AQA
Questions matter

Economics

Answers and commentaries

A-level (7136)

Paper 2: National and international economy

Marked answers from students for questions from the June 2022 exams. Supporting commentary is provided to help you understand how marks are awarded and how students can improve performance.

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Answers and commentaries

This resource is to be used alongside the A-level Economics, June 2022, 7136/2, National and International Economy question paper and mark scheme.

Context 1

Question 3

Extract B (lines 18–19) states: 'FDI can have many benefits. It should create employment, boost long-run economic growth and increase exports.'

With the help of a suitable diagram, explain how a rise in inward foreign direct investment (FDI) may lead to increased exports.

[9 marks]

Mark scheme

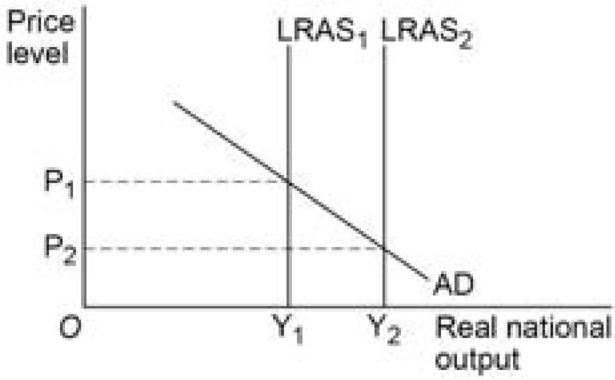
Below is the levels of response marking grid which should be used to mark the 9 mark questions.

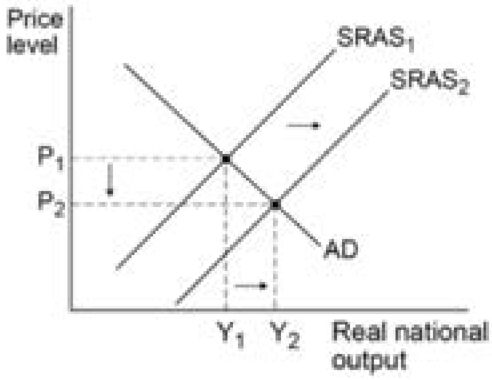
Level of response	Response:	Max 9 marks
3	• is well organised and develops one or more of the key issues that are relevant to the question • shows sound knowledge and understanding of relevant economic terminology, concepts and principles • includes good application of relevant economic principles and/or good use of data to support the response • includes well-focused analysis with a clear, logical chain of reasoning • includes a relevant diagram that will, at the top of this level, be accurate and used appropriately.	7–9 marks
2	• includes one or more issues that are relevant to the question • shows reasonable knowledge and understanding of economic terminology, concepts and principles but some weaknesses may be present • includes reasonable application of relevant economic principles and/or data to the question	4–6 marks

	• includes some reasonable analysis but it might not be adequately developed and may be confused in places • may include a relevant diagram.	
1	• is very brief and/or lacks coherence • shows some limited knowledge and understanding of economic terminology, concepts and principles but some errors are likely • demonstrates very limited ability to apply relevant economic principles and/or data to the question • may include some very limited analysis but the analysis lacks focus and/or becomes confused • may include a relevant diagram but the diagram is not used and/or is inaccurate in some respects.	**1–3 marks**

An AD/AS diagram which shows LRAS shifting right is expected although candidates may explain potential benefits from SRAS shifting right and the subsequent effects on the price level and exports. Candidates may also use a Production Possibility Frontier shifting right.

Expected diagrams are:





Note: Some candidates may show the ‘effect’ of a rise in investment or exports by **only** shifting AD to the right. However, this does not explain why FDI may lead to an increase in exports and should not be credited as a suitable/relevant diagram.

Relevant issues include:

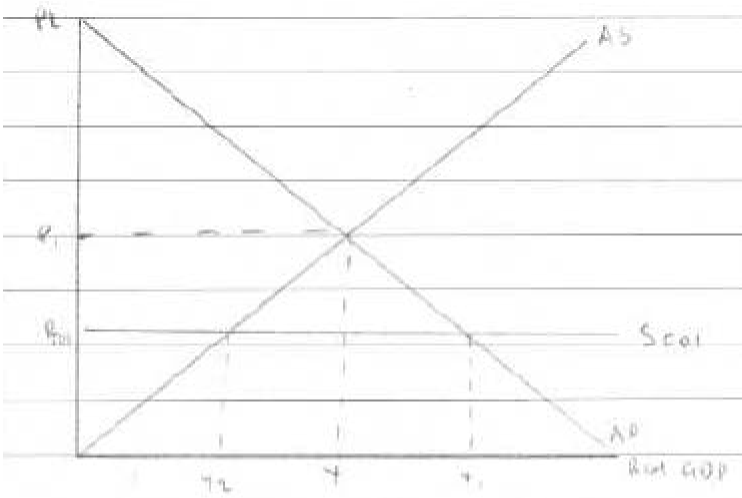
- definitions/explanations: investment, inward investment, foreign direct investment (FDI), exports
- explaining reasons why inward FDI may occur such as reduced corporation tax
- linking FDI to increases in productive capacity/potential
- linking FDI to forcing domestic firms to become more efficient
- the possible effects on the price level of boosts to efficiency/productive capacity
- if firms' costs fall (or at least don't rise) then firms become relatively more competitive
- linking FDI to possible benefits from economies of scale
- if firms which used to provide imports have relocated to the domestic economy, they may now be providing exports
- if total output rises firms may export surplus stock
- linking the increases in FDI to disinflation or benign deflation
- multinational corporations export around the world and hence FDI by a foreign MNC is likely to lead to an increase in exports.

Student responses

Response A

Foreign direct investment is when a firm outside of an ~~economy~~ economy invests into the country, creating jobs, increasing exports and boosting growth.

A rise in inward foreign direct investment helps an economy produce more so they can export. Many MNCs research a country before investing in it, knowing the country can help them produce more efficiently than other places. 'French companies are the largest investors in Africa' because of its natural resources and workforce. This gives Africa advantages so they can produce ~~with~~ at lower prices, so exports increase.



where other economies produce quantities at different prices, countries with competitive advantage can produce any quantity at the same price, so ~~exports~~ demand for exports increase. Foreign investors benefit greatly from their investment and the economy increases its exports.

When MNC's ~~invest~~ from developed countries invest in foreign economies, ~~the~~ the whole economy benefits and can increase its exports. For example, FDI rose in Africa ~~by~~ to ~~$46~~ '$46 billion' allowing Africa to improve their infrastructure, including ~~rod~~ ~~road~~ roads, bridges and ports. This then paves the way for other exports to leave the country which weren't able to before, increasing ~~growth~~ enterprise and innovation as people see a way to make money. This increases growth and exports further.

This is a Level 2 response

The response begins with a reasonable explanation of FDI. There is then some quite basic analysis which states "so they can produce at lower prices" without explaining why. The diagram is slightly confused and the analysis drifts into comparative advantage. There is some relevant understanding, but it is certainly not adequately developed and is confused in places.

5 marks

Response B

3) Whilst African nations must take the first steps to tackle their failures their policies will likely have little to no affect if they don't simultaniously recieve Foreign direct investment.

African nation's current global trade is only around 3%, however due to its size, SEZ's and raw materials such as fossil fuels (nigeria contains huge amounts of oil), it would be an attractive area for multinational corporations (foreign firms) to invest in. However, due to the current living conditions, poverty and corruption they face any investments put into the countries may have little success. so ultimately would be futile.

African nations must first focus on creating policies that improve the welfare of citizens if they want a chance at recieving any investment. As they don't have a large financial budget to invest into the welfare of the people that can focus on policies that are not costly such as environmental protection policies and they can reduce corruption from within. This would make them more attractive to MNC.

However, investment is needed alongside policies changes as people need to be incentivised to change. For example if people see infastructure such as factories being built they may aim to work reducing unemployment. Furthermore, unemployment can also be decreased by investment into education. This would incentivies and improve attitudes as people would have greater opportunities.

In conclusion, African should pursue policies to change current levels of corruption and failures but overall MNC, must be willing to also invest alongside these changes if they want to see a successful and prosperus outcome.

This is a Level 1 response

The response begins by correctly explaining that FDI is an injection into an economy, however, it quickly becomes confused over what FDI actually is, and who it affects. The student does correctly explain that more goods are produced, which could be exported, but this demonstrates a very limited ability to apply and lacks focus. The explanation of contractionary monetary policy is largely irrelevant and there is no diagram. Overall, a weak response.

2 marks

Question 4

Extract C (lines 13–14) states: 'Some argue that African governments should be doing more to improve the living standards of their citizens, rather than relying on foreign firms.'

Using the data in the extracts and your knowledge of economics, assess the view that to improve the living standards of their citizens, African nations should pursue policies to attract foreign direct investment (FDI).

[25 marks]

Mark scheme

Below is the levels of response marking grid which should be used to mark the 25 mark questions.

Level of response	Response	Max 25 marks
5	**Sound, focused analysis and well-supported evaluation that:** • is well organised, showing sound knowledge and understanding of economic terminology, concepts and principles with few, if any, errors • includes good application of relevant economic principles to the given context and, where appropriate, good use of data to support the response • includes well-focused analysis with clear, logical chains of reasoning • includes supported evaluation throughout the response and in a final conclusion.	**21–25 marks**
4	**Sound, focused analysis and some supported evaluation that:** • is well organised, showing sound knowledge and understanding of economic terminology, concepts and principles with few, if any, errors • includes some good application of relevant economic principles to the given context and, where appropriate, some good use of data to support the response • includes some well-focused analysis with clear, logical chains of reasoning • includes some reasonable, supported evaluation.	**16–20 marks**

3	**Some reasonable analysis but generally unsupported evaluation that:** • focuses on issues that are relevant to the question, showing satisfactory knowledge and understanding of economic terminology, concepts and principles but some weaknesses may be present • includes reasonable application of relevant economic principles to the given context and, where appropriate, some use of data to support the response • includes some reasonable analysis but which might not be adequately developed or becomes confused in places • includes fairly superficial evaluation; there is likely to be some attempt to make relevant judgements but these aren't well-supported by arguments and/or data.	**11–15 marks**
2	**A fairly weak response with some understanding that:** • includes some limited knowledge and understanding of economic terminology, concepts and principles is shown but some errors are likely • includes some limited application of relevant economic principles to the given context and/or data to the question • includes some limited analysis but it may lack focus and/or become confused • includes some evaluation which is weak and unsupported.	**6–10 marks**
1	**A very weak response that:** • includes little relevant knowledge and understanding of economic terminology, concepts and principles • includes application to the given context which is, at best, very weak • includes attempted analysis which is weak and unsupported.	**1–5 marks**

Areas for discussion include:

- definitions/explanations: foreign direct investment (FDI), living standards
- explaining how living standards can be measured in terms of monetary measures such as GDP per capita
- explaining how living standards can be measured in terms of qualitative factors such as education, health, inequality, the environment, human development and sustainability
- alternative measures of living standards such as the Human Development Index (HDI)
- explaining the benefits of FDI on living standards in terms of:
  - employment
  - incomes and consumption possibilities
  - economic growth and GDP per capita
  - multiplier/accelerator arguments
  - human development/skills progression
  - potential improvements in infrastructure created by MNCs
  - possible health implications of increased formal, regular employment
  - generating more government tax revenue which may be spent on merit/public goods without creating debt
  - crowding in arguments
- explaining the drawbacks of FDI on living standards in terms of:
  - exploitation of workers by MNCs
  - damages to the environment caused by MNCs
  - possible inflationary pressures causing the cost of living to rise
  - 'footloose' industries causing instability in employment for example
  - repatriation of profits acting as a leakage from the circular flow
- considering that governments may not benefit from rising tax revenues as they may have been forced to offer tax breaks
- how global shocks, such as the pandemic, may lead to changes in investment beyond the control of the domestic government
- the alternatives to attracting FDI to improve living standards such as aid and the possible problems of tied aid
- other possible alternatives such as government spending and the potential problems of rising debt
- other possible alternatives such as the promotion of free trade or protectionism and the potential problems of each method
- whether the government should intervene at all or if the free market would provide better solutions
- the possible inequalities caused by FDI and the possible regional differences
- issues such as corruption affecting the distribution of the benefits of FDI.

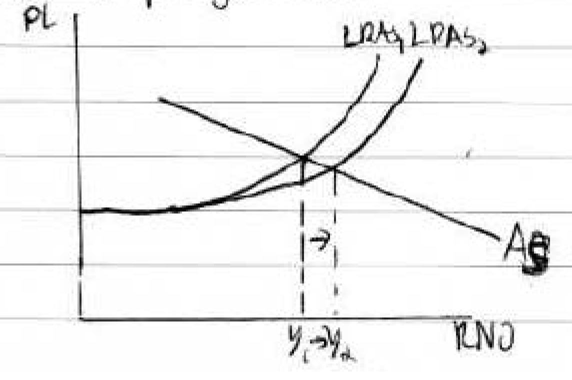
The use of relevant diagrams to support the analysis should be taken into account when assessing the quality of the student's response to the question.

Student responses

Response A

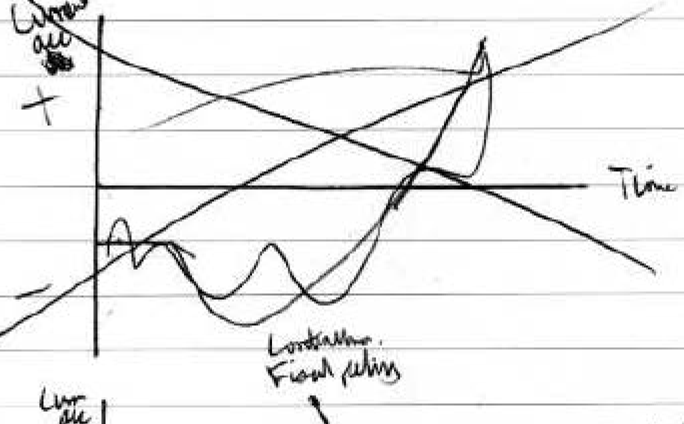
4) Living standards of an economy can be looked at through Unemployment rates, real gdp per capita, literacy rates and mortality rates. If gdp, literacy rate ~~and other~~ low then living standard may be bad. If unemployment rate and mortality rate are high this is another indicator living standards may be bad. Macroeconomic policies include the fiscal policy a policy that looks at taxation on the people; Monetary policy which looks at the interest rates and flow of money and its quantity, and supply-side policy which looks at ~~[illegible]~~ using government spending in order to improve [illegible] and infrastructure.

One way ~~African~~ nations can attract foreign direct investment with policies is with supply-side policy. This looks to tackle the output of an economy. ~~By~~ By bringing in a supply-side policy for the education and apprenticeship schemes for people in the economy the African nations can show their economic growth increasing in a stable way as more and more people finish the programmes.

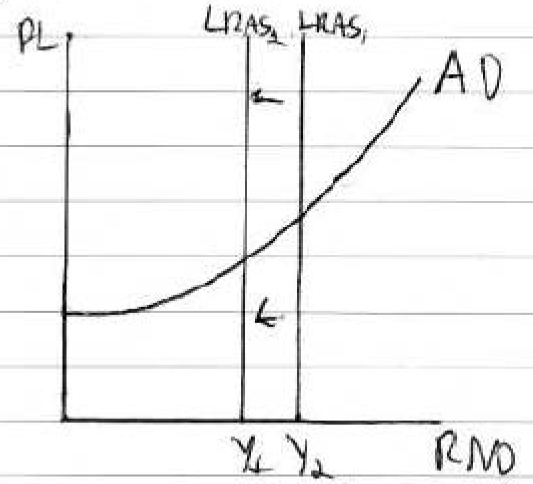


The move from Y_1 to Y_2 in the long run shows the foreign investors that the ~~[illegible]~~ nation economy is worth investing in. This ~~[illegible]~~ is because economic growth is shown with a new bigger output gap. This investment can then be used on the living standards of the economy by the nation. A problem with this however is the time lag and opportunity cost of the policy. With the implimentation of training programmes, results may not be seen for 6 or 7 years. By then it may be too late. Opportunity cost here as well, the government will have to spend a lot of money training people how to train others and ~~[illegible]~~ a big gamble on what sector to focus on. The benefits of FDI and a larger nation output may not be worth the huge sums being spent on the supply-side policy.

Another policy that a given nation could use to continue in FDI to help with living standards is a contractionary fiscal policy. By lowering tax rate on individual and ~~[illegible]~~ firms the country ~~[illegible]~~ may see a rise of companies setting up in their country and a surplus of people moving in. The new companies bring around job opportunities for the nation people and the ~~[illegible]~~ increase in ~~[illegible]~~ the population may see tax revenue increase significantly. The cyclical deficit may decrease and become a surplus leading to the govt having money to spend on improving living standards.



This cyclical deficit in its ~~boo~~ recovery of the economic cycle will be close to being a surplus. This means less borrowing from the government or more as they see they could pay it back with more tax revenue. One problem with lowering the ~~corporation tax~~ Corporation tax on companies is that although they have set up in another economy, instead of hiring workers from that economy, workers are brought in from elsewhere. This is a problem for living standards as unemployment rate won't improve and may worsen for the economy. A problem with lowering tax rates would be for the population so, income tax is the fact people may work less. Even though people may be incentivised to work more there will be a disincentive to work more as you can work the same amount you were working before the tax cut and end up with more money.



This can be seen with an inward shift in RNO from y_1 to y_2. People work less, less output from the economy. The economy shrinks.

In conclusion, neither policies on their own may be as effective as the nation wants them to be but together a supply-side policy and a contractionary fiscal policy can provide the ~~good~~ economy with a more able workforce and therefore shift out RNO and ~~xxx~~ have a budget that is high and stable. This will attract FDI as the investors will believe the economy will get better. This FDI can then be spent on improving living standards.

for the economy as the extra funds can have a focus on just living standards.

This is a Level 2 response

The student begins with a reasonable explanation of how living standards can be measured. The student then describes government policies which are not directly linked to the question. The initial analysis is not really linked to FDI. The analysis is slightly confused stating "This investment can then be used on the living standards of the economy by the nation". There is confusion over FDI and domestic government spending. The student then confuses contractionary fiscal policy and totally loses focus. There is some relevant analysis of reduced corporation tax, however, this again becomes confused with a diagram that has an upward sloping AD curve. This is a fairly weak response with a highly speculative evaluation.

8 marks

Response B

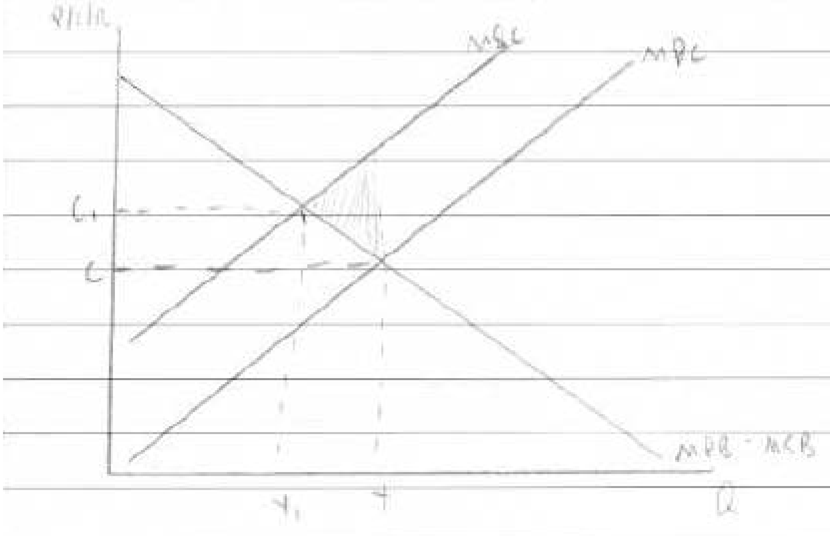
Standard of living can be measured in ~~many~~ many ways and is used to show the level of living standards in a country. HDI is a good indicator of this and measures ~~real~~ GDP per capita, literacy rates and life expectancy.

FDI can improve living standards and with expansionary fiscal policy, with attracting foreign investors in mind, they can improve. Currently there is a lack of infrastructure which ~~at~~ deters investors. ~~as it gets~~ ~~them~~ With the right Government Spending on transport, electricity and education could make Africa a perfect place to invest in, which therefore increases jobs. This increasing employment ~~attracts~~ improves the overall standard of living in the economy as ~~real~~ GDP increases due to wages, literacy rates increase as governments ~~sp~~ have improved education and life expectancy rates increase as governments can spend on healthcare. Due to the ~~g~~ Government spending, ~~AD~~ ~~also~~ aggregate demand also increases so structural unemployment decreases. This is a big reason of why African nations should persue policies to attract ~~A~~ FDI. However this is unlikely to happen as often, ~~MN~~ multi-national corporations who invest in foreign economies exploit workers in developing countries so their standards of living could even decrease.

On the other hand, African Nations should implement policies so that their country ~~is~~ ~~no~~ ~~to~~ develops so that in the long run they no longer need foreign investment and have their own sustainable growth. Due to resource depletion, many nations in Sub-Saharan and central Africa expriened falls in FDI, showing the objectives of MNC's is to capitalise on these natural resources and ~~not~~ not to improve economies. Therefore policies like ~~in~~

& decreasing interest rates could help them. With this, ~~consumers~~ supply is stimulated as firms in African Nations can borrow cheaper and be able to re-invest into their firms. This investment into research and development can help these firms maximise profits by achieving ~~econo~~ economies of scale, and the corporation tax goes back to the Government. This also creates jobs which further improve standard of living and firms that maximise profits can also give higher wages. This could work but it leaves the economy ~~susceep~~ prone to income inequality as business owners experience increases in wealth, whereas ~~cons~~ consumers don't and workers may not get paid fairly.

Another reason for not attracting FDI is the environmental effect it can have. Often times, MNC's ~~w~~ ~~st~~ move their production to countries with lenient regulation or with 'political instability and corruption'. This allows them to produce with ~~environ~~ many negative externalities as they can get away with it and achieve their economies of scale.



The diagram shows the cost to society is far greater than the cost to the firms, and this cost can greatly affect health of workers and people nearby. This impact severely degrades standard of living. However, regulations can be put in place to prevent this, ~~&~~ ~~at~~ although this means the ~~MNC's won't~~ FDI won't come in the first place. ~~Overall~~

Overall I ~~believe~~ believe that African Nations ~~should~~ Shouldn't look to attract FDI and should try to achieve economic development on their own, ~~sustain~~ sustainably. This will help their standard of living much more.

This is a Level 4 response

The answer begins with reasonable identification of how living standards can be measured demonstrating sound knowledge. The student describes how improving infrastructure and education can attract FDI. There is some minor confusion over structural unemployment but generally the analysis is OK. There is then some basic evaluation regarding the role of MNCs and whether they exploit workers. The student then considers implementing domestic policies rather than relying on FDI, however, the analysis is quite basic. The student also considers the environment with a micro diagram which is applied appropriately. This response has sound analysis with logical analysis, with some basic evaluation.

16 marks

Context 2

Question 7

Extract E (lines 7–9) states: ‘It was hoped that policy measures, including a reduction in tariffs… would help to reduce inflation.’

With the help of a diagram, explain how a reduction in tariffs could help to reduce inflation.

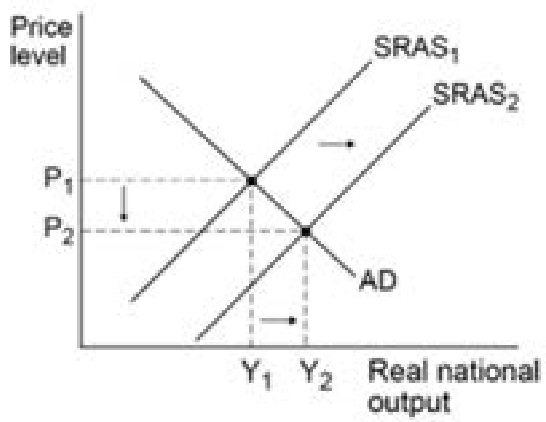
[9 marks]

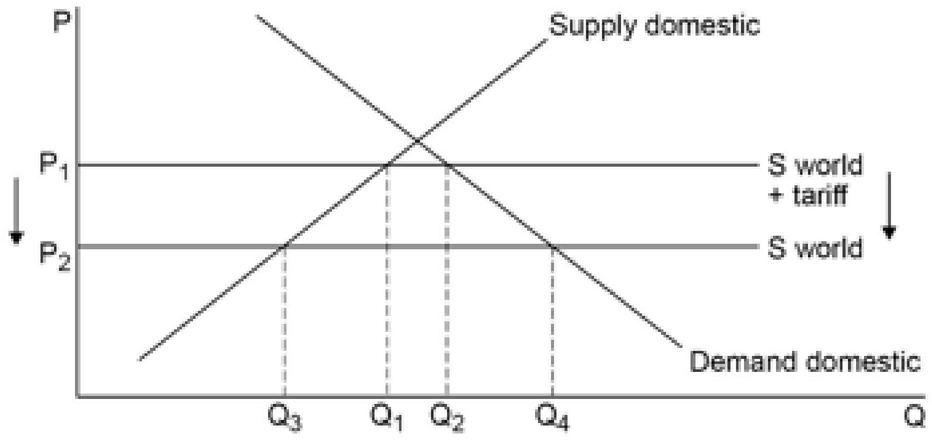
Mark scheme

Use level of response table on page 3.

An AD/AS diagram showing a rightward in SRAS is expected, however a micro diagram illustrating the effect of removing a tariff and the resultant effect on price is equally acceptable.

Expected diagrams are:





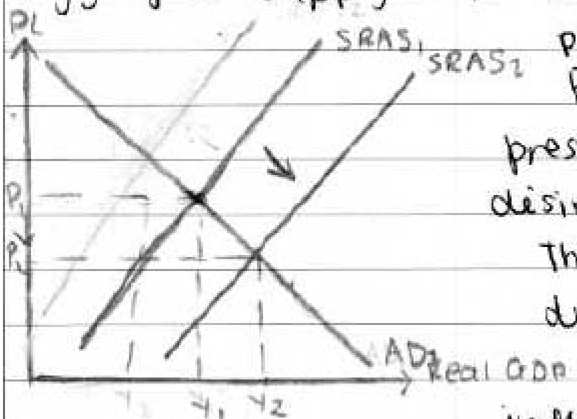
Relevant issues include:

- definitions/explanations: tariff, inflation
- linking the reduction in tariffs to falling import prices
- the concept of the basket of goods and its 'weighted' components
- linking falling import prices to a fall in the general price level
- linking the fall in import prices to issues such as being able to obtain raw materials cheaper
- linking falling import prices to costs and the determinants of SRAS
- contributing to a reduction in cost-push inflation
- the impact of reducing tariffs on competition and the prices charged by domestic firms linking falling prices to falling inflation or disinflation.
- linking falling import prices to rising demand for imports, reducing demand-pull inflationary pressure.

Student responses

Response A

tarriffs are taxes imposed on ~~imports coming from~~ exports going to the abroad, meaning ~~the foreign~~ our country has to pay these tariffs in order to ~~import~~ export any materials they want to. When tarrifs are reduced it means costs of production for domestic firms reduces, meaning the ~~$~~ short-run aggregate supply will shifts to the ~~left~~ right, meaning



price will decrease from P1 to P2, meaning inflationary pressure will decrease, causing a disinflation in the economy. This decrease in inflation is due to the decrease of ~~inflationar~~ cost-push inflation, due to the fall of pressure for ~~fa~~ the country's ~~ø~~factors of production, meaning now factors of production aren't that scarce are their demand is much lower meaning its

at a lower prices. For example, wages will be lower, price of land will be lower as well as for capital.
Thanks to a reduction of tariffs on exported goods is allows firms to access ~~f~~ easily the international market and ~~exports~~ costs of production for them to decrease, this will also be impacted positively to the consumer, as they will also pay a lower price ~~fo~~ due to this reduction of tariffs.

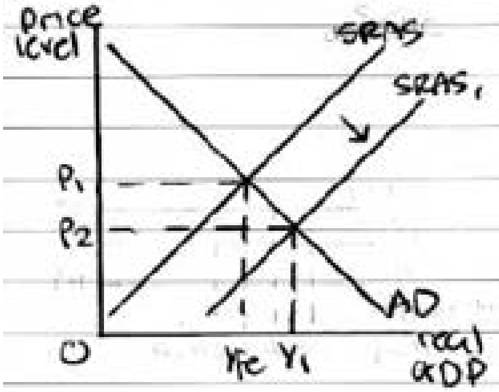
This is a Level 2 response

The answer begins with an incorrect definition confusing imports and exports. The student then correctly links the analysis to costs of production. There is some reasonable analysis and understanding but there are clear weaknesses with some confusion over the costs of the factors of production.

5 marks

Response B

Tariffs are a tax on imports and a protectionist policy. A tariff placed at P2 means that Yfe level of goods are demanded, whereas an absence of tariffs would lead to the price level being lower. Since tariffs add towards a firms costs of production, by reducing tariffs, firms have a greater incentive to increase production from Yfe to Y1, causing a rightward shift in SRAS to SRAS1. This good deflation leads not only to lower inflation but also higher levels of short run economic growth. Argentina's inflation rate hit 53.8% and by lowering tariffs and increasing competition, firms seek to lower costs. These cost savings can be passed on in the form of lowered prices reducing inflation.



This is a Level 3 response

The response begins with a sound definition and explanation of tariffs. There is then some well-focussed analysis with clear explanation of how a reduction in tariffs can help reduce inflation. The student uses a relevant diagram with good application to the scenario.

7 marks

Question 8

Extract E (lines 15–17) states: 'Policies were put in place to reduce the money supply and reduce government spending. The control of inflation became the main target of UK government macroeconomic policy.'

Using the data in the extracts and your knowledge of economics, evaluate the view that achieving a low and stable rate of inflation should be the main economic objective of governments.

[25 marks]

Mark scheme

Use the level of response table on page 10.

Areas for discussion include:

- definitions/explanations: inflation, low-stable inflation, government economic objectives
- explaining the other main macroeconomic objectives of governments: economic growth, minimising unemployment and a stable balance of payments on current account
- other economic objectives such as the reduction of inequalities or protection of the environment
- the role of central banks, such as the Bank of England or Monetary Policy Committee (MPC) and inflation targets
- ways that central banks can use monetary policies such as interest rates and the transmission mechanism
- ways that central banks can use other variables such as forward guidance, operational independence and forecasting to influence inflationary expectations
- other policies such as supply-side policies which may create low inflation
- other policies such as contractionary or expansionary fiscal policies in attempting to maintain low, stable rates of inflation
- the possible beneficial effects of maintaining low stable inflation such as:
    - the creation of confidence and stability
    - the avoidance of wage-price spirals
    - the avoidance of deflation and possible creation of delayed consumption
    - allowing economic agents to factor in changes to decision making and the effects on consumption and investment
    - maintaining international competitiveness
    - the avoidance of hyperinflation
    - the effects on households, such as those on fixed incomes and the effects on savings
    - effects on government finances
- the possible negative effects of maintaining low stable inflation such as:
    - the possible trade-off with unemployment if inflation is too low
    - the possible trade-off with growth if inflation is too low
    - the focus on achieving low, stable inflation may impact upon certain groups more than others for example borrowers with variable rate mortgages
- considering the effectiveness of policies to control inflation
- the relative merits and problems of policies designed to create low stable inflation

- external shocks such as the pandemic, may force governments to alter economic targets
- the possibility that objectives may be achieved simultaneously
- whether deflation is more of a concern than low stable inflation
- whether the control of inflation depends upon the stage of the economic cycle and priorities may change
- the importance of other objectives of economic policy

The use of relevant diagrams to support the analysis should be taken into account when assessing the quality of the student's response to the question.

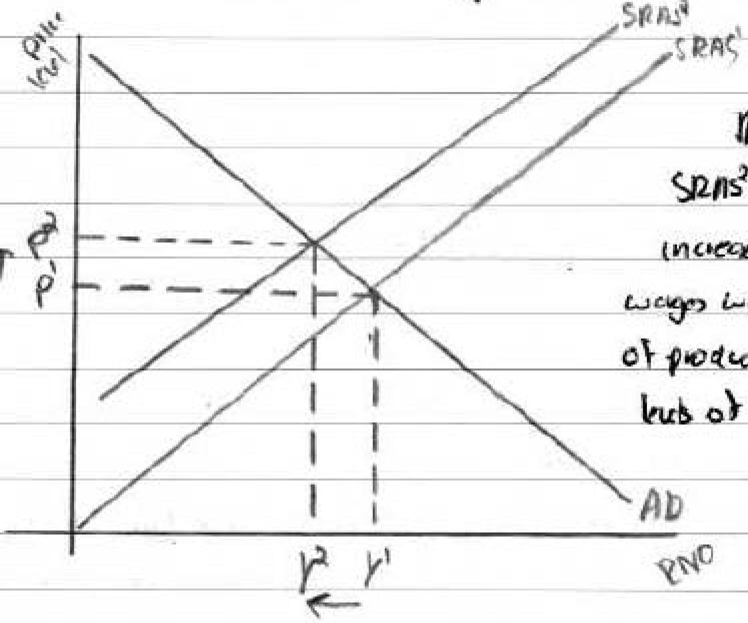
Student responses

Response A

In this essay I will be evaluating the view that achieving a low and stable rate of inflation should be the main economic objective of governments. Inflation is the general rise of price levels in the economy over a given time period. I believe that they are very important but that there are other objectives that shouldn't be overlooked such as low unemployment

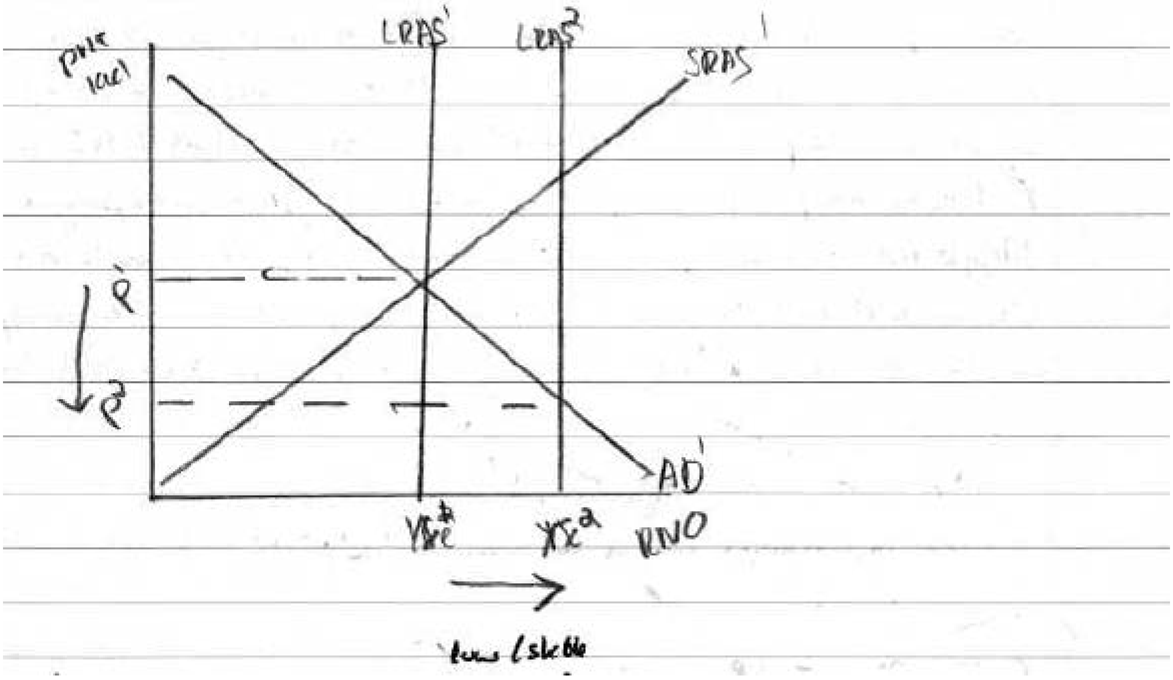
The first reason why it should be the main objective is that if it is low and steady, it will lead to a rise in real incomes. A rise in real incomes is when the nominal income rise is higher than the current rate of inflation. Having a lower rate of inflation means that it is more likely that individuals will have a higher rate of real income increase. This will be significantly beneficial for individuals on minimum wage or on state benefits as a small rise in real income may mean that they have a higher level of disposable income if inflation is low too. This will lead to them having a better quality of life as they will be able to spend more money than the year previously or even save it for future years. This therefore shows the importance of having low inflation as if otherwise individuals with low incomes and low savings may be aware of if the rise in income is lower than the rate of inflation. However this point is only true on the condition that the population will experience high levels of unpredictable inflation such as Argentina who saw an increase in inflation of almost 49% in 2018, whereas in many developed countries such as the UK and the USA they have low levels of sustainable inflation as shown in the figure 4.

A reason why achieving low and stable inflation may not be the most important aim of the government is that it has conflicting objectives with unemployment. Unemployment is the current rate of individuals who are actively looking and, willing and able to work but without a job. A possible cause of low inflation can be due to high unemployment, as shown by France who in 2015 had 10.4% unemployment but only 0.1% inflation. This is because if more individuals are employed the current wage rate will be higher, meaning that individuals will be willing to pay higher prices for goods that will of previously been cheaper. This is called demand pull inflation and occurs when demand that is higher than supply and individuals are willing to pay higher prices. This can be shown on a graph by an increase in the price level of P¹ to P² and a lower level of RNO from Y¹ to Y². However this point is only true on the condition that unemployment is likely to rise, as in reality many economically developed countries such as the UK and USA will only see a less than proportionate rise in unemployment due to a decrease in inflation, meaning that it may not be as significant



The decrease in SRAS¹ to SRAS² may be caused by an increase in employment and wages which will increase costs of productions, leading to lower levels of supply

Another reason why low and stable inflation should be an an aim is because it will lead to an increase in business and consumer confidence. A rise in these will likely lead to an increase in investment especially from businesses as they will have positive views on the current stage in the economic cycle. These investments may be be in the form of purchasing new capital or paying their staff members to take training course. This will help the long run of the economy as these new things will lead to a rightwards shift in the LRAS curve from LRAS^1 to LRAS^2. This will lead to a higher level of RNO from YFe^1 to YFe^2 and subsequently an ~~inflex~~ decrease in the price level of P^1 to P^2. This then shows the effectiveness of having low inflation as businesses are likely to invest due to it being cheaper to do so now rather that in future years. However, this point is only true on the condition that businesses have the available finances to invest, as in reality many smaller businesses in Argentina / Brazil will be focusing on surviving rather ~~that~~ than on long term growth / investment.



In conclusion I believe that inflation should be an objective that is highly important for lesser economically developed countries such as Argentina who have over 30% inflation. But it is less important for countries such as the UK who already have low levels of inflation that can easily and effectively be controlled. These types of countries may be more beneficial to focus on macro economic objectives such as low unemployment as it can be much more dangerous to the population an needs to be addressed well.

This is a Level 4 response

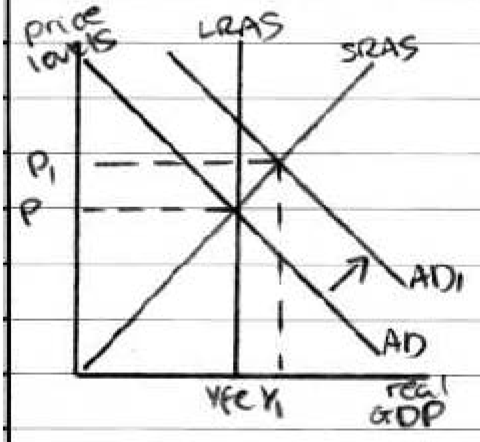
This answer starts with an accurate definition of inflation and some understanding of alternatives. There is some sound analysis of why low and stable inflation may be beneficial for an economy linked to real incomes. The student then evaluates considering the trade-off with unemployment. They also successfully analyse the possible effects on investment with accurate use of diagrams. There is sound, focused analysis but the evaluation, although reasonable, is quite basic in places. This is a good answer, but is not quite developed in places.

17 marks

Response B

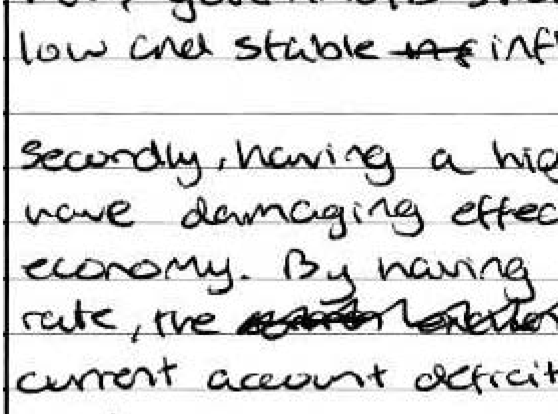
Governments have several macroeconomic objectives they wish to achieve such as: economic growth, low unemployment, low and stable inflation, balanced budget and a balance on the balance of payments.

Most governments around the world regard inflation as their main objective. While some



see inflation as bad, inflation tends to be a positive sign that the economy is doing well. Demand-pull inflation(which is where growth in aggregate demand causes the price levels to increase) is a sign that confidence among consumers, investors and the government is high. in addition, inflation also leads towards economic growth in the short run as an increase in AD also causes lower unemployment. However if inflation becomes volatile and unpredictable the uncertainty in the economy causes a loss in confidence and harsh recessions can follow. High price levels can lead to increased inequality as poorer consumers are hit hardest having to use up a larger proportion of their income. This can lead to increased poverty and the government having to use a larger proportion of their budget to finance this. Therefore to avoid the damaging effects that high inflation can have, governments should focus on keeping low and stable ~~inf~~ inflation.

Secondly, having a high inflation rate can have damaging effects on growth and the economy. By having a high inflation rate, the ~~[illegible]~~ the current account deficit is likely to worsen. Foreigners stop consuming exports since they see artificially high prices, which causes a deficit. At the same time imports for the domestic country appear cheaper. As imports begin to increase and exports decrease there

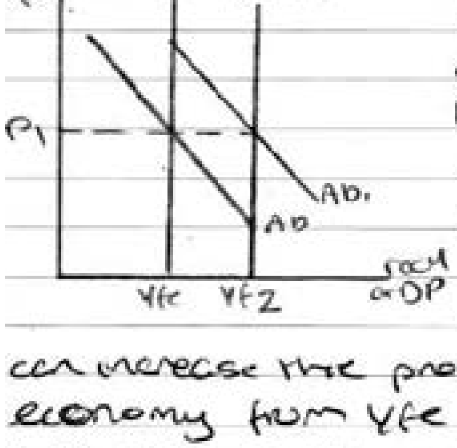


is a reduction in aggregate demand from AD to AD1. As more consumers are spending abroad, domestic AD is shifting inwards, showing a shrinking real economy. Whilst this might cause deflationary pressure on inflation the change may not be enough depending on the rate of inflation and the elasticities of imports and exports. Hence a consequence of high inflation is lower growth

as the economy shrinks, unemployment occurs from Yfe to Y_1. This results in complete government failure. Therefore the government should have low and stable inflation as their main objective.

~~Finally, high inflation could lead towards fiscal drag. By having high inflation in order to maintain the same level of national income, governments have to find ways to increase nominal national income. By increasing~~

Finally, a governments main objective should be long run economic growth. Inflation can be self correcting as the effective use of monetary policy ~~monetary policy~~ can reduce inflation ~~[illegible]~~ in the short run but long run economic growth is the best way to allow AD to expand without adding inflationary pressure to the economy. By



the use of fiscal and supply side policies the government will increase LRAS outwards. For example, investing into education and training schemes such as T-levels in the UK, governments can increase the productive capacity in the economy from Yfe to Yf2. By increasing long run economic growth they are also increasing employment. Higher employment levels means trade unions and workers are more ~~[illegible]~~ successful at increasing their wages allowing them to afford high inflation rates. Despite the real wage unemployment that might occur by shifting LRAS outwards and increasing the productive capacity of the economy, more workers are needed, mitigating and reducing any unemployment that might occur. Hence why the government should focus on long run economic growth instead of low inflation.

Overall, no government can accomplish all of the objectives simultaneously. Trade-offs are inevitable and the objective governments mainly focus on depends on the economy. The stage of the economic cycle greatly affects this as well as during a boom inflation is likely to be high in contrast to a recession. It also depends on the state of the population. If unemployment is high at the same time as inflation such as Argentina which had 34.3% inflation with 9.2% unemployment then the negative effects of ~~unempt~~ inflation have occurred and should be reduced. in the short run inflation can be seen as a sign of prosperity, economic growth and high confidence but if uncontrolled high inflation could lead to no government objective being met as AD reduces shrinking the economy, causing a reduction in growth and increased unemployment in the long run. The costs to inflation are high and though investing in long run economic growth can help a country deal with it, inflation should be a main objective as an economy's macroeconomic success greatly depends on it. Lack of growth damages international competitiveness and should be stopped. So inflation should be main objective.

This is a Level 5 response

The response begins by accurately identifying the macroeconomic objectives and explains why a low and stable rate of inflation may be beneficial for an economy. They successfully provide supported evaluate throughout, for example when they consider the alternative of volatile and unpredictable inflation causing uncertainty. The analysis is sound and focused throughout with suitable application in terms of diagrams, and the students use of data and their own knowledge. The student also considers alternatives to inflation such as achieving economic growth. It is worth pointing out that an answer does not have to be perfect to reach full marks.

25 marks

Essay 1

Question 9

The UK has been running a deficit on its balance of trade in goods and services since 1998. Expenditure-reducing and expenditure-switching policies can both be used to correct a trade deficit. However, the UK government has focused on other objectives rather than achieving a trade balance.

Explain how expenditure-switching policies can be used to reduce a deficit on a country's balance of trade in goods and services.

[15 marks]

Mark scheme

Below is the levels of response marking grid which should be used to mark the 15 mark questions.

Level of response	Response	Max 15 marks
3	**A good response provides an answer that:** • is well organised and develops a selection of the key issues that are relevant to the question • shows sound knowledge and understanding of economic terminology, concepts and principles with few, if any, errors • includes good application of relevant economic principles to the given context and, where appropriate, good use of data to support the response • includes well-focused analysis with clear, logical chains of reasoning.	**11–15 marks**
2	**A reasonable response provides an answer that:** • focuses on issues that are relevant to the question • shows satisfactory knowledge and understanding of economic terminology, concepts and principles but some weaknesses may be present • includes reasonable application of relevant economic principles to the given context and, where appropriate, some use of data to support the response • includes some reasonable analysis but which might not be adequately developed or becomes confused in places.	**6–10 marks**

1	**A weak response provides an answer that:** • has identified one or more relevant issues • has some limited knowledge and understanding of economic terminology, concepts and principles but some errors are likely • has very limited application of relevant economic principles to the given context and/or data to the question • might have some limited analysis but it may lack focus and/or become confused.	**1–5 marks**

Relevant issues include:

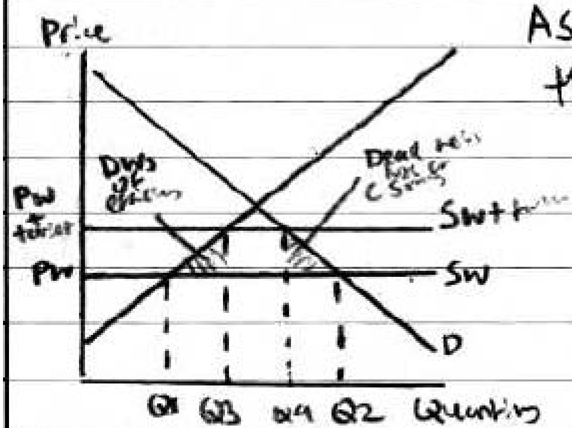
- definitions/explanations: expenditure-switching policies, trade, trade deficit, balance of trade
- explaining the difference between expenditure-switching policies and expenditure-reducing policies
- how expenditure-switching policies cause a shift in consumption away from imports and towards domestic consumption and exports
- reasons for wishing to reduce a trade deficit
- explaining expenditure-switching policies linked to protectionism in terms of:
    - tariffs
    - quotas
    - non-tariff barriers
    - export subsidies
- explaining expenditure-switching policies in terms of exchange rate manipulation in terms of:
    - direct government intervention in terms of buying and selling currency
    - indirect intervention in terms of manipulation of interest rates
- explaining expenditure-switching policies in terms of supply-side policies and making domestic goods and services more competitive
- the relative effects on the volume and value of imports and exports
- the impact on net trade.

Student responses

Response A

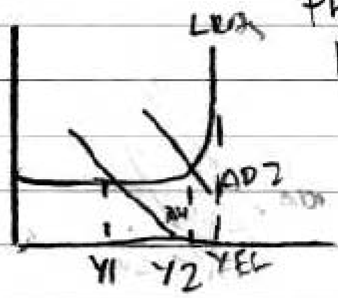
Expenditure Switching Policies are Policies that ~~Switch~~ are used to Switch consumer Spending ~~from domestic~~ to domestic goods from imports.

One ~~method~~ Policy that can be used to reduce a current account deficit (value of ~~exports~~ imports greater than exports) is through the implementation of trade tariffs. These are an added tax to the prices of imported goods.



As a result of an ~~import quota~~, ~~the~~ trade ~~barrier~~ tariff, there is a contraction in demand ~~from~~ for imported goods ~~of Q2~~ from Q2 to Q4. This area creates a deadweight of consumer surplus as consumption of imported goods is deterred due to the upward shift in prices. In addition, there becomes an increase in domestic supply from Q1 to Q3 due to the artificial price increase. Domestic ~~Consumers~~ Producers benefit from this by being able to charge at the PW price and so experience a greater demand for their goods reducing the import withdrawals and bringing balance.

Another policy that can be used is expansionary monetary policy. The lowering of interest rates acts as a signal to foreign investors to no longer invest due to the low returns. This subsequently leads to hot money outflows as these investors no longer demand the pound sterling and as a result weakens the value of the ~~£~~ exchange rate. In turn, this makes the cost of importing go up but exports more internationally competitive. As a result the value of net exports increases leading to a rise in AD and greater balance of trade.



This is a Level 2 response

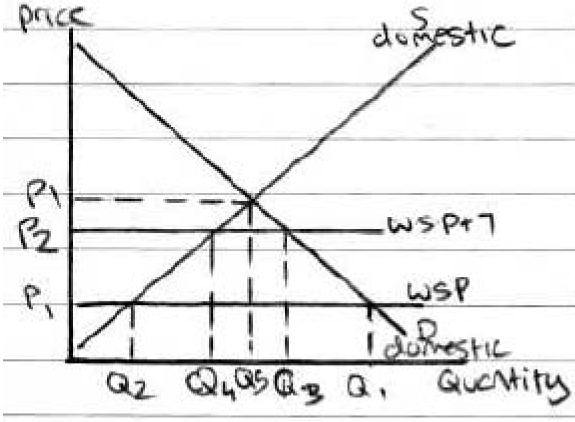
The student demonstrates accurate knowledge by providing an explanation of expenditure-switching policies. They go on to provide sound analysis of how a tariff works although there is a small error on the diagram. The second issue is confused. Although the student does try to link interest rates to the exchange rate, they don't consider the likelihood that reduced interest rates are likely to increase imports. The diagram also has parts missing. This is a reasonable response, but it is not adequately developed and confused in places.

10 marks

Response B

Expenditure-switching policies are policies used ~~to~~ by governments to switch from imports to domestically produced goods. Protectionism are policies implemented to reduce imports.

A tariff is an expenditure-switching policy as it is a tax on imports and reduces the quantity of imports in favour of domestically produced



goods. The World supply shows the ~~quantity~~ of effect international trade has on an economy. Low cost producers from abroad supply at P_1 and imports are demanded at Q_1 whereas domestic producers are ~~demanded~~ supplied at Q_2 since they cannot compete. In order to reduce the amount of imports and reduce the deficit a tariff is implemented at (WSP+T) at P_2. This makes imports more expensive and reduces their demand to Q3 whereas domestic supply increases to Q4. Hence the expenditure-switching policy of tariffs has reduced the current account balance of trade deficit.

A balance of trade in goods and services deficit means the amount of goods/services imported exceeds the goods/services exported. Another expenditure-switching policy are quotas. Quotas are a physical limit placed on imports. By placing a quota, the amount of imports allowed into the economy is reduced. The limited supply increases their price and consumers will turn towards domestically produced goods since they are cheaper and more accessible. As the amount of imports reduces the balance of trade in goods/services ~~redu~~ deficit reduces as well.

This is a Level 3 response

This response begins with accurate definitions of both expenditure-switching policies and protectionism. They explain the effect of the imposition of tariffs with an accurate diagram. In general, the analysis is sound although there is a small error in their explanation of the diagram. The student also analyses quotas with accurate explanation. This is a well organised response with clear, logical chains of analysis.

12 marks

Question 10

The UK has been running a deficit on its balance of trade in goods and services since 1998. Expenditure-reducing and expenditure-switching policies can both be used to correct a trade deficit. However, the UK government has focused on other objectives rather than achieving a trade balance.

Assess the view that floating exchange rates are always better than fixed exchange rates.

[25 marks]

Mark scheme

Use the level of response table on page 10.

Areas for discussion include:

- definitions/explanations: exchange rates, floating exchange rate, fixed exchange rate, exchange rate systems
- explaining the possible ways in which 'better' can be assessed by linking this to the macroeconomic objectives
- how floating exchange rates work and the factors that may cause supply and demand of currency to change
- linking floating exchange rates to FOREX
- explaining the possible advantages of being on a free-floating exchange rate system (or the disadvantages of being in a fixed system) in terms of:
    - automatic correction/stabilisation
    - allowing monetary policy freedom, for example interest rate manipulation
    - reduced needs for currency reserves and government intervention
    - speculation may be reduced
    - depreciation may improve injections leading to benefits of growth and employment
- explaining the possible advantages of being in a fixed exchange rate system (or the disadvantages of being in a floating system) in terms of:
    - avoiding sudden fluctuations which may alter costs and imports/exports
    - encouraging confidence and investment
    - encouraging trade
    - possibly avoiding transaction costs if fixed in a monetary union
- the nature of a fixed system, whether it is in a monetary union or not
- considering real-life examples and the fact that very few nations actually work on a truly fixed system
- whether currencies do actually correct or stabilise trade
- the possible trade-offs that can occur, for example a depreciation may improve short-run growth at the expense of inflation
- that speculation is more prevalent in a floating rate system although it may become more serious in a fixed rate system when it becomes obvious that the currency is over or undervalued (the one-way option problem).
- considering managed floats rather than truly 'fixed' systems

- considering real-life examples such as: the Bretton Woods system, the ERM, Danish Krona fixed to the euro and attempts by some other countries, particularly in Africa, to fix their currencies to the US$ or the euro.

The use of relevant diagrams to support the analysis should be taken into account when assessing the quality of the student's response to the question.

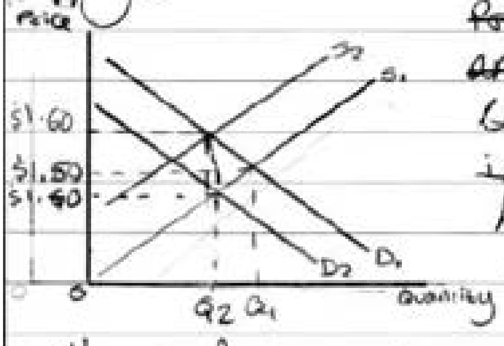
Student responses

Response A

~~Exchange rates are the value of one currency~~

An exchange rate is the value of one currency in terms of another e.g £1 = $1.16. A floating exchange rate is one which is determined by the forces of supply and demand. A fixed exchange rate is determined by the Centeral Bank and Government Intervention.

Floating Exchange rates are determined by supply and demand. ~~An increase in the Price of another value of another currecy this may lead to an a reduction in demand~~



This may lead to constant fluctation or uncertainty in the economy this ~~will reduce saving as there is no confid~~ will reduce FDI and other economies confidence in the UK economy as there is no stability Quantity reduces from Q1 to Q2. With floating Exchange rates free from Government Intervention the government may now focus and fund ~~at~~ other macroeconomic objectives such as unemployment reducing. The Central Bank may also increase attention towards other policies such as

Quanitative easing or inflation. The floating exchange rate is also automatically adjusted for BOP. ~~Fixed exchange~~

Fixed Exchange rates are contolled / determind by the Government and Centeral Bank. with the Centeral Bank (The Bank of England in the UK) ~~involve~~ as determinants of the ~~exhe~~ exchange rate there is less volitility and uncertainy. This means It will be more attractive for economies to trade and investening ~~buying~~ in our economy as there is ~~certainity~~ there is stability. This however means there is less focus on ~~macroe~~ macro ecconomic objectives such as employment or inflation due to both the government. Fixed Exchange rates may also increase outflows of Hot money.

Overall, it depends on the state of an economy. It may be argued that the development of an economy will play an impact on the type of ~~economy~~ exchange rate used. Less economically developed countries may tend to use floating exchange rate systemes as other mackroeconomic, as welle as submacroenomic, objectives may need to be prioritised. A country such as the UK may benefit more from a fixed echange rate as speculation is a heavy influencer in countries as such. (evidently seen in the UK during the pandemic) Speculation cause irrational descions leading to unintended consequences. As the UK ~~ha~~ uses the 5th strongest currency in the word (pound sterling) the Economy shouldn't suffer from lack of investment as seen in previous years where even in a finacial crisis around 2008 and intrest rates being the lowest they have been in around 400 years, Despite an increase in current account and Budget deficit countries and other economies invest and have confidence.

This is a Level 2 response

The answer begins with a reasonable definition and explanation of what exchange rates are. The student then provides reasonable analysis of why floating exchange rates may affect FDI. They also consider the fact that floating exchange rates may allow the focus of monetary policy to be shifted but this is underdeveloped. The student then considers benefits of fixed rates, however, the analysis doesn't fully explain the effects and there is no justification regarding the outflows of hot money. The conclusion is highly speculative and unsupported. This is a fairly weak response but with some understanding which is limited and confused in places.

8 marks

Response B

Free floating exchange rates are exchange rates influenced by free market forces of supply and demand with no government intervention. Fixed exchange rates are pegged to another currency or the price of ~~gold~~ gold and need government intervention to maintain value.

Floating exchange rates tend to be better than fixed because there is no chance of overvaluing or undervaluing the currency. The fact that the government cannot decide its value and that it is the free market that determines the value ~~means~~ means that it is ~~a more stat~~ better for governments. In the late ~~19th~~ 20th century, the UK turned part of the ~~fixed~~ Single European Market a precursor to the EU. As a result of ~~stopping~~ not having a free floating exchange rate the S.E.M exchange rate overvalued the UK's £ sterling. In order to still be a part of the managed exchange rate the UK had to spend over 3 billion pounds in one day in order to avoid being kicked out from the S.E.M all because its currency was over-valued. Hence, having a free floating exchange rate ensures greater macroeconomic stability.

The main argument for fixed exchange rates is that the stability they bring has several benefits. Free-floating are very volatile as their value are continuously changing with large ~~more~~ fluctuations. This can deter investors away as there is a greater risk of loss. Fixed exchange rates provide greater certainty for investors. This tends to lead to higher levels of Foreign Direct Investment (FDI) into the economy. However fixed exchange rates are very expensive to maintain as they require large levels of foreign ~~reserve~~ reserves in order to buy and sell on the forex market to maintain the value. Despite fixed exchange rates sounding good for less economically developed countries as it provides a steady inflow of FDI, they often lack the large levels of foreign currency reserves needed to maintain this. Therefore, free floating are a better option than fixed. Finally countries such as the UK, USA and the Eurozone all have complete control over their monetary policy. If the UK experiences high levels of inflation ~~[illegible]~~. The central Bank can use interest rates to incentivise saving instead of borrowing, reducing the level of aggregate demand and inflation. Likewise it can decrease interest rates to increase the inflation ~~[illegible]~~ rate by making borrowing more attractive than saving, increasing aggregate demand. A country with a fixed exchange rate would be more cautious of using monetary policy as changes to interest rates and inflation have a direct impact on the exchange rate and in the event they have to use monetary policy tools it is going to require large levels ~~to~~ of foreign currency reserves to counteract its effects on the exchange rate. This is why free floating exchange rates are better.

Overall, free floating exchange rates are easier to manage and give the economy greater use, ~~&~~ freedom and control over their monetary policy tools. More economically developed countries such as the UK, USA and Eurozone tend to have free floating exchange rates. Despite their volatility which often deters investors from investing FDI into them, they don't run the risk of over/under valuing their currencies if a fixed exchange rate over-values they are going to need to spend more money on the forex market by selling their foreign reserves and buying their own currency to increase its value, like what happened to the UK when it was part of the S.E.M. Countries who have sufficient reserves may wish to have a fixed exchange rate to increase stability and FDI but LEDCs who are the ones who could benefit often do not have sufficient funds. In the long run free floating exchange rate is cheaper and allows the central bank to use monetary policy fully without worrying about the exchange rate as the market will adjust on its own to any corresponding changes. Whether to have a floating or fixed exchange rate greatly depends on the governments objective as they might prioritise other ~~goe~~ macroeconomic objectives. In conclusion I believe free floating is a better long term solution as it is cheaper and prevents the risk of overvaluing the currency having detrimental effects on trade ~~etc~~ as the free market will always adjust.

This is a Level 4 response

This response begins with accurate explanations of floating and fixed exchange rates. The student goes on to explain the problems of being in a managed or fixed exchange rate (although confuses the European single market and European exchange rate mechanism). They then successfully analyse the benefits of fixed rates and in particular, the effects on investment. The answer has clear, logical chains of analysis and develops arguments about control over monetary policy in terms of interest rates. There are occasions where the student repeats issues. There is some reasonable evaluation but this is not always fully supported.

20 marks

Essay 2

Question 11

In 2018, the European Commission estimated that Bulgaria and Romania were both experiencing positive output gaps whilst the UK was experiencing a negative output gap. Persistent output gaps can cause problems for economies which may be addressed by supply-side improvements.

Explain the main problems for an economy of having a large positive output gap.

[15 marks]

Mark scheme

Use the levels of response table on page 36 and 37.

Relevant issues include:

- definitions/explanations: output, output gap, positive output gap, economic cycle
- linking positive output gaps to booms
- reasons which may have caused an economy to end up in a positive output gap
- linking positive output gaps to real output growing faster than productive potential
- if the output gap is persistent it will eventually lead the economy to overheat
- explaining the problems which may be caused by positive output gaps such as:
    - demand-pull inflation as too much money is chasing too few goods
    - cost-push inflation due to labour shortages
    - wage-price spirals
    - rising imports as consumption is rising and possible leakages rise
    - falling exports if inflationary pressure occurs
    - an increase in the current account deficit
    - unsustainable asset price rises
    - potential effects on the exchange rate
- linking the 'problems' of the economy having a large positive output gap to the causes such as low productivity growth.

The use of relevant diagrams to support the analysis should be taken into account when assessing the quality of the student's response to the question.

Student responses

Response A

An output gap occurs when the actual, short-term, growth of an economy is either above, positive gap, or below, negative gap, the trend, long-term, growth of the economy.

A positive output gap is something common, as it occurs within the economic cycle, it has got positive implications but also negative, in case of the gap being excessively big. The two main problems arising from a positive gap are: Increased inflation & the creation of asset bubbles.

Increased inflation might be desirable in some ocasions, yet it has got to be controlled and stable. If inflation rises more rapidly than wages there will be fiscal drag, where some people pay for a tax band in which, if accounted for in real terms, they shouldn't be in as their income, in real terms, hasn't rise. This creates social tensions and pushes ~~trade~~ unions & workers to strive for higher wages, firms will, likely, give in and incur a higher cost of production, which further increases inflation as they charge higher prices to account for the higher costs, this means it becomes a self-fulfilling cycle, which needs govt. intervention to be controlled, or firms taking lower profits and internalising the cost of higher wages. It is also likely that firms are not willing and or able to have the same employment level after an increase in wages which means that it could create inflation

Secondly, the creation of asset bubbles as a result of herding, ~~be~~ this imitating the behaviour of others, is extremly dangerous if the asset is not accounted for in the CPI's basket of goods and services as the central bank might over-look the asset bubble allowing it to grow further, which will have ripple effects when it bursts.

Asset bubbles, like the one in 2008, can grow alarmingly fast and most commonly during positive output gaps as there is high confidence, high growth & positive expectations of the future, as well as more disposable income, due to a higher than normal level of employment, this results in consumers and firms wanting to invest and herding takes place until rational ~~consum~~ investors realize there is a bubble and begin cashing out before its too late leading to the burst of the bubble.

In conclusion positive output gaps are something desireable but they should be controlled, with the use of contractionary policies to avoid the negative consequences associated.

This is a Level 2 response

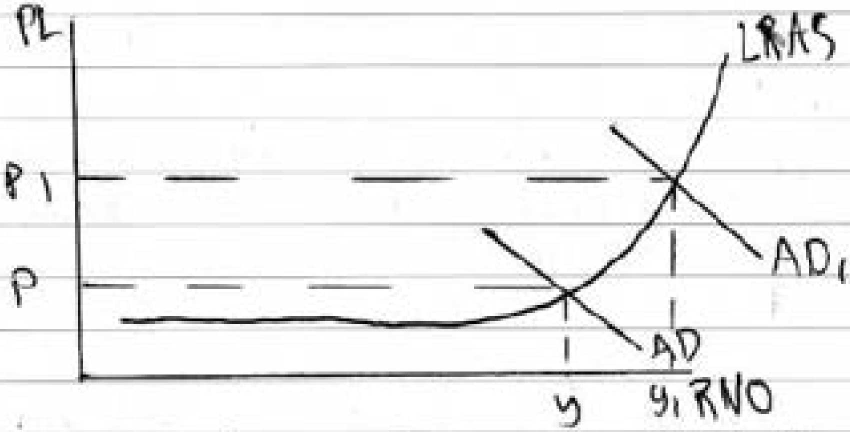
The response begins with an accurate knowledge and understanding of output gaps. The student accurately explains the effects on inflation with logical chains of analysis although this would have benefitted from application including a diagram. The student also describes potential asset bubbles although the analysis is quite basic. There is no need to provide a conclusion in this type of response as evaluation skills are not required. This is a reasonable response which focuses on relevant issues but isn't quite adequately developed in places.

9 marks

Response B

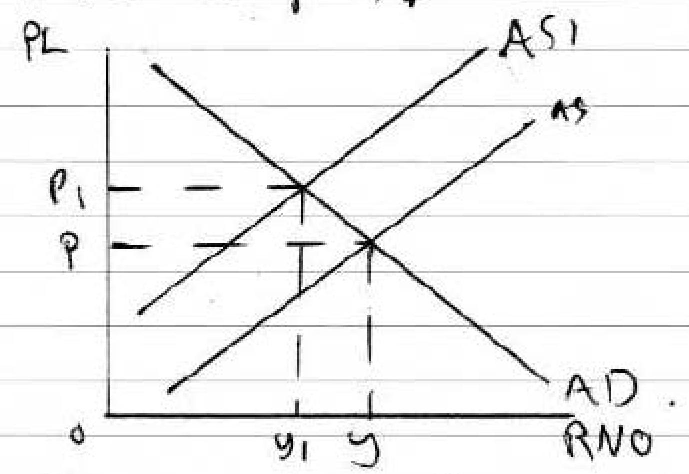
A positive output gap is where an economy is operating beyond is productive potential, which poses significant risks in the economic cycle, such as the threat of recession. The UK is currently operating with a positive output gap of 0.7%.

The risks involved in a positive output gap can be quite extreme. Keynesian economic theory suggests that there is no spare capacity in an economy when there is a positive output gap, and there is no room for an increase in aggregate demand without significant ~~inflationary~~ ~~pressures. This~~ demand-pull inflationary pressures. This is shown in the diagram below:



This is a problem because it means that the purchasing power of money is weakened and consumers ~~are~~ are worse off, as the price level have increased from P to P_1.

Also another risk is the reduction in international competitiveness stemming from the high inflation. This means that consumers will have to pay more for foreign goods and services. This is a particular problem for firms purchasing raw materials as their costs of production would increase, driving a leftward shift in SRAS, shown in the diagram:



The decrease in output from y to y1 also represents an increase in unemployment, as demand for labour is derived from the demand for a good / service. This is a problem because less people will be in work and paying taxes which would negatively impact government finances.

This is a Level 2 response

The student begins with some explanation of the output gap, although loses focus slightly. The student successfully explains how a positive output gap could lead to demand-pull inflationary pressure and successfully applies a diagram to the situation. The student then identifies that this may reduce competitiveness but switches to cost-push inflation with no relevant explanation. The final analysis is speculative and not well developed. This is a reasonable response which includes some reasonable analysis but is not adequately developed in places.

8 marks

Question 12

In 2018, the European Commission estimated that Bulgaria and Romania were both experiencing positive output gaps whilst the UK was experiencing a negative output gap. Persistent output gaps can cause problems for economies which may be addressed by supply-side improvements.

Evaluate the view that supply-side improvements in the UK economy can best be achieved through the use of interventionist policies.

[25 marks]

Mark scheme

Use the levels of response table on page 10.

Areas for discussion include:

- definitions/explanations: supply-side, supply-side improvements, interventionist policies
- explaining why supply-side improvements may be necessary
- the difference between interventionist and free-market approaches
- the differences in targeting labour markets or product markets
- explaining interventionist supply-side policies such as:
    - education
    - apprenticeships/vocational training
    - infrastructure
    - regional policy
    - health spending
    - housing supply policies
- explaining free market supply-side policies such as:
    - privatisation
    - deregulation
    - tax and welfare benefit system changes
    - flexible labour markets including trade union reform
    - promoting free trade
    - removing red tape/bureaucracy
    - policies to promote immigration
- the effects of supply-side policy on the macroeconomic goals or living standards
- considering that some supply-side policies require 'intervention' to make them more 'free-market' such as legislation reducing trade-union power to allow the market system to work
- the problems that so called 'carrot and stick' policies may create
- the merits of interventionist versus free-market approaches
- the unintended consequences of policies or government failure
- the real-life experiences and effectiveness of policies: for example, has privatisation worked in all markets such as railways?
- the potential financial costs or cost effectiveness of supply-side policies
- considering that supply-side policies can affect AD
- the difficulties of measuring the effectiveness of supply-side policies and time lags.

The use of relevant diagrams to support the analysis should be taken into account when assessing the quality of the student's response to the question.

Student responses

Response A

Supply-Side improvements makes reference to firms improving supply without govt. intervention This usually takes place in the form of investment towards R&D which ~~...~~ aim to improve the efficiency and productivity of production, investment in the training of workers is another form.

The use of interventionist policies might encourage firms to strive towards supply-side improvements by the use of regulation, where firms, for example, have to meet an investment threshold according to their revenue, and in exchange recieve a decrease in taxation, to incentivise firms, and attract foreign firms.

The use of interventionist policies would be most efficient as firms tend to disregard the positive externalities associated with supply-side improvements, this is because there exists imperfect information which, therefore, creates bounded rationality for firms. An example of why firms should accept intervension for supply-side improvements:

If a firm invests in training of their workforce they will be more efficient and productive, making that firm more competitive than the rest, which means the rest will also train the workforce, this results in a better skilled workforce and higher output but also higher occupational mobility for workers, which would reduce unemployment as they can switch jobs more rapidly

Given this, it makes sense for interventionist policies to be used as govt's want to achieve macroeconomic objectives, in this case benefiting from growth & lower unemployment.

However if the interventionist policies are too intrusive or agressive firms might decide to go abroad where they can have lower costs of production for the same level of output, making them more revenue and likely more profitable.

If firms leave the economy there is a decreas in the employed ~~worf~~ workforce, lower output, and more people claiming benefits meaning higher costs to the govt.

In conclusion, due to imperfect information leading to bounded rationality interventionist policies would be most effective at achieving supply-side improvements. However the way and degree of intervention when implementing policies should be taken into account to avoid firms fleeing the economy because of the intervention, which would result in a loss of jobs and lower GDP amongst others.

This is a Level 2 response

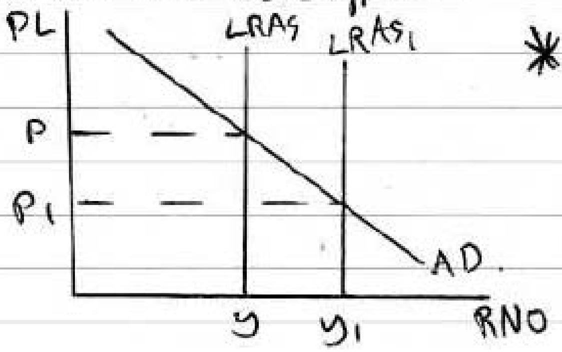
This response begins with a slightly confused statement that supply-side improvements do not require government intervention, possibly confusing the term with free-market supply side reforms. There is then some quite confused analysis about regulation and interventionist policies. The analysis regarding training is reasonable but quite basic. Again, analysis and evaluation of firms possibly leaving the economy is unsupported and confused. This is a fairly weak response with some basic understanding but confuses terms and issues throughout.

8 marks

Response B

Supply side policies aim to influence the supply aspect of an economy. There are two main forms of supply side policy: ~~interventionists~~ an interventionist approach and a free market approach. Both share the aim of increasing supply but do it in very different ways. Arguably, interventionist policies are better because free market policies can see negative effects such as increasing inequalities.

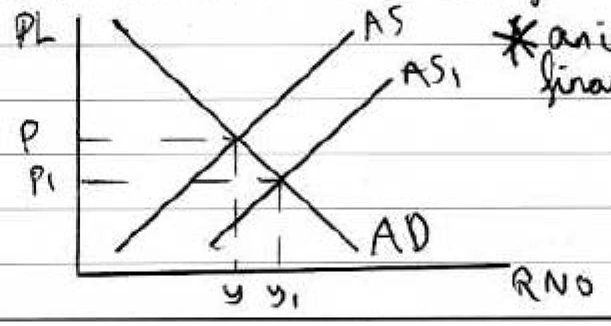
Primarily, it is arguable that supply-side ~~improvements~~ improvements can be best achieved through the use of ~~supply~~ interventionist policies ~~because~~ such as increased government spending on training and education*. This would see an increase in LRAS as the workforce will be better equipped in the future. This is shown in the diagram:



* Indeed, Tony Blair famously remarked that "education is the best economic policy".

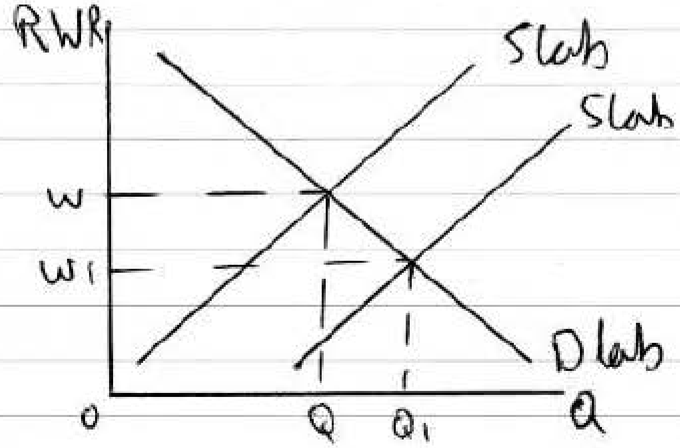
However, a proplem of this policy is the time lag from when it is introduced to when it begins to take effect. We would not see the results until a new generation has undergone training and education. Therefore, it could be argued that interventionist policies are not the best way of improving the supply side of the UK economy.

Additionally, interventionist policies could be argued to fall short of free market policies in influencing the supply side of an economy. For example, by cutting benefits there will be* a greater incentive for people to join the labour market which will see a shift right in the aggregate supply of an economy, shown in the diagram:



* an improvement to government finances, as well as

This, arguably, is a better policy because the effect would be rather quick, with people not being able to live off benefits so quickly joining the labour market. However, the effects of such a policy could see rising inequality. With more workers joining the labour market, this would see an increase in the supply of labour, leading to lower real wage rates at W_1, shown in the diagram below:



Therefore, free market supply side policies are flawed because the lowest earners will suffer from increasing inequalities and lower wages.

In line with this argument, it is arguable that interventionist policies are more effective, ~~as it will be~~ such as increased spending on infrastructure, helping the market failure of geographical ~~immobility~~ immobility of labour. This will increase supply as more workers will be able to travel to work if, for example, there is a better railway service funded by interventionist supply-side policies. However, this would cost the government significant amounts of money and would potentially create a tax burden on future generations.

This has led some to argue that interventionist policies are two costly and free market supply-side policies are preferable.

In conclusion, supply-side improvements in the UK economy can be best achieved through the use of interventionist policies because although they will cost a lot and we may not immediately see the benefits, they are preferable to free-market policies as they will not increase inequality like free market policies inevitably would.

This is a Level 4 response

The answer begins by explaining the difference between interventionist and free market supply-side policies demonstrating accurate knowledge and understanding. The student explains interventionist policies in terms of education and accurately analyses the effects with logical chains of reasoning. There is suitable application from the student's own knowledge and diagrams are used effectively. The student considers alternatives and other interventionist policies such as improving infrastructure. There is evaluation throughout, although in places it is quite surface level. The final conclusion is quite short and basic which stops it from achieving Level 5.

20 marks

Essay 3

Question 13

Over the past 20 years, the growth of world trade has averaged 6% per year, twice as fast as the growth in world output. As countries become ever more interconnected, they experience both economic opportunities and threats.

Explain reasons for changes in the value of exports from the UK to the rest of the world.

[15 marks]

Mark scheme

Use the levels of response table on page 36 and 37.

Relevant issues include:

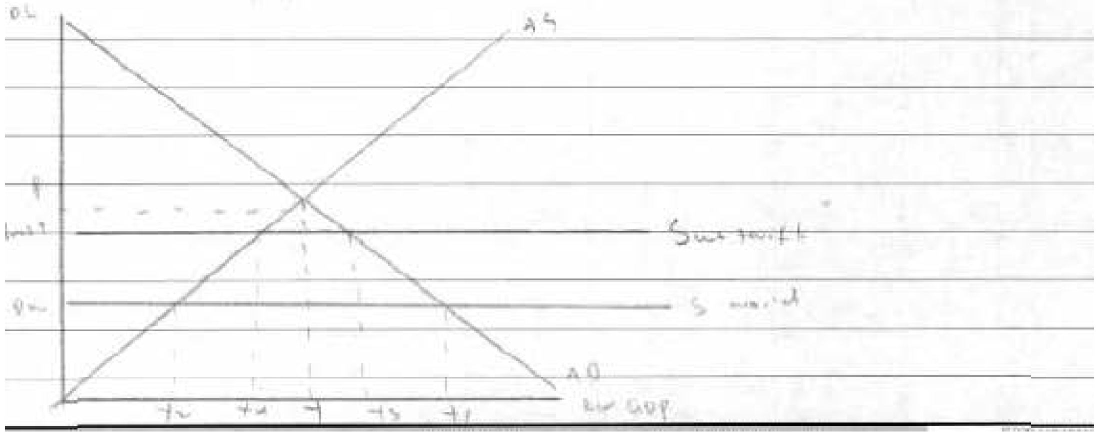
- definitions/explanations: trade, exports, value of exports
- explaining the value of exports in terms of the quantity/volume and price of exports
- explaining how changes in the pattern of trade can affect trade values
- the significance of trade and exports to the UK economy
- using relevant examples to illustrate the changes in the value of exports
- explaining comparative advantage and possibly giving a numerical example of comparative advantage
- explaining possible reasons for changes in the value of exports from the UK to the rest of the world such as:
    - changes in comparative advantage
    - changes in protectionist/free trade policies in other countries
    - leaving or changing membership of trading blocs such as the EU
    - consideration of trade diversion/trade creation arguments
    - exchange rate changes
    - changing quality/reputation
    - de-industrialisation
    - economic growth (or decline) in other nations
    - external shocks
    - innovation and invention (both product and process)
    - technological improvements that have led to reductions in cost of transport and communications.

The use of relevant diagrams to support the analysis should be taken into account when assessing the quality of the student's response to the question.

Student responses

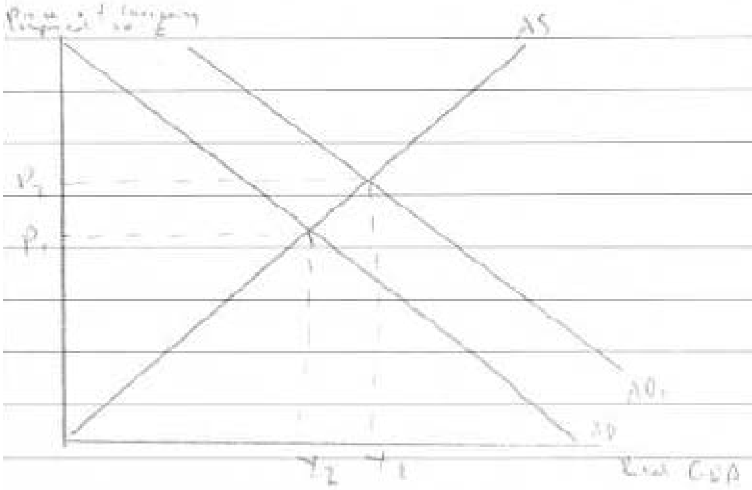
Response A

One reason for the ~~difference~~ change in ~~value~~ value of exports from the UK to the rest of the world is that the UK has many different trade deals and agreements. An export from the UK to countries in the EU can be one price but to ~~A~~ Russia for example it would be a different price. This is because of allies and trade deals so barriers to trade for EU ~~contacts~~ countries are less than Russia, so prices of exports differ. Recently, due to the war between Russia and Ukraine, the UK has increased prices of wheat to Russia as a retaliation for increased gas prices. Many countries use tariffs and quotas as ways of retaliation because countries have become so interconnected, some ~~ex~~ imports have become the norm for people.



Tariff prices vary for different countries so ~~UK's~~ the value of UK's exports vary.

Another reason for the UK's exports varying in value across the world is because of its exchange rates compared to other economies. If the £ is strong compared to another economy, the ~~x~~ importing consumer will find it expensive and vice versa. For example, the turkish Lira plummeted which saw a huge decrease in their demand for UK goods, as the ~~price~~ value increased whereas ~~demand~~ imports from Turkey in the UK grew massively. This is sometimes auto-correcting as due to a great increase in demand for the turkish Lira due to the decrease in value, supply and demand forces in the free market bring its ~~k~~ value back up.



This is a Level 2 response

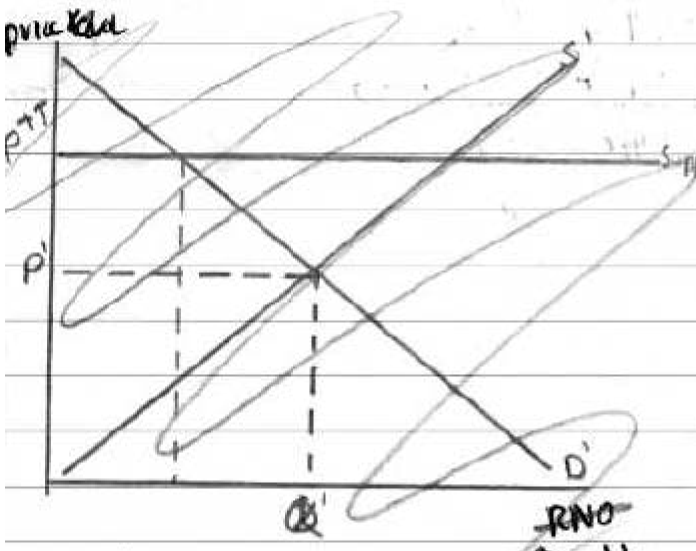
This response begins by identifying trade deals as a reason why the value of exports has changed from the UK to the rest of the world. There is a little confusion part way through where the student discusses wheat prices. The diagram used is also confused with some micro and some macro elements. The student then provides reasonable analysis of exchange rates, however, confuses the diagram again. This is a reasonable response which shows some satisfactory knowledge, but the analysis is not quite adequately developed in places although there are some attempts at application.

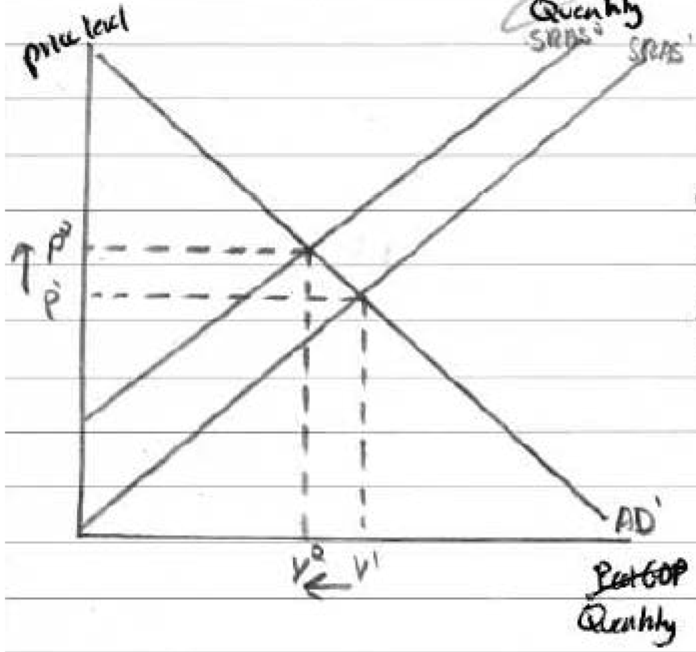
8 marks

Response B

The first reason why there may be changes in the value of exports from the UK to the rest of the world is due to exchange rates. This is the value of one currency to the value of another currency for for a different country. If the UK has a high exchange rate value it would be more expensive for other countries to buy the UK's exports as they would have to spend higher amounts of their own currency to purchase the same amount of goods. ~~This is further why some~~. However on the other hand, if the UK has a weak exchange rate, it would be cheaper for other countries to buy our exports as their currency would be more valuable and ultimately would be able to buy more exports for a cheaper price.

Another reason why a possible change in the value of exports from the UK to the rest of the world is due to tariffs. This is a tax that some countries add on to exporters wanting to sell their goods to another country. This can be shown on the bellow diagram in the left wards shift

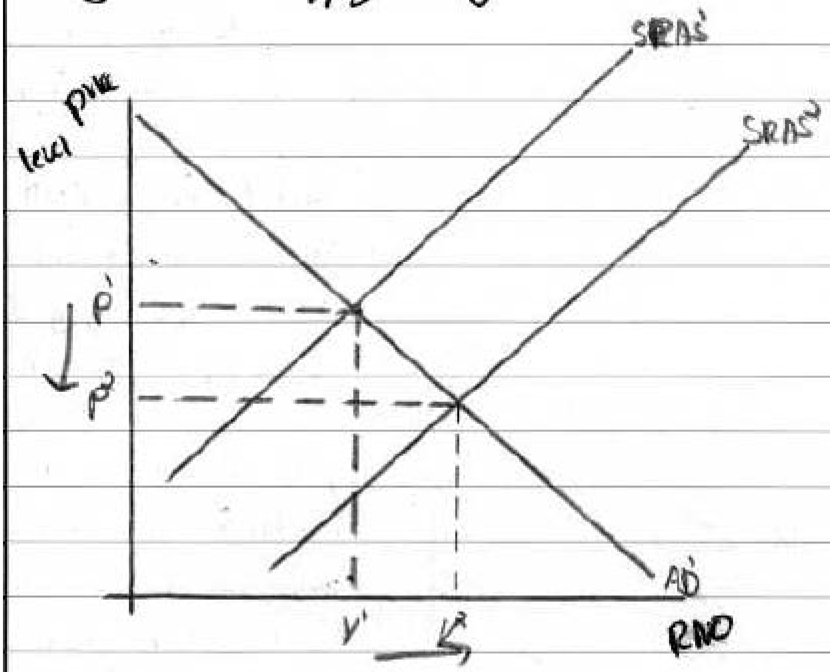




in SRAS' to SRAS² this is due to firms having less of an incentive to sell their goods to a country as they will have ~~to~~ higher costs of production which means that the firm will sell less goods abroad. This will lead to ~~the~~ lower quantity ~~of~~ of goods being exported from Y' to Y² and ultimately causing a price increase from P' to P². This then shows that a country wanting to buy UK exports will have to pay a higher price if they have an tariff on goods and services.

Another possible cause for the changes in the value of exports to the UK to the rest of the world is due to trade agreements. This is similar to my point above but different if the UK have a free trade agreement with the other country. An example of this is that the UK have

have recently signed a free trade agreement between New Zealand. This means that goods sold between these two countries ~~both~~ won't be restricted by quotas or have to have a tariff on them. This will incentivise the UK to sell more goods to countries ~~to~~ with free trade as they won't have to ~~p~~ raise the prices. This means that the ~~g~~ exported goods will have a lower price compared to countries that have trade restrictions that will ultimately have to pay a higher price. This can be shown on a diagram with SRAS' shifting to SRAS², leading to a price ~~incr~~ decrease in P¹ to P² and a rise in quantity from Y¹ to Y² as a result in ~~both~~ the UK ~~exports~~ having incentives to supply more goods.



This is a Level 3 response

The student begins with analysis of exchange rates with sound knowledge and logical chains of analysis. There is then consideration of tariffs and the possible effects on short-run aggregate supply. There is an error on the diagram and the student should refer to 'price level' rather than 'price' in the analysis but generally it is sound. The student then discusses trade agreements. There is some suitable application. This is a good response which develops a selection of key issues.

12 marks

Question 14

Over the past 20 years, the growth of world trade has averaged 6% per year, twice as fast as the growth in world output. As countries become ever more interconnected, they experience both economic opportunities and threats.

Evaluate the view that international trade always benefits nations.

[25 marks]

Mark scheme

Use the levels of response table on page 10.

Areas for discussion include:

- definitions/explanations: international trade
- explaining the alternatives to international trade such as protectionism or closed economies
- different stakeholder groups for analysis such as firms, households, the government or in terms of the macroeconomic objectives or other objectives such as the environment
- explaining the benefits of trade such as:
    - benefits from comparative advantage
    - economies of scale
    - increased competition
    - lower prices
    - access to more diverse markets
    - trade creation
    - export-led growth and employment
    - encouraging FDI
    - increased product and process innovation
    - welfare gains
    - improving international relations/reducing conflict
- explaining the potential drawbacks of trade such as:
    - loss of domestic industry
    - structural unemployment
    - potential loss of infant/sunset industry arguments
    - leakages to the circular flow if a net importer
    - environmental damage due to transportation
    - trade deals may cause political arguments
    - potential trade of demerit goods/illegal goods/weapons
- using real-life examples of where international trade has helped or damaged industries in the UK or the rest of the world
- whether protectionist policies or having a closed economy would have benefited different nations rather than trade
- the limitations of trade such as assumptions about the model of comparative advantage
- the different industries that LEDCs and MEDCs end up specialising in and the effects of this in terms of development

- the different experiences of LEDCs and MEDCs regarding the terms of trade or problems of primary product dependency
- considering living standards in LEDCs may be damaged in terms of worker exploitation or the environment
- considering the term 'always'
- the inability of some nations to be able to fully exploit their comparative advantage
- considering both the positive and negative impact of MNCs on different nations.

The use of relevant diagrams to support the analysis should be taken into account when assessing the quality of the student's response to the question.

Student responses

Response A

4) International trade is a result of Globalization. This is the increased interconnectivity and inter-dependancy between countries. Whilst it has been extremely beneficial in economic growth it can have downsides on both the supply and demand sides of trade.

Some countries have excelled at international trade such as china being the largest manufacturer of goods to the western world. Countries like America and the United kingdom are dependent on their production for items such as clothing, toys and electronics. These countries are attracted to china as the country has high production productivity and a weak currency making the goods extremely cheap. Whilst this has been beneficial to china in the global market, this excessive production has lead to significant down falls.

China has some of the poorest living standards ~~as~~ ~~to~~ They havent ~~chosen~~ enforced environmental protection policies and due to the over production in factories they experiance some of the highest levels of pollution. In addition due to factors such as a weak currency ~~to~~ which they have to maintain in order to keep their global market competitiveness ~~the~~ ~~as~~ ~~result~~ ~~the~~ people are often ~~poor~~ live in relative poverty. Furthermore, due to most of their government investment going into manufacturing infrastructure they may see a 'brain drain'. This is a term use to ~~describe~~ describe a net ~~m~~ outward migration of skilled workers who may seek to enter coutries with more development.

On the other hand, courties can become too reliant on international trade (through imports) causing higher levels of ~~of~~ unemployment ~~to~~ and low economic growth. An example of this can be seen it the UK, periods such as the industrial revolution saw a huge boom in the UK economy. However, as globalisation became increasing accessable to people and products became cheaper to manufature elsewhere there was a huge decline in unskilled jobs avaliable. The loss of jobs combined with peoples occupational ~~imp~~ immobility, ~~has~~ lead to huge levels of unemployment. The effects of this can still be seen today as most jobs require skill or expertise. This increases the number of people unable to find employment. Ultimatly, as internation trade has removed some low skilled jobs from countries it doesn't always have beneficial affects.

Furthermore, the United Kingdoms reliance on international trade has meant it has truggled to grow it's own economy. The UK has a high current account deficit.

Things such as Brexit aim to improve this as it isn't beneficial to a nation to have a weak economy in the global market.

In conclusion, international trade can and has had extremely positive affects on the welfare and economy of nations. However, it does not always completely benefit nations as being to reliant on it either through the amount you demand from it or how much you supply in it can have negative affects.

This is a Level 2 response

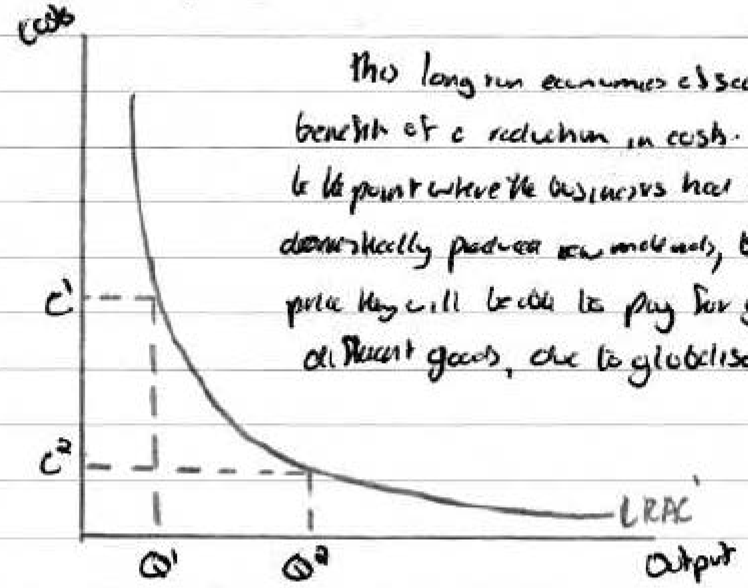
The answer begins with a slightly confused explanation of trade linked to globalisation. The student analyses how China has benefitted from trade, however, the analysis is quite weak and the response is not developed well. The student moves on to explain environmental issues, however, the response is not particularly focussed on trade. They then consider the UK's experience of running a trade deficit, but again, the analysis is very limited and opportunities to use economic terminology are missed. Overall, it is a fairly weak response with some understanding, but the analysis is very limited.

10 marks

Response B

In this essay I will be evaluating the view that international trade always benefits nations. I believe that international trade is highly beneficial for most countries that take part. But I disagree that it is "always" beneficial for nations. Globalisation is the process in which multiple nations become inter dependent and inter connected.

The first reason why I believe that international trade is benefit for nations is that it allows the domestic firms to benefit from economies of scale. If countries are getting more interconnected it will allow firms to buy raw materials from foreign countries for much cheaper than they would be able to in their own country. They will likely purchase them in larger quantities, purchasing e. of. s, which will allow them to reduce the average unit cost. This is beneficial for the nations as it will allow them to sell the goods at a lower price level, improving the international competitiveness of the country. This is highly beneficial as it may improve the trading account if they are able to increase the sales of their exports. However, this point can be weakened as it means that the country loses domestic production of raw materials to other countries that can produce them cheaper. For example the UK lost its ~~[illegible]~~ ship building industry to India and China in the 1980's. This may have been because they have lower restrictions on how much they can pay their staff, this means that the UK faced large amounts of unemployment, especially in the North West due to the decline for UK built ships as a result of cheaper prices elsewhere.

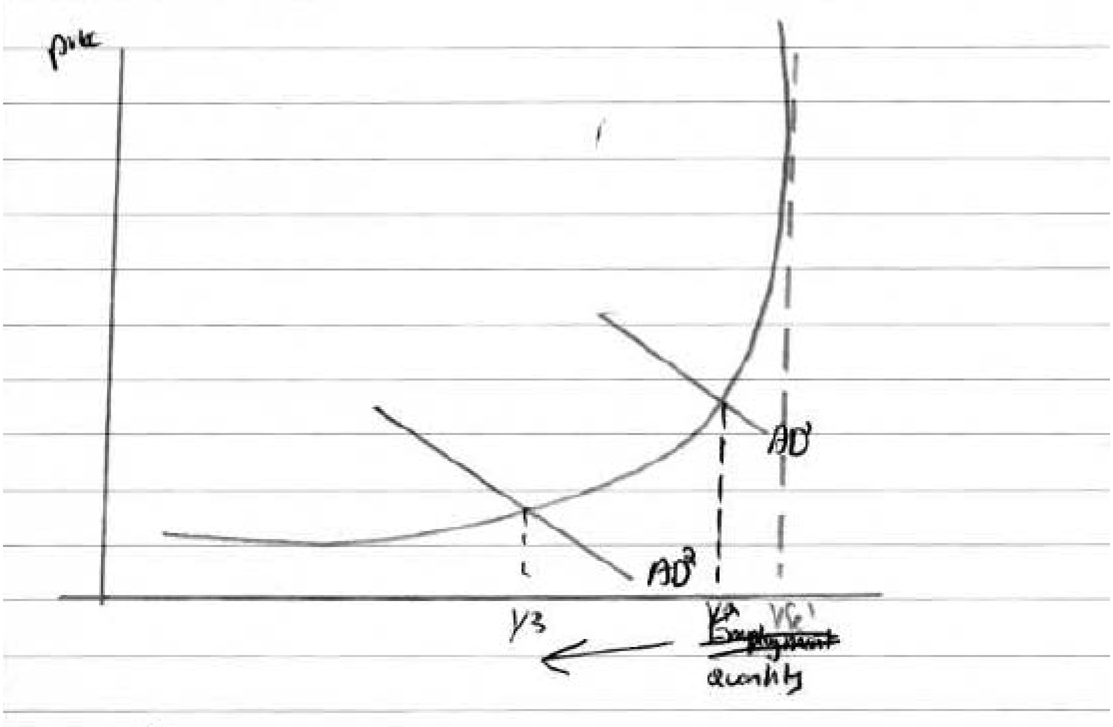


This long run economies of scale diagram shows the benefit of a reduction in costs. Point C1 and Q1 could be the point where the business had to pay higher prices for domestically produced raw materials, but C2 Q2 is the new price they will be able to pay for goods produced in different goods, due to globalisation.

However a possible reason to why international trade is not allways beneficial to nations is that they may become over reliant on another economy. This is when a country has to buy many of its factors of production or raw materials from foreign countries. This is a disadvantage as if one day the foreign country cannot supply these items, it may mean that they won't be able to produce. Previously the countries who would of been had to produce all of the factors of production by themselves so would minimally be effected if another country ran out. This can be linked to comparative advantage as countries that have absolute advantage over another country may decide to stop producing the good that has the largest opportunity cost and be import it from other countries. This means that if the other country can no longer produce it and you are dependant on them producing it then you will no longer be able to have access to it. However, in reality it is unlikely that a country will be massively impacted ~~that one country~~ from being over dependant on one ~~count~~ country as in reality it is likely that they will be able to purchase the same type of good else where. Reducing the overall effect of the weakness of globalisation

On the other hand a reason why international trade has benefited nations is due to it increasing ~~[illegible]~~ the choice that consumers have. Due to countries being able to ~~pr~~ buy and sell goods easier than before it is more likely that individuals will be able to purchase from a wider portfolio of goods, this will be highly beneficial for consumers in a nation as the firms will now likely be price competitive to ensure that they still have the higher level of demand. Previously the nation would of had to settle for higher priced goods due to a lacked competition from firms which means that consumers of the good would of likely had to pay a higher price. This means that international trade has massively benefited the nation ~~[illegible]~~ However, this is only true on the condition that the ~~[illegible]~~ growth of international trade has been in the form of free trade because if not, then the nation may have to pay higher prices for goods due to the ~~[illegible]~~ tariff on imports or supply of the goods may be limitted if a quota has been placed.

In conclusion I believe that international trade has been significantly beneficial as it has given consumers greater choice of goods and has also ~~[illegible]~~ benefitted the firms as they are now likely able to buy cheaper raw materials from foreign countries. However in the long term it is not "allways" beneficial as it may cause a decline in domestic ~~[illegible]~~ industries where the goods can be produced elsewhere, this can lead to large decreases in AD for the country and ultimately can cause large structural unemployment as individuals may not be able to apply their old ~~[illegible]~~ job skills with new job skills that are required. This will cause a large amount of people to have significant occupational immobilities of labour. This can be highly dangerous and can potentially massively outweigh the positives that ~~internationl~~ international trade could have created.



Decrease in employment.

This is a Level 4 response

This response begins by stating international trade benefits most nations and then goes on to describe globalisation. It is important that students understand the distinction between trade and globalisation when responding to questions. The answer describes the benefit of economies of scale with sound analysis. There is some suitable application and good use of a diagram. They then analyse issues such as dependency and comparative advantage with suitable logical explanation. There are small points of evaluation throughout and a reasonable conclusion at the end considering the term 'always' from the question. The diagram at the end does contain errors, however. The analysis is generally sound and focussed with some basic evaluation.

19 marks

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