

Examiners' Report  
June 2018

GCE Economics A 9EC0 02

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June 2018

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# Introduction

This is the second exam in the 2015 Specification series. The focus of this exam is on macroeconomics, themes 2 and 4 of the specification. Candidates' answers to the questions on this paper have generally been of an expected standard. All questions were accessible to the candidates, although inevitably candidates were scoring more highly on some than others.

In Section A the majority of candidates answered the multiple-choice questions correctly and there does seem to have been an improvement in candidates' understanding of how to answer these types of questions. The main focus for continued improvement is on quantitative skills. Candidates need to ensure they can calculate key things such as percentage change and index numbers, as many candidates are still losing marks for these. Candidates should also ensure they take the time to understand the data they are presented with, particularly on question 5. Candidates should also ensure they are using their time efficiently in this section, not spending time writing things that aren't going to get any marks, for example rewriting the question or including application when it hasn't been asked for.

In Section B it is important that candidates read the question carefully and ensure they are answering the precise question set, for example, with 6(c) ensuring they are discussing policies that could be used to reduce the negative effects of globalisation. A number of candidates used up valuable time focusing on explaining the negative effects themselves as opposed to policies. In 6(e) there needed to be a focus on the role of financial markets to promote growth and development, not on other markets or on the markets themselves.

In all questions it is important for candidates to remember that when a question includes the words 'with reference to...' then candidates should actually refer to whatever they have been asked to. In shorter questions there are discrete marks for application and in levels-based questions, examiners are looking for context to enhance the answer and move it into the higher KAA levels. A common issue when marking candidates' answers was a lack of application – answers should not be entirely theoretical and should be placed within the context of the real economy of the world or particular countries and regions.

For Section C where the candidates have a choice of which question to answer, around two-thirds of candidates answered question 7 and the rest question 8. In both questions it was important for candidates to understand how to both analyse and evaluate in a way that is relevant to the question. In question 7 candidates needed to ensure they are evaluating the effects. Effects that can be both positive and negative. In question 8 the focus is on the word impact, and for evaluation thinking about whether that impact is significant or not. The vast majority of candidates could offer a reasonable answer to both of these questions but many struggled to reach the top levels as the points were not fully developed and lacked application to back up the arguments being made; something that often distinguished between Levels 3 and 4.

## Question 1 (b)

The marks for this question are divided into two marks for knowledge, one for application, and one for analysis. Knowledge marks can come from a definition of comparative advantage or other relevant points. Application could come either from the data or the candidate's own knowledge. Analysis generally involved explaining the link to an increase in GDP/output.

*→ one good country produces a goods has an opp cost in the production of producing a goods*

(b) With reference to the theory of comparative advantage, explain how CETA may increase the GDP of both the EU and Canada.

(4)

The theory of Comparative advantage refers to when one country has a lower cost of producing a good in one country ~~is~~ as a result of an opportunity cost. ~~from another~~ In this case it states that the EU had an comparative advantage in the elimination of this trade barrier as they it would lead to boost of 12 billion euros.



This answer achieves only one mark for application about 12 billion euros. The rest of the answer is too vague/imprecise to achieve any marks.

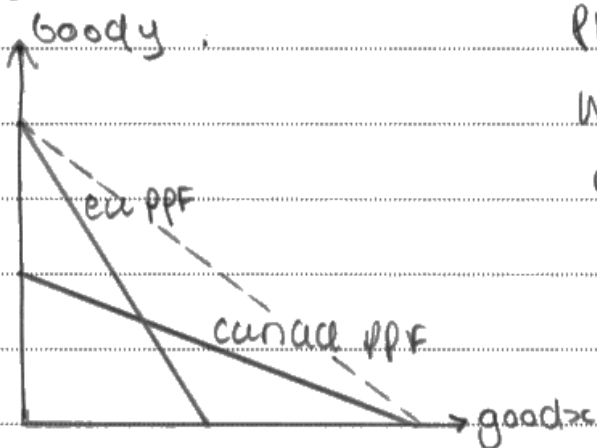


Be clear and accurate when it comes to defining or explaining things like comparative advantage.

(b) With reference to the theory of comparative advantage, explain how CETA may increase the GDP of both the EU and Canada.

(4)

Further the theory of comparative advantage states that if countries have a lower opportunity cost than another at producing the good "x" they should specialise in producing good "x" and trade. By trading their



PPF can increase to where the dotted line is showing a clear increase in the size of the PPF



**ResultsPlus**  
Examiner Comments

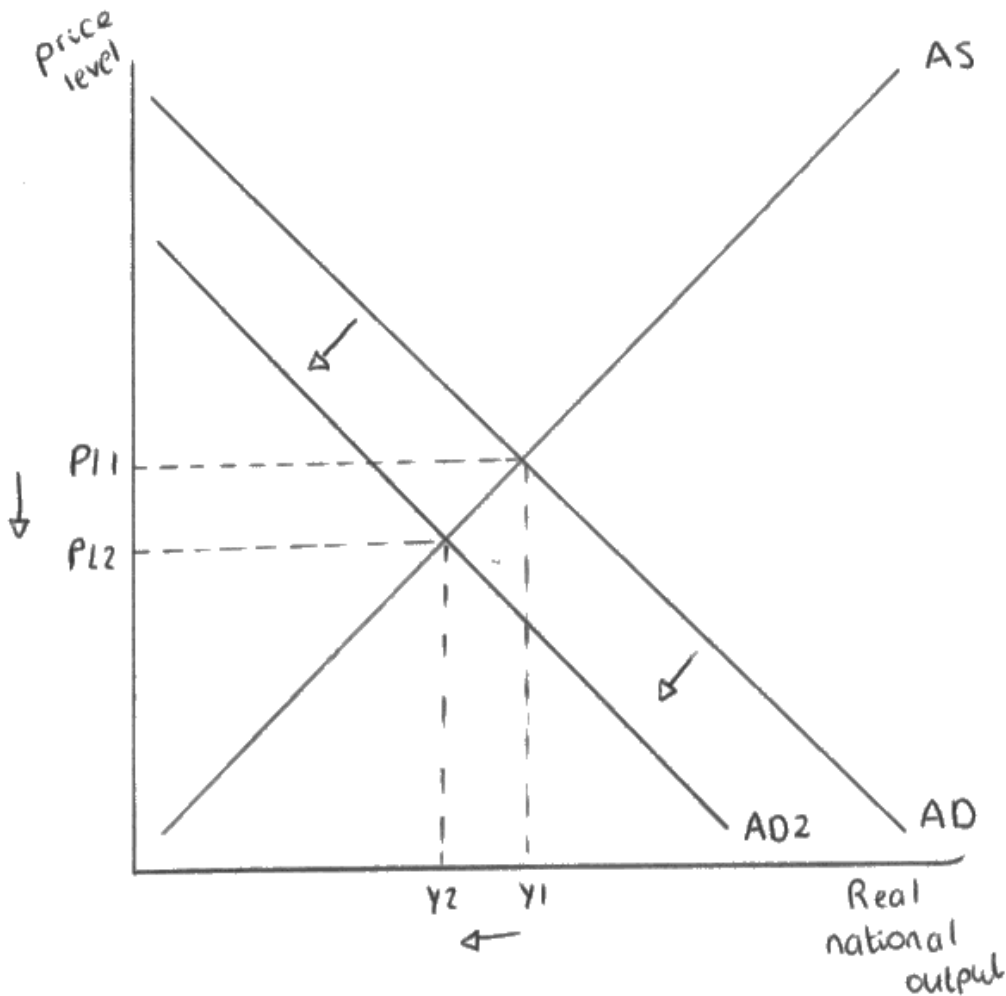
This answer achieves 3/4. In terms of knowledge there is one mark for lower opportunity cost and one for a reference to specialisation. There is then one further mark for the diagram.

## Question 2 (b)

This question specifically asks candidates to draw a diagram. There is **no need** for candidates to write any explanation to go along with their diagram. When drawing diagrams candidates should always double-check that the lines and axes are correctly labelled. In this question half of the marks are awarded for this.

- (b) Draw an aggregate demand and aggregate supply diagram illustrating the likely impact of a rise in interest rates on the price level and real output.

(4)



**ResultsPlus**  
Examiner Comments

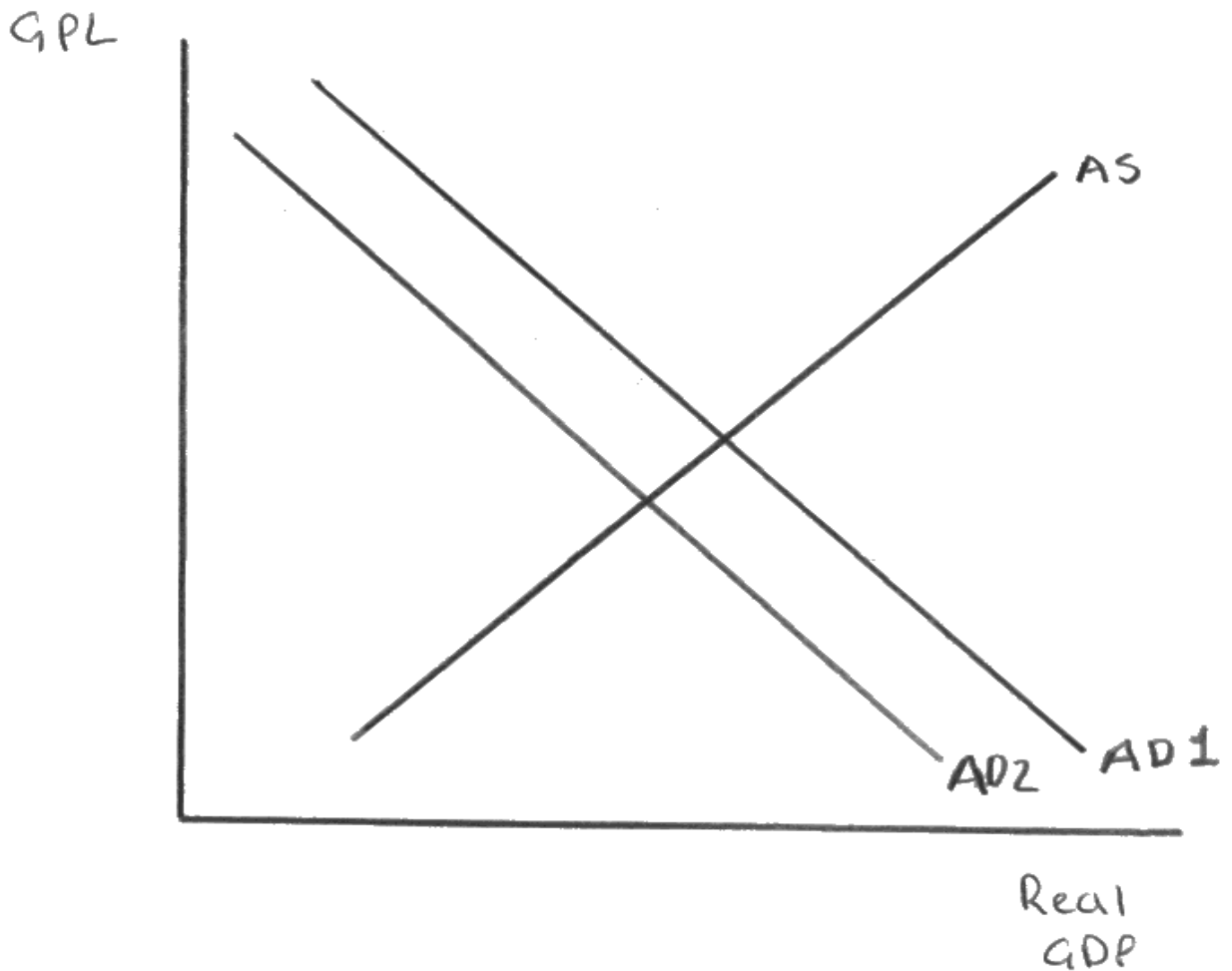
This diagram is correctly labelled. It also shows the shift in the correct direction and illustrates the impact on the price level and real output. Therefore this answer achieves full marks.



Draw diagrams clearly and large enough to be easy to interpret, like this answer.

(b) Draw an aggregate demand and aggregate supply diagram illustrating the likely impact of a rise in interest rates on the price level and real output.

(4)

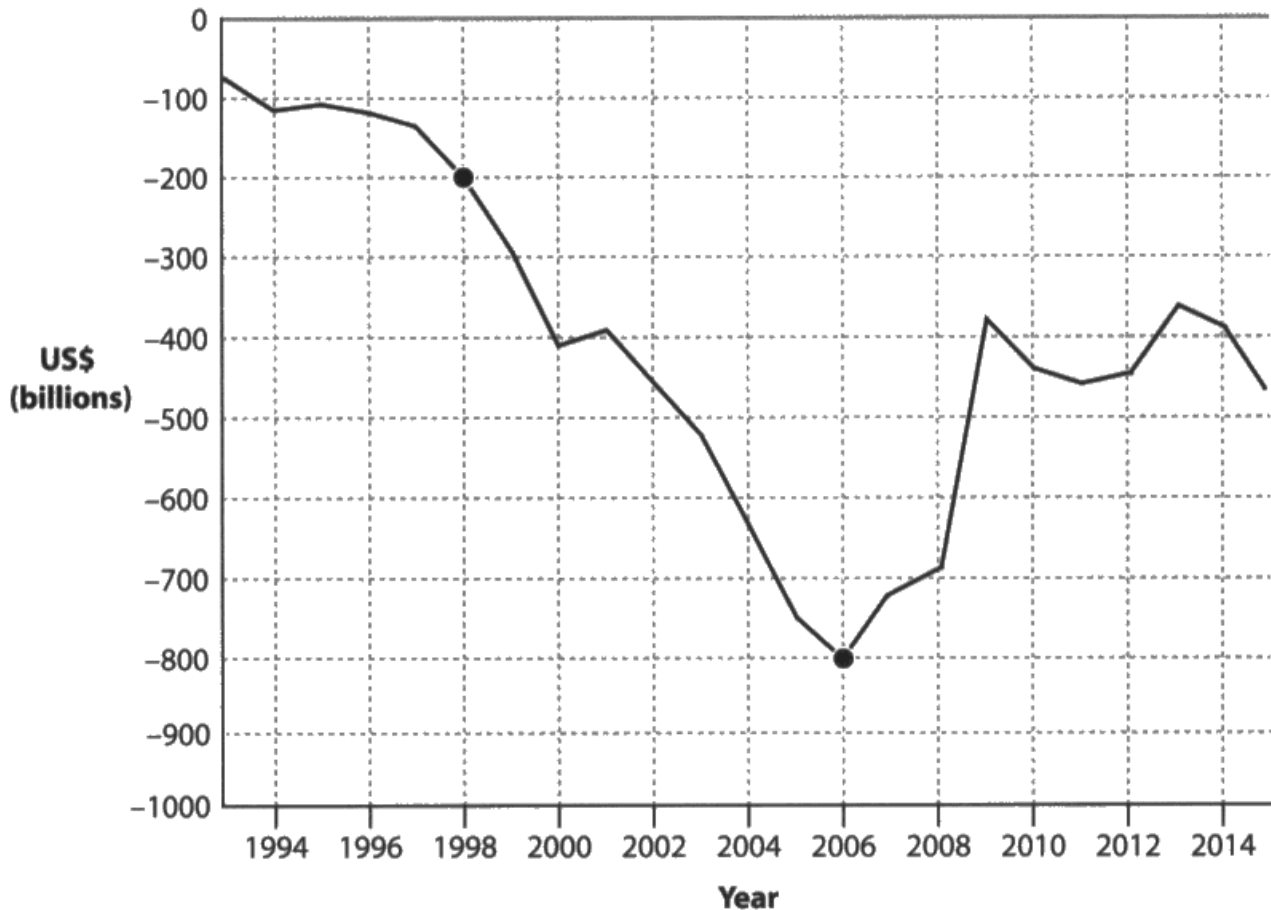


This answer has correct labels and the shift of AD is in the correct direction, but the candidate has not illustrated the change in price level or real output, and hence scores 3/4.

### Question 3 (a)

This question should be a standard calculation task. Candidates simply need to calculate the percentage change using the data provided. The main mistake candidates made was not correctly working out that the change in the current account from -200 to -800 is 600.

#### 3 United States current account of the balance of payments, 1993–2015



(Source: <http://data.worldbank.org/indicator/BN.CAB.XOKA.CD?end=2015&locations=US&start=1993>)

- (a) Calculate the percentage change in the United States current account deficit on the balance of payments between 1998 and 2006.

(2)

Initial deficit = ~~-200~~ - \$200 billion

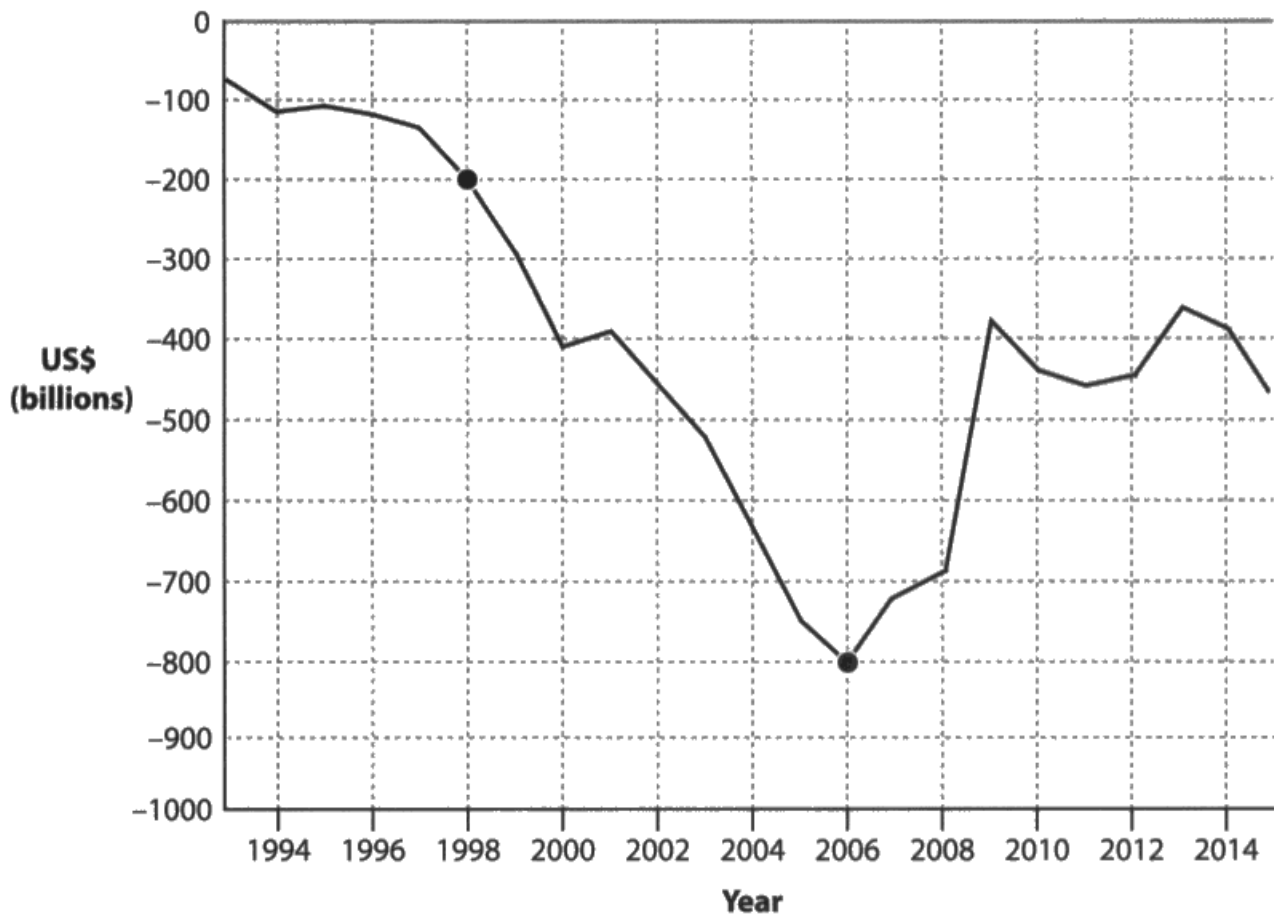
Change = \$600 billion

Change in current account deficit as a percentage = 300%



This candidate has the correct answer of 300% and hence achieves full marks.

### 3 United States current account of the balance of payments, 1993–2015



(Source: <http://data.worldbank.org/indicator/BN.CAB.XOKA.CD?end=2015&locations=US&start=1993>)

(a) Calculate the percentage change in the United States current account deficit on the balance of payments between 1998 and 2006.

(2)

$$1998 = -200 \text{ bn} \quad 2006 = -800 \text{ bn}$$

$$\frac{-800}{-200} \times 100 = 400\%$$



This answer achieves no marks as the candidate is not using the correct numbers in their formula.

### Question 3 (b)

This question is simply asking candidates to 'explain the term'. A short and concise answer can get the full marks and there is no need to do anything else such as application or analysis.

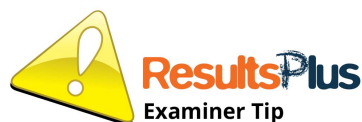
(b) Explain the term 'current account of the balance of payments'.

(2)

Current account of the balance of payments refers to ~~the~~ the difference between government spending and government revenue. If revenue is greater than spending, the government ~~is~~ has a current account surplus but if spending exceeds revenue the government is in debt, known as a deficit.



This answer achieves no marks as the candidate is incorrectly explaining the government budget rather than the current account.

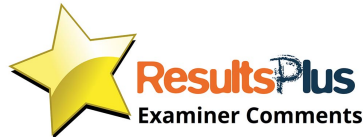


Candidates must remember that the word 'deficit' simply means something is a negative value. A current account deficit is a totally different thing to a budget deficit.

(b) Explain the term 'current account of the balance of payments'.

(2)

It includes net trade of imports, net trade of exports, primary income flows (money coming in ~~and~~ <sup>and</sup> out of the economy) and secondary income flows such as government transfers.



This answer correctly explains the term in terms of the four parts of the current account and therefore achieves full marks.

## Question 4 (a)

In this question there is one mark for knowledge and one for analysis. The knowledge mark comes from identifying 'one likely reason' and the analysis mark is for explaining/justifying that reason.

- 4 The UK has experienced a budget deficit since 2001. The government aimed to reach a budget surplus by 2019, but in 2016 this target was abandoned.

(Source: adapted from <https://www.gov.uk/government/news/autumn-statement-2016-some-of-the-things-weve-announced>)

(a) Explain **one** likely reason why the 2019 budget surplus target was abandoned.

(2)

A budget surplus occurs when the UK is exporting more than it is importing.

They may have abandoned the target as they realise it is not realistic as the UK is not ~~productive~~ competitive in goods, it is more service-based. Therefore, we need to be importing lots from other countries.



**ResultsPlus**  
Examiner Comments

This answer does not include a relevant reason and so achieves no marks.



**ResultsPlus**  
Examiner Tip

Remember the distinction between the government budget and the current account.

- 4 The UK has experienced a budget deficit since 2001. The government aimed to reach a budget surplus by 2019, but in 2016 this target was abandoned.

(Source: adapted from <https://www.gov.uk/government/news/autumn-statement-2016-some-of-the-things-weve-announced>)

- (a) Explain **one** likely reason why the 2019 budget surplus target was abandoned.

(2)

Economic growth was revised down due to lower than expected growth rates, currently being only 0.1% in Q1 of 2018. As a result ~~of~~ of low confidence as a result of BREXIT the economy must be further stimulated through expansionary policies pushing back the 2019 budget surplus target.



**ResultsPlus**  
Examiner Comments

This answer includes a relevant reason – Brexit and the resultant fall in confidence. The candidate has also explained their reason, discussing the resultant expansionary policies that would be needed as a result.

## Question 4 (b)

In this question the marks are split into one mark for knowledge and one for application. The knowledge mark is for explaining that the national debt would increase and the analysis mark is for explaining **why** it would increase.

(b) Explain the likely impact of abandoning the budget surplus target on the UK national debt.

(2)

Due to the UK abandoning the budget surplus their national debt will get bigger as they will still be in a budget deficit, so they'll have to finance their spending through government borrowing which will increase the debt national debt



**ResultsPlus**  
Examiner Comments

This answer achieves full marks. One mark for saying that the national debt will 'get bigger'. The second mark for explaining that the government will have to 'finance their spending' etc.



**ResultsPlus**  
Examiner Tip

Ensure you read the question carefully. Here the question is specifically asking what the impact will be **on the UK national debt**, not the economy in general.

(b) Explain the likely impact of abandoning the budget surplus target on the UK national debt.

(2)

Through abandoning the budget surplus target national debt is likely to grow, currently standing at ~~over~~ <sup>around</sup> £2 trillion and could 60% of GDP (3.2 trillion). ~~As~~ will lead to



This answer achieves one mark for saying that 'national debt is likely to grow' but there is no analysis here to explain **why** it will grow.

## Question 5 (a)

There are two marks for this question, one for knowledge and one for identifying a likely reason. The second analysis mark is for linked development – justifying the reason.

### 5 UK total bank lending to individuals, percentage change on previous year

2014	2.5%
2015	3.2%
2016	4.0%

(Source: Bank of England 2017)

(a) Explain **one** likely reason why consumer demand for bank loans has increased.

(2)

If ~~the~~ interest rates decrease, the cost of borrowing reduces so consumers are more likely going to demand bank loans to spend. This explains why total bank lending increased from 2.5% to 4% in 2014 to 2016.



This answer achieves full marks – one knowledge mark for interest rates decrease. Then the analysis mark for the rest of this sentence in the candidate's answer.



5 UK total bank lending to individuals, percentage change on previous year

2014	2.5%
2015	3.2%
2016	4.0%

(Source: Bank of England 2017)

(a) Explain **one** likely reason why consumer demand for bank loans has increased.

(2)

Individuals had increased confidence as the UK economy recovered from the credit crunch, a period where the economy had at least one quarter of negative growth and, until figures were revised so the next following quarter was actually positive, was technically in recession.



**ResultsPlus**  
Examiner Comments

This answer achieves one mark for 'increased confidence'. However the rest of the answer doesn't explain why increased confidence would lead to an increase in demand for bank loans.



**ResultsPlus**  
Examiner Tip

When you are asked to explain a reason, make sure you not only identify your reason but that you then go on to justify that reason.

## Question 5 (c)

This answer is actually very straightforward but it seems that many candidates did not correctly understand the data they had been presented with before starting to answer the question. The data is already presented as percentage change, as it says clearly in the title. Therefore candidates simply needed to add 4 to 100 to get the answer of 104.

- (c) Calculate the index number for the total value of bank lending in 2016 using 2015 as a base year.

(2)

$$2015 = 100 \text{ (3.2\%)}$$

$$2016 = 1125 \text{ (4.9\%)}$$

$$\frac{100}{3.2} = 31.25 \times 0.8 = 25$$



**ResultsPlus**  
Examiner Comments

This answer achieves 1 mark for 2015=100, since this shows the candidate has some understanding of index numbers and base years.

- (c) Calculate the index number for the total value of bank lending in 2016 using 2015 as a base year.

(2)

$$100 \times 1.04$$

$$= 104$$



This candidate has the correct answer of 104 and as such achieves the full two marks.



Ensure you understand what index numbers are and that you can calculate them.

## Question 6 (a)

In this answer there are two marks for knowledge, two for application, and one for analysis. Candidates were generally better at explaining absolute poverty than relative poverty. Many candidates achieved 4/5 as they did not offer anything that earned the analysis mark.

(a) With reference to the information provided, explain the distinction between absolute poverty and relative poverty.

(5)

Absolute poverty is defined as individuals who do not have enough money/income for the basic needs e.g. food, water and shelter. It is said that people living on less than \$1.90 a day 2011 PPP - as stated in figure 1 are in absolute poverty. This figure has since risen to >\$2 per day.

Relative poverty occurs when individuals have very low incomes in comparison to other people. It is said that people who earn 20% (or more) less than the average wage rate are in relative poverty. Extract A states that "a billion people have been taken out of absolute poverty, but relative poverty remains a problem".

The distinction is that in absolute poverty an individual does not have the required funds to live and afford basic needs but in relative poverty you do, you simply have less than average but enough to survive.



This answer achieves a total of 4/5. In the first paragraph the candidate gains one knowledge mark for defining absolute poverty and two application marks for \$1.90 a day at PPP. In the second paragraph they explain the idea of relative poverty.

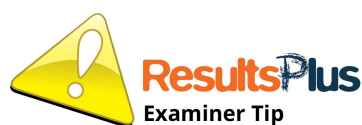
- (a) With reference to the information provided, explain the distinction between absolute poverty and relative poverty.

(5)

Absolute poverty is the inability to have/purchase basic needs such as food, water and shelter, whereas relative poverty relates to the inability to afford what is considered essential in their region, such as a mobile phone or a computer. "In emerging economies, billions of people have been taken out of absolute poverty" however relative poverty is "remains a problem" as the requirements for living in relative poverty are higher.



This answer achieves a total of two marks. One mark for a definition of absolute poverty and one mark for application. The relative poverty definition is not correct.



Ensure you know accurate definitions of key terms from the specification.

## **Question 6 (b)**

With the 'examine' question, the marks are allocated evenly across all four categories – so two marks for each of knowledge, application, analysis, and evaluation. The question specifically asks for **two** factors. Therefore, candidates need to ensure they have discussed two factors in their answer. The other thing that candidates need to remember is that there are two marks for evaluation here – many answers were well-written but without evaluation they are limited to 6/8.

(b) With reference to the information provided and your own knowledge, examine **two** factors that might explain the differing rates of decline in absolute poverty in East Asia and Sub-Saharan Africa.

(8)

- One factor may be the opening of economies in East Asia and the cutting of tariffs.

- Closed economies are ones who are self-reliant and choose to depend solely on themselves, with the absence of trading.

- However, increasing the amount of trade in East Asia allows the country to access a larger variety of goods and services which increases the level of utility in the economy and increases the standard of living. This leads to an increase in consumption which increases aggregate demand and accelerates economic growth.

- However, there may be a time lag involved as trade protectionism is a lengthy process if it involves changing laws and it may be difficult to build up relationships and negotiate with other countries.

- Another factor may be its climate. Sub-Saharan Africa has a much hotter climate, making its conditions for growing crops very narrow and restricted. If it decides to import or export these goods, it will have difficulty due to it being a very LANDLOCKED AREA. This results in high

transportation costs which leads to a decrease in the level of trade which lowers the country's level of globalisation.

This leads to a decrease in Sub-Saharan Africa's investment level, which prohibits economic growth.

However, developing technology has increased the efficiency of transportation and managed to lower its costs.



This is an excellent answer to this question. Two distinct policies are discussed – opening up to trade and the landlocked state of many Sub-Saharan African countries. Both policies are also evaluated effectively.



Remember the allocation of marks for these 8-mark 'examine' questions will be consistent – 2 marks for each of knowledge, application, analysis, and evaluation.



(b) With reference to the information provided and your own knowledge, examine **two** factors that might explain the differing rates of decline in absolute poverty in East Asia and Sub-Saharan Africa.

(8)

In East Asia ~~relate~~ the proportion of people living in absolute poverty has fallen by around 60% to 3% ~~in~~ since 1990 but only by around 10% to 50% in Sub-Saharan Africa.

One reason for the difference maybe the huge growth that East Asia has seen in the past 20 years in part due to massive growth in its export market for manufactured goods such as clothing and electronics. By ~~are~~ growing in these areas East Asia have been able to export way more than they import in all sectors. For example the company Samsung produce and export ~~many~~ billions of dollars worth of goods from East Asia creating jobs which have lifted people out of poverty. ~~Africa~~ Sub-Saharan Africa however have specialised / depended on primary products such as food which have an inelastic ~~elastic~~ PED. This means as people get better off they don't demand ~~as~~

Proportionally more as they do manufactured goods so Sub-Saharan Africa have seen a worsening in their terms of trade so have to export more to maintain same standard of living so hasn't reduced <sup>absolute</sup> poverty as much.

2) Africa has also suffered from civil war which means many working age men have been killed. This means fewer people working so lower GDP per capita so lower standard of living and more people living in absolute poverty.



**ResultsPlus**  
Examiner Comments

This is a good answer to this question which has clear application as well as two points that have both been analysed. Unfortunately, there is no evaluation so the highest mark they can get is 6/8.



**ResultsPlus**  
Examiner Tip

Remember there are two marks available for evaluation on this question.

## Question 6 (c)

The focus of this question is on **policies** to reduce the negative effects of globalisation. Successful candidates focused on this aspect of the question and analysed and evaluated specific policies. They also related the policy specifically to the negative effects of globalisation. Some candidates spent too long discussing what the negative effects of globalisation were, rather than policies to solve them. Other weaker answers failed to be specific when talking about policies.

(c) With reference to Extract A, discuss **two** macroeconomic policies, apart from protectionism, that a government could use to reduce the negative effects of globalisation.

(12)

Globalisation is defined as when countries are more interdependent on each other through goods and services.

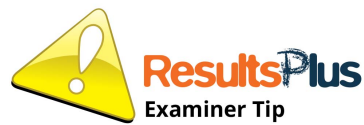
One policy would be protectionism of the environment.

Since there is an increase in trade a lot more raw materials will be used and things such as fuels in boats, <sup>Planes</sup> ~~ships~~ will damage the environment.

Globalisation has caused low wages and insecure employment in other countries due to multi national companies as there is a lot more alternatives for businesses to go. The government could try and help these in increase employment by giving workers a certain wage and providing more stability for them to work in. However if this occurs the firms could move elsewhere and pay for cheaper labor to lower cost of production which would reduce its economic growth as well as employment which could make them worse off for it.



This answer has only limited relevance to the question as the candidate fails to focus on analysing and evaluating any specific policies. They mention protection of the environment and wages but don't clearly offer specific policies to answer the question. As such this answer scores only 4/12.



Make sure you read the question carefully and understand what the key words in it are – **policies** being key in this case.

(c) With reference to Extract A, discuss **two** macroeconomic policies, apart from protectionism, that a government could use to reduce the negative effects of globalisation.

(12)

As Extract A mentions, creating an efficient welfare system may be one way of reducing negative effects of globalisation.

By creating a welfare system negative effects such as low wages and insecure employment are offset. This is because people of low wages will be able to receive welfare payments to increase their overall wealth which they can use to buy more essential goods such as food or towards housing. Also, insecure employment will be helped as people who lose their jobs will be able to claim welfare payments to spend on essentials which will safeguard them from income poverty. The welfare payments may be beneficial as they will be spent in the economy contributing to growth.

However, high levels of welfare payments likely lead to a high government <sup>budget</sup> deficit as tax revenue may not be enough. Also, poor efficiency and corruption in developing nations will lead to failure of the system.

Also, to reduce the negative effects, governments could introduce minimum wages ~~for~~ to curtail low wages. By doing this companies that are investing will have

to pay workers are at a wage rate that is enough to give to workers decent purchasing power and to buy essential; e.g. living wage. This will cause observable poverty and stop exploitation of cheap labour and outsource also towards the economy and higher wages lead to more disposable income, leading to more consumer spending, an increase in aggregate demand and GDP growth.

However, this could risk capital flight and investors may move to a neighbouring country where labour costs are lower and there are no minimum wage laws. This could lead to no wage instead of low wages.



**ResultsPlus**  
Examiner Comments

This is a good answer to this question that suggests two relevant policies – welfare payments and minimum wages. The candidate is a bit confused between income and wealth and it is not a perfect answer, but it does achieve a mark of 9/12 in total.

## Question 6 (d)

Answers to this question were generally quick to grasp what the question was about. Weaker answers focused on explaining how inequality is measured or ways to solve it rather than whether it is 'desirable' or not. Stronger answers effectively presented both sides of the argument e.g. focusing on incentivising people to work harder through the possibility of higher wages and as an evaluation the risk of disincentivisation if the gap gets too great.

(d) Assess the view that 'some level of inequality is desirable to maintain an appropriate incentive structure in the economy' (Extract B, lines 19 and 20).

(10)

- Inequality is the level of distribution of income across an economy, measured by the Gini Coefficient.
- Extract B claims that among the estimated 780 million illiterate adults worldwide, two thirds are women.
- This leads to the argument that this kind of shocking statistic will encourage people worldwide to commit to a (corporate) social responsibility and help to improve the standard of living for the <sup>ECONOMY/</sup>world.
- This proportion will encourage members living in more economically developed countries to take advantage of the privileges and education they receive and act as inspiration to alleviate this problem.
- However, this may not be the case if people and firms face different career objectives for their lives and futures. For example, some people may be more profit-incentivised and focused on financial gain as opposed to corporate social responsibility. It also depends upon how well known these statistics are, as it may be certain people in the economy are facing asymmetric information.
- Another argument for the view of incentives is that inequality in an economy encourages competition.

All firms and consumers in an economy will have the incentive of being at the top of the income inequality range. This leads to firms being pressured into keeping costs low and improving their efficiency and charging low prices. This competition provides the incentive for people and firms to earn the highest level of profit they can relative to others which otherwise, may not exist.

Populations will also be encouraged to get the best grades out of their education etc. in order to access the highest-tier careers. If everyone in the economy had the same standard of career and wage, there would be no motivation or point.

However, it is difficult to obtain an 'optimum' level of inequality as it is a difficult thing to quantify and measure. Firms may also fail to keep costs and prices low, should they be in competition with much larger firms should they not be interested in income equality.





This answer has only limited relevance to the question. The candidate might have written a lot and it is loosely related to the topic of inequality, but it fails to address the key focus of the question. As such it only achieves a score of 3/10.



It is important to focus on the quality of your answer and ensure it is answering the question, rather than trying to write down everything you know about a particular topic.

(d) Assess the view that 'some level of inequality is desirable to maintain an appropriate incentive structure in the economy' (Extract B, lines 19 and 20).

(10)

I agree to some extent with this statement. An incentive to better yourself is one reason why people work hard at their education and go after jobs which may be harder and more demanding but pay better wages.

If all jobs paid the same for example or everyone received a basic income as some people propose and has been tried in Sweden then this ~~case~~ could cause a disincentive to strive for better paying jobs which are of greater value to society.

For example if teachers and doctors were paid the same as people who stack shelves at super markets some may decide to chase the easier job at the super market. This could be bad for the economy as there would be an even greater shortage of people entering teaching and medical professions.

A shortage in supply of these professions would reduce the quality of

labour in the economy which is an important factor of production so there would be a reduced long run aggregate supply in general. This would mean lower economic growth and lower GDP per capita meaning worse standard of living for all residents.

However it may be argued that it is unfair to allow people to be poor just because they chose not to or cannot get a better paying job. Particularly people who due to illness or health disabilities cannot access better paying jobs should be given benefits even though this reduces inequality and potentially the incentive structure as was ~~made~~<sup>quoted</sup> clear by the governor of the Bank of England. There is a balance that must be kept between fairness and maintaining the incentive for economic growth.



This is a clear and well-written answer to the question which addresses the key elements of it, especially on the KAA side, for example looking at different jobs and their differing pay rates. The evaluation is, unfortunately, a little bit on the brief side. Overall this is a very good answer and it achieves 8/10 in total.

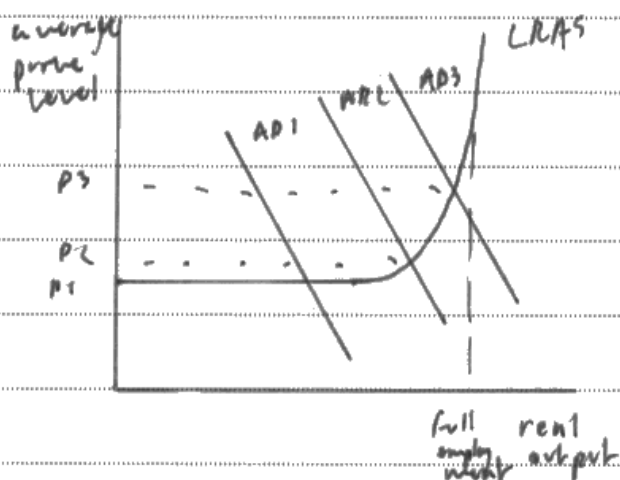
### **Question 6 (e)**

This was a nice open question which allowed candidates to bring in a wide range of issues or institutions when discussing the role of the financial markets. Many candidates discussed the 'traditional' role of banks in terms of savings and loans, with better candidates relating this to the Harrod-Domar model. Microfinance was also discussed by many candidates including the role of central banks in using monetary policy as well as international institutions such as the IMF. The main thing that held some candidates back was that they forgot this question was asking specifically about financial markets and started to answer just in terms of general development issues such as primary product dependency.

(e) Discuss the role of the financial sector in the growth and development of developing countries.

(15)

Firstly, the financial sector provides developing economies with a platform for people to save their money and therefore for firms to be able to draw from people's savings and increase their investment levels. Indeed, without banks, there would not be a loanable funds market for firms to borrow and increase investment levels. As firms borrow and invest into new capital, they can reduce their unit production costs, become more productive and increase profit margins. The increase in investment will shift the AD to the right as it is a part of the AD equation and an injection in the circular flow of income, and depending on the size of the accelerator and multiplier, it will lead to subsequent rounds of growth.



However, depending on the size of the negative output gap, this could lead to inflationary pressures. For instance, the UK has a low 4.5% unemployment rate, so this would create AD demand pull inflation as the economy already operates on the relatively flat part of the LRAS. But this is a developed country, and Zimbabwe has a 80% unemployment rate, so this means it has a huge negative output gap and will not cause inflation.

Secondly, financial sector can help them to develop. Indeed, financial services mean that a country can enter the foreign exchange market and import goods from other countries through either buying some foreign currency. This will lead to development as developing countries will <sup>import</sup> capital goods necessary for development.



**ResultsPlus**  
Examiner Comments

This is a well-written answer to this question, particularly in terms of the KAA where there are two good points. The first one focuses on the role of banks in terms of savings and investment and the second on foreign exchange. These are also evaluated, although this isn't quite as good as the KAA points. Therefore, overall this answer achieves Level 3 KAA and Level 2 evaluation.



Focus on quality rather than quantity. This answer is less than two pages in total yet still achieves very highly.

(e) Discuss the role of the financial sector in the growth and development of developing countries.

(15)

The ~~financial~~ financial sector can assist developing countries by offering financial support to aid growth.

~~The most obvious example of this is the aid offered by various financial institutions~~

An example of this is the HIPC initiative offered to countries struggling to repay excessive debt. This method of debt forgiveness was ordained by the World Bank, and allowed developing countries reduced debt repayments to ease the financial burden and promote growth.

However, this method is only offered to the countries struggling most extremely, ~~and this~~ ~~means that it is only for a few~~ which means that the majority of other struggling countries are left with the burden of debt.

Aid can instead be offered to countries in order to reduce poverty, increase spending and promote growth. This is particularly useful after an economic shock. However, aid usually does not stem from the financial sector and instead



flow from country to country (bilateral aid) or through third party organisation (multilateral aid).

However, aid may be unsuccessful when tied aid is used. Tied aid is aid that has conditions attached. This can result in developing countries becoming trapped by their aid-giver and be forced to buy their goods or adopt certain political systems.

Another ~~great~~ strategy to promote growth and development is the use of microfinance schemes.

Extract B states that nearly two thirds of 780 million illiterate adults are women. Microfinance schemes are set up to support the most disadvantaged groups in society. Microfinance schemes offer small sums of money to the smallest businesses in a developing country, and this investment results in profitable businesses, aiding the country's growth.

However, microfinance schemes are risky and small scale - therefore may not be sufficient in aiding growth of an entire country.

Larger investments however can be extremely

beneficial to the growth of an economy. The Harrod-Domar model connects investment to capital accumulation to increases in GDP. Further, the accelerator theory describes how investment ~~results~~ results in more than proportional GDP increases, due to the accelerator coefficient.

~~Changes~~ Changes to an exchange rate of a country can also stimulate growth, since depreciation of an exchange rate makes exports more internationally competitive, and improves the trade balance, which is a component of AD. The MPC controls inflation rates and therefore can have a large ~~to be argued that governments play~~ impact on the growth of countries.



This answer discusses the HIPC initiative and microfinance, although it does not explain them as well as the previous answer. The answer explains what microfinance schemes are but doesn't really explain how they are related to growth and development. It also discusses aid, although this is not relevant to the question. Overall this answer achieves Level 2 for KAA and Level 1 for evaluation.

## **Question 7**

The key word in this question is **effects**. Candidates are asked to evaluate these, NOT to discuss whether the £23 billion of spending is a good idea or not. This was the main issue for candidates when answering this question – not answering the question they had been set. What was required for success in this question was effects for KAA – these could be either positive or negative. For evaluation candidates should have been critiquing these effects and whether they are significant or not e.g. discussing whether £23 billion is a lot of money or not. Having said that, there were a lot of good answers to this question and candidates generally found it accessible and frequently referred to the effect on aggregate demand and/or aggregate supply of this government spending.

**SECTION C**

multiple ← ↑G ↑AD  
 ↑I  
 ↓C & AD  
 ↓C & AD  
 infrastructure  
 ↓ PL

Answer ONE question from this section.

Write your answer in the spaces provided.

You are advised to spend 30 minutes on this section.

**EITHER**

7 In 2016 the UK Chancellor of the Exchequer announced that the government would spend an extra £23 billion on innovation and infrastructure over the following five years.

Evaluate the likely economic effects of this planned increase in government expenditure.

(Total for Question 7 = 25 marks)

**OR**

8 The British pound fell by over 10% to a 30-year low against the US dollar after the UK voted to leave the European Union.

To what extent will this depreciation impact on future economic growth in the UK?

(Total for Question 8 = 25 marks)

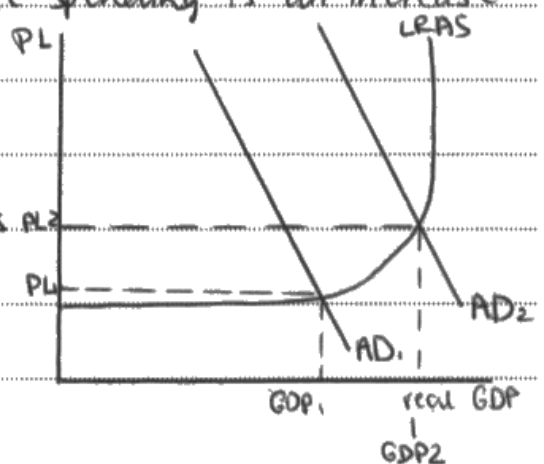
Indicate which question you are answering by marking a cross in the box ☒. If you change your mind, put a line through the box ☒ and then indicate your new question with a cross ☒.

Chosen question number: Question 7 ☒ Question 8 ☒

Write your answer here:

An injection into the economy, such as the planned increase in government spending of £23 billion, may have numerous positive and negative impacts on the UK economy.

One likely economic effect of the spending is an increase in aggregate demand. As government spending is a component of AD, an increase would cause a shift outwards of the AD curve from AD<sub>1</sub> to AD<sub>2</sub>. Thus, real GDP would also

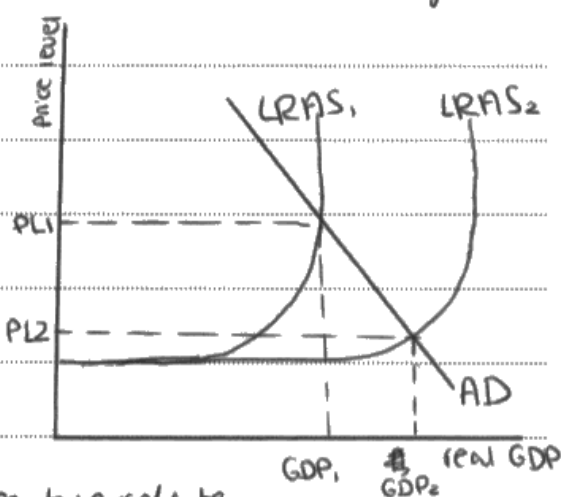


increase, from  $GDP_1$  to  $GDP_2$ , as shown on the diagram. Therefore, an impact of the planned increase in government spending is an increase in output and aggregate demand.

However, as AD shifts outwards, the price level in the economy increases from  $PL_1$  to  $PL_2$ , showing an increase in inflation. This could negatively impact the economy, particularly for people on fixed incomes such as pensioners. Furthermore, if wages do not increase at the same rate, real wages will fall, causing an increase in the cost of living.

Another economic effect of the planned increase in government expenditure is an increase in

~~the~~ long run aggregate supply. An increase in spending on innovation and infrastructure in the economy would likely reduce the cost of production for all firms at different



price levels. Thus LRAS<sub>1</sub> shifts outwards to LRAS<sub>2</sub>, causing an increase in GDP from  $GDP_1$  to  $GDP_2$ . Furthermore, a shift in LRAS causes a fall in the price level, which could benefit workers on fixed wages as the cost of living reduces, as long as disinflation is controlled.

However, a negative economic impact due to investment in innovation is ~~an~~ unemployment. For example, if the £23 billion, or part of it, was spent on producing capital machinery that is more ~~or~~ productive than

human labour at certain jobs, production costs would reduce for firms if they were to use <sup>the</sup> machinery, and thus cause structural unemployment in these industries. This would also have the knock-on effect of reduced consumption in the economy due to lower incomes, and the need ~~is~~ for the government to spend further money on retraining workers who are consequently occupationally immobile. Thus, due to the nature of the spending, unemployment may occur, carrying secondary negative impacts on the economy with it.

Another economic effect of this government spending is an improvement in the current account on the balance of payments. Improved infrastructure would reduce production costs for firms in a variety of industries, thus ~~not~~ allowing them to reduce their prices and become more internationally competitive. This would likely increase exports relative to imports, which, in addition to increasing aggregate demand, would improve the current account deficit that the UK has had for over 20 years.

However, the extent to which this is beneficial may be dependent on other factors, influencing competitiveness, such as the exchange rate. If the country was particularly uncompetitive in producing a certain good to begin with, improved infrastructure may not be enough to reduce prices ~~an~~ enough.

to increase foreign demand.

To conclude, there are ~~many~~ many positive economic ~~impacts~~ <sup>effects</sup> to be reaped from this injection into the circular flow of income, ~~as~~ the impact of which would be ~~also~~ enhanced by the multiplier.

However, there are also ~~also~~ unintended consequences associated with these impacts, which may do more damage than good.



This is a good, solid answer to the question which presents clear effects on the economy of the increase in government expenditure and does an equally good job of evaluating them. Overall this answer achieves top Level 3 for KAA and top Level 2 for evaluation. It is just slightly lacking the depth and context to reach the very top levels but nonetheless is a good answer.

SECTION C

Answer ONE question from this section.

Write your answer in the spaces provided.

You are advised to spend 30 minutes on this section.

increase in firms  
capital flight?

monopolies?

new markets

pollution / noise  
unproductivity

EITHER

7 In 2016 the UK Chancellor of the Exchequer announced that the government would spend an extra £23 billion on innovation and infrastructure over the following five years.

Evaluate the likely economic effects of this planned increase in government expenditure.

transport, roads, competitive, productivity  
schools

(Total for Question 7 = 25 marks)

OR

8 The British pound fell by over 10% to a 30-year low against the US dollar after the UK voted to leave the European Union.

To what extent will this depreciation impact on future economic growth in the UK?

(Total for Question 8 = 25 marks)

Indicate which question you are answering by marking a cross . If you change your mind, put a line through the box  and then indicate your new question with a cross .

Chosen question number: Question 7  Question 8

Write your answer here:

Evaluate the likely economic effects of this planned increase in government expenditure

Infrastructure is the transport, buildings, roads and general services in a country, most infrastructure is either paid for by the government - as it is a non-excludable good and so private firms cannot make money off of it - or is subsidised



subsidised by the government (rail companies). Innovation is known as new ideas and concepts. In 2016 it was announced that the government would spend an extra £23 billion on innovation and ~~transport~~ infrastructure over the next 5 years. This could affect the economy in many different ways, including:

An improvement in transport shows less barriers of trade, but also can bring production costs down to firms operating in the UK. This can then lead to higher profits which could result in more investment and so ~~therefore also~~ show economic growth in the economy. ~~This could also show as~~

However, an improvement in transport will not happen overnight and so ~~it~~ could negatively affect the economy for the short period of time that it takes to improve the transport. These negative effects could mean that workers have longer travels to work and so are more stressed, meaning that they are less productive. It could also increase

Congestion on the roads meaning that ~~the~~ transportation of goods and services will cost more over this time period, increasing costs and so decreasing profit whilst transport improves.

Another benefit from an improvement in infrastructure is that it could be said that schools are part of infrastructure, this then means that by improving schools we could see (in the long-run) an increase in productivity and economic growth which will improve the economy. However, the quality of schools can be hard to measure as it takes a long time and we have to question whether exams really measure the quality of the school or determined mind of the pupil? Also, it could be said that not everything taught in schools (e.g. relationships + general skills) are tested through exams ~~examining~~ questioning if we can ever fully measure the quality of schools?

~~Infrastructure is also seen~~  
The Chancellor of Exchequer announced

in 2016 that the government would spend an extra £23 billion on innovation and infrastructure. The ~~the~~ effect ~~of the~~ ~~economy~~ of the government spending extra money on innovation could be really beneficial to the economy. One benefit ~~is~~ from innovation could be that an increase in new ideas leads to an increase in new markets. ~~of which~~ These new ideas could ~~be~~ <sup>have</sup> huge demand and so could lead to big profits which would therefore increase the growth of the economy in the long-run.

The new infrastructure improvement could lead to firms in other countries moving to the UK to take advantage of the quick transportation of goods and services. This could be similar to Capital Flight which is where ~~firms~~ <sup>companies</sup> move <sup>money</sup> to the country with the best interest rates to take advantage of the extra savings. This could benefit the UK as it would mean that there are more companies paying more corporation tax. This then means that the government will

receive a higher tax revenue and so ~~it~~ it will benefit the economy through more government spending.

Overall, this increase in government expenditure will lead to huge benefits for the UK's economy in the long-run. However, it may be seen that the economy is stressed and may<sup>not</sup> be working at full productivity or efficiency in the short-run. So, this infrastructure and innovation improvement will overall help the economy but will mean that it may go through some short-term issues.



**ResultsPlus**  
Examiner Comments

This answer has many relevant effects of the UK government expenditure. However, this candidate has failed to develop their answers. Hence this answer fits squarely into the Level 2 description for KAA - 'a narrow response or superficial, two stage chains of reasoning only'. In terms of evaluation there is only a limited bit right at the end which achieves Level 1.



**ResultsPlus**  
Examiner Tip

Less is more. Focus on providing answers that are fully developed with as many chains of reasoning as possible. This will allow you to achieve much higher marks than simply writing down as many different points as you can think of.

## Question 8

This question was accessible to the vast majority of candidates. In particular most candidates picked up on the impact of a depreciation on both the current account and, consequently, on aggregate demand. Strong candidates drew an AD/AS diagram to clearly illustrate their point. Common evaluation points centred on the J-curve and the Marshall-Lerner condition, although some candidates were better able to explain the logic behind these than others. The best answers offered some context to their answers and moved beyond simply theoretical explanations to relate their answers to the current situation of the UK economy, e.g. record low unemployment or the uncertainties surrounding the Brexit negotiations.

### EITHER

- 7 In 2016 the UK Chancellor of the Exchequer announced that the government would spend an extra £23 billion on innovation and infrastructure over the following five years.

Evaluate the likely economic effects of this planned increase in government expenditure.

(Total for Question 7 = 25 marks)

### OR

Confidence investment  
WPIDEC

- 8 The British pound fell by over 10% to a 30-year low against the US dollar after the UK voted to leave the European Union.

To what extent will this depreciation impact on future economic growth in the UK?

(Total for Question 8 = 25 marks)

Indicate which question you are answering by marking a cross in the box . If you change your mind, put a line through the box  and then indicate your new question with a cross .

Chosen question number: Question 7  Question 8

Write your answer here:

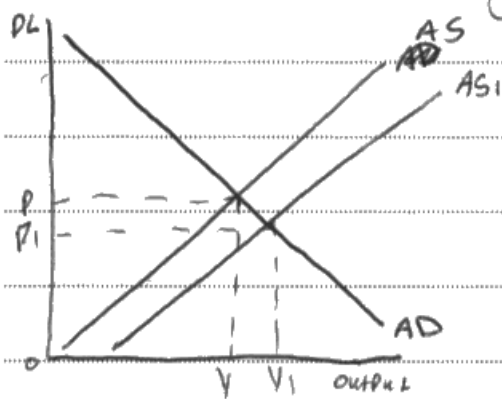
Depreciation is when the value of a currency decreases along the value of another currency.

Depreciation will cause the pound to be weak which will cause imports to be expensive and for exports to be cheap. Due to imports being expensive, less money will be leaving the UK economy as people will buy domestic goods.

As it's cheaper than importing goods. Exports being cheap allows for the UK to be more competitive and attract more demand for UK goods.

This means more money is coming into the UK and the economy can grow. GDP increases.

However some may say that exports being cheap won't help the economy as ~~the~~ other countries also have cheap exports. The UK also doesn't export much so economic growth won't increase as much.



← Exports are cheaper in price allowing for the UK to output more.

Depreciation will cause consumer confidence to go down. This is because Brexit has caused people to become unconfident and uncertain about the future of the UK economy. This then means that less people will be <sup>consuming goods/services</sup> buying and more people will be saving their money. This leads to less money flowing around the UK economy. This then leads to ~~the~~ demand for ~~the~~ domestic goods to decrease and ~~the~~ future economic growth to

decrease. However some may say that confidence can be increased through policies like lowering interest rates. This will encourage people to start spending and consuming again which will increase economic growth.

Depreciation will cause investment to decrease. This is because businesses are uncertain about the future of the economy, therefore they cannot afford to invest as they are not sure if they will get that money back. Lack of investment means that there is less innovation and this gives other countries a competitive advantage. Production costs in the UK ~~due~~ will be high due to a lack of investment in research and development, so no new ideas can be made. This means that UK firms will be performing badly compared to other country firms and will bring in less money to the UK economy. This leads to low economic growth in the future for the UK.

In conclusion, there are more negative effects on the UK's future economic growth due to depreciation. ~~These~~ Things like confidence plays a big part as if people are not confident in the economy, they will be less willing to buy and consume but instead save. However with the use of policies, trust ~~can~~ can be gained back and confidence can increase and the future of the UK's economic growth can look bright again. Also time plays a part as if confidence is ~~only~~ low for only a while, it can be increased much easier. But if confidence is low for a long time, uncertainty will continue to rise and economic growth in the future will decrease.



This answer largely fails to answer the question and therefore is unable to access many of the marks. The candidate has correctly identified the impact of a depreciation on demand for imports and exports. After that the answer drifts off and discusses Brexit, investment, and other issues. There is no logical link from a depreciation of the currency to these impacts so unfortunately the candidate is only going to achieve a low mark of low Level 2 for KAA and Level 1 for evaluation.





Always look back at the question whilst you are answering it. In the pressure of an exam, it's easy to forget the precise question asked and start going off in a different direction.

**EITHER**

7 In 2016 the UK Chancellor of the Exchequer announced that the government would spend an extra £23 billion on innovation and infrastructure over the following five years.

Evaluate the likely economic effects of this planned increase in government expenditure.

(Total for Question 7 = 25 marks)

**OR**

8 The British pound fell by over 10% to a 30-year low against the US dollar after the UK voted to leave the European Union.

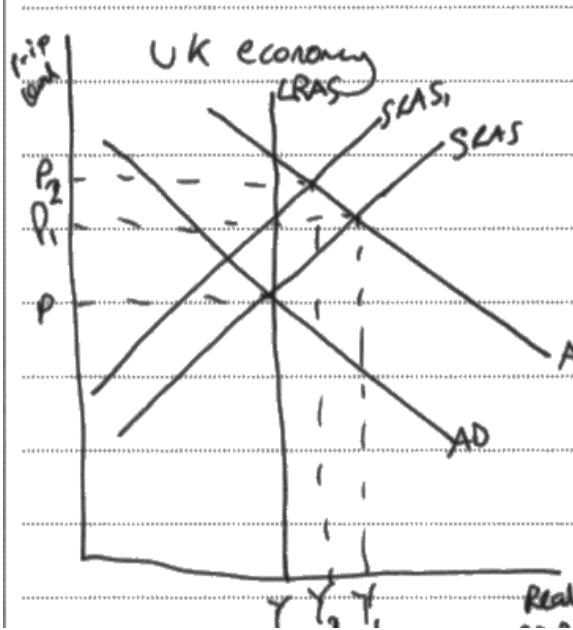
To what extent will this depreciation impact on future economic growth in the UK?

~~AD RS~~ ~~SR~~ → AD RS But SR  
 → 4.2% low spare capacity → +ve output gap US deval  
 → investment → accelerator → +ve  
 → multiplier → size of multiplier → low confidence  
 1.7 → multiplier  
 2.5% → multiplier  
 decisional  
 (Total for Question 8 = 25 marks)  
 length of Km → depends on...  
 Only LR but limited business confidence so limited.

Indicate which question you are answering by marking a cross in the box . If you change your mind, put a line through the box  and then indicate your new question with a cross .

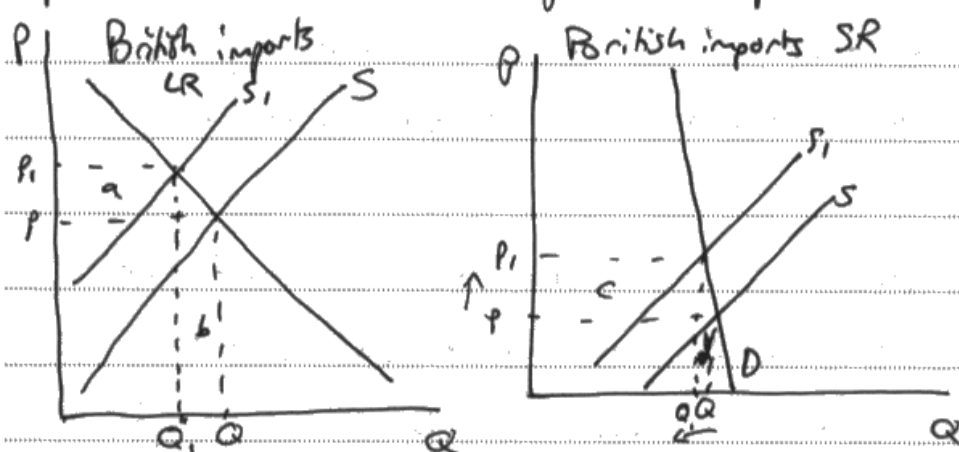
Chosen question number: Question 7  Question 8

Write your answer here:



A depreciation of the British pound against numerous exchange rates around the world will make imports to the UK more expensive, since if a pound buys fewer dollars the US imports for instance will require more pounds. Here, it is possible that British import value  $M$  will fall. Conversely, foreign

currency now buys more pounds, so each British export is cheaper to foreigners, therefore arguably foreign sales of British exports and export values rises (XP). Since  $AD = C + G + I + X - M$  and  $XP$  and  $M$  ↓, AD shifts right, leading to a new and higher real GDP of  $Y_1$ , hence economic growth has occurred. However, this analysis assumes that price of exports and imports is constant, which is not the case. Therefore it is important to consider PED of exports and imports.



In the short run, UK importers are likely to be bound by fixed contracts and therefore are unable to substitute to British produce as prices rise to  $P_1$ . Therefore PED is inelastic which causes an increase in import value of  $(c-d)$ . Only in the long run, where contracts can be broken can UK importers of for example beef decide to buy UK beef instead. So in the long run import value falls by  $(b-a)$ . ~~So~~ If MP in the SR then AD will shift left rather than right, moving growth rate down from the 1.7% current value.

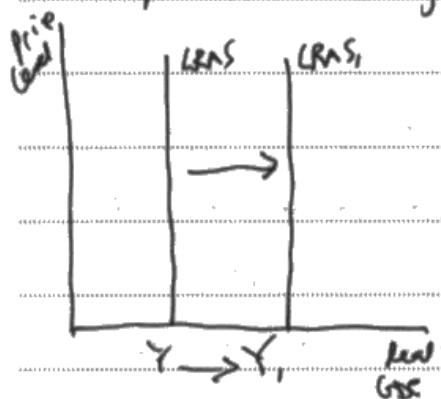
Additionally, since the UK GDP is now 80% in the tertiary sector, it is clearly very much dependent on foreign imports for production. ~~the UK~~ Therefore the rise in the price of imports from  $P$  to  $P_1$  is likely to raise costs of production for British firms, causing SRAS to shift left from SRAS to SRAS,

reducing the increase in GDP to  $Y_2 - Y$ . ~~But~~ equally

But there are also implications on the labour market for growth.

Inflation of  $P_2 - P$  will erode the real value of workers' incomes so trade unions may push for wage rises in order to preserve the purchasing power of members. Therefore, the costs of production faced by British firms rise even further which could shift SRAS left, further restricting growth increase. However this is likely to be a relatively insignificant rise. Trade union density in the UK has fallen from 52% in 1970 to 25% today, so bargaining power may be restricted due to the lower impact strikes would have on British firms.

But on the other hand, the rightward shift in AD is likely to contribute towards a positive multiplier effect. A rise in national income from  $Y$  to  $Y_1$ , may indicate increased demand for labour, since labour is a derived demand from demand for products. Therefore unemployment falls and wages rise, increasing purchasing power of consumers and also higher incomes mean higher income tax revenue for governments. Therefore GP and CP, pushing AD further right and causing a recurring growth pattern. However, following uncertainty of Brexit deal, workers are likely to have low confidence on their future employment prospects, so MPC is likely to be low, causing the multiplier,  $\frac{1}{1-MPC}$  to reduce. Therefore the gains to economic growth in the UK arising from the multiplier effect are likely to be limited.



Another important consideration is the effects on longer growth in the UK. The accelerator model can be given as  $I_{t+1} = a(Y_t - Y_{t-1})$ .

So the increase in the growth rate due to rightward AD suggests  $(Y_t - Y_{t-1}) \uparrow$  so  $I \uparrow$ .

This can be explained by the fact that businesses anticipate the higher growth rate to continue, so rising incomes and demand requires them to increase their capital stock to meet the extra demand. With more capital, the UK productive capacity will rise, pushing LRAS out to LRAS<sub>1</sub>, hence causing long run growth of  $Y_1 - Y_0$ .

The extent to which growth is sustained in the UK following the depreciation really depends on the quality of the Brexit deal gained. A good deal will restore confidence in the pound, raising its value and halting the gains the UK receives to its competitiveness and growth. However in the SR, increases in the productive capacity are likely to be weakened by <sup>low</sup> business confidence. Businesses are unsure what tariffs may arise following Brexit etc so this uncertainty reduces animal spirits in the British economy. So investment gains are likely to be limited and so most of the growth is likely to only be short run.



This is a high-quality answer to this question that achieves top levels on both KAA and evaluation. The candidate starts with an explanation of the impact on AD, via imports and exports. This is clearly explained both in words and a diagram. It is also convincingly evaluated regarding the elasticity of demand for imports and exports. The answer continues well, discussing in detail other impacts. What is also good here is the candidate has included some context in their answer, for example declining power of trade unions and the ongoing uncertainty in the UK's Brexit negotiations. This was used to particularly good effect at the end of the candidates' answer in their judgement.



Remember a judgement is expected to get the very top marks for evaluation on the 25-mark question.

## Paper Summary

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

- Ensure you manage your time effectively: it does say in the exam paper to spend 30 minutes on Section A, 1 hour on Section B, and 30 minutes on Section C. If candidates spend too long on Section A they are in danger of running out of time for the 15 and 25-mark questions at the end of the exam paper.
- Bearing this in mind, candidates can answer the paper in whichever order they see fit – some candidates may find it helpful in terms of time management to start with Section B or C instead of A.
- A multiple-choice question is worth one mark whereas questions 7 and 8 are worth 25 marks. Bear this in mind in terms of how long you are spending on individual questions – especially those in Section A.
- Ensure you can interpret statistical data and understand what it means, for example the difference between data presented as totals and that presented as percentage change.
- When drawing diagrams remember to ensure they are clear and have correct labels on both axes and lines.
- Be aware of all formulae and quantitative skills as explained in the Specification.
- Ensure you carefully study and understand the figures and extracts provided in Section B. These form the context for the questions, and answers should be related to this context and not be entirely theoretical.
- Remember to keep your answers within the space provided. If you run out of space you should ask for additional paper and clearly indicate which question you are writing about.
- It is indicated on the front of the exam paper that 'there may be more space than you need'. Do not feel obliged to fill up all the space just because it is there.
- There is no need to repeat the question back to the examiner – save yourself some time and get straight on with answering the question.
- Remember that in Section B the five and eight mark questions use a points-based mark scheme whereas the other questions use the levels mark schemes.
- Ensure you answer the precise question you have been set, for example in the essays if you have been asked to evaluate 'effects' make sure you do that.

## 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>

