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Examiners' Report
January 2011

GCE Economics 6EC02 01

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Introduction

Overall the paper was considered to be of a slightly more demanding standard than the previous year, but it differentiated between candidates well. In general student performance was at a good level, with answers showing a firm grasp of the requirements of the specification. The majority of entrants knew how to recognise the evaluation command words, and made good attempts at demonstrating this higher-order skill.

Question 1(a)(i)

In general this question was well understood and the data was referred to. The best answers recognised either that the price level was rising less fast when the inflation rate was falling (disinflation) or that the RPI experienced a period of deflation.

(a) (i) With reference to Figure 1, explain what happened to the price level in the period shown.

(6)

Figue 1 shows the rate of CPI and RPI from the period 2007 - 2009. The consume Price index and RPI measures the rate of inflation ie sustained rise in general price level

CPI stated at 2.1% and RPI at 4.2% roughly there was then an increase in both showing inflation rising to 5.2% and 4.9% respectively.

After Nov 2008, the ~~[illegible]~~ the CPI continued to ~~[illegible]~~ show inflation but at a slower rate, but RPI became negative showing deflation.

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Examiner Comments

2 marks were awarded for the definition at the end of the first paragraph. The second paragraph achieved 2 marks for refering to the data. The final sentence correctly identified deflation in the RPI whilst recognising inflation slowed. Potentially 2 marks for each point, but this response easily reached the maximum of 6 marks.

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Examiner Tip

Refer to the data when possible and especially when the question requests it.

(a) (i) With reference to Figure 1, explain what happened to the price level in the period shown.

(6)

Figure 1 shows the rates of inflation in the UK from November 2007 to 2009. There are two measures of inflation, consumer Price Index (CPI) which is a weighted measure, and retail price Index (RPI) which is a price survey. The measure which is used in the UK and internationally is CPI.

Fig 1 shows an increase in CPI from November 2007 to August 2008 from 2% to ~~5~~ 5.2%. This means the price level of goods increased at a faster rate. However from August 2008 - August 2009 the ~~inflo~~ CPI decreased meaning the price level was increasing at a slower rate.

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Examiner Comments

The penultimate sentance earns 2 marks for reference to the data and the final sentence correctly identified the trend in the price level gaining another 2 marks.

Question 1(a)(ii)

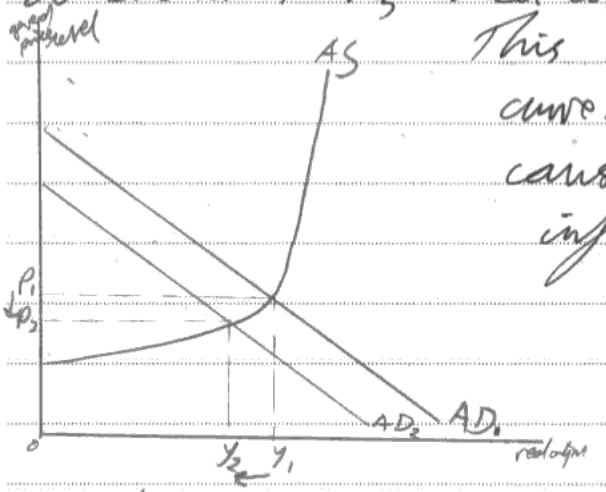
Candidates were familiar with the M.P.C.'s target and the tolerance. Many commented on the period of time the CPI was in or out of tolerance and explained how interest rates might have been used to try and manage inflation. Strong candidates successfully evaluated and many explained the difficulty of managing the impact of the recession.

(ii) With reference to Figure 1, and your own knowledge, to what extent has monetary policy, as conducted by the Monetary Policy Committee, been a success?

(12)

The Monetary Policy Committee (MPC) is a branch of the Bank of England which which controls ~~th~~ Monetary Policies, such as interest rates. They set the interest rates depending on the level of inflation. The inflation target set is at 2% (±1%).

If inflation gets too high above the set target of 2%, such as was experienced in August 2008, when the inflation level was as high as 5%, they will chose to increase interest rates. This will increase the cost of credit and mortgages. This will reduce the Marginal Propensity to Consume, so consumption will decrease, as people are ~~receiving~~ gaining more from saving. Firms decrease their borrowing as the amount they need to pay back will be increased.



This will cause a shift of the AD curve to the left. This will cause a decrease in inflation, lowering it back down to a stable target of around 2% (±1%).

If the inflation rate gets too low, ~~they will~~ the MPC will lower interest rates to encourage spending to help increase inflation.

The MPC ~~set~~ increased interest rates in the summer of 2008, to try and bring inflation back down. It took a month or so to start to decrease, as it takes time for the change in interest rates to affect the whole economy. But they were efficient and successful in lowering it back down to 1% after a year.

The current inflation rate is at 3.2% and the interest is ~~are~~ ~~also~~ at a historic low of 0.5%. The rate of inflation is rising gradually, and the MPC a planning on increase in the rate of interest over the next few months.

Due to the inflation rate constantly going up and down, the interest rates need to be changed also.

The MPC ~~have used these~~ usage of monetary policy ~~tools~~ has been a success to a certain extent, as monetary policy can have an effect on other parts of the economy, such as those with fixed incomes such as pensioners. Also the constantly changing inflation and therefore interest rates can create issues

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Examiner Comments

Four marks are obtained in the third sentence where the target and tolerance are correctly identified. Another four marks are earned for a correct explanation of how interest rates can be used to bring inflation back into tolerance.

On the final page in the new paragraph a couple of marks were awarded for evaluation as the candidate recognised that it takes time for interest rates to have their full effect.

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Examiner Tip

Although there are some wayward comments in this answer the candidate does enough to earn full marks.

(ii) With reference to Figure 1, and your own knowledge, to what extent has monetary policy, as conducted by the Monetary Policy Committee, been a success?

(12)

Monetary policy is actions taken by the monetary policy committee in an attempt to control inflation levels, consumption etc through in polices such as interest rates.

The MPC have successful in using monetary policy as when inflation reached highs of 5% we then see a sudden dip of 3.5% to make inflation rates 1.5-2%, this is successful as the MPC have acknowledged the increase of inflation, due to the economic boom of the cycle, and have introduced policies such as the increase of interest rates which will encourage savings because of high returns in savings account. This will discourage consumption and possible borrowing as ~~loan~~ interest on loan repayments and mortgages will increase. this has caused price levels and inflation to decrease back to down to 2% which is generally the inflation target made by the government.

However it can be argued that the MPC have not been so successful at using monetary policy to control inflation as inflation rates managed to reach upto 5% in CPI and RPI which is 3% higher than the inflation target, also RPI had reached below 0% in 2009 at -1.3% and this can suggest deflation, high inflation is not good as it lead to the currency becoming weaker however this could possible promote export. Deflation is not necessarily good as it strengthens the currency and unfavourable affect exports however may benefit import.

Overall the MPC have been good at using monetary policy in controlling inflation as they have been able to use policies effectivly when inflation was too high, and increase inflation when it was too low. The argument that inflation was highly over the target by 3% may not be very releted as it can be argued that due to the natural fluctuations caused be economic cycle, inflation was bound to be high ~~at~~ ~~are~~ ~~the~~ at the peak of the cycle.

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Examiner Comments

In the second paragraph four marks are awarded four identifying the target and that the inflation rate successfully fell towards target. Another 4 were obtained for explaining how interest rates could have been used to control inflation. At the bottom of the first page benefit of the doubt was given and the candidate was awarded 2 evaluation marks for explaining that the inflation rate was was out of tolerance but not out of control.

On the second page in the final paragraph a further 2 evaluation marks were awarded for recognising that the business cycle caused fluctuations in the rate of inflation.

Question 1(b)(i)

The majority of candidates understood what was meant by a fall GDP at constant prices, but the question did effectively differentiate between candidates.

(b) With reference to Figure 2,

(i) Explain what is meant by a **fall** in *Gross Domestic Product at constant prices.*

(4)

Gross domestic product is the total value of a country's goods and services, what a county produces. A fall in GDP means the country is producing less and not working at its maximum output. At constant prices means it is not accounting for inflation. Accounting for inflation would be Real GDP.

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Examiner Comments

Two marks were awarded for the definition but there was no reference to the data.

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Examiner Tip

Try to use different words from the word you are trying to define!

(b) With reference to Figure 2,

(i) Explain what is meant by a **fall** in *Gross Domestic Product at constant prices.*

(4)

Gross domestic product is the total output in the economy so a fall of Gross domestic product may mean that theres a decrease in output however it may not be as fast but theres a fall in output.

For example united kingdom has decreased from 2.6 to 0.5 so theres a fall in Gross domestic product.

There may be an increase in price etc.

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Examiner Comments

This student gets 1 mark for the definition in the first sentence. However the second and third sentences suggest that the candidate is confused about the data and the definition.

Question 1(b)(ii)

Again this question effectively differentiated between candidates with the most able students accurately identifying two problems of comparison and evaluating. Typically answers referred to two of the following: the black economy, the effect of exchange rates, population growth's impact and alternative methods of measuring development.

*(ii) Discuss **two** problems of comparing the economic growth of the UK and developing economies using GDP as a measure.

(12)

One problem with comparing economic growth of developing economies with UK using GDP is that there may be statistical inaccuracies with the GDP measure of developing economies. This is because there may be unrecorded data from factors such as self-produced goods or ~~output~~ goods from the black economy which are common in ~~the~~ developing economies. Therefore the GDP measure underestimates the economic growth in developing economies. Therefore when comparing the GDP measures of developing economies with the UK, it is shown that there is much more economic growth in the UK than in developing economies which is inaccurate. ~~Another problem~~ However, it can be said that the GDP measures ~~of~~ for the UK may also be inaccurate due to factors like the black economy as well. But this factor is likely to be less significant in magnitude to that of developing countries due to strict regulation and copyright control in the UK.

Another problem of GDP measures in develop-ing economies is that it does not include the ~~ex extent of poverty in the economies. Poverty is a major issue in developing economies as there are many who cannot get easy access to healthcare, education or even clean water. Therefore, economic development in terms of the material well-being~~ of the population in developing countries compared to the population of the UK. Developing countries generally have a much larger population size compared to the UK. Therefore economic ~~[illegible]~~ growth in developing economies would be high because of the quantity of labour, not the quality or efficiency of the ~~[illegible]~~ output. GDP changes ~~However, GDP per capita~~ may be due to changes in population, not the changes in development in terms of the material well-being of the population.

However, GDP per capita may be used to calculate GDP with changing population size which would be a more reliable ~~compari~~ comparison between the UK economic growth and economic growth in developing economies.

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Examiner Comments

On the first page this candidate obtains 4 marks for the explanation of the effects of the black economy and a further 2 evaluation marks for explaining the reasons for the relative magnitude in different countries.

On the second page 4 marks were awarded for identifying an increasing population as a possible source of GDP growth and there were 2 evaluation marks for identifying GDP per capita as a more useful measure in this context.

This is an excellent answer in which the candidate exceeds the maximum marks available.

*(ii) Discuss **two** problems of comparing the economic growth of the UK and developing economies using GDP as a measure.

(12)

~~Fa~~ The UK and developing economies have two different currencies. Therefore if the values are not adjusted there will be inaccurate results. If GDP were to increase in the UK and developing economies they will need to have the same currency values so we can compare the two. This can be done by using GDP at Purchasing Power Parities (PPP). If this is used there will be more accurate results as to which countries have seen economic growth. However, the reason why GDP is used is because it is easy to obtain the statistics of GDP. But a country like the UK is likely to have a much higher GDP than the developing economies because it is a much wealthier nation. But the volume of GDP doesn't show whether a country has grown more than another one, that is why an index such as constant prices ~~currency values~~ ~~&~~ or PPP needs to be used.

Another problem of using GDP as a measure of economic growth is ~~it~~ it doesn't highlight the distribution of income, and it doesn't take into the fact of black economies. In developing economies, such as in Africa, the distribution of ~~i~~ income can be so wide between the rich and the poor. This is mainly to do with corruption and political instability. Compared with a rather stable UK. It shows signs of growth, but people in poverty ~~will~~ will not feel the effects of economic growth. However, if we used GDP per capita as a measure it would give a more accurate figure as to how an economy grows, through education, health and income; which the HDI does. Also some economies are driven by black markets such as narcotics which contribute to the wealth of many people, but this isn't taken into account when measuring GDP. Therefore a country can have a lot of wealth circulating around the country but it's not taken into account. It will then be compared to a country like the UK which has less black markets, and the GDP figure for the UK will be higher.

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Examiner Comments

4 marks were awarded on the first page for recognising that currency values can distort comparison and PPP can help resolve this. There were 2 evaluation marks for stating that GDP figures were relatively straight forward and easy to obtain.

The second page contained three sets of 4 marks for the discussion of the distribution of income, the Human Development Index and black economy. The second set of evaluation marks came from stating that GDP per capita could be a helpful measure in throwing light on the nature of the growth.

Question 1(b)(iii)

Candidates found this question difficult. However a significant minority managed to described a scenario where the government's policy responses to over/under-estimated growth might cause a recession/inflation.

(iii) Analyse **two** possible implications for macroeconomic policy of inaccurate forecasts of GDP growth.

(8)

Inaccurate forecasts of GDP growth could have a large effect on macroeconomic policy. For example, if an economy is predicted to grow by 4% the next year, the government may decide to implement policy to keep this growth sustainable. However, if growth is lower than this prediction, then the policy will have had little effect and would have been a waste of money.

Another implication could be that if forecasts are low, then the government may assume that consumer confidence is low and so will use a fiscal stimulus to increase demand for goods and increase consumer confidence. If, however, consumer confidence wasn't low, then the government has just caused a rise in prices and demand that was unnecessary.

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Examiner Comments

4 marks were awarded for the explanation of the fiscal stimulus causing inflation in the second paragraph.

(iii) Analyse **two** possible implications for macroeconomic policy of inaccurate forecasts of GDP growth data.

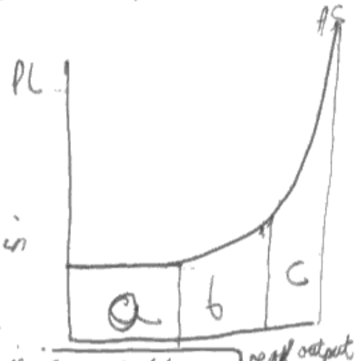
(8)

Inaccurate growth data may cause fiscal and monetary policy to be wrongfully deployed. If growth rates are predicted to be higher than normal it may cause the goverment to decrease spending and increase taxation. This type of fiscal policy is contractionary and itended to dampen demand. However if growth is not that great it may result in demand being reduced to a deflationary level.

Furthermore on increasing interest rates aggregate demand would fall. Investment would decrease as they become more expensive to finance and interes paid on mortgages rise. If growth is not as much as believed it may lead to deflation.

Alternatively if growth is underpredicted it may result in inflation as monetary and fiscal policies fail to dampen demand.

Depending on the level of spare capacity left in the economy the effects on the price level would differ. In section 'A' where there is spare capacity changes in demand will not affect the price level. At 'c' however they will cause inflationary pressures if demand is increased too much.



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Examiner Comments

4 marks were awarded for the deflationary effects of unnecessarily contractionary fiscal policy and a further 4 were earned for the tighter monetary policy.

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Examiner Tip

In questions that start with “analyse” it is unlikely that extra credit will be awarded for stating the same arguments in reverse and so the candidate unnecessarily wasted time writing them out on the second half of the answer.

Question 1(c)

Although this topic can be considered to be more challenging then most, this question was answered well. The answer to the effect of negative economic growth was actually stated at the end of the first paragraph of Extract 1. This then left candidates to explain how this might have come about and most described how more low skilled workers tended to be laid off first because of lower redundancy costs and ease of replacement. Better answers explained how richer people tend to have more secure income from their jobs and their investments.

(c) With reference to Extract 1, analyse the possible impact on the distribution of income of negative economic growth.

(8)

Negative growth will cause the distribution of income to besome more unbalenced. This is because the ~~distri~~ poorer population with less disposable income will struggle the most as less workers will be needed due to the fall in potential productive capacity. Essentially the distribution will become more uneven.

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Examiner Comments

This candidate recognised from the extract that the distribution of income had become more unequal and was awarded 2 marks for this. A further 4 marks were obtained for explaining that there would be less disposable income as a result of higher unemployment amongst lower income individuals.

(c) With reference to Extract 1, analyse the possible impact on the distribution of income of negative economic growth.

(8)

The distribution of income is likely to worsen due to negative economic growth. There will be high unemployment which will mean that people of a lower income group will suffer more than those of a higher income group, as they will have less savings. Moreover, in the long-run they will lose their skills.

There is a lack of confidence from banks and they would not want to lend therefore they are unlikely to offer loans to people of a lower income group as they are riskier than those of a higher income group. Increasing the income distribution gap.

However, there is likely to be redundancies in all sectors, so noone will benefit.

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Examiner Comments

Although the benefit of the doubt was given on a couple of occasions in this answer the candidate did enough to achieve full marks. The were 2 marks for identifying greater inequality and a further 4 marks for explaining how unemployment will affect those with lower savings more. Similarly a further 4 marks were awarded for the explanation of the greater reduction in the availablity of funds for lower income groups. The maximum was 8 marks.

Question 1(d)

The vast majority of candidates correctly drew an AD/AS diagram illustrating the impact of supply-side measures on real output and the price level, and identified the three main effects in the extract. Possible remedial supply-side policies tended to refer to education and training, but were rather vague and did not explain how the unemployed might be given vocational training. Similarly deregulation and privatisation were frequently offered as a solution to the destruction of capital stock, but without actually suggesting which industries they might be implemented in. The use of government grants or tax breaks and even the development of university research to encourage R and D tended to be well applied. Most candidates provided some suitable evaluation but it was not always developed. Candidates found it easier to score more highly on this question than question 2d.

*(d) Assess the effectiveness of supply-side measures that the government could use to deal with the problems outlined in paragraphs 3, 4 and 5 of Extract 1.

(30)

Supply side policies are a range of measures that governments take on board in order to affect the aggregate supply of the economy.

one of the problems outlined in paragraph 3 was the high unemployment and misalocation of resources.

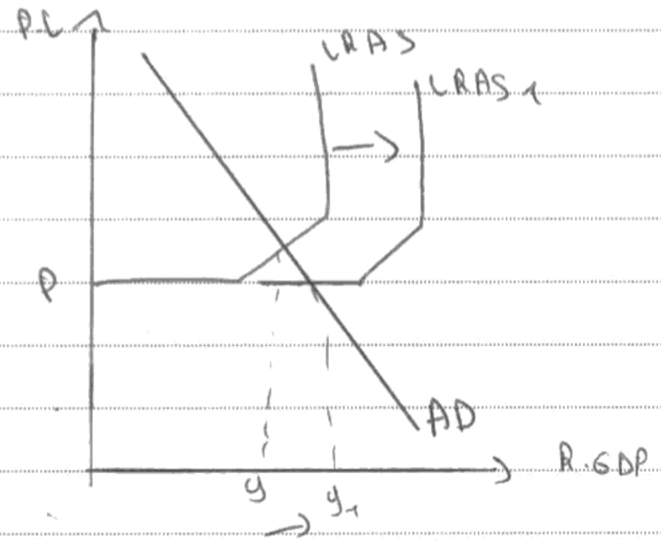
Inorder to tackle such proble the government might try to reform trade union power, in doing so firms can offer lower wage rates and ~~reduce~~ people are more inclined to accepting them seeing unemployment is high and finding a job isn't easy especially in times when an economy is experiencing negetive growth.

this would help to reduce unemployment and maintain business in competion.

However reforming trade union power might upset citizens and can see this action to be a sign of breaching their human right as they are forced into accepting lower wages.

In order to tackle the problem of misallocation of resources, the ~~g~~ government might privatise some of their industries, this is because the private sector is profit motivated and are more cost efficient and therefore ~~aff~~ allocate resources more efficiently. However privatisation is a length process and takes time to have any implication on the economy.

To tackle the problem of availability of credit, the gov can lower corporation tax, this has the effect of increasing revenue and thus profit. These profits can be invested into the economy ~~an~~ which can increase the potential output of the economy. This is illustrated in the figure below.



However this depends on the level of tax fall, and wether or not firms are willing to invest as their confidence can be ~~dep~~ dampened due to the recession.

In order to tackle the problem of productivity, the government can encourage inward migration, this has the ~~B~~ effecting of attracting highly skilled workforce who are willing to accept lower wage rate this has the effect of increasing productivity as more is made with less cost ~~involv~~ involved. the profit made can be spent on R & D thus increasing productivity in the long ~~run~~ run.

However inward migration does come with its costs, as it tends to put strains on thing like schools, hospitals, ~~etc~~ and therefore increasing spending of the economy.

To conclude supply side policies can be effective in tackling unemployment, but are less efficient in tackling problems such as misallocation of resources as it can incure time lags.

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Examiner Comments

On the first page there were 2 marks for the explanation of supply-side policies effect on AS. The second paragraph obtained 4 marks for the discussion over reducing trade union power. The final paragraph discussion of privatising industry was awarded 4 marks despite not being very clear about what industries would be privatised.

At the top of the second page there were 2 evaluation marks for recognising that privatisation takes time to deliver. There were 4 marks for the effects of corporation tax in the next paragraph and 4 evaluation marks were awarded for qualifying the success of this policy below the diagram.

4 marks were awarded for the diagram for demonstrating the impact of the AS shift to the right.
The mark allocated for labelling the equilibria was given despite the original price level not being marked. The original output was indicated and as the problems in the question were to do with output the benefit of the doubt was given.

By the bottom of the second page the candidate had achieved all 18 marks for Knowledge, Analysis and Application.

A further 4 marks were awarded for immigration and on the third page 2 marks were awarded for evaluating the possible effects of immigration.

In order to give the candidate maximum marks the 4 marks for the trade unions were dropped in favour of the 4 marks for immigration and additional 2 evaluation marks. KAA remains 18 marks and there were 2 + 2 + 4 evaluation marks.

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Examiner Tip

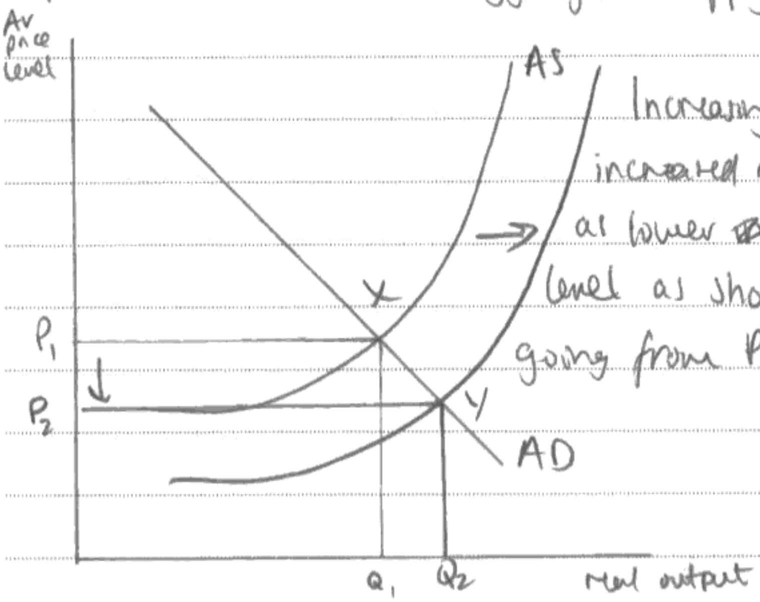
Use paragraphs as it demonstrates you have structured your answer and helps to guide the reader through your essay.

This candidate showed excellent exam technique by tackling the question directly and so earned high marks very quickly.

*(d) Assess the effectiveness of supply-side measures that the government could use to deal with the problems outlined in paragraphs 3, 4 and 5 of Extract 1.

(30)

Supply-side measures are instruments used by the Government to increase aggregate supply (AS)



Increasing AS leads to increased real output as well as lower average price level as shown in the diagram going from P_1Q_1 to P_2Q_2 (X to Y).

One beneficial effect of supply-side measures is countering the 'productivity fall' by increased Government investment on education and training. This would provide a more skilled and thus more efficient workforce which increases productivity thus reducing the impact on productivity of the recession. Also, increased productivity leads to increased output or potential output leading to increases in GDP, potentially above the UK forecast of '1.3%' in 2010.

However, the impact of an improved workforce is a long-term effect such that developing this increase in productivity takes many years and so in the short term, there may be little benefit of increased spending on education and training. In fact, this increased spending is likely to negatively impact the Government's budget so in the short term, this may negatively effect the economy.

Another way in which supply-side policies could be beneficial is in reducing the 'high unemployment' from the recession. By reducing income tax, the Government can provide incentives to work for the unemployed which may increase the supply of labour, therefore reducing unemployment.

~~However, these incentives are likely to The reduction in income tax is likely to also provide incentives for~~

However, it seems the problem is not the supply of labour but the demand for labour and so reducing income tax may prove ineffective in reducing unemployment - as producers simply cannot afford to hire more workers ~~Bba~~ due to the negative financial impact from the recession.

~~B~~ On the other hand, supply side measures may prove ineffective ~~in~~ for example in reducing the amount of 'capital stock destroyed'. Increasing aggregative supply is unlikely to improve the use of capital stock purely because during the recession there is a huge reduction in aggregate demand.
However, due to the decreased value of inflation in 2009, aggregate demand may be increasing in the near future so the ability to ~~supply~~ increase supply by increasing capital stock is particularly important.
Furthermore, ~~a~~ if the Government ~~deregula~~ conducted ~~dert ake~~ deregulation of markets, competition may increase leading to increased investment in capital in these markets due to business confidence increases. Therefore, the reduction in capital stock may be lower than expected so in this context, supply-side policies may prove effective.

Finally, another way that a supply-side policy could be used to effectively decrease ~~the~~ unemployment is by reduction or even abolishment of national minimum wage. This would be particularly effective in increasing the demand for labour as producers could afford to hire more workers which is significant during recession. The fact that more people will be employed will also reduce the extent of 'former employees losing skills' which is obviously desirable for the economy.

However, the reduction or abolishment in national minimum wage may lead to increased income inequality due to unfair wages which is seemingly undesirable for the economy, and so although this may be effective in reducing unemployment, it may prove to be unfair for people employed at such low wages. ~~Thus~~

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Examiner Comments

The candidate starts the answer very efficiently earning the full 6 marks for identifying the impact of supply-side policies on the AS curve and drawing an accurately labelled diagram. 8 marks were awarded for the explanation and evaluation of education and training at the bottom of the first page and the top of the second page.

On the second page in the second paragraph there were 4 marks for education and training and in the third paragraph 2 evaluation marks were earned.

On the third page the second paragraph achieved 2 marks for deregulation, but with the 4 further marks for abolishing the minimum wage in the next paragraph the KAA reaches 18 marks and these 2 marks are not counted. In the final paragraph 2 evaluation marks were credited for identifying increased income inequality. The lack of fairness wasn't clearly explained so wasn't credited.

Question 2(a)(i)

This was answered well with many students gaining full marks. Some students did not refer to the extract or found it difficult to explain how the deficit might be increased.

(a) (i) With reference to the information in Extract 1, explain what is meant by 'a modest increase in the fiscal deficit' (line 7).

(6)

~~The fiscal~~ A fiscal deficit occurs when government spending is greater than tax revenue, it is an expansionary fiscal position. Extract 1 says that there is a modest increase in the deficit because although it increases to £178bn, that represents an increase of just £3bn, or less than ~~2~~ 2%. ~~Hence~~ Increasing the fiscal deficit is likely to shift AD right, because it is an increase in net govt spending and Govt spending is a component of AD. This ~~will~~ should increase the price level and ~~GDP~~ RNO.

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Examiner Comments

2 marks each for definition, increased government spending and reference to the data.

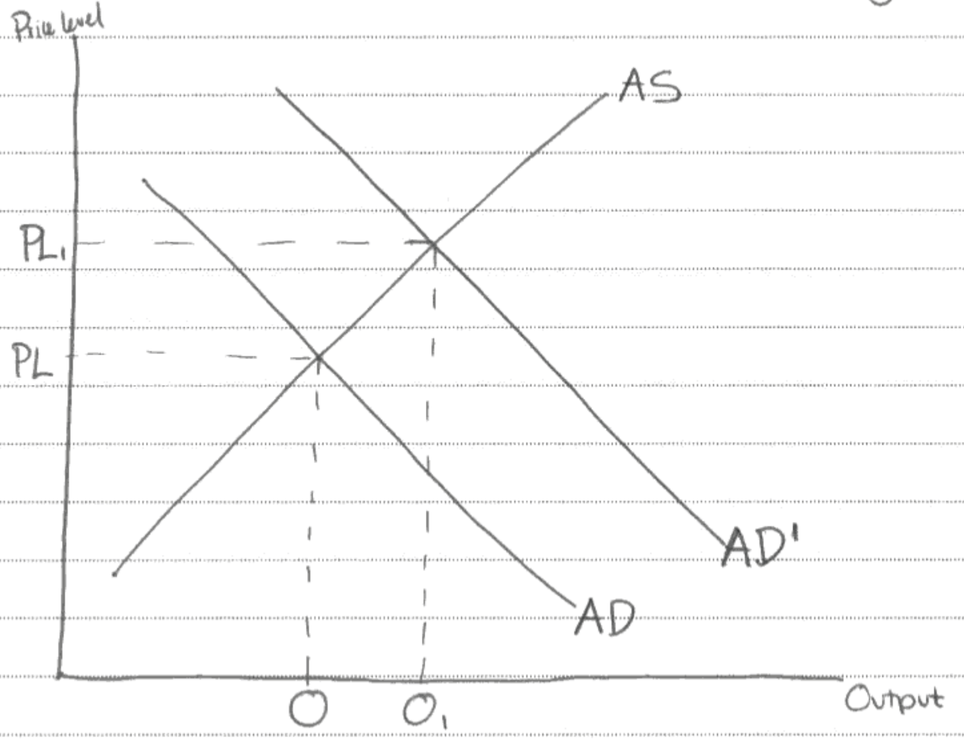
Question 2(a)(ii)

Most candidates explained the shift in the AD curve, drew the diagram and correctly identified the effect on the price level and output. The explanation of the multiplier was more challenging for some, but many students described it effectively. A number of candidates did not provide evaluation, but those who did evaluate typically developed their points well enough to be awarded the full 4 marks.

(ii) Illustrating your answer with an aggregate demand and aggregate supply diagram, evaluate the likely effect of an increase in the fiscal deficit on the level of real output and on the price level. Refer to the multiplier effect in your answer.

(16)

Fiscal Policy is the use of government spending and taxation in order to run the economy.



Evident in the diagram an increase in the fiscal deficit is set to have a positive impact of AD which in ~~nature~~ return cause AD to shift to the right which increases inflationary pressure as the PL increases and also allows output to expand.

An increase in the fiscal deficit will ~~a~~ produce a multiplier effect as by increasing government spending there will be an injection into the circular flow of income. Eventhough extract 1 does not refer to a fall in the level of tax, this would also satify the AD curve as it reduces the leakages. However if ~~the~~ the Government increase their spending but ~~taxes~~ taxes remain high, then the multiplier effect will not have such a great impact.

By increasing government spending consumption should increase, as more people will go into employment as more firms will employ creating a positive multiplier effect as these ~~new~~ newly employed people will also create incomes to consume which will help other firms and everyone begins to benefit. Those already employed may be helped by an increase in ~~real~~ wages, causing them to increase their spending ~~unless~~ however it is important that they have a real wage increase in tandem with the change in inflation from the right shift in AD. The multiplier effect will continue until it is all leaked away.

The impact of the multiplier very much depends on the size of it and on the MPC of the people. If people have a high MPC (Marginal Propensity to Consume) then consumption should increase significantly, however today people tend to have a higher MPS (Marginal Propensity to Save) as people will save in fear of losing their jobs or may have forp use their wages in order to pay back debt. All these factors would be a withdrawal from the circular flow of income and will reduce the impact of the multiplier.

Furthermore £xtract 1 refers to a £3 billion increase, however will this have a significant effect on AD. There ~~are~~ are also other factors than just consumption that should be considered such as business confidence, due to low sales ~~as~~ firms will have no incentives to invest and shift AD right. There are also time lags with fiscal policy as ~~it~~ it could take up to 2 years for the effects to be felt.

In conclusion the fiscal deficit may increase AD which will help the economy, however if inflation gets to high, new ~~mea~~ measures will have to be met.

ResultsPlus

Examiner Comments

On the first page 3 marks for the diagram, 4 for price level and output increases, and 2 for the reference to the injection reach the maximum of 8 marks.

On the second page there is 4 for an evaluation of the tax rate, followed by 4 for the multiplier reaching full marks. In addition there is a further 4 marks for evaluating the multiplier.

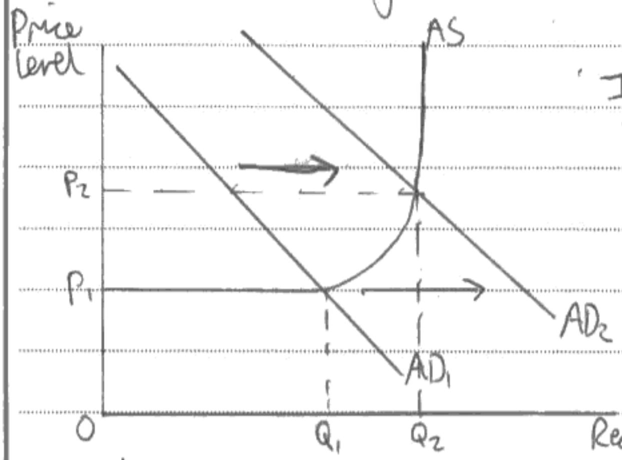
On the third page there are 2 evaluation points each would have received 2 marks: for other factors and time lags.

(ii) Illustrating your answer with an aggregate demand and aggregate supply diagram, evaluate the likely effect of an increase in the fiscal deficit on the level of real output and on the price level. Refer to the multiplier effect in your answer.

(16)

Aggregate Demand is made up of Government spending, investment, consumption and net exports:
$AD = G + I + C + ~~(x-m)~~ (X-M)$

Government is 45% of Aggregate demand. An increase in the fiscal deficit implies that government expenditure has increased which will therefore increase Aggregate demand as shown on the diagram below:



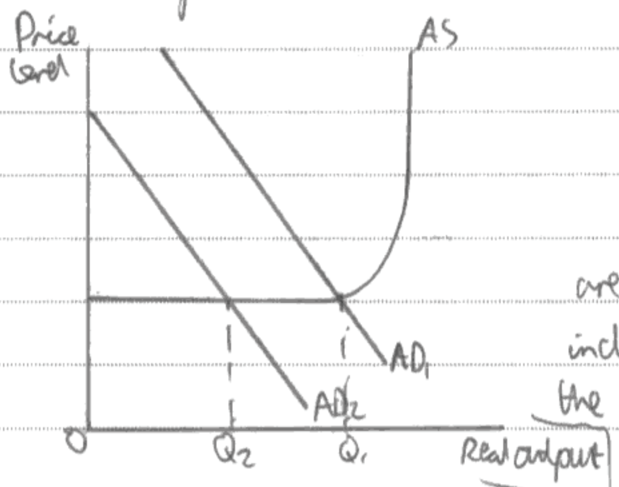
If government expenditure is increased the economy will experience an increase in aggregate demand. This increases the quantity of real output, yet it also increases price level.

* fall

As the price level has increased, this suggests ~~the~~ inflation has occurred. If inflation occurs, Consumption will fall and in turn, investment will * ~~fall also~~. This is shown in Figure 1 where as government spending has increased by 2%, consumption has fallen by 3% and investment has fallen by 14%. Consumption falls has the higher prices ~~ca~~ caused by inflation leads to demand of goods and services falling. This leads to a fall in sales for firms and therefore falls in revenue and profits. Due to falls in revenue, ~~and prof~~ firms will be unable to invest as much. As these firms have become less internationally competitive, consumers will buy ~~exports~~ imports as they are relatively cheaper. This will see a rise in net exports as shown in Figure 1 where net exports have increased by 29%.

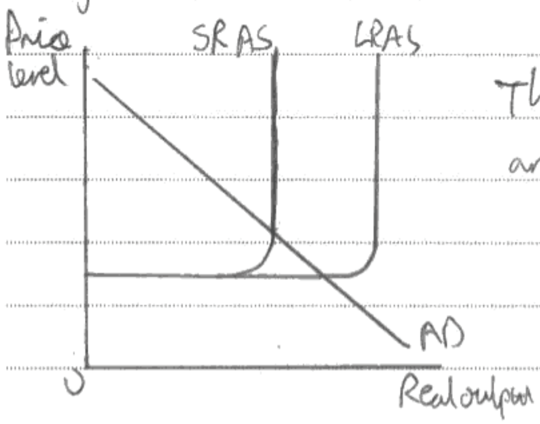
~~As consumption, investment and net exports are all factors of aggregate demand, a fall in each of these~~

~~An~~ Consumption makes up 65% of aggregate demand, so if fiscal deficit ~~is to~~ increased, the decrease of consumption and investment will outweigh the positive effects of increased government expenditure and net exports. Therefore the AD curve is more likely to shift to the left as aggregate demand falls:



This will cause a decrease in real output with no price level change. As interest rates are high, consumers will be more inclined to save, a withdrawal from the circular flow of income and therefore a decrease in multiplier effect and marginal propensity to consume

However, The Chancellor said the extra spending that caused the increased fiscal deficit will be spent on education and health. If education of ~~pe~~ workers increases this will increase output per work. If health is improved, workers are less likely to take days of work ~~to~~ and therefore become more productive. However, the people who ~~use~~ NHS more are either too young or too old to be in work. These supply-side policies will shift aggregate supply to the right as it ~~as~~ will increase, but only in the long run.



Therefore, real output will increase and price leve will be lower

As Government expenditure represents an injection in the circular flow of income, the multiplier will increase leading to an increase in the marginal propensity to consume. As interest rate are increased, due to savings increasing, marginal propensity to consume will fall.

ResultsPlus

Examiner Comments

On the first page 3 marks for the diagram, 4 for price level and output increases, and on the third page in the final paragraph 2 for the reference to an injection reach the maximum of 8 marks.

On the second page 4 evaluation marks for the explanation of consumption having larger effect than government spending.

No marks for the multiplier.

Question 2(b)(i)

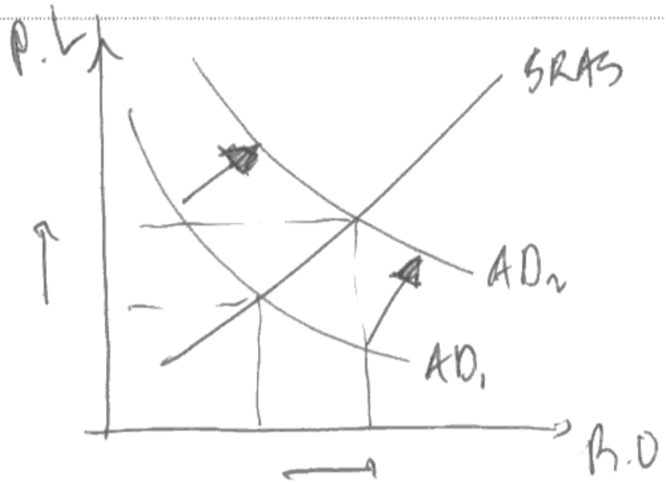
In general candidates responded well to a piece of data that was not immediately accessible. Most identified that imports had fallen and referred to the data before explaining the effect on the current account deficit. Only the best answers identified that exports had not risen but had actually fallen less fast than imports.

(b) (i) Explain the impact on aggregate demand of the fall in the size of the current account deficit in 2009, as represented in Figure 1 by 'Exports – Imports'.

(6)

The current account deficit (Exports - Imports) falls from -39 602 to -28,034 in 2008/9 this is 29%.

This suggests that either exports are on the rise or imports are falling, or both.
AD = C + I + G + (X − M)
, if (X − M) is negative but getting closer to 0, then AD will rise. This rise will show an outward shift on an AD/AS diagram

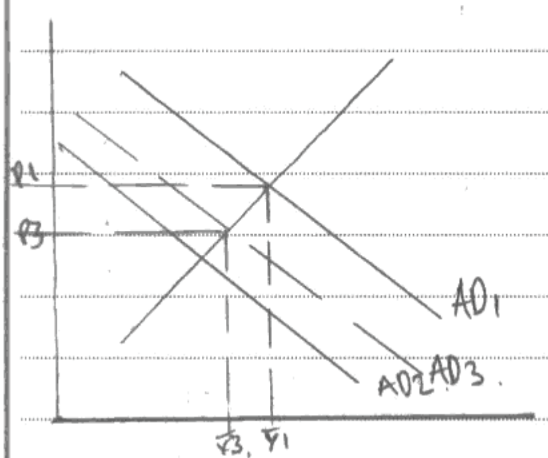


ResultsPlus
Examiner Comments

The total mark is 5 out of 6 marks.
2 for correct data (29%), 1 for explanation of imports falling, 2 for the impact on AD.

(b) (i) Explain the impact on aggregate demand of the fall in the size of the current account deficit in 2009, as represented in Figure 1 by 'Exports – Imports'.

(6)



Although the current account is still ~~a~~ showing a deficit, the rate of this deficit has reduced, ~~and~~. Therefore, although it is still a withdrawal of income from our economy, it is at a reduced rate, and so instead of AD shifting left at the same rate, to AD2, it will shift left still, but by a smaller proportion AD3. AD will shift as current account effects it, but it is questionable as too how ~~as~~ much it effects a shift. The shift on the diagram looks large, but other factors like gov. spending + consumption could influence it more. In 2008 current account was -39,602, to -28,034 in 2009, increase of 29%

ResultsPlus

Examiner Comments

2 for withdrawal, 2 for AD impact and 2 correct data (29%).

Question 2(b)(ii)

Most answers identified at least one reason for the fall in consumer expenditure and referred to the data. The most popular reason given was rising unemployment and where a second reason was provided a common response was the negative wealth effect. Candidates found evaluation challenging in this question.

*(ii) With reference to Figure 1, discuss **two** likely reasons for the fall in consumer expenditure in 2009.

(14)

Consumer expenditure, or consumption is ~~a~~ key component of aggregate demand. A reduction in this suggests spending in the economy, which could be for a variety of possible reasons, for example, consumer confidence or ~~[illegible]~~ income.

When considering GDP, this is a measure of the total of incomes in an economy, hence it can represent the amount of money that people have. A fall in GDP was shown in 2009 from 1330088 to 1266533 by 5%. This tells us that the total amount of incomes has reduced, ~~and~~ so people have less money. This suggests that spending power is reduced. As spending power is reduced, people cannot spend as much and consumption therefore falls, so this is a likely reason for a fall in consumption.

However, if prices are falling in line with price levels, than real income may not be so different. It is necessary to consider this when suggesting GDP as a reason for a fall in consumption, as spending power may not actually be ~~[illegible]~~ affected. However deflation is unlikely, so in this case, it is likely to be a significant factor for a fall in consumption.

Another reason may be a fall in consumer confidence due to wealth effects. This refers to the value of assets, for example houses. As the value of a person's house goes down, the value of their property is lower, and they may have less consumer confidence. This would lead to a decrease in spending, and overall consumption. Other assets such as stocks would have a similar effect, and the value of stocks fell in 2009 by -19.06%. This would have reduced consumer confidence, therefore reducing spending, therefore reducing consumer expenditure.

However, it is likely that real money factors such as interest which would affect the level of mortgage repayments would have a greater impact than the psychological impact of wealth effects.

Overall, GDP and consumer confidence are two possible reasons for a fall in consumer expenditure. GDP is likely to be more significant as it refers directly to the amount of income that people have, rather than psychological confidence through wealth.

ResultsPlus

Examiner Comments

First page: 2 for data and fall in income in the second paragraph and 2 for evaluation in the third paragraph.

Second page: 4 for negative wealth effect and 2 evaluation marks for a fall in consumption having the largest impact in the final paragraph.

*(ii) With reference to Figure 1, discuss **two** likely reasons for the fall in consumer expenditure in 2009.

(14)

Figure 1 shows that consumption fell from 852,918 to 826,436 with a percentage change of -3%. One reason for this could be due to an increase in interest rates. Interest rates are the reward for saving and the cost of borrowing. Therefore a rise in this will greatly affect people with loans, for example mortgage holders of which there are about 10 million in the UK. Increased interest rates would mean that mortgage repayments are higher, leaving less disposable income to spend in the economy, thereby explaining a fall in consumption. Furthermore, with high interest rates, savers will have greater incentive to keep saving than to spend. As there are so many mortgage holders in the UK, the impact is likely to be great, but this might not take immediate effect, for example some mortgage holders may actually be on fixed rates so that it does not affect them greatly which could explain only the small percentage decrease.

A second reason is that consumer confidence may fall due to factors such as high unemployment rates or high inflation. This creates uncertainty about job security and therefore may encourage consumers to reduce their spending. With a lack of confidence consumers are very unlikely to make purchases which they may be able to repay later thereby causing this 3% fall in consumer spending. Out of the two reasons I have explored, I can conclude that it ~~is~~ the second reason is the most probable. This is because ms interest rate increases are a blunt tool, affecting consumers over different incomes, which would most likely to have caused a greater percentage ~~de~~ decrease than just 3%, thereby reinforcing that the second reason I have put forward is more likely of the two.

ResultsPlus

Examiner Comments

First page: 2 for data, interest rate argument was accepted and given 4 marks and a further 4 for evaluation of the extent and timing of the impact. The last paragraph was awarded 4 marks for consumer confidence and unemployment.

Question 2(c)(i)

Most students understood this question clearly and gained full marks for good explanations of the exchange rate.

(c) (i) With reference to Figure 2, explain the term *exchange rate*.

(4)

Exchange rate is rate ~~that~~ of how much one currency is able to buy of another currency. ~~Fig~~ Figure 2 shows that from 2004 to 2009, the amount of US $, the pound can buy for a certain unit of currency (sterling) has decreased. This means the dollar has become more expensive for UK citicens and vice versa.

ResultsPlus

Examiner Comments

2 for definition and 2 for data reference (used year and shows understanding).

ResultsPlus

Examiner Tip

It is better if the data is also referred to as well as the year.

Question 2(c)(ii)

This calculation question differentiated between students. Those students that showed their working usually obtained some credit even if their final answer was wayward.

(ii) Using the data in Figure 2, calculate the percentage change in the value of the pound against the Euro between 2004 and 2009.

(4)

EURO	US $
1.43 − 1.10	1.90 − 1.62
= 0.33	= 0.28
$\frac{0.33}{1.43} \times 100$	$\frac{0.28}{1.90} \times 100$ = 14.736842 11
= 23.07692308	= −14.7%
= −23.1%	

ResultsPlus

Examiner Comments

Correct answer with minus sign and percentage.

ResultsPlus

Examiner Tip

Show your working in case you make a mistake in the calculation so the examiner can credit you for the part of the process you got right.

(ii) Using the data in Figure 2, calculate the percentage change in the value of the pound against the Euro between 2004 and 2009.

(4)

	Euro	~~dollars~~	
2004	1.43	~~1.90~~	1.43 − 1.10
2009	1.10	~~1.62~~	0.33.

$$\frac{0.33}{1.43} \times 100$$

= ~~23%~~.

= 23.08%.

ResultsPlus

Examiner Comments

Showed working and although the final answer could have been presented more clearly the full 4 marks were awarded.

Question 2(d)

Candidates found this a demanding question. Definitions tended to be adequate but not comprehensive, typically only referring to exports and imports. On the whole the analysis was well done, particularly the effects of the exchange rate changes. However a number of responses did not refer to Figure 1 when explaining consumption and investment. Unfortunately they incorrectly assumed investment and consumption had risen. There were some excellent responses to this question, but on the whole evaluation was rather limited. It was good to see students use examples and their knowledge of policies in the current economic climate.

This was a good answer and the candidate did enough to achieve full marks.

*(d) Evaluate the likely effects on the UK's current account of the balance of payments of changes in consumption, investment and the exchange rate of the pound sterling (£), as shown in Figures 1 and 2.

(30)

The UK's current account of the balance of payments is composed on the level of exports from the UK to other countries, and the level of imports from other countries to the UK.

From 2008 to 2009, consumption fell by 3%. If consumption ~~is~~ falls, the level of imports are likely to fall. This ~~as~~ ~~As spending increases~~ is because ~~as~~ consumers are not only spending less in their own economy but also spending less on goods and services from abroad. If the level of imports falls, this will reduce the deficit on the UK's current account.

Investment fell by 14% ~~from 2008~~ in 2009. ~~As~~ Investment by firms is likely to improve the quality of their goods and services and may also reduce the prices of their products as the investment may be aimed at making ~~their~~ their firms more efficient. Therefore as the level of investment falls it may be that the level of exports falls, ~~which~~ which may ~~also~~ increase the deficit on the current account, depending on the level of imports. ~~As it~~ ~~is~~ If businesses abroad are offering goods and services at lower prices and better quality, ~~the UK will not be~~ due to increased investment, the UK will not be able to compete and therefore the level of imports will fall.

From 2008 to 2009, the pound strengthened against the dollar. This means that imports from America have become cheaper to consumers and businesses in the UK. As a result the level of imports are likely to increase, resulting in an increase in the deficit on the current account. However, from 2008 to 2009 the value of the pound weakened against the euro. This means that consumers and businesses in the Eurozone will find that goods and services in the UK have become cheaper. ~~and consumers and businesses in the UK~~ In addition the price of goods and services in the Eurozone has increased for those in the UK. As a result the UK may see an increase in exports to the Eurozone and a fall in imports from the Eurozone, which will reduce the deficit on the current account.

The extent to which changes in consumption will affect the UK's current account depends on the elasticity of demand for exports and imports. If the elasticity of demand for imports is inelastic, a change in consumption is not likely to affect the level of imports, it may only affect the level of goods and services bought within the UK. Although ~~as consumption changes falls we ass~~ the level of imports fall we assume the deficit on the current account will be reduced, ~~we now~~ this may not be the case. We need to also consider the level of exports to other countries. If there is an even greater fall of exports from the UK than the fall of imports to the UK, the deficit on the current account will actually be increased.

As the effects of investment are usually seen in the long run, a fall of investment may not have a great effect on the UK's current account in the short run. The effects of investment which took place in 2005 for example, may only be felt in 2009. Therefore it is difficult to conclude that a fall in investment will reduce the level of exports and hence create a large deficit on the current account.

When looking at the changes in ~~exchange rate~~ the value of the pound in euros and US dollars, it is difficult to predict the effect on the current account. As the ~~value of the~~ pound ~~has~~ strengthened against the dollar but weakened against the Euro, the effect on the current account may be negligible as the increase in imports from America may cancel out the fall in imports from the Eurozone. Also as we are only looking at two currencies, we have not taken into account the level of exports from other countries which will also ~~help~~ affect the current account.

ResultsPlus

Examiner Comments

First page: the full 6 marks were awarded for the definition of the components of the current account in the first two paragraphs. Implicit understanding of the trade in goods and services was shown in paragraph one of page two. The second paragraph gets 4 marks for the effects of falling consumption. There are 6 marks for the effects of falling investment in the third paragraph.

Second page: in the top half of the page 6 marks were awarded for the effect of changing exchange rates. The maximum of 18 for KAA is achieved. In the bottom half of the page there was 4 evaluation marks for elasticity.

Third page: 4 evaluation marks for investment and 4 evaluation marks for exchange rates.

*(d) Evaluate the likely effects on the UK's current account of the balance of payments of changes in consumption, investment and the exchange rate of the pound sterling (£), as shown in Figures 1 and 2.

(30)

balance of payments represent the difference in a Countries imports and exports.

The UK is currently running at a trade deficit of £-28,036. This means Imports outweigh exports by £28,036. Within the past 5 years the £ has been depriciated and from £1 = €1.43 = $1.90 now represents £1 = €1.10 = $1.62. This ~~has~~ will have had an effect on BoP as exports in theory should appear cheaper to forgien countries and they will be more likely to buy from the UK. This also means UK consumers see forgien goods as more expensive, as a result imports should decrease.

~~How~~ The exchange rate changes have had the desired effect on Imports, as forgien goods seem ~~cheaper~~ more expensive they have seen a 13% drop in Imports. However as a result usually Consumption and Investment should have increased, yet have both faced reductions. ~~However~~ Allthough overall CS has dropped by 3%, it is likely a large number of people represented would have brought from abroad, as a result CS would have been lower if it were not for the transfer. As UK goods appear cheaper to UK consumers because of the depriciation of the £ it has had an effect on BoP as instead of buying abroad they are buying UK, possibly inferior goods because of the recession and reducing imports.

Exports have also ~~was~~ fallen by 11%, the natural idea is for Exports to rise as the £ depriciates and appears cheaper to forgien buyers.

The level of investment has fallen in the UK, from by 14%. As UK firms are not investing in an attempt to boost output ~~ab~~ or quality it's possible the UK market does not have the quality of goods to ship to a forgien market nor ~~t~~ are they able to produce enough output to sufice them without suffering ~~f~~ from rising long run costs. ~~However~~ However the fall in exports regardless of the depriciation of the £ indicates that a more likely cause of the reduction in exports is there is no demand from other continents.

~~&~~ Knowledge of wider impacts makes it appear that the global recession has resulted in a common trend throughout the world. During a recession people will buy inferior goods and this will reduce the level of imports into countries.

As the £ is cheaper some will still buy from the UK, but lack of ~~cons~~ consumer confidence and disposable income on a large scale imply that global imports have reduced, this will have effected the UK's import rate.

The overall effect ~~of~~ on BoT appears positive as ~~A~~ although exports have fallen, the ~~deflation~~ of depriciation of the £ has still encouraged forgien trade to the UK. ~~ch~~ Also with falling imports due to lack of disposible income and foreign products seeming more expensive it's resulted in a 24% reduction to the balance of trade deficit.

ResultsPlus

Examiner Comments

There are 4 marks for definition; 2 marks in the first paragraph and 2 marks at the end of the second paragraph in the implicit reference to the trade in goods. In the second paragraph there are 4 marks for the effects of the exchange rate changes.

ResultsPlus

Examiner Tip

There are another 2 marks for exchange rates at the top of the second page. In the third paragraph there are 2 marks for investment and a further 2 marks for evaluation of investment.

There was a 3:2 split in favour of answering question 1, probably as a result of the more well-practised concepts being assessed in 1d, which was a relatively straight forward question and gave students the opportunity to display their skills. Candidates who chose question 2 tended to score more highly on the shorter parts of the question than those who did question 1, and thus the two questions' mean scores were very similar. For example 1 biii was a low scoring question on average. Nonetheless there were many excellent answers to 1biii as well as 1d and 2d.

This paper did challenge candidates. The data reflected the very different economic circumstances of a recession and therefore required understanding of different policy choices from previous years. Many entrants showed considerable awareness of the current state of the economy and some were truly outstanding in their using this information to help them evaluate. This real interest in the economy was evident in many papers, and was easy to credit within the flexible mark scheme.

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