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Examiners' Report
January 2012

GCE Economics 6EC02 01

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Introduction

Overall the paper was considered to be of a broadly similar standard to the previous year. In general candidate performance was at a high level, with answers showing a firm grasp of the requirements of the specification. Many of the candidates knew how to recognise the evaluation command words and some made good attempts at demonstrating this higher-order skill.

Question 1 (a) (i)

(a) (i) With reference to Figure 1, what is meant by 'labour productivity'?

(4)

Labour productivity represents output per worker. Between 1995 and 2007 the average labour productivity growth increased for the ~~Unite~~ US, UK and the EU. However, during the 2007 - 2009 recession labour productivity decreased by 0.7% in the UK and by 0.5% in the European Union, whereas labour productivity increased in the US by 2.1%.

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Examiner Comments

Correct definition (2) and reference to data (2).

(a) (i) With reference to Figure 1, what is meant by 'labour productivity'?

(4)

- labour productivity is described as output per worker per period of time.
- Figure 1 shows labour productivity growth of the UK decreasing from 2.2% in the years 1995 - 2007 to - 0.7% in 2007 ~~to~~ 2009
- Whereas the US remained at 2.1% over both terms

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Examiner Comments

Correct definition (2) and reference to data (2).

Question 1 (a) (ii)

(ii) Explain **two** possible reasons why UK labour productivity declined during the period 2007-2009 (Figure 1).

(8)

If heathcare ~~got~~ worse in the UK between 2007-2009 that would explain the decrease of "0.7%". If heathcare gets worse it mean that ~~per~~ the ~~labor is more~~ people providing the labor are more likely to get ill and will therefore take more days of ~~f~~ sick therefore becoming less productive as they are spending less days working. There is also a ~~snowball~~ ~~multiplier~~ effect in that if one person gets ill then it spreads quickly to others leading to more and more people taking days off work.

If there become less Trade unions or their power ~~di~~ decreased then the working environment for labor may decrease and so they may lack motivation or they may not feel as comfortable therefore producing less as they will be more unhappy. Less trade union power also mean they're likely to have a ~~good wa~~ worse wage, this is likely to cause them to be resentful and less motivated to work their best and so their productivity is likely to decrease.

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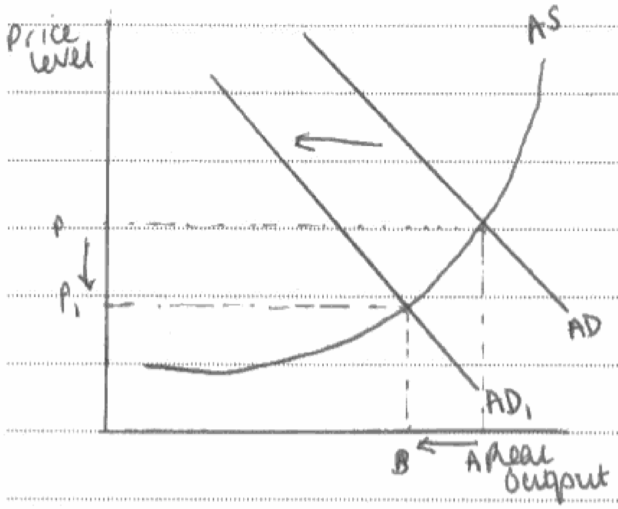
Examiner Comments

4 marks for worsening healthcare leading to the workforce becoming less productive. 4 marks for less TU or worker power leading to a poorer working environment and resentful and less motivated staff.

(ii) Explain **two** possible reasons why UK labour productivity declined during the period 2007-2009 (Figure 1).

(8)

One reason that labour productivity could have declined is because of an increase in unemployment. If less people are in work then labour productivity will be low. ~~them~~ Demand defficient unemployment, where the demand for labour has decreased, is shown in the diagram below.



The shift in the demand curve to the left has reduced output from A to B.

Another reason why the UK labour productivity declined is because of investment. Figure 2 shows that between 2007-2009 gross investment declined and became negative. Investment in education is a way of increasing productivity, so a reduction in investment would cause labour productivity to decline.

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Examiner Comments

Nothing for the first paragraph as it referred to a fall in total output. 2 marks for investment in education and the benefit of the doubt was given for the second 2 marks, although the candidate should really have explained how education raises a worker's output.

Question 1 (b) (i)

(b) (i) With reference to Extract 1, explain what is likely to be 'the biggest risk to growth in the UK.' (Lines 1 -2)

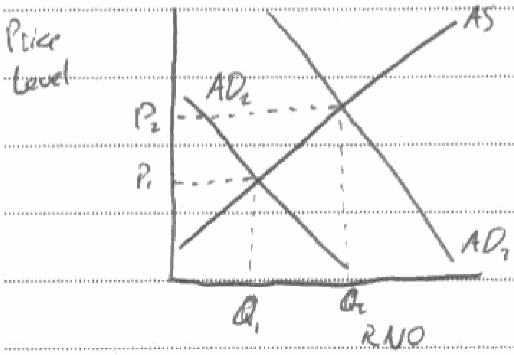
(6)

Mervyn King suggests that the biggest risk to growth is the economies of other countries as if they struggle, they may not ~~be able~~ ~~to~~ purchase UK exports.

Economic growth is ~~one~~ when the production potential of a nation increases.

If other economies can no longer afford UK exports the balance of trade may result in a current account deficit, where more is imported than exported. As this forms part of aggregate demand, AD will shift to the left

so output and price level fall, all other things being equal.



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The first sentence generated the marks for the reference to the data and a further 2 marks were awarded for effect on the UK's exports. The explanation of AD shifting to the left and the output falling was awarded another 2 marks. The diagram would have gained a further 2 marks but the maximum for that section had been reached.

(b) (i) With reference to Extract 1, explain what is likely to be 'the biggest risk to growth in the UK.' (Lines 1 -2)

(6)

The biggest risks to the UK is when UK's trading partners are suffering badly in economic recession so demand for UK exports are reduced. Especially the Eurozone where 60% of UK Exports go there.

The risks are substantial since the UK exports a lot of "services" to other countries, for example the UK financial sector is a major sector that export "services". Since these banking and financial services have a high income elasticity of demand (YED), when others are suffering from declining GDP growth they will demand less of these services when their incomes are reduced.

Another risk is the credit or debt-fuelled households which they account for 65% of the aggregate demand and when the UK is suffering from a recession after the credit crunch the loss of income due to rising unemployment will seriously hinder growth of aggregate demand and real output will decline as well as labor productivity. This is True when there's also a lack of investment that sparked a negative accelerator effect when there's less demand for goods and services.

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Examiner Comments

The first paragraph was awarded 4 marks for the effect on UK exports and the reference to the data. The second paragraph generated another 2 giving full marks.

Had the final paragraph been submitted in isolation it would have also reached full marks.

Question 1 (b) (ii)

(ii) Explain **two** factors that might lead to an increase in investment in the UK.

(8)

~~Amount~~ Investment is when the capital stock of the economy increase. A cut in corporation tax would ~~leave more firms with pos~~ result in firms having more profit after tax. A likely impact of this is that firms would invest this profit back into the firms. This would occur as firms may feel confident enough to invest large sums of money into the firms if they pay a lower rate of corporation tax.

Another factor that could lead to increased investment in the UK would be if government decided to offer ~~tax~~ subsidies or tax breaks to firms that engage in research and development. Firms may feel more secure ~~[illegible]~~ about investing if the government provide some sort of financial help. Firms will be encouraged by both the financial support by government but also encouraged by having government actively supporting the investment.

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Examiner Comments

The first paragraph: cut in corporation tax awarded 2 marks, would result in firms having more profit after tax awarded 2 marks.

The second paragraph: subsidies awarded 2 marks; make firms feel more secure about investing awarded 2 marks. Maximum 8 marks but tax breaks to firms was also correct.

(ii) Explain **two** factors that might lead to an increase in investment in the UK.

(8)

Lower interest rates ~~could~~ lead to an increase in investment in the U.K as the cost of borrowing decreases firms are more likely to borrow money and invest knowing that they will receive more profits made from the investment and have to pay less back to the bank had interest rates had been higher.

Another factor is confidence, if firms expect to make larger profits ~~or~~ expect a quicker rate of return from their investment they are likely to invest ~~investme~~ more as investment carries risks, therefore the smaller the perceived risk, the bigger or larger value the ~~an~~ investment will be.

Other factors such as the state of economy could also lead to an increase in investment, if an economy is in boom firms are more likely to make a profit. However this is unlikely to occur due to U.K being in recession. ~~and~~

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Examiner Comments

Decrease in cost of borrowing awarded 2 marks and receive more profit awarded 2 marks.

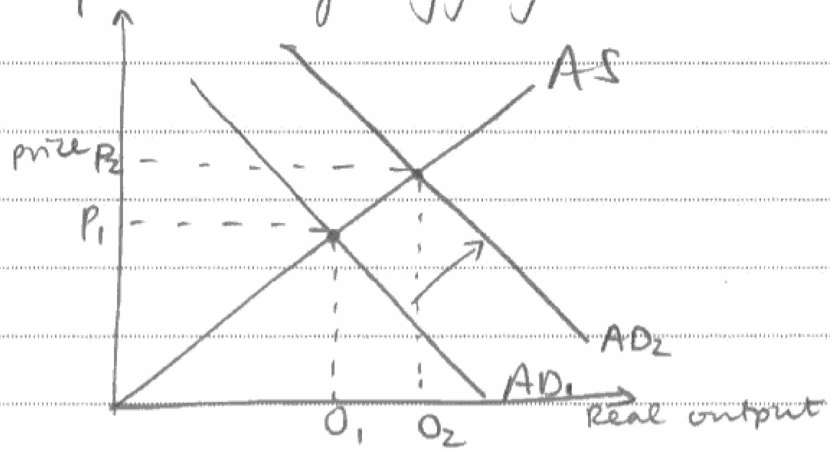
Confidence awarded 2 marks and a quicker rate of return awarded 2 marks.

Question 1 (b) (iii)

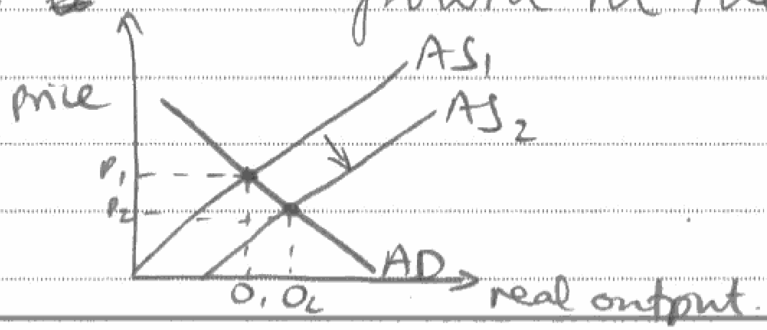
*(iii) With reference to Figure 2, discuss the significance of investment for economic growth. Illustrate your answer with an aggregate demand and supply diagram.

(12)

Investment is the change in the value of capital stocks by adding value to it. It is a component of aggregate demand.



Investment is import to the economy regardless of where it is made, either in the human capital or the capital market. An increase in investment in the human capital by offering training makes workers more productive, hence increasing ~~AS~~ aggregate supply in the long term. Also new technology may be developed due to the investment, also increasing productivity hence aggregate supply which lowers price in the economy, leading to ~~to~~ economic growth in the long term.



However investment is dependent on its magnitude, i.e. a £1 billion investment is likely to have a larger multiplier effect than a £200 investment (since investment is an injection). Even though the size of the multiplier is difficult to predict and often experiences time lags or a slow rate of return. Therefore in the short term it is unlikely to cause economic growth however in the long term, investment may increase the rate of economic growth. On the other hand the effect of investment on ~~the~~ economic growth also depends on employment rates, only when employment rate is high and people have more disposable income to purchase goods and services made by the investment will we see economic growth caused by investment.

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Examiner Comments

Diagram 3 not 4 as Y axis labelled as Price not Price Level. Makes workers more productive (2), hence increasing AS in the long term (2). KAA max 6 marks (as no data). The new technology point is separate but it is explained and the idea of the effect being in the long term was worth 2 evaluation marks. The AS diagram is also worth 3 marks for the same reason but full KAA marks have already been awarded.

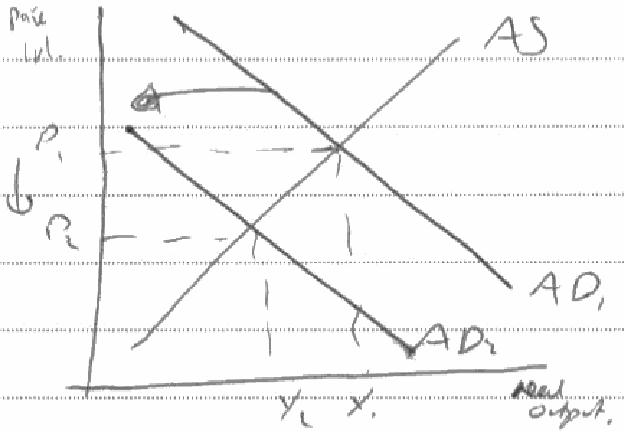
On the second page 2 marks were awarded for evaluation of the magnitude of the investment.

*(iii) With reference to Figure 2, discuss the significance of investment for economic growth. Illustrate your answer with an aggregate demand and supply diagram.

(12)

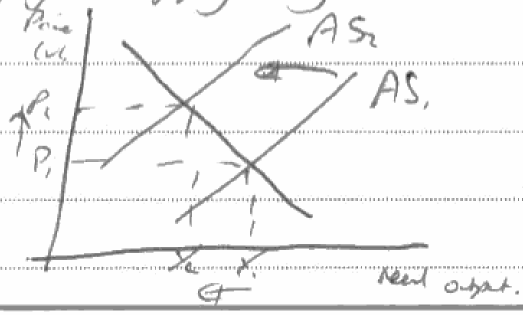
Figure two shows that between 2007 & ~~2008~~ 2009, investment decreased 5.0% in the first year & 15.0% in the second year. At the same time, GDP growth decreased 0.1% & ~~6~~.9% respectively. This shows a strong correlation, and is most likely explained by a strong significance of causality.

Investment is a component of aggregate demand so if ~~A~~ investment falls, it causes a negative shift in AD.



This causes real output to decrease from $Y_1 \to Y_2$, decreasing GDP growth & economic growth.

Investment is also likely to be positively correlated to levels of capital in the economy as most of the investment would be spent on capital. This means that low investment ~~may~~ means low capital, so aggregate supply may ~~be~~ have a negative shift as well. This would decrease real output further, so suggesting a higher significance than first thought.



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However, it could be argued that ~~[illegible]~~ the significance of investment to economic growth is lower, as, while consumption is around ~~[illegible]~~ 65% of AD, investment is around just 15%, less than both Consumption & Government spending.

It could also be argued that both sets of data in the table, although correlated, were in actual fact both influenced by another factor not shown to us, and there is little element of causality between investment & economic growth. This would show a ~~data~~ misinterpretation of the data.

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Examiner Comments

The first Paragraph: 2 marks awarded for data. Diagram awarded 4 marks as benefit of the doubt on the abbreviation of Price Level. Investment is a component of AD and a fall causes a leftward shift and a fall in GDP 2 marks. Maximum KAA 8 marks, so nothing could be credited for the AS diagram.

On the second page each paragraph was awarded 2 marks for evaluation.

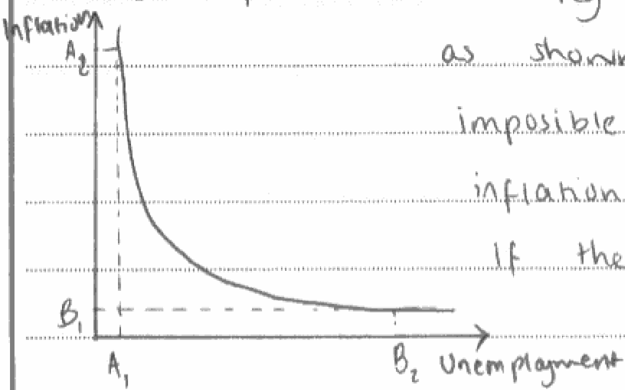
Question 1 (c)

*(c) Assess the likely impact of UK government labour market policies on any **three** macroeconomic objectives. Refer to the information provided and to your own knowledge.

(30)

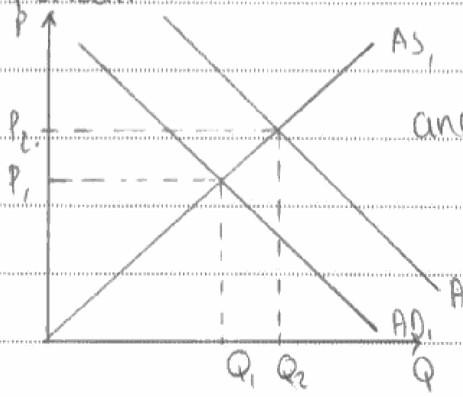
Macroeconomic objectives are goals and targets set by the government. A few examples of macroeconomic objectives are low stable inflation (2% ± 1%), low unemployment, and a cleaner, greener environment. ~~UK~~ The UK's government labour market policies are to decrease unemployment and increase the productivity of labour.

Low unemployment would have an impact with low stable inflation. According the the Phillips curve,



as shown in the diagram, it is imposible to have low stable inflation and low unemployment. If the government ~~and~~ would like low unemployment at A_1, inflation would be high at A_2. In reverse, if the government would like low stable inflation at B_1, unemployment would be high at B_2. This ~~would me~~ Phillip's curve shows that it is ~~impossible~~ impossible to have both low stable inflation and low unemployment at the same time. This will mean that the government will have to review the ~~of~~ current situation in order to choose which ~~to do and~~ is more important and which would benefit the UK

economy at that point.
Increasing the productivity of labour ~~could~~ would mean that the Aggregate demand would increase. This could have a negative impact on the environment as if consumption increases, firms will have to produce more goods which would ~~create a~~ result in more CO_2 gases into the environment. This would conflict ~~the~~ with the macroeconomic objective of cleaner, greener environment. It could be argued that if labour is more productive, an increase in demand would not result in more greenhouse gases being polluted in the environment as machinery etc could be more efficient. This also depends upon how productive the labour market is. If they are not very productive, there will have more impact on the environment than if they were very productive. The government may not be able to compare how much CO_2 gases the firm was producing before and after the productivity of labour therefore it may not be important.



This Aggregate demand and supply diagram shows the increase in ~~quantity~~ output when the Aggregate demand is shifted outwards.

An increase in productivity of labour would result in a decrease in unemployment. If labour is more productive more people are allocated ~~to~~ to jobs that are needed which would mean that less jobs are loss. This would keep unemployment low and the productivity of labour high.

~~An~~ If labour is more productive, price of ~~g~~ goods might decrease. This would have a positive impact on the low stable inflation of 2% ± 1% that the government would like. This would keep inflation low due to the fall in prices of goods and services rather that a general rise in price level.

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Examiner Comments

Full marks for identifying 3 macroeconomic objectives in the first paragraph, 6 marks.

However this candidate received no further marks as the essay addressed a different question. It focused on the conflict between macroeconomic policies rather than identifying the impact of labour market policies on macroeconomic objectives. No evaluation marks can be awarded either.

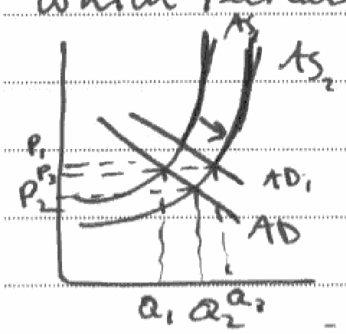
This candidate does just enough to reach full marks.

*(c) Assess the likely impact of UK government labour market policies on any **three** macroeconomic objectives. Refer to the information provided and to your own knowledge.

(30)

Labour market policies are implemented to increase aggregate supply and therefore increase economic growth.

Firstly and increase in education levels and quality of education means that there will be a more skilled labour force. This decreases training costs and increases productivity which increase AS and therefore growth (Q_1 to Q_2).



Inflation is also decreased which may encourage more consumer spending and confidence and therefore increase AD too and - therefore even more growth.

However, ~~if~~ this policy is expensive for the government which means that PSBR (public sector borrowing requirement) and govt. debt will increase. Taxes will need to be increased to ~~[illegible]~~ compensate which may decreas quality of life. If AD increases too much then it will only cause inflation where there is no spare capacity (vertical AS curve). Increased education takes time and will not be achieved in the short run.

A second policy may be ~~too~~ to make trade

Unions weaker. This will therefore decrease the number of strikes and increase productivity. The removal of minimum wage will decrease costs of production and make the business more efficient, which therefore increases AS and growth.
However this exploits people and may cause inequality to increase. An increase in inequality may lead to poverty especially if people are only earning minimum wage. It could lead to crime and may lead to benefits trap as unemp. benefits may be higher than wages.
Thirdly, the government ~~can~~ could decrease income tax and decrease benefits. This creates incentive to work harder ~~and~~ as people can keep most of their rewards. A decrease in benefits will ~~decre~~ force people to get jobs as they will have no other ~~forms~~ of income, and may improve govt. debt (PSBR ↓s)
~~How In evaluation this may be cancelled out by a tax~~ 'Slash the £12.5 billion a year spent on incapacity benefits to just over £4 billion. ~~A decre~~
In evaluation, this could get cancelled out by the lack of tax revenues so the PSBR may not improve that much.

~~It is also impor~~ It may also caus poverty to increase if the people on benefits can not get employed.
A decrease in benefits means that the poorer people have less disposable income and as they have a ~~low~~ higher propensity to spend, Mc may decrease which would ~~balanced~~ balance the BOP.

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Implicit objective of economic growth identified, 2 marks. Education and training leading to higher productivity and therefore growth, 4 marks. 6 evaluation marks were awarded for explaining that the policy is expensive leading to higher government debt and also that the improvement in performance will take time.

Making trade unions weaker would lead to less strikes and more productivity therefore higher growth, was awarded 4 marks. Implicit objective of reducing inequality was given the benefit of the doubt, 2 marks and 4 evaluation marks were awarded for the driving down of wages and social repercussions.

Reducing the government debt 2 marks, by reducing income tax and benefits which lead to higher output and productivity awarded 4 marks. KAA max 18 marks is reached. A further 4 evaluation marks were awarded for the lower tax revenues impact on the PSBR and also the potential increase in poverty of the people who remain on lower benefits. Evaluation Max 12.

Question 2 (a) (i)

(a) (i) With reference to Extract 1, what is meant by a "budget deficit" (line 2)?

(4)

A budget deficit is where government spending is greater than government revenue. Extract 1 says that the budget deficit is expected to be 10% of GDP in 2010-2011.

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Examiner Comments

Definition 2 marks and 2 marks for data reference.

(a) (i) With reference to Extract 1, what is meant by a "budget deficit" (line 2)?

(4)

A budget deficit refers to when a deficit is run on the fiscal budget. This would occur when government spending exceeds the revenue that they gain from taxes.
In the UK the government spending continues to rise and taxes fall as the unemployed cant pay them.

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Definition awarded 2 marks but no data provided.

Question 2 (a) (ii)

(ii) With reference to Extract 1, explain the likely impact of a reduction in the budget deficit on the circular flow of income.

(8)

A reduction in budget deficit means the gap between spending and revenue must close, by ~~the~~ spending cuts and/or increased taxes. This is being planned with "£81 billion" cuts in spending and a VAT rise to 20%.

The multiplier effect is how much an injection of cash (in this case Government spending) will increase as it travels round the circular flow of income. It is ~~affected~~ reduced by withdrawals such as saving and taxation.

So, with ~~planned~~ plans to reduce Government spending, the injection will decrease, meaning less money is flowing anyway, and taxation has increased, meaning withdrawals are higher reducing the ~~in~~ income flow further. This money is also ~~going out being spent~~.

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2 marks for the data in the first paragraph.

In the third paragraph 2 marks for injection will decrease. The candidate already had the notion of the money flowing round in the second paragraph, so 2 marks were awarded for less money flowing in the third.

(ii) With reference to Extract 1, explain the likely impact of a reduction in the budget deficit on the circular flow of income.

(8)

~~R~~ A reduction in the budget ~~depost~~ deficit means that government spending will ~~be~~ reduce or ~~while~~ tax is increased.

~~A~~ The circular flow of income consists of injection and leakage. Injection includes government spending ~~and~~ leakage includes tax. In Extract 1 ~~it~~ the government is going to cut ~~pub~~ spending of ~~by~~ £81 billion by 2014-2015 ✓. When the size of injection gets smaller and size of ~~ug~~ leakage is still the same, the size of ~~certi~~ circular flow of income is ~~go~~ likely to decrease. Also due to the multiplier effect (~~as~~ a change in injection leads to a greater change in income), ~~the~~ the decline in the circular flow of income is likely to be much ✓ greater than the reduction in the budget deficit.

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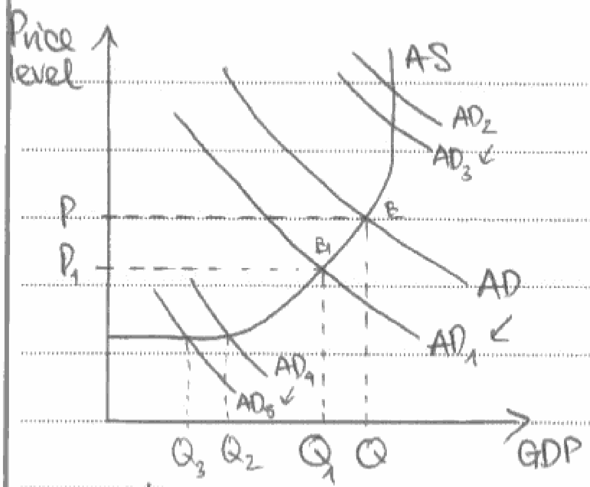
No marks for definition of circular flow as both attempts were insufficiently comprehensive. In the two sentences following the candidate picked up 6 marks.

Question 2 (a) (iii)

This is an excellent response.

(iii) Using an aggregate demand and aggregate supply diagram, evaluate the effect on output of the half a million public sector job cuts (Extract 1, Line 12).

(12)



A cut of half a million public sector job is likely to result in higher level of unemployment. When people ~~are~~ become unemployed, they will tend to have consume less goods and services as ~~their~~ ~~inco~~ regular they are unable to earn regular income. This will result in low confidence to consume goods & services (due to lower money have). Consumption is likely to decrease to a large extent since the number of job cuts amount to "half a million".

A decrease in consumption will therefore cause AD to decrease from AD to AD_1, resulting in a fall in output from Q to Q_1. The extent of the impact of a decrease in AD have on the level of output depends on where the economy is operating. If the economy is operating at full capacity, a decrease in AD from AD_2 to AD_3 will also result in a fall in the price level without affecting the level of output. On the other hand, if it is operating at spare capacity, a decrease of a AD from AD_4 to AD_5 will only result in a considerable fall in the total output from Q_2 to Q_3. However, some may argue that since the number of private firms in UK is relatively large, the people ~~made~~ that work for public sector made unemployed can quickly find another jobs at private firms, the extent of a fall in AD may not significant. Also, it still have to depends on other components of AD to assess the actual impact of public sector job cuts in the total output. For example, unemployment may increase but at the same time ~~in~~ the net exports may improve due to people consume less imports, AD may not fall as much.

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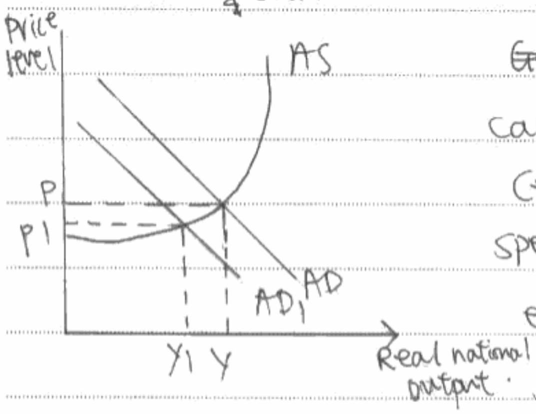
Diagram awarded 4 marks and consume less goods and services awarded 2 marks with fall in AD and output a further 2 marks making KAA maximum of 8 marks.

3 sets of 4 marks for evaluation could have been awarded; full capacity 4 marks, private sector picking up the slack 4 marks and the impact of other components 4 marks.

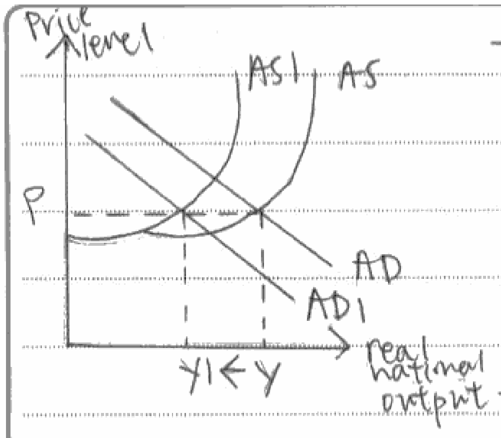
(iii) Using an aggregate demand and aggregate supply diagram, evaluate the effect on output of the half a million public sector job cuts (Extract 1, Line 12).

(12)

Aggregate demand is the total level of planned real expenditure of UK produced goods and services. Aggregate supply is ~~to~~ the ~~to~~ amount of UK produced goods and services in an economy over a period of time. It includes both consumer and capital goods.



~~Govern~~ Aggregate demand's calculation consists C + I + G + (X - M), with government spending as one of the main elements of affecting AD, cutting government spendings directly pulls the AD down and causes a shift to the left just like the diagram has shown. This shift in AD has caused a reduction in employment and real national output (Y - Y1), which affects the price level to decrease and causes ~~a slower rate~~ deflation. However, this is assuming if AS stayed constant and remain unchange. If there has been cuts in public sector jobs, this may also mean that the productivity falls in public sector which may trigger AS to fall as well as AD and both shift to the left.



Therefore, if AS also fell, this causes the total real national output to fall drastically ~~compared to~~ but with price level that remained unchange so no effect on inflation or deflation.

~~In both cases, this means a~~

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Diagram awarded 4 marks, cutting G 2 marks and pulling AD and RNO down awarded 2 marks mean KAA maximum of 8 marks was achieved.

Credit would have been awarded for an explanation of the effect on AS had full marks not already been obtained. However on the second page 2 marks for evaluation was awarded for explaining that the combined effect might lead to a large fall in RNO.

Question 2 (b) (i)

(b) (i) With reference to Extract 2, explain what has happened to "spare capacity" (line 29) in the context of the UK economy.

(6)

Spare capacity has ~~decreased~~ increased due to the global recession that has effected the UK economy. This is because many people have lost their jobs and unemployment has risen so the UK economy is not ~~at full employment~~ working at full employment.

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Recession awarded 2 marks, unemployment 2 marks and the definition of not working at full employment 2 marks. A total of 6 marks awarded.

(b) (i) With reference to Extract 2, explain what has happened to "spare capacity" (line 29) in the context of the UK economy.

(6)

Spare capacity indicats that the economy is not opperating at maximnum productive potential.

~~This is shown in Extract 2~~ Spare capacity exists when there is high levels of unemployment, as can be found in the UK, as there are job cuts throughout the UK in public and private sector. It also suggests that there is poor utilisation of capital ~~as~~ caused by firms cutting back production as they struggle with competition from overseas. Low confidence caused by the recession caused huge amounts of withdrawals from investment promises meaning growth has not been matched compared to EU counterparts.

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Definition 2 marks, unemployment 2 marks, poor utilisation of capital 2 marks give the maximum of 6 marks. The reference to a recession would have been worth another 2 marks.

Question 2 (b) (ii)

(ii) With reference to Extract 2, analyse **two** of the causes of inflationary pressure that the Governor views as "temporary".

(8)

~~One~~ Inflation is a sustained rise in the price level and a fall in the purchasing power of money (£).

One of the temporary measures is the world food prices risen by 31.5%. This has caused the cost of production in the food markets to increase, especially if the goods are imported i.e. foods that are not grown all year round in this country or at all, which will be subject to further import duties. With an increase in the cost the price level will increase and so will the quantity of food goods which causes AS to shift to the left. This will be temporary because when consumer confidence and income increases with inflation so will the demand for these goods and spare capacity will be utilised.

An increase in the oil prices (made by OPEC) have caused the costs of production to increase but because oil is in inelastic demand the suppliers/firms will need to purchase it meaning that the increase in their costs will be passed on to the consumer and price level/inflation will increase. ~~The~~ This will be temporary as the rise in inflation will match the reflationary policies of the government to increase AD. ~~by~~

These cases will have a temporary affect because the losses of jobs and unused capital the food and oil ~~business~~ related/dependent businesses occurred will be fixed with the usage of spare capacity in the long run.

ResultsPlus
Examiner Comments

World food prices rose by 31.5% and the increase in the cost will shift the AS left, awarded 4 marks. An increase in oil prices 2 marks, increase the cost of production 2 marks, leads to the maximum of 8 marks.

A further 2 would have been awarded for the costs being passed on to the consumers and the price level would increase.

(ii) With reference to Extract 2, analyse **two** of the causes of inflationary pressure that the Governor views as "temporary".

(8)

The Governor states that the main rate of VAT going from 15% during the recession back to 17.5% in January 2010 is a significant temporary inflationary pressure. The rise in VAT automatically makes a huge amount of the basket of goods more expensive, Therefore, this will affect CPI inflation as the Food survey is used to compile information. It is a temporary factor tax. Also, the Governor suggested that past rises in oil prices are to blame. The increase in price of inputs causes cost-push inflation as firms are forced to increase price of goods. Oil Price increase affect almost all firms as most manufactured goods need oil to be produced.

ResultsPlus
Examiner Comments

Vat rise 2 marks, increases the prices of a large number of items in the basket of goods therefore increasing the CPI 2 marks.

The rise in oil prices 2 marks, cause cost-push inflation as firms are forced to increase the price of goods 2 marks. A further 2 marks could have been awarded most manufactured goods need oil to be produced.

Question 2 (b) (iii)

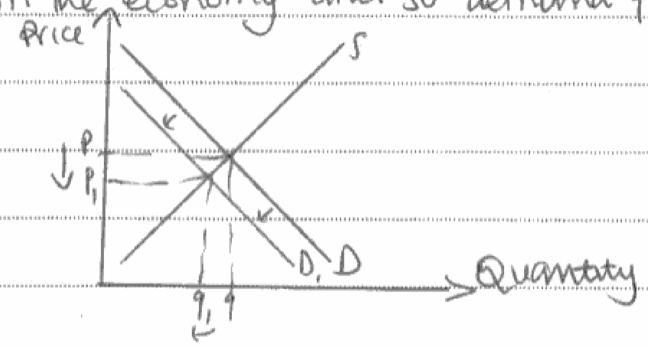
This was a very good answer.

*(iii) In light of the information provided, assess the case for an increase in the base interest rate set by the Monetary Policy Committee.

(12)

(MPC)

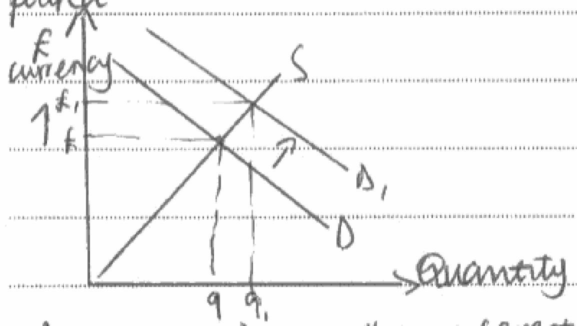
The Monetary Policy committee ~~comprises~~ is made up of a group of economists that come together in order to decide on the base interest rate of the economy in order to manipulate inflation. If inflation is high and is caused by demand-pull inflation, the MPC can decide to put interest rates up. This will increase the costs of borrowing for individuals and firms in the economy and so demand falls.



With demand falling, there is less inflationary pressure in the economy and so inflation can fall back down to target.

However, the Extract implies that inflation is due to cost push inflation rather than demand led. This is because of the sustained increase of world food prices (significant 31.5%) which will mean an increase in the costs of production for firms. Also, the projected rise in VAT to a further 20% by January 2011 will mean that firms also have to raise their prices (depending on elasticities) in order to maintain their profits. This is an increase in price that raised interest rates cannot solve.

However, raise interest rates could increase the value of the pound.



An increase in the interest rates will encourage more foreign investors into the UK in the form of 'hot money'. This will increase the demand for the pound, thereby increasing the value of the pound. As a result, inflation caused by import prices will be solved as less of the pound can buy more foreign goods, ~~and~~ therefore reducing inflationary pressure in the UK.

On the other hand, this will reduce the UK's international competitiveness and so the value of exports could fall, leading to a deterioration of the current account balance of payments deficit. It is important to note however, that the sole purpose of the MPC is to keep inflation ~~targets~~ at target and not the balance of payment.

ResultsPlus
Examiner Comments

The first paragraph described the mechanism but does not make the case for it.

In the second paragraph the candidate established the cause as cost push inflation 2 marks and identified that it cannot be solved by an interest rate increase 2 marks.

On the second page the case for an increase in interest rates is effectively made in terms of strengthening the pound 2 marks and reducing imported cost push inflation 2 marks.

The final paragraph earned maximum marks for the reflection on the effect on exports 2 marks and the current account 2 marks, as well as recognising it is not the main target of the MPC 2 marks.

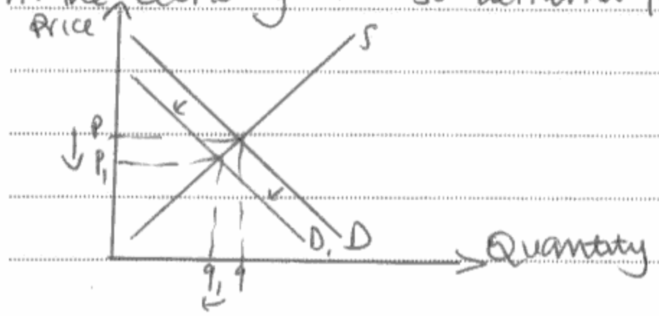
This was an excellent answer.

*(iii) In light of the information provided, assess the case for an increase in the base interest rate set by the Monetary Policy Committee.

(12)

(MPC)

The Monetary Policy Committee ~~comprises~~ is made up of a group of economists that come together in order to decide on the base interest rate of the economy in order to manipulate inflation. If inflation is high and is caused by demand-pull inflation, the MPC can decide to put interest rates up. This will increase the costs of borrowing for individuals and firms in the economy and so demand falls.



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ResultsPlus
Examiner Comments

This candidate identified that the rate is above target and tolerance, 2 marks and that a rise in interest rates would make consumer demand and the general price level fall, 2 marks.

After establishing that the origins are cost push inflation, 2 marks; an increase would lead to a rise in borrowing costs and therefore the costs of production, 2 marks.

By identifying the time lag for the full effect of the interest rate change to take effect, 2 marks and that the inflationary pressures are only temporary, 2 marks then an increase will not address the problem.

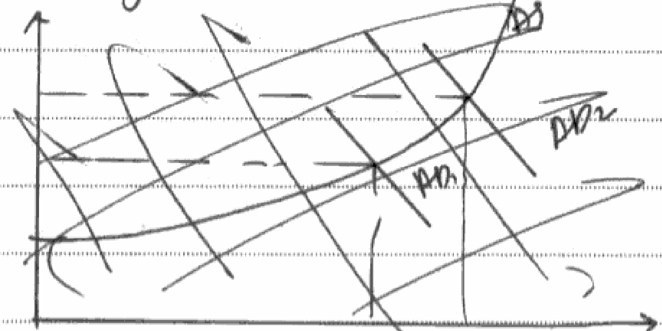
Question 2 (c)

This is not a particularly strong answer but it does just enough with the benefit of the doubt to reach full marks.

*(c) With reference to Extract 2, evaluate the likely impact of higher inflation on **three** macroeconomic objectives.

(30)

~~The~~ The objectives of a country is to achieve growth with low inflation, relative unemployment, a positive Balance of payment, a clean environment and close the income gap. However, high inflation may put an end to the objectives.



~~The cost of inflation is the cost push inflation factor~~

Let's look at the Balance of payment (BOP) BOP record all the financial transaction of one country with (which is made up of current account ~~and capital~~) the rest of the world. High inflation would mean that the final cost of goods and services ~~to~~ is very high. ~~UK will lose out~~ This will erode UK's price competitiveness. In the discipline of exports ~~as~~ or traditional trading partners ~~like~~ like ~~UK~~ France, Germany ~~and~~ and US will ~~move also~~ increase their ~~exports~~ with other ~~cheap~~ Cheap Asian Countries like China and ~~VN~~ Vietnam. Hence, the net export of UK will decline, causing the current account deficit to widen. (BOP consists of current account and ~~f~~ capital and financial account).

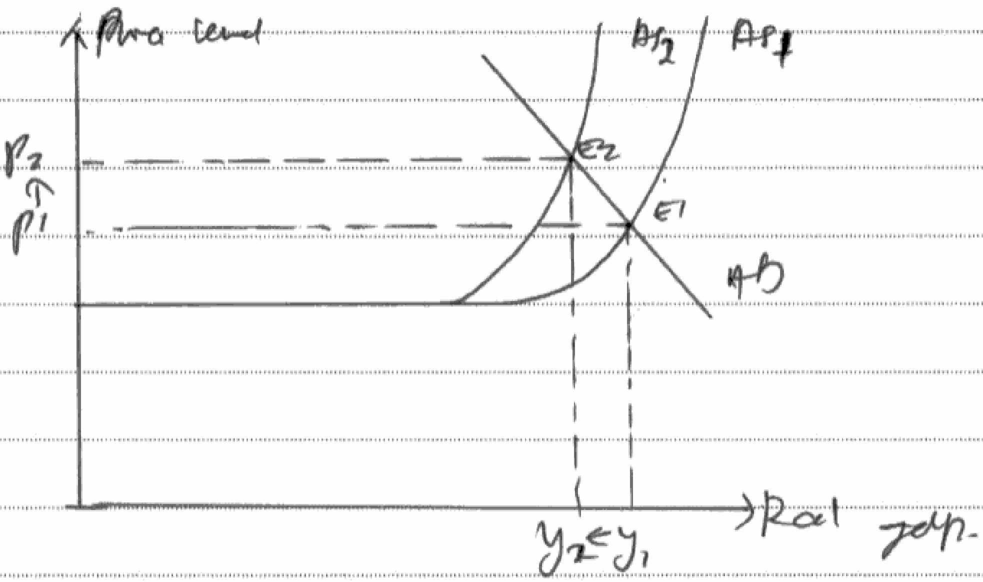
However, UK's current account deficit may not be that grave after all. This is owing to the fact that UK, just like US, has been very successful in attracting short term and long term capital inflows via the capital and financial accounts. Hot money which refers ~~to~~ to short term capital inflow is in the form of fixed deposits at bank and purchasing of security. Long ~~term~~ term capital inflows refer to foreign direct investment. This can compensate for the outflow of money in the economy. Hence, objective achieved.

Minimizing
< Unemployment is the second ~~macro~~ objective of ~~the~~ UK, as Ue ~~ma~~ can inhibit growth. When ~~she~~ inflation is on the rise, people's trim their spending because of expensive goods. ~~They pay to the lesser good~~ ~~income will fall, and they deter spending due to job insecurities~~ ~~into the economy~~. When this happens, naturally ~~g~~ demand for goods and services will fall, resulting in lower profits for firms. As it is non-sensical to keep workers when the money ~~is~~ is not flowing in, therefore firms will have to retrench them, ~~d due to the fact of the higher inflation~~. Ue will hike, contravening the objective.

Perhaps in this case, the government can play a role by increasing ~~the~~ the government expenditure. Building new schools, infrastructure and roads would require business tenders from the ~~firms~~ firms, ~~the~~ and manpower to execute the job. Firms will have to employ more workers and therefore UE can be reduced. However, extract 1 states that due to the mounting national debt and budget deficit, the government would in fact ~~be~~ cut back on public spending. Unemployment will reduce perhaps a little, but not as a whole.

The third objective would ~~have~~ to ~~be~~ be an equal income distribution. High inflation would walk hand in hand with growth. In other words, when inflation is high, it indicates that growth is on the rise too. When inflation is high, normally the high income bracket is better off, whilst the low income bracket is worse off. The MPC will have to increase the interest rate to ~~tack~~ curb inflation. The return on savings in banks will surge ~~[illegible]~~ and that is how the rich become richer. ~~Most of them~~ they store money in the bank. ~~While it~~ However, it is worse off for the lower income bracket because the cost of borrowing for them is very high. Therefore, with the lower purchasing power, these people would ~~[illegible]~~ rather ~~[illegible]~~ not spend ~~always into the economy~~ onto goods which would further deteriorate their standards of living.

However, extract 2 ~~of~~ paragraph one ~~is~~ clearly states that the inflation target is yet to be missed and will remain as such for ~~the next pe~~ a period of time. Perhaps ~~the~~ UK should consider supply side policies to meet inflation. The Growth can be achieved with any inflationary ~~fear~~ fear. Besides that, ~~a~~ ~~of~~ approaches such as privatisation, deregulation or ~~redistributing~~ / reducing the unemployment benefits could increase real output and at the same time bring the price level down.



ResultsPlus

Examiner Comments

6 marks for macroeconomic objectives.

4 marks for the erosion of UK's price competitiveness and a widening of the balance of payments deficit. The second page gains 4 marks for evaluation by explaining that the UK has been effective at attracting capital flows which might to some extent offset the deficit. The argument goes beyond the syllabus at AS and despite not addressing the impact high inflation might have on capital flows, the candidate was given the benefit of the doubt.

4 marks for rising unemployment from a contraction in spending generated by high inflation. 4 marks for evaluation explaining that the government's ability to take remedial action is severely reduced by the mounting national debt.

4 marks for the widening of the inequality of income. On the final page 4 marks were awarded for evaluation on how the government might mitigate the impact already identified through supply side policies.

*(c) With reference to Extract 2, evaluate the likely impact of higher inflation on **three** macroeconomic objectives.

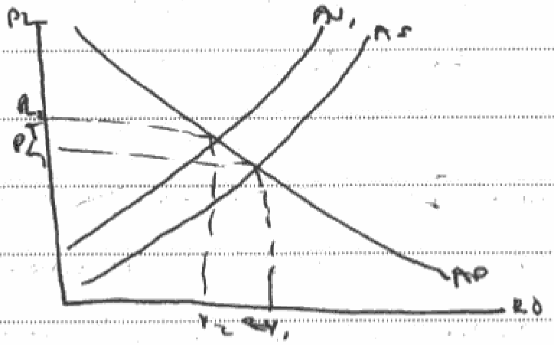
(30)

Higher inflation would mean that domestic goods and services will have a higher price. Therefore, they will be less internationally competitive, causing our level exports to decrease. This ~~would cause~~ may cause a net deficit on the trade on goods and services ~~account~~ on the current account, therefore causing a negative impact on the ~~..~~ current account. At the moment the UK is roughly 8th ~~in the bes~~ biggest exporter of goods and the 2nd best exporter of services, and ~~the~~ inflation may cause them to fall lower due to being less internationally competitive. This is because the inflation rate is roughly rose by *3.2% in October 2010, and so it is not within the inflation target 2% (~~7~~.±1%).

Although, ~~so~~ many consumers and firms ~~may be importing~~ from other countries may be importing from the UK for their quality of the goods and services. It is true that the cost of production in the UK is already fairly high in comparison to other countries, as unlike many LEDCs where cost of production is low, we have to legally maintain costs such as the national minimum wage. Therefore, if our prices are already higher than other countries, it could be feasible to assume that our ~~exp~~ high export levels are due to the quality of goods and services, making them ~~more~~ price inelastic.

Higher inflation may also cause unemployment to increase. If the cost of raw materials and other factors such as 'oil' have increased, then it will make the overall cost of production to the firms increase.

The demand for these goods are price ~~ele~~ inelastic for the firm, as these ~~go~~ goods are necessary for the firm to continue production as they need material. Therefore, they may have to make more workers redundant to maintain the overall same cost of production. ~~This diagram shows this cost push inflation~~ // However, due to the decrease in workers, there will be a decrease in production and a decrease in aggregate supply which may cause inflation. Therefore, the reduction in labour will



not have succeeded in maintaining the same price level for consumers by maintain the same cost of production. The diagram above shows the cost push inflation of the good making the price level higher to reducing supply.

Furthermore, another evaluation point is that firms may not have to pay these extra costs of production. They could switch to substitute material which is cheaper and has a similar effect. Therefore, they would keep the same level of ~~—~~ costs while maintaining the same level ~~of~~ production.

Finally, if there is higher inflation they it will cause greater regards. Inequality in the distribution of income. It affects the poor more than the rich as if there is inflation of for example bread, then ~~the~~ the extra costs are a greater proportion of their income and so it affects them more than ~~the~~ the rate.

However, ~~the~~. the level of benefits ~~could increase~~ could increase proportionally and so their living standards would remain the same. Therefore, the increase in inflation would not affect their consumption, and they can ~~[illegible]~~ afford the same things as they could previously.

Overall, ~~the increase in inflation is~~ in my opinion the higher inflation would cause the greatest consequence of causing lower ~~[illegible]~~ international competitiveness. A decrease in exports and an increase in imports ~~would~~ ~~[illegible]~~ may cause a net leakage in the circular flow of income, therefore resulting in ~~[illegible]~~ a negative impact on economic growth.

ResultsPlus
Examiner Comments

The first paragraph got 4 marks for the effect on the balance of payments and the candidate was given the benefit of the doubt on implicit understanding of the related macroeconomic objective, 2 marks even though it wasn't stated explicitly. 4 evaluation marks were earned in the next paragraph.

Keeping unemployment low, 2 marks was assumed to be the implicit objective but only 2 marks were awarded for the explanation of why rising costs might lead to redundancies, as the AS shift to the left is actually caused by oil and food rather than labour. However switching to substitute materials which is cheaper and had a similar effect earned 4 evaluation marks.

Once again an implicit understanding of the objective of a fairer distribution of income, 2 marks; was assumed from the level of analysis. The analysis was awarded 4 marks. A further 4 evaluation marks were awarded for the explanation about the level of benefits potentially offsetting the impact on living standards.

The final paragraph could have earned 2 marks for an implicit understanding of the growth objective and 2 marks for the brief explanation. However it would not have exceeded the section on unemployment and so the total marks for KAA was 16 and evaluation 12 = 28.

Paper Summary

There was a 7:3 split in favour of answering question 2, probably as a result of the more central concepts being assessed. 2 aiii and 2c were relatively straight forward questions and gave candidates the opportunity to display their skills. 2biii challenged many candidates and differentiated between them. It was felt candidates may have avoided question 1 because of its focus on the labour market, particularly as questions on labour productivity seemed to challenge the candidates more rigorously than most. At the weaker end of the cohort there were a significant number of candidates who did not answer the longer essay questions (1c and 2c) directly. Some preferred to write about the effectiveness of supply side policies. Having said that there were some very good answers to questions 1c and 2c by the stronger candidates.

Most candidates showed considerable awareness of the current state of the economy and some made good use of this information to help them evaluate. This real interest in the economy was evident in many papers and was easy to credit within the flexible mark scheme.

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