Teacher Resource Bank

GCE Economics

Candidate Exemplar Work

ECON2: The National Economy

Introduction

Below are three selected candidate answers to the AQA GCE Economics **ECON2** question in the *Additional Sample Questions and Mark Schemes** document. For your convenience, the question has been reprinted at the beginning.

The three answers have been selected to reflect a range of attainment and, for each, a commentary been produced by an experienced examiner, explaining where the marks have been awarded and why.

Please be aware that Parts (a), (b) and (c) are assessed using an issue based mark scheme and Part (d) is assessed using the AS levels mark scheme**.

* This document does **not** contain complete question papers, only selected sample questions.

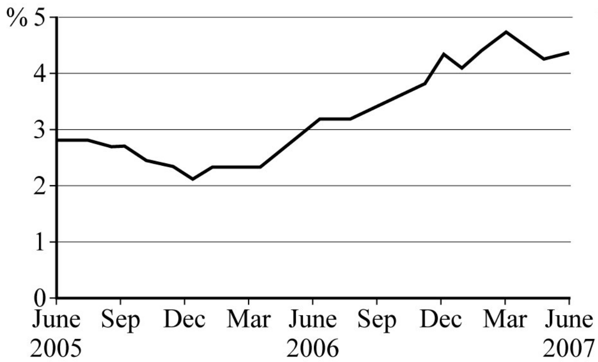
** For a copy of the corresponding mark scheme for this question, see the following link, pp 9-13: http://www.aqa.org.uk/qual/gce/pdf/AQA-2140-W-TRB-ASQMS.PDF

Total for this question: 50 marks

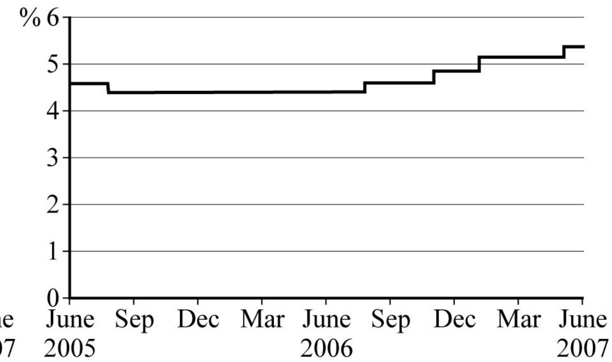
Study **Extracts A, B and C,** and then answer **all** parts of the Question which follows.

Extract A: Changes in the Retail Price Index (%) and the Bank of England Bank Rate (base rate) of interest (%), June 2005 to June 2007

Changes in the Retail Price Index



Bank of England Bank Rate



Changes in the Retail Price Index (RPI) provide a measure of the rate of inflation in the UK.

Sources: Office for National Statistics/Bank of England

Extract B: It seems to have been all doom and gloom in the summer of 2007

In the summer of 2007, share prices saw significant falls in the UK and across the world; poor weather brought flood damage, and consequently tourism suffered; the housing market and retail sales suffered downturns, with sales of food, drink and furniture being hardest hit.

Amidst all the gloom, interest rates have continued their upward trend with the Bank Rate set by the Monetary Policy Committee (MPC) threatening to hit 6%, in order to bring the rate of inflation nearer to the Government's target of 2%, as measured by the Consumer Price Index (CPI). Although in June the CPI measure of inflation was near to this target at 2.4%, the RPI measure of inflation stood at 4.4%, suggesting that inflation remained a problem.

Interest rate policy remains central to the control of inflation but does not necessarily come without some costs. Credit and mortgages become more expensive and investment can be discouraged. Saving does, however, become more attractive.

In economic terms, the summer of 2007 has been something of a disaster, especially when, in the same period last year, retailers enjoyed a twin economic boost from a heat wave and the football World Cup.

Extract C: The pound soars to a 26-year high against the US $

The exchange rate of the pound can be one factor influencing the rate of growth of UK Gross Domestic Product (GDP). Recent rises in UK interest rates have attracted overseas funds to the UK, creating a higher demand for pounds and thus causing the value of the pound to rise against some other currencies, including the US $. It means more good news for British tourists but spells further problems for exporters and, in turn, British industry. Both UK businesses and consumers can, however, benefit from cheaper imports.

A rising rate of inflation and a stronger pound can damage UK competitiveness. However, we may not need to be too concerned if the supply-side of the economy is able to counteract any negative effects these two factors might otherwise have. Rising labour productivity, low labour costs, more investment, and better quality products, for example, can all give the UK a fighting chance in world markets, even when trends in the rate of inflation and in the exchange rate do not offer much reason for optimism.

Question

(a) Define the term ‘rate of inflation’ (**Extract B**, line 7). *(5 marks)*

(b) Using **Extract A**, identify **two** main points of comparison between the UK rate of inflation and the Bank Rate (base rate) of interest over the period shown. *(8 marks)*

(c) **Extract C** (lines 1 and 2) refers to the exchange rate of the pound as a possible ‘factor influencing the rate of growth of UK GDP’.

Explain the term ‘the exchange rate of the pound’ and analyse **one** way in which a strong pound can influence the rate of growth of UK GDP. *(12 marks)*

(d) **Extract C** (line 8) suggests that we ‘may not need to be too concerned’ about a rising rate of UK inflation and a stronger pound.

Using the data and your economic knowledge, evaluate the significance for UK macroeconomic performance of **both** a rising rate of inflation **and** a stronger pound. *(25 marks)*

Candidate A

Question 2

2)

a) The rate of inflation, is the rate at which the general price level goes up per annum leading to a reduction in the internal processing power of money.

b) The Retail Price Index measure of the inflation shows that between the period December 2005 and June 2007 its general trend was to rise. Contrastingly the Bank of England base rate has remained much more static as it has only risen by approximately 0.8% during the same period. Despite the fact that the RPI is rising from December 2005 much more steeply - by June 2007 the rate of inflation has only reached 4.3%, whereas the Bank of England base rate is at 5.2%

c) The exchange rate of the pound is the external price of the pound quoted in terms of another currency i.e. how much of a particular currency a pound can buy. Exchange rates can also be measured against gold. One way in which a strong pound can increase the rate of growth is through industries dependent on imports. As Extract C says - they will benefit from cheaper imports. This is because the pound will be stronger compared to other currencies therefore they will be able to buy more imports.

This will widen the amount of profit, attracting more businesses to join the markets using imports, hence adding to GDP. Furthermore it may make foreign companies more likely to base their companies in the UK further increasing the rate of growth in GDP.

d) rising rate of inflation :- redistribution, less investment,
Strong pound :- cheap imports, bad news for exporters. less growth

As said in Extract C a rise in the rate of inflation and a strong pound can reduce UK competitiveness. ~~A~~ The rate of inflation is how much prices rise per annum, and a stronger pound means that more can be bought of imports.

A rising rate of inflation will have a detrimental effects on economic growth. This is because in times of high inflation investment is less profitable therefore firms are unlikely to invest. This will also lead to fewer employment opportunities and perhaps may lead to an increase in the level of unemployment. When this is combined with a stronger pound economic growth will be hindered further as UK industries will suffer because the goods they are producing are more expensive - as said in Extract C.

Competitiveness will be hit greatly as UK industries lose out to imports which became relatively cheaper in comparison. This is a concern as it could lead to a Balance of Payments deficit, as the amount of imports vastly exceeds the amount of exports. It will lead to many firms leaving the market and some may go bankrupt.

In addition a rising rate of inflation could lead to a massive redistribution of income as the real purchasing power of money changes. It could include redistribution between firms and households - particularly hitting those on fixed incomes. Furthermore if taxes and government spending are not altered this will increase the redistribution effects. Combining this with a strong pound means that consumers will be even more likely to purchase ~~a~~ imports, which are cheaper because a high rate of inflation is eroding the value of their money as it continues to be above the Bank of England base rate - shown in Extract A.

In conclusion a rising rate of inflation and a strong pound will have negative effects on the UK macroeconomic performance. This is because it will reduce economic growth and investment as well as making the UK less competitive international market.

Candidate A

Commentary

Part (a)

A full 5 marks were awarded to this answer. The benefit of the doubt was given to the error in the last line, “processing” rather than “purchasing”. Otherwise, it is clear and concise and the mark scheme points to the full award. **5 marks *(out of 5)***

Part (b)

Essentially, the mark scheme wants a point made (2 marks) and then supported by use of the data (2 marks). The first half of the answer contains a valid point but use of data is minimal and so 3 marks seemed a suitable reward. The last part, although making better use of the statistics, does not make the point as well as it might. The RPI is rising more steeply but more steeply than what? Than what happened previously? Than interest rates? The statistics used are adequate (so, 1 + 2 marks). **6 marks *(out of 8)***

Part (c)

The definition of exchange rates gets 4 marks. The higher mark allocation per part answer in these new papers allows examiners to better discriminate between candidates. The other 1 mark for the definition could have been gained by a simple example (preferably one set in the real world). The reference to imports and further explanation receives 4 marks but it is not explained that well…what are businesses importing and how do cheap imports link to economic growth? The last few lines erroneously suggest that businesses will settle in the UK at a time when they are having to pay more for £s! **8 marks *(out of 12)***

Part (d)

The candidate does attempt to deal with both parts of the question and includes a few relevant issues. He/she spends some time (quite a large part of the answer) on redistribution of income but, disappointingly given the specific requirements of the question, never explicitly brings this round to macroeconomic performance indicators, e.g. in this case, the balance of payments on current account and economic growth. The analysis and evaluation do not always rise above the superficial but there is evidence of analysis and an attempt to reach (an albeit) fairly simplistic evaluative judgement (which allows a higher Level 3 mark). The answer develops fairly logically and coherently. **15 marks *(out of 25)***

TOTAL MARKS = 34 *(out of 50)*

Candidate B

a) Inflation is the general rise in prices. The rate of inflation is the speed of which it rises or falls over a period of time.

b) The rate of inflation fluctuates more than the rate of interest. This is because the interest rate can't just suddenly leap up as it will affect peoples standard of living as they will have less disposable income. There is a similar shape to both graphs. If inflation rises between Dec '05 and March '06, interest rates rise too after a lag. This occurs because the Bank of England want to control inflation.

c) The exchange rate of the pound is the value of the pound in comparison to other currencies. Higher Interest rates will encourage foreign investors to invest in the pound and this will result in the a stronger pound.

A stronger pound will make british exports less competitive compared to countries with a weaker currency. This will mean that UK GDP will fall. There is less aggregate demand for british goods and services so firms will have trouble selling their goods. Production will decline because there is no need to produce more.

d) The Bank of England will react to levels of high inflation by increasing the rate of interest. This will encourage foreign investors to invest in the pound and the value of the pound will increase.

②

The strength of the pound enables the UK to buy imports at a cheaper rate. Domestic producers will have to lower their prices in order to compete with the imports. This will help lower inflation. However UK exports are more expensive and are therefore less competitive in world markets which will cause a trade deficit.

The strong pound will discourage foreign investors from expanding their business in the UK so UK GDP will not increase.

4.

The Bank of England would be worried if inflation continued to rise and would increase interest rates to help control inflation. Although saving would be more attractive, mortgages will become more expensive. This will mean that people will have less disposable income and so their standard of living will decline.

Candidate B

Commentary

Part (a)

This candidate scores the full 5 marks. A definition of inflation is given and the "rate" issue is dealt with, although we might have preferred some better phraseology. An element of benefit of the doubt here. **5 marks (*out of 5)***

Part (b)

Commentary (why the statistics are as they are) receives no marks in this part of the question and so the candidate is really wasting valuable time. There is no use of data so this will always limit an answer to 4 marks. Three points are made: the relative degree of fluctuation, the similarity of shape (poorly expressed) and the way in which the RPI and interest rates increase. Two of these can be awarded (2 + 2) to give 4 marks. Incidentally, note the all-too-common error when referring to disposable income. **4 marks *(out of 8)***

Part (c)

In a definition it would be good to see some understanding, in a simplistic way, that the exchange rate is relevant when trading or exchanging currencies (see Candidate A). Also, here there is no simple numerical example. 3 marks were awarded. In the next few lines, the causation is not relevant to the question. The reference to exports and GDP gains 5 marks (less competitive exports causing demand for them to fall…3 marks, production cuts linked to GDP…2 marks). The candidate does him/her self no favours in the last paragraph…GDP would have been better as the final point after referring to production cuts. **8 marks *(out of 12)***

Part (d)

It is true that there are a few issues included but where is the analysis and evaluation of them? It really isn't good enough to bring into an answer some legitimate references to cheaper imports helping to lower inflation and potentially reduce the trade deficit, and less FDI damaging growth, without providing further analysis and some evaluation. For example, it could have been mentioned as evaluation that, whereas the strong pound helps to achieve lower inflation and a better trade deficit, the damage to competitiveness might affect economic growth because of fewer exports. The last paragraph does not bring the impact of higher interest rates round to the macroeconomy and, again, included a misunderstanding of disposable income. Evaluation marks could also been gained if the word "significance" had been given some attention. It is really only the two paragraphs at the top of the second page of the answer which attempt to answer the question actually asked, whereas the first and last paragraphs are partly repetitive of each other and make no reference to any macroeconomic performance indicators when pointing to consequences of higher interest rates. Mid-Level 2 is thought appropriate here (9 marks). **9 marks *(out of 25)***

TOTAL MARKS = 26 *(out of 50)*

Candidate C

(a) The rate of inflation is the average price level in a country, measured by a price index such as the CPI. The government sets a target price level of 2 percent measured by the CPI and instructs the Bank of England to hit this target.

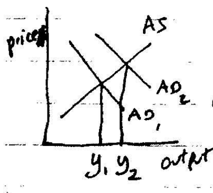
(b) The retail price index (RPI) was about 2.8% in June 2005. It then fell to bottom out at 2.2% in January 2006, rising thereafter to peak at 4.8% in April 2007.

The Bank of England Base rate hardly changed at all during the period covered by the data, rising just a little bit from June 2005 to June 2007

The changes in the RPI are more volatile than the changes in the Bank rate, and overall there is a positive relationship between the two. The changes were caused by the Bank of England's monetary policy.

(c) ~~The exchange rate of the pound is the money that can be~~ got for the pound at a foreign exchange bureau.

A strong pound can influence the rate of growth of UK G.D.P (gross domestic product) by making UK citizens feel good about themselves. For example, last summer I went with my family on holiday to New York and bought lots of American goods because the pound was so strong. This must have been good for the UK economy. If British citizens feel confident about the future because the exchange rate is so high, the aggregate demand curve will shift rightward as shown in my diagram, leading to economic growth (the movement from y_1 to y_2.



(d) UK macroeconomic performance means how well the British economy is doing at the macroeconomic level.

A rising rate of inflation means that British goods are being sold at a high price level in other countries. This in turn means that people living in other countries need a lot of money to buy British goods. The money comes to the UK for us to spend, which must be good for the British economy.

However there is a possible downside to this. Both a high price level and a stronger pound can make British goods such as cars less competitive in foreign markets. People living in those countries may say "no thank you, we don't want British goods." This would be bad for the United Kingdom.

In conclusion, I think there are both bad and good results from a rising rate of inflation and a strong pound. Overall I think the 'goods' outweigh the 'bads'.

Candidate C

Commentary

Part (a)

Only an award of 1 mark for this answer. The definition is wrong but there is a reference to the CPI which is catered for in the mark scheme. **1 mark *(out of 5)***

Part (b)

At first, this answer gives the impression of a trawl through the data. But on re-reading, if we take the point in the last paragraph about relative volatility, it is this point which is being illustrated in the first two paragraphs but not very well as far as interest rates are concerned (so 3 marks). There is a further point in the answer concerning an (approximate) positive relationship between the two (1 mark). **4 marks *(out of 8)***

Part (c)

The definition is very elementary. To what does “money” refer? Other currencies or perhaps the domestic currency but given in notes rather than coins or vice versa? From the other paragraph, we can take the point about a higher exchange rate creating more consumer confidence (perhaps a greater sense of well-being would have been better), so benefiting AD, so leading to more growth. But it is a pretty thin answer when we are shown by the mark scheme the “meatier” points which could have been chosen. Buying lots of US goods is supposed to help us! The diagram does have some correct labelling (the AD/AS curves) and the correct information in relation to the text, so it was awarded the full 2 marks. Definition 2 marks + 2 marks for confidence and AD, 2 marks for the diagram = 6. **6 marks *(out of 12)***

Part (d)

The first paragraph tells us nothing and is a lost opportunity. The point about loss of competitiveness in the second paragraph is completely lost on the candidate although he/she does salvage something in the third paragraph. Elasticity is a theme which runs through both paragraphs but this concept doesn’t get a mention. However, there is no linkage to any macroeconomic performance indicator, but we are told that it would be “bad for the UK”. The last paragraph adds nothing, it is a token attempt at evaluation which cannot be realistically rewarded. There is no mention of the significance of rising inflation. If you breakdown the criteria included in the Level 1 descriptor, the answer fulfils many of them and, essentially, we are trying to reward an answer of 5 lines, i.e. the third paragraph because this is the one which has some relevant economics. One issue is inadequately dealt with; poor, if any, application of concepts; no satisfactory analysis or evaluation (how can the candidate conclude that the “goods” outweigh the “bads” when he/she only vaguely refers to one factor?); a failure to answer the question set on macroeconomic performance; little use of economic terminology except, for the most part, that which is included in the question. There is some attempt at organising the answer logically and some coherence so marginally above mid-level. Although the answer fulfils a criterion given in Level 2 (one relevant issue) that issue is not used to answer the question, i.e. it falls short in relating the issue to macroeconomic performance and so, overall, the answer fails to answer the question. There is barely any economics throughout. **5 marks *(out of 25)***

TOTAL MARKS = 16 *(out of 50)*