General Certificate of Education
June 2002
Advanced Level Examination

ASSESSMENT and QUALIFICATIONS ALLIANCE

ECONOMICS **EC4W**

Unit 4 Working as an Economist: The European Union

Friday 21 June 2002 Morning Session

In addition to this paper you will require:
- an 8-page answer book.

You may use a calculator.

Time allowed: 1 hour 40 minutes

Instructions
- Use blue or black ink or ball-point pen. Pencil should only be used for drawing.
- Write the information required on the front of your answer book. The *Examining Body* for this paper is AQA. The *Paper Reference* is EC4W.
- Answer the compulsory question.
- **At the very start of the examination**, tear along the perforations in order to detach the question on page 2 from the extracts.
- **The extracts** are printed on pages 3, 4, 5 and 6 which can be unfolded.

Information
- The maximum mark for this paper is 84. This includes up to 4 marks for Quality of Written Communication.
- You will be assessed on your ability to use an appropriate form and style of writing, to organise relevant information clearly and coherently, and to use specialist vocabulary where appropriate. The degree of legibility of your handwriting and the level of accuracy of your spelling, punctuation and grammar will also be taken into account.

Advice
- You are advised to spend the first 20 minutes reading the Case Study.

Answer the compulsory question.

You may detach this page by tearing along the perforations.

Case Study:

THE EUROPEAN UNION

You are advised to spend the first 20 minutes thoroughly reading the Case Study before writing the report. The instructions below set the scene of the Case Study and explain what you should include in your report. The whole report will be marked out of 84, including 4 marks for quality of written communication.

Setting the Scene

It is July 2001. You are an economist working as a special adviser to the Secretary of State for Trade and Industry in the new UK government.

After the general election in June 2001, the new government immediately announced that it would NOT join in the single European currency ('the euro') for at least five years.

The Secretary of State will shortly be attending a Cabinet meeting which will assess the consequences to the UK economy of **not** being a member of the euro.

You have been asked to write a report for the Secretary of State to use at that meeting. When writing your report you should make use of the information in Extracts A, B and C, together with any other relevant knowledge you possess.

Requirements of the Report

You are to write a report dated July 2001 which discusses the economic consequences of the UK's decision **not** to join the euro for at least 5 years.

Your report should:

- outline the arguments for and against joining the euro which were being discussed before the government's decision;
- discuss the extent to which the UK economy was converging with other economies in the Euro Zone;
- assess the consequences of non-membership;
- conclude by recommending whether or not the government should reconsider its decision, giving reasons to justify your recommendation.

You will be given credit for demonstrating your ability to analyse and make effective use of the data provided, and for your use of economic principles.

(84 marks)

Extract A

THE CASE FOR JOINING

The euro is up and running and we can begin to see clearly how it will transform the European economy. Increasingly, companies will serve the whole euro area, just as US companies serve the whole US market. Should Britain join?

The case for joining consists of five basic points.

1. To improve living standards, Britain needs to belong to a large market such as exists in the US. This will enable business to sell more widely, and so to achieve the economies of scale seen in the US. It will force companies to compete more aggressively, driving up productivity. It will also enable families and businesses to buy from a wider, and thus cheaper, range of suppliers.

2. The elimination of trade barriers is not enough to create a truly single market. You also need to have a single currency, as in the US. Separate currencies are in effect barriers to trade, because of the uncertainty about the exchange rates between the currencies and their tendency to damaging fluctuations from time to time.

3. These fluctuations in exchange rates will continue and may increase as capital mobility intensifies through increasingly integrated and electronically linked global financial markets. We have already seen this in the unexpected and sustained strength of the pound in the late twentieth and early twenty-first century. This cripples many exporting and import-competing companies and was one reason, for example, why BMW sold Rover. Caught between two large currency blocs (the dollar and the euro) the only predictable thing about sterling is that it is likely to go in unpredictable directions. Only by joining the euro can Britain protect itself against this danger.

4. The disadvantage of Britain's separate currency has increased now that the euro has eliminated currency fluctuations within most of Europe. Before monetary union, any firm outside (say) Germany that wanted to sell in Germany faced an exchange rate risk, whether it were located in Britain, France or Italy. Today, producers in France and Italy face no exchange rate risk when they trade with Germany; but those in Britain do. So producers wanting to sell into the massive continental market will increasingly move their operations into the euro area.

5. The issue of influence. Joining the euro will not increase the power of the EU to legislate for Britain. But it will increase Britain's ability to influence that legislation, and it will increase the credibility of British arguments for reform in Europe. Being represented in the European Central Bank will also give Britain more influence over the swings in the European economy. A stronger US link is not an alternative to joining the euro.

Thus for Britain the euro poses both an opportunity and a threat. It is crucial to consider the question of British entry in the 'real world' context, where Britain now lives next door to a large and expanding Euro Zone bloc. Too much of the euro debate is devoted to a static analysis: it assumes that nothing is changing outside Britain, or there is hankering after an old status quo for Britain in which the euro had not yet been invented. That scenario is no longer on offer. The euro exists, and Britain has to live inside it or outside it. Either is risky, but the superficially 'safer' route of staying outside until the argument is beyond dispute is almost certainly the most risky of all.

Source: adapted from LAYARD, R., ET AL *The case for the euro*, (The Britain in Europe Campaign Ltd) 2000

Extract B

THE DANGERS OF EUROPEAN MONETARY UNION

Should Britain join the European single currency? In this timely new book, ex-Conservative Cabinet minister, John Redwood, explores the enormous and far-reaching implications of monetary union and explains why it is vital to stay out.

From his unique vantage point at the heart of the parliamentary debate over preparations for the euro, and drawing on his industrial and financial experience, John Redwood spells out the major issues. He argues that a single currency would lead to a European superstate solely governed by Brussels. What would be the point of general elections, he asks, when all the major economic decisions would be settled by unelected bankers behind closed doors?

Monetary union, he argues, would result in:

- big increases in taxes to bail out the poorer areas of the union;
- higher unemployment, as regions find it difficult to live with the common interest rate;
- substantial costs for British business to gear up for the new currency, and very few benefits;
- such impracticalities as going shopping in a foreign currency, with shops needing double tills to handle the changeover.

With the future prosperity and sovereignty of Britain at stake, John Redwood concludes that it must be a case of keeping our currency if we are to keep our country.

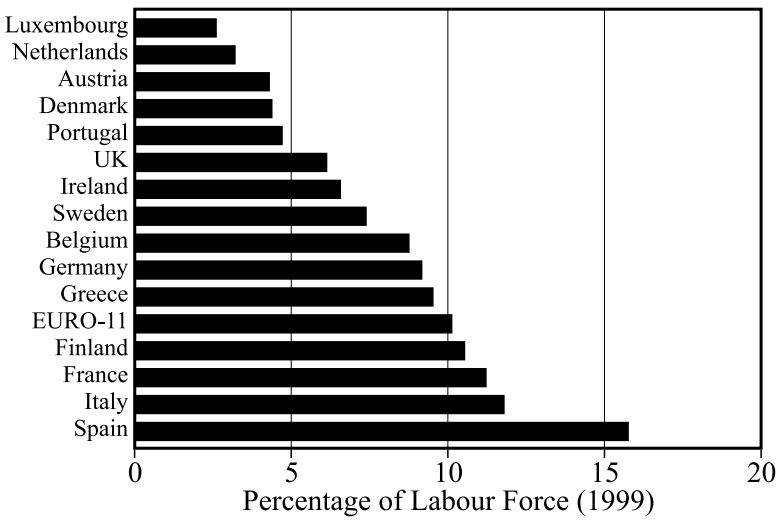
Source: adapted from publisher's notice for REDWOOD, J., *Our currency, our country*, (Penguin) 1997

Extract C: CONVERGENCE

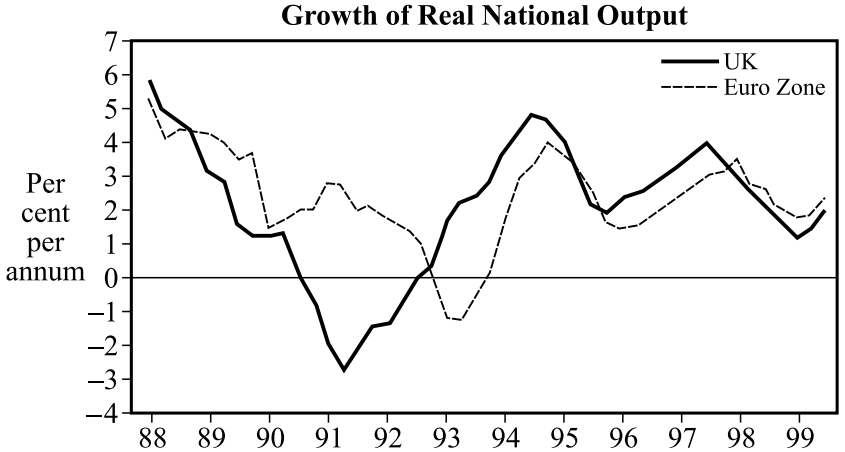
Unemployment

Unemployment within the EU has been persistently high in the 1990s. Why is European unemployment so high? The main reason is relatively slow average economic growth together with low rates of new capital investment. Unemployment has started to fall within the Euro Zone in 1999, but there is still a long way to go.

Unemployment Inside the European Union



Growth of Real National Output



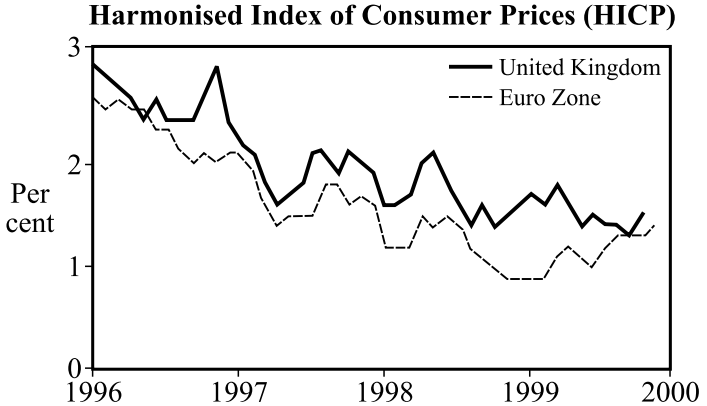
Economic Growth

The British economic cycle has tended to be more volatile than the rest of the EU, with larger deviations of actual GDP from trend growth.

Inflation

Inflation fell quite sharply within the Euro Zone in the latter part of the 1990s. For the single currency to be a success, the convergence of inflation rates between stronger members like Germany and weaker members like Spain and Italy will have to be maintained.

UK and Euro Zone
Harmonised Index of Consumer Prices (HICP)



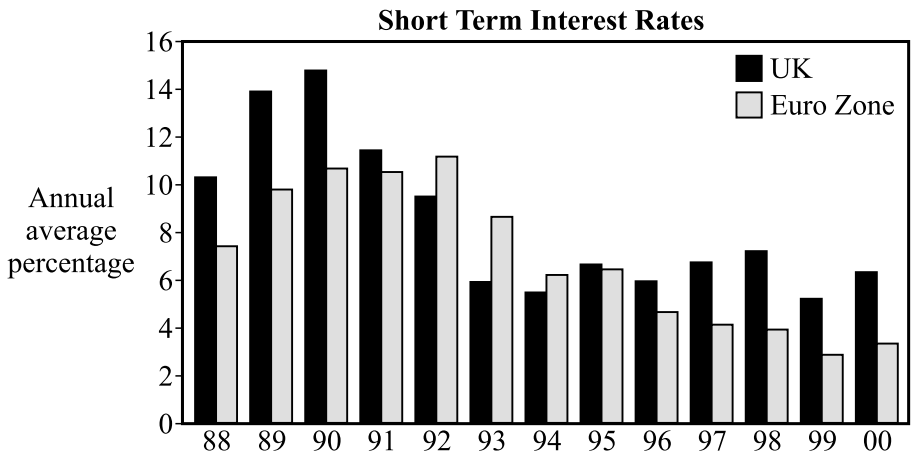
Footnote: HICP is the EU's preferred measure of inflation.

EXTRACT C CONTINUES ON PAGE 6

Turn over ▶

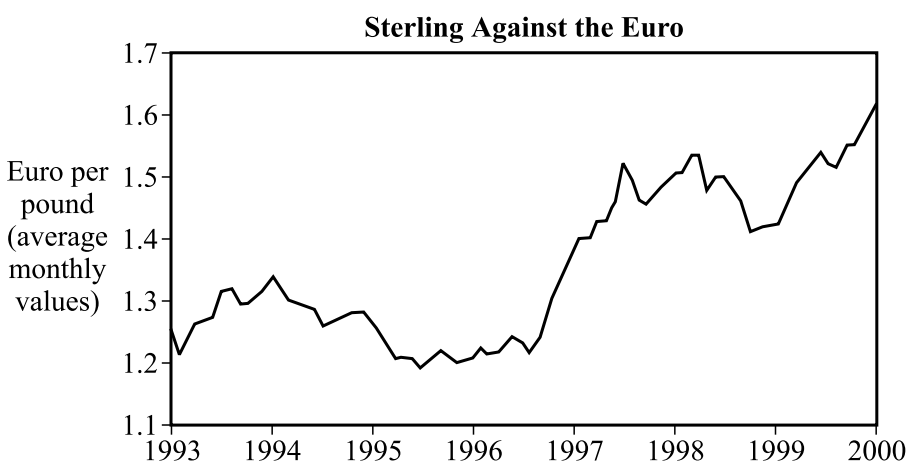
Interest Rates

For Britain to participate in the euro its interest rate cycle will have to converge more closely with other countries. A common interest rate places responsibility on individual governments to use fiscal policy to help control inflation.



Exchange Rates

Can Britain benefit from joining the euro at current high exchange rates? Or might we be making a mistake by entering into a fixed currency arrangement with an over-valued exchange rate?



Source: adapted from RILEY, G., *The UK economy, 1990-2000,* (Anforme) 2000

END OF EXTRACTS

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