

Examiners' Report
June 2013

GCE Economics 6EC02 01

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Introduction

This seems to have generally been an accessible paper, as there were very few candidates who could not answer at least some of the questions; however there were also questions which allowed the more able candidates to show their understanding, and which less able candidates struggled to grasp conceptually. Most candidates completed the paper in the time available, although those who ran out of time tended to be those who either tackled the questions in reverse order, and hence spent too long on the 30 mark part (c) questions, or who wrote overly long answers to early, lower mark questions. As the questions do tend to build upon one another, I would personally recommend working through them in order, whilst remaining conscious of the need to leave at least 30 minutes to answer the final question. It is important that candidates practise past Unit 2 papers under timed conditions to strengthen these skills.

Candidates have a choice between two data response questions on this paper. Around 40% of candidates opted for Q1 (balance of payments, inflation and unemployment), while around 60% answered Q2 (real incomes, growth and monetary and fiscal policy). It is obviously important that candidates base their choice on their ability to answer the higher mark questions, rather than the 4 and 6 mark questions. Whilst many candidates did view the first, 6 mark question in Q1 as less accessible than the equivalent in Q2, some of those who made their question choice on this basis alone did appear to struggle with the later parts of Q2.

The performance on individual questions is considered in the next section of the report, and there are two examples of candidate work for each one. These examples act as a guide as to why a question was well answered and also on how to improve further.

A slightly lower mean score was recorded for Q2 than Q1. This was due to a significant number of responses not answering the question asked in Q2(c) (the effects of reducing the budget deficit on the government's achievement of its macroeconomic objectives), a confusion between falling price level and falling inflation in Q2(b)(ii), and perhaps inopportune question choices, as referred to above.

Candidates should also remember that their quality of written communication (QWC) is being assessed in those questions highlighted with an asterisk. Although no marks are specifically awarded for this, in these questions examiners will be far more reluctant to 'do the work for the candidate' in terms of trying to ascertain the meaning of an unclear, or poorly expressed answer.

Finally, I would reiterate the importance of candidates using accurate definitions for the key economic terms covered in this Unit. Particularly towards the bottom end of the mark range, some candidates could have picked up a good number of additional marks had their definitions been a little tighter. Those that seemed to cause particular problems were:

Q1(b)(i) - a deficit in the trade of goods and services (see the comments on this question)

Q1(b)(iii) - exchange rate

Q1(c) - economic growth (many candidates omitted a reference to 'real' GDP increasing)

Q2(a)(iii) - real

Q2(a)(iii) - standard of living

Q2(c) - budget deficit (many candidates defined this as 'the difference between government spending and government tax revenue' which was insufficient)

Question 1 (a) (i)

Although a proportion of candidates were unaware of how to calculate an index number, it was pleasing to see that a good number were, as understanding data presented in index form is obviously an essential skill for any student of economics. This question functioned very well as a discriminator of ability, as less able candidates were able to access up to 2 marks for data reference alone, mid-grade candidates could attain additional marks for calculating the percentage change in the oil price and/or showing understanding of the base period in an index, while the more able candidates could attain full marks.

Common errors were to mis-read one of the oil prices from Figure 1 (often stating that the price in March 2012 was \$135 rather than \$125), and to calculate the initial price as a percentage of the final price rather than working out the percentage change. A number of candidates also wrote the correct formula for calculating the index number ($(\$125 - \$45) \times 100$) but then interpreted their answer as meaning that oil prices had increased by 277.8%. Candidates do need to be secure in this basic calculation, and practising reading from charts, and calculating percentage changes would be valuable to less able candidates in particular.

(a) (i) Referring to the data in Figure 1, calculate an index number for the oil price in March 2012, using January 2005 as the base period. Show your working.

(6)

Let 45 \$ per barrel of oil = 100
(in Jan 2005)

The price increased to 125 \$ per barrel in March 2012, which is $\frac{125}{45}$ times bigger.

$$100 \times \frac{125}{45} = 278 \text{ (3sf)}$$

If base rate is 100 in Jan 2005, the new index number is 278



ResultsPlus Examiner Comments

This is a good answer which secured full marks:

There are two pieces of accurate data reference: January 2005 = \$45 (1) and March 2012 = \$125 (1)

The candidate shows understanding of the idea of a base period: Let \$45 = 100 (1)

The candidate writes the correct formula: $100 \times (125/45)$ (2)

And produces the correct answer: 278 (1)



ResultsPlus Examiner Tip

When a question asks you to 'Show your working' make sure that you do. This will allow you to gain all available marks, and also will help you to order your thoughts, and prevent minor mistakes.

- (a) (i) Referring to the data in Figure 1, calculate an index number for the oil price in March 2012, using January 2005 as the base period. Show your working.

(6)

Jan 2005 price = ~~125~~ 45 dollars

March 2012 price = 125 dollars.

$$\therefore \text{index number} = \frac{45}{125} = 0.36$$



ResultsPlus

Examiner Comments

This response scores 2/6 marks, as 1 mark is awarded for each piece of data reference. 0 marks are awarded for the calculation, as this is not the percentage change in oil prices.



ResultsPlus

Examiner Tip

Take care reading charts and graphs - double check your figures to avoid losing marks.

Question 1 (a) (ii)

Given the 'With reference to Figure 1' beginning to this question, there were up to 2 data reference marks available for the use of oil price figures to show either a fall or rise in price. Most candidates picked up these marks, but some (often those with a low total score for the question) did not.

Many candidates found the use of supply and demand analysis within a macroeconomics paper confusing, and tried to use **aggregate** supply and demand analysis to explain the changes in the oil price instead. This led to comments that the 'aggregate demand for / supply of oil was rising/falling', often accompanied by AS/AD diagrams showing the referred to changes, which was obviously incorrect, and therefore gained limited marks.

More worrying was the fact that in this question and in Q2(a)(ii), a good number of candidates wrote that during a recession, demand for goods fell, and so producers raised prices to maintain their revenue/profit levels, and that this was therefore an explanation for either rising oil prices over the period January 2009 to July 2011 (Q1), or for above target inflation (Q2). This was not a sophisticated answer looking at the interventions of OPEC to maintain revenue, but a more fundamental understanding of the working of the price mechanism.

As the question asked for 'possible' ways, we accepted references to either actual economic events (global recession/recovery, growth of the emerging economies, growing world populations etc) or relatively realistic hypothetical events (the discovery of new oil reserves, increased environmental regulation raising oil producers' production costs etc). As the Figure showed oil prices in US dollars, we tended not to accept straightforward answers based on changes in the exchange rate, and neither did we accept general inflation (or deflation) in either oil producing or oil consuming countries as an explanation for the changes in oil prices.

(ii) With reference to Figure 1, explain **two** possible ways in which changes in the world economy could cause the movements in the oil price shown.

(8)

one way which could cause movements in between January 2005 at \$45 a barrel to around \$135 a barrel ~~in January 2008~~ could have been because of china's massive growth which raised demand for oil by a lot and drove up the price of oil as well as increasing demand from other developing countries is india.

After the huge peak, the barrel of oil costed a lot less and prices plummeted from \$135 in Jan 2008 down to \$40 in Jan 2009. This could have been caused by the steep fall in demand after a global recession kicked in which was triggered in wall street when Lehman brothers group collapsed and reduced demand significantly; Furthermore, during that time, more oil fields started functioning ^{during 2008} and increased the supply and helped reduce the price of oil.



ResultsPlus Examiner Comments

This is a very good answer, which not only receives full marks, but is clear and concise. Marks were awarded as follows:

First paragraph: data reference (2), the growth of China (2) increases demand for oil, which raises its price (2)

Second paragraph: global recession (2) decreases demand for oil, which led to a fall in its price (2); and more oil fields started functioning (2), which increased supply of oil, contributing to the price fall (2)

Full marks were therefore reached half-way through the second paragraph.

Note that the data reference marks were only awarded once - 2 marks maximum for any one correct, illustrative use of oil prices from Figure 1.

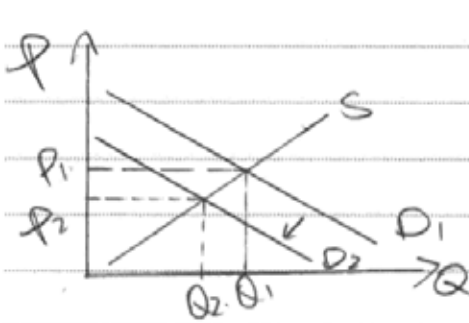


ResultsPlus Examiner Tip

To some extent the line between microeconomics and macroeconomics is artificial - supply and demand analysis is a powerful tool in macroeconomics too so be prepared to use it where appropriate.

(ii) With reference to Figure 1, explain **two** possible ways in which changes in the world economy could cause the movements in the oil price shown.

(8)



According to figure 1, the price of oil was keep increasing from \$40 per barrel in January 2009 to \$125 per barrel in 2012. The main causes are inflation and imports.

Firstly, inflation is the ~~price~~ sustained rise in the general price level, ~~this will lead as~~ as price goes down, demand decreases, shifts to the left from D_1 to D_2 , lead to a fall in quantity.

Secondly, as the UK government imports raw materials, components and capital goods from other countries, if the exchange rate goes up, this will cause the price of the goods increase.



ResultsPlus Examiner Comments

This response received 2/8 marks

If the supply and demand diagram had been accompanied by correct written analysis, explaining why demand for oil had fallen, it would have been worth 2 marks, but here that is not the case, so it didn't receive any marks.

There are 2 marks for data reference in the first paragraph.

0 marks are awarded for the idea of inflation, particularly as the rest of the paragraph is confused: while inflation refers to changes in the **average** level of prices, the candidate goes on to write about the price of oil alone, and on a microeconomic level, is also incorrect in his/her assertion that 'as price goes down, demand decreases'.

Similarly 0 marks are awarded for the third paragraph. As Figure 1 shows oil price in US dollars, exchange rate-based answers were largely irrelevant, and in this case the candidate also incorrectly writes that an appreciation of the pound Sterling would raise the price of imported goods.



ResultsPlus Examiner Tip

Do use diagrams to support your answers where possible, but remember that they must be accompanied by (and ideally integrated into) correct written analysis too.

Question 1 (a) (iii)

This question functioned effectively as a discriminator of candidate ability, as while more able candidates were able to identify either a rise in firms' production costs, and hence a decrease in (SR)AS, or an increased trade deficit, and hence a decrease in AD, less able candidates often believed incorrectly that consumption in the UK economy would fall following a rise in oil prices, and based their whole answer around this (on the basis that if households were spending more on oil and related products, they would have less money to devote to other areas of expenditure). No marks were awarded for a fall in consumption unless it was explained as part of a negative multiplier effect as firms looked to reduce costs to compensate for the rise in oil prices.

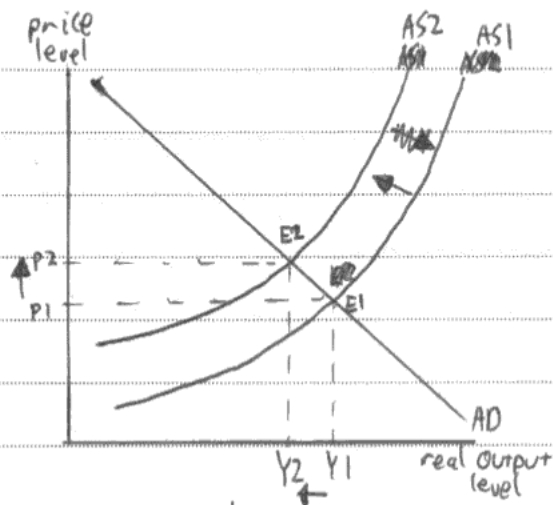
Candidates are expected to have a basic knowledge of the UK economy, and as part of this, we would expect them to understand that the UK is a net importer of oil. Therefore although full marks could be attained in this question without this (by analysing the effect of a rise in production costs only), we did not allow answers based on the UK being a net exporter of oil, and hence seeing an improvement in its trade balance following a rise in oil prices.

AS/AD diagrams were generally sound, although a large majority of candidates used microeconomic supply and demand diagram labels on their axes ('P' and 'Q'), and a small minority did not label the equilibria, or labelled them incorrectly. The latter was particularly the case when candidates had shifted both AS and AD curves, and care does need to be taken to identify the correct final equilibrium in this case. We accepted either short run or long run AS curves of various shapes.

In terms of evaluation, candidates do seem to realise that there are 4 marks for evaluation in a 12 mark question, and so most attempted some form of evaluative comment. Given that candidates were shown in Figure 1 exactly how much oil prices had increased from January 2009 (at least to March 2012), very few (if any) marks were awarded for a simple observation that the extent of the effects depended on how much oil prices had risen by. Far better was to make an evaluative comment based on the data provided, for example that as oil prices had increased by around 200% over the period, the effects on the UK economy were likely to be very significant, or alternatively that perhaps the previous spike in oil prices in late 2008 had led firms to take measure to reduce their reliance on oil, which would reduce the severity of the effects etc. This issue was also found in Q2(b)(iii), Q2(c), arguably Q1(a)(iii), and Q1(b)(iii). More generally candidates should try to avoid using generic, rote learned evaluation points without applying them to the specific question or context in hand.

(iii) Using an aggregate demand and aggregate supply diagram, assess the effect on the UK economy of the rise in oil prices since 2009.

(12)



Since oil is a major factor input cost for many industries, the increase in the price of oil from \$45 per barrel in 2009 to \$125 per barrel in March

2012 will increase costs for many businesses, reducing the real output level and shifting AS to the left (AS1 to AS2). This also causes the price level to increase from P1 to P2, and ~~can~~ could also increase spending on imports, potentially shifting AD to the left.

However, the significance of the increase must be considered when assessing its effects. The price of oil rose by 177.78%, which is a highly significant increase in price. Since oil is also used in many industries and is a crucial part of some, this could have a major effect on the UK economy and cause

a fairly large shift left in AS.
The rise in price may also

worsen the UK's current account.

Since we are a net importer of oil and produce very little of it ourselves, we would have to continue to import a relatively unchanged volume of oil but at a higher price. This would increase import spending - $AD = C + I + G + (X - M)$ - and worsen our current account, potentially shifting AD to the left.

Although, the UK may have made bought stockpiles of oil prior to its price increase. If the increase is in part due to speculative buying, then the UK may have imported more oil than was needed before its price went up, allowing them to import less now and instead use up the stockpiles.



ResultsPlus Examiner Comments

This is an excellent answer which received full marks. These were awarded as follows:

AS/AD diagram (4) - correct shift in AS curve, and axes, curves and equilibria correctly labelled.

Oil identified as a factor input / rise in production costs identified (2) leading to a fall in real output / rise in price level (2)

Maximum KAA marks are achieved here, although on the second page the candidate does go on to analyse:

UK is a net importer of oil (2) so the UK's trade balance will worsen (2) hence reducing AD

Evaluation: as the price of oil has risen significantly (calculation in not quite correct), and oil is a significant factor of production for the UK, the rise in oil price is likely to have **large** effects on the economy. (This is a good example of a candidate doing more than just saying: 'it depends on the magnitude of the rise in oil prices'.) (4 evaluation marks)

Additional evaluation marks could have been awarded for the observation in the final paragraph, that if the UK had stockpiles of oil, this would reduce the impact of the price rise on the economy (2 evaluation marks).



ResultsPlus Examiner Tip

A 12 mark question always has 8 marks for knowledge, application and analysis (KAA), and 4 marks for evaluation.

When a question specifically asks for an AS/AD diagram as part of your answer, there will be up to 4 marks available for it. If a question doesn't ask for a diagram, but where a diagram would supplement an answer, there will be up to 2 marks available for it.

Worsening BOP
↑ exports

(iii) Using an aggregate demand and aggregate supply diagram, assess the effect on the UK economy of the rise in oil prices since 2009.

(12)

The UK is a net importer of oil, meaning we import more than we export. This means that a rise in oil prices will have a worsening effect on the current account of the balance of payments (a record of transactions in terms of value from the UK with the rest of the world). Oil is a high value good, and is consumed in high quantities; this means that there is a large amount of money flowing out of the economy. A worsening current account of the balance of payments can cause a reduction in aggregate demand within an economy, because net exports is a component of aggregate demand.

$$AD = C + I + G + (X - M)$$

↑ net exports

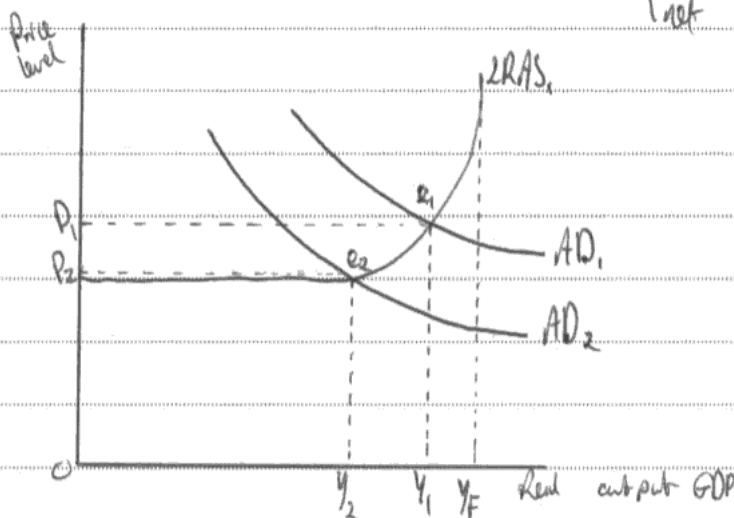


Diagram shows UK economy Aggregate Demand falling causing price to fall and output gap to increase.

An increasing output gap will mean that there ~~is~~ will be less investment by businesses because they have less confidence in the UK economy. (output gap was 1.1%, but increased to 2.4%). Investment is a component of aggregate demand, and less investment could cause a negative multiplier effect - for example, a business reduces investment by £10 million, but AD will fall in value of more than £10 million. This would cause the UK economy to contract.



ResultsPlus

Examiner Comments

This response earns full KAA marks, but there is no evaluation, meaning that the candidate is limited to a mark of 8/12. The KAA marks were awarded as follows:

The UK is a net importer of oil (2) so a rise in the oil price will worsen the current account deficit (2)

AS/AD diagram (4)

Full KAA marks reached, but additional marks could be awarded for:

Falling investment (2) caused by increasing output gap / low confidence (2) with negative multiplier effect.

Question 1 (b) (i)

For a 4 mark question, this proved to be an effective discriminator. We were strict in insisting that definitions had to be explicit that a trade deficit is when the **value** of imports is greater than the **value** of exports (or words to this effect) - rather than just referring to the 'amount', 'number', 'volume' of both - to receive the 2 available knowledge marks. This caught out a large number of candidates.

In terms of data reference, we were looking for a reference to **either** the 25% (1) depreciation of the sterling (1) being expected to reduce the trade deficit, **or** the fact that export volumes had increased by 21% (1) and import volumes by 16% (1) since 2009. As the question asked for references to Extract 1, data marks were not awarded for use of candidates' own knowledge, for example, current trade or current account deficit figures, or stating that the UK ran a trade deficit in goods, but a (smaller) trade surplus in services etc.

A number of candidates gave overly long explanations of all of the components of the balance of payments, or of the current account on the balance of payments, which were largely irrelevant.

(b) (i) With reference to Extract 1, define a "deficit in the trade of goods and services on the current account of the balance of payments" (lines 2–3).

(4)

'Deficit in the trade of goods and services on the current account of the balance of payments' usually refers to the value of imports on goods and services is greater than the value of exports on goods and services. A fall in the sterling's exchange rate 'fall by 25%' and was expected to reduce the current account deficit as this would mean the UK's goods + services will seem relatively cheaper than other countries and so other countries from other countries will purchase our goods, and the amount of imported goods will reduce because it will seem more expensive. And thus reducing the deficit on the current account.



ResultsPlus Examiner Comments

This response earns full marks, as there is a correct definition of a trade deficit (2), plus relevant data reference (2).



ResultsPlus Examiner Tip

Any question that begins 'With reference to ...' has up to 2 data reference marks available. Make sure that you pick up these marks.

(b) (i) With reference to Extract 1, define a "deficit in the trade of goods and services on the current account of the balance of payments" (lines 2–3).

(4)

A deficit in the trade of goods and services on the current account of the balance of payments means that the UK is importing more goods/services than it is exporting.

The UK has a deficit in the trade of goods and has a surplus in the trade of services.



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Examiner Comments

This response was awarded 1/4 marks. 1 mark was for the idea that a trade deficit means that 'more' goods/services are being imported than exported, as there is no reference to 'a greater value of' imports than exports.

0 data reference marks were awarded here, as the candidate is using their own knowledge, and not referring to the extract as instructed.

Question 1 (b) (ii)

This was generally an accessible question, with most candidates being able to suggest and explain at least one likely cost of a sustained trade deficit. The most popular answers referred to a trade deficit representing a net withdrawal from the circular flow of income, or a negative component of aggregate demand, and hence constraining the growth of the UK economy. Some candidates then went on to link this to a lower derived demand for labour in the UK, and hence rising unemployment.

While answers that referred to the need to finance a trade/current account deficit (and perhaps even run higher interest rates in order to encourage the inflow of capital to do so) were awarded marks where appropriate, less able candidates did often confuse a trade deficit with a budget deficit, and wrote about the need to raise taxes or cut government expenditure to reduce the deficit, or the opportunity cost of the government having to pay more in debt service. On occasion it was difficult to tell whether a candidate was referring to the need to finance a budget or a trade deficit. In this case, candidates tended to be given the benefit of the doubt, but it does highlight the need for clarity of expression, even in answers where candidates' quality of written communication is not being assessed.

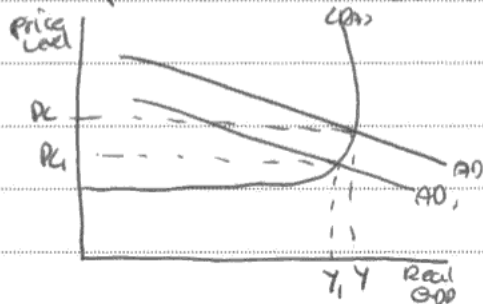
Some candidates were able to identify that a persistent deficit would put downward pressure on the exchange rate, but were unable to explain why this might be a cost to the UK economy (as it would tend to increase price competitiveness). The best option here was to analyse the effect on the price of imported raw materials, and several clues were given to this effect in the extract.

Finally, a number of candidates confused a 'cost' with a 'cause', and wrote about the UK's goods and services lacking either price or non-price competitiveness. While there was some merit in answers based on the loss of certain manufacturing skills (a kind of hysteresis effect), answers needed to be definitely looking forwards in time, rather than backwards to earn marks.

(ii) Explain **two** likely costs to the UK economy of a sustained UK deficit in the trade of goods and services on the current account of the balance of payments.

(8)

Having a Current account deficit is bad. One reason for this is the (Exports - imports) is a component of AD, so if it is a negative figure over a prolonged period of time it will decrease AD and therefore decrease economic growth.



Having a high ~~budget~~ Current account deficit could also conflict with the Macroeconomic objective of Lowering Unemployment. If there is less demand for UK goods and services it means that the UK companies are not producing as many goods so do not need the staff. This could lead to high unemployment.



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Examiner Comments

This response received full marks: 8/8. It is quite a straightforward answer, and is not perfect, but it does incorporate a well-drawn AS/AD diagram, and is clear and concise. Marks were awarded:

Decreased AD (2) leading to decreased economic growth (2)

Reduced demand for UK goods and services leading to reduced demand for labour (2) resulting in high unemployment (2)

- (ii) Explain **two** likely costs to the UK economy of a sustained UK deficit in the trade of goods and services on the current account of the balance of payments.

(8)

A sustained deficit refers to the the deficit in the current account, which is sustainable, without compromising the needs of the future generations.

Even though it is a sustained deficit, over time this would add to the national debt. Which would have to be eventually paid off. In times

In times of economic recession, the current account deficit would be a problem. As during the recession the government expenditure would increase and business activity would ^{slow down} ~~come to a stop~~. This will further worsen the current account deficit. The impact would have been lower if there was a current account surplus.



ResultsPlus Examiner Comments

This response is typical of the work of a less able candidate who has confused a trade deficit with a budget deficit, and as such it received 0/8 marks.



ResultsPlus Examiner Tip

It's very important to be clear on the difference between a trade deficit and a budget deficit.

Question 1 (b) (iii)

This question was generally very well answered, and the more able candidates made very good use of the information in the extract in order to fully evaluate their answer, which was very pleasing to see. The vast majority of the candidates understood that a depreciation of the sterling exchange rate would make imports more expensive, and exports cheaper, and that we would therefore expect the value of our imports to fall, the value of our exports to rise, and hence our trade balance to improve. This got candidates 6/8 KAA marks. In order to achieve maximum KAA marks candidates needed to either include some relevant data reference in their answer, or to define either 'exchange rate' or 'a **fall** in the sterling exchange rate'. Candidates do need to remember to look out for definition and data reference marks on the higher mark questions as well as on the shorter ones.

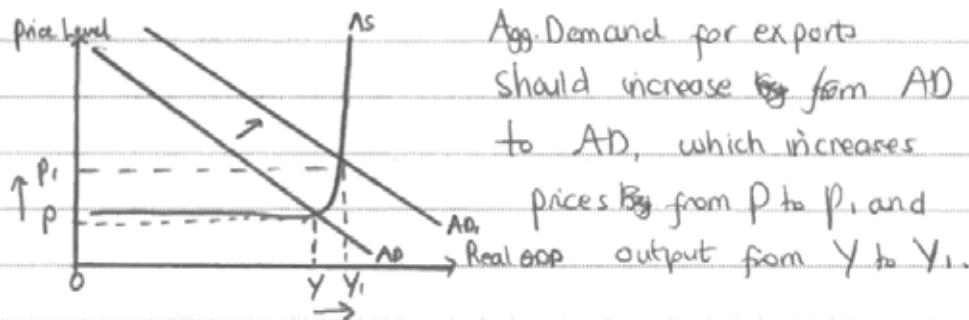
A fairly common mistake was to lose focus on the question, and instead to analyse the effects of an improvement in the trade balance on the UK economy. Many candidates noted that AD would increase, drew an AS/AD diagram to illustrate this, and wrote about the impact on price level, real output, employment etc. While often correct, this analysis was not relevant to the question, and so did not earn any marks. The issue was more that some candidates then went on to evaluate these wider economic effects (eg however if the oil price is rising, AS may decrease, so real output will not increase), rather than the effect of the depreciation on the trade balance. This meant that they did not receive any evaluation marks, and so their total score for the question was limited. Candidates do need to read the questions carefully, and be encouraged to re-read them throughout writing their answers, particularly with the higher mark questions, where it is easy to lose focus during a response.

Given that large amount of stimulus material on which to base evaluative comments, it was a little disappointing that (as with Q1(a)(ii)) a fair proportion of candidates stuck to very generic evaluative comments, eg 'however it depends how much the sterling exchange rate fell by'. Such comments, particularly when it was unclear what the 'it' being referred to was, were not rewarded generously. Similarly if candidates are going to refer to a likely time lag in evaluation, we would really expect them to suggest why this might occur, particularly when the extract referred to 'long-term supply contracts'.

* (iii) With reference to Extract 1, assess the likely effect of a fall in the sterling exchange rate on the UK's deficit in the trade of goods and services.

(12)

The UK sterling exchange rate fell by 25% between mid 2007 and 2009. A fall in the sterling is most likely to lead to an improvement on the UK's deficit on their current account. This is because a fall in the sterling makes imports more expensive to the UK and makes exports cheaper for foreign individuals. If exports are cheaper to people abroad, then AD for exports should increase and this would lead to ^{the} overall value of exports increasing. ^{which rose by 21% in 2009} In addition with rising prices for imports, this should put firms and households off from buying them as they are more expensive and so this should decrease the value of imports leading to an overall improvement in the UK's deficit which should decrease in size.



However, the current state of the world economy and many of the UK's main exporters such as the Eurozone are going through periods of slow growth and may be close to entering a recession.

If this is the case, ~~the demand for~~ demand for UK exports may increase due to ~~to~~ them appearing cheaper, but the overall increase may only be small if ^{foreign} countries try to hold back on buying from the UK. This means that the value of UK exports may only increase by a minimal amount.

Furthermore, even though imports are more expensive to the U.K due to a fall in the sterling, ~~the~~ demand for them may not decrease by a lot if the demand elasticity for the product is high. Extract 1 shows that some goods are no longer made in the U.K so are a necessity to import. In addition, manufacturing in the U.K requires importing raw materials such as oil and other capital goods to increase their supply so this means that UK firms may stop buying imports but only by a very small amount.

Therefore the fall in sterling should help the UK's trade deficit by improving it slightly as the volume of exports may increase and the volume of imports may decrease. However due to the current state of many economies in the Eurozone, exports may only increase by small amounts whereas imports may still remain quite high because a lot of imported goods are necessities. This means that the improvement in the UK's ~~trade~~ deficit of trade of goods and services may only be by a very small amount.



ResultsPlus

Examiner Comments

This response receives full marks: 12/12, however the candidate does also make a few errors which is useful to point out. Firstly, marks were awarded:

Data reference - 25% depreciation (2)

Trade balance should improve (2)

Price of imports rises (1) and price of exports falls (1), so value of exports increases (1) and value of imports falls (1)

Full KAA marks achieved.

Evaluation: economic stagnation in the eurozone and the UK's other trading partners may mean that they don't increase buy more of our exports even when the price falls (2 evaluation marks)

Imports are likely to be (price) inelastic in demand in the UK as some goods are no longer made here and we need to import many raw materials (4 evaluation marks)

Note that the candidate draws a correct but irrelevant AS/AD diagram, and also that his/her conclusion is nothing more than an edited version of their answer; there is nothing at all new in it. A conclusion can be useful, and can earn marks if it makes additional points (for example prioritising the various analytical or evaluative comments), but if it is no more than a re-statement of the answer, then it is not an efficient use of a candidate's limited time.



ResultsPlus

Examiner Tip

If you are going to write a conclusion, make sure that it does more than just repeating the points that you have already made.

*(iii) With reference to Extract 1, assess the likely effect of a fall in the sterling exchange rate on the UK's deficit in the trade of goods and services.

WPIDEC

(12)

The deficit in the trade in goods and services is when imports are greater than exports, hence more money leaving the country. The exchange rate is how much of one currency can buy of another currency.

A fall in the sterling exchange rate by 25% between mid 2007 and early 2009, would have caused imports to become more expensive for ^{the} UK and so less attractive. This would lead to a reduction in imports, and so ~~an increase~~ an increase in net exports, leading to a reduction in the deficit in the trade of goods and services.

This depends on the length of contracts UK manufacturers have with overseas suppliers. If the contract length is large (eg. 2 years), then they will not feel the effect of the sterling depreciation. Therefore there may not be as large decrease in ~~imports~~ imports and so not as significant reduction in the deficit.

Also, a fall in the sterling value would cause UK exports ^{to become} cheaper and so more competitive on global markets. This would lead to an increase in exports and so an increase in net exports and so a reduction in the deficit.

However, this depends on the growth of our major exporters. For example, in the EU currently, there has been the Euro crisis, therefore, there may not be ~~an~~ as significant increase in exports due to the slowing growing countries in the EU, and therefore not a significant reduction in the deficit.



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Examiner Comments

This response also earns full marks, 12/12, but does so more succinctly than the previous one. Marks are awarded as follows:

Definition of an exchange rate (2) - not perfect, but benefit of the doubt given

Data reference - 25% fall in sterling (2)

The price of imports rises (1) so the value of imports falls (1)

This reduces the trade deficit (2)

Full KAA marks are now achieved, however later the candidate does also note that the price of exports falls (1), so the value of exports will rise (1).

Evaluation: the presence of long-term supply contracts may mean that the effects of the depreciation are not felt immediately (2 evaluation marks)

Slowing growth in the eurozone may mean that there is no significant increase in the UK's exports (2 evaluation marks)

Question 1 (c)

Candidates were generally able to produce good answers to this question, and had obviously studied a range of different supply side policies and their impact on the UK economy. The vast majority of candidates did include a reduction in corporation tax within their discussion. The four main reasons for candidates not achieving high marks were:

Not linking supply side policies to economic growth. The question asked about the use of supply side policies to increase economic growth, and so we expected to see some analysis of how each policy would do this. Candidates who tried to reproduce their notes on supply side policies, rather than using their knowledge to answer the question often only explained why a certain policy may reduce unemployment, rather than taking that final step and linking the policy to growth. Candidates must answer the question asked.

Focusing on the demand side effects of policies, rather than the supply side effects. For example when analysing the effects of a reduction in corporation tax, many candidates identified that this would hopefully increase investment, but then only discussed the impact of this on aggregate demand in the economy, and made no mention of its effect on aggregate supply. While observing that aggregate demand would also increase was perfectly valid (and indeed was used by some candidates to good effect as an evaluative point: this is a particularly effective policy, as solely increasing aggregate supply is ineffective if aggregate demand remains very low), as the question was about supply side policies, we did expect to see an analysis of the supply side effects of each policy as well.

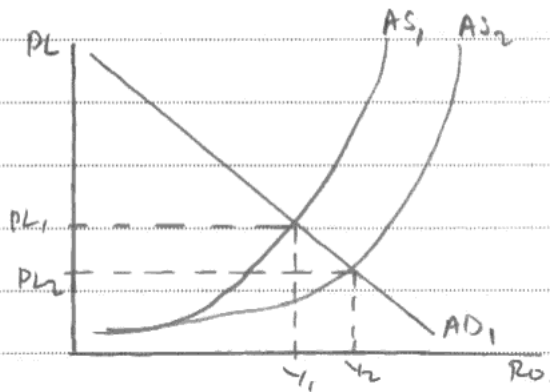
The use of undeveloped, generic evaluation points: it depends how much corporation tax is reduced by; investing in education is only effective with a time lag etc. Some marks were awarded for these points, but candidates struggled to achieve close to maximum evaluation marks without explaining their points in detail, and where possible making them specific to the context. Further, each general evaluation point can only be rewarded once, so for example in terms of magnitude, 'it depends on the amount of money invested into education' might be given some marks, but if the next supply side policy is evaluated by, for example, 'it depends on the size of the income tax cuts', no further marks will be awarded. Identification of there being a time lag is similar.

The use of irrelevant evaluation points. As the question was asking about the effectiveness of supply side policies to increase economic growth, the effect of these policies on other economic variables was largely irrelevant. For example, analysing how increased education/healthcare/infrastructure spending might lead to economic growth, but then saying that it would likely worsen the government's budget deficit is not really evaluation; it's just an irrelevant, further analysis point. The only way that negative side effects of policies become relevant is if they are used to prioritise the two/three policies that a candidate has discussed: for example 'I would recommend that the government should cut benefit payments rather than increasing its spending on education or infrastructure, as while all of these will produce economic growth, the former will also be beneficial for the government's budget balance, while the two others will increase the size of the deficit, at least in the short term.'

* (c) Using the information provided and your own knowledge, assess the use of supply side policies, including a reduction in corporation tax, as a means of increasing UK economic growth.

(30)

Supply side policies are a range of measures aimed at ~~shifting~~ boosting productivity and shifting the AS curve to the right.



By increasing the productive capacity of the UK, AS shifts to the right causing price level to decrease from PL_1 to PL_2 and real output to

increase from Y_1 to Y_2 .

One policy the government could use is to decrease corporation tax. This is a ~~decrease to the~~ tax on profits. The current chancellor is planning on reducing corporation tax from 28% to 21% in 2014. This ~~should~~ should help to achieve economic growth for 2 reasons. Firstly, higher business investment will increase the efficiency of capital stock (and ~~other~~ factors of production) through R&D. This will help firms to increase their output and will boost overall levels of productivity in the economy, hence shifting AS rightwards as firms have higher output causing

economic growth. Also, investment is a direct component of AD so an increase in investment will shift AD to the right, causing real output, and hence economic growth to increase. * →

However, ~~corporate~~ reduction in corporation tax may not be the most effective strategy. The reduction by 2% in 2008 did not have much of an effect as business confidence remained pessimistic, thus leading to no increase in investment but a larger budget deficit as ~~spending~~ government revenue was lower. Furthermore, firms may not use the extra profit for lower taxes on investment and R&D but will instead ~~spend~~ spread the increased profits throughout share holders. To combat this the government could offer tax credits for only those who invest.

Another policy is education and retraining. The government could invest money into the education system, helping students to receive higher quality education so they will be better prepared for working life, thus helping to increase both the quality and quantity of the labour force. This will shift AS to the right as productive capacity is larger, hence causing output to increase, thus boosting economic growth.

A drawback of this policy is the huge time lag. It

takes students ~~many~~ many years to go through the education system, so any increases in productivity will only be seen in the long term. This policy is not the best one to use if immediate economic growth is required, but will be useful if the UK desires long term, sustainable growth.

In the short run, the UK could relax border controls to allow more skilled immigrants into the country. This will help to increase productivity in the short run, whilst education ~~takes place~~ takes place.

A final policy is privatisation. This is where firms are transferred from the ~~the~~ public sector into the private sector. As a result, directors of firms will have more of an incentive to make profit because losses are no longer paid for by the tax payers, and so directors wish to keep their jobs if they make losses. Consequently, investment in R&D will increase and firms will become more efficient in order to lower costs, causing productivity in the UK to increase, hence shifting AS to the right and causing real output and therefore economic growth to increase. However, some firms will take drastic measures to reduce costs, as can be seen by the example

of Railtrack, where consumer safety was compromised and a train crash caused hundreds of deaths. Firms may also make staff redundant in order to cut costs. This will increase unemployment levels in the UK, which will have ~~the result of~~ a negative ~~effect~~ effect on productivity and will also mean the government's budget deficit is larger as there is less revenue from income tax but more spending due to benefits ~~paid~~ payments e.g. JSA.

* Also, the ~~tax~~ planned ^{corporation} tax rates for 2014 for certain G20 and G7 countries shows that the UK is one of the lowest, just ~~to~~ above ~~the~~ Russia at 20%, whereas the UK will be 21%. Other countries such as the US, will see rates of 40%.
 Due to lower taxes in the UK, US firms may decide to shift their factors of production into the UK as they can make larger profits.
 As a result, employment will increase ~~and~~ some these firms provide new jobs and overall output will be higher, causing AS to shift ~~to~~ right and hence boosting economic growth.



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Examiner Comments

This is a good response which received 18/18 KAA marks, and 8/12 evaluation marks, so 26/30 marks overall:

6/6:

Definition of supply side policies (2)

AS/AD diagram (2)

Data reference - corporation tax rates (2)

12/12:

Corporation tax cuts (4)

Education and training (4)

Privatisation (4)

8/12 evaluation marks:

The effects of a corporation tax rate cut depend on the level of business confidence in the economy (2) and there is no guarantee that firms will invest their additional post-tax profits, rather than pay them out to shareholders etc. (2)

Education and training acts with a time lag (2), so to improve the quantity of labour in the short run it would be better to relax immigration restrictions (2)

Privatisation might endanger consumers' health and safety, and increase unemployment (0) - not related to economic growth, and note that increasing unemployment would reduce AD rather than AS, and would actually tend to increase average labour productivity, rather than decrease it.



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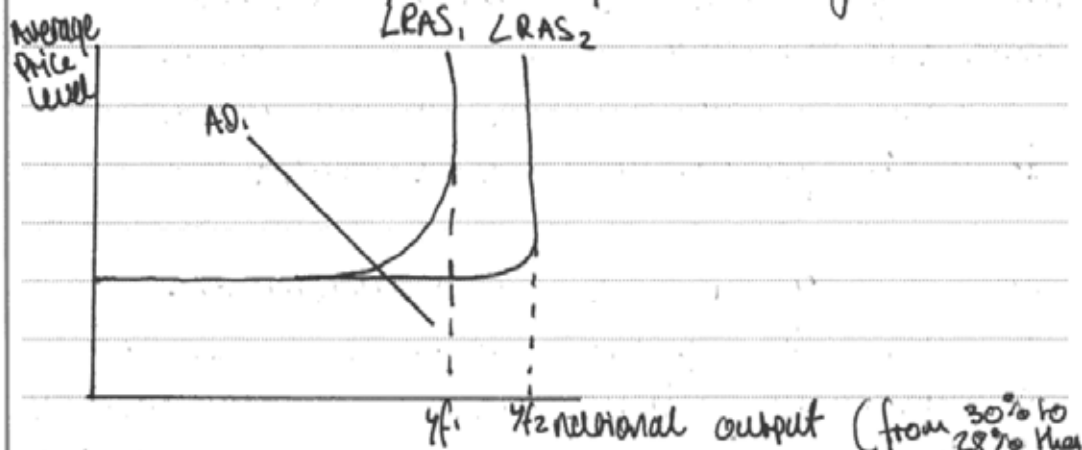
Examiner Tip

Remember to look out for definition marks in the 30 mark question - very few candidates defined 'economic growth', but this was an easy way to earn 2 marks.

* (c) Using the information provided and your own knowledge, assess the use of supply side policies, including a reduction in corporation tax, as a means of increasing UK economic growth.

KAAG
4x3
4x3
(30)

Supply Side policies are policies adopted by the gov't to stimulate Aggregate supply as a means of increasing economic growth.



Firstly Supply Side measures including a reduction in corporation tax (essentially a tax on the profits of firms), would increase growth because; Firms will have a greater incentive to grow productivity and re-invest their profits back into the firm rather than satisfying or producing less goods/services in order to pay less corporation tax. Firms will subsequently have a greater ability to invest profits into fixed capital, which in the long run, would boost the productive capacities of the ~~domestic~~ economy, as shown in the above diagram.

Similarly it would also incentivise start up firms to enter the market which would also increase economic growth in the long run.

Although, it could be argued that this raises the

risk of oligopolies and monopolies forming which would affect economic growth as that would create barriers to entry to the market, therefore discouraging start-ups to join the market. Also it could be said that cutting corporation tax may result in firms choosing to save their profits, therefore becoming a leakage from the circular flow of income and constraining growth.

Secondly the Gov't could cut unemployment benefits. This would force those who are unemployed to get a job and seek employment which could potentially reduce the rate of unemployment. This would mean that likewise the gov't could provide those seeking work with educational vouchers and training incentives in order to increase the unemployed occupational mobility of labour. This would increase their job flexibility and make them more attractive to firms with

demand for labour. This would increase economic growth in the UK as firms would be more able to ~~more~~ change production of particular goods/services to changes in demand. However during a recession, there is likely to be Keynesian unemployment, therefore it is unlikely that increased education and training of the labour force will make a significant difference in the short run as firms look to keep production costs down. Therefore this causes a constraint on

increasing growth.

Thirdly the gov't could reduce marginal tax rates for lower income earners.

Lower income earners have a high marginal propensity to consume when they have a disposable income, therefore by reducing marginal tax rates for them, the gov't would incentivise greater productivity within lower income jobs. Therefore both Aggregate demand and Long run Aggregate Supply would increase, therefore stimulating economic growth.

Such a move would lessen the levels of inequality within the economy whilst

potentially improving the standard of living. This may also result in increases of investment into the UK as firms look to take themselves in an economy where the labour force is motivated. Although this would be more likely in production of secondary goods.

Also the gov't could increase expenditure within the economy on benefits.

This would also stimulate Aggregate demand and potentially increase growth.

This, as a result of households having a higher disposable income would increase the flows of money into the circular flow of income. Such a move may also cause demand pull inflation, which

would cause a devaluation of the pound.
This would be good for the current A/c
as exports become cheaper which would provide
a boost to domestic producers. However, unless
there is sufficient demand for exports, growth
will not increase and result in excess supply.
This would therefore make imports more
expensive, UK is a net importer, and reduce the
purchasing power parity as real income would decrease, therefore ~~see~~
constraining growth.

(Total for Question 1 = 80 marks)



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Examiner Comments

4/6:

Definition of supply side policies (2)

Data reference - cuts in corporation tax rates (2)

AS/AD diagram (0) - as no equilibria labelled

12/12:

Cuts in corporation tax (4)

Education and training (4)

Cuts in income tax (4)

Note that the best three policies were awarded, so cuts in benefits, and increases in benefits were marked but then discounted.

6/12 evaluation marks:

Corporation tax

Education will not be effective if firms are not confident enough to hire workers (2).

Question 2 (a) (i)

Candidates found this to be a relatively accessible question, with all but a few scripts receiving some marks. Less able candidates tended to focus on the 'basket' of around '650' goods and services, while more able candidates showed an excellent understanding of the two different surveys undertaken, and the significance of the weightings applied.

(a) (i) Explain how the Consumer Price Index (CPI) is calculated.

(6)

CPI is calculated by collecting a 'basket' of goods of 650 ^{types} ~~items~~ which result in 10000 goods + services a typical family spends its income on. The office of National statistics conducts a price survey of these goods, from 150 different areas of the UK. The products ^{prices} are recorded and these are the results for the base year. Next year's prices are recorded + compared with the base year's prices to see if prices of these goods have risen or fallen + what percentage of rise or fall. Weights are then given to these products to show the ^{relative} importance + how much of each family's proportion of income is spent on it. Price relatives are then calculated by multiplying the weights by the expenditure.
$$CPI = \frac{\text{price relatives}}{\text{weights}} \times 100 = \text{---} \%$$

For eg, if in the base year the price of clothing was 100 altogether then in the next year prices were 105 then the increase would be 5%.



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Examiner Comments

This answer receives full marks, 6/6, as follows:

Basket (1) of 650 (1) goods;

Price survey (1);

Base year (1);

Weights (1) reflect the relative importance of goods (1).

(a) (i) Explain how the Consumer Price Index (CPI) is calculated.

(6)

Consumer price index is a way to measure inflation. Exposed (1) mentions 'Compare with a headline CPI inflation rate of 5%'.

CPI can be calculated through weighting, this is to attached the relative importance of good/services. Also, food and expenditure survey will be used to figure out the good/services that the individual is most likely to consume. Today, a basket of good (650 items) will updated annually to show the most commonly consumed products. ~~Finally~~ CPI usually excludes housing costs and the top/bottom 4% of the richest and poorest people, therefore the rate is usually lower than RPI. Also, CPI is an international measurement.



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Examiner Comments

This response also secured full marks. Marks were awarded as follows:

Weightings (1) reflect the relative importance of goods (1)

The Food and Expenditure Survey is used (1)

There is a basket (1) of 650 goods (1) which is updated annually (1)

Maximum marks reached, but an additional mark could have been awarded for CPI excludes housing costs (1)



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Examiner Tip

The Consumer Price Index (CPI) is **not** a measure of inflation. It is a measure of the average price of goods and services in the economy. The annual **change** in the CPI is a measure of inflation.

Question 2 (a) (ii)

This proved to be a challenging question, despite the fact that several possible reasons for the above target inflation were mentioned in Extract 3 (the VAT rise, high commodity prices, the low 0.5% Bank rate, and quantitative easing). While mid-level candidates were able to analyse the role of inflationary monetary policy, only the more able candidates identified the cost-push inflationary factors, and less able candidates gave a variety of incorrect answers as to why aggregate demand might have increased. These usually focused on increased consumption due to rising nominal incomes, which we did not allow as Extract 1 told candidates that real incomes had actually fallen, or increased government spending, which we also did not allow, as both Extracts 1 and 2 referred to the government's austerity policies. Given the negative growth figures also reported, cost-push inflation was undoubtedly the stronger answer, but candidates seem to be far less secure with this than with the idea of demand-pull inflation.

A reasonably common, incorrect answer was also to focus on the limitations of the CPI calculation method; for example suggesting that errors had been made in data collection/sampling, or that because of the various goods and household groups excluded from the measure, the 'measured' CPI was above the 'actual' CPI. Given that inflation was running at 3 percentage points above the 2% CPI target, we did not reward suggestions that measurement accuracy was the sole reason.

(ii) Analyse **two** possible reasons why the CPI measure of inflation was above its target range in 2011.

(8)

The CPI measure of inflation was above its target range 2011 due to high global ^{commodity} ~~commodities~~ prices. The price of ^{food and} oil rose substantially which increased the cost of the factor input cost of goods so the prices for many goods ~~unintentionally~~ rose as the UK government has no control over the inflation of global commodity prices.

Also, the increase in VAT ^(from 17.5% to 20%) ~~has~~ has caused a ~~temporary~~ temporary inflationary effect. This increase ~~among~~ prices of many goods which ~~led~~ led to higher than expected inflation rate which is ~~higher~~ above the target range.

Inflation is a general and persistent increase in price.

However, there was a weak international demand which ~~can~~ could cancel the ^{inflationary} effect of the high commodities prices, as prices would fall due to low demand.



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Examiner Comments

This is a fairly straightforward answer, but it was sufficient to secure this candidate full marks (8/8), as follows:

High global commodity prices (2) raises the production cost of goods, so leads to price rises (2);

The increase in VAT (2) increased the price of many goods in the basket (2)

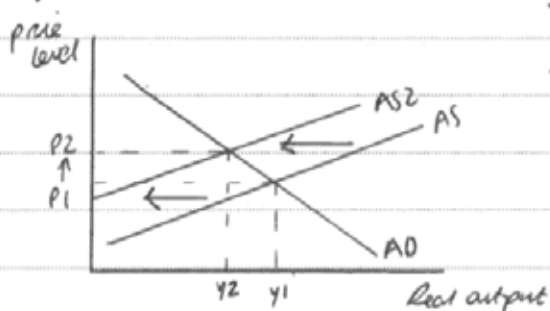
Note that there is no need for candidates to evaluate their answers to the 8 mark questions, so the final paragraph of this answer is extraneous.

(ii) Analyse **two** possible reasons why the CPI measure of inflation was above its target range in 2011.

(8)

See definition of CPI. The target range of inflation is 2%, however in 2011, the CPI measure of inflation was at 5%.

CPI ~~may have~~ would have increased due to falling wages. A decrease in wages would shift ~~AD~~ ^{AS} backwards, causing price level to rise.



This would rise price level from P_1 to P_2 .

Another reason ~~what~~ would be that CPI fails to take the substitution effect into account. This is when households buy ~~sets~~ alternatives to goods that they purchased. Or the weight of goods is not being taken into account, meaning consumption is changing, but the real price level is not.



ResultsPlus Examiner Comments

This response scored 0/8 marks:

The first point uses incorrect economics: if wages had fallen, then AS would increase and shift to the right, reducing inflationary pressure in the economy.

The second point is based on weaknesses in the method of CPI calculation, as explained above.



ResultsPlus Examiner Tip

Use the data to help you - often the answers to the questions are in the data, and you just need to use your economic knowledge to identify and explain them.

Question 2 (a) (iii)

Practically all candidates managed to pick up some marks on this question, and there were some excellent answers which received full marks. The vast majority of candidates understood that living standards would decrease as consumers' purchasing power had decreased, and most suggested that consumers might be forced to switch away from normal and/or luxury goods towards inferior goods. More able candidates were able to explain why the resulting fall in consumption might cause a negative multiplier effect, further reducing employment and average incomes.

Definitions of both 'real income' and 'standard of living' were poorly done. In the case of real income, too many candidates confused this and disposable income, and so defined real income as income after taxation (which is even a weak definition of disposable income). In the case of standard of living, very few candidates offered any definition of the term. This was disappointing, as those who did use this as a prompt to think about what it meant to have a good standard of living were often also able to use the idea that more than just income is important in determining this as the basis for an evaluative comment.

As the question was asked in the context of the UK, answers that focused on a lower level of healthcare and/or education being able to be consumed following a fall in real incomes were treated fairly cautiously, as these services are, to an extent, provided free at the point of access. Similarly considerations of homelessness, or absolute poverty were probably exaggerations, given the small extent of the fall in real incomes referred to in the extract (3.5%), and the UK welfare state. Less able candidates did tend to fall into the trap of writing such descriptive responses.

Candidates of all ability levels found it relatively challenging to evaluate their answers further than the ubiquitous comment on magnitude ('it depends how much real incomes fall by'). Better evaluation points considered the different effects that the fall in real incomes might have on different household groups: high income earners, low income earners, those on fixed incomes, or more generally discussed the idea that households might dip into savings to maintain their consumption patterns, or become eligible for certain means tested benefits as their incomes fell. Some candidates also used the forecast of slowing inflation from the extract to good effect to question the time period over which real incomes would continue to fall.

(iii) Assess the likely impact of a reduction in households' real income on the standard of living in the UK.

(12)

Real income is the income of households with respect to inflation. For example, nominal incomes may rise by 2%. However, if inflation rises by more than 2%, then real incomes have decreased as the purchasing power of households has been decreased.

The general effect impact of this would be a decrease in the standard of living in the UK.

This is because households will be unable to buy as many goods. A larger fraction of household income will be spent on necessities such as rent or mortgage payments, or food. This in turn leaves a smaller fraction of income to spend on other, 'luxury' goods. This means that the standard of living decreases.

In reality, it is likely that workers on lower wages will be more greatly affected than workers on higher wages. This is because low income households would already see a large proportion of their income spent on necessities. A further reduction in real incomes would see this already large proportion increase even more, leaving low income households with a decline in their standard of living. In contrast to this, high income households may not experience the same decline in living

standards. For high income households, a small proportion of their income is spent on necessities. Therefore, a reduction in real incomes would not see the proportion of their incomes spent on necessities rise very much. Secondly, high income households tend to have a reasonable amount of savings, which they can use as a buffer against the decline in real incomes.

Therefore, a reduction in households' real incomes is likely to cause a decline in living standards for low income households but is less likely to have as much of a visible impact on high income households.



ResultsPlus Examiner Comments

This is a good response which shows a good level of economic understanding, and so earned full marks, 12/12:

Definition of real income (2) - the first sentence is not very clear, but the example in the second and third sentences work effectively as a definition.

Consumers' purchasing power falls (2) so they can consume fewer goods and services (2)

A higher proportion of income is spent on necessities, and a lower proportion on luxury goods (2)

Full KAA marks attained.

Evaluation: those on lower wages will be more negatively affected as they were already spending a high proportion of their income, while those on higher wages may have savings to fall back on (4 evaluation marks)



ResultsPlus Examiner Tip

Make sure that you can define the basic macroeconomic terms used in this Unit. There is a very useful list of definitions in the specification.

(iii) Assess the likely impact of a reduction in households' real income on the standard of living in the UK.

(12)

As inflation rises, and rose by 1.4% in 2011 the cost of living is increasing. However people are not receiving pay cuts but their wages have a reduced value as the wage rise fail to keep ~~pace~~ pace with inflation. In real terms ~~that~~ household are having a pay cut of 3.5%. This is because as inflation rises, goods & services cost considerably more. As wages aren't rising people's incomes are being stretched. After all the ~~see~~ ~~essentials~~ essentials are paid, gas, electric & water many households have very little disposable income left.

The disposable income of a family after goes on clothing, insurance and trips like holidays. As families have less disposable income they will not buy the luxuries. This could include only buying supermarket own brand ~~to~~ instead of well known brands like Coca Cola and Cadbury's.

Real income is adjusted for inflation, as inflation rises incomes decrease.

Many families may have to forfeit long car journey or even clothing to make wages stretch. Standard of living will decrease as real income decreases.

Living standards can be anything from branded clothes to holidays. Families may fall below the poverty line as they can only just afford the necessary food with no extras. Some families during the winter months, especially the very cold one just past will have to choose between feeding the family or heating the house.

In the long run this will affect economic growth, making it 'sluggish' as consumers are reluctant to spend any of the very little money they have.



ResultsPlus

Examiner Comments

This is a sound answer, although it is more descriptive than the previous response, and lacks any evaluative comments. It earns maximum KAA marks, but without any evaluation it is limited to a total mark of 8/12:

Definition of real income (2) - in the next to last line of the first page

Data reference - 3.5% fall in real income (2)

Wages have a 'reduced value' (2)

Fewer luxuries can be bought / switch to 'own brand'/inferior goods (2)

Maximum KAA marks attained.



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Examiner Tip

Only the two 12 mark questions and the 30 mark question require you to evaluate your answer. If you don't do this successfully then you will not be able to achieve maximum marks on these three questions.

Question 2 (b) (i)

As with the 4 mark question within Q1, candidates found this surprisingly challenging. Many candidates failed to understand that these were estimates of growth that had occurred previously, and instead took them to be forecasts for growth during future quarters, which meant that the reasons for revision presented were often based on the possibility of economic conditions changing, or external shocks affecting the economy, making old forecasts inaccurate. Many candidates also failed to appreciate that these were growth estimates for the same quarter, and instead thought that they were being asked to explain why growth had fallen from -0.2% in one quarter to -0.3% in the next. More practice reading economic analysis from newspapers and other such sources may therefore be beneficial.

We accepted answers that explained both why a revision might be needed (new/improved data becoming available), and why it was important for estimates to be as up-to-date as possible (to accurately reflect the state of the economy for policy purposes).

(b) (i) With reference to Extract 2, outline **one** possible reason why GDP estimates are frequently revised.

(4)

GDP is the measure of the output of the whole economy. Extract 2 mentions that revised GDP estimations shows that the economy's output actually fell by 0.1% more than expected. It is important that they are frequently revised as omissions ~~are~~ often occur and the GDP is only an estimate. It is impossible to precisely ~~as~~ measure total output so it is important it is done often to be as accurate as possible.



ResultsPlus
Examiner Comments

This answer received full marks, 4/4:

Data reference (2) - output fell by 0.1% more than previously thought
Estimates are revised so that they are 'as accurate as possible' (2). The candidate also alludes to the idea that data is imperfect and there are often 'omissions', which could have also earned him/her 2 marks.

(b) (i) With reference to Extract 2, outline **one** possible reason why GDP estimates are frequently revised.

(4)

GDP is the measure of the growth and output in an economy. According to extract 2, GDP estimates are frequently revised as there are frequent changes and unexpected results from the calculation and to ~~to~~ prevent the government from making the wrong choice to correct the recession in the country. As stated in the extract, ~~it~~ it is told that the chancellor made the wrong choice in sticking to policies that are failing on jobs, growth and the deficit. Therefore, the GDP estimates need to be frequently revised so that the best alternative could be made to ~~correct the~~ pull the economy out from going through a recession.



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Examiner Comments

This response achieved 2/4 marks, as the candidate explained the need for estimates to be as accurate as possible to help government decide on the best policies, but did not include any data reference in his/her answer.

Question 2 (b) (ii)

This proved to be a very challenging question for a good number of candidates as they confused falling inflation with falling prices. Although deflation is a possibility if inflation falls below the 2% target, and candidates could be awarded marks for analysing this outcome, these marks were only given if it was obvious that candidates realised that this was just one possible consequence (ie it would only occur if inflation fell below 0%, not just 2%), so that falling inflation did not necessarily mean deflation. Answers that began 'falling inflation means that goods and services will become cheaper...' were hence not awarded any marks.

Similarly a good number of candidates were confused between price stability and inflation rate stability, for example, writing that a falling inflation rate would increase price instability, and so reduce consumer and business confidence. This would incorrectly imply that a 2% inflation rate would lead to more stable prices than a lower, but still positive, inflation rate. Less able candidates are therefore still not secure with the relationship between price level and inflation rate.

A second issue was a confusion between the possible causes of a falling inflation rate, and possible consequences of the same. Many candidates assumed that the only possible cause of falling inflation was a reduction in demand-pull inflationary pressures caused by a decrease in aggregate demand (as with Q2(a)(ii), less able candidates tend to focus on demand-pull inflation and forget cost-push inflation), and so suggested that a consequence of falling inflation was falling real output, and/or rising unemployment. This went against the evidence provided in the extract which cited the inflationary effects of the increase in VAT falling out of the basket, and the decrease in commodity prices as the major causes of falling inflation, and also confused a possible (if not main) cause of falling inflation with its likely consequence.

That said, a good number of candidates were able to analyse the effect of falling inflation on the UK's international competitiveness, and conclude that the falling **relative** prices of the UK's goods and services might lead to an improved trade balance. A smaller number raised the possibility of falling inflation leading to further loose monetary policy, which was also rewarded.

(ii) Explain **two** likely economic consequences of inflation falling "below the 2% target" (Extract 3, lines 5-6).

(8)

If inflation fell below 2% target set by the Monetary Policy committee, it could lead to increased consumer spending due to real incomes increasing resulting in more consumer spending ~~or~~ even though there is still inflation. This could also lead to increased investment as firms receive more revenue with stable ~~cost~~ costs of production resulting in more investment in to capital goods, if they choose so. This will all lead to a shift (increase) in aggregate demand to the right and thus grow the economy.

However if the fall in rate of inflation was negative ^{leading} ~~due~~ to deflation then people wouldn't spend as much as there is no point in buying a good which will cost less a week later and speculation of price falling leads to the housing market decreasing as well as less investment by firms. This will reduce aggregate demand and thus the economy will shrink.



ResultsPlus Examiner Comments

This is a very good response, which received full marks, 8/8:

Rising real incomes (2) lead to increased consumer spending (2)

More stable production costs for firms lead to increased investment (2) which leads to economic growth (2)

If inflation falls below 0%, this is deflation (2) in which case consumers and firms may defer consumption and investment leading to decreasing real output (2)

Note that the candidate actually explains three likely consequences. Any two of these would be sufficient for full marks.



ResultsPlus Examiner Tip

Make sure that you are comfortable with the relationship between the price level and the rate of inflation. In particular the idea that a falling (but positive) rate of inflation means that the price level is still rising, but just at a slower rate than previously.

(ii) Explain **two** likely economic consequences of inflation falling "below the 2% target" (Extract 3, lines 5-6).

(8)

Low inflation results in UK domestic ~~price~~ goods and services becoming relatively cheap. This will improve our competitiveness internationally, as our products ~~will~~ may be cheaper than others'. This will likely increase our exports ~~and decrease~~ and decrease imports. This will affect our balance of payments. It will also result in fewer goods being available for domestic consumption, and may impact the UK's standard of living.



ResultsPlus Examiner Comments

The first part of this answer earns the candidate 4 marks:

Increased international competitiveness (2) leads to an increase in exports and a decrease in imports (2).

The final sentence is incorrect economic analysis, and so adds no further marks. Therefore the total score for this response is 4/8 marks.

Question 2 (b) (iii)

Most candidates found this a very accessible question, and could write a solid answer showing good levels of knowledge, application and analysis. More able candidates were able to add some excellent evaluative comments to this.

Definitions of monetary policy were mostly good, and a majority of candidates gave some relevant data from the extract to support their answers. In addition, most candidates could explain at least one monetary policy transmission mechanism in good detail, and so were able to achieve the maximum 4 KAA marks available for written analysis. AS/AD diagrams were generally good, although as with Q1(a)(iii), axes sometimes had microeconomic labels, losing candidates 1 mark.

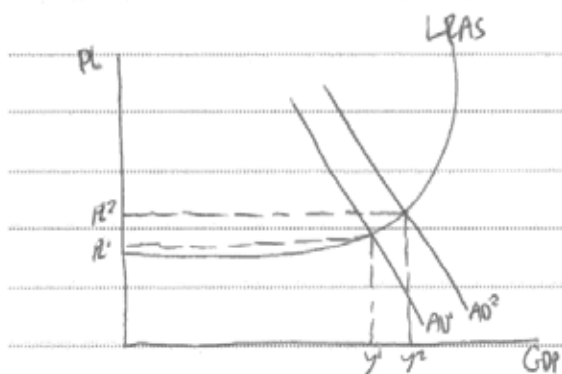
Less able candidates' evaluation tended to be undeveloped ('however monetary policy has a time lag of 18-24 months', or 'however this creates inflation in the economy'), which limited their total score. More able candidates were able to discuss the importance of other economies, or more general outside factors in the UK's economic recovery, and how these may prevent loose monetary policy from generating economic growth. Alternatively, there were some good considerations of the role of high street banks in the transmission mechanisms, the relatively untested impact of quantitative easing, and the limited ability of the MPC to further reduce the Bank rate.

Although quantitative easing is not on the specification, and candidates did not need to refer to it to attain full marks, it was pleasing to see how many candidates could explain how it worked, and also discuss its limitations.

*(iii) With reference to Extract 3 and using an aggregate demand and aggregate supply diagram, discuss the extent to which "Monetary policy is supporting economic recovery" (Extract 3, lines 7-8).

(12)

Monetary policy is supporting economic recovery as it has a low interest base rate of 0.5%. Which lowers the cost of borrowing money.



If consumers and businesses can borrow money more cheaply then the rate of consumption and investment in the economy

should rise, aiding to increase economic growth (GDP). As monetary policy has made it cheap to borrow money, the businesses can invest more cheaply which will increase the circular flow of money as investment is an injection, and the money invested might have a multiplier effect on the economy. If consumers can also borrow money more cheaply then consumption should also increase as they can now purchase more durable goods such as houses and cars, which will help aid recovery by increasing the GDP.

Evaluation

① The low interest rates of 0.5% will only help aid recovery if the banks are lending money. If they are not lending money to consumers and businesses then GDP will not increase.

② Investment by businesses will only occur if businesses feel confident they will be able to make their money back in the long run. If there is no confidence in the economy then investment is unlikely to happen.



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Examiner Comments

This is a good response to the question which earned full marks, 12/12. These marks were awarded as follows:

Data reference (2) - Bank rate is currently at 0.5%

Consumption transmission mechanism explained (2)

Note that the maximum 4 KAA marks for written analysis have therefore been achieved, but marks could also have been awarded for:

Investment transmission mechanism explained (2)

Continuing: Evaluation: the role of high street banks (2 evaluation marks)

AS/AD diagram (4)

The role of business confidence (2 evaluation marks)



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Examiner Tip

When a question asks for an AS/AD diagram, the 4 available marks are awarded as follows:

Correct labelling of axes (1)

Correct shift(s) of curve(s) (1)

Correct labelling of curves (1)

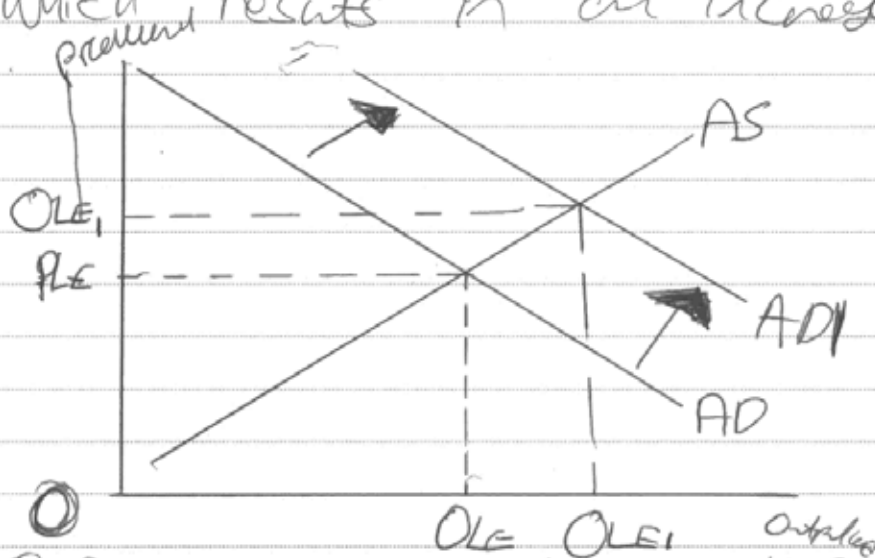
Correct labelling of initial and final equilibria (1)

* (iii) With reference to Extract 3 and using an aggregate demand and aggregate supply diagram, discuss the extent to which "Monetary policy is supporting economic recovery" (Extract 3, lines 7-8).

(12)

Monetary policy is the use of interest rates and money supply/Quantitative easing to influence Aggregate demand. Monetary policy is supporting economic recovery by resuming the quantitative easing or the money supply ~~as~~ as a result of this the Sterling will be devalued which will result in the exchange rate being lower because of the fact that there will be ~~less money~~ more money in the economy causing UK firms to become internationally competitive causing ~~a~~ more ~~of~~ exports. Also as interest rates are at a low of 0.5% this will result in more borrowing from business and consumers.

As there confidence is increased because of the low interest rates will result in business expanding causing total an increase in growth. And also shifting AD to the right which results in an increase



AS ALSO AS a result of this it will cause foreign investors to be investing into the UK and business expansion because there are borrowing AS a result of this consumption is increased as well as investment which not only encourage economic growth but decrease the unemployment rate



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Examiner Comments

This response earned full KAA marks, but as there was no evaluation, the total score was limited to 8/12 marks. These were awarded as follows:

Definition of monetary policy (2)

Data reference (2) - Bank rate at 0.5%

Note that the maximum 4 KAA marks for written analysis are now achieved, but additional marks could have been awarded for:

The effect of quantitative easing on the net trade component of AD (2)

Investment transmission mechanism (2)

Additionally:

AS/AD diagram (4)

Question 2 (c)

Candidates found this to be a challenging question, as it was perhaps conceptually more challenging than some recent 30 mark questions, and also required candidates to apply their economic knowledge in a new way. Less able candidates struggled to 'think on their feet' to the required extent, and so often failed to meet any of the assessment objectives beyond AO1: knowledge. On the other hand, more able candidates really had the opportunity to shine through writing thoughtful, interesting and well-constructed answers.

We allowed candidates to tackle the question by either analysing macroeconomic objectives that were achieved through deficit reduction for KAA marks, and objectives that weren't achieved for evaluation marks, or by analysing the positive or negative effect of deficit reduction policies on a range of objectives for KAA marks, and then discussing the significance of their arguments for evaluation marks. No one approach was more popular than the other.

A number of candidates misread or misinterpreted the question, and discussed the extent to which **running** a budget deficit helped the government to achieve its macroeconomic objectives. In this case, candidates were usually unable to score more than 12/30 marks (6/6 + 6/12 + 0/12 evaluation). An equally common error was to lose focus within an answer: a number of candidates wrote about the effects of various tax increases, and then said that the increased revenue earned could be spent on benefit payments to reduce income inequality, environmental policies to achieve environmental goals, education programmes to reduce unemployment etc. As the extract was explicit that government spending was being cut, as well as taxes being raised, such analysis was not rewarded beyond marks for identification of up to three macroeconomic objectives.

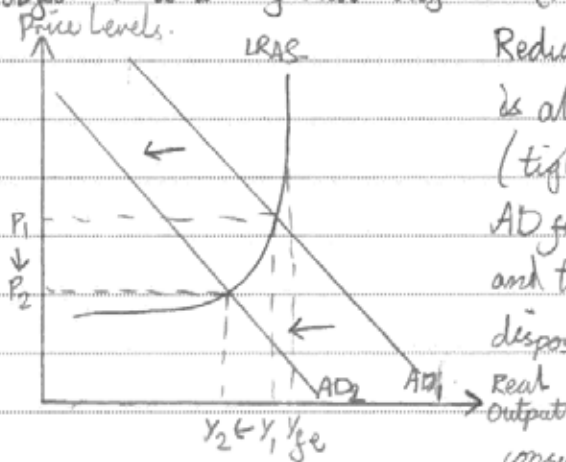
A small number of candidates included an increase in the standard of living as a macroeconomic objective, which was not rewarded beyond a consideration of the impact on real GDP, or unemployment. Most candidates were able to identify an increase in income equality as a macroeconomic objective, but analysis of the effects of deficit reduction on this objective caused the most problems for candidates. Only more able candidates were able to identify the one or several of the UK's direct taxes as progressive, and one or several of the UK's indirect taxes as regressive, and to demonstrate a sound understanding of what this meant. Less able candidates often assumed that all tax rises would be felt proportionally more by those earning lower incomes - perhaps a confusion between income and standard of living?

Despite being conscious of the above remarks, there were many good answers to this question. Given that this question asked candidates to think and really apply their knowledge under exam conditions, this is a pleasing result. Thinking carefully, planning an answer, and understanding the need to answer the question precisely as set were the real keys to success. As the majority of candidates do not appear to be too pressed for time on this exam, I would strongly advocate the use of an essay plan.

* (c) To what extent is the policy of reducing the 'fiscal (budget) deficit' (Extract 2, line 7) helping the government to achieve its macroeconomic objectives?

(30)

The fiscal deficit occurs as the government's spending is higher than tax revenue. The government macroeconomic objective is low fiscal deficit (debt), which is being improved.



Reducing the fiscal deficit is also known as contractionary (tight) fiscal policy.

AD falls as government spending falls and tax rises. Rising taxes causes disposable income to fall as government retains more wages, causing consumption to fall.

By reducing the fiscal deficit, inflation may fall to the 2% ($\pm 1\%$) target, where in 2011, 'CPI was measured at 5%'. The government objective is low stable inflation. Inflation falls (disinflation) due to the decrease in AD. This fall in inflation will be demand-side as AD falls and also as the productive potential of the economy hasn't risen.

However, the macroeconomic objective of full employment may not improve. Due to the fall in AD, consumers demand fewer goods and services. As a result, firms will decrease their output as their goods won't get sold. Due to the decrease in output, $Y_1 \rightarrow Y_2$ on the diagram, firms will require fewer workers as they will

require fewer factors of production (Capital, Enterprise, Land, Labour). As a consequence, more workers will be ~~not~~ made redundant and so unemployment rises, conflicting with the macro-economic objective. Extract 3 mentions 'unemployment rising to 9% in 2013.'

The macroeconomic objective of having a concern for the environment may ~~not~~ occur as AD falls. Due to AD falling, workers would be less well off and so not be able to afford to go on as many luxury holidays. This resulting in a reduction in air travel. Also, firms may decrease their output and so may use less non-renewable resources such as oil. Both of these effects on consumers and producers will cause the ~~level~~ ^{amount} of CO₂ being released into the atmosphere to decrease. This causes global warming to slow down and therefore causes the environment to ~~be~~ be protected.

But, inequality may worsen. The macroeconomic objective is low inequality. Due to the rise in taxes to reduce the government fiscal deficit, consumers may have to pay larger amounts of regressive taxes e.g. VAT which has been at a record 20% in the UK. A regressive tax is a tax that decreases as incomes increase. As VAT has risen, low income families have to pay ~~more~~ ^{a larger proportion of their income} for a good than high income earners. This causes the Gini Coefficient to rise as the gap between rich and poor will

increase, as the rich pay less and poor pay more.

Also, economic growth will fall ~~not~~ which contradicts the objective of high, stable economic growth. Due to AD falling, real output falls from $Y_1 \rightarrow Y_2$ on the AD/AS diagram and so economic growth falls. This

is bad for the economy as growth is the only way to recover from the recession and fuel a recovery. By causing the deficit to fall, economic growth will also fall which may halt a recovery.

Also due to incomes falling, domestic consumers may consume fewer imports from abroad which could help the trade deficit. This is because they wouldn't be able to afford the imports. Exports shouldn't be hugely affected as they are sold abroad. ^{and are not affected by lower domestic income.} The objective is a balance of trade and currently, the UK has a large deficit on the current account, so ~~but~~ by imports falling, the balance of payments may improve, ~~help~~ which is a macroeconomic objective. Although ~~if~~ exports may fall due to real output falling.



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Examiner Comments

This is an excellent answer, which remains focused on answering the question at all times, and does so in a clear and concise manner. There is an excellent level of economic knowledge and understanding displayed. As such, this response achieved full marks, 30/30. These were awarded as follows:

6/6 (note that the candidate makes more than the necessary number of points here):

Definition of a budget deficit (2)

Identification of government spending being cut (2) and taxes being raised (2) to reduce the deficit

Data reference (2) - various pieces of data are cited, eg unemployment will reach 9%

Correct AS/AD diagram (2)

12/12 (macroeconomic objectives which **are** achieved by the policy):

Inflation at 2% (4)

Protection of the environment (4)

Reduction of the current account on balance of payments deficit (4)

12/12 evaluation marks (macroeconomic objectives which **are not** achieved by the policy):

A reduction in unemployment (4)

A reduction in income inequality (4)

Sustainable economic growth (4)

*c) To what extent is the policy of reducing the 'fiscal (budget) deficit' (Extract 2, line 7) helping the government to achieve its macroeconomic objectives?

(30)

The fiscal (budget) deficit is the excess of government expenditure over ~~taxation~~ revenue from taxation.

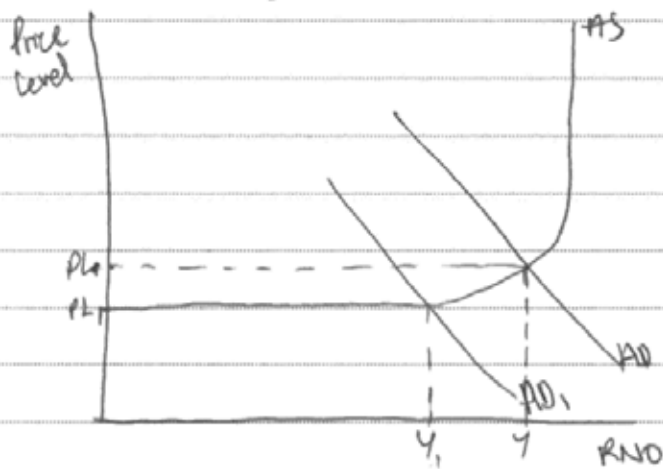
The UK's main macroeconomic objective is to improve welfare. The policy of reducing the fiscal deficit would be to increase taxation and reduce government spending or in other words, contractionary fiscal policy.

~~Reducing government spending may be contra~~
One of the government's objectives is to increase economic growth however in recent times, growth has been very low and the policy to reduce the fiscal deficit could be ~~worsening~~ ^{and increased taxation} this impact.

Reducing gov. spending ^{and increased taxation} would mean there are less injections into the circular flow of income, in which the multiplier would have ~~an~~ a negative effect. This would mean households and firms receive less real income. In evaluation, the ~~impact~~ ^{negative} impact of the reduced injections and increased taxation would depend on the size of the multiplier.

~~As~~ A reduction in government spending would decrease aggregate demand, as would ~~an~~ increase in taxation as ~~consumer~~ an increase in a income tax would mean consumers have less disposable

income \therefore consumption decreases and ~~from~~ an increase in VAT or corporation tax would mean firms have less retained profit to invest with.



~~This decrease in AD would cause an increase in inflation ($P_1 \rightarrow P_2$) which ~~is~~ would move the country further away from achieving its target of 2% as currently ~~is~~ the rate of inflation~~

This decrease in AD would cause a decrease in output from $Y \rightarrow Y_1$, as showing that the government's policy of reducing the budget deficit is not helping in achieving economic growth.

However, the UK rate of inflation currently stands at roughly 2.8% and a contractionary fiscal policy would cause inflation to fall ($P_2 \rightarrow P_1$) moving closer to the government's target of 2%.

As ~~reduction~~ ~~spending~~ has to be evaluated, the impacts of the effects of on growth and inflation

depend on the elasticity of the AS curve

taxation \uparrow and spending \downarrow on training
would ~~cause~~ reduce quantity of all quality
of labour, increasing occupational mobility
of labour and \therefore increasing unemployment



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Examiner Comments

This is a decent response, although the candidate unfortunately appears to run out of time at the end. In addition, the two evaluation points made are very brief, and are not applied to the context of the question. In total this response was awarded 20/30 marks, as follows:

6/6 (note that the candidate made more than the necessary number of points):

Definition of a budget deficit (2)

Identification of an increase in taxation (2) and a cut in government spending (2) as policies to reduce the budget deficit

Correct AS/AD diagram (2)

10/12 (macroeconomic objectives affected positively or negatively by the policy):

Sustainable economic growth will not be achieved (4)

2% CPI inflation will be achieved (4)

Reduced unemployment will not be achieved (2) - in questions where QWC is being assessed, answers written in note form are unlikely to receive maximum marks

4/12 evaluation marks (considering the significance of the analysis):

The impact on growth depends on the size of the multiplier (2 evaluation marks)

The impact on growth and inflation depends on the elasticity of the AS curve (2 evaluation marks)



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Examiner Tip

Make sure that you leave at least 30 minutes to answer the final, 30 mark question. Running out of time on this question can cost you a lot of marks.

Paper Summary

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

- When deciding which question to answer, put more weight on how well you think that you are able to answer the higher mark (12 and 30 mark) questions.
- If you have started answering more than one part of one of the questions it is usually better to stick with it, rather than to change to the other question. Think about the amount of time that you have left very carefully before switching questions.
- Remember that questions that include the phrase 'with reference to ...' have data reference marks available. Make sure that you pick up these marks.
- Remember to look for definition marks in questions, particularly the higher mark questions. Being able to define the key terms used in this unit is a basic skill. Look at the definitions list in the specification for help with this.
- Think carefully about the relationship between the price level and the inflation rate. Remember that a falling inflation rate doesn't necessarily mean a falling price level.
- You must answer the questions asked, not write out your notes on a topic, or answer a similar but different question. Make sure that you read the questions carefully, and for the higher mark questions, re-read the question while you are writing your response to make sure that your answer doesn't lose focus. It is a very good idea to plan your answer to the 30 mark question.
- When evaluating your answer, try to make your points specific to the argument that you have just made, rather than using very general evaluative points. For example, don't say 'it depends on the magnitude of the change' when you are told the size of the change, comment on the actual size - is it significant? Similarly, rather than just writing 'it depends on the elasticity of the AS curve / level of spare capacity in the economy', try to think about where that specific economy might actually be during the period that you're analysing. This will help you to gain 4 marks for each evaluative point, rather than 2 marks each.
- Remember that you don't need to evaluate your answer to the 8 mark questions. The marks for the questions are as follows:
 - One 4 mark question - 2 marks for data reference (application), and 2 marks for knowledge
 - One 6 mark question - 6 KAA marks (no evaluation marks)
 - Two 8 mark questions - 8 KAA marks (no evaluation marks)
 - Two 12 mark questions - 8 KAA marks + 4 evaluation marks
 - One 30 mark question - 18 KAA marks + 12 evaluation marks

Grade Boundaries

Grade boundaries for this, and all other papers, can be found on the website on this link:

<http://www.edexcel.com/iwantto/Pages/grade-boundaries.aspx>

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