



Rewarding Learning

ADVANCED
General Certificate of Education
2013

Economics

Assessment Unit A2 2

The Global Economy

[AE221]

FRIDAY 17 MAY, AFTERNOON



TIME

2 hours.

INSTRUCTIONS TO CANDIDATES

Write your Centre Number and Candidate Number on the Answer Booklet provided.
Answer **Question 1** and **one** question from **Questions 2, 3 or 4**.

INFORMATION FOR CANDIDATES

The total mark for this paper is 80.

Quality of written communication will be assessed in all parts of **all** questions **except 1(a)**.

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 allocated for each part question in allocating the available examination time.

Question 1

The following passages were written in October 2011. Please read them carefully and answer the questions which follow.

Case Study: World economies becoming interdependent

Source 1: Financial flows to developing countries

A rapidly increasing benefit for developing nations is the flow of funds which migrants return to their home country, better known as migrants' remittances. These far exceed the aid contributions of richer nations.

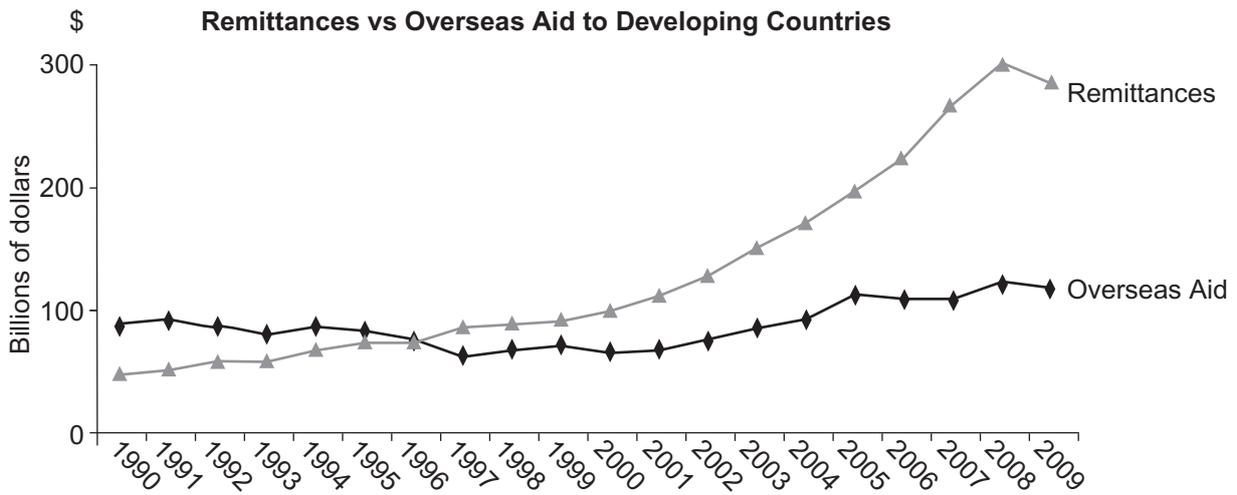


Fig. 1

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Source 2: Foreign direct investment rises

Foreign Direct Investment (FDI) globally rose in 2010 to \$1,122 billion. A popular destination for much of this investment was Mexico which saw FDI rise by 28 per cent in the first half of the year.

One of the multinational investors was Ficosa, a Spanish car parts company. Its director of operations, Antonio Ibañez, stated that Mexico offered numerous advantages, including geographical location, the quality of labour and membership of the North American Free Trade Area (NAFTA).

As a producer of parts for the world's top car manufacturers, Ficosa needs to get its products quickly to vehicle assembly plants in Mexico and the USA. It also needs to respond quickly to changes in orders. By being only about three hours from the US border, Ficosa can truck parts to anywhere in the US within two or three days. From China it would take fifteen.

Indeed Lego, the Danish toy manufacturer now produces one third of its global output in Mexico. Again proximity to the USA and a relatively cheap but skilled labour force were key considerations. Furthermore corporation tax rates are similar to those in the USA.

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Source 3: Politics threatens free trade

With presidential elections due in 2012, American politicians have wasted no time in the campaign trail. Unemployment, which remains stubbornly above nine per cent, seems to be a key issue.

Unfortunately, neither Republicans nor Democrats have a clear strategy for promoting growth and employment which is why they have united in pinning the blame for America's economic woes on China. Last week the two parties proposed the imposition of tariffs on Chinese goods unless Beijing allows the yuan to appreciate faster. American companies that have been competitively disadvantaged by China's currency manipulation would be able to treat "misaligned" currencies as a form of subsidy and apply for tariff protection.

The prospect of imposing tariffs on Chinese exports would certainly be popular with many voters. A recent academic study found that regions with firms most exposed to competition from China suffered higher job losses than firms in other areas and that this applied to both manufacturing and non-manufacturing jobs. One of the authors said, "There are really huge adjustment costs to local communities that are far worse than people had appreciated".

Indeed the costs of international competition are being felt even by those in employment. Ford Motor Company recently signed a deal with its largest trade union by which it agreed to repatriate to the USA some 12 000 jobs in manufacturing facilities currently located in Britain, China, Mexico and Turkey. However, these workers are to receive a wage rate which is half that of existing Ford workers!

With American voters facing rising unemployment and falling living standards they are not in a mood to be lectured on the benefits of free trade. If they were they would hear:

- that the US's goods deficit with China represents a mere 1.8 per cent of GDP
- that improvements in technology destroy many more manufacturing jobs than trade with China
- that the Federal Reserve Bank's programme of quantitative easing is just as much a form of "currency manipulation" as the activities of the Peoples' Bank of China
- and that the history of the great depression shows that the Smoot-Hawley tariffs of 1930 made everyone worse off!

Adapted from: © "Free trade takes a blow in the battle for jobs" by Irwin Stelzer, published in the Sunday Times, October 9th 2011

Source 4: Migration promotes growth

Starting with the theory of comparative advantage economists have emphasised the gains from free trade in goods and services. So successful have they been that most arguments for protection are now made on the basis of a special case. Mention free movement of labour, however, and immediately the case for immigration controls is made without any qualification.

So how can free movement be fine for goods and services but not for labour? A recent study concluded that the gains from migration would dwarf those from free trade. However, like all welfare gains, they are not evenly distributed. In this instance the bulk of the gains go to the migrants themselves.

Most economic analysis of migration has focused on the impact on the host country. These include effects on wage rates and employment. There may be benefits for employers in terms of cheaper and often more motivated workers. There may also be gains for consumers as these cost savings are passed on through lower retail prices. Balancing these positive and negative impacts is not easy and the net effect on the host country is unclear. But once the welfare gains for migrants are included in the calculation then migration is unambiguously beneficial.

There is however one last piece of this complex jigsaw and that is the impact on the country left by the migrant. Is this outflow of labour depriving these countries of their brightest and best? So concerned has the NHS been about this that it has banned recruitment from around 150 developing nations. Once again the jury is out with regard to this impact. There is a possibility that it may even be beneficial for developing nations. After all, if we recruit doctors and engineers at comparatively high salaries does this not provide an incentive to train as a doctor or an engineer, leaving the developing nation with more doctors and engineers even after the migrants have departed?

One of the many reasons for the economic success of the USA has been its readiness to accept migrants from all parts of the world. The Statue of Liberty bears the inscription "Send me your poor, your huddled masses". Perhaps a rich nation trying to improve development in Less Developed Countries (LDCs) should open its borders not just to their products but also to their people.

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- 1 (a) Using the data from **Fig. 1**, compare the trend for migrants' remittances with that for overseas aid to developing countries for the period 1990/2009. [5]
- (b) Explain why Mexico is a popular destination for foreign direct investment. [10]
- (c) Examine the impact of trade with China on the US economy. [10]
- (d) Critically examine the view that rich nations should open their borders to many more migrants from LDCs. [15]

Essays:

Answer **one** question from **Questions 2, 3 or 4.**

2 EU membership costs UK too much

- (a) Explain why membership of the Single European Market may cause both trade creation and trade diversion. [15]
- (b) Critically examine the view that the time has come for the UK to leave the European Union. [25]

3 Global instability leads to calls for fixed exchange rates

- (a) Compare the roles of the World Bank and the World Trade Organisation in the global economy. [15]
- (b) Evaluate the view that the global economy would benefit from the introduction of a system of fixed exchange rates. [25]

4 Growth more important than eliminating a current account deficit

- (a) Explain the main components of the current account of the UK balance of payments. [15]
- (b) Examine the view that the UK government's fiscal and monetary policies should take no account of the state of the balance of payments on current account. [25]

THIS IS THE END OF THE QUESTION PAPER

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