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Examiners' Report
January 2013

GCE Economics 6EC02 01

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Introduction

Overall this was felt to be an accessible paper, and reflecting this the mean mark was slightly higher than last year's paper. In particular candidates found the 12 mark question requiring the use of AS/AD analysis to discuss the effects of a change in an economic variable on the economy (question 1(a)(iii) and question 2(b)(iii)) relatively straightforward, and more generally, AS/AD analysis was used well throughout the paper. Candidates used the written data given to them well, but found some of the figures more difficult to interpret, and as such more practice at using economic charts and graphs may be beneficial. That said, candidates are good at recognising where they need to make explicit reference to the data provided, and did, on the whole, make a good effort to do this in a way which added to their responses. Both questions included one 12 mark question which candidates tended to find challenging (question 1(b)(ii) and question 2(a)(iii)), as they were perhaps a little different to questions that students had seen before, and so called for candidates to 'think on their feet' more. Some students really excelled here, producing interesting, well-considered responses, which, in the case of 2(a)(iii) in particular, often came to an overall, reasoned conclusion, however others found difficulty in applying their knowledge of economic theory in an unpractised way. The two 30 mark questions were generally well attempted, and on the whole responses included a good level of economic analysis. Students are obviously aware of the need to evaluate their arguments in this question, but there is a noticeable gap between those who solely use very general evaluative points (e.g. there may be a time lag etc.), and those who are able to really apply evaluative points to the specific analytical points they accompany, and to explain them in detail.

The two questions were answered by approximately equal numbers of candidates, and although the mean score was slightly higher for question 1 than for question 2, there was not a large difference between performance on the two.

Question 1 (a) (i)

This question was meant to be a very accessible introduction to the paper, and as such was answered very well by a majority of candidates. Candidates who only gave the abbreviated formula for aggregate demand (AD=C+I+G+(X-M)) were only awarded 2 out of the 4 available knowledge marks, but this did not affect many. Reference to the data was well done, although candidates must make sure that they select the data that is most relevant to the question. For example, references to changes in 'disposable income', 'earnings growth' and 'employment' were not credited unless they were explicitly linked to one of the components of aggregate demand.

(a) (i) With reference to Extract 1, outline the components of *aggregate demand*.

(6)

Aggregate demand is the total planned expenditure in the economy, it is the total demand of goods and services.

The components of AD are consumption, investment, government spending and net export (x-M).

Extract 1 tells us that they predict a current account deficit which means imports is more than exports. This would cause aggregate demand to shift to the left.

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Examiner Comments

The second paragraph of this response earned the maximum 4 knowledge marks for stating the components of aggregate demand in full. The third paragraph earned the 2 available application marks, as the candidate referenced some data from the extract which was then explicitly linked to the components on aggregate demand.

(a) (i) With reference to Extract 1, outline the components of *aggregate demand*.

(6)

Aggregate demand or total demand within the macroeconomy is made up of consumption, which is the level of spending on durable and non-durable goods of a household. Investment is the next component of AD and is defined as the level of money spent on goods and services that will provide monetary returns or losses in the long run. There are different types of investment, for example fixed investment, ~~which is money~~

The next component is Government expenditure which is the level of money that the government spends on the economy. An example of government expenditure is the money spent on the national education system by the government.

The final component is net exports. This is the total value of goods and services being imported and exported.

An import is a withdrawal from AD and the circular flow as money is leaving the economy and an export is an injection and will boost AD.

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Examiner Comments

This response explains the components of aggregate demand in detail to earn all 4 available knowledge marks, but makes no reference to Extract 1, so only scores 4 out of 6 marks.

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Examiner Tip

Look out for questions including the instruction "With reference to ...." as this means that marks will be available for including explicit and relevant references to the stated extract or figure in your answer.

Use the number of lines given to help you decide how much to write in answer to a question. Writing too much in response to the lower mark questions might mean that you run out of time to answer the higher mark questions.

Question 1 (a) (ii)

This question was well answered by a majority of candidates. The factors most commonly discussed were the interest rate and the level of business, or consumer confidence. 2 marks were awarded for each factor correctly identified, and a further 2 marks were given for explaining why, or how, this factor influenced the level of investment in the economy, that is examiners were looking for an explicit link back to investment for these 2 additional marks.

(ii) Identify and explain **two** factors that influence the level of business investment (Extract 1, line 10).

(8)

Investment is the increase in capital stock of an economy and it's rate is determined by several factors. One of them is the rate of interest. When interest rate are low (which they are now 0.5%) it is likely that investment is going to increase. This is because it gets cheaper for investors to get a loan from a bank and the ~~rate are smaller~~ profits are greater as their interest payments are smaller. However with interest rates being high, the opposite places. As shown in the text, interest rates themselves aren't enough to boost investment.

Another factor might be ~~animal spirits of the investors~~ overall business confidence in the economy. If business confidence is high, it is more likely that investment is high as they can expect high profits as a return. However, right now in recession, business confidence is usually very low which leads to overall investment of an economy being low or remaining the same.

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Examiner Comments

This is a good answer to the question, which states two correct influences, and explains how each of them affects investment. The first paragraph which explains the role of the interest rate is worth 4 marks, and so is the second paragraph, which explains the role of business confidence.

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Examiner Tip

Look for specific instructions given in bold. Here it is important to note that you are being asked for two factors. This means that you cannot earn full marks for explaining only one factor, and if you mention more than two factors, only your best two will be counted.

(ii) Identify and explain **two** factors that influence the level of business investment (Extract 1, line 10).

(8)

One factor that can influence the level of business investment is interest rate. If interest rate is high, then loans will get harder to obtain and finance. This reduces the incentives for firms to take out loans and invest more in their businesses. It also reduces the incentive for people to start up their own businesses, hence reduce the level of investment in the economy. On the other hand, if interest rate is ~~high~~ low, then firms will find it easier to ~~invest~~ take loans from banks as well as pay back the loans. It leaves them more profit to invest in their businesses, hence increase the level of investment in the economy. Extract 1 shows that 'Businesses have used some of their profits to pay back bank loans', which means interest rate ~~is~~ is likely to have a profound effect on the profits left.

Another factor that influences the level of business investment is business confidence in the current situation of the economy. Extract 1 states that businesses 'may also have started to build up cash reserves against further shocks as uncertainty over the outlook has risen' (line 13-14). The building up of cash reserves due to ~~the~~ a lack of business confidence means that businesses have less profit to reinvest in their ~~firm~~ operation, hence reduce the level of investment in the economy.

Both of the factors can lead to 'a reduction in business investment in 2012' (Extract 1, Line 15).

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Examiner Comments

This is a very detailed answer, which makes good use of Extract 1 to support the candidate's analysis, and explicitly relates the two factors considered to the level of investment. The first paragraph earns 4 marks, as does the second paragraph.

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Examiner Tip

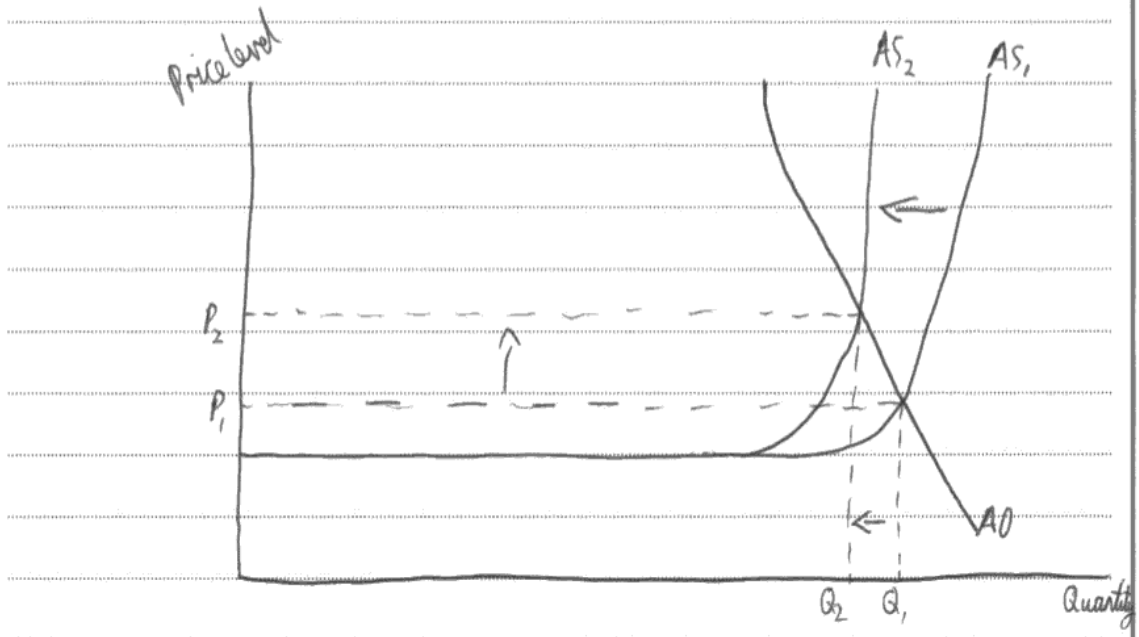
Hints as to possible answers to the questions are often given in the data provided, so do read it carefully and use it where relevant.

Question 1 (a) (iii)

Candidates are obviously comfortable tackling AS/AD analysis questions, and as such most could explain the changes in aggregate demand and aggregate supply, draw a diagram to illustrate this, and then state and explain at least one effect on the economy of these changes. As the question specifically asked for a diagram, a maximum of 4 knowledge, application and analysis marks were awarded for written analysis. There was, however, much inaccuracy in the labelling of AS/AD diagrams, particularly in terms of using the microeconomic 'price' and 'quantity' labels for the axes, and less so, 'D' and 'S' for the curves. Candidates must also remember to label the initial and final equilibria on their diagrams; this was sometimes omitted or done incorrectly, particularly when candidates were shifting both curves. Most candidates made an attempt at evaluating their arguments, and as the 4 available evaluation marks were awarded as either 2+2 or 4 marks, many scripts achieved all 4 evaluation marks. Despite this apparent success, however, candidates must be wary of using the same rote learned evaluation points in all situations, for example a good number analysed the effects on the economy of just a decrease in aggregate supply, but then said that the magnitude of these effects was dependent on the level of spare capacity in the economy (or elasticity of the aggregate supply curve), which is obviously incorrect.

(iii) With the aid of an aggregate demand and aggregate supply diagram, assess the likely effects on the UK economy of 'a reduction in business investment' (Extract 1, line 15).

(12)



As we can see from the Aggregate demand and supply diagram, a reduction in business investment will result in a leftward shift in AS from $AS_1 \rightarrow AS_2$. This is because the production techniques used by the firms will become outdated and inefficient, and the

output of firms will therefore not increase at a fast enough rate due to the reduction in investment. This means that the cost push inflation will occur as the leftward shift in AS means that AD will now intersect AS at P_2 instead of P_1. Therefore the general price level has now increased, which will result in negative growth as quantity of goods demanded falls from Q_1 to Q_2.

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Examiner Comments

In this response the candidate has labelled the x-axis of their AS/AD diagram 'Quantity'. As this has a definite microeconomic 'feel', the diagram as a whole is only worth 3 out of the 4 available marks. The candidate goes on to explain the effects of the reduction in investment on the economy, earning 2 marks for their mention of an increase in the price level ('cost-push inflation), and a further 2 marks for 'negative growth' at the top of the second page (although the end of this sentence, which is written in terms of the 'quantity of goods demanded' is incorrect). The candidate makes no attempt at evaluation, so this response earns 7/12 marks.

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Examiner Tip

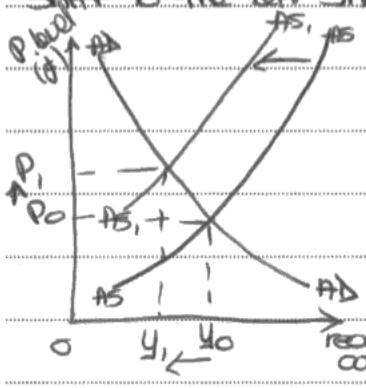
Learn the command words which tell you that you must evaluate your answer: they are evaluate, discuss, assess, to what extent, and examine.

(iii) With the aid of an aggregate demand and aggregate supply diagram, assess the likely effects on the UK economy of 'a reduction in business investment' (Extract 1, line 15). (12)

- ↓ AD
- ↓ eco growth
- ↑ prices.

A business reducing it's investment levels, means that they spent less money to invest on new goods and services, or to up-to-date them old ones.

If business investment decreases then the aggregate supply will shift to the left since businesses will produce less. The new supply curve will be AS1, AS1. Due to this decrease, prices of goods and services are going to increase from Po to P1 and consequently real output will fall from Yo to Y1.



Decrease investment will have a negative impact on the UK economy since inflation will increase above the target that is 1%-2%. As a result exports will appear expensive and domestic consumers will prefer imported goods and services that will be cheaper. Consequently budget current account will worsen since more money will be leaving the country than entering it. Additionally economic growth will fall. Unemployment might also increase as producers will need less workers to produce their goods and services.

To evaluate the extend of the effects depends on the elasticity of aggregate demand curve. If AD is elastic then the effects will be more significant but if Aggregate demand is price inelastic then the effects will not be so dramatic.

Secondly time lags are another important factor when considering

the effects, since in the short run the effects will not be so negative, but in the long run, they will be worse.

Lastly, the effects also depend on the extend that businesses investment decreases. If it decreases to a small extend, then the effects will not be so significant. But if it ~~extra~~ decreases at a larger extend the impact will be much more worse.

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Examiner Comments

This response achieves full marks. The AS/AD diagram shows a correct shift and is fully labelled earning 4 marks; the candidate identifies and explains the likely effect on the current account of the balance of payments for 4 marks; and additionally identifies negative economic growth. The discussion of the effect of the elasticity of the AD curve warrants 2 evaluation marks, as does the discussion of a possible time lag.

Question 1 (b) (i)

Many candidates found this to be a challenging question. The first issue was not referring to the time period as specified in the question ("from 2010"), as many candidates focused their responses on the earlier rise in the savings ratio, which severely limited the marks available. Definitions, or explanations, of the multiplier were marked fairly leniently, but many attempts were still too vague, or incorrect to earn the 2 available marks. The best approach here was either to have learnt a more formal definition (for example, "the multiplier is the ratio of a change in equilibrium real income to the autonomous change that brought it about"), or to describe the process through which one person's spending becomes another person's income, and so money travels around the circular flow of income more than once. Finally, many candidates did not actually answer the question, as they simply explained why a multiplier effect would occur, or stated that in this case there would be a positive multiplier effect, rather than identifying that there would likely be a LARGER multiplier as the savings ratio fell.

(b) (i) With reference to Figure 1, explain how the forecast change in the savings ratio from 2010 might affect the value of the multiplier.

(8)

Savings ratio is the % of disposable income people save. The forecast shown in figure 1 shows the savings ratio from 2010 and onwards decreases from roughly 9% in 2010 to 5.75% in 2017.
This means people are saving less and spending more of their disposable income.
The multiplier is a formula that relates to injections into an economy ~~such how which affect the~~ final and how the injection multiplies as it is used by different consumers ~~in an~~
The forecast of more spending with increase the multiplier as more money is injected into the circular flow of income. The size of the multiplier depends on the percentage to consume disposable income which means the multiplier should increase year on year in the UK economy. This will boost AD right as consumption increases.

However, the UK has a high marginal propensity to import. Imports are a leakage to the UK circular flow of income. ~~with~~ With more consumption forecasted

consumers in the UK will import more goods which will limit how long the multiplier goes on for. The multiplier stops when all extra income is leaked out of the economy.

ResultsPlus
Examiner Comments

The first paragraph of this response earns the candidate the 2 available data reference marks, as they give figures for the savings ratio from two relevant years. In the next sentence, the mention of people "spending more of their disposable income" warrants another 2 marks, as does the explanation of the multiplier in the first sentence of the third paragraph. Finally, the observation that the multiplier will increase is worth 2 marks for actually answering the question. This response therefore earns full marks 8/8.

ResultsPlus
Examiner Tip

Remember to look out for definition marks! In this question, a definition or explanation of the multiplier is worth 2 marks.

(b) (i) With reference to Figure 1, explain how the forecast change in the savings ratio from 2010 might affect the value of the multiplier.

(8)

The multiplyer is the theory that money ~~passes~~ that one person spends becomes another person income. in 2010 savings reached its peak with 9% of disposable income saved. when money is saved it is removed from the circular flow of income causing less money to flow from houses to firms via expenditure and vise versa through wages/income. This will decrease the value of the

Multiplyer as less Money is flowing around the economy. However from 2010 onwards there is a steod decrease of about 3.2%. Saving as in 2017 there is forcast to be 5.8%. Saving. This will raise the Money spent in the economy raising the value of the multiplier as it is likely More Money will be Spent causing increased profit allowing employment which increases income. Less Saving Means More spending = Multiplier = eco. growth

ResultsPlus

Examiner Comments

The first sentence of this response earns the 2 available marks for a definition or explanation of the multiplier. The candidate then goes on to analyse the period up to 2010, so this does not gain any marks, however half-way down the page, he/she then gives data from the correct period (2 data reference marks), identifies that this will "raise the money spent in the economy" (2 marks), and hence increase the value of the multiplier (2 marks). This response therefore gains full marks (8/8).

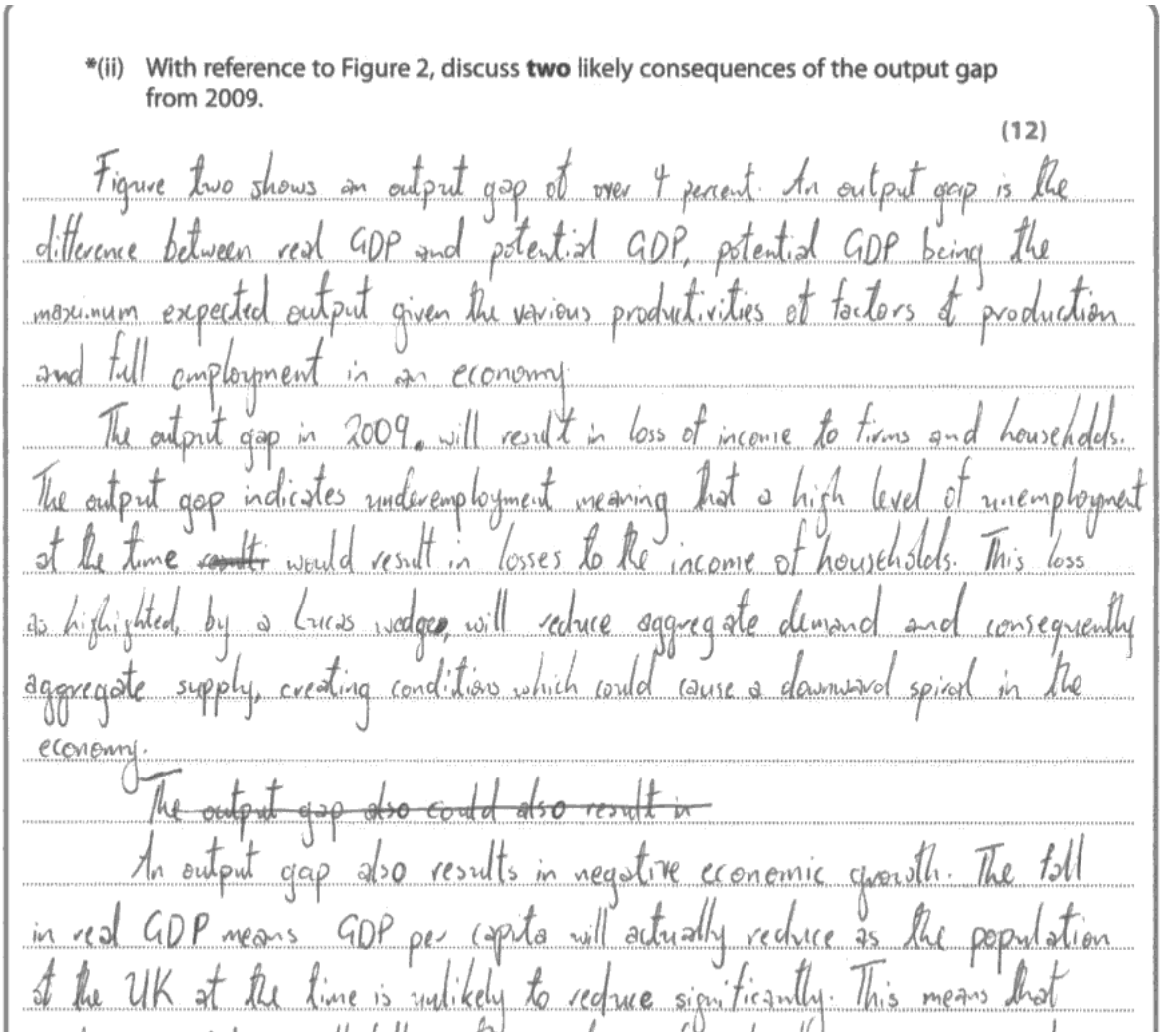
Question 1 (b) (ii)

This question was an excellent discriminator between higher and lower ability candidates, as students found the data relatively difficult to interpret, and a good answer required students to really apply their knowledge of output gaps to the data provided. While most candidates could pick up the 2 knowledge marks for a definition of an output gap (either in words, or using a diagram), the 2 data reference marks available for identifying the (changing) size of the negative output gap were less frequently awarded. More generally, many candidates were unaware that the negative output gap was closing, and indeed there were many references to the output gap "increasing", either because candidates find describing negative numbers challenging, or simply because the line had a positive slope.

In terms of identifying and explaining the effects of the output gap, marks were awarded for either a static analysis, in terms of a negative output gap means unemployed resources in the economy etc., or a dynamic analysis, in terms of the negative output gap closing, and so unemployment decreasing, average incomes rising etc.

Even very able candidates found it difficult to give valid evaluation of the effects that they had identified. The most successful line here was to consider changes over time as the negative output gap closed, or to consider how rising inflationary pressures as the economy approached its potential output level may begin to hit export-based industries or consumer and business confidence, so that the positive effects predicted may not occur.

Finally, some candidates found being asked for "consequences" difficult, and tried to change the question to discuss possible causes of the negative output gap instead.



*(ii) With reference to Figure 2, discuss **two** likely consequences of the output gap from 2009.

(12)

Figure two shows an output gap of over 4 percent. An output gap is the difference between real GDP and potential GDP, potential GDP being the maximum expected output given the various productivities of factors of production and full employment in an economy.

The output gap in 2009, will result in loss of income to firms and households. The output gap indicates underemployment meaning that a high level of unemployment at the time ~~result~~ would result in losses to the income of households. This loss as highlighted by a Laffer wedge, will reduce aggregate demand and consequently aggregate supply, creating conditions which could cause a downward spiral in the economy.

~~The output gap also could also result in~~

An output gap also results in negative economic growth. The fall in real GDP means GDP per capita will actually reduce as the population of the UK at the time is unlikely to reduce significantly. This means that

investor expectations will fall on the evidence of a shrinking economy, and the level of ~~exp~~ investme net investment will also fall. The output gap also means a fall in government revenue as loss of income to households and lower business output mean less taxes. Also job losses means more government spending on benefits and other welfare expenditure meaning the government has less to spend and may have to borrow more in its attempt to induce more growth, resulting in a budget deficit. Another effect of the output gap therefore is a government deficit.

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Examiner Comments

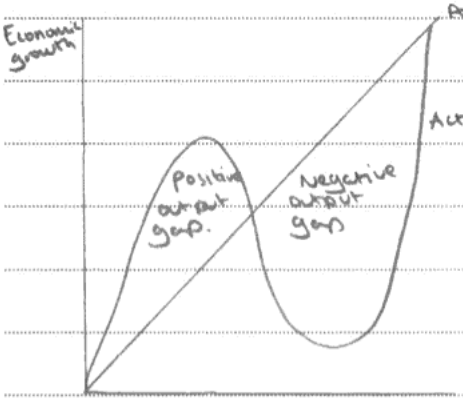
The first paragraph of this response earns 2 marks for a definition of an output gap. The second and third paragraphs identify various effects of the negative output gap: low incomes (2 marks); unemployment (2 marks); and low investor confidence (2 marks). In the third paragraph there is also an identification and explanation of the effect on the government budget balance (4 marks). The best two points are counted, plus the definition marks, which gives 8/8 marks for knowledge, application and analysis.

The candidate makes no attempt at evaluation, and so the total score is 8/12.

*(ii) With reference to Figure 2, discuss **two** likely consequences of the output gap from 2009.

(12)

The output gap is the difference between ~~positi~~ potential and actual economic growth. If actual growth is higher than potential growth this is described as a positive output gap whereas the vice-versa is described as a negative output gap.



In 2009 the output gap has fallen below -4% meaning the economy is in a recession A Recession is when there is a negative economic growth in two consecutive quarters. As a result, one of the first likely consequences is an increase in unemployment. As the economy is in recession a profitability of firms has fallen, firms will begin to make many of their employees redundant in an attempt to cut costs. Increased unemployment leads to ~~another~~ a number of ~~poor~~ problems, one of which is an increase in the government budget deficit. As unemployment increases Claimant Counts for Job seekers allowance is likely to increase meaning that government spending increases in order to fund these benefits whilst tax revenue falls as less employment means less income tax.

The UK economy was hit hard by the recession but figure 2 shows that the output gap is to recast to narrow to below -0.5%. This shows that in the short run, the before mentioned unemployment and increased government deficit is likely to occur but in the long term as the ~~econ~~ economy improves and approaches the

positive output gap, unemployment is and government budget deficit is likely to fall. As economic growth improves and output increases, firms will need to make use of the spare capacity in labour force to keep up with production, automatically giving the unemployed a workplace. There is also a time lagging factor that comes into play with these likely consequences. For example for a person to be technically unemployed, they must be out of work for 4 weeks and be actively looking for a job and the criteria in which a person can make an allowance claim is very tight. As a result, even if the unemployment levels rocket in the short run, the government budget deficit may not be affected ~~at all~~ all until a few months or after a year due to the the criteria that the unemployed have to meet in order to claim the benefits.

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Examiner Comments

This is a good response which earns full marks. There is a definition of an output gap (2 marks), and reference to the output gap being below -4% in 2009 (2 data reference marks). The candidate goes on to explain the likely effect on unemployment (4 marks), and the government budget balance (4 marks), and therefore reaches the maximum 8 marks available for knowledge, application and analysis.

On the second page, the candidate evaluates their answer, discussing the changes likely to occur as the negative output gap closes, and the fact that unemployment tends to be a lagging indicator. They therefore earn all 4 available evaluation marks too.

Question 1 (c) (i)

This question was generally well answered, with most candidates understanding the need to give data from the Figure, either in terms of government expenditure and tax revenue as percentages of GDP separately, or simply the budget deficit as a percentage of GDP. A few candidates did not actually answer the question, as they simply gave figures to show that government expenditure had risen, and tax revenue remained approximately constant, without linking this to the concept of a budget deficit, and this cost them the 2 available marks for stating that the budget deficit had risen over the period.

A minority of candidates were confused by the use of financial years rather than calendar years (i.e. "2002-03"), and interpreted this as two separate questions, that is as asking them to calculate the change in the budget deficit between the years 2002 and 2003, and between the years 2010 and 2011. More practice working with economic data would help to increase students' familiarity with such concepts.

(c) (i) With reference to Figure 3, identify the change in the UK budget deficit between 2002–03 and 2010–11.

(4)

In 2002-03, the budget deficit = 2.5% of GDP

In 2010-11 the budget deficit = 9.8% of GDP

Between 2002-03 and 2010-11, the budget deficit increased by approximately 7.3% of GDP.

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The first two lines of this response earn the 2 available data reference marks, while the final sentence earns the further 2 available marks. Overall this merits full marks: 4/4.

(c) (i) With reference to Figure 3, identify the change in the UK budget deficit between 2002–03 and 2010–11.

(4)

According to figure 3, there is a huge UK budget deficit shown in the graph.

Budget deficit is when money outflow is more than money inflow.

As shown in figure 3, the government has been spending more than what they are ~~gaining~~ receiving thus creating a bigger budget deficit. As the years go by, the budget deficit appears to bigger as shown in the diagram.

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In the final paragraph, this candidate identifies that the budget deficit has increased over time (2 marks), but does not include any explicit data reference in his/her answer. This response therefore earns 2/4 marks.

Question 1 (c) (ii)

Candidates found this 30 mark question more difficult than the equivalent part of question 2, although as the reverse was true for the lower mark parts, this helped to equalise the mean scores on the two questions overall.

As the question was explicit in asking for strategies that could be pursued by the UK government, we did not credit references to changing the Bank rate or the money supply (although references to monetary policy in terms of changing the inflation target set for the MPC so as to encourage lower interest rates, appointing external experts to the MPC who might be more likely to vote for such low interest rates, and so on were, of course, allowed).

Candidates who were able to discuss the effects of specific policies (e.g. a rise in the basic rate of income tax, or a 10% cut on defence expenditure, rather than simply raising taxes and cutting government spending, often lumped together as one policy) tended to score higher marks, as their analysis was more detailed.

Overall, there seem to be two main lessons for candidates to take from this question: firstly, to read the whole of the question; and secondly if a question asks for a discussion of possible effects, it is not the case that positive effects count as analysis, and negative effects count as evaluation. In terms of the first point, many candidates ignored the caveat that economic growth remained weak, and so discussed the use of expansionally fiscal policy or supply side policy to generate economic growth and so reduce the budget deficit in the long term. Such policies were not credited, as they were going against the assumption in the question. In terms of the second lesson, whether an effect is positive or negative for the economy, explaining the effect and why it might arise is always credited as application and analysis; evaluation would be explaining why it might not occur, or what its occurrence or magnitude might depend on etc. This meant that a good number of candidates gave six analytical points, when a maximum of three could be considered, but no valid evaluative points.

*(ii) Evaluate the macroeconomic effects of the UK government trying to reduce its budget deficit, assuming economic growth remains weak.

(30)

PLAN: ~~Budget~~

→ definition of budget deficit ⇒ government spend > tax

Explanation:

→ ↓G → ↓AD

→ ↓ money spent on health & education

→ ↑T → ↓Ye → ↓C → ↓AD.

→ ↑ savings.

→ multiplier.

~~[illegible]~~ ↑ unemployed.

Diagram: ↓↓ ~~[illegible]~~AD – two curves. ~~[illegible]~~ ↓↓ price level

↓↓ real output

Eval: ↓G may only be short term will benefit the UK when there is no deficit.

↑T → government will have more money to benefit deficit and fund projects.

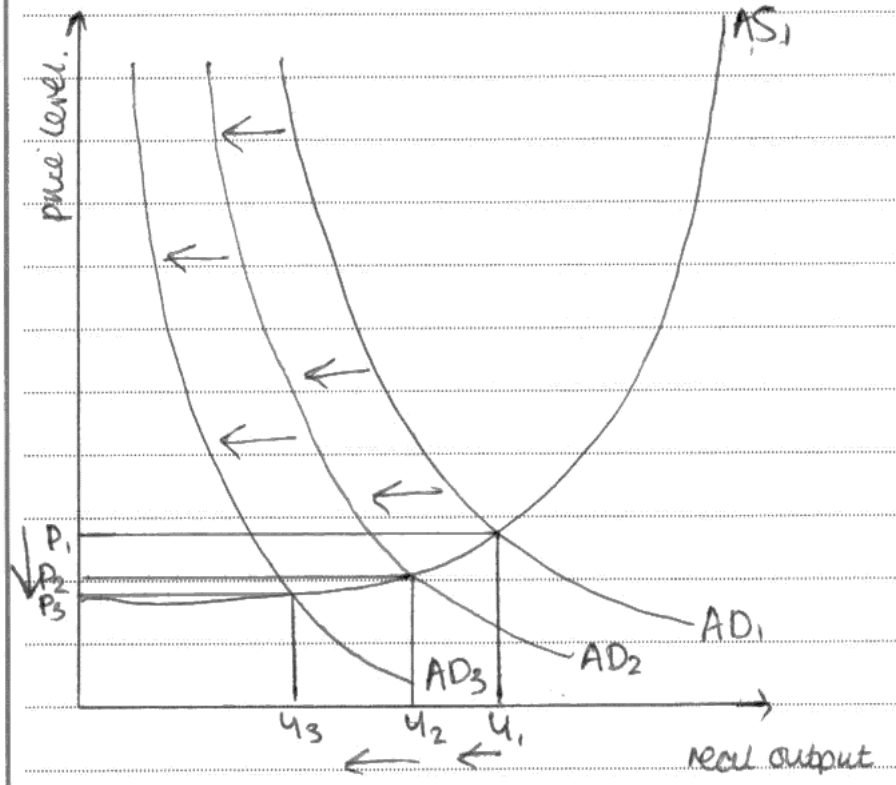
A budget deficit occurs when government spending exceeds taxation. In order to reduce the budget deficit the government would have to decrease its spending and increase taxation – for example income and corporation tax.

Decreasing the level of government spending would decrease aggregate demand, as it is one of the components. This decrease would mean the government would decrease spending on healthcare, education and infrastructure. This decrease may mean that people will lose their jobs in the public sector. As shown in Extract 1, 710000 people lost their jobs in order for the government to decrease its budget deficit.

However this decrease may only be in the short term, especially if the government cut spending a significant amount. In the long run this cut in spending will benefit the economy and decrease the deficit, possibly increasing economic growth. 710000 people may have lost their jobs but according to Extract 1 1.7 million jobs in the private sector will be created which will mean that not as many people will be unemployed.

Another way that the government could decrease the deficit would be to increase taxation. An increase in income tax, for example, would decrease the consumers disposable income which would then decrease consumer spending. A decrease in consumer spending would cause a decrease in aggregate demand. Consumers may also save more of their income because they may be worried that income tax would increase further. An increase in saving and a decrease in consumer spending would affect the circular flow of income as money would be withdrawn. The multiplier will also magnify this affect on the whole economy.

Figure 1 shows the UK savings ratio and from 2011 consumers seem to be saving less money. The graph may only show a forecast, but it still shows a decrease in saving. Therefore the effect on the circular flow of income may not be as large as expected.



The graph shows a huge decrease in aggregate demand due to both a decrease in government spending and an increase in taxation. The decrease in AD leads to a decrease in real output and a decrease in the price level.

All of the problems associated with decreasing government spending and increasing taxes may offset the benefits when the ~~the~~ budget deficit is smaller.

The government could also increase corporate tax which is a tax on firms' profits. The increase in corporate tax will mean firms will have less profit to spend on wages and other projects. Employers may face a decrease in wages or possibly unemployment which may eventually lead to a decrease in aggregate supply because firms may have to decrease their output and supply. Firms may also face a decrease in demand if consumer spending decreases.

It depends on how much corporate tax is increased by and how large the firm is to how much of an impact it will have on the firm. If the firm is very large and has abnormal profit it may not make much of a difference. ~~Lorem~~ whereas if the firm is small and just makes normal profit it may have a large impact on the firm and whether it stays in ~~bestpe~~ business.

ResultsPlus
Examiner Comments

On page one, the first paragraph earns 6 marks: a definition of a budget deficit (2 marks), identification that the government may cut government spending (2 marks) and/or raise taxation (2 marks).

In the next paragraph, the candidate discusses the effect of this on unemployment, and uses some data from the Extract to support his/her point (4 marks). In evaluation, s/he suggests however that an increase in private sector employment might limit the increase in unemployment (2 marks).

In the fourth paragrapah on the first page, the AS/AD diagram, and the first paragraph on the third page, the candidate explains the likely effect on national income (4 marks), although then uses the data provided on the savings ratio to question whether aggregate demand would actually fall in the economy (4 marks).

Finally, in the third paragraph on the third page, the candidate explains the effect on wage rates (4 marks), and in evaluation discusses the importance of considering the magnitude of any changes (2 marks).

Overall, this response earns 26/30 marks (18/18 marks for knowledge, application and analysis, and 8/12 marks for evaluation).

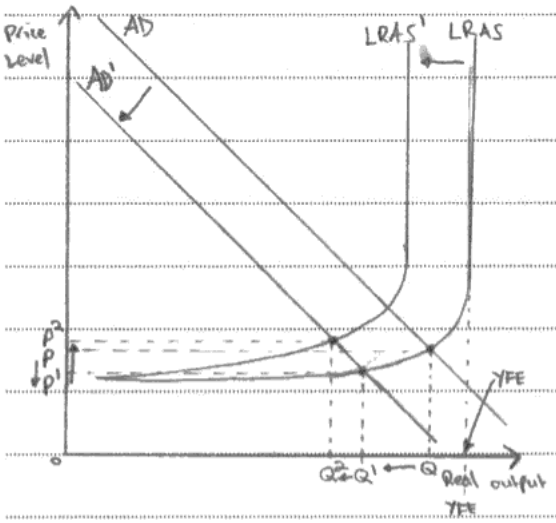
ResultsPlus
Examiner Tip

This candidate has begun by planning his/her answer. This is a good idea, as it will help you to formulate and prioritise your ideas before you start writing.

*(ii) Evaluate the macroeconomic effects of the UK government trying to reduce its budget deficit, assuming economic growth remains weak.

(30)

A budget deficit is when government spending exceeds tax revenue. Fiscal policy is the use of government spending and taxation to affect the demand within an economy. Economic growth is when the level of output in an economy is increased, this can be actual or potential.



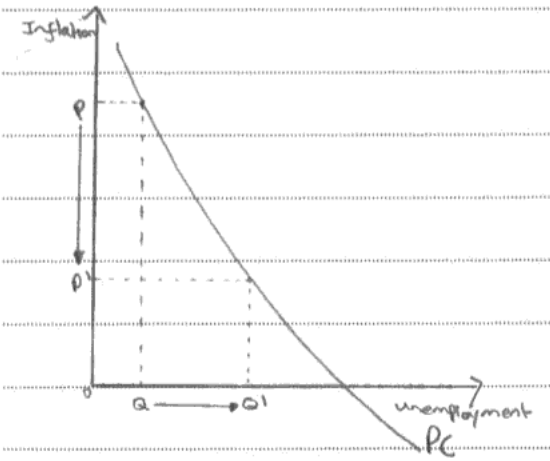
When the government attempts to reduce their budget deficit they will initiate contractionary fiscal policy. This means that they will reduce government spending and increase taxes.

Government Spending is a component of aggregate demand and therefore when it is decreased, AD will decrease. Along with this, higher taxation means that consumers cannot to afford as much. Direct tax increases would mean that ~~income~~ expendable income would decrease meaning they have less to spend and indirect tax will make goods and services more expensive. So the consumer will not be able to buy as much. When contractionary

fiscal policy causes AD to shift leftward to AD', negative economic growth occurs as output decreases from Q to Q'. This means that the output gap is then increased from Q YFE to Q' YFE. The output gap represents the difference between actual output and potential output in an economy. The Larger the negative output gap the higher the level of unemployment. Therefore, when the output gap increases to Q' YFE, unemployment has increased. This could in fact stop the budget deficit being reduced, as the more people unemployed, the more money the government must spend on unemployment benefits. Along with this, a negative multiplier effect will occur, as when more people become unemployed expendable incomes fall further, meaning that consumption decreases. This will lead to another leftward shift in AD, causing further more unemployment. ~~However the mag~~ However, the magnitude of this multiplier effect may no be huge, because due to the negative economic growth in the UK, many UK businesses may export which will lead to more injections into the

circular flow of income.

Through this original leftward shift in AD inflation will decrease from P to P'. This happens because when less people are employed there is less demand for goods and services, therefore the equilibrium price should be decreased.



The Phillips curve can be used to show the trade-off between unemployment and inflation. When ~~world~~ unemployment is low at Q then inflation is high at P, but when unemployment is increased to Q', inflation falls to P'.

Along with the leftward shift in AD affecting economic growth negatively, a leftward shift in LRAS could occur. This is because much government expenditure is spent in areas which increase the productive potential of an economy e.g. healthcare and education. When this is decreased, in the long-run production in the UK will become less efficient as the work force becomes

less skilled and takes more time off due to illness. ~~However, this depreciates~~ This would cause the long-run aggregate supply to shift leftward from LRAS to LRAS'. Which would lead to further unemployment and higher inflation. Therefore, the magnitude of the negative effect on the macroeconomic objectives is huge.

If the aggregate supply curve is inelastic the leftward shift in demand would have ~~the~~ no effect on unemployment.

ResultsPlus

Examiner Comments

This response earns 2 marks for a correct definition of a budget deficit, and 2 marks for a correct definition of economic growth. Another 2 marks could be awarded for identification of both an increase in taxation and a reduction in government spending, but the candidate has reached their maximum 6 marks for this section.

Over pages one and two, the candidate explains the likely effect of the policies on economic growth (4 marks), and in evaluation points out that this policy may not reduce the budget deficit by as much as originally thought, as additional money will need to be spent on unemployment benefits (2 marks). The candidate then goes on to explain the effect of increased unemployment in more detail, incorporating the multiplier effect into his/her analysis (4 marks). Note that the attempt at evaluation following this is incorrect, as a change in the value of exports has no effect on the value of the multiplier (0 marks). On the third page, the candidate then goes on to explain the effects on the inflation rate, using the short run Phillips curve in his/her analysis (4 marks). There is a final, brief evaluative point, that the elasticity of the AS curve is important in determining the effects (2 marks).

Overall, this response scores 22/30 marks (18/18 for knowledge, application and analysis, and 4/12 for evaluation).

Question 2 (a) (i)

This question was very poorly answered. While a good number of candidates were able to gain the 2 available data reference marks for giving figures for the inflation rate over the relevant period, many candidates incorrectly wrote that the "price level fell from 5% to 1%", indicating that they did not understand the relationship between the price level and the rate of inflation, and not earning these data reference marks. Some candidates also gave inflation figures for a period other than that specified in the question. Very few candidates correctly identified that the price level was rising at a slower rate, with the vast majority writing that the price level fell over the period. Overall, the relationship between absolute and percentage changes in a variable seems to be poorly understood.

(a) (i) With reference to Figure 1, explain what happened to the UK price level from late 2008 to mid-2009.

(4)

The Figure 1 shows that the rate of inflation fell from late 2008 to mid 2009. The graph indicates that during late 2008 inflation was at 5%. This is well above the 2% (CPI) ± 1% target that the Monetary Policy committee is charged with by the government. As we move towards mid 2009, the rate of inflation fell from 5% to just 1%. This indicates that deflation has occured as this below the inflation target. This shows that in late 2008, price levels were high and in mid 2009 price levels decreased drastically.

Inflation is a sustained rise in the Average price level.

ResultsPlus

Examiner Comments

This response earns the 2 available data reference marks for correctly identifying the change in the inflation rate over the period, but does not earn any more marks, as the candidate incorrectly states that the price level has fallen. Overall, this response scores 2/4 marks.

(a) (i) With reference to Figure 1, explain what happened to the UK price level from late 2008 to mid-2009.

(4)

Figure 1 shows that ~~inflat~~ between late 2008 and mid-2009 inflation levels fell, this means that price levels in the economy continue to rise, however they rose at a decreasing rate. In late 2008, they were rising by over 5%, however this decreased to around 1% in 2009.

ResultsPlus
Examiner Comments

This response earns full marks (4/4). In the second half of the first sentence, the candidate correctly identifies that the price level was rising at a decreasing rate (2 marks), and in the final sentence, he/she gives correct figures from the chart (2 data reference marks).

Question 2 (a) (ii)

When marking this question we were strict in not allowing consequences that were based on the average price level falling, rather than a lower (but still positive) rate of inflation. This caught out many candidates, again implying that the relationship between the price level and the inflation rate is not very well understood. The most common correct answer to this question involved considering the likely effects on the relative prices of imports and exports, and hence on the trade balance or current account on the balance of payments position. Alternatively, candidates wrote some good responses based on likely improvements in either business or consumer confidence.

There was a tendency for candidates to try to change this question, either by stating in the first line of their response that a lower rate of inflation would mean lower rates of interest, and then describing the consequences of a cut in interest rates, or by explaining the possible CAUSES of a lower rate of inflation, rather than the likely consequences. While there is some merit in the first approach, it was generally only credited as one possible consequence, rather than two separate points.

(ii) In Extract 1, the UK's rate of inflation is predicted to be significantly lower in 2012 than in 2011. Explain **two** likely economic consequences of the lower rate of inflation in 2012.

(8)

Inflation is an increase in the overall cost of living. If there is a lower rate of inflation, and the economy is seen to be "picking up" then this could be likely to encourage investment from firms as they can easily forecast the future. Linked to this is the idea that people will feel they have more disposable income, potentially meaning they may spend more than they otherwise would have done. Another possible consequence could be the raising of the interest rate from the Bank of England. This would be the reversal of the lowering interest when inflation was higher in an attempt to increase demand by encouraging spending over saving. This could be especially likely, such because the interest rate has been at a low of 0.5% for some time now.

ResultsPlus

Examiner Comments

The first suggested consequence here earns all 4 available marks, as the candidate explains that investment may increase because lower (less variable) inflation rates improve businesses' ability to forecast, and may increase consumers' real incomes, leading to more consumer expenditure.

The second suggested consequence is incorrect, and so not worth any marks.

Overall, this response earns 4/8 marks.

(ii) In Extract 1, the UK's rate of inflation is predicted to be significantly lower in 2012 than in 2011. Explain **two** likely economic consequences of the lower rate of inflation in 2012.

(8)

"rate of inflation has begun to fall"

A lower rate of inflation may increase international competitiveness if inflation is below the international average British goods may be relatively cheaper compared do domestic goods raising exports as demand is higher and cutting the deficit of net exports in the UK

The MPC will use this new data of a lower rate of inflation to set future interest rates, if the rate of inflation look to be falling below the 1-3% target they are likely to lower interest rates promoting economic growth and inflation, having used the data to work out the best path forward

ResultsPlus

Examiner Comments

This response earns full marks (8/8). The first point about an improving trade position is very well made (4 marks), and the second point refers to inflation dropping below target when suggesting that interest rates may be cut, and then links this to the promotion of economic growth (4 marks).

Question 2 (a) (iii)

This question was an excellent discriminator between higher and lower ability candidates, as a good answer required students to really apply their knowledge of the workings and target(s) of the Monetary Policy Committee to the data provided. While most candidates could pick up the 2 knowledge marks for a definition of monetary policy, and the 2 marks available for an explanation of a monetary transmission mechanism (i.e. how a change in the Bank rate or money supply affects the inflation rate), many were not able to go past this hypothetical scenario ("if the MPC cut the Bank rate...") into an assessment of the success or otherwise of the actions taken by the MPC. Similarly, purely hypothetical reasons as to why monetary policy may not be effective (e.g. the effect on real GDP and the price level depends on the elasticity of the AS curve, without consideration of the likely level of spare capacity in the UK economy over this period etc.) were not credited with evaluation marks.

The best answers compared the actual inflation rates shown in the Figure to the inflation target, identifying both the positives and negatives here, as well as showing an appreciation of the role of cost-push inflationary pressures - which are perhaps out of the MPC's control - in pushing the inflation rate up above target. Candidates at the very top end were also able to consider whether there had been an implicit change in the MPC's mandate in terms of using monetary policy to stimulate growth, as much as to control inflation (the Extract hinted at this), and so assessed the success of monetary policy in this regard also, perhaps even concluding as to which aim they thought was the most important in the current economic climate, and hence which should be the overall criterion of success.

(iii) With reference to Figure 1, Extract 1 and your own knowledge, assess the effectiveness of UK monetary policy.

(12)

Monetary policy: the Bank of England control the rate of inflation by rise or reduce the interest rate.

As can be seen in Extract 1, the Bank of England want to set a low interest rate. When bank set a low level of interest rate which means the borrowing of individuals and firms will be much cheaper than before. Therefore the cost of producing goods and ~~saving~~ serves will be lower. The price level of goods and servke will be lower. At the same time the Bank will also discourage the savers to save money in the bank. Therefore, the most savers will not save money in the bank. Therefore the demand of goods and service will be ~~in~~ increased. Due to low level of ~~e~~ interest rate, and lower cost than before, the exports of ~~UK~~ goods and

service of UK will be much lower than any other foreign countries, the consumer will consumer less imports goods and service as well. Therefore the government will not get budget deficit. the Bank of England set a low level of interest rate due to these will get a low level of inflation ~~rate~~ in rate in the future.

However, ~~the~~ when Bank of England send to set a low level of interest rate, the other banks such as HSBC, Lloyd TSB ~~would~~ might not get these

ResultsPlus
Examiner Comments

This response was typical of many in that it earns 4/12 marks overall. 2 marks are awarded for the definition of monetary policy in the first sentence, and a further 2 marks are given for the explanation of how a change in interest rates affects the inflation rate (monetary transmission mechanisms). No marks are awarded for the attempt at evaluation on the second page, as this is all hypothetical, rather than assessing the actual success of monetary policy as conducted in the UK. Overall this candidate does not engage with the question as asked.

(iii) With reference to Figure 1, Extract 1 and your own knowledge, assess the effectiveness of UK monetary policy.

(12)

UK monetary policy can be defined on the manipulation of interest rates, ~~in order to achieve the MPC's aim of inflation~~ ~~MPC's aim of keeping inflation between~~ ~~mean~~ There are contrasting views on the successfulness of this, however figure 1 and extract 1 show there have been ~~some success~~ many failures

The first ~~a~~ one example ~~of~~ which shows the ineffectiveness of UK monetary policy is that how MPC (Monetary Policy Committee) who dictate base interest rates have been largely unsuccessful in keeping inflation between the target levels of 1%-3%.

figure 1 shows that ~~for~~ for the vast majority of times, there has

levels of CPI have been out of the boundaries, resulting in ~~an extra Meeting~~ Sir Mervyn King having to write many letters to the chancellor, as Extract 1 states.

Furthermore, extract 1 ~~st~~ says that ~~s~~ many external factors have caused levels of inflation, such as supermarket inflation price wars, which shows the further ineffectiveness of UK monetary policy and as it highlight it has not been the MPC's decisions that have slowed down inflation.

One final example which shows the ineffectiveness of UK monetary policy is the failure of Quantitive ~~Easy~~ Easing, costing millions of pounds, it has failed to increase any tangible liquidity in the economy, which was its aim and as such it has not helped to kick start growth in the economy.

However there are some potential ~~problems~~ with this

ResultsPlus

Examiner Comments

The definition of monetary policy in the first sentence earns 2 marks. The candidate then goes on to explain why monetary policy has been ineffective: the inflation rate has been outside of the target ceiling and floor, leading to letters having to be written by the Governor to the Chancellor (2 marks); other factors apart from monetary policy seem to have had a greater influence on the inflation rate, for example the supermarket price wars (4 marks); and QE has failed to increase the level of tangible liquidity in the economy, so has not stimulated growth (4 marks). As the best two arguments are rewarded, the candidate earns 8/8 marks for knowledge, application and analysis.

At the bottom of the first page, the candidate then goes on to give the alternative view, that monetary policy has been successful: the inflation rate was on target in 2009 (2 evaluation marks); deviations from the target have been caused by external factors outside of the MPC's control, so we cannot blame it for this (4 evaluation marks); and the MPC has managed to remain independent throughout this period (2 evaluation marks). The maximum of 4 evaluation marks is therefore easily reached.

Overall, this response earns full marks (12/12).

Question 2 (b) (i)

Credit was given for any of the pre-2010 or current HDI indicators in the question (or indeed a mixture of the two). It was noticeable that very few candidates were aware of the new indicators, despite the change having occurred almost three years ago, although this probably reflects the content of the vast majority of text books. Most candidates achieved good marks for their knowledge of the education and health dimensions and their indicators, but struggled to explain the standard of living component (indeed many candidates wrote that the index as a whole was a measure of a country's standard of living, confusing quality of life, and standard of living). In particular, although most candidates knew that there was a GDP element to the HDI, a good number omitted the per capita and PPP adjustments. We insisted on the former for the mark, but not the latter.

(b) (i) Explain the three main components of the Human Development Index.

(6)

The HDI is a composite measure of economic development. The 3 components are health, ~~ge~~ education ~~et~~ and GDP per capita at PPP. The health component is measured by the life expectancy at birth and the education is measured by the number of years spent in schooling. The GDP per capita is measured at purchasing power parity.

ResultsPlus
Examiner Comments

This response was fairly typical, as better marks were scored for knowledge of the education and health components, than for the standard of living component. This response is worth 5/6 marks: health (1) measured by life expectancy at birth (1); education (1) measured by years of schooling (1); the standard of living dimension is omitted (0), but its indicator, GDP per capita PPP (1) is mentioned.

(b) (i) Explain the three main components of the Human Development Index.

(6)

Human Development Index is a measure of economic development of a country that takes into account 3 main components, namely health, education and GDP per capita. Health is to be indicated by the life expectancy which represents the healthcare facilities, freedom from warefare, food and shelter that the citizens of a country have available to them. Education which is indicated by literacy rates is meant to represent the value of a country's human capital, their ability to produce goods and services as well as their income levels and distribution. GDP per capita is used to measure the standards of living of the general populace of the relevant economy.

ResultsPlus

Examiner Comments

This response earns full marks (6/6): health (1) measured by life expectancy (1); education (1) measured by literacy rates (1); and standard of living (1) measured by GDP per capita (1). Note that GDP per capita is allowed for the mark.

Question 2 (b) (ii)

This question was generally well answered, with the most common difficulties discussed being that of income (or health, or education) inequality, and the presence of non-marketed produce, and the shadow economy. The best answers explained these points well, and referred to the data given to bring out their significance, for example by stating that the presence of much subsistence agriculture in Ethiopia probably meant that the GNI per capita PPP figure was an under-estimate.

Candidates who looked closely at the data often also saw that there were discrepancies in countries' ranking according to the two different measures, and were able to use this well as one of the difficulties.

Given that the question was asked specifically in reference to Figure 2, and all of the data in Figure 2 was adjusted for population size and cost of living, we did not award either of these points as difficulties, although a discussion of the weaknesses of these adjustments was credited with marks.

(ii) With reference to Figure 2, explain **two** difficulties of comparing living standards between countries.

(8)

~~It is difficult to measure quality of life~~

The GDP per head (at PPP) component of HDI or GNI per head (at PPP) does not take subsistence, barter or black economies into account. For example, ~~Germany has a high GNI~~ Germany has a high HDI of 0.905 and GNI of 34,854 while China has a low HDI of 0.687 and GNI of 7,476. However, China has a much larger agriculture sector than Germany ~~where~~ which may not be income generating but self-sufficient. In this case, the measures do not accurately reflect difference in living standards.

Furthermore, it is difficult to tell quality of life from measures used to compare living standards. Even though HDI includes measures of health and education, there is no indication of the quality of education or life generally – it may be that despite higher GDPs and GNIs, like in Germany, Spain and UK (around 30,000 GNI per head), people are more stressed and less happy than those living in Fiji, China and Ethiopia ~~and Ethiopia~~ (~~the~~ less than 10,000 GNI per head).

ResultsPlus

Examiner Comments

This response earned full marks (8/8). The first paragraph identifies the issue of subsistence, barter and black economies, gives some data from the Figure, and uses it as part of the explanation of this difficulty (4 marks). The second paragraph identifies the issue of a lack of a measure of the quality of provision in the three dimensions, and goes on to apply this to countries in the Figure, particularly focussing on the level of stress and happiness (4 marks).

– social costs
– income distribution

(ii) With reference to Figure 2, explain **two** difficulties of comparing living standards between countries.

(8)

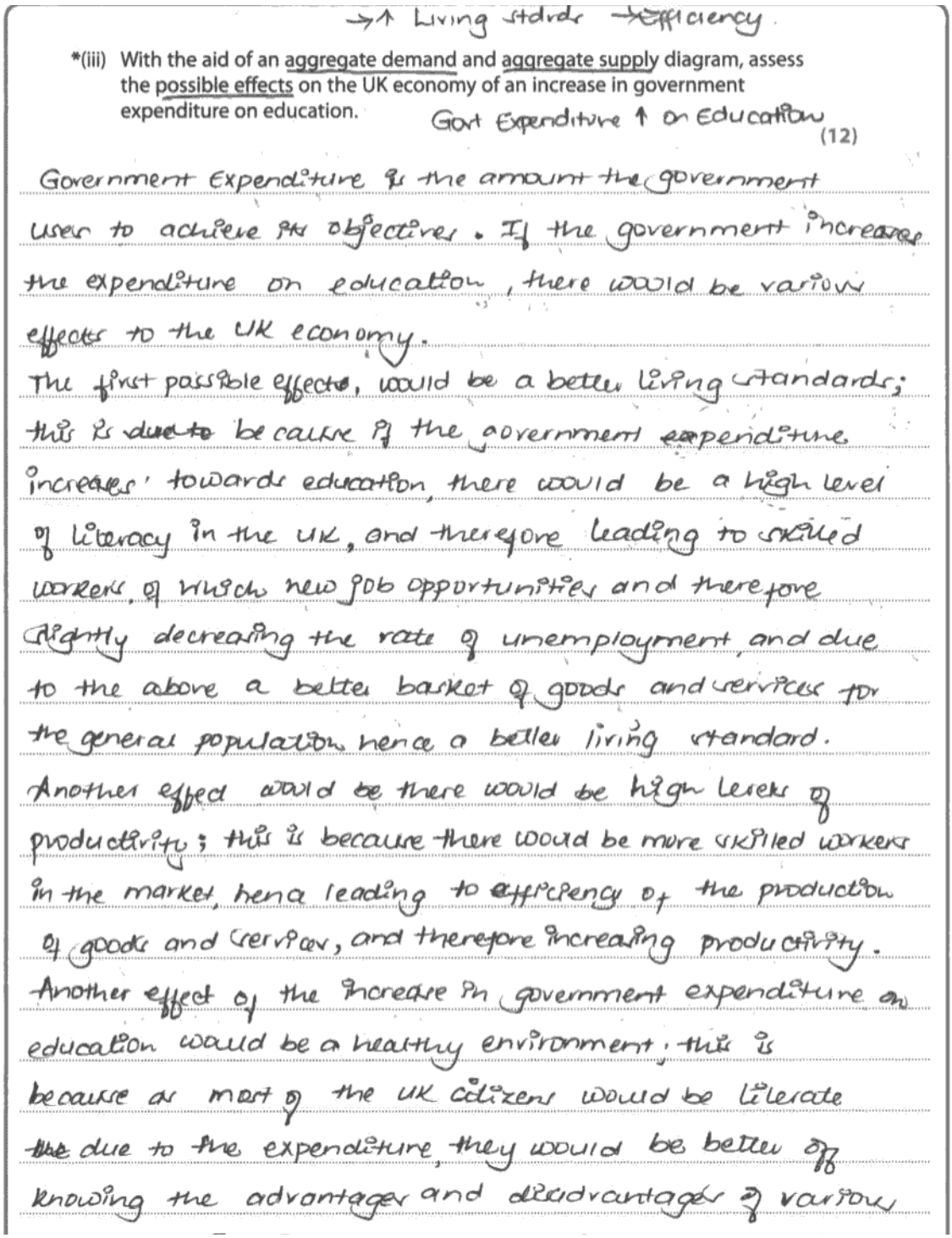
Figure 2 suggests that Germany is more ~~than~~ developed in terms of HDI (0.905 compared to 0.688) and ~~GNP per~~ GNI per head ($34854 compared to $4145). This may indicates that Germany has better living standards than Fiji. Albeit, this may not be exactly true. One difficulty of comparing living standards of countries with such measures may be ~~excluding~~ social cost not being ~~taken~~ considered. Social costs ~~in~~ ~~to~~ like congestion ~~and~~ and ~~pollu~~ pollution may be higher in Germany due to industrialisation than Fiji. Hence, quality of ~~time~~ life in Germany may be lower than Fiji because of these social costs. Secondly, income distribution is also ~~not~~ ignored. ~~In~~ Income per head and HDI says nothing about income distribution. The rich ~~minority~~ minority in Germany may contribute to ~~hold~~ most of the wealth and ~~a~~ earnings while the majority population ~~poor~~ ~~most~~ stays poor. ~~than~~ Hence, living standards are likely to be lower in such country despite the high HDI.

ResultsPlus
Examiner Comments

This response is worth full marks (8/8). The first sentence gives data from the Figure (2 marks), and the answer then goes on to explain how industrialisation may actually mean more pollution and congestion, leading to a worse living standard (4 marks). The candidate then identifies and explains the issue of income inequality within countries (4 marks).

Question 2 (b) (iii)

As with question 1(a)(iii), candidates found this a very accessible question, and as such most could explain the changes in aggregate demand and/or aggregate supply, draw a diagram to illustrate this, and then state and explain at least one effect on the economy of these changes. As the question specifically asked for a diagram, a maximum of 4 knowledge, application and analysis marks were awarded for written analysis. There was, however, much inaccuracy in the labelling of AS/AD diagrams, particularly in terms of using the microeconomic 'price' and 'quantity' labels for the axes, and less so, 'D' and 'S' for the curves. Candidates must also remember to label the initial and final equilibria on their diagrams; this was sometimes omitted or done incorrectly, particularly when candidates were shifting both curves. Most candidates made an attempt at evaluating their arguments, and as the 4 available evaluation marks were awarded as either 2+2 or 4 marks, many scripts achieved all 4 evaluation marks.



→↑ Living stdrds → efficiency.

*(iii) With the aid of an aggregate demand and aggregate supply diagram, assess the possible effects on the UK economy of an increase in government expenditure on education. Govt Expenditure ↑ on Education (12)

Government Expenditure is the amount the government uses to achieve its objectives. If the government increases the expenditure on education, there would be various effects to the UK economy.

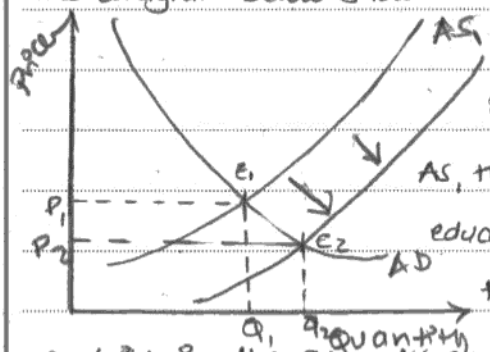
The first possible effects, would be a better living standards; this is ~~due to~~ because if the government expenditure increases towards education, there would be a high level of literacy in the UK, and therefore leading to skilled workers, of which new job opportunities and therefore slightly decreasing the rate of unemployment and due to the above a better basket of goods and services for the general population, hence a better living standard.

Another effect would be there would be high levels of productivity; this is because there would be more skilled workers in the market, hence leading to efficiency of the production of goods and services, and therefore increasing productivity.

Another effect of the increase in government expenditure on education would be a healthy environment; this is because as most of the UK citizens would be literate ~~the~~ due to the expenditure, they would be better off knowing the advantages and disadvantages of various

situations. For example pollution, the education would allow the people to know not to litter around, not to smoke in public areas and therefore creating a healthy environment for the citizens. Further more, there would be less people falling sick as the education would have taught them on cleanliness. and such

The diagram below shows the effect on increased productivity.



The diagram shows the significant increase in the Aggregate supply curve AS, to AS_2, due to the expenditure on education, therefore due to the efficiency the productivity increases, leading to a shift in the axis AS curve to the right bringing an increase in quantity from Q_1 to Q_2 and a decrease in price from P_1 to P_2, creating a new equilibrium from E_1 to E_2.

The increase in government expenditure on education brings out more positive possible effects, however, the education is beneficiary to the economy in the Long run, as the effect of education is brought out after the whole process of learning is completed, therefore not bringing out the immediate change in the economy, of which if needed in the short run it wouldn't work out.

ResultsPlus
Examiner Comments

In the second paragraph of this response, the candidate explains the impact of increased education spending on the standard of living in detail (4 marks). He/she then goes on to identify the likely increase in productivity (2 marks), and then comes back to add to his/her explanation of why standard of living would improve. As there are only 4 marks available here, the candidate has more than secured them.

The AS/AD diagram has incorrectly labelled axes, but is otherwise correct (shifts in AS and/or AD were accepted) so earns 3/4 diagram marks.

In the final paragraph on the second page, the candidate mentions that the effects will only occur in the long run, although this is not very clearly explained (2 evaluation marks).

Overall this response earns 9/12 marks (7/8 for knowledge, application and analysis, and 2/4 for evaluation).

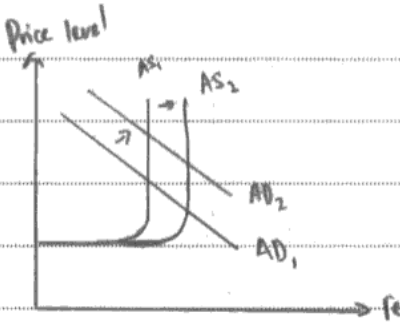
*(iii) With the aid of an aggregate demand and aggregate supply diagram, assess the possible effects on the UK economy of an increase in government expenditure on education. (12)

supply side policy

technology → training for teachers → technical eos → higher quality → higher productivity → ↑ growth

demand for teachers → create jobs → ↓ unemployment

create more jobs → I ↑ → C ↑ → AD ↑ → growth



The increase in government expenditure on education has resulted in the creation of more jobs. This is due to the construction of new schools which require manpower. In turn, unemployment rate in the UK will decrease as more jobs are created.

Besides that, increase in government expenditure on education would mean more training for teachers. This will help create high quality teachers who in turn create high quality individual and profesionals. Thus, productivity and efficiency will due to the increase in high quality individuals. create more jobs and therefore

On top of that, the creation of more schools will increasing the demand for teachers. As more people get jobs, consumers will have money to spend on goods and services therefore increasing consumption. With that, the aggregate demand will increase causing the curve to shift rightward from AD1 to AD2. As more jobs are a

However, Furthermore, the increase in expenditure on education has allowed more people to recive education. This has given people a higher chance of getting a job therefore improving living standards

ResultsPlus
Examiner Comments

This AS/AD diagram earns 3/4 marks, as the equilibria are not labelled. The written analysis of the effects of the increased government expenditure on education earns 4/4 marks: unemployment falls (2 marks); productivity increases (2 marks); living standards increase (2 marks) - the best two points only are credited. However, there is no attempt at evaluation, so overall this response is worth 7/12 marks.

Question 2 (c)

This question was generally well answered, with candidates including good levels of analysis in their responses, particularly showing a solid knowledge of AS/AD analysis. As this was a broad question, and not specific to any one country, candidates were free to discuss the use of monetary, fiscal and/or supply side policies in their responses. Evaluation was not done as well as analysis, and in particular, candidates often did not appreciate the need to centre their evaluation around policies' impact on living standards; for example, simply stating that an expansionary fiscal policy may also increase the government budget deficit is an analytical rather than evaluative point. To make it into the latter, a candidate would need to explain that therefore in the future, taxes may have to rise, or government spending on public services be cut, therefore leading to a fall in living standards in the long run. As with question 1(c)(i) this relates to candidates needing to appreciate that just because an effect may be negative for an economy, mentioning it does not necessarily constitute evaluation.

Marks could be awarded for directly opposed policies, depending on how they were presented. For example, candidates were awarded marks for either writing that benefit payments should be increased, so as to increase consumers' disposable income, or that benefit payments should be cut, so that there was more incentive for the voluntarily unemployed/inactive to take work, and hence increase their incomes and living standards. This also applied to industrial relations legislation policy.

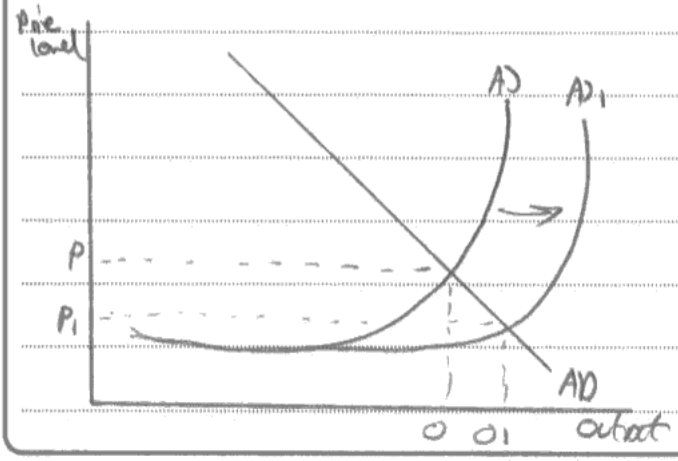
A minority of candidates had obvious timing problems which curtailed their answering of this question. Often the same candidates tried to finish their answers using bullet points, or by writing in note, or abbreviated form. Given that candidates' quality of written communication was assessed in this question, such answers were not given full credit.

*(c) Other than investing in education, evaluate policies a government can implement to raise living standards.

(30)

There are 3 types of policies that can be implemented, these are supply side policies, fiscal policies and monetary policies. Supply side policies aim to shift AS to the right and increase productive capacity. Monetary policy is demand side and aims to shift AD to the right using the base rate and money supply. Fiscal policies are where the goverent manipulates it tax or spending rates to attain economic objectives.

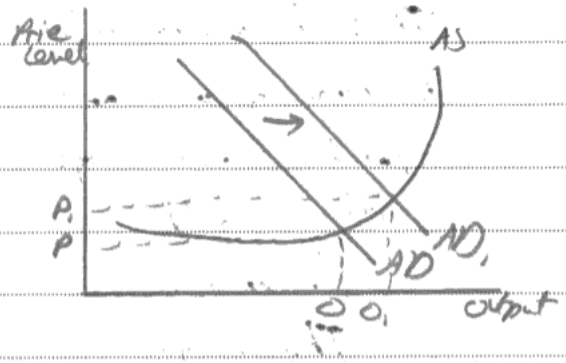
My first policy is a supply side policy and is purpose money into the health sector. This means that individuals get better healthcare so are late less sick days, can work for longer and therefore can increase capacity.



This shift to the right for the AS means that price level will drop from P to P, and output moved here.

To not only are we increasing the health of the population, we are also increasing incomes with the policy. This can also be thought of as government spending, so fiscal policy. There are large time lags involved also which could range last 10 years will professionals are being trained and buildings constructed.

Another policy is a simple monetary policy of cutting interest rates. There will enable more people in the economy to borrow as they have to pay back less. This increases living standards as it means that people can have more money to spend on necessities, such as heating and food.

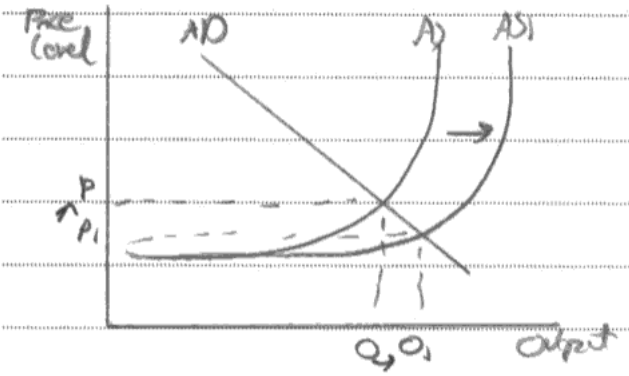


The decrease in interest means that consumer spending and investment is effected as well as net exports improving. As consumer spending is around 65% of aggregate demand and so it creates a huge shift in increasing output and price level.

If we look at it in terms of circular flow, there are likely to be minimal leakages and so therefore incomes get larger creating

better living standards. Monetary policy has an asymmetric effect as it either benefits savers or borrowers and it has also increased inflation.

Another policy is partly fiscal but mostly supply side. It is to improve infrastructure works in a country. This also gives the country higher levels of employment but also a smoother operating system for transporting goods or travelling. This would reduce stress levels and improve the social side of things while also helping growth and incomes.

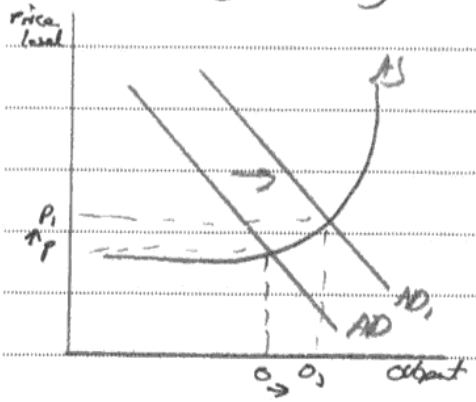


This work on infrastructure increase AD and therefore price level drops and growth increases.

There is an opportunity cost in doing this as it could be spent on something like training. It also might just not work leaving AD to shift towards full capacity.

My last policy is a fiscal policy and it is a decrease in income tax rates from the government. Many people get taxed and it takes away a lot

of disposable income. This would if taxes were reduced, more luxuries could be brought as well as less steps of having more money.



This decrease in income tax shift AD to the right increase due to higher levels of consumer spending. It increases output but increases price level.

More income means we are more likely to import which decreases net exports and limits the shift in AD limiting output growth. This is a side effect of decreasing tax.

In conclusion, all three policies could be effective but my

(Total for Question 2 = 80 marks)

ResultsPlus

Examiner Comments

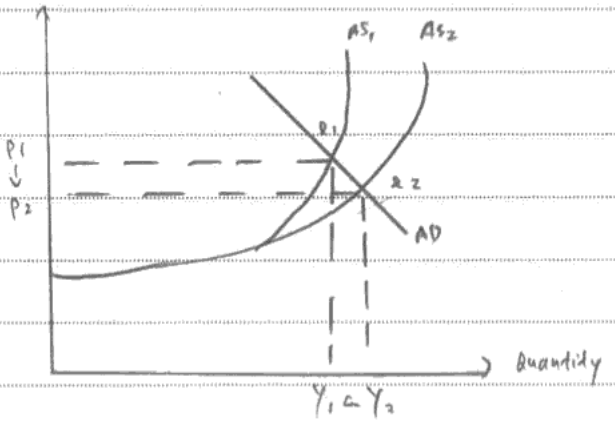
This response is rather typical in that it scores far more highly on knowledge, application and analysis than on evaluative content. The first sentence identifies three types of policy that may be used to increase living standards (2+2+2 marks). The candidate then explains how investing in healthcare would work (4 marks), but mentions that this would have a time lag (2 evaluation marks). Next the candidate identifies and explains how loose monetary policy would raise living standards (4 marks), but states that this would have an asymmetric impact on borrowers and savers (2 evaluation marks). The third policy discussed is investment in infrastructure (4 marks), although the candidate notes that this would have an opportunity cost (2 evaluation marks). Finally the candidate discusses a reduction in income tax rates (4 marks), but counters that as increased disposable incomes may be spent on imports, the expected increase in real GDP may not be as large as expected (4 evaluation marks).

As we award up to the best three policies, and evaluation points, this response earns 18/18 for knowledge, application and analysis, and 8/12 for evaluation, making an overall score of 26/30.

*(c) Other than investing in education, evaluate policies a government can implement to raise living standards.

(30)

There are three policies the government can used to raise the living standards. There are fiscal policy, monetary policy, and Supply-side policy. Fiscal policy are ~~~~ policies used by the government to increase the movement of AD and the overall level of economic activities by manipulating the taxation rate and government spending. Monetary policy are policies used by the government to influence the movement of AD and overall level of economic activities by manipulating the interest rate.



Supply-side policies are policies used by the government to increase the movement of AS and by increasing the potential capacity of the economy.

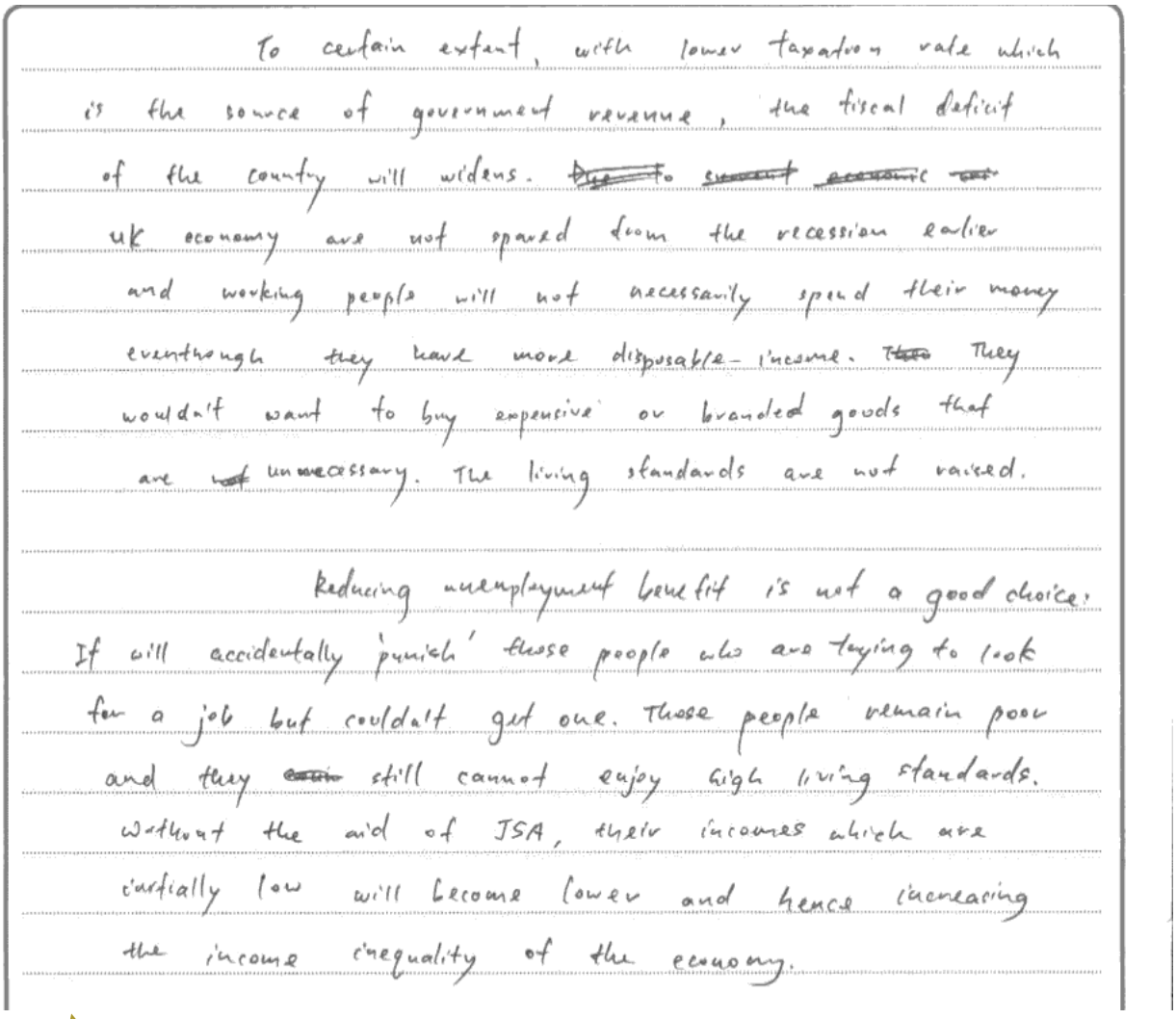
Considering monetary policy, the bank can lower down the interest rate. The UK people will therefore borrow more money from the bank to consume branded bags, travelling around the would or send their children for further

education. With more money, they can enjoy themselves and therefore help to raise the living standards.

By using fiscal policy, the government can cut down the taxation rate. With more disposable income, the working people can consume more goods or buy import goods. Firms that enjoy the lower business tax can produce more higher quality of products for UK people to enjoy. This will lead to a raise in living standards.

By using supply-side policies, the government can choose to reduce the unemployment benefit. This will encourage more idle people to look for jobs and give them the incentive to work for higher income. The people who earn more income will consume more goods and hence the living standards can be raised.

However, when UK people spend more money onto import goods, this will widens the balance of payment deficit of the country. And also some banks are reluctant to lend money to UK people, they still cannot enjoy buying goods and thus the living standards are still the same.



To certain extent, with lower taxation rate which is the source of government revenue, the fiscal deficit of the country will widens. ~~The~~ To ~~current~~ ~~account~~ ~~of~~ UK economy are not spared from the recession earlier and working people will not necessarily spend their money eventhough they have more disposable-income. ~~They~~ They wouldn't want to buy expensive or branded goods that are ~~not~~ unnecessary. The living standards are not raised.

Reducing unemployment benefit is not a good choice. It will accidentally 'punish' those people who are trying to look for a job but couldn't get one. Those people remain poor and they ~~still~~ still cannot enjoy high living standards. Without the aid of JSA, their incomes which are initially low will become lower and hence increasing the income inequality of the economy.

ResultsPlus

Examiner Comments

In the second sentence, the candidate identifies the three policy options for governments (2+2+2). The discussion of the use of loose monetary policy is not awarded any marks, as the candidate explicitly writes that the central bank could lower interest rates, rather than this being action that the government takes; this is therefore not answering the question as set. On the second page, the candidate explains the use of expansionary fiscal policy (4 marks), and reform of the benefits system (4 marks). No marks are awarded for the mention that this may worsen the current account deficit, as this is an analytical, rather than evaluative point, and similarly no marks are awarded for the idea that banks might not extend credit to consumers even if interest rates fall, as this is related to the invalid loose central bank monetary policy point. However the ideas that the candidate thinks that if confidence is low, consumers may not spend any additional income is valid evaluation (2 evaluation marks). Finally the candidate evaluates that reducing benefits may not raise living standards, as some people may be unable to find jobs, and this would increase income inequality (4 evaluation marks).

Overall, this response earns 20/30 marks (14/18 marks for knowledge, application and analysis, and 6/12 marks for evaluation).

Paper Summary

Based on their performance on this paper, candidates are offered the following advice:

- Make sure that your answers address the exact question asked - this could mean looking at only a selected time period, or having to take into account certain additional assumptions;
- Remember that in the UK the Bank of England's Monetary Policy Committee set the interest rate, not the government (although the government do retain certain powers, as the MPC are only operationally independent). If a question is **specifically about UK government policy**, you will not be awarded marks for analysing how either the government could change the interest rate (incorrect), or the MPC could change the interest rate (not answering the question);
- In questions that explicitly ask you to use an AS/AD diagram in your answer, up to 4 marks will be available for this diagram. To earn all of these marks, you must make sure that you label the axes correctly (using macro, not micro labels), label the curves correctly, show correct shift(s) in the curve(s), and label the initial and final equilibria;
- Remember to look out for questions that ask you to evaluate your answer. In such questions, try to **apply** your evaluation to the **specific** analytical point that you have just made, for example, rather than a throwaway comment at the end of a paragraph that "it depends on the elasticity of the AS curve" etc., explain **what** depends on this, **why** it does, and **how** this affects your initial argument. Expanding on your evaluative points in this way will help you to earn up to 4 marks per point. This is particularly important in the 30 mark question;
- Make sure that you are happy with the relationships between the price level and the rate of inflation, and real GDP and the economic growth rate. In particular you must understand that lower, but still positive rate of inflation/economic growth mean that the price level/real GDP is still increasing, just at a slower rate;
- Watch your timing throughout the exam, and try to incorporate some time for planning your answers to the longer questions.

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