OCR – A Level Economics

Component 2 – Macroeconomics

9. The global context

Worked Examples

Contents

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- The global context

9. The global context

Exam Style Question 1

The trade deal known as the Comprehensive Economic and Trade Agreement (CETA) is designed to eliminate or reduce trade barriers between the European Union (EU) and Canada. It is estimated that it will increase trade by 20% and boost EU GDP by 12 billion euros.

(Source: http://www.theguardian.com/business/2016/oct/30/eu-canada-sign-ceta-free-trade-deal-trudeau-juncker)

(a) Which **one** of the following is most likely to decrease as a result of CETA?

[1]

A Economic growth in EU countries

B Exports from EU countries to Canada

C Imports from Canada to EU countries

D Tariffs on European exports to Canada

(b) With reference to the theory of comparative advantage, explain how CETA may increase the GDP of both the EU and Canada. **[4]**

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Exam Style Question 1

Answer:

(a) Which one of the following is most likely to decrease as a result of CETA?

✅ **Answer: D** – Tariffs on European exports to Canada. **[1]**

Explanation:

CETA is all about reducing or eliminating trade barriers like **tariffs**, which are taxes placed on imports and exports. If tariffs are reduced on EU goods entering Canada, it becomes **cheaper** for Canadian consumers and businesses to buy European products boosting trade.

Why the other answers are wrong:

- **A, B and C** – wrong as they are likely to increase.

(b) With reference to the theory of comparative advantage, explain how CETA may increase the GDP of both the EU and Canada.

Answer:

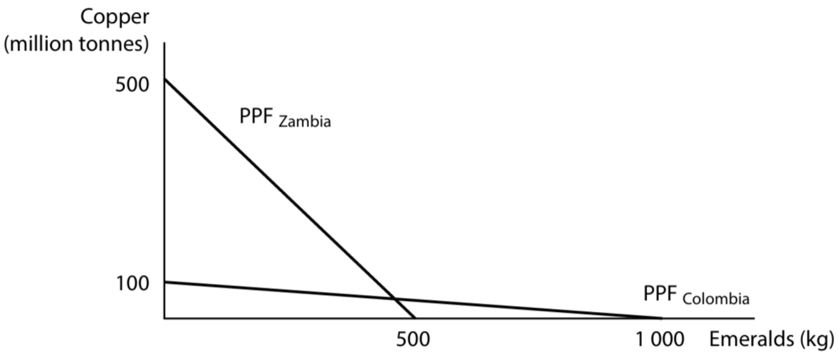
CETA reduces trade barriers between the EU and Canada, allowing them to trade more freely. According to the theory of **comparative advantage**, countries should specialise in producing goods where they have the **lowest opportunity cost** meaning they give up less to make that good. **[2]**

For example, **Canada could specialise in timber**, while the **EU focuses on cars**, if those are their most efficient industries. By doing so, both can trade and **consume more overall** than they could alone. **[1]**

Because of this specialisation and increased trade, CETA is estimated to increase trade by **20%,** and both economies are likely to produce more, which leads to **higher GDP. [1]**

Exam Style Question 2

Colombia and Zambia each produce copper and emeralds. The production possibility frontiers below show that two countries' productive capacities for these goods.



(a) With reference to the diagram above, which **one** of the following statements is correct?

[1]

A Colombia has an absolute advantage in the production of copper

B Zambia has an absolute advantage in the production of copper

C Zambia has an absolute advantage in the production of emeralds

D Neither Colombia nor Zambia has an absolute advantage in the production of emeralds

(b) Using appropriate calculations, explain which country has a comparative advantage in the production of emeralds. **[4]**

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Exam Style Question 2

Answer:

(a) With reference to the diagram above, which one of the following statements is correct?

✅ **Answer: B** – Zambia has an absolute advantage in the production of copper. **[1]**

Explanation:

Absolute advantage is when a country can produce more of a good than another country using the same amount of resources.

- Zambia can produce up to **500 million tonnes** of copper.
- Colombia can only produce **100 million tonnes** of copper.

So, Zambia has the **absolute advantage** in copper production because it can produce more.

(b) Using appropriate calculations, explain which country has a comparative advantage in the production of emeralds.

Comparative advantage is when a country can produce a good at a lower **opportunity cost** than another.

Zambia:

- Max copper = 500 million tonnes
- Max emeralds = 500 kg

To produce 1 emerald, Zambia gives up:

500 million tonnes ÷ 500 emeralds = 1 million tonnes of copper per emerald

Opportunity cost of 1kg of emerald = 1 million tonnes of copper [1]

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Exam Style Question 2

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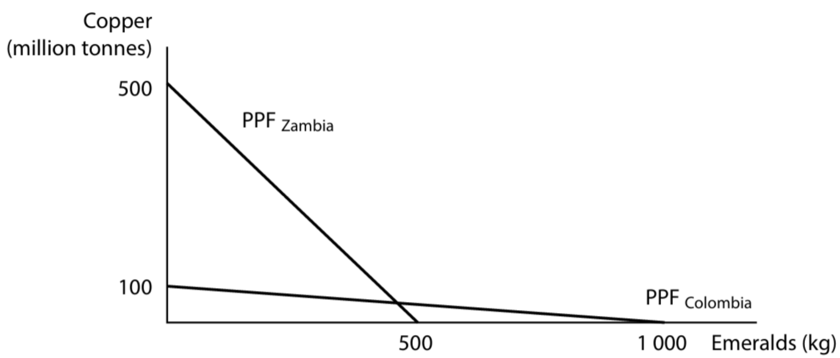

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Exam Style Question 2

Answer:
(b): Using appropriate calculations, explain which country has a comparative advantage in the production of emeralds.

Colombia:
- Max copper = 100 million tonnes
- Max emeralds = 1000 kg

To produce 1 emerald, Colombia gives up:
100 million tonnes ÷ 1000 emeralds = 0.1 million tonnes of copper per emerald
Opportunity cost of 1kg of emerald = 0.1 million tonnes of copper [2]

Colombia has the **comparative advantage** in producing emeralds because it gives up **less copper per emerald** than Zambia. Therefore, Columbia can produce emeralds relatively more efficiently than Zambia. **[1]**

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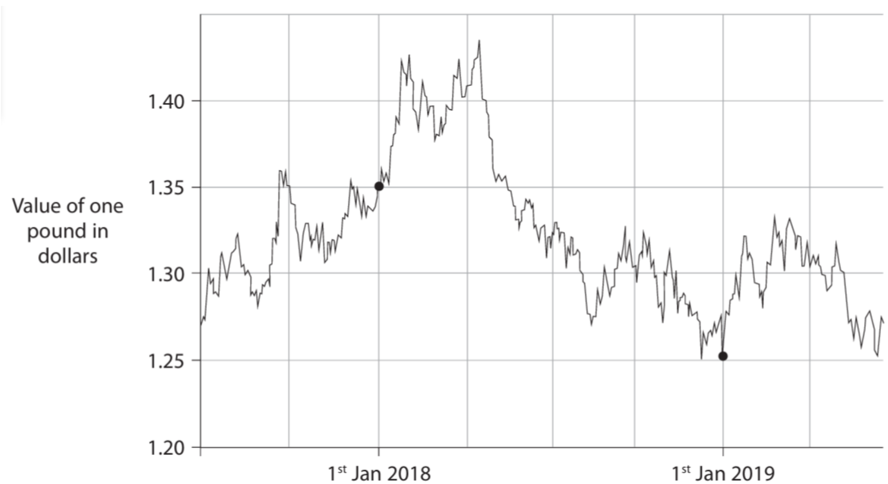
Exam Style Question 3

British pound to US dollar exchange rate (value of one pound in dollars), June 2017 to June 2019.



(Source adapted from: https://www.xe.com/currencycharts/?from=GBP&to=USD&view=2Y)

(a) Which **one** of the following has been the overall change in the British pound to US dollar exchange rate from 1st Jan 2018 to 1st Jan 2019?

[1]

A Appreciation

B Depreciation

C Devaluation

D Revaluation

(b) Explain the likely impact of the change in the exchange rate of the pound shown in the graph from 1st Jan 2018 to 1st Jan 2019 on the UK current account of the balance of payments. **[4]**

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Exam Style Question 3

Answer:

(a) Which one of the following has been the overall change in the British pound to US dollar exchange rate from 1st January 2018 to 1st January 2019?

✅ **Correct answer: B –** Depreciation **[1]**

Why the other answers are wrong:

A – wrong as the pound has fallen in value

C and D – wrong as the pound-dollar is a floating exchange rate system

(b) Explain the likely impact of the change in the exchange rate on the UK current account of the balance of payments.

The **current account** is part of a country's balance of payments and mainly records exports and imports of goods and services, as well as income from investments.

Between 1st January 2018 and 1st January 2019, the value of the British pound **depreciated** against the US dollar, falling from around **$1.35 to $1.26**. **[1]**
A **depreciation** means that the pound is worth less in terms of other currencies. This makes **UK exports cheaper** for foreign buyers and **imports more expensive** for people in the UK. **[1]**

As a result, UK exports are likely to increase because they're more competitive abroad, and imports are likely to fall because they now cost more. This would likely lead to an **improvement in the UK's current account** meaning a smaller deficit or even a surplus. **[2]**

This assumes that the **Marshall-Lerner condition** is met (i.e. the total demand for exports and imports is elastic enough to respond to price changes).

Please see the '9. The global context Revision Notes' pack for detailed notes.

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