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Examiners' Report
June 2014

IAL Economics WEC02 01

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Introduction

This was the second sitting of the new International Advanced Level (IAL) Economics Unit 2. As before, the paper was split into 2 sections: Section A had 8 supported multiple choice questions (SMC) with a total of 32 marks and Section B had a choice of 2 data-response questions with a total of 48 marks. The total available marks was therefore 80. Many more students attempted Q10 than Q9.

Question 1

This question was intended to ease students into the paper, relying to a large extent upon recall. The majority of students should have learned definitions and be able to achieve marks for the use of these in the supported multiple choice section. As it was, this question was generally not well done. Many students had not learned an accurate definition of GNP and were largely unclear about the distinction between GDP and GNP. Thus, many were choosing the incorrect response for part (a) as Option B instead of the correct Option C. Many students achieved the rejector mark for Option D by stating that it refers to the balance of payments but did not achieve any other marks.

This question was intended to assess student understanding of the GNP measure and the response is fairly typical of the more successful ones. It was clear that many students confuse GNP with GDP, not understanding the difference between the two measures. Many only achieved the balance of payments rejection mark.

1 Malaysia's GNP increased from MYR127 billion in 2009 to MYR185 billion in 2012.

GNP can best be defined as the annual

(1)

A profit earned by Malaysian firms

B value of total output produced within Malaysia

C value of total output produced by Malaysian owned factors of production

D value of total exports from Malaysia minus the value of total imports into Malaysia

Answer C

Explanation

(3)

Gross national product refers to the total value of out produced using resources that are owned by Malaysia regardless where it is produced from.
In that case, GNP of malaysia is the total output produced by factors of production owned by Malaysia and hence option A is incorrect because profit can also be repatriated into the Malaysian economy by workers who worked abroad
Option B is incorrect, because the total output produced within malaysia is referred to as GDP
Option D is incorrect; because it defines the Balance of payment of Malaysia

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Examiner Comments

The student clearly has an understanding of the difference between GNP and GDP and was rewarded for this. They were also awarded a rejector mark for Option B, showing knowledge of the GDP measure and the rejector mark for Option D, again demonstrating good knowledge.

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Examiner Tip

It is important to learn definitions and, where appropriate, examples. This basic knowledge and understanding can then be brought to the examination paper. It is useful not only in SMC in Section A, where there are invariably marks awarded for definitions related to the stem of the question, but also in Section B where there are also many marks awarded for definitions. It is also good to do something with the data. Students who, for example, calculated the difference in GNP (either as a value or a percentage) were rewarded with a mark.

Question 2

This question again examined the understanding of a basic element of the syllabus, economic growth and the factors contributing to increasing or decreasing aggregate demand. A surprising number of students chose Option D as the answer and then discussed an increase in growth, whereas the question asked about a lower growth rate.

This is a good response. However the student has clearly spent more than 3 minutes on the explanation and has written too much for a question of this type. What was required was a definition of GDP growth and an explanation as to why falling exports may reduce aggregate demand (AD), all else being equal.

2 In 2010, Brazil's GDP growth rate was 7.5%. In 2012 it fell to 0.9%.

The most likely cause of this fall in Brazil's GDP growth rate was

(1)

A a fall in Brazilian exports

B increased spending by Brazilian consumers ×

C increased Brazilian government spending on transport infrastructure ×

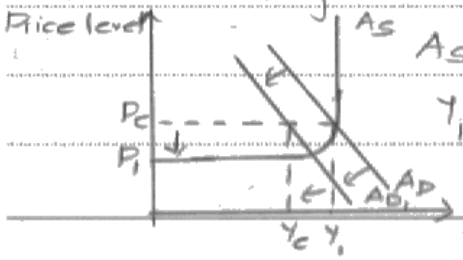
D a fall in Brazilian imports ×

Answer **A**

Explanation

(3)

GDP is the total market value of all final goods and services produced in an economy using the factors of production available within the economy usually one year. Growth rate is the percentage increase in the volume of output produced in the economy. Exports are goods and sevices produced locally and demanded/purchased by foreigners. Export is a component of AD when demand for exports fall (leads to shift to the left of AD) firms scale down their production so as not to make losses. When output falls the volume of final goods and services eventually falls, as a result the GDP growth is negative that is from 7.5% to 0.9%



As shown in the diagram GDP falls from Y_1 to Y_e.

GDP/GNI/Employment.

(Total for Question 2 = 4 marks)

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Examiner Comments

The student tries to cover every possible knowledge mark and is successful, scoring full marks. However, better examination technique would have achieved full marks in three sentences. The student also does not attempt to achieve a rejection mark. These are often easy marks to achieve. Time saved in Section A can be spent on Section B.

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Examiner Tip

An accurate diagram will invariably achieve a mark. Then there are only two additional marks to achieve with a sentence explaining why the answer is correct and a sentence explaining why it could not be one of the other options.

Question 3

This question was intended to check student understanding of how consumer price index (CPI) is calculated and that they understand deflation, as opposed to inflation. While many students did select the correct answer, a large number did not really explain their answer clearly, linking foodstuff to CPI weighting. Even less actually indicated that this was an example of deflation.

Many students began by defining inflation, although there were no marks for this as the question actually indicates deflation. Some students also gave a very general definition of CPI, simply stating that "it measures inflation". Examiners were looking for a more precise understanding of CPI as a weighted index. Quite a few students confused the cause with effect, describing the likely impact of deflation rather than the cause.

3 In August 2013 Bulgaria's consumer price index indicated that the average price level had fallen by 0.7% compared with the previous year.

Which **one** of the following is most likely to account for this change in average prices?

(1)

A A depreciation of the Bulgarian currency

B A decrease in the price of foodstuffs in Bulgaria

C A reduction in direct taxation in Bulgaria

D An increase in consumption in Bulgaria

Answer B

Explanation

(3)

Consumer price index shows the changes in the average prices of goods (general price levels) in a country. Foodstuffs is an important components of spending of people and thus its weighting when calculating CPI is important. Fall in prices of foodstuff will be reflected as fall in general price levels.

Increase in consumption will increase the aggregate demand and cause inflationary pressure so general price levels are likely to increase when consumption increases

so D is incorrect.

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Examiner Comments

This response as awarded full marks, as there is evidence of understanding that CPI is a weighted index and an application reference to foodstuffs being an important weighted component. They also achieve a rejection mark for linking increasing consumption to AD and rising prices.

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Examiner Tip

Be precise with definitions and make sure that they are relevant to the question. If the question shows an example of deflation, then define deflation not inflation. Make sure that you understand how inflation is calculated and why it is calculated in this way.

Question 4

This question was intended to assess understanding of the Macroeconomic Policy Instruments and the impact of supply-side policies upon AS. There was evidence that many students did not really understand what type of policies may be used to promote competition and the possible consequences of such policies. There was also some confusion about the relationship between cause and effect with many students talking about the effects of a rightward shift in long run aggregate supply (LRAS) rather than the likely cause of such a shift. The LRAS curve is determined completely independently of demand. LRAS position depends upon the quantity and productivity (quality) of factors of production. It is also important to understand that governments can intervene in markets in many ways. There were a surprising number of students who simply suggested that "subsidies" are the only way governments can intervene to increase output.

This is one of the better responses and shows how all of the available marks can be efficiently achieved with 3 sentences.

4 Which **one** of the following is most likely to cause an outward (rightward) shift in an economy's long run aggregate supply (LRAS) curve?

(1)

A Government policies to promote competition

B A fall in the quantity of imports of goods and services

C A rise in unemployment

D An increase in indirect taxation

Answer [A]

Explanation

(3)

If competition in an economy increases, firms will ~~compete~~ try their best to reduce their production costs, ~~this will lead~~ since productivity increases, there will be a outward shift of LRAS. B is wrong as the fall in imports will lead to an increase of net exports, it ~~lea~~ results in an outward shift of AD. C is wrong as a rise in unemployment will reduce consumption in the economy, it leads to an inward shift of AD.

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Examiner Comments

The student explains how increased competition may create pressures in firms to reduce costs and increase productivity and they then link this to LRAS. A mark was awarded for this explanation. A rejection mark for B is awarded, stating that falling imports will increase net exports and thus increase AD (rather than LRAS). A rejection mark is also awarded for linking rising unemployment to consumption and thus to AD.

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Examiner Tip

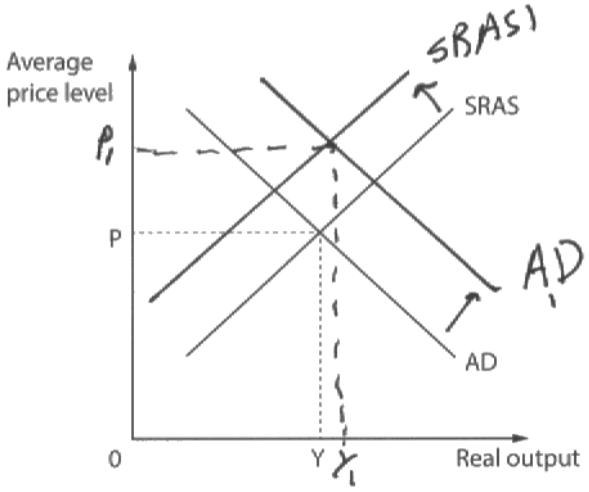
It is always a good idea to explain why the choice of option is correct and then explain how one or more of the other answers could not possibly be correct.

Question 5

This question assesses the understanding of components of AD and short-run aggregate supply (SRAS). While there was no explicit request to annotate the diagram, two marks were available for annotating the diagram. There was clearly some confusion about the components of AD and the way in which an increase in net exports, due to a depreciation of the currency, may increase AD. Many students also did not understand that rising import prices, again due to currency depreciation, may increase costs for manufacturers and shift the SRAS inwards.

This is a good response, where the student has annotated the diagram, correctly answered Part A and then gone on to explain their answer.

5



The aggregate demand (AD) and short-run aggregate supply (SRAS) diagram above represents the Indian economy in equilibrium at real output Y and average price level P.

Which of the following is likely to happen to the position of the curves following a 23% depreciation of the Indian currency from May to September 2013?

(1)

A Shift of AD curve to the right **and** SRAS curve to the left

B Shift of AD curve to the left **and** SRAS curve to the right

C No shift of the AD **or** SRAS curves

D Both AD **and** SRAS curves shift to the left

Answer A

A depriciation of a currency means that the this currency's value is being lost against another currency. As a currency depriciates, imports become more expensive. This causes cost push inflation as seen on the diagram from SRAS to SRAS1. However, exports become cheaper to other countries and so to India then exports more. This shifts AD to AD1

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Examiner Comments

Two marks were awarded for the correct annotation of the diagram. A mark is awarded for defining depreciation and another for reference to cost-push inflation. There is also a reference to the impact upon exports and AD.

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Examiner Tip

Examiners are looking to award marks. It is a good idea to annotate a diagram if appropriate, particularly if this helps you to visualise the correct answer to a question. Correctly annotated diagrams will be rewarded with marks.

Question 6

This question was intended to examine understanding of the likely effects of unemployment and not the causes. Again, many students confused cause and effect, selecting the wrong Part A and then explaining how unemployment may have been caused by rising wages, inflation or the value of the Euro.

This response was awarded full marks, even though unemployment is defined, for which there were no marks, rather than unemployment rate. It is important that students read the question carefully before writing the first definition they believe to be relevant.

6 Spain is a member of the eurozone. In the third quarter of 2013, the unemployment rate in Spain rose to almost 30%.

The most likely effect of this increase in the unemployment rate is

(1)

A an increase in wages in the Spanish economy

B an appreciation in the value of the euro

C an increase in the rate of inflation in Spain

D a reduction in tax receipts

Answer [D]

Explanation

(3)

Unemployment is a situation in which people who are willing and able to work can't simply find jobs. In this case the increase in unemployment by 30% will lead to less people employment hence reduction in income tax. In addition to this increase unemployment reduces purchasing power hence less goods and services bought which reduce the indirect tax collected by the government. option C is incorrect as unemployment reduces AD and prices decrease so inflation reduces.

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Examiner Comments

Marks were awarded for a reduction in income tax and for a reduction in purchase tax, both linked to falling incomes and unemployment. A mark was also awarded here for the rejection of Option C, as there is an explanation of the link to AD.

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Examiner Tip

Always try to explain why an Option could not be correct to achieve a rejection mark. Read though your response and if you think the examiner could write "Why?" next to the answer, try to develop it a little more.

Question 7

This question examines a new area of the syllabus and was the first time a question had been asked directly in this area. There were some excellent responses showing a good understanding of the theory. However, many students simply re-wrote the stem of the question and did not show any understanding of Asset Purchase Facility (APF) or Quantitative Easing (QE). Many explanations were left totally blank.

The response here is one of the better ones, showing a good basic understanding of the process. There is also a clear understanding of how the policy is intended to tackle deflation.

7 In January 2009, the Bank of England set up an Asset Purchase Facility (APF) to buy high-quality assets from commercial banks, financed by the issue of Treasury bills.

The main aim of this policy, known as Quantitative Easing, was to

(1)

A reduce the rate of inflation

B cause an appreciation in the value of the UK pound

C increase the money supply ✓

D reduce real output

Answer C

Explanation

(3)

Quantitative Easing is ~~one of the~~ a type of ~~expan~~ monetary policy. When APF buys high-quality assets from the commercial banks, the money supply in banks increases and so as their reserves. They are likely to lend more loans, and thus increasing the money supply in the market. It is a kind of expansionary monetary policy, which aims to increase money supply or reduce interest rate to stimulate consumption and investment, increasing the Aggregate Demand. It is usually used to solve the problem of deflation or to increase the rate of inflation to the targeted rate.

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Examiner Comments

A mark was awarded for identifying QE as a type of monetary policy. Marks were also awarded for explaining the intended impact, both on bank reserves, interest rates, upon AD and inflation. An excellent answer.

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Examiner Tip

All syllabus areas will be examined. It is therefore important that materials and textbooks are updated to take account of the changing syllabus content.

Question 8

The final SMC question examined knowledge and understanding of Human Development Index (HDI). A surprising number of students failed to notice that Ireland's (HDI) was higher than that of Sweden even though the GNI Per Capita was significantly lower. This is the reason the two countries were chosen, as there could only be one explanation given the GNI per Capita figures.

Once again, an accurate definition of HDI was important for achieving marks on this question. An accurate definition ought to have led to the conclusion that Ireland's higher HDI could only be explained through years in education and life expectancy.

8 The table below shows the Human Development Index (HDI) and GNI per capita for two developed countries Ireland and Sweden in 2012.

Country	HDI	GNI per capita (current US$)
Sweden	0.913	55 245
Ireland	0.916	45 836

Which one of the following may be deduced from the data?

(1)

A Ireland had lower levels of human development than Sweden

B Ireland had higher standards of education or health than Sweden

C Sweden had a higher level of energy consumption per capita than Ireland

D Sweden's population had less access to clean water than Ireland's population

Answer B

Explanation

(3)

HDI is the index introduced by the United ~~to~~ Nations to measure the economic development of a country. This uses three elements which are: GDP per head at ~~per~~ purchasing power parity, life expectancy at birth and number of years schooling. Higher the index it shows better results on a country's development of both GDP and Non-GDP factors. Here it can be seen that Ireland is ahead of Sweden in education and health standards as it has achieved a higher index even if the GNI per capita is ~~less~~ than Sweden. However, this index does not indicate energy consumption of a country.

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Examiner Comments

The student achieves a mark for defining HDI. There are also marks for indicating Sweden's higher GNI Per Capita and explaining how this must mean Ireland higher HDI is due to being "ahead in education and health standards". There is also a rejection mark in the final sentence, gaining another mark if it had been required.

ResultsPlus
Examiner Tip

Accurate definitions can lead to better explanations of answers, application and analysis. Students would do well to practice SMC questions requiring definitions in timed conditions.

Question 9 (a)

Only around a third of students attempted Question 9.

Very few students attempted to explain why Reserve Bank of New Zealand (RBNZ) has an inflation target. Most simply defined inflation and described a target. Examiners were really looking for the reasons 'why', such as to maintain price stability and support macroeconomic objectives. Inflation targets are in the specification and New Zealand was the first country to have an inflation target. Very few students achieved full marks on the question.

This is one of the better responses where the student achieved full marks.

(a) With reference to Extract 1, explain **one** reason why the RBNZ has an inflation target.

(4)

Inflation target is when a government sets a target of inflation rate which can be moderated in the economy if it overshoots or undershoots. Thus, the government set an inflation target because the forecast says that inflation will be 1.9% in the future. Thus, by setting a target between 1% to 3%, it can tell the government when to increase its interest rate in the economy to curbal inflation or when to lower the interest rate. It will aid the government in decision making. Thus, the government knows when inflation will increase in the economy and when to implement policies to curbal it.

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Examiner Comments

The student clearly understands why the RBNZ sets an inflation target and how it is used to adjust monetary policy. Unlike many other students, they do more than just describe the target, repeating what is in Extract 1.

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Examiner Tip

When attempting four marks questions, the aim is to achieve at least two knowledge and two application marks. Always refer to the context for application marks and make sure that definitions are clear for knowledge marks.

Question 9 (b)

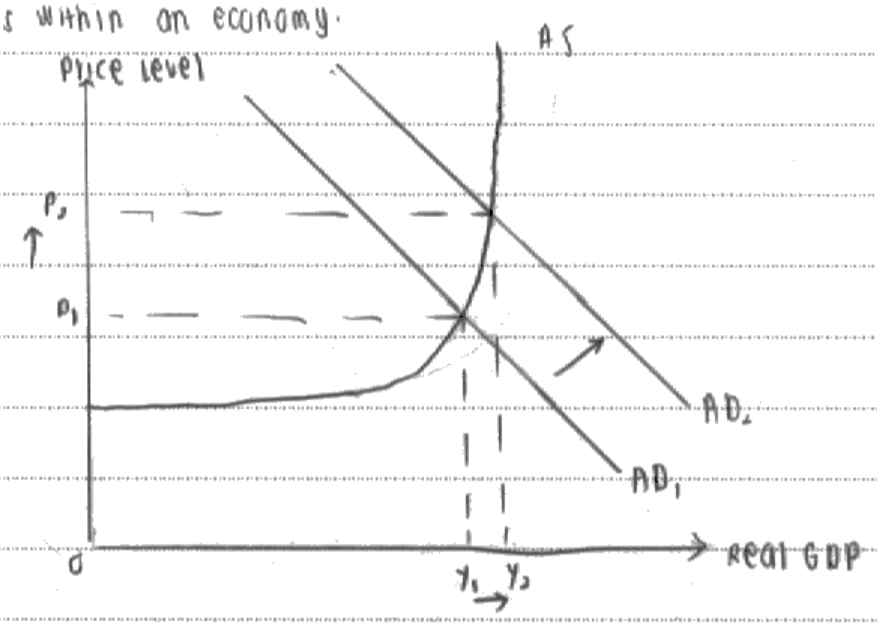
This question was intended to test understanding of the concept of productive potential. Some students shifted LRAS inwards, increasing the average price level and reducing real output but this is not what the extract describes. The extract describes demand-pull inflation, occurring due to rising AD and not reduced capacity.

This response is one of the best responses seen by examiners. The diagram and explanation show that the students has a good understanding of capacity constraints and of the context in which the term is used.

(b) Using an appropriate aggregate demand and aggregate supply diagram, illustrate and explain what is meant by the term "capacity constraints". (Extract 1, line 3)

(6)

Aggregate demand (AD) is the total planned expenditure into the economy. Aggregate supply (AS) is the total ~~planned~~ output produced by all firms within an economy.



capacity constraints means that the economy is already producing ~~at~~ near its potential.

~~eg~~ If there is a rise in AD through an increase in consumption and investment, ~~growth~~ real GDP will increase ~~at~~ at a slower rate than price level. This is because ~~all~~ most of the resources are already employed. Firms will have to bid price upwards in order to obtain scarce resources like land, labour and capital. The higher costs will be passed on to consumers.

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Examiner Comments

While the student chose to show the impact of an outward shift in the AD curve on the AS curve, rather than also showing the SRAS curve, they were rewarded for an accurate diagram. The explanation shows good understanding and is related to the context.

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Examiner Tip

It is important to know the difference between the SRAS and LRAS, also to be aware of factors which may shift the SRAS and the LRAS.

Question 9 (c)

The most common error here was to state "high inflation" but inflation in the case study is relatively low. The best responses tended to focus upon rising incomes and Marginal Propensity to Import. It was important that there were references to data here rather than generic, learned responses. The New Zealand context was very specific which is one of the reasons it was chosen.

This was one of the better responses, achieving full marks. There is good knowledge, application and analysis at Level 2, as well as some evaluation. The most common response identified just one reason and proceeded to analyse in context; others identified two reasons but did not develop the analysis in any way.

(c) With reference to Figure 1, Extract 1 and your own knowledge, assess **two** factors that influence New Zealand's balance of payments on current account.

(10)

Two factors that influence the balance of payments is inflation and interest rates.
New Zealand's current accant balance has recently been in deficit (exports < imports). If inflation were to increase above target, the demand for exports will fall as foreign countries will not want to buy expensive products. However, if inflation were to fall, this would have the opposite effect and improve the current account deficit. It should be noted that this depends on the level of inflation. If New Zealand's level of inflation is higher than lower than other countries, it will not have an effect on the level of exports. But the effect would be great if the level was higher than other countries.

If interest rates were to rise in New Zealand, foreign savers would transfer savings to New Zealand for higher rewards which will increase demand for and value of the currency. This will make exports expensive and imports cheap, reducing the demand for exports and increasing demand for imports. This will worsen the current account deficit. However, this depends on the price elasticity of demand for exports and imports. If price inelastic, then ~~dema~~ the current account will not face any change. This also depends on Domestic firms. Even if prices of exports change, they may still sell the at old prices. This will not have any effect on exports.

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Examiner Comments

Two factors are identified, each in context, and each is then developed to achieve the available marks for each factor.

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Examiner Tip

Always try to use the data given in the case study. Application marks will be awarded for relevant data references. Analysis should then be based upon this context.

Question 9 (d)

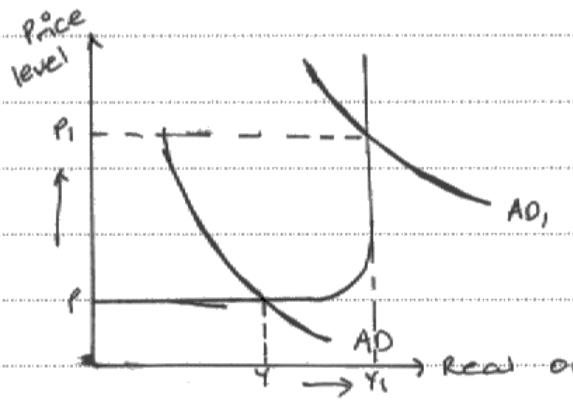
The key point here is that there must be some application to the context and purely generic answers could only achieve Level 1 for knowledge, application and analysis. The best answers identify a couple of factors from the evidence, develop and evaluate each one.

This question invites students to use the data, where New Zealand experienced very specific problems partly as a result of the destruction in Christchurch. Unfortunately too few students contextualised their response.

(d) With reference to the information provided and your own knowledge, discuss the factors that might lead to an increase in the rate of inflation in New Zealand by 2015.

(14)

Inflation ~~rate~~ is the ~~rate at which price~~ general and persistent increase in general price levels. Inflation rate is the rate at which price levels are rising. ~~Due t~~ As mentioned in extract 1, official interest rate in New zealand has been left at 2.5%, a record low. This fall in ~~investment~~ interest rate leads to a fall in the cost of borrowing, thus increasing borrowing, which will lead to a rise in consumption and in turn, aggregate demand, causing a rise in price levels. Also, low interest rates encourage investment due to increased borrowing, leading to a rise in consumption and in turn, aggregate demand cause a rise in price levels. Since investment is an injection, the rise in aggregate demand will be magnified by the multiplier effect.



However, it will depend on the magnitude and duration of the fall in interest rates. As mentioned in Extract 1, interest rate is at an all time low of 2.5% and any rise in interest rate is not expected to start that year. Therefore, it's impact will be more significant on inflation rate.

Also, since the rise in inflation rate is brought about largely by the multiplier effect, it will depend on the size of the multiplier. In addition, the multiplier effect has significant time lags and will take time to take effect, and will eventually die out. Therefore, the rise in inflation rate may not be very high.

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Examiner Comments

This is one of the stronger responses, achieving 12 marks. There is good knowledge, application and analysis as well as some evaluative comments. The diagram is also accurate and relevant to the context.

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Examiner Tip

As with the previous question, make sure that the answer is given in context as data is selected carefully, so that questions can be set which enable students to develop their analysis of a specific situation.

Question 9 (e)

Here examiners were looking for an examination of the trade-off between interest rates, growth, employment and inflation. There was plenty in the case study to suggest New Zealand (NZ) is faced by conflicting policy objectives. Some students managed this well while others really only produce a list of good and bad things about interest rates as a tool of monetary policy.

There were some strong responses to this question and the one included here achieved 12 marks. There is good knowledge, application and analysis in context. There is also some evaluation towards the end of the essay.

(e) Evaluate the use of interest rate changes to control inflation in New Zealand.

(14)

New Zealand's use of Interest rates to control inflation could be an effective policy. Raising interest rates would prompt consumers ^ as the return on saving would be higher to save more of their disposable income rather than spend it, decreasing consumption and thus decreasing aggregate demand ceteris paribus. Furthermore, raising interest rates would decrease the ~~likely~~ likelihood of investment, as the cost of borrowing ^ money would rise and they would need a relatively greater return on their investment to outweight the loan. This would also lead to a fall in ~~investment~~ ^ investment as aggregate demand as ~~inflation~~ is a component of aggregate demand. However, other factors should be taken into consideration. Possibly the use of fiscal policy could be more effective such as raising profit and income tax, ~~Not~~ depending on the country's population. ~~If~~ It is ^ likely there are more people employed in New Zealand than those who would save due to a rise in interest rates, so fiscal policy could be more effective in the short-run, for example.

When raising interest rates, those with outstanding loan repayments also lose out as the real interest rate ~~fall~~ rises (interest rate less inflation) which means they have to repay more in terms of money, eroding their purchasing power. Also, not all banks follow interest rates set by the government. Commercial banks could still maintain the record-low interest rates, rendering the policy largely ineffective as consumers, the largest determinants of aggregate demand, utilise commercial banks, not the RBNZ.

Finally, raising interest rates is possibly only a short-term solution, as is fiscal policy and supply side policy should be considered to cause Benign deflation, with lower prices and a greater productive capacity for ~~the~~ the economy in the long-run.

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Examiner Comments

The response focuses on the NZ context, where there are concerns expressed about rising asset prices. The evaluation of the likely effectiveness of monetary policy is also quite well developed.

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Examiner Tip

Remember that evaluation can be achieved at any stage in the essay and does not have to be achieved in a conclusion. It is good technique to make a point and then evaluate this point in the same or in the next paragraph.

Question 10 (a)

Surprisingly few students achieved full marks for this question, given that the majority of students attempted question 10 rather than question 9. Once again, definitions were often limited. Few students understood that current account is more than importing and exporting and thus did not understand why the current account deficit was maintained although there was a balance of trade surplus. The graph clearly shows this but the implications where not explored in any depth. Students who did look at this feature of Australia were well rewarded.

This is one of the best responses achieving full marks for the question.

(a) With reference to the information provided, explain what is meant by a 'current account deficit'. (Extract 1, line 8)

(4)

Current account records the trade of goods and services of a country with the rest of the world. It is a part of BOP and current account = (Exports − Imports) + investment flows + current transfers.

Current account deficit occurs when the value of imports are greater than the value of exports causing current account balance to worsen. From Extract 1, it can be seen that Australia's value of total international trade grew by 9·9% between 2010 and 2011. Australia's exports grew by 10·2% in 2011 and manufacturing exports grew by 3·1% in 2011, causing a reduction in current account balance.

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Examiner Comments

There are two knowledge marks achieved and two application marks for reference to the context (in this case the data provided on Australia).

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Examiner Tip

For the four mark questions make sure that there is at least one data reference. If at all possible, try to do some kind of calculation with the data even if this this only calculating a percentage change in a value.

Question 10 (b)

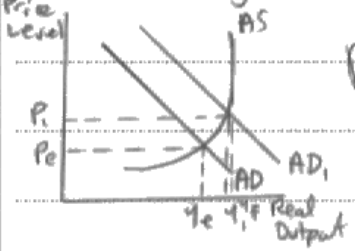
This question was answered quite well but usually in a rather generic way. However, there tended to be more evaluative comments and the marks tended to be higher than other questions.

Again, the example used is one of the strongest responses achieving full marks.

(b) Examine how low interest rates may 'stimulate private investment and allow businesses to prosper'. (Extract 2, line 16)

(10)

Low base interest rates charged by the central banks to commercial banks which are then passed on to consumers through the monetary policy transmission will serve to decrease the cost of borrowing. A reduction in cost of borrowing will increase the amount of firms willing to purchase capital goods that will increase the productivity of the firm in the long run. Firms will be more willing to invest into capital goods and as investment makes up a significant proportion of aggregate demand, AD will shift out to AD_1 as demonstrated. This increase in aggregate demand will increase



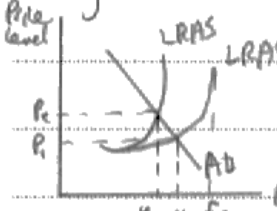
prices from P_e to P_1 which may cause inflationary pressure. This policy is therefore an example of expansionary monetary policy. An increase in the price level may see firms having to face difficulty maintaining increases in total revenue as the real price of their goods and services becomes eroded. This policy may therefore possibly be counterproductive as firms may struggle during inflationary periods. Furthermore, individuals may be motivated to bid up their wages and this increases the price as firms have to increase costs; this wage price spiral may further do damage to the firm instead of allowing businesses to prosper as suggested!

However real output does not just increase from Y_e to Y_1 so this low interest rate may seek a high rate in return as the extract suggests in that a multiplier effect will create increased employment from Y_e to Y_1 as the economy shifts closer to full employment at Y_f. More employment could mean less costs to the

government in terms of welfare benefits which allows them to seek their opportunity cost and invest in more worthwhile activities, such as for instance the their strong Keynesian stimulus enforced previously during a global recession.

Also, more employment would mean an increase in the number of citizens with higher disposable incomes which can be used upon consumption and increasing aggregate demand. This may then cause further employment as more firms need to operate to satisfy demand and then profit motive will attract them into operation. This effect can therefore be a positive multiplier across the economy.

Furthermore, a stimulation of private sector investment may seek to increase the long run aggregate supply of the economy as capital goods may be invested into which can produce further consumer goods.



Instead of the policy therefore producing inflationary effects as suggested prior, the increase in investment may seek to cause ~~inf~~ benign deflation and decrease price from Pe to P, and the firms' output increases from Ye to Y, as they have become more productive possibly due to efficiency maximising investments such as new technology. However, this depends on whether the investments were in fact ones that would increase productivity or not. Furthermore, the extent to which the natural rate were lowered must be considered. If this isn't significant it may have no effect whatsoever on consumers the market of firms. Additionally the magnitude of an inflation or deflation will depend on the elasticity of aggregate demand. More inelastic AD causes a greater change in price level while more inelastic AD causes less effect.

ResultsPlus
Examiner Comments

There is good knowledge and application here, as well as analysis, including a suitable, relevant diagram. Evaluation is also present and pushes this response into the top level.

ResultsPlus
Examiner Tip

Diagrams are a good way of focusing a written explanation and achieving marks. The student does this very well and goes on to evaluate as a result of this.

Question 10 (c)

Although commodities appeared in the January paper a surprising number of students clearly did not understand what a commodity is. This meant many were unable to provide a coherent response. However, where students understood what a commodity is and that Australia is a major commodity exporter, answers were generally well-developed. Some focused the impact upon domestic manufacturers missing the significance of commodities to the Australian economy.

The response here is one of the best seen by examiners. It shows excellent knowledge, application and analysis and is very well written. There are also some good evaluative comments.

(c) With reference to the information provided and your own knowledge, discuss how changes in commodity prices may affect the Australian economy.

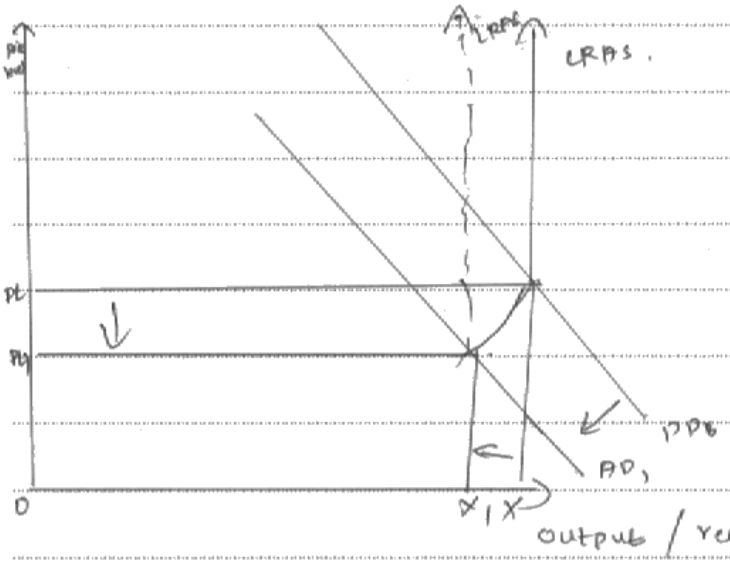
(14)

Commodity is a main part of Australian export. It includes iron ore, minerals and coal. ~~Here~~ According to extract 3, the commodity prices are falling which also led to reduce in mining sector Investment.

A fall in commodity prices will affect the the firms involved in commodity production directly. It will reduce their profitability and hence they would reduce their Investment to to reduce the cost of extra production as it doesnot yeid high incomes. So, this will reduce the new investment also causing fall in new job opportunities for new labour comming into market to after education and training period. Also, some existing firms may close down causing mass unemployment in the country. So, it thereby leads to increase in unemployment and fall in Investment.

Another affect is, however a positive one, that if ~~exporters~~ foreigners would find it cheap to buy Australian commodities now due to the price fall. So, (other things being equal) rise in exports would lead to ~~rise~~ ~~Export~~ fall in current account deficit of Australia.

Another impact will be due to the mass unemployment which will cause the income level to fall thereby, reducing the consumption spending. So, it would cause, Aggregate demand to fall too.



A fall in commodity price would reduce AD from AD to AD1 and output would fall from X to X1, and price level would fall from PL to PL1. In long run, LRAS may also shift left due to the reduced investment.

However, it depends on the magnitude of the fall. If it is fallen by a small percentage, Investment would not feel it unprofitable to invest in commodity market. Also, it may change aggregate demand, but there are other factors which influence AD. So, If for, say, ↳ Net export rose ~~and also~~ with Government spending ~~that~~ (as they are components of AD) the fall in AD due to fall in commodity price would be offset by the ~~fall~~rise in AD from Government spending and Net export. So, AD wont be much affected. Also, If the country is working at full capacity, It would only lead to fall in price level and not output.

ResultsPlus
Examiner Comments

The most important aspect of this response is that it is in context and is applied to the Australian case study. The evaluative comments are also in context and clearly developed.

ResultsPlus
Examiner Tip

Read the case study carefully and highlight any key details, such as a reliance upon commodity exports. The examiner is trying to highlight key features of an economy in the extracts and data. It is worth spending a few more minutes analysing the context rather than producing a generic response that may not be relevant.

Question 10 (d)

Good responses needed links to export markets and a clear explanation of how this may impact on employment/unemployment in Australia. The best responses linked to AD and included an accurate diagram.

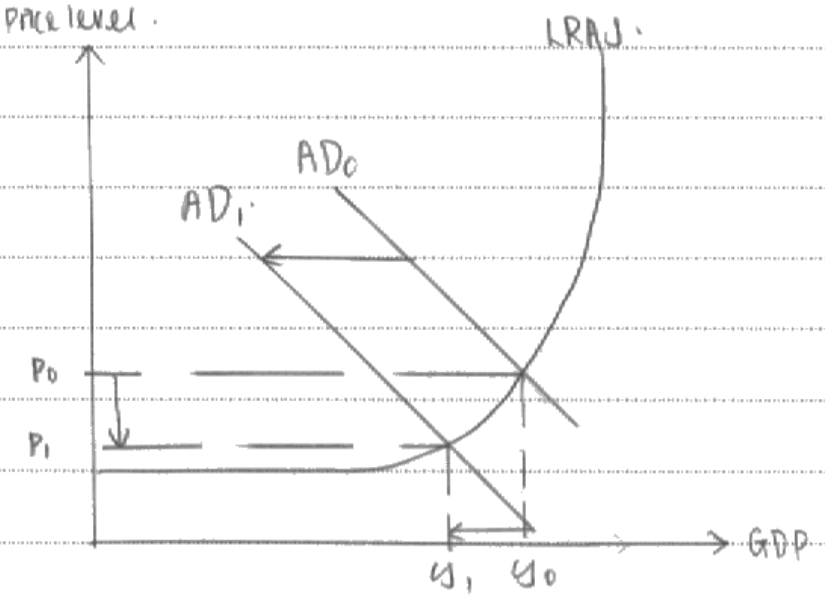
This is a strong response, achieving full marks. There were 2 knowledge, 2 application and 2 analysis marks available.

(d) 'Growth is slowing in many key export markets.' (Extract 2, line 8)

Explain how this could affect the unemployment rate in Australia.

(6)

Unemployment refers to the number of individuals in the labour force, ~~out of job~~ are out of jobs. When exports are slow, an economy's net exports gradually decline as well. Since net exports is a component of AD, a fall in ~~A~~ NX would cause a decline in AD too.



This can be seen in the leftward shift of the AD from AD0 to AD1, causing an increase in ~~unemp~~ unemployment as seen in the shift from Y0 to Y1. Since this is ~~cur~~ currently occuring in Australia, it would seem that unemployment rate ~~would spike~~ in Australia would rise too, as seen and explained above.

ResultsPlus
Examiner Comments

The student answers the question very logically, using a diagram at the centre of the response. The analysis is in context, relating falling exports to AD and to employment.

ResultsPlus
Examiner Tip

Again, a good diagram can provide the centre of a response, as long as the explanation is in context.

Question 10 (e)

There were some good responses here, with some students aware of the positive, as well as the negative impact, of cutting public spending. The best responses included reference to the long term impact upon tax receipts and employment/unemployment, as well as efficiency in the economy.

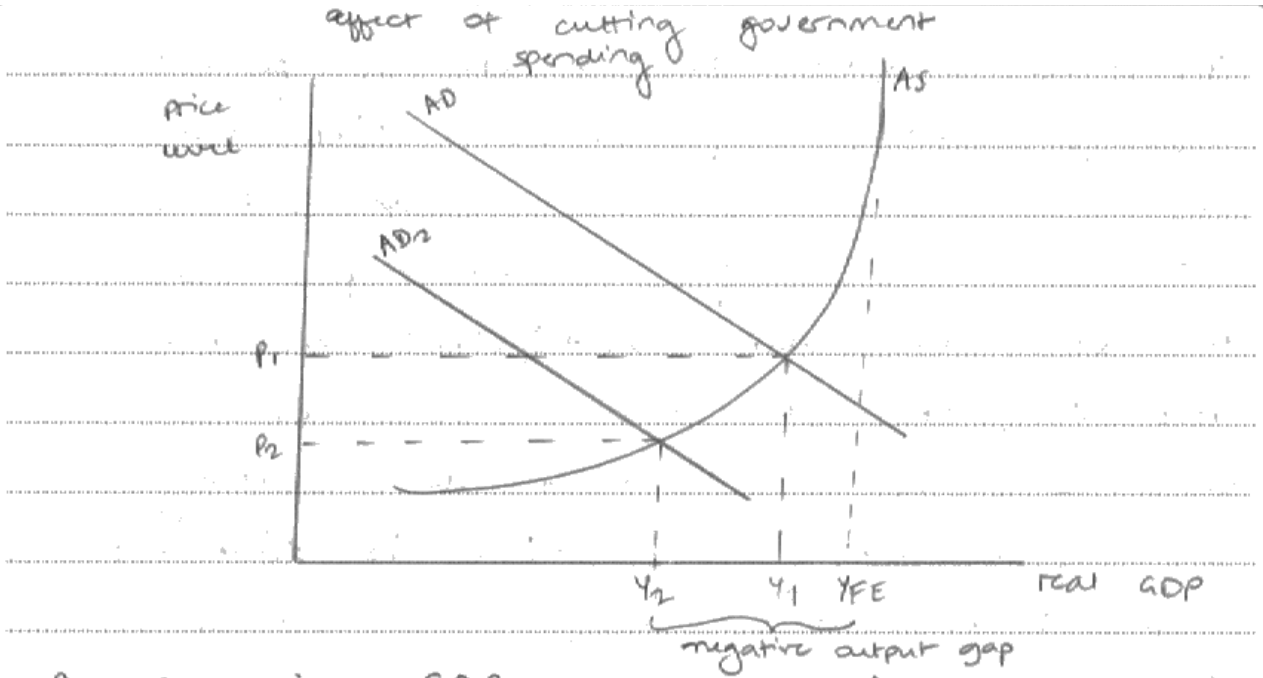
Again this a strong response, achieving Level 3 for knowledge, application and analysis and Level 2 for evaluation.

(e) Evaluate the likely impact of 'cutting government spending by AUS $70 billion' (Extract 2, lines 10–11) on the Australian economy.

(14)

The policy of reducing government spending is referred to the Fiscal policy. Fiscal policy is the government policy to control the level of economic activity through taxation and government spending; in order to achieve its macro-economic objectives of low unemployment, control rate of inflation, economic growth and a surplus on current account.

A reduction in government spending will create a deflationary fiscal policy as ~~a~~ AD will dampen. This will result in a fall in the GDP growth by 2%. Due to the fall in growth, derived demand, unemployment will increase where Australia will ~~lose~~ ~~a~~ give up upto 90,000 jobs. ~~An increase in~~ As a result, there will be an increase in the negative output of the ~~Australian~~ Australian economy (YFE - Y2)



A fall in GDP and an increase in unemployement will cause negative multiplier effects and cause AD to shift in to AD2. The Australian economy will suffer a loss of output. Moreover, the Australian government will face a reduction in the tax revenue collected due to the increased loss of jobs. Furthermore, government expenditure will increase to pay unemployement benefits (Job seekers' Allowance) to the unemployed.

However, the contraction of AD curve will depend on the magnitude of the reduction in government

spending. Maybe the effects of ~~a~~ reduction of government spending will not be as high as 2% ~~to~~ fall in GDP i.e the effect will depend on the size of the multiplier. Moreover, the impact on the Australian economy depends on if the cutting of government spending is ~~fast~~ a for a short run or a longer period of time ~~Short~~ short term effects could be a fall in GDP and a loss of jobs but a long run impact could severly damage the Australian economy Moreover, the government might reduce spending to ~~re~~ invest in public sector for public transport or infrastructure as the government is facing an opportunity cost.

ResultsPlus
Examiner Comments

This is a clearly written response, with logical, coherent analysis in context. There is a more generic evaluation but again this is clear and logical. The diagram is also relevant and useful.

ResultsPlus
Examiner Tip

It is a good idea to plan 14 mark responses rather than simply going straight into writing them. This may mean that the essay can be planned around achieving the different marking levels used for assessment.

Paper Summary

There seemed to be a marked division in performance between the students who had learned the theory, including definitions and accurate diagrams, and those who had more limited knowledge. This meant that some students struggled to achieve knowledge marks and were then less likely to be able to apply, analyse and evaluate to any extent.

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

- It is important to learn definitions and be aware that accurate definitions can achieve knowledge marks. It may be worthwhile students producing their own glossary of definitions and practice writing them out in timed conditions.
- While there was some improvement in the general standard of diagrams compared to January, students are reminded that diagrams need to be correctly labelled and explained if used to illustrate an answer. There were still examples of generic, micro diagrams being substituted for AS/AD diagrams.
- Timing appeared to be a problem for many students, who did not sufficiently develop their more extended responses. It is a very good idea for students to practice writing 14 mark questions, in timed conditions, from quite early on in the course. Similarly with the short answer questions and supported multiple choice (SMC). Many students were using extra paper for the SMC questions when there was only 3 marks for the explanation. Too much time was being spent on Section A and this meant there was insufficient time for Section B.
- Students also need to use the data provided to support their answers in Section B. There were still examples of purely learned, generic responses to questions. This meant that for some questions which related to an economy in question, the student produced an inaccurate response. The data for Australia, for example, shows it to be a major commodity exporter. Thus the impact upon the economy of falling commodity prices will be significantly different to a major commodity importing economy.

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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