AQA ECON4 ANSWERS

25 MARK QUESTIONS

JANUARY 2011

I wish to make clear that these answers are my own suggested approach and are not endorsed by AQA.

There are other approaches to the question besides the ones taken here, although the intention is that these are examples of good answers to the questions set. In particular, different evaluative judgements to those which I have made in answer to a question may be equally valid if supported by well-placed economic theory or real world evidence or examples. The guidance below provides some support in approaching questions.

Good luck with your studies and the exam.

Peter Cramp

<table>
<tr><td colspan="2">Symbols – The answers here are annotated in much the same way that they would be by the examiner when marking candidate scripts. The symbols are designed to highlight the skills being demonstrated at each point in the answer:</td></tr>
<tr><td>D</td><td>Definitions</td></tr>
<tr><td>Kn</td><td>Knowledge, for example of economic events or data</td></tr>
<tr><td>I</td><td>Issue – A relevant issue or point is raised. This is often in the first sentence of a paragraph.</td></tr>
<tr><td>Ap</td><td>Application – Applying the information in the extract, or knowledge of economic events or data, to help support the answer to the question.</td></tr>
<tr><td>An</td><td>Analysis – The use of relevant economic theory in answering the question, building up logical chains of reasoning.</td></tr>
<tr><td>E</td><td>Evaluation – Making judgements about the significance of particular factors, especially in providing a final answer to the question. Evaluation should be supported by relevant economic theory, information from the extract or the candidate's own knowledge</td></tr>
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GUIDANCE

1. It is common exam practice to define key terms in the question in the introduction to your essay.
2. The first sentence of each main paragraph of your work should clearly specify the point or issue which will be analysed in the paragraph.
3. The issue to be analysed in each paragraph should be clearly related to the question. Suppose the question is “Evaluate the effects of economic growth in Brazil on the UK economy.” It is appropriate to use paragraphs beginning “One way Brazilian economic growth may affect the UK economy is………”
4. The analysis in each paragraph should be a logical chain of reasoning. The more detailed this analysis is, the better, so include as many “links” in your chain as possible.
5. Appropriate use of economic diagrams is another way of demonstrating the skill of analysis
6. You must have tight focus on the question set. Good economic analysis, but based on material which is irrelevant or of borderline relevance may result in a lower mark than if the material had not been included.
7. The skill of evaluation is vital to scoring high marks for 25 marks answers. This involves making reasoned judgements in response to the question.
8. The main place that evaluation is expected in your work is in your conclusion. You must reach a final judgement that answers the question set and your judgement must be backed substantially by appropriate economic theory and/or “real world evidence”
9. You are also likely to include some evaluation in the main body of your essay. This can usefully be undertaken at the end of a paragraph following substantial analysis, or in a separate evaluative paragraph following on immediately.
10. The more specific your judgement can be the better. Suppose for instance the question is to “Evaluate the effect of higher oil prices on macroeconomic performance”. After analysis of the impact of higher oil prices on the main macro indictors, some students might state by way of evaluation: “However, the effect all depends on whether the economy is based on manufacturing or services”. The evaluation would be much stronger if specific judgement is made, such as: “Some economies, such as the UK, increasingly specialise in services. Because services do not use as much oil as the manufacturing sector, the macro performance of these economies will be less damaged than the performance of industrial economies such as that of China, which needs oil to grow”. This may be one of a number of concluding judgements made. Another might be: “Although higher oil prices generally damage macro performance by constraining growth and employment and fuelling cost-push inflation, some economies might actually benefit. This might be

the case for net exporters of oil, whose trade position and therefore national income may improve. Such a scenario is especially likely for Middle East economies for which oil revenue is a large proportion of national income, such as Saudi Arabia".

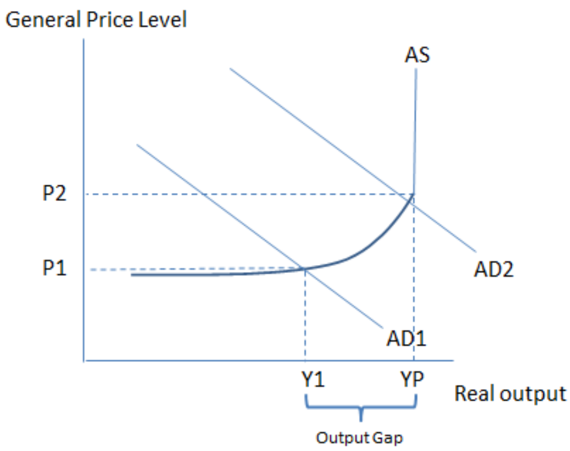
It is a good idea to study previous questions and to have a stock of examples and real world data that would help to answer them. You can pick up such examples from these suggested answers.

AQA ECON4 JANUARY 2011 CONTEXT 1

D Economic growth is measured via the year-on-year change in Gross Domestic Product. **Ap** As noted in Extract B, China has continued to achieve strong economic growth in recent years, with a forecast from the OECD of 9.3% growth in 2010, although this is down from double digit growth enjoyed in previous years.

I A benefit to the UK economy of strong Chinese economic growth is that it could provide a market for our exports. **An** As Chinese incomes grow, so too does their consumption. Some of this demand may be met by the output of UK firms, this boosting UK aggregate demand. Higher aggregate demand would not only boost UK output but also create a derived demand for labour, helping to lower unemployment and close the output gap, as illustrated in the diagram.

An **Diagram** Chinese growth could boost exports, stimulating UK aggregate demand



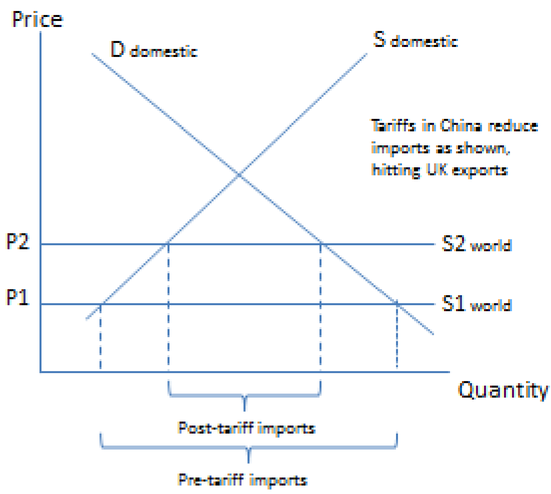
I/Ap/E A boost in demand for UK exports to China would be especially useful in the context of the global recession being experienced at the time of the data. **An** There was a lot of spare capacity and growing unemployment in the UK economy, so any factor stimulating AD would be welcome. This would especially be the case as the boost to exports would help to tackle the UK's current account deficit and help to create export-led growth. **Kn/Ap** The UK economy has been overly dependent on debt fuelled spending by the domestic consumer, and growth in exports to China would contribute to a much needed rebalancing of the UK economy that has been widely called for by economic leaders including Mervyn King. Such optimism should be qualified, however, by the fact that UK exports to China, although growing, remain small. **Kn/Ap** Figures from HMRC suggest that they were worth £8.7bn in 2011, and were dwarfed by exports to the USA (£39.8bn) and European nations such as Germany (£32.5bn). While exports to China had more than doubled in the period since 2006, it may be some time before they are of sufficient size to be a key driver of UK economic growth.

I/Ap A second benefit for the UK of Chinese economic growth is that "China continues to invest in the production of raw materials and resources in other countries". **An** In the case of the UK, this could mean production of capital resources as China becomes a source of FDI for the UK economy. Such investment helps to boost the productive capacity of the UK economy and thus to promote long term growth. **E/An** This investment could be especially useful given the relative lack of investment by UK firms during the recession, caused by a lack of profitability and difficulty in accessing credit.

I/E China's economic growth should not be welcomed by the UK without qualification, however, until the sources of this growth have been considered. **Ap** Export B highlights China's policy of "holding down the external value of its currency". **An** If the Chinese yuan is weak against the pound, this will raise the yuan price of UK exports to China and make it difficult for UK firms to compete successfully.

I/Ap Further, it appears likely that Chinese growth may be accompanied by protectionist measures, again as noted by the extract. **An** These measures, such as tariffs, would shelter Chinese producers from competition from firms in other countries, such as the UK. By raising the price of exports to China the Chinese consumer would be less likely to buy UK products and this would be a limiting factor on the benefit that the UK economy could derive from Chinese growth. The effect of a tariff in discouraging imports in China, and therefore UK exports to China, is shown in the diagram.

An **Diagram** Chinese protectionism could limit UK exports



Evaluation/final judgement (s)

Overall, the growth of the Chinese economy should be welcomed by the UK. **I/An** After years in which rapid growth of low cost production in China had created the need for the UK economy to adjust to the erosion of our manufacturing base, and accompanying regionally concentrated unemployment, China is now beginning to develop a substantial consumer economy and this offers potential opportunities for the UK to use its comparative advantage in some high technology niche markets and financial services. **An** There are few viable drivers of growth in the UK economy at present, as the finances of consumers, firms and governments are all stretched, and our usual export markets, such as the EU, are experiencing weak growth or stagnating. So new export markets such as China will be of growing importance. This must include other nations besides China, but China will undoubtedly be important. **I** It should also not be neglected that China will also help to bolster growth in other nations in the global economy, and this could produce secondary benefits for UK exporters.

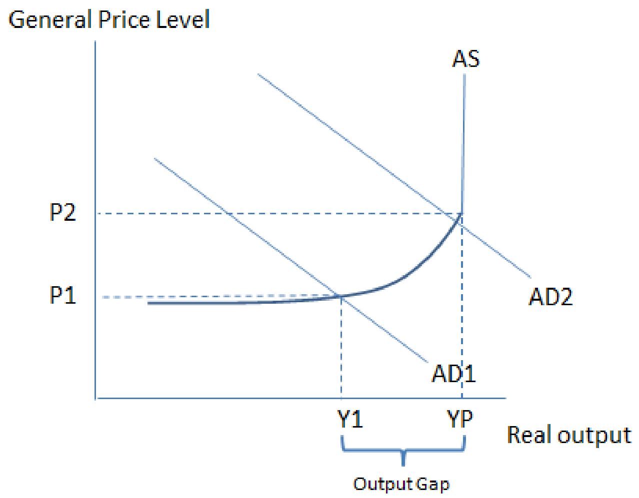
An Qualification to this welcome comes from the continued reliance of the Chinese economy on an artificially weak currency and protectionist measures, and the fact that it may be a number of years yet before China is able to provide a market for UK exports comparable to that of our major trade partners at present, namely the US and some European nations. There is also a danger that having helped to hold down prices with low cost manufactured goods, China may become a source of exported inflation in the years to come, as its demand helps to push up global commodity prices, for example. However, these factors should not be allowed to disguise the fact that the UK needs export led growth and that Chinese growth is amongst the most promising factors that might make this possible.

AQA ECON4 JANUARY 2011 CONTEXT 2

D Recovery refers to the growth of output between the trough of a recession and the peak of the business cycle. During a phase of recovery, GDP rises, and it is usual for unemployment in a recovering economy to fall.

I A benefit to the UK economy of recovery in the EU as a whole is that it would boost the market for our exports. **An** As incomes in European economies grow, so too does consumption. Some of this demand may be met by the output of UK firms, this boosting UK exports and hence aggregate demand. Higher aggregate demand would not only boost UK output but also create a derived demand for labour, helping to lower unemployment and close the output gap, as illustrated in the diagram. These effects may be bolstered by the multiplier as the incomes created lead to more spending and the generation of further income. These effects are illustrated in the diagram.

An **Diagram** EU recovery could boost demand for UK exports and hence AD



I A recovery in the EU could generate secondary benefits for the UK by helping to support growth in the world economy. **An** Large trading regions such as the EU can be important drivers for world growth, thus boosting demand for UK exports from countries beyond the EU.

I Recovery in the EU could also be seen as important to investment in the UK, for numerous reasons. **An** Firstly, firms in other EU countries are a source of inward investment into the UK and are more likely to undertake such investment when the EU economy is growing. Secondly, by generating orders for the output of UK firms, an EU recovery could induce UK firms to invest to meet these orders. Finally, recovery in the EU makes debt default less likely amongst European firms who have borrowed money. This may then make banks more willing to lend helping to relieve the "credit crunch" which has hampered investment in recent years. Such investment is important to the UK economy as it helps to generate increased capacity and sustainable improvements to living standards.

Evaluation/final judgements

I/Ap Recovery in the EU would be especially useful to the UK in the context of the time of the extract, "the greatest crisis in the history of European integration". This integration has led to the creation of the Single European Market (SEM) with free movement of goods, services and factors of production. **Kn/Ap** As a result many of our major trading partners are EU countries and the EU in aggregate dwarfs all our other export markets. ONS data shows that in 2011, German, the Netherlands, France and Ireland were placed 2nd to 5th in the league of UK exports, behind only the USA. £32.5bn of exports were made to Germany alone. Any threat to the continued existence of the SEM could severely damage the UK, destroying the benefits that it brings to the UK. Many UK firms would suffer severely if barriers to trade were again erected in Europe. By helping to avoid this, recovery in the EU would be very welcome.

An It is important not to overstate this case, however. Although the SEM benefits the UK by allowing for greater specialisation and trade, it might be noted that UK net exports to the EU are still negative and thus our trade with the EU constitutes a net leakage of AD from our economy. This said, any recovery in the EU would help to close this gap or at least stop it from growing.

I How useful the EU recovery is to the UK would be affected by which countries within the EU were the ones contributing most to that growth. **An** Arguably, growth in our more established trading partners such as German and the Netherlands (which has "experienced a 34% rise in unemployment" in little over a year) would be particularly beneficial, as in relation to newer members, we are more likely to import than export. This said, growth in the less prosperous member states would help to prevent rising tensions that might lead to the break-up of the SEM.

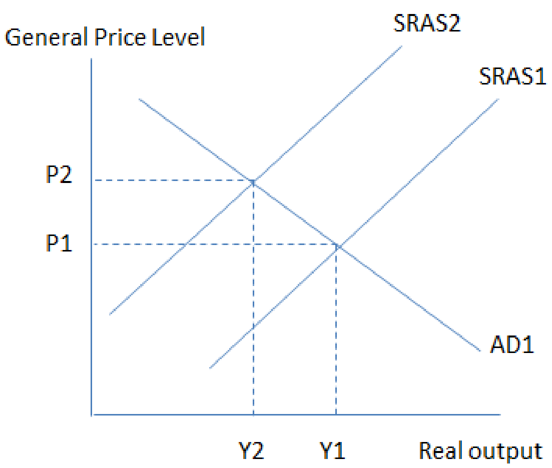
I The UK is currently desperate for an export led recovery, as both our consumers and our government are heavily indebted and poorly placed to support growth. **Kn/Ap** This has been highlighted by economic leaders including Mervyn King. Clearly, an EU recovery could only help this. It is particularly important given that the only real sources of global economic growth at the time of the extract came from emerging economies, such as China, India and those of Africa. While the opportunities provided by these countries are welcome to the UK, the UK does not yet have strong trade links with many of them, and they are only just developing consumer economies, so it will be some time before the benefits of their growth can be fully felt. In the meantime, the EU remains of crucial importance to the UK and its recovery would be very useful indeed.

AQA ECON4 JANUARY 2011 ESSAY 1

D/Kn Oil is a commodity whose price is set in global markets. The macroeconomic performance of an economy is measured by key indicators such as Gross Domestic Product, Inflation (derived from a consumer prices index, for example), unemployment and the current account of the Balance of Payments.

I Rising oil prices are likely to damage economic growth and cause inflation. **An** This is because oil if a key factor of production required in many industrial processes and also in transport and distribution. Rising oil prices reduce the profit margin on supplying goods at any given price, leading to a reduction in aggregate supply. Firms may pass some or all of the increase in costs to the consumer. Their ability to do this is affected by elasticity of demand, in other words the sensitivity of consumers to prices. Any part of the increased oil cost which is passed on to consumers is a potential source of cost-push inflation. Assuming that the firm has to absorb some of the costs, this may lead firms to cut back on output, and thus economic growth is also hit. The effects of an increase in oil prices on aggregate supply are shown in the diagram.

An Diagram Rising oil prices could damage economic macroeconomic performance



I It is also likely that rising oil prices cause unemployment. **An** This is because as prices rise and aggregate demand contracts (again, see the diagram) there will be a reduced derived demand for labour. In essence, firms do not need so many workers because they are not producing so much output.

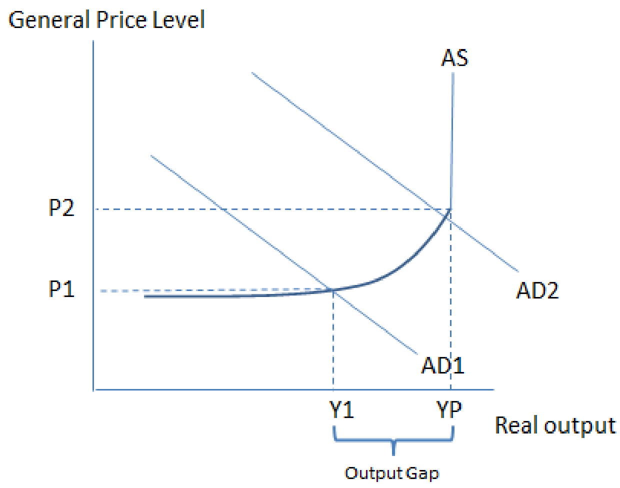
Evaluation/final judement (s)

I Taken together, these factors suggest that rising oil prices will damage macroeconomic performance. **An** However, as the question suggests, oil prices tend to be quite volatile. They can be driven up or down by political factors affecting supply, for example, or by particularly cold winters boosting demand for oil. Speculation on oil prices exacerbates the effects. Such volatility means that the rise in oil prices may not be particularly long lasting. **Kn/Ap** In 2008, for example, oil prices peaked at a record high of $147 per barrel but less than a year later had fallen to under $40 per barrel. **An** This means that firms may be able to ride out the increase and that this would limit the damage to macroeconomic performance. On the other hand, a permanent increase in the price of oil driven by demand from emerging economies or by depletion of this non-renewable resource would impose more serious macroeconomic consequences, and may require permanent structural change to economies in terms of changing the composition of output or finding new production techniques.

I A rise in oil prices is more damaging to those economies where manufacturing dominates than those with a strong service sector. **An** The UK's manufacturing base is now relatively small, for example, as our comparative advantage in this area has been lost to emerging nations with plentiful labour supply, low wages and therefore low unit labour costs. Instead, the UK has turned to high technology and the service sector, especially financial services. These areas are much less oil-intensive than manufacturing. While the UK can still be damaged by rising oil prices, the effect would be greater in a manufacturing economy such as Germany or China.

I The effect of rising oil prices would also differ according to whether a nation is an oil producer. **Kn/Ap/An** As north sea oil supplies dwindle, the UK is now a net importer of oil and thus the current account of our balance of payments would be damaged as rising oil prices lead to a higher value of oil being imported, on the assumption that demand for oil is inelastic. On the other hand, an oil exporter may actually benefit from higher oil prices. For some middle-eastern nations such as Saudi Arabia, for example, oil accounts for a large proportion of GDP. Higher oil prices would boost the value of exports from these nations, and this would raise aggregate demand for their goods and services. In turn this would have the potential to create employment opportunities and growth in the economy, reinforced by multiplier effects as the injection to the circular flow of income from exports would create incomes for some, leading to further rounds of spending. The benefits would probably not be particularly evenly distributed, but the economy would receive a stimulus. The effects of an increase in AD for net exporters of oil is shown in the diagram (see next page)

An **Diagram** Countries exporting oil could benefit from higher AD



An Thus it is possible to conclude that rising oil prices generally damage macroeconomic performance, especially if they are permanent in nature, although oil exporting countries are likely to provide an exception to this rule. It might be added that a rise in oil prices is even more damaging in today's globalised, integrated economy. It is difficult to isolate nations from the effects of events in other countries. Although the UK uses less oil due to the strength of its service sector, for example, Germany may experience greater damage. Germany is a key market for UK exports and thus the UK would experience secondary effects on its aggregate demand, while UK firms based in nations around the world would also suffer from any downturn in the economies where they are based: Oil prices really do damage macroeconomic performance, with just a few exceptions.

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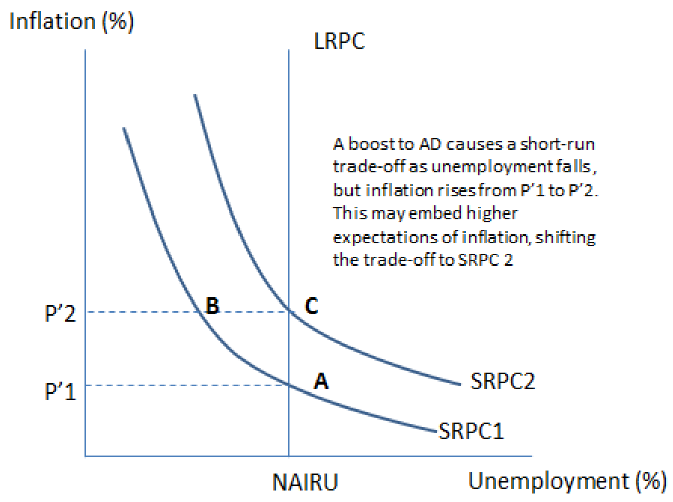
AQA ECON4 JANUARY 2011 ESSAY 2

D/Kn Government policy objectives usually include strong economic growth, low and stable inflation ('price stability'), low unemployment ('full employment') and an acceptable position on the balance of payments.

I It is common for trade-offs to exist between government objectives. **An** This can be understood by looking at what happens when the government stimulates aggregate demand (AD), for example by using an expansionary fiscal policy (increasing government spending or cutting taxes) or an expansionary monetary policy (cutting interest rates, increasing the money supply or weakening the exchange rate). Higher AD may enable the economy to grow, as firms are able to respond by supplying more output, making use of existing capacity. Such an increase in output also has favourable impacts on unemployment by creating a greater derived demand for labour. However, this may occur at a cost of rising inflation if the economy is close to its capacity. Higher AD is likely to cause excess demand for products in individual markets and prices will rise through the rationing function of prices. Aggregated across the economy this is inflationary. In essence, firms have more pricing power when demand is high. It may also be the case that high demand forces up the cost of factors of production and that this cost is passed on to the consumer in the form of higher prices. The current account of the Balance of Payments is also likely to suffer as demand grows, because consumers will not just demand domestic output but also imports. As the economy nears full capacity, more and more of demand will have to be met through imports.

An The potential conflict between price stability and full employment is illustrated by the Phillips Curve, as shown in the diagram. As AD grows and unemployment is reduced, each successive reduction in unemployment is shown to carry a greater cost in terms of inflation especially once the natural rate of unemployment has been reached. This can be understood as the rate of unemployment when the labour market is in equilibrium. It can also be reinterpreted as the non-accelerating inflation rate of unemployment. If AD is increased any further when the economy is already at its natural rate, then the resulting increase in demand for labour creates excess demand for labour and acceleration of wage claims. This in turn raises price inflation above whatever rate was embedded into the economy via inflationary expectations.

An Diagram The Phillips curve shows short-run unemployment-inflation trade-offs



I One way to reconcile conflicts between objectives is to establish credibility in monetary policy. **Kn/Ap** The Bank of England, for example, has worked hard to try to anchor inflationary expectations at 2% and the fact that it has a legal obligation to target this rate of inflation is intended to reinforce this expectation. **An** If inflationary expectations were currently 4%, but can be reduced to 2% by a credible policy framework, it is possible to make the inflation-unemployment trade-off more favourable, reversing the shift in the Phillips Curve shown in the diagram.

I Conflicts between economic objectives may also be avoided by the successful application of supply-side policies. **An** These are policies designed to increase productivity and promote stronger growth, usually by reducing the role of the government in the economy and creating stronger market incentives. Successful supply-side policies increase the capacity of the economy. This means that the economy can grow through higher levels of demand without coming up against capacity constraints and thus trade-offs between growth/unemployment and inflation are not such a concern. Further, the increased capacity may make the economy more competitive and help to improve the current account of the Balance of Payments. Supply-side policies, in theory, have the potential to help simultaneously improve all four main economic indicators, so that no trade-offs are present.

Evaluation/final judgement (s)

Experience shows that reconciling objectives may be easier in theory than in practice. **Kn/Ap/An** While the UK enjoyed both economic growth and price stability for at least ten years after the Bank of England was given control of interest rates in 1997, it has proven difficult to respond to supply-side shocks such as increases in global commodity prices. For the five years from 2007 onwards, inflation was above its 2% target for much of the time and the Bank was reluctant to raise interest rates for fear of damaging growth, especially when the problem was compounded by the global financial crisis. The dilemma facing the

Bank showed that policy trade-offs were very much present, even if those trade-offs were centred on a lower rate of inflation than they were in the 1970s and 1980s.

Kn/Ap/An Further, despite decades of attempting to improve the supply-side of the UK economy, it could be argued that this has been of limited success. It has not been possible significantly to raise trend growth above its existing level, widely thought to be around 2.5% and productivity in the UK still lags substantially behind that in key comparator nations such as the USA and Germany, by as much as 40% in the case of the USA.

Kn/Ap/An Still more, it is apparent that there has been little success in reconciling the conflict between the current account of the balance of payments and other objectives. The UK now has a small manufacturing base, with the result that when the economy grows the propensity to import is very high. Periods of economic growth have therefore almost inevitably led to further rises in an already large current account deficit. This means that the current focus for reconciling conflicts between objectives is to promote manufacturing, so that the UK can benefit from a rebalancing of its economy towards export led growth.

An Although it is possible to take measures to make the trade-off between macroeconomic objectives more favourable, it is not possible to reconcile conflicts completely: Demand-side policy is inevitably a balancing act and is the only tool available to provide a short-term response to shocks to the economy and attempt to smooth the business cycle. The on-going potential for conflict is shown conclusively by the possibility of supply-side shocks to the economy such as higher oil prices. Such shocks are inflationary and also hit economic growth. If the authorities are focused on economic growth, they must respond by stimulating demand and making the inflationary problem worse. If they are focused on controlling inflation they must constrain demand and risk turning a slowdown into a recession.

AQA ECON4 JANUARY 2011 ESSAY 3

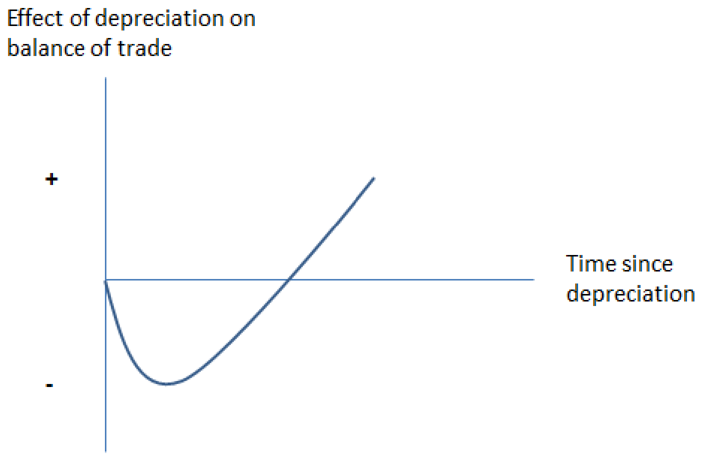
D/Kn The UK runs a substantial deficit on its trade in goods and services. This means that it imports a higher value of output than it exports. In 2010, the UK's trade deficit was £36.3bn. Policies to reduce the deficit are normally grouped into expenditure switching and expenditure reducing policy.

I One expenditure switching policy to reduce the deficit is to engineer a depreciation of the sterling exchange rate. **An** UK exports would become more competitive as consumers in other countries have to give up less of their own currency for each pound that they spend on UK products. By the same token, UK consumers would find the sterling price of imports had risen and would be less likely to buy them. Together, these effects would lead to an improvement in the balance of trade. **Kn/Ap** The UK benefited from such effects in the wake of a 25% fall in the Sterling effective exchange rate in 2008-09 (a trade-weighted exchange rate against a basket of other currencies), and this could be argued to be partly a deliberate intention of policies such as cutting the base rate and introducing quantitative easing.

I/E The success of an exchange rate depreciation depends crucially on the elasticity of demand for imports and exports. **An** For the policy to work, these should be as high as possible. Were import demand to be inelastic, for instance, the rise in the Sterling price of imports would produce a less than proportionate contraction of demand for them and total expenditure on imports would actually rise. The Marshall-Lerner condition shows that for a depreciation to lead to balance of trade improvements, import and export elasticities should sum to more than one. There could be some doubt about whether this is the case for the UK, which specialises in niche exports with low elasticity, but empirical evidence does suggest the Marshall-Lerner condition is satisfied at least in the long term. **Kn/Ap** The UK's recovery from recession in 1992, for instance, was sparked by improvements in the balance of trade when a large fall in the value of the pound was experienced when Sterling left the European Exchange Rate Mechanism. While the Marshall-Lerner condition may not be satisfied in the short-run as traders are tied to existing contracts (this is the J-curve effect illustrated in the diagram), it can confidently be expected to be satisfied in the longer term.

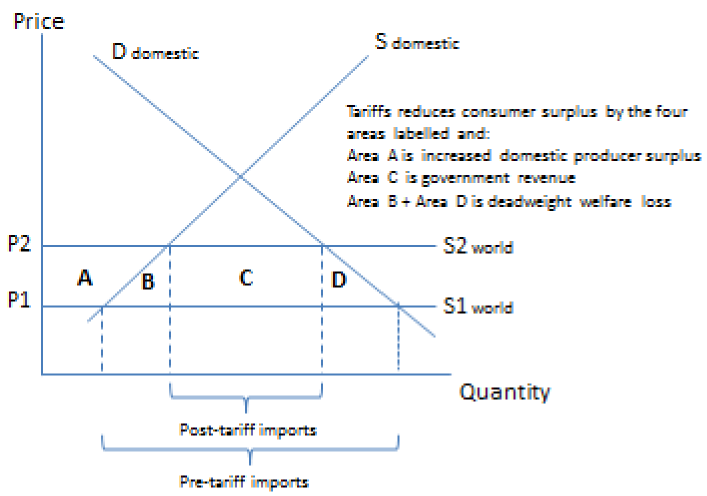
[Diagram on next page]

An Diagram Currency depreciation may initially make things worse, before improvements



I A second expenditure switching policy is to put in place a protectionist measure such as a tariff to shelter domestic producers from foreign competition. **An** The tariff raises the price of imports, encouraging consumers to substitute towards domestically produced output. This is shown in the diagram.

An Diagram Tariffs may reduce imports and improve the balance of trade



I/E Such policies are not appropriate to reducing the UK's trade deficit, however. This is largely because the UK is part of a customs union as a member of the EU, so cannot decide its own trade policy in isolation. Even if it could, protectionist policies should be avoided because they penalise the domestic consumer by raising the price that he/she must pay for goods. The result is a loss of consumer surplus and an overall deadweight welfare loss to society (again, shown in the diagram).

I Expenditure reducing policies aim to tackle balance of trade problems by constraining consumption. **An** Fiscal or monetary policy could be tightened in order to reduce expenditure. If consumption is lowered, spending on imports will be lowered too, and this effect may be substantial as the UK has a high propensity to import due to its small manufacturing base. **E** Expenditure reducing policies would be appropriate if the UK economy were operating at or close to full capacity and in danger of over-heating. If this were the case, expenditure reducing would help the UK to meet other objectives such as price stability, in addition to helping improve the balance of trade. In the current context, however, where UK output has yet to return to its pre-recession peak, we would want to avoid expenditure reducing policies because they would serve to increase the amount of spare capacity in the economy and would exacerbate our substantial unemployment problems.

Evaluation/final judgement (s)

In the long run, the solution to the UK's trade deficit may lie in measures to make our exports fundamentally more competitive. **An** It would be difficult to achieve price competitiveness because the UK is always likely to have relatively high unit labour costs in comparison to emerging nations with plentiful labour supply and low wages. However, it remains important to UK exporters that productivity is as high as possible and this suggests an important role for supply-side policies in helping to tackle the trade deficit. Further, it may be possible to exploit our existing comparative advantages in some high technology areas and financial services more, and to seek new comparative advantages in niche manufacturing. Products in these areas can retail at a price premium and are often not sensitive to price. **Kn/Ap** There is widespread agreement that the UK needs to tackle its trade problems in this way, and this is reflected by the frequent calls from economic leaders such as Mervyn King for export-led growth.

I The UK's trade deficit is likely to remain difficult to tackle because it is structural in nature, reflecting our difficulty in competing in a globalised economy. **An** Of the short-term expenditure switching and reducing measures available, a depreciation of the pound has been shown to be the one that carries most potential. Even this is problematic. **Kn/Ap** When the pound weakens, other currencies strengthen by implication and the result is that nations around the world have been fighting "currency wars" competing to have the weakest currency in order to win the largest possible share of the world export market in the wake of the global recession. **An** A weak pound is therefore not likely to provide a viable and lasting solution to the UK's trade deficit. Instead, this must be tackled from the supply-side and by seeking new markets for our goods by forging trade links with emerging economies such as China and various African nations. This is in spite of a lack of certainty about the success of such policies: Governments have been taking measures to try to make our economy more competitive for decades, and yet the UK's trade deficit has only grown over time.