Examiners' Report
June 2017

IAL Economics 2 WEC02 01

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Introduction

This was the ninth sitting of the International Advanced Level (IAL) Economics paper, Unit 2, relating to macroeconomic performance and policy.

The unit introduces the key measures of economic performance and the main objectives and instruments of economic policy in an international context. Candidates will learn how to use a basic AD/AS model to analyse changes in real output and the price level. Candidates will look at when demand and/or supply side policies may be appropriate ways of improving an economy's performance; consider these policies in a historical context; predict the possible impact of such policies and recognise the assumptions involved. Candidates should understand different approaches that may be used by policy makers to address macroeconomic problems and to identify criteria for success. The ceteris paribus assumption must be used when developing economic models.

As in previous series, the paper is split into 2 sections: Section A comprises of 8 supported multiple choice questions with a total of 32 marks. Section B has a choice of 2 data response questions with a total of 48 marks. The total available marks for this unit is 80.

There continues to be a marked division in performance between the candidates who had learned the theory, including precise definitions and accurate diagrams, and those who had more limited knowledge. This means some candidates struggled to achieve knowledge marks and were consequently less likely to be able to apply, analyse and evaluate to any extent.

In this series, slightly more candidates attempted Q9 (the economy of Mexico) than Q10 (the economy of Finland).

Question 1

This question was intended to examine the understanding of AD and factors likely to cause a decrease in the rate of inflation. It was generally answered well. Candidates who understood that consumption is a component of AD provided a diagram as part of their explanation. There also needed to be some explanation of how increased income tax rates may decrease consumption.

For 2 marks candidates should have drawn an AD/AS diagram (axes and curves labelled correctly) with a leftward shift of the AD curve. Only 1 mark was awarded if candidates had not labelled the diagram correctly or if the AS curve was also shifted.

The labels for a diagram were expected to show:

- Y-axis: Price Level/Average Price Level/CPI (Price on its own is incorrect).

- X-axis: Real Output (not quantity).

- SRAS curve labelled.

- AD curve labelled.

- Shifted AD curve labelled correctly.

- Changes in price level and real output labelled correctly (P and Y are the standard here).

It is possible to achieve full mark on this response without using a diagram. The following example illustrates this.

SECTION A

Answer ALL questions in this section.

You should spend 35 minutes on this section. Use the data to support your answers where relevant. You may annotate and include diagrams in your answers.

1   Which one of the following is an example of a fiscal policy measure that aims to reduce the rate of inflation?

(a) An increase in

(1)

    A interest rates

    B income tax rates

    C asset purchases by the central bank

    D government spending on pensions

Answer   B

(b) Explanation

(3)

A fiscal policy is a demand side policy which aims to influence economic activity and is implemented by the government. B is correct as an increase in income tax rates ~~used~~ e.g. income tax would leave consumers with less disposable income to spend leading to lower consumption and therefore a reduction in aggregate demand (AD). If AD decreases, the price level falls leading to a reduction in the rate of inflation. A is wrong as interest rates are an ~~ex~~ instrument of monetary policy, not fiscal.

ResultsPlus
Examiner Comments

This response achieves 2 marks for the explanation, linking income tax to disposable income and then to consumption as a component of AD and, in turn, to inflation.
There is then an additional mark for the rejection of Option A.

ResultsPlus
Examiner Tip

An accurate diagram can achieve 2 marks and can take less time than a written explanation. Be sure to follow the above guidelines for drawing and labelling the diagram. It is generally the case that you should try and reject at least one of the distractors to gain an extra mark. The response here shows how this can be done efficiently.

Question 2

This question was intended to test the understanding of nominal and real data. Overall, this question was generally well done. Stronger responses showed clear understanding and used the data to calculate the inflation rate in their explanation or rejection. A surprising number of candidates did not appear to understand the difference between nominal and real data and this could impact upon their use of data in Sections B. Candidates for this unit are expected to apply an understanding of definitions and to be able to achieve marks for the use of these in the supported multiple choice section.

This response provides a good example of how the use of data can be rewarded with marks. In this case, nominal and real income figures are provided. From these figures, it is possible to calculate the inflation rate to support the correct option.

2   In the United Kingdom, between the first quarter of 2010 and the final quarter of 2012, per capita nominal income increased by 2.0% and per capita real income decreased by 2.4%.

(a) From this information it can be deduced that, over this period, the

(1)

A rate of inflation was higher than the increase in nominal income

B economy experienced deflation

C rate of inflation was lower than the increase in nominal income

D level of real consumer spending increased

Answer   **BA**

(b) Explanation

(3)

Per capita nominal income is total income of the country divided by the population, an it is a nominal figure the effects of inflation have not been taken into account. The inflation rate in that year can be calculated using this, Per capital nominal income increase − Inflation rate = per capita nominal real income after change/increase/decrease. Using this

$$2\% - x = -2.4\%$$
$$x = 4.4\%$$

inflation was at 4.4% which is higher than nominal income per capita increase. Answer B is incorrect as had it experience deflation per capita real income increase would be positive

Question 3

This question was generally answered well. Most candidates were able to link business confidence to investment. There was a mark available for defining investment and many candidates achieved this mark.

The following is an example of a response that achieved full marks, although all of the marks were awarded for 3 rejections points, rather than for an explanation of the correct answer.

3   Between 2011 and 2014 investment in Ukraine decreased from 22% to 14% of real GDP.

(a) Which one of the following is the most likely cause of this decrease in investment?

(1)

     A Decrease in the rate of corporation tax

     B Increase in consumer spending

     C Decrease in interest rates

     D Decrease in business confidence

Answer   D

(b) Explanation

(3)

A is false, lower tax rates mean firms retain more revenue this would encourage investment.

B is false, an increase in consumer spending would grow the economy's most likely result in an increase in business confidence leading to higher levels of investment.

C is false, a decrease in interest rates encourages firms to borrow or spend profits instead of saving which makes investment more attractive.

Question 4

The next question was again answered quite well, with many candidates able to link a deficit on the current account with a net withdrawal from the circular flow of income. There was also a mark available for an accurate definition of balance of payments on the current account.

The following example achieves full marks for the explanation and for the rejection of Option A.

4 The table shows the balance of payments on current account as a percentage of GDP for Canada between 2011 and 2014.

Year	Balance of payments on current account (% of GDP)
2011	−2.6
2012	−3.2
2013	−2.9
2014	−2.0

(Source: http://data.worldbank.org/country/canada)

(a) From the data it can be deduced that in each year the balance of payments on current account led to

(1)

A   a net injection into the circular flow of income

B   a net withdrawal from the circular flow of income

C   an increase in aggregate demand

D   an increase in aggregate supply

Answer   B

(b) Explanation

(3)

A withdrawal is an outflow of income from the circular flow of income; for example – taxes, imports and savings. The current account balances in all years show a deficit – which means imports were greater than exports in each year. Therefore, more money flowed out of the circular flow of income rather than flowing in.

However, A is incorrect because if a net injection took place - exports will be higher than imports and the current accounts would have a surplus balance.

Question 5

This question was intended to test the understanding of GDP per capita data. Again, it was generally answered well with most candidates using the third column in the table for their calculations to support the correct answer. A correctly completed column, with the correct answer, achieved full marks. There was also a mark available for defining GDP per capita.

This is an example of a response where the written explanation is vague but the calculations used to support the correct answer are sufficiently accurate to be awarded full marks.

5   The table shows total GDP and population between 2009 and 2013 for Australia. (You should use the last column for your calculations.)

Year	Total GDP (US$ billion)	Population (Million)	GDP per capita (US$)
2009	1 055	21.3	49 500
2010	926	21.7	42 700
2011	1 141	22.0	51 800
2012	1 388	22.3	62 200
2013	1 534	22.7	67 600

(Source: http://www.tradingeconomics.com/australia/indicators)

(a) From the data it can be deduced that GDP per capita

(1)

A   increased between 2009 and 2010

B   was lowest in 2011

C   decreased between 2012 and 2013

D   was highest in 2013

Answer   D

(b) Explanation

(3)

~~GDP~~ Gross domestic product measures economic growth. GDP per capita measures the impact of people on average in a economy. GDPper capita can be found by dividing population from total GDP. A is wrong since in 2010 total GDP decreased and the population increased causing decreased GDP per capita.

Question 6

This question was intended to test the interpretation of data included in a chart as well as understanding of the CPI. It was not answered well, with the majority of candidates unable to interpret the index numbers.

The specification clearly states that candidates need to understand "the process of calculating the rate of inflation using the consumer price index". An understanding of this process would have enabled candidates to accurately interpret the CPI data presented.

The following example shows how it was possible to achieve full marks with an understanding of the CPI and interpretation of what changes in the index numbers signify. Most incorrect responses selected Option C, just seeing that the index number for 2012 is higher than for 2011. This may be the case; however, the CPI shows that inflation was up 3 points in 2011 but the index only increases by 0.9 in 2012.

6   The chart shows the Consumer Price Index (CPI) for Sweden between 2008 and 2014 (2010 = 100).

(Source: http://data.worldbank.org/country/sweden)
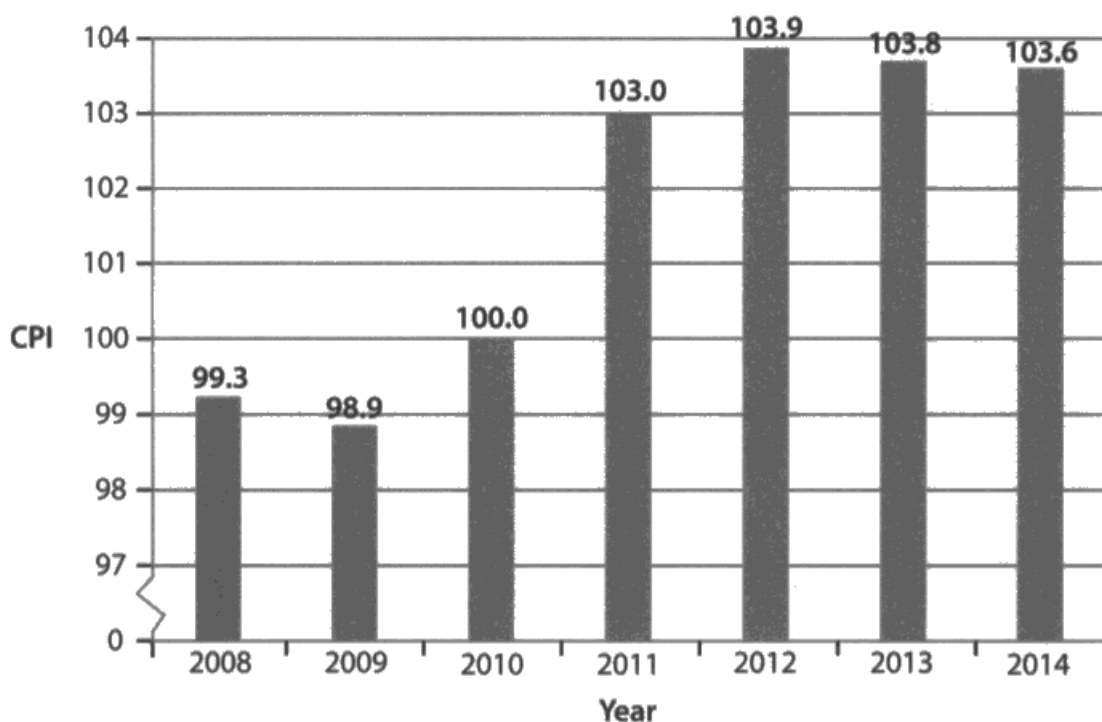
(a) From the data it can be deduced that

(1)

A   there was inflation in all years ✗

B   there was deflation in 2014 ✓

C   the rate of inflation was higher in 2012 than in 2011 ✓

D   there was disinflation in 2009 ✗

(b) Explanation

(3)

CPI is a weighted price index, measuring the change in prices of different goods and services.

The CPI decreased from 103.8 to 103.6 in 2014. The price level fell, so deflation occurred.

Option D is wrong as in 2009, deflation occurred, and not disinflation.

ResultsPlus
Examiner Comments

There is a mark awarded for the definition, the crucial term being "weighted" index. Then correct Option B is supported by the statement that the lower index in 2014 indicates deflation. There is then a correct rejection of Option D

ResultsPlus
Examiner Tip

Make sure that you understand how CPI is calculated and are able to interpret changes in index numbers accurately. This could also help with the use of data in Section B of the paper.

Question 7

This question was intended to test the understanding of the components of aggregate demand and was generally answered well. The *ceteris paribus* assumption was included to ensure that candidates understood that exports remained unchanged.

There were a number of ways in which full marks could be achieved for the explanation of the correct answer but, again, it is important to remember that it is a good idea to reject at least one of the other options.

7
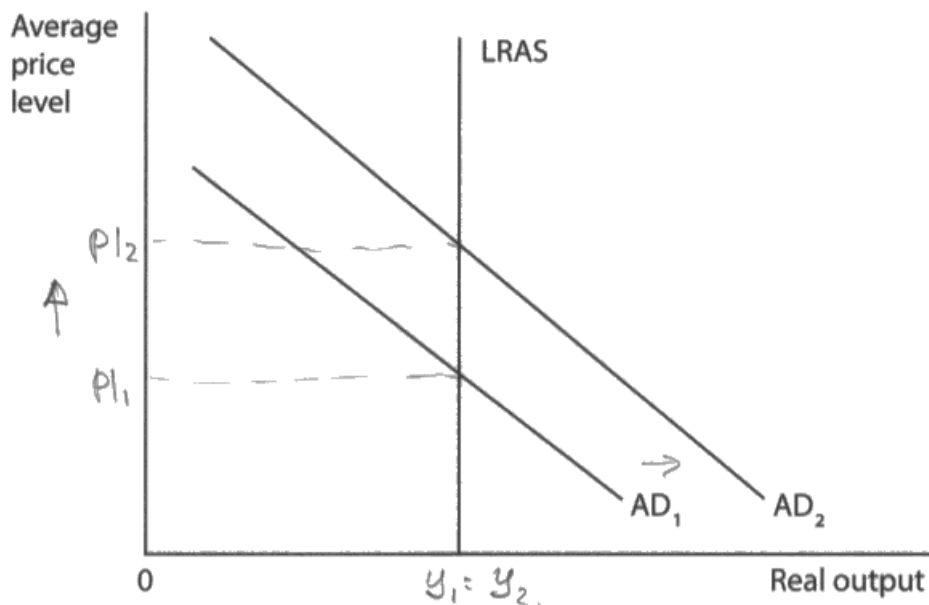
(a) Which one of the following, ceteris paribus, is most likely to cause the shift in the aggregate demand curve from AD_1 to AD_2, as shown in the diagram?

(1)

    A   Decrease in imports

    B   Decrease in investment   ✗

    C   Decrease in government spending   ✗

    D   An advance in production technology —

Answer   A

(b) Explanation

(3)

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

B is wrong because decrease in Investments will decrease AD as it is a part of AD formula.

C is wrong because decrease in government spending will decrease AD.

D is wrong because an 'advance in production technology will increase LRAS

ResultsPlus
Examiner Comments

One mark was awarded for the correct formula for AD. There were then two additional marks awarded for all of the rejection points (1 mark already having been achieved with the AD formula).

ResultsPlus
Examiner Tip

Understand how changes in AD components might impact upon real output and the average price level. Also, be able to distinguish between factors impacting upon SRAS and LRAS.

Question 8

The final supported multiple choice question was testing understanding of the multiplier and required a simple calculation. It was generally answered well.

The example shown illustrates how it was possible to achieve full marks with an accurate definition (formula) and calculation. No other material was required. Again, it shows how important it is to learn the formula, not just for knowledge marks but so that it can be used as the basis for simple calculations.

8   The UK Government is spending £1.5 billion building the 'London Gateway', a new deep water port. The final increase in GDP as a result of this investment is estimated to be £3.2 billion.

(a) In this case the value of the multiplier is expected to be

(1)

~~A~~ 0.4

~~B~~ 1.7

C   2.1

~~D~~ 4.7

Answer C

(b) Explanation

(3)

Multiplier = % Change in Real GDP / Change in injection

1.5 billion pounds is injection, and estimated GDP will be 3.2 billions so $\frac{3.2}{1.5} = 2.1$

ResultsPlus
Examiner Comments

The response was awarded a mark for a correct formula for multiplier and 2 marks for the correct calculation showing value of 2.1.

ResultsPlus
Examiner Tip

It is a good idea to learn any formula as presented in the specification, although alternatives will be accepted provided they are accurate.

Question 9 (a)

The case study presents a number of possible causes for increased consumer spending in Mexico. We were looking for the use of data to identify the reason, along with some development of explanation in context.

The use of data from the extracts is important as it allows not only for the identification of two reasons, it also provides a context for application and analysis.

(a) With reference to Extracts 1 and 2, analyse **two** possible reasons for the increase in consumer spending in Mexico in 2015.

(6)

One possible cause for the increase in consumer spending is 'low interest rates' (extract 2). Lower interest rates mean consumers have less return on savings therefore reducing incentive ∴ encouraging spending. This is because money borrowed can now be payed back with lower interest. Evidence of this can be seen by a 6.2% increase in retail sales during the first three quarters of 2015.

Another cause of increased consumer spending is the depreciation of the peso. Many mexicans recieve income transfers from relatives in the US. Due to depreciation mexican consumers can now buy more these transfers are now worth more. This increases disposable income of consumers

in turn causing increases in consumer
spending.

Question 9 (b)

This question was generally answered well and, as it used an 'assess' command word, required an examination of the benefits and the costs of increased consumer spending. A diagram was also required for this question. For an explanation of the correct labelling for a diagram, see question 1 above.

A strong response to this question needed an explanation of the link between consumption spending and AD, real output and the average price level. There should then be some analysis of the wider economic impact, for example on employment. Evaluative content would need to look at the possible impact on inflation and other factors that may limit the positive impact of increased consumption.

(b) With reference to the information provided and your own knowledge, assess the impact of increased consumer spending on the Mexican economy. Illustrate your answer with an aggregate demand and aggregate supply diagram.

(14)

An increase in consumer spending is likely to increase AD. Consumption is part of the formula for AD ($C+I+G+(X-M)$)
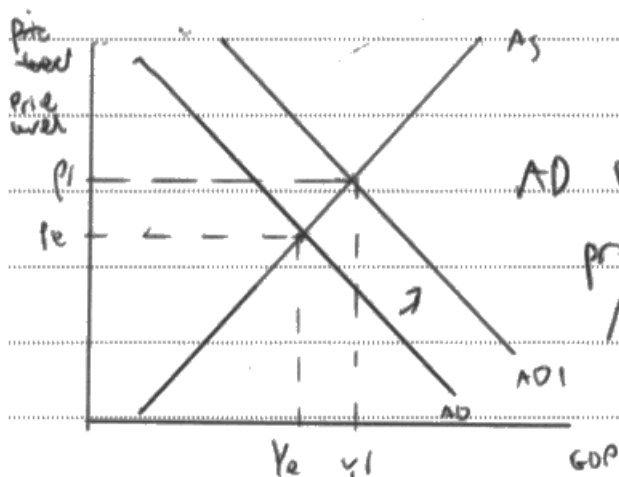
As a result of rising spending AD will rise, leading to a rise in price level to P1 ong and output /GDP to Y1.

As a result of rising output/GDP the unemployment rate will fall as more workers are required to match rising demand. This could lead to a fall in inequality as many and poverty as more people are employed.

The government will therefore benefit as since more people are in jobs they will be collecting more

income tax as a result. They can use these tax revenues to further boost AD by increasing investment in capital goods. This could makes FDI more attractive in the long run.

As a result, of increased consumer spending The government w would also benefit as is less people are unemployed. then this the government needs to spend less money on benefits and transfer payments.

Increase Price levels are likely to increase therefore inflation will occur. Mexican government needs to be wary inflation does not rise above 3% target. They could impose higher interest rates is inflation is too large.

There is a time lag involved. An increase in consumer spending may take large time to feed into the economy. As a result employment, inflation will rise at a slow rate.

AD may not rise as there are other components of AD such as government spending. If Government spending was too small, AD may not have risen.

The multiplier effect means the initial impact of consumer spending on AD may lead to a bigger rise in AD. This could rise inflation larger than expected.

Question 9 (c)

This question was intended to assess understanding of the purpose of inflation targets. Why do Central Banks and governments have targets? Most responses did show an understanding of the benefits of low and stable inflation, as well as the idea that inflation can be too low as well as too high. Some responses also explained how Central banks and government might respond to off-target inflation. Reference to the Mexican context was rewarded with application marks.

There were many full mark responses and candidates tackled the question in a number of ways. Some explained how inflation targets can be used to guide monetary policy, help to avoid high inflation and allow for transparency of monetary policy. Others referred more specifically to the context, where it would appear the threat of high inflation is the main concern.

(c) With reference to Extract 2, briefly explain why the Mexican Central Bank has an inflation target.

(4)

> Mexican Central Bank has a target rate of 3%.
> If inflation rate is low, it will increase real wages and consumer spending.
> If inflation rate is high, it will increase uncertainty and confusion of firms and consumers
> Mexican Central Bank can use interest rate to control aggregate demand and to affect inflation.

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Examiner Comments

This response was awarded 4 marks for identifying the Mexican target as being 3%. It explains that low inflation encourages consumer spending and that high inflation creates uncertainty. There is then the development of the chain of reasoning to explain that the Central Bank can manipulate interest rates to affect the inflation rate.

ResultsPlus
Examiner Tip

It is important to consider the number of marks available for Section B. Ideally, a 4 mark question should be completed in 4 sentences with each sentence making a valid point or developing a previous point. It should not be necessary to use more than the space provided for these questions.

Question 9 (d)

This question was intended to assess understanding of the likely impact of a weak currency upon the current account. This requires an understanding of how the current account is calculated, as well as how changes in the exchange rate might affect the current account. There were many reasonable responses, looking at the likely impact upon the economy as a whole, but relatively few that really addressed the question. This meant that the number of responses reaching the higher levels was lower than might have been expected.

What distinguishes this response is that it addresses the question throughout. This is good examination technique; to return to the terms of the question frequently as the essay progresses.

(d) Assess the likely impact of the decrease in the value of the peso against the US dollar on Mexico's balance of payments on current account.

(10)

Exchange rate is the value of one currency in terms of another. A decrease in value of the peso against the US dollar is know as depreciation which is a decrease in the value of one currency expressed in terms of another.

Current account is a record of the international flow of money to and from a country arising from imports and exports of gs + ss, as well as income transfers and other net transfers. It is made from the Visible Trade balance and the Invisible Trade Balance. In 2012 exchange rate was 13.1 Mexican Pesos per one US $ and by 2013 it fell to 12.7 Mexican pesos per one US $. A depreciation decreases price of exports which makes them more price competitive and at the same time it increases prices of imports, making them more expensive. Exports is an injection into the circular flow of income and imports are withdrawls. ↑ in demand for exports means that net exports (export – imports) which is a component of AD ↑ increases, net injections arise since injections are greater than withdrawls and this AD ↑.

The value of exports is greater than the value of imports as a result there is an improvement on Mexico's balance of payments on current account.

Mexico exports oil which is an important commodity and part of

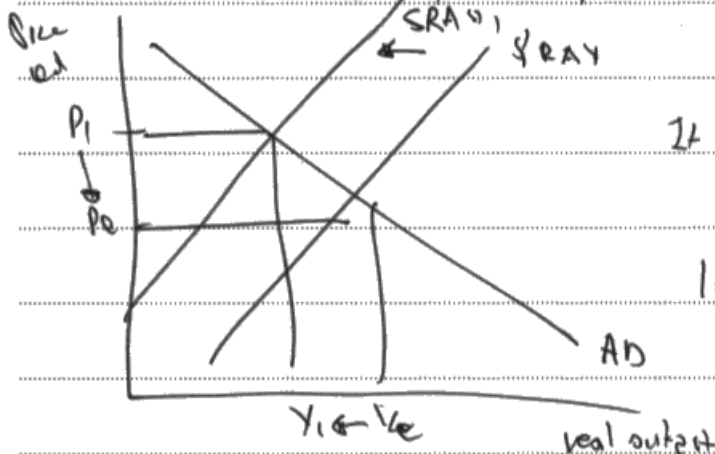the production process of all Gs + Ss. A deficit on current account
becomes smaller and may turn
into a surplus. In this case
the deficit becomes smaller as from
figure 2 it can be seen that
value of exports (32.7) is
smaller than imports (33.7)
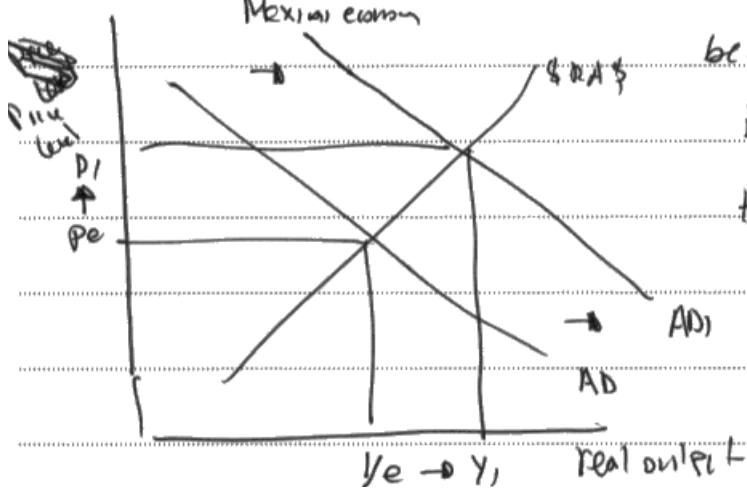
Mexican economy

Price level

D/

Pe

$RAS

AD1

AD

Ye → Y1   real output

but there is an improvement in comparison to last year (2012). ✱
This depends on the magnitude of the falling value of the peso against the
US dollar. A large fall in value will decrease exports price (eg oil)
by more so it will make Mexico's exports much more price competitive and
impact will be larger. This also depends on the rate of inflation in
the other countries with which Mexico trades. If rate of inflation is relatively
low in trading countries, it means that price competitiveness of exports
won't increase by that much as they may still be more expensive than
the imports Mexicans buy.
Also, if Mexicans import raw materials (other than oil that the country
it sell products) it might mean that cost-push inflation may created
since value of imports is more expensive so there will be an ↑ in production
costs, and value in $RAS. This may cause cost-push inflation and
offset any of the previous benefits.
It also depends on PED of imports
and exports. If it is price inelastic
like oil is, a decrease in price will lead
to a relatively lower ↑ in QD,
so not ↑ in revenue ⟹ insignificant

Price level

P1

P0

SRAS1

$RAS

AD

Y1 ← Ye   real output

+ Mexican producers of oil can now compete more

Question 9 (e)

This question assessed understanding of macroeconomic objectives and how there may be conflicts between these objectives. The specific challenge was for candidates to use the data provided to identify potential conflicts and then assess the extent to which these are evident in the data for Mexico.
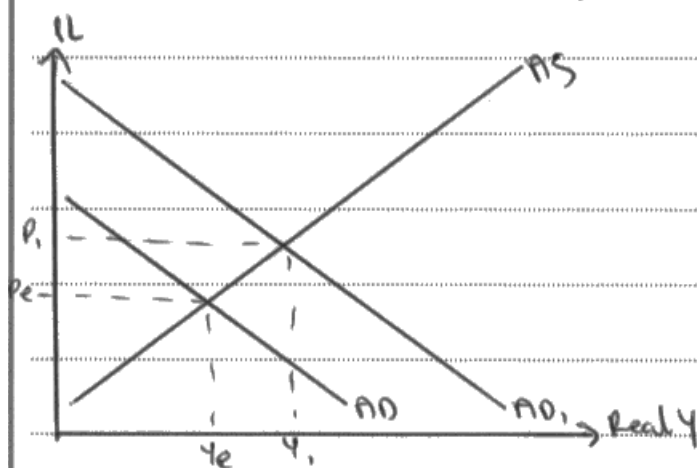
This example is a particularly strong response with two possible conflicts identified and some analysis of how Mexico appears to have avoided or minimised these conflicts. There is also a good use of data to support the arguments. Evaluation is a little more limited but this is certainly a good response and a useful example.

- conflicts: inflation & growth ✓
  growing current account ✓
  growth & sustainability ✓

  inflation & current account.

(e) With reference to the information provided and your own knowledge, evaluate the view that Mexico is successfully avoiding a conflict between macroeconomic objectives.

(14)

Conflicts between Macroeconomic objectives occur when an objectives prevents another from being achieved. An objective A conflict between objectives that Mexico is successfully avoiding is low inflation and growth. Mexico is achieving growth by increasing aggregate demand. By increasing aggregate demand they As net exports are increasing, aggregate demand does too (As $AD = C + I + G + (x-M)$) which would usually cause growth and inflation as shown on the diagram. As shown, growth will increase as GDP increases from $Ye - Y_1$, however price level will rise ($Pe - P_1$).

This did not occur in Mexico. In the years that net exports increased, inflation in the country also dropped to 2.5% (a record low below the inflation target of 3% of the country). This shows they have been successful in avoiding conflicts.

Another conflict of objectives they have successfully avoided is growth and a surplus on the current account. Normally, when growth happens people buy more imports so the current account goes down. However, in this case the value of the peso has dropped so imports are more expensive but exports are cheaper. As net exports are larger growth still occurs and the current account is not depleted by imports being bought as demand for imports falls as they are more expensive.

However, they also have some policies which are conflicting. One example of this is the objective of growth and sustainability. They attempted to increase growth by decreasing production costs for oil firms by deregulating the sector. This increased pollution, so sustainability was not achieved (and also they did not achieve growth due to worldwide falling oil prices.

However, these conflicts are likely to frequently change as the value of the currency varies. In a few years when the imports become cheaper again due to a stronger peso, it is likely to conflict with growth and the current account.

Also, inflation has only dropped so low in one year, if it is not sustained they may see inflation rise as growth does again.

Question 10 (a)

Question 10 focuses upon the economy of Finland. The first question was intended to asses knowledge and understanding of HDI, as Finland is usually associated with a high HDI measure.

The best responses here were concise and referenced the data provided.

(a) With reference to Figure 2, briefly explain how HDI is measured.

(4)

The human development index, HDI, measures the welfare of people in an economy ~~by measuring~~ and their standards of living. This is done by making surveys to find out the average life expectancy, average literacy rate and average GNI per capita of a population.
The HDI of finland remained constant at 0.88 from 2008 to 2014 even as GNI per capita fell ~~annually~~ almost every year.

ResultsPlus
Examiner Comments

The response identifies the life expectancy component (1 marks) GNI per capita component (1 mark) the response then goes on to identify the constant 0.88 HDI for Finland (1 mark) even as GNI per capita fell over the period (1 mark).

ResultsPlus
Examiner Tip

For these 4 mark questions, accurately define the terms and then refer to the case study to exemplify the definition. This response is a good one as it is concise and achieves full marks.

Question 10 (b)

As is often the case, the largest cause of low performance on this question was where responses focused on the effects of the recession rather than the causes. While the question was generally answered well, it is important that the two causes are distinct. The best way to emphasise this is to provide 2 paragraphs, each identifying a likely cause.

The data provides a number of possible causes, including recession in Russia and the decline of Nokia. The following response actually identifies rising inflation and recession in Russia as the two likely causes.

(b) With reference to the information provided, analyse **two** possible causes of the recession in Finland from 2012.
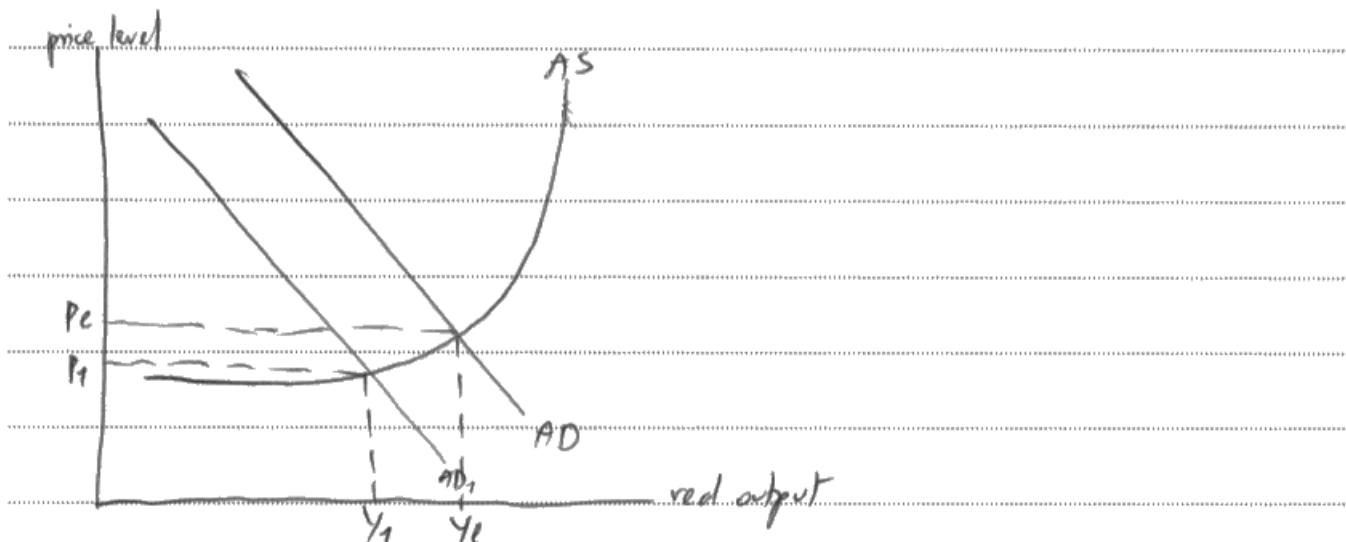
(6)

A recession is when there is negative economic growth for at least 2 consequtive quarters. Finland had negative GDP rate of growth from 2012 to 2014, around −1.3% in 2012.

As inflation increased annually from 2012 to 2014, it suggests that the price level was rising. Consumer confidence may have declined due to the decrease in purchasing power and the trend of inflation which kept increasing. Consumption hence decreased as people began to save more because they feel insecure. AD shifts to the left and real output decreases, decreasing economic growth.

This could also have been due to high unemployment rates, ~7.5% in 2012. People feel insecure with their jobs and future income so they reduce spending. By the transmission mechanism of consumption, the AD curve shifts to the left and economic growth decreases.

Russia, Finland's largest trading partner is weak due to low oil prices and is in a recession. Hence, demand for exports decreases. As a large part of aggregate demand is from demand for exports, the AD shifts to the left by the transmission mechanism of (x−m).

A hand-drawn AD–AS diagram. The vertical axis is labelled "price level" and the horizontal axis is labelled "real output". The aggregate supply curve is labelled "AS". Two aggregate demand curves are shown, labelled "AD" and "AD₁". On the vertical axis, price levels Pc and P₁ are marked, and on the horizontal axis, output levels Y₁ and Yₑ are marked.

Question 10 (c)

This question encourages candidates to use their understanding of economic theory to assess the likely impact of the 'decline of Nokia' on the economy of Finland. The strongest responses looked at the impact on the current account, as well as the price level and real output. They also included at least one relevant diagram.
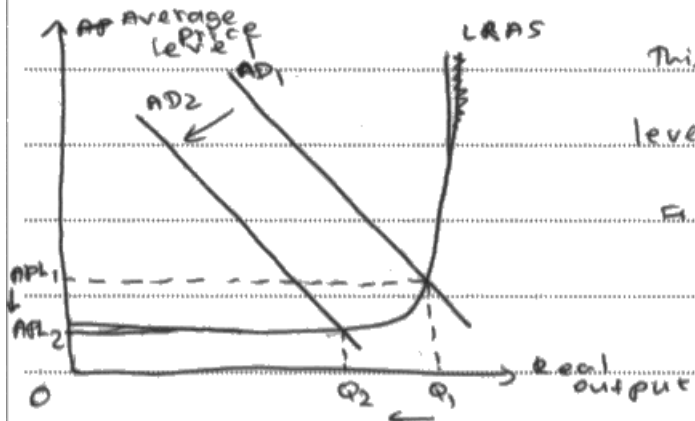
The structure of the essay was important with this question. The response here is particularly strong, as there is an effort to address all of the demands of the question. The only real weakness is in the evaluation, where the impact of lower incomes on the current account is not really fully explained.

(c) With reference to the information provided, assess the likely impact of the 'decline of Nokia' (Extract 1, Line 9) on Finland's current account balance, price level and real output. Illustrate your answer with an aggregate demand and aggregate supply diagram.

(14)

Current account consists of net trade of goods and services, net income investments and net transfers.
- Since Nokia contributed to approximately 25% of Finland's economic growth and was a major exporter, when it declined, less money would have flowed into Finland, through exports, thus there would have been a fall in aggregate demand. The current account balance thus fell to negatives of -1.8% of GDP in 2014 as due to a fall in exports. This causes a fall in price levels and real output of Finland.
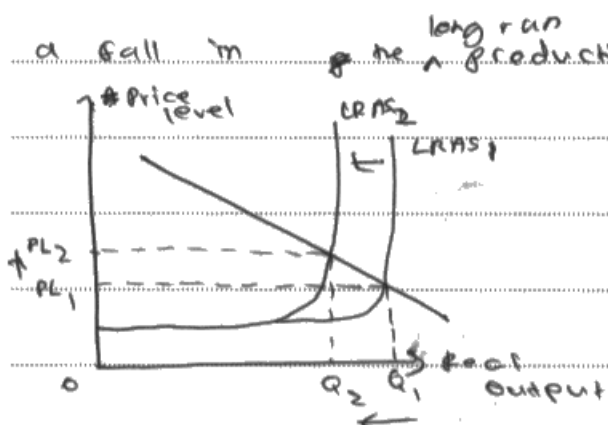
Furthermore, this may cause citizens of Finland to import more mobile phones as Nokia has declined, causing a further worsening of the current account as more money is

leaving ~~the country~~ through imports. This ~~then~~ then causes a paradox of thrift.

However, this may only ~~have~~ have short term effects as ~~decline as Nokia falls~~ more companies in Finland may start exporting as the government might introduce policies to make trade more flexible and ~~allow~~ thus the current account balance may be made to improve in the future. Further, since many workers would have been made unemployed due to the decline of Nokia, as unemployment rate is at a high of ~~71~~ 8.5%. in 2014, incomes will fall, causing the ~~current account~~ ~~fall~~ to possibly improve as ~~a~~ people would import less ~~it~~ due to falling incomes. Thus fall in imports might outweigh the ~~to~~ fall in exports to balance the current account. Furthermore, the impact of net withdrawals on Finland's economy and real output will depend on the size of the multiplier. It also depends on the magnitude, ~~of~~ E and since ~~Nokia declining~~ Nokia was responsible for 25% of Finlands economic growth, ~~they may have~~ it will have a significant impact on ~~but~~ the economy and real output. ~~$~~ There will also be a fall in ~~the~~ investments, from Nokia in the economy which may cause a fall in ~~the~~ long run productive potential of Finland and long run ~~the~~ real output.

Question 10 (d)

This question tested understanding of the economic impact of unemployment, specifically in the context of Finland. The best responses not only demonstrated an understanding of the effect of unemployment generally but also were able to link this to the economy of Finland and the evidence provided.

A question on the economic impact of unemployment is always an opportunity to demonstrate good understanding of competing arguments. In this case, with the decline of Nokia and Finland's generous benefit system, unemployment does not necessarily mean rising social problems. It could also mean increased opportunities for voluntary work or new business start-ups and enterprise.

(d) Assess the likely effects of unemployment on Finland's economy.

(10)

Unemployment is the number of ~~workers~~ people who are willing and able to work but do not have jobs.

Firstly, ~~is~~ this will cause such a high unemployment rate of 8.6% in 2014 falling incomes and living standards and worsen income inequality in Finland as ~~more~~ some workers will have jobs and ~~most~~ some will not. This may cause a fall in GDP as output and aggregate demand falls. Further, it will worsen the governments budget ~~deficit~~ as there will be less income tax revenue and more unemployment benefits must be given out. This may also further which may cause increased debts. reduce incentive to work as people who have jobs may be taxed more to pay unemployment benefits. Moreover, this may cause a hycterisis effect as the unemployed may lose their skills over time, or cause brain drain as Finland citizens leave the country in search of better job opportunities. This causes a waste of resources, and if Finland tries to improve its GDP growth in the future, it might face scarocity of resources. Additionally,

It this may cause many social problems as vandalism and crime rates (eg: murder, theft, rape) increases when people are unemployed.

However, high rates of unemployment may reduce wage rates as ~~people~~ the unemployed would be willing to work for lower wages in order to have a steady income. ~~This~~ this will control cost-push inflation ~~of~~ and thus achieve the macroeconomic objective of price stability. This is seen in figure 1, from 2011 to 2014, where inflation rates have fallen from 3.4% to 1% due to higher unemployment rates. Furthermore, this may help improve Finland's balance of trade that recently worsened due to the decline of the major exporter Nokia. Lower prices of Finland's exports, due to lower wage costs, will allow them to be more price competitive in ~~the~~ the global market and cause an improvement in the ~~current~~ current account. Lastly, low wage costs may attract potential forein direct investments into Finland ~~as~~ to increase & cost-efficiency, thus benefitting Finland's balance of payment and ~~employment~~ employment rates in the long run.

What is particularly pleasing about this response is that it is balanced. It does not focus entirely on the negative impact of unemployment. It is good on the negative impact and certainly achieved Level 3 (6 marks) with a coherent and logical analysis with reference to the data. It then goes on to look at the potential positive impact of higher unemployment, such as falling wages, lower costs and increased international competitiveness. This was awarded Level 2 (4 marks) for evaluation. A total of 10 marks.

Remember that an 'assess' or 'evaluate' command word requires a balanced response. An awareness of competing arguments. If a response is one-sided, it is unlikely to access the evaluation levels.

Question 10 (e)

The final question encouraged candidates to think about the costs and benefits of a minimum income guarantee in Finland. Specifically, how this might impact upon the achievement of possibly conflicting macroeconomic objectives. The best responses dealt with the question systematically, examining how the benefit system might impact upon objectives such as economic growth or budget balance.

This question really demanded that candidates 'think like an economist', focusing upon the economic arguments for and against the benefit system, rather than on some other, more common-sense or moral assertions. In this sense, it was a challenging question but one which produced some excellent responses.

(e) With reference to the information provided and your own knowledge, evaluate the likely effects of the new benefit system on Finland's macroeconomic objectives.

(14)

The new benefit system would guarantee every citizen a minimum basic income. Any income earned beyond the basic income of €800 per month will be taxable. This will decrease income inequality in the economy. Reduction in inequalities lead to higher and almost equal standards of living. So, Finland's macro economic objective of reducing income inequality may be achieved by this system.

However, those who earn more than the basic income may act rationally and not want to pay tax. This can lead to a creation of an informal sector or black market in the economy.

Further, Finland's steadily increasing level of unemployment may not affect the standard of living of the people anymore. As a result of the scheme, people may even settle for part time jobs are start their own businesses. This will reduce

the level of unemployment in the economy.

However, if people get an income without working, this may be a disincentive to workers to work in the economy. This may decline the productivity of the economy leading to a fall in its economic growth.

This benefit system increases government spending which may trigger the positive multiplier of the economy, causing a rise in AD.
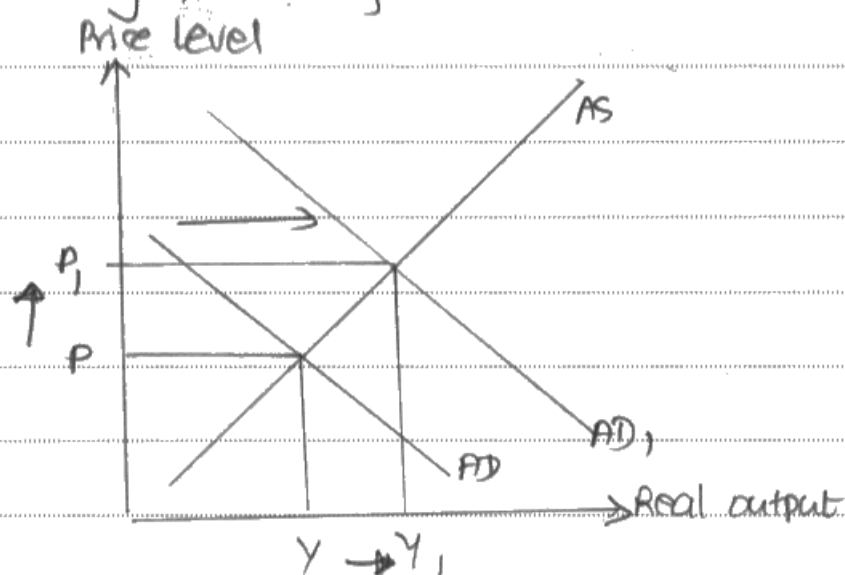
This may cause inflation in the long run. Also, an increased level of government spending may affect a balanced budget resulting in a deficit and other problems like fiscal crowding out. This conflict with the objectives of low rates However, of inflation and balanced budgets.

However, these problems may be overcome if the new benefit system is a short term practice. If this is carried out for a longer period of time, the government's budget may run through

a deficit and price levels may increase causing hyperinflation in the long run.

Paper Summary

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

- It is vital to learn definitions and be aware that accurate definitions can achieve knowledge marks. It may be worthwhile candidates producing their own shared glossary of definitions and practice writing them out in timed conditions.

- While there continues to be some improvement in the general standard of diagrams compared to previous series, candidates are reminded that diagrams need to be correctly labelled and explained when used to illustrate an answer. There were still examples of micro diagrams being substituted for AS/AD diagrams. This is really not appropriate at AS Level.

- Timing continues to be a problem for some candidates, who do not sufficiently develop their more extended responses particularly in terms of evaluation. It is recommended for candidates to practise writing 14 mark questions, in timed conditions, from early on in the course. Similarly, with the short answer questions and supported multiple choice. Many candidates again used extra paper for the supported multiple choice questions when there was only 3 marks for the explanation. Far too much time was therefore being spent on Section A and this meant there was insufficient time for responses in Section B to be fully developed.

- Candidates need to use the data provided, wherever possible, to support their answers in Section B in order to achieve higher marks. While good generic responses do provide clear evidence of learning, they do not provide evidence of higher skills and are unlikely to achieve the higher levels.

- Always note the command words used in Section B. The key words are 'assess' and 'evaluate' which require costs and benefits. As far as possible arguments and counter-arguments should be supported by relevant data, ideally from the case study material.

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