



General Certificate of Education  
Advanced Level Examination  
June 2015

## Economics

## ECON4R

### Unit 4 The National and International Economy

Friday 19 June 2015 9.00 am to 11.00 am

**For this paper you must have:**

- an AQA 12-page answer book
- a calculator.

#### Time allowed

- 2 hours

#### Instructions

- Use black ink or black ball-point pen. Pencil should only be used for drawing.
- Write the information required on the front of your answer book. The **Paper Reference** is ECON4R.
- In **Section A**, answer **either** Context 1 **or** Context 2.
- In **Section B**, answer **one** essay.

#### Information

- The marks for questions are shown in brackets.
- The maximum mark for this paper is 80.
- There are 40 marks for **Section A** and 40 marks for **Section B**.
- This paper is synoptic. It assesses your understanding of the relationship between the different aspects of Economics.
- You will be marked on your ability to:
  - use good English
  - organise information clearly
  - use specialist vocabulary where appropriate.

#### Advice

- You are advised to spend 1 hour on **Section A** and 1 hour on **Section B**.

## Section A

Answer **either** Context 1 **or** Context 2.

**Total for this Context: 40 marks**

**Either**

**Context 1**

### THE GLOBAL CONTEXT

Study **Extracts A, B and C**, and then answer **all** parts of Context 1 which follow.

**Extract A: New Zealand marginal income tax rates for every \$1 of taxable income**

Taxable income	Income tax rates 2010/11	Income tax rates 2014/15
from \$0 to \$14 000	12.5%	10.5%
from \$14 001 to \$48 000	21%	17.5%
from \$48 001 to \$70 000	33%	30%
\$70 001 and over	38%	33%

Source: Inland Revenue - New Zealand, 2014

**Extract B: New Zealand's low tax economy**

In New Zealand, The National Party recently won the general election on policies of cutting taxes and balancing the budget, beating a Labour Party opposition that promised to put up taxes. When taxation is progressive, it is highly debatable whether or not increasing top rate taxes on income raises extra revenue, or whether it may result in less money being collected. Significantly reducing the top rate of income tax appears to have revived the economy, and been rewarded with electoral success as well. 1  
5

After the financial crash of 2008, New Zealand started shifting taxes from earnings to consumption. While VAT was increased from 12.5% to 15%, income taxes were cut, including the top rate from 38% to 33%, and corporation tax was also cut by 2%. The government believed that lower taxes would create faster growth, a risky assumption at the time. Some cuts in government spending were also made to accompany the package. 10

The lower taxes seem to have worked. New Zealand has witnessed one of the most robust recoveries in the developed world, despite suffering a major shock (the Christchurch earthquake in 2011). The economy is forecast to expand by 3.9% in 2014, a faster rate than the UK or US. Higher tax revenues, and tight control of public spending, meant it was one of only three OECD countries able to balance its budget in 2014. 15

However, there are plenty of differences between the UK and New Zealand. For a start, it is a tiny country, with only 4.5 million people. It has been helped by strong dairy prices, although agriculture only accounts for 4% of GDP. New Zealand currently ranks 7th in the Human Development Index whereas the UK is 14th. Perhaps most importantly, its major trading partners are the fast-growing Asian-Pacific economies, while the UK is linked with the Eurozone. One big difference is in the structure of the economy. New Zealand has a far smaller public sector, with the state responsible for 32% of GDP, compared with almost 43% in the UK, but a smaller state also needs less tax revenue to fund it. Maybe the UK also should consider tax cuts to secure growth. 20  
25

Source: news reports, 2014

**Extract C: Where does tax go in the UK?**

In the UK, from November 2014, HM Revenue & Customs will begin sending 24 million working people the first Annual Tax Summary, showing how their money is being spent by the state, in order to make taxation more transparent. For example, someone on a salary of £30 000 will see that £1663 of their money is spent on welfare, with £1280 going to health, £892 going to education, £822 going to the state pension and £475 going on national debt interest. Ministers believed that showing exactly where taxpayers' money goes could make voters more receptive to controversial Government changes to the benefits system. 1 5

However, the tax summaries have been heavily criticised in that they may make individuals more inclined to support political parties which favour lower taxes, without considering the wider picture of what state spending provides. The breakdown does not make clear that most of the welfare budget goes to pensioners, the sick and disabled people. The Treasury originally planned to show just 3% went towards unemployment benefits while much larger amounts went to children and families, elderly people and those unable to work, but this has been left off the tax summaries. 10 15

A Labour Party spokesperson said: 'This government's record on tax is giving millionaires a huge tax cut while everyone else pays more.' She added: 'Families and pensioners are paying more in higher VAT, but that tax isn't included in these tax summaries and independent figures from the Institute of Fiscal Studies show that, by next year, families will be £974 a year worse off because of tax and benefit changes since 2010.' 20

Source: news reports, 2014

0 1

Using the data in **Extract A**, calculate the income tax payable in 2014/15 for someone in New Zealand earning \$30 000 of taxable income **and** identify **one** significant feature of the tax rates between 2010/11 and 2014/15.

[5 marks]

0 2

**Extract B** (lines 3–5) states: 'When taxation is progressive, it is highly debatable whether or not increasing top rate taxes on income raises extra revenue, or whether it may result in less money being collected'.

Explain the term progressive tax **and** analyse why a rise in income tax rates may lead to lower tax revenue.

[10 marks]

0 3

**Extract C** (lines 9–11) states: 'However, the tax summaries have been heavily criticised in that they may make individuals more inclined to support political parties which favour lower taxes, without considering the wider picture of what state spending provides.'

Using the data and your knowledge of economics, to what extent do you agree that cuts to direct taxation would benefit growth **and** living standards in the UK? Justify your answer.

[25 marks]

Turn over ►

Do **not** answer Context 2 if you have answered Context 1.

**Total for this Context: 40 marks**

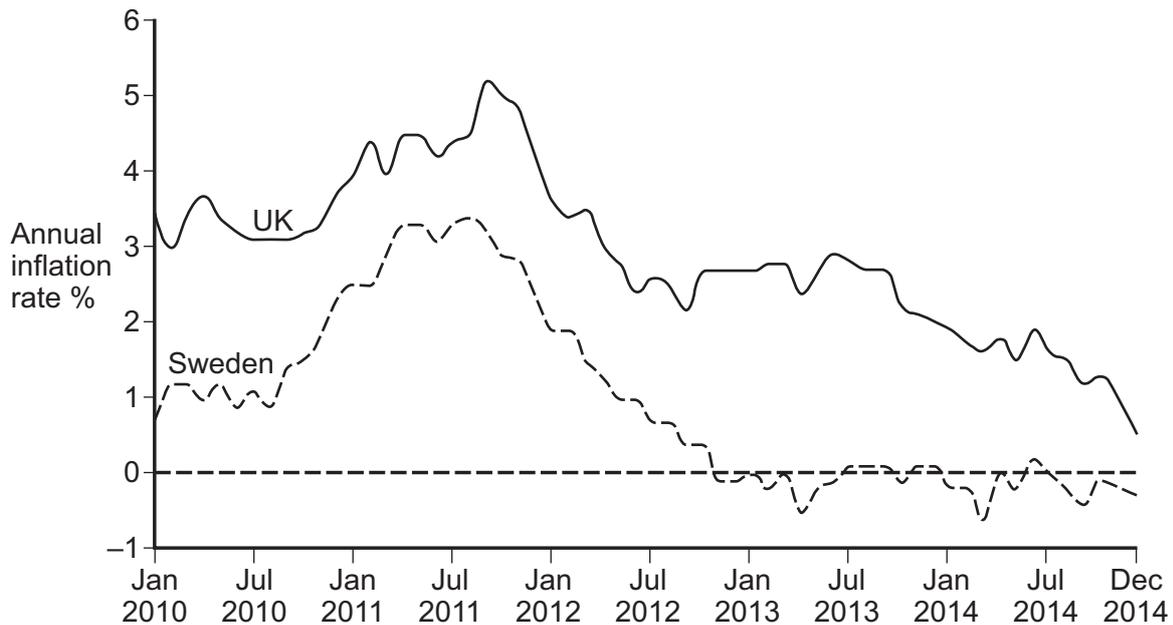
or

## Context 2

### THE EUROPEAN UNION CONTEXT

Study **Extracts D, E and F**, and then answer **all** parts of Context 2 which follow.

#### Extract D: Annual inflation rates of the UK and Sweden using the Consumer Price Index (CPI)



Source: iEconomics <http://ieconomics.com/inflation-rate-sweden-uk> accessed 16/01/15

#### Extract E: Sweden's economic fortunes

Only a few years ago, the Riksbank (the central bank of Sweden) was the envy of the world. The Swedish economy was a star performer early in the global recovery following the 2008 economic crisis. Sweden's economy grew three times faster than the Eurozone's in 2010. Even better, the Riksbank felt confident enough in recovery to start raising interest rates. Its main interest rate reached 2% by July 2011, while rates in most other rich economies stayed nearer to zero. 1

However, some economists argue that, from the beginning, Sweden's interest rate increases looked premature. When the first rate increase came, unemployment stood at 8.2%, while the inflation rate was 1.1%, well below the central bank's target. Concerns about financial stability influenced the decision to maintain higher interest rates, even though economic conditions deteriorated. The Riksbank was worried that rising household borrowing and soaring house prices could lead to adverse consequences in the long run. Yet the strategy did not go as planned and no doubt contributed to deflation in 2013. 5

Unemployment in Sweden has remained high and private sector debt as a share of GDP is higher now than it was in 2010 but, at the same time, house prices have continued to climb. In October 2014, the Riksbank announced it was cutting its main interest rate to zero in an effort to stimulate the economy. 10

However, the effectiveness of the central bank's ability to respond to avoid deflation is a concern because it becomes very difficult to further stimulate domestic demand as real interest rates approach zero. On the other hand, low interest rates contributed to the Swedish currency, the Krona, falling sharply in value, which helped exports and provided some cushion against weak global demand and further deflation. 20

Source: news reports, 2014

### Extract F: Is deflation a bad thing?

Deflation is the new economic menace threatening European economies including the UK. In the Eurozone in particular, the European Central Bank is considering the use of quantitative easing to help avoid deflation; but why is it such a problem? Firstly, there is the argument that deflation delays spending. However, this does not relate to all forms of consumption. Another reason is the effect on debtors. Prices and perhaps incomes may fall, but the real value of debt increases. For firms experiencing falling revenues, and households with declining incomes, debt repayments become more of a burden. Governments can be caught in the same trap, because if prices and incomes fall, so does tax revenue. 1

There is an alternative view that moderate deflation is not a bad thing, especially if it is the result of innovation that reduces production costs. Also, some comfort is to be had from falling or barely rising prices as this goes some way to improve competitiveness. Some of the Eurozone's economies desperately need to become more competitive and they need to either reduce costs or increase productivity. However, falling prices deter investment, which makes productivity improvements far more difficult. 5 10 15

Source: news reports, 2014

0 4

Calculate (to 2 decimal places) Sweden's Consumer Price Index (CPI) figure in December 2015 if the CPI figure stood at 314.05 in December 2014, and the annual rate of inflation was minus 0.3% **and** using **Extract D**, identify **one** significant comparison between the inflation rate for Sweden and the UK.

[5 marks]

0 5

**Extract E** (lines 20–22) states: '...it becomes very difficult to further stimulate domestic demand as real interest rates approach zero. On the other hand, low interest rates contributed to the Swedish currency, the Krona, falling sharply in value...'

Explain the term 'real interest rates' **and** analyse why low interest rates may lead to a fall in the value of a currency on the foreign exchange market.

[10 marks]

0 6

**Extract F** (line 1) states: 'Deflation is the new economic menace threatening European economies including the UK.'

Using the data and your knowledge of economics, evaluate the view that deflation in the EU's economies would inevitably be damaging to the UK's macroeconomic performance.

[25 marks]

Turn over for Section B

Turn over ►

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**Section B**

Answer **one** essay from this section.

Each essay carries 40 marks.

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**Either**

**Essay 1**

In 2014, George Osborne revived the idea of 'full employment' as a macroeconomic goal but what is actually meant by full employment is often debated by economists, with some arguing that a natural rate of unemployment exists.

**0 7** Explain the factors which might determine the natural rate of unemployment. **[15 marks]**

**0 8** Evaluate the view that reducing unemployment inevitably has trade-offs with other macroeconomic objectives. **[25 marks]**

**or**

**Essay 2**

Globalisation and outsourcing of manufacturing provides several potential benefits to economies. However, some countries, such as the UK, continue to suffer persistent trade deficits but are unable to resort to import controls.

**0 9** Explain how the UK Government could reduce a balance of payments deficit on the current account, other than through the use of import controls. **[15 marks]**

**1 0** Assess the view that, for the UK, the economic benefits of globalisation outweigh the costs. **[25 marks]**

**or**

**Essay 3**

Savings often provide the funds for investment. In 1997, the UK saving ratio stood at 13%, at the beginning of the financial crisis in 2007 it was only 5% and by 2014 it had risen slightly to 7%.

**1 1** Explain why the saving ratio may fall. **[15 marks]**

**1 2** Evaluate the likely impact of a fall in the saving ratio on the performance of the UK economy. **[25 marks]**

**END OF QUESTIONS**

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