Rewarding Learning

ADVANCED
General Certificate of Education
January 2012

Economics

Assessment Unit A2 2

The Global Economy

[AE221]

AE221

TUESDAY 31 JANUARY, MORNING

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 August 2010. Please read them carefully and [answer] the questions which follow.

Finance flows around the world

Source 1: Current Account Surplus Short-Lived

In the last quarter of 2009 the UK economy achieved something last seen in the third quarter of 1998. Its balance of payments on current account actually showed a surplus. It wasn't much of a surplus, a mere £0.5 billion or 0.1 per cent of GDP, but a surplus nonetheless.

Sadly, this phenomenon did not last long. The first quarter of 2010 showed the UK current account returning to its customary deficit. Debits exceeded credits by £9.6 billion or 2.7 per cent of GDP. The UK's current account has shown annual deficits since 1983 and the situation shows no signs of improvement. Gone are the days of almost permanent surpluses which existed for most of the 1950s, 1960s and early 1970s.

In the 1950s the UK had total current account surpluses of £1.6 billion. In the decade from 2000–2009 it had total deficits of £262.3 billion. A number of factors have contributed to this deterioration in the UK's trading performance, with de-industrialisation as one of the most important.

In the 1950s UK manufacturing could compete with the rest of the world, but this was in an era before the rise of low cost, high productivity Asian tigers like China and India. The international trading environment today is totally different. So successful have these Newly Industrialised Countries been that they are recycling their current account surpluses into purchasing prominent UK firms such as Corus, Land-Rover and Blackburn Rovers Football Club!

Unlike the UK, Germany has preserved its manufacturing base and with it a healthy balance of payments surplus.

Manufacturing as percentage of GDP

	1995	2007
UK	21	13
Germany	22	24

The UK was once known as the "workshop of the world". Today it is a largely service-based economy which closely resembles Napoleon's description of a "nation of shopkeepers"; though were he alive, Napoleon might amend his description to "a nation of shopkeepers and bankers".

Source 2: New economic superpowers

China is the world's largest exporter and is the second largest economy. China and India have developed a comparative advantage in manufacturing, whilst Russia and Brazil have comparative advantages in natural resources. While the UK and the USA have massive current account deficits, the emerging economic powerhouses of Brazil, Russia, India and China (BRIC) have equally large surpluses.

These global imbalances can only exist when there are capital and investment flows to match the current account deficits and surpluses. So the BRIC nations, and China in particular, have vast sums ready to invest in more developed economies.

Until recently China was content to buy US government securities but has recently sought to diversify into more tangible assets. The China Investment Corporation is actively seeking investment opportunities in a wide variety of UK firms.

Source 3: British business under attack!

It was 132 years ago when Henry Tate founded the Tate & Lyle sugar-refining business. Over the years it has diversified into corn sweeteners and industrial starches and in 2010 its sugar refining business will be sold to American Sugar Refining for £211 million. This is not the first UK company to be have been taken over by American firms and it certainly won’t be the last. Recently, Kraft, the American food giant, spent over £12 billion pounds on the purchase of Cadbury, the chocolate maker.

Standard & Poors, the credit-rating agency, recently published a shopping list of UK companies which could interest American predators. These included pharmaceutical giant, Astra Zeneca, defence contractor, BAE Systems and construction firm, Balfour Beatty. Standard & Poors said that these three were particularly attractive as they were in profitable industry sectors and their share price was relatively low in relation to their earnings.

A number of factors have contributed to this wave of transatlantic takeovers. American firms are awash with cash as a result of cost-cutting during the recession. UK share prices have plummeted and the value of the pound against the dollar has fallen by 25 per cent in two years. And it is not just American firms which are plundering the UK economy. Britain’s largest manufacturer is Indian industrial giant, Tata Industries, which owns Corus, Tetley, Jaguar and Land-Rover.

The takeover of large sections of UK commerce has raised concerns from trade unions and politicians. One leading trade unionist said that acquisitions generally led to redundancies and that shareholders got giant payouts whilst workers faced the sack.

Paul Kenny, General Secretary of the GMB Union said “For far too long there has been an assumption that “who owns what” does not matter, but it does! Where cutbacks have to be made it is people in outlying overseas plants, like those in the UK, that are hit with job losses.”

Following the Kraft takeover of Cadbury, its Somerdale plant was closed and production of mini eggs was shifted to Poland. Many trade unionists argue that the time has come for a complete ban on foreign takeovers of UK firms.

Some free market economists take a different view, arguing that mergers and acquisitions are an essential feature of the market economy, and that the threat of takeover prevents management from becoming complacent and inefficient.

In the aftermath of the Kraft acquisition of Cadbury, the UK Takeover Panel announced that it was conducting a review of the rules governing foreign takeovers of UK firms. This is unlikely to lead to a complete ban, but may make it more difficult for foreign businesses to acquire shares in UK companies.

Source: from the Sunday Times 4 July 2010: authors James Ashton and David Smith

1 **(a)** Explain what is meant by a current account surplus on the balance of p [5]

(b) Analyse the reasons for the UK's persistent current account deficit.

(c) Examine why some UK firms are attractive takeover targets for foreign companies. [1

(d) Critically examine the view that there should be a complete ban on foreign takeovers of UK firms. [15]

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

2 "**Recession leads to increased calls for trade protection**"

(a) Explain the main reasons why nations engage in international trade. [15]

(b) Critically examine the view that protectionism is the best method of safeguarding living standards. [25]

3 **"Fixed exchange rates create stability"**

(a) Explain the main factors which influence the rate of exchange of the UK pound (£) against the American dollar ($). [15]

(b) Critically examine the desirability of the world's major economies introducing a system of fixed exchange rates. [25]

4 **"Trade is the key to economic development"**

(a) Explain the roles of the International Monetary Fund and the World Bank. [15]

(b) Evaluate the view that trade liberalisation alone is insufficient to ensure development of poorer countries. [25]

THIS IS THE END OF THE QUESTION PAPER