 1999, which created the Welsh Assembly Government, household income in Wales has risen faster than the UK average; employment in Wales has significantly outperformed the UK (see Figure 2); exports have doubled and inward investment into Wales is now at a record level. The figures clearly show that our long-term economic plan is working for Wales.

20 The Welsh government's long-term economic plan is based on investing in skills, innovation and infrastructure to make Wales a better place to do business and targeting business support to key sectors."

Figure 2 % change in unemployment

– December 2014 to February 2015

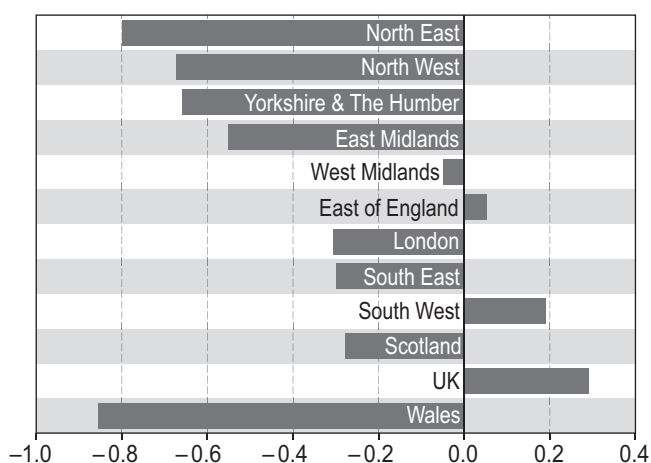
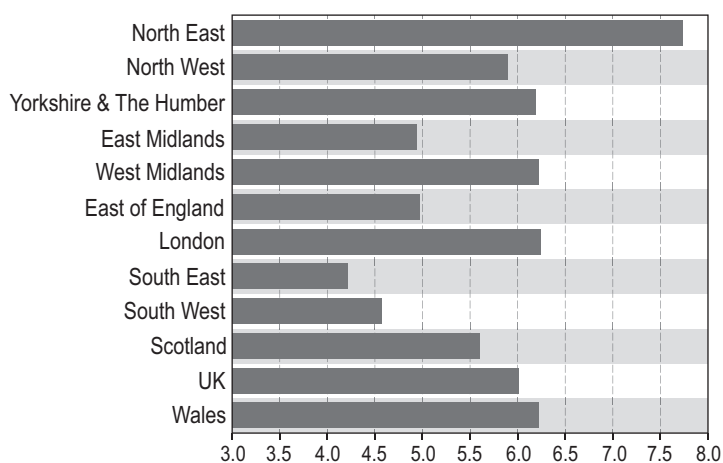


Figure 3 Unemployment (%)

– December 2014 to February 2015



Conservative Shadow Assembly Minister for Business, William Graham argued: “While we welcome improvement wholeheartedly, this 3.4% increase in GVA is coming from an extremely low base and so the high percentage rise should be fully expected”. Professor Karel Williams, of Manchester Business School agreed, saying that devolution has been “something of a non-event” in economic terms with Wales relying on growth from a multiplier process from a booming south east of England. He believes that Wales has been lacking in imaginative policy ideas and needs to experiment.

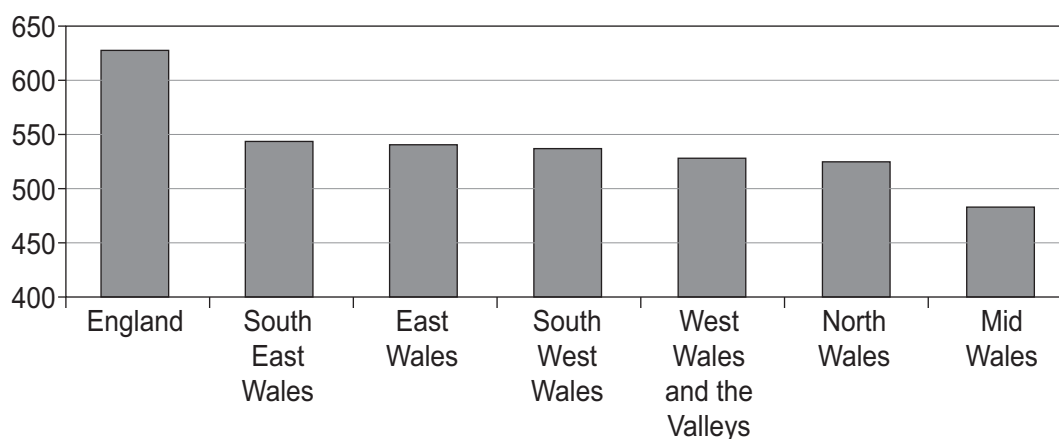
The Welsh economy: The future?

Concerns have also been voiced over the prospect that an increase in interest rates by the Bank of England in the near future may be inappropriate for Wales, damaging the economic recovery claimed by the Welsh government.

According to Professor Gerry Holtham of the Institute of Welsh Affairs (IWA), Wales needs to grow significantly faster than it has done in the past to have any chance of closing the GVA gap with the rest of the UK. He added: “Do we want to pursue small traditional policies that will change our situation only very gradually? Or are we ready to venture something bolder with no certainty of success but some hope of making a faster change in Wales’ economy?”

IWA Director Lee Waters said: “There was a need for borrowing by the Welsh government to invest in large capital projects like the South Wales Metro, high speed broadband and making Wales self-sufficient in renewable energy with projects such as the proposed £1bn tidal lagoon project in Swansea Bay”. Critics of these projects, however, have argued that they are centred in South Wales and will do little to improve the imbalances within the Welsh economy such as the wage differentials shown in Figure 4.

Figure 4 Average gross weekly wages per person (£)



- (a) Explain what is meant by: “Using an index figure of 100 for the UK as a whole, Wales scored just 72.2” (lines 11-12). [2]
- (b) Explain, using an example, why William Graham believes that the 3.4% increase in GVA per person isn’t quite as good as it sounds (lines 22-24). [2]
- (c) Explain what is meant by the ‘multiplier process’ (lines 26-27). [2]
- (d) With reference to economic theory, explain two possible reasons for the differences in the average gross weekly wages **within Wales** shown in Figure 4. [6]
- (e) Evaluate the Welsh government’s claim that its long-term economic plan has been a success. [10]
- (f) Discuss whether a policy of borrowing heavily to invest in capital projects is always likely to benefit employment levels and economic growth. [8]
- (g) To what extent will an increase in interest rates by the Bank of England be harmful for the Welsh economy? [10]

END OF PAPER