

Examiners' Report

June 2016

IAL Economics 4 WEC04 01

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Introduction

The entry for this paper continues to grow with just over 1,200 candidates sitting this exam.

In Section A, Question 1 was the most popular choice, followed by Question 3, and then by Question 2. The mean of Question 3 was higher than for questions 1 and 2. The mean scores for questions 1 and 2 could have been higher if the candidates had not misread part (a) of their questions. Although this mistake was common among the weaker candidates, it was made by candidates at all levels. These questions were no more difficult than the others, but candidates simply did not read them carefully.

Many candidates were also not able to show sound depth and breadth to their answers. Typically, examiners are looking at three well developed and contextualised analysis points and two well developed and contextualised evaluative points for 15 mark essay questions. Similarly, examiners are looking at four well developed and contextualised analysis points and three well developed and contextualised evaluative points for the 25 mark essays.

In Section B, the split between the two optional data response questions was uneven, with around 65% of candidates attempting question 4 and 35% answering Question 5. There was not much difference in the mean scores for questions 4 and 5.

The questions were generally accessible at all levels and provided some good opportunities for candidates to differentiate themselves by ability. Answering the precise question asked, integrating data with analysis and strong evaluation remain the key ways that A-grade candidates achieve higher marks.

It is pleasing that the standard of responses was generally slightly higher than previously, and that candidates seem to have a good understanding of what is required of them when attempting this paper, including the mark distribution for each question and the four assessment objectives. Candidates are also making more consistent efforts to apply their answers to real world examples and contexts, particularly in Section A. There is no evidence that the candidates have problems with timing or completing the paper in the allotted time.

Question 1

For (a), this question was highly challenging for candidates as they were not able to evaluate the likely impact of the rapid growth of emerging and developing economies on world trade patterns. Many candidates have not shown that they understand what trade patterns means. Some candidates explain effects on the domestic economy or between emerging economies rather than in a global context and therefore, were not able to access the higher levels.

Candidates needed to consistently explain analysis points in world context to achieve higher levels. Stronger candidates' mostly analysed impact on the increase in overall size of world trade due to increase in proportion of world trade conducted by developing and emerging economies. They also discussed how developed economies have moved to importing goods from emerging economies and exporting more services they produce. Weaker candidates were often confused and discussed the impact of free trade.

For almost all candidates who attempted this question, evaluation was fairly weak, focussing mainly on a learnt list of points but not answering the question. Whilst candidates have made some attempts to evaluate, they were not consistent in context of world trade patterns.

For (b), most candidates were able to show an understanding of the term specialisation and at least some were able to relate this to the concept of comparative advantage. Weak candidates were not clear on this concept, while stronger candidates could give accurate definitions which were well supported with diagrammatic or numerical examples.

Stronger candidates were able to discuss that if specialisation is according to the law of comparative advantage, trade will increase and therefore the world output will increase, raising the standard of living. They were able to develop and expand on this point. Many candidates also discussed the benefits of economies of scale and lower inflation rates. Some also made links to economic growth and employment as a result of more trade. Few weaker candidates failed to explain these points and scored low marks. A handful of candidates were able to effectively evaluate discussing issues of law of comparative advantage, over dependency but most answers did not show sufficient breadth to the evaluation points to achieve Level 5.

Across scripts, there was little application to countries. This question explicitly asks candidates to refer to a country or countries of their choice; applying answers in this way may have provided candidates with a framework in which to base more in-depth analysis and evaluation of possible policies. Candidates were capped at Level 4 if they did not refer to a country in their response.

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

Chosen question number: Question 1 Question 2 Question 3

a) Economic growth is the increase in the national level of income in a country. A developing country is a country that hasn't ~~exceeded~~ standardized or industrialized yet. There are many advantages of the ~~the~~ rapid growth of emerging and developing countries on world trade patterns. The growth of emerging economies means that the level of income is that people have in these countries are also high. This might lead to them having more money to spend on imports, therefore trade will increase. More people will be able to afford to purchase goods/services from other countries, hence increasing ~~can~~ the world trade. Furthermore, since ~~emerging and developing~~ ^{there is a growth in these economies,} ~~there is~~ technological transfer will increase between countries. This will increase the relationships between countries, which will lead to world trade increasing. Emerging economies can specialize in what they are good at producing ~~and~~ ^{at} which would give them a comparative advantage, therefore ~~they~~ they will be able to produce their goods at a lower

price, ~~loss~~ and increase their international competitiveness. This would encourage and increase world trade. Eg- Botswana in diamonds, Saudi Arabia for oil.

However the increase in ~~international~~ ^{world} trade, ~~leads~~ ^{might lead} to global imbalances. Some countries end up having large deficits - UK and USA - and some countries have large surpluses - China & Japan. Therefore this global imbalance could reduce world trade. Moreover the impact on world trade would also be affected by the exchange rates of countries. Furthermore developing countries might put up protectionism in order to protect the domestic ~~as~~ jobs and infant industries. therefore this might restrict trade to some extent.

In conclusion we can say that the world trade patterns are affected by many ~~using~~ factors. The rapid growth of emerging and developing countries wouldn't be the only factor to affect the world trade patterns.

b) Specialisation is when countries produce goods/services that ~~which~~ they are most efficient in producing. It would lead to them benefiting from low costs. There are many countries that specialise in a particular good or service. Eg- Saudi Arabia in oil, Botswana in diamonds, Ghana for cocoa.

In this ~~the~~ case the benefit to these countries in specialisation is that they will be able to reduce their unit costs of production. This is because, since they focus on producing only one particular good or service, they can become very efficient in their production, hence allowing them to produce it that good/service at a lower cost.

This will ~~help~~ ^{also help} ~~not~~ the country to gain a comparative and absolute advantage ^a over its rival countries. Saudi Arabia is one of the main exporters of oil, therefore since they specialise in it, their international competitiveness will rise. They are able to sell their exports at a lower cost compared to others. Therefore their export revenue will also rise.

Countries that specialise in a particular good or service will be able to ^{benefit} ~~benefit~~ from ~~economies~~ external economies of scale. This is

because since firms increase their output, their long run average costs will fall. They will be able to exploit external economies of scale; such as an increase in infrastructure. Furthermore ~~it is possible~~ Saudi Arabia will be able to gain a significant amount of foreign currency. This is because ~~that~~ ~~export~~ since they specialise in the production of oil, their export revenue will increase.

The disadvantages are that, ~~however~~ countries that specialise in the production of a particular good/service tends to suffer from high occupational immobility. This is because the workers will only have a ^{few} ~~range~~ of skills therefore cannot easily move from one job to another.

However this can be overcome if the government provides training schemes. This will increase the human capital of workers, hence ~~and~~ increasing their occupational mobility.

Countries that gain an international competitiveness by specialising in a good or service, might see a ^{decline} ~~decrease~~ in their terms of trade. This is because they will have to sell

more exports to gain a desired quantity of imports.

In this case since China only specializes in Manufacturing and India in services, they will need to get other goods/services which they aren't specialized in from other countries. However since they are part of a trading bloc they might be faced with trade diversion.

In conclusion we can say that since the benefits of specialization to a country outweigh the disadvantages, a country that specializes in a good/service will benefit.



ResultsPlus
Examiner Comments

- a) The candidate shows some understanding of growth of developing and emerging economies. Good points on increase in trade and technological transfer and one well developed point on comparative advantage (using examples and linking it to trade) was made. However, there is only one evaluative comment on offer when the candidate discusses a rise in protectionism that could restrict trade. This response was therefore given a Level 4 score of 10 marks.
- b) The candidate covered a couple of analytical points that were well developed. The answer showed an in depth discussion on lower costs and external economics of scale, both using context of countries. There was however only one evaluative comment on occupational immobility on offer that was well developed. There was not enough development of the terms of trade argument and hence it was not able to achieve higher levels. To access this, development on law of comparative advantage was required. This response was therefore given a Level 4 score of 18 marks.

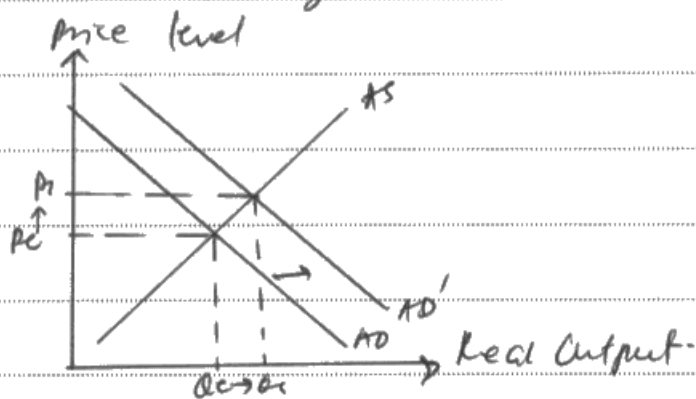
Indicate which question you are answering by marking a cross . If you change your mind, put a line through the box and then indicate your new question with a cross .

Chosen question number: Question 1 Question 2 Question 3

a) Emerging and developing countries are countries which are having an increase in their economic state. China, Taiwan, Hong Kong and South Korea are the examples of emerging economies in the world ~~or~~ ^{are} known as the ~~the~~ ~~the~~ Tiger economies.

The first impact of such rapid growth of emerging and developing countries on world trade pattern is the increase in producer productivity in the global economy. For instance, ~~after the~~ ^{the} Open ~~door~~ ^{door} policy ~~practised~~ ^{practised} by China in 1970s, has enabled China to develop its economy. ~~that~~ ~~is~~ China has received a tremendous amount of FDI as a result of the such policy and has enabled them to become the world's largest exporter. ~~that~~ ~~is~~ ~~the~~ ~~FDI~~ ~~received~~ ^{FDI} ~~has~~ ~~enabled~~ ~~China~~ ~~to~~ ~~increase~~ ~~their~~ ~~production~~ ~~of~~ ~~exports~~ ~~to~~ ~~global~~ ~~market~~ ~~and~~ ~~as~~ ~~a~~ ~~result~~ ~~of~~ ~~this~~ ~~the~~ ~~productivity~~ ~~in~~ ~~the~~ ~~global~~ ~~world~~ ~~also~~ ~~improved~~. As China increases its export, the aggregate demand shifts to the right, showing an increase

in real output from O_e to O_i and price level to rise from P_e to P_i . The rise of real output also symbolises the productivity in the global economy is increasing.



Secondly, the rapid growth of developing countries also has the impact of increasing international competitiveness in the world trade. Before the ~~development~~^{growth} of developing countries such as India and China, the world trade is dominantly manipulated by the developed and western countries. This ~~is not~~ also, as a result of this, the international competitiveness in the global economy is only restricted to ~~these~~ ~~countries~~ ~~to~~ western countries which trade among themselves. But, after the appearance of new ~~developing~~ emerging economies, the ~~world trade is now even~~ world trade among both developing and developed nations increase. The ~~emergence of India as world's new~~ ~~services expo~~ ~~now, the eve before this~~

India, as a developing country is now ~~is~~ ~~has~~ manipulating the IT industries in the world economy ~~with its own~~ ~~as it~~ and this has result in the rise of international competitiveness of ~~the~~ⁱⁿ the world economy. ~~USA developed countries~~ such as ~~USA which also produces~~ ~~established~~ ~~factories~~. For instance, the company such as Microsoft or Apple which come from USA ~~has~~ ~~has~~ might having an increase in the competition of IT industries with the coming of ~~such as~~ ~~it~~ developments of IT industry in India.

Thirdly, the rapid growth of these emerging countries has also caused ~~the~~ ~~democratization~~ in the world ~~order~~ pattern. Before this, the manufacturing sector is mainly exploited by ~~developed~~ ~~country~~ countries such as UK and USA. ~~There~~ ~~the~~ ~~main~~ focus of economy in the developing nation, for instance ~~is~~ India only restricted to primary production. But after 1980's, UK has shifted its main economy focus to service sector and thus leaving its mining and manufacturing industries behind. Now, UK the service sector accounts for ~~for~~ 78% of UK GDP. As a result of this

Also, the manufacturing sector in the developing countries has developed. As more & more developed countries are focusing on service sector, they have their production shift to countries with low labor cost such as India and China. ~~Thus, what has contributed to~~ these developing countries are now focusing on the manufacturing sector while the developed countries are focusing their economies on the service sector.

However, the rise in productivity as a result of the growth of the developing economies have led to more environmental degradation. As ~~more~~ the emerging countries industrialised, more pollution will be made thus leading to ~~a reduction~~ deteriorates the environment.

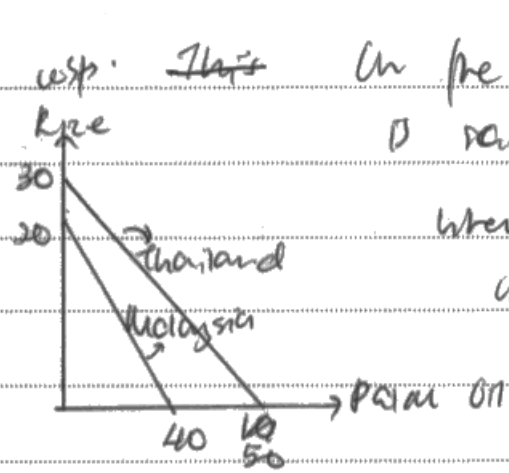
Moreover, the impact of increase in the international competitiveness ~~to be~~ will not be that high due to the existence of trading blocs. The European Union imposes Common External Tariff on imported goods coming ~~to~~ from ~~non-members~~ non-member countries and this has reduced the

ability of these emerging economies to increase the exports. So, the international competitiveness in the ~~new~~ world economy is not likely to be enhanced.

Lastly, the ^{rapid} growth of emerging economies does not mean that the ~~whole~~ ~~developed~~ developed countries are ~~deindustrializing~~. This is because there are still countries such as Germany and even USA which produces their manufactures their own brand of car ~~is not~~ and manipulates the world market with their products.

b) Specialisation occurs when a ~~country focuses their production~~ ~~country~~ country keeps on producing and ~~focusing~~ focusing their production on a particular good or service.

The first benefit of specialisation to a country is its enable the country to achieve globalisation. Specialisation relates to the theory of comparative advantage in which one country will produce good which they ~~have the~~ that have the best opportunity

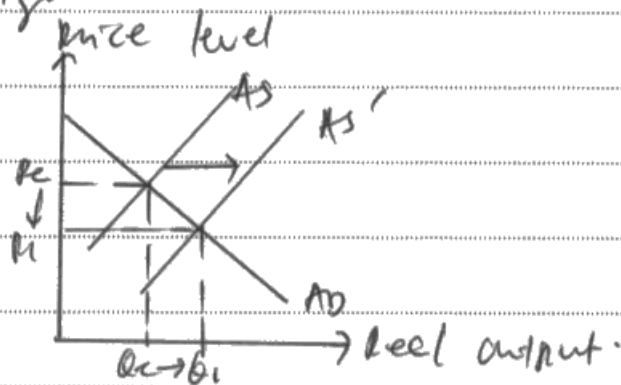


On the ^{graph} ~~diagram~~ shown, the specialisation is said to be achieved by Thailand when they focus their economy on the production of rice which they have the and Malaysia focuses their production on the palm

oil. So, when ~~a~~ Thailand for instance focuses their economy on rice, their ability to ~~be~~ increase their production of ^{rice} ~~rice~~ at a large amount is higher due to the fact ~~that~~ they have the comparative advantage in it. This will then leads to increase in trade done and hence globalisation is achieved when Thailand managed to trade in the international market

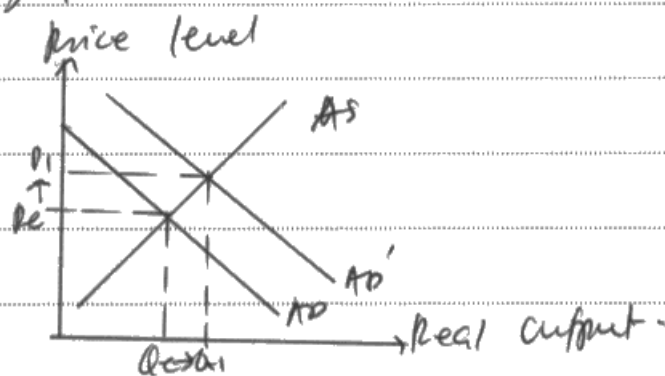
Secondly, the specialisation also ~~contributes~~ ~~can~~ contributes to the economic growth of an economy. ~~For~~ for instance, when China specializes its economy on the manufacturing sector, ~~the~~ ~~output~~ ~~is~~ ~~to~~ ~~be~~ the output produces by China can be increased. This is due to the fact that instead of diversifying their production on other goods which they are

not specialising in, it is better to focus
 on production that they have comparative
 advantage in. The production less
 cost factor thus enables them to maximise
 their factor of production when the factors
 are not diverted to produce unnecessary
 unprofitable production. ~~The~~ ~~is~~
~~with~~ ~~a~~ ~~focused~~ ~~product~~ ~~then~~ This will
 then result in more output that can
 be produced by China and as the
 aggregate supply curve shifts to
 the right as a result of this. The
 increase in output also indicates that
 the economic growth of China is
 increasing.



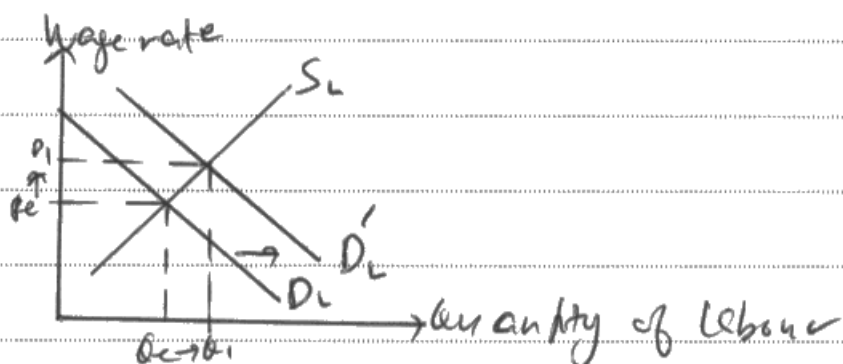
Thirdly specialisation also improves
 the ~~balance of payments~~ ^{current account} ~~current account~~
~~balance~~ of a country. For instance,
 when ~~India~~ ~~producing~~ ~~goods~~ ~~specialise~~
 China & Malaysia is specialising in

the palm oil production, then quantity exports can be increased. This rise in exports (produced by by 6 Malaysia) will improve the current account balance of Malaysia. The rise in exports ~~shift~~ of Malaysia's palm oil production shifts the ~~AD~~ AD to the right.



Lastly, the specialisation also reduces the unemployment rate in particular country. Due to more production is being made by China, for example, the demand for labour will increase due to the fact that labours are derived demand. This rise in demand for labours shift the demand curve for labour market to the right and thus quantity of labour employed increase from Q_e to Q_e' . At P_{lab} , when more people in China is being employed, this results in

The increase ~~of the~~ of standard of living in China as the citizens of China is getting a higher income compared to before



However, ~~the specialist~~ specialising on only one type of production may lead to the economy of a country becomes vulnerable. This is because, ~~when they are~~ ^{when} Malaysia, for instance, only producing palm oil and not diversifying their production on other goods, they will be easily affected by the ~~the~~ fall in the world's palm oil price. ~~Due to no other~~ ~~As a result of this,~~ ~~their economy~~ ~~will be easily~~ so, when price of palm oil falls, Malaysia's Gross National Income (GNI) ~~are~~ might fall in a large amount.

Moreover, the use in exports of and improvement of current account balance of a

country depends on the ~~alt~~ price elasticity of demand ^(ϵ) for exports of one's country. ~~So, if the PED of~~
Malaysia for if production of palm oil is not been highly demanded ^{or} Malaysia in the world's market, even so when ~~the~~ Malaysia is able to produce palm oil in a low price, the exports of palm oil will not increase, even when the price is low.

Lastly, there are other factors that would likely leads to an ~~at~~ the achievement of specialization in a particular country.

The existence of multinational company ^(MNC) is likely to increase the productivity and transfer of capital to a country which then enables them to achieve ~~achieve~~ specialization. This particularly true for China which has received a ~~for~~ large amount of FDI in terms of MNCs. So, specialization may not be the only causes which lead to specialization.



ResultsPlus

Examiner Comments

- a) This response was strong as the candidate showed good depth and breadth to their answer. There is a good understanding of developing and emerging economies in paragraph 1. The answer contains an in depth analysis of the rise in world trade, deindustrialisation and has shown some understanding of world trade patterns due to changes in production and FDI flows, albeit a little muddled at times. A couple of well-developed evaluation points were offered, whereby the candidate discusses how trading blocs and deindustrialisation have not altered world trade patterns much. This response was therefore given Level 5 score of 13 marks.
- b) This is a strong response which covers a good number of points and addresses the key aspects of the question. The candidate shows in depth development of points on comparative advantage, economic growth, current account position and unemployment; with each of the points supported by diagrammatic analysis, giving it the higher level for analysis. Evaluation points were discussed in detail but did not have the same depth as analysis points to achieve the top end of Level 5. This response was thus given Level 5 score of 21 marks.



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Examiner Tip

- a) Although both candidates were able to show understanding of what world trade patterns are, a vast majority misinterpreted what this meant. Candidates need to read the question carefully and answer questions in a global and not local context to achieve higher levels.
- b) It is beneficial to support points using numerical or diagrammatic analysis as it helps add depth to arguments. For questions on the concept of specialisation, it is important to discuss the comparative advantage in depth. Ensure that there is consistent application to countries throughout the answer.

Question 2

For (a), this question was poorly answered by a significant proportion of candidates who chose to attempt it. The problem was not really with the answers themselves but with the candidates misinterpreting the question. Candidates of all ability levels thought that it was asking about benefits to Ethiopia and Uganda and of the expansion of free trade rather than fair trade schemes. Candidates wrote essays about free trade instead, meaning that little of what they wrote was answering the question set and so could not be awarded marks. It did not seem to be the case that this was a difficult topic or question – those that knew the concept of fair trade managed to produce responses of a similar quality to the other essay questions. It is not clear whether this was because candidates had not covered fair trade and so were not aware that it might be different to free trade, or due to some other reason. This meant that candidates scored low marks overall if they misinterpreted this concept.

Responses that did understand fair trade schemes were able to suggest benefits to the countries, from reducing poverty to diversification up the value chain to community based development. Some candidates however only discussed benefits to farmers and not to Ethiopia and Uganda. They were not able to access Level 3. Candidates of all ability levels did find it more challenging to evaluate these benefits though and did not offer good depth and breadth to their points.

For (b), many candidates presented a sound understanding of economic effects on these countries of joining COMESA. Almost all the candidates answered the question either taking positives (negatives) as knowledge, application and analysis and negatives (positives) as evaluation; this was credited. Discussion of benefits of common markets and free trade areas were awarded due to the nature of the question.

Stronger candidates showed good depth and breadth to their analysis and evaluation points. Many were able to access Level 5 as they had sufficient development of points. They discussed trade creation, economies of scale and FDI in depth and supported their points using AD/AS analysis and in context to their arguments. A few candidates also explained the impact on the labour market as a result of joining the common market. Evaluation was often linked to trade diversion, and the impact on infant industries and current account deficit. Weaker candidates drew on these economic concepts to a lesser extent in their answers and although they had sufficient breadth to their answers, their arguments lacked the depth to receive higher levels.

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

Chosen question number: **Question 1** **Question 2** **Question 3**

~~a)~~ a) Fair trade schemes involve providing producers of a country with fair prices i.e. often setting a minimum set price at which ~~the producers~~ the producers can sell their goods. This helps to prevent the exploitation of farmers and give them a better standard of living. Firstly, set prices are beneficial to producers as it reduces the negative impact of fluctuating prices due to primary product dependency. As a result farmers in

Uganda and Ethiopia can ~~also~~ plan further growth and supply of coffee beans as there is reduced uncertainty in the market. As a result, domestic ~~producers~~ farmers are better off than without the fair trade schemes.

However, if developed countries are providing their primary product producers with subsidies they are able to produce coffee beans at a much lower cost than developing countries such as Ethiopia, which also lack the ~~best~~ most efficient technology. If the ~~best~~ farmers in Ethiopia and Uganda charge consumers also a higher fair trade price they become price uncompetitive.

Additionally, if the government buys the coffee beans at the provided fair trade prices it provides an opportunity cost to government spending. It can be argued that the economy would be better off if the government spent on other areas such as education and healthcare.

The increased revenue that farmers receive as a result of fair trade schemes prevent ~~only~~ this specific group from experiencing relative poverty. ~~Relative~~ Absolute poverty is defined as the inability of a person to meet the basic standards of living such as food and shelter. Relative poverty means that a person ~~is~~ earns less or falls under the certain criteria for a specific country. For example, UK's relative poverty is measured as ~~the~~ the people living below median (50%) income. Since the farmers of coffee beans in Uganda and Ethiopia earn more they are able to meet the basic standard of living and living standards in the country rise as a whole.

Since 28% of Ethiopia's exports are coffee beans this has a large impact on the people.

However, the provision of a set price in a fair trade scheme does not provide an incentive for the farmers to become more efficient or increase the quality of their products. This results in the support of inefficient domestic producers.

Fair trading schemes may also result in better wages paid to workers. Since the producers have a larger profit margin they are less inclined to exploit the work force by ~~paying~~ paying them very low wages. As a result poverty would decrease further and wage inequality within the country would reduce. This is especially important in countries that ~~rely heavily on~~ employ most of its population in the primary sector.

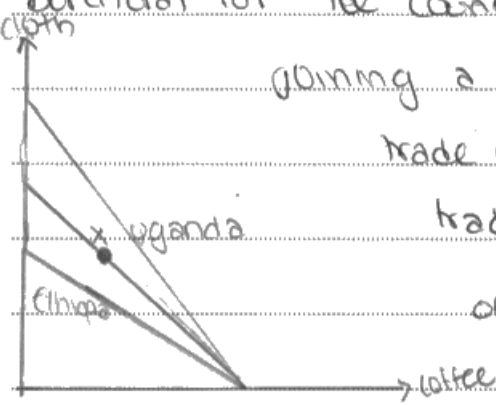
b) Trading blocs are regional agreements between countries to reduce or eliminate barriers to trade so they can efficiently trade with each other. Trading blocs have varying degrees of integration ranging from ~~preferential trade areas~~ PTA to customs unions. ~~The increased creation of~~ The increased creation of trading blocs can be considered as an effect of the increased levels of globalization in recent years.

It can also be ~~considered~~ considered that the creation of trading blocs will lead to an increase in globalization. Globalization can be defined as the increased trade and interdependence among the world's ~~countries~~ countries. The creation of trading blocs reduces trade barriers such as quotas and

tariffs and allows free trade to take place. This encourages further integration between the countries in the trading bloc.

~~This~~ However, trade diversion can occur as a result of trading blocs. This is when trade is diverted away from a more efficient country that is outside the trading bloc to a less efficient country inside the trading bloc. Furthermore, trading blocs lead to more regionalization than globalization as trade is fixed around a particular geographical area.

Another impact of joining a trading bloc is that a country is able to specialize in a certain product in which they may have a comparative advantage. For example, Uganda and Ethiopia may choose to specialize in the production of coffee beans. Specialization may allow a country to increase its efficiency in the production of its particular good meaning it is even more beneficial for the country. As shown in the diagram



joining a trading bloc and increasing a country's trade will ~~improve~~ improve its terms of trade as they are able to import more of a good than if the country had produced both goods on its own.

Another impact of joining a trading bloc is the increased market available for the country's firms to expand and produce for. In the same manner, the country is exposed to more MNCs and FDI's entering the country. This can be beneficial as it creates jobs

in the country thus reducing the level of unemployment. Additionally, any investment the company makes within the country adds to the GDP of the country and causes economic growth.

However, it is important that the government monitors the activities of MNCs as it may exploit the labour and resources of resource rich countries such as Ethiopia. These countries should ensure that more developed countries are not exploiting their resources and using them up rapidly.

Trading blocs can also provide countries with support during ~~the~~ times of downturn and recession as the member country's economic state affect the state of the other member countries. As a result, by ~~the~~ joining COMESA Uganda and Ethiopia will receive ~~some~~ aid and financial support from countries in times of need.

However, the degree of all these effects depends on the level of integration in a trading bloc. For example, the effects would be ~~the~~ ^{more} significant in a trading bloc such as a ~~the~~ common market or a customs union.

Additionally, certain trading blocs are more productive than others which ~~the~~ affects the impact it has on its member countries. ~~The~~ Trading blocs may be created but if there is no strong and active trade between its member countries its impacts on their economy is reduced.

In conclusion, ^{the level of the impact on a country's economy} ~~it~~ depends on the country and the particular trading bloc in question.



- a) The candidate shows understanding of fair trade schemes. The point in the first paragraph related to removing uncertainty by preventing fluctuating prices was in context of benefits to farmers and not the country and hence got Level 2 for this point. No credit for minimum price scheme/buffer stock scheme. Relative poverty point at the start of page two was taken together with the last paragraph on page two as further development and this point received a low-level 3. However, there is only one evaluative comment on offer when the candidate discusses about inefficiency of farmers but not in context of the countries. The response was therefore given a Level 3 score of 9 marks.
- b) This is a strong response which covers a good number of points and addresses the key aspects of the question. The candidate shows in depth development of points on comparative advantage, more trade creation, wider markets and FDI; with one supported with an accurate diagram, giving it the higher level for analysis. There were only two evaluation points which were discussed in detail – trade diversion on page 1 and degree of integration on page 2, but this did not have the breadth to achieve the top end of Level 5. This response was thus given Level 5 score of 21 marks.

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

Chosen question number: Question 1 Question 2 Question 3

(a) Fair trade schemes are schemes introduced to aid primary sector workers in securing a fair price for their products. By expanding fair trade schemes, it could result in various benefits for ~~the~~ countries like Uganda and Ethiopia.

Firstly, both Uganda and Ethiopia are not very developed, and ~~are~~ have a high level of primary product dependency. Primary products have high price fluctuations and low terms of trade. According to the Prebisch-Singer ~~the~~ hypothesis, terms of trade ~~is~~ for primary products would decline in the long run ~~is~~ compared to manufactured products. The ~~is~~ expansion of fair trade schemes would reduce ~~is~~ the price fluctuations, and help ~~stabilise~~ to improve the terms of trade of both Uganda and Ethiopia's coffee industries.

Furthermore, ^{fair} expansion of ~~the~~ trade schemes in Uganda and Ethiopia would stabilise the prices of coffee, and allow workers in the industry to earn steadier and higher incomes. These workers would ~~be~~ become more prosperous and well-off, which could increase motivation, leading to increased productivity in the industry. This ~~is~~ would then help to decrease their costs, and allow them to earn more profit in the long run.

Also, fair trade schemes are considered ethical business practice. When such schemes are expanded, it would improve the image and perceived quality of the Ugandan and Ethiopian coffee. As a result, export could increase, as more ~~more~~ consumers around the globe are becoming more ethically conscious about ~~the~~ their consumer habits. ~~This would~~

On the other hand, ~~the~~ fair trade coffee may be more expensive due to the ~~the~~ ^{higher} ~~fair~~ prices given to coffee suppliers. This could mean that ~~the~~ ~~the~~ exports in Uganda and Ethiopia ~~we~~ would become less ~~comp~~ competitive in the international market, and despite better quality and image of the coffee, ~~the~~ exports in these countries may decrease.

Furthermore, coffee beans account for 28% of Ethiopia's exports versus only 19% of Uganda's exports. The expansion of fair trade schemes for their coffee industries may impact Ethiopia more than Uganda, because Ethiopia's economy is more dependent on the exports of coffee.

Lastly, long term ~~eff~~ ~~the~~ effects and benefits must be considered against the short term. Although expanding fair trade schemes can benefit coffee industries in Uganda and Ethiopia in the short run, ~~it~~ it may not make much of a difference in the long run as markets ~~are~~ change.

The magnitude of the expansion could also affect the how beneficial ~~the~~ the schemes would be; if the expansion is small, benefits will be ~~to~~ less significant, and vice versa.

In conclusion, depending on the magnitude and various other economic conditions, the expansion of fair trade scheme could definitely bring about benefits for the Ugandan and Ethiopian coffee industries.

(b) The Common Market for Eastern and Southern Africa ~~for~~ (COMESA) is a free trade area. This means ^{that} member countries are in agreement to trade freely with one another. This could affect countries that join the COMESA such as Ethiopia and Uganda in many ways.

Firstly, joining COMESA would result in both trade creation and trade diversion. Trade creation means that there would be increased trade between ~~be~~ member countries, which would help boost economic growth and level of exports in countries like Uganda, which can aid in raising living standards for them in the long run.

Trade diversion on the other hand means that countries would have to import from less efficient

~~can~~ countries that are within the COMESA. For example, Uganda may have to ^{import goods from} ~~trade with~~ Ethiopia, despite the higher price and despite there being other non-member countries that are selling the goods at cheaper prices. This ~~is~~ is considered a disadvantage for COMESA members like Uganda.

Another effect would be the increase in ~~FDI~~ foreign ~~ex~~ direct investment into the country. As countries join the COMESA, other countries in the free trade area would start to invest ~~to~~ ~~if~~ because Uganda joined the COMESA, there would be a boost in foreign direct investment which can ~~help~~ result in technological transfers, improvement in infrastructure and ~~be~~ a boost in economic growth. Multinational companies would also start setting up in Uganda, which can further ~~boost~~ boost their economic growth and increase employment levels in the country.

However, the entering of multinationals into the ~~domest~~ ~~home~~ home market could have negative impacts on Uganda's domestic and infant industries. Multinational companies are typically very large and have achieved a high level of economies of scale, and can therefore charge low prices. Domestic firms in Uganda ~~or even~~ may not be able to compete with them, and may eventually be driven out of business. This is particularly dangerous for ~~countries~~

still developing countries like Uganda and Ethiopia, as they need to protect their infant industries in order to improve their levels of economic development.

Another negative effect of joining COMESA is the loss of sovereignty. As COMESA is a free trade area, its member countries are in agreement to trade freely with one another. These economic decisions have already been made for the member countries by COMESA. Countries like Uganda and Ethiopia therefore lose their control over some of ~~areas~~ decision making in some areas. Thus, it can be said that these countries ~~loss~~ lose their sovereignty.

On the other hand, despite all of these possible economic effects, it is important to take into consideration the economic situation of each of the member countries. For example, the economic climate of Uganda may be very different from Ethiopia, so joining COMESA would impact both of those countries differently. Hence, it is important to analyse the individual country's economy before making judgment.

Furthermore, joining COMESA may have different short term effects compared to long term ones. ~~For Uganda~~ In Uganda, there may have been ^{a high} ~~an~~ increase in ~~multinational~~ short run economic growth, but in the long run, such spiked levels of growth may not be present anymore.

Also, as COMESA is a free trade area, joining COMESA may not yield as significant ~~eff~~ impacts as joining a ~~common~~ common market union, or even a monetary union for example.

Lastly, ~~the economic~~ analysing the likely effects of countries joining COMESA would require extensive economic ~~research~~ research and the availability of 'necessary' data. Hence, it is difficult to say the exact impacts of joining COMESA for countries like Uganda.

In conclusion, joining COMESA is likely to improve levels of economic development in undeveloped countries like Uganda, but ~~if it is~~ we must consider ~~a~~ the economic situation of ^{the} individual countries to find out ^{more accurate} the economic effects ~~with~~ of joining COMESA.



ResultsPlus

Examiner Comments

- a) This response was strong as the candidate showed good depth and breadth in their answer. On page 1, the answer shows the development of terms of trade in the context of countries but only develops higher revenue and profits point in terms of farmers. Page 2 offers a sufficient level of development of ethical practices and exports increasing for these countries. This therefore gave the analysis at mid-level 3. There were three well-developed evaluation points offered on page 2 and in context. This allowed the response to access a Level 5 score of 14 marks.
- b) The candidate presented positive and negative benefits of joining COMESA. The negative effects were taken as analysis and the positive as evaluation. The paragraph on trade creation lacked discussion of comparative advantage and increase in FDI were developed but did not have sufficient breadth to gain higher levels. The negative effects lacked depth and each gained Level 2, apart from the inability of domestic firms to compete against MNCs, which was seen as a Level 3 point – giving the analysis a mid-level 3. Therefore, this response was given a Level 4 score of 18 marks.



- a) Although both the candidates were able to show an understanding of fair trade schemes, a majority misinterpreted this as free trade and received very little or no credit. Candidates need to read the question very carefully and answer questions in context of the countries and not farmers to achieve higher levels.
- b) Candidates need to ensure there is a good balance on positive and negative economic effects if they follow this approach for analysis and evaluation. Often arguments are heavily one sided. To access higher levels, there needs to be sufficient breadth and depth to the answers. Ensure that there is consistent application to the countries throughout the answer.

Question 3

For (a), candidates have been able to explain the various reasons for an increase in public expenditure, showing breadth to their analysis. Some have also demonstrated good depth. Stronger candidates have explained points as recession, ageing population, paying of debt interest and a rise in spending on healthcare and education. Most of them discussed these in the context of Japan. They were able to provide logical chains of reasoning and this gave candidates a high score putting them in Level 3 for analysis.

Weaker candidates were also able to identify reasons but they were not as developed and focussed on one area of discretionary policy. For example the answers focussed on spending on healthcare, training and education as three separate points. This was credited but at top Level 2, as this did not demonstrate good breadth to the answers.

However, many candidates have often evaluated the general effects of an increase in the public expenditure rather than reasons for it. Although the examiners accepted one point on this, candidates were not able to access Level 5. A few candidates made evaluative comments in context and were able to relate it to the increase in public expenditure or prioritise different reasons. Some discussed the significance of these reasons and showed a good level of depth allowing them to gain access to higher levels.

For (b), many candidates found it easy to access higher levels. They have presented a sound understanding of the economic effects of the reduction in the level of public expenditure. Almost all the candidates answered the question either taking the positives (negatives) as knowledge, application and analysis and negatives (positives) as evaluation; this was credited.

Stronger candidates produced some good answers to this question, and in particular were able to apply their answers to a country of their choice in a beneficial way. It was obvious that when candidates chose to discuss their countries, they were able to include more detail, and integrate their analysis and application to a greater extent. Candidates were capped at Level 4 if they did not refer to a country in their response.

The differences between strong and weak candidates were two-fold. First, weaker candidates tended to give very descriptive answers, struggling to include much economic knowledge or theory in their analysis. This meant that the responses lacked depth, limiting them to Level 3 marks. Second, weaker candidates struggled to evaluate factors that they had identified.

Responses that received higher levels had strong analysis and evaluation points. They were able to explain the effects using AD/AS analysis and in context to their arguments. They explained good development of points relating to crowding out, productivity and inflation. Weaker candidates drew on these economic concepts to a far lesser extent in their answers.

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

Chosen question number: Question 1 Question 2 Question 3

3.
a)

Increase in the level of public expenditure is an example of an expansionary fiscal policy where public expenditure which is government spending is greater than tax revenue. This could mean a fiscal budget deficit. A fiscal boost (increase in the level of public expenditure) could stimulate rising demand and lead to an increase in output and employment beneficial and needed during a recession. Here are the reasons for an increase in public expenditure (or a rising budget deficit)

- An increase in the level of public expenditure could be a cause of ~~econ~~ automatic stabilisers at work - which includes transfer payments (welfare benefits - unemployment benefits pensions) which ~~fluctuate~~ fluctuate around the economic cycle. For instance, a government can operate a fiscal boost during a recession to stimulate AD, output and employment and a fiscal drag during periods of strong growth. Also, could be a discretionary fiscal policy which is using the policy of government spending and tax revenue to stimulate AD.

To stimulate output, AD and employment during periods of economic inactivity, ~~Economic~~ ^{Government} spending and ^{increasing} ~~tax revenue~~

decreasing tax rates could have a multiplier effect - bigger effect on AD, which may lead to increase in output and employment.

- To improve the level of public services and ~~sp~~ public expenditure on infrastructural development which could attract future inflows of financial capital, increased FDI, provide a range of jobs and lead to job creation.
An ^{infrastructural} development could be crucial to an increase in economic development and ~~AD~~ growth.

- Ratio of dependants ~~can~~ could be high in a country. This could mean a large number of unemployed, disabled or retired people who depend on the working population for their livelihood. For example, if there are a large number of retired, old people, the government has to provide for them in the way of increased pensions or spending on hospitals and retirement homes.

- ~~Aggravate~~ Public expenditure can be also used to reduce relative and absolute poverty and improve the distribution of income in a country. For example, public expenditure could be on providing credit, working families grant, income support, child and career support. Unemployment benefit may have to be given out to those unemployed.

- To provide for increased level of
- To offer grants, subsidies, business startup loans to infant or struggling industries so that they can exploit economies of scale and develop a cost and comparative advantage and increase their competitiveness.
- Increased public expenditure could be on providing government initiatives and projects and services that the public need.
- Increased public expenditure could be to^{on} stimulating job creation and reducing the level of unemployment in an economy.
- An increase in public expenditure could lead to an increase in PSNCR (Public Sector Net Cash Requirement) and increase public and external debt.
- An increase in public expenditure if it leads to accumulation of debt could increase the level of ~~debt~~ interest rates in the economy.
- An increase in public expenditure may 'crowd out' private sector investment (Increase in interest rates may deter private investment) since resources are allocated to the inefficient public sector. Private sector more productive.

⇒

- An increase in public expenditure to stimulate aggregated demand could be inflationary.
- Public expenditure may be inefficient and less productive and could be met with government failure. This could also be costly and is an opportunity cost for the government.
- Accumulation of public debt (national debt) may be a constraint on future growth.

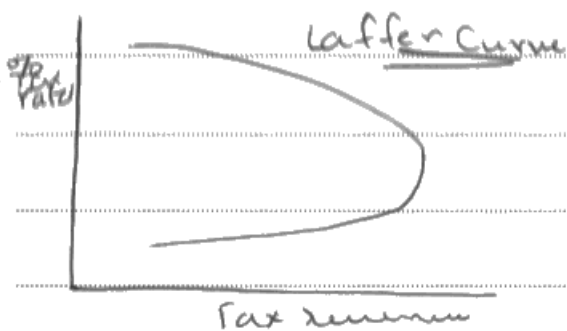
However, an increase in public expenditure could act as a fiscal boost to stimulate the economy especially after and during a recession and could be used on providing essential public services.

b) Reduction in the level of public expenditure is an example of a contractionary fiscal policy where government spending is less than what it had received in tax revenue. Public expenditure fell to below 50% in Italy. This is also when the government is operating a budget surplus.

An increase in tax revenue rates is potentially used to increase government tax revenue. But could work in the opposite way. The Laffer curve demonstrates that an increase in tax rates

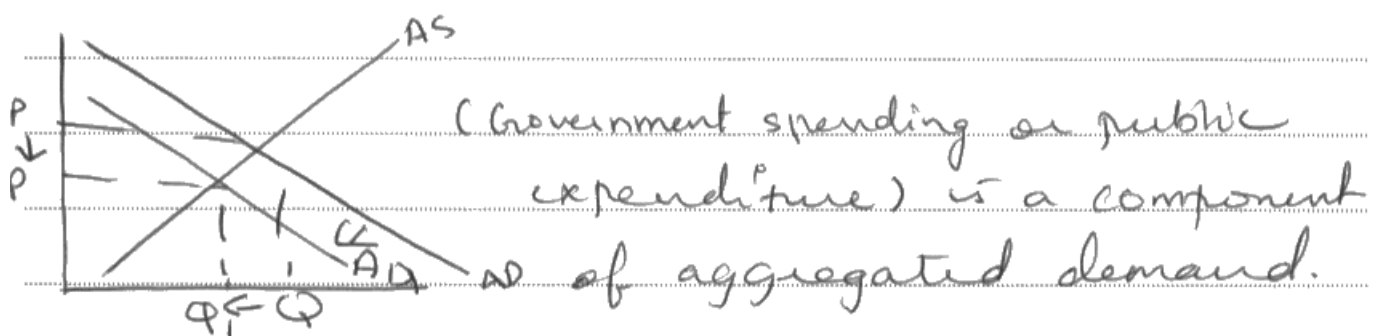
could potentially lead to a decline in tax revenue.

Tax revenue will rise at first but after a certain point will start to fall.



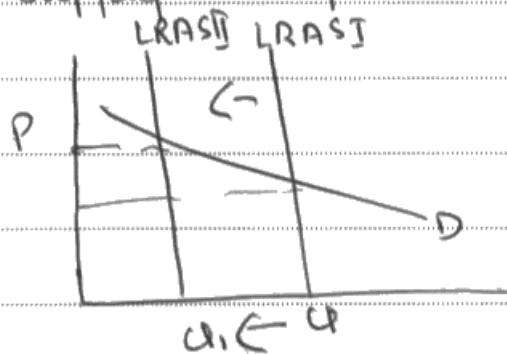
A reduction in the level of public expenditure in Italy from 55% to less than 50% is a sizeable decrease.

Operating a budget surplus or an increase in the level of public expenditure will mean that the government spending is less. This could potentially have a negative effect through the multiplier effect. Government spending decreasing would mean that AD (Aggregated ^{demand} decreasing) would decline meaning less output, meaning ~~a~~ higher unemployment and less job creation.



A decrease in public expenditure could mean less is spent on public services and public goods - meaning a potential decline in

the quality of government services. This could mean that less government spending is provided on education (meaning a decline in the quality of education - which could mean a decline in productive human capital) and less is spent on providing healthcare (a decline in the provision of medical services). Healthcare and education is normally provided free of cost or is heavily subsidised by the government which could mean more people would turn to private education and health care which is more expensive and could mean poor people would be unable to afford it. All this could mean an inward shift in LRAS (long run aggregated supply and productive potential)



A reduction in public expenditure could also mean government spending on benefits has decreased. A government provides mean-tested and universal benefits - which includes career support, income support, child support, unemployment benefit, grants

and this could have a regressive effect on the distribution of income and lead to widening inequality and gap between the rich and poor.

Reduction in the level of government spending may mean less is spent on infrastructural development. A decrease in the level of infrastructural development could pose a threat ~~to~~ and as a constraint on the future growth and development of a country.

~~Reduction~~ Reduction in public expenditure could also mean a decrease in the provision of grants, subsidies, tax relief and government provided incentives such as business start up loans which could mean struggling or declining industries or small infant industries may struggle to reach finance and could ~~be~~ mean that these industries would be unable to achieve economies of scale and develop a comparative cost advantage.

This is a fiscal drag during periods of strong economic growth. But a reduction in the public expenditure would pose a constraint

on the future growth of the country and mean poor, inefficient government services provided and lead to displaced workers.

However inflationary pressures subside due to the constraint on aggregated demand.

Re A reduction in the level of public expenditure could also mean less crowding out leaving more funds for the private sector which is more efficient.

A decrease in external debt due to a decrease in the size of public expenditure.



ResultsPlus
Examiner Comments

- a) This candidate gives a range of reasons for public expenditure increasing, from recession to welfare payments on page 1, to redistribution of income and an aging population on page 2. These are well developed and get access to Level 2. There is only one argument on infrastructural development which was in depth and thus analysis was awarded a low level 3. However, there is only one evaluative comment on offer when the candidate discusses a reason against high government spending. This response was therefore given a Level 4 score of 10 marks.
- b) Although the answer starts incorrectly discussing taxes, it improves as it goes along. This candidate discusses falling AD through multiplier and impact of inequality in some detail and gets a Level 2. Arguments on reduction of quality of services (education and infrastructure has been taken as one) and impact on infant industries was very well developed. This gave the analysis an overall top Level 3. There are only two Level 1 evaluative comments, which gets them access to one further mark. This response was thereby given a Level 4 score of 16 marks.

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

Chosen question number: Question 1 Question 2 Question 3

(c) Public expenditure is the total sum a government spends in an economy in a given fiscal year. It comprises of current expenditure, capital expenditure and transfers. Current expenditure is recurring expenditure that constantly needs to be paid for example expenditure of healthcare like NHS, and education like state schools. Capital expenditure is investment on assets that will benefit the economy over a long period of time. It is a one-off expenditure for example spending on infrastructure like building a bridge or a road. Transfers are expenditures that do not yield a return like pension payments. GDP is the total revenue generated from sale of goods and services in an economy.

An increase in the level of public expenditure as a proportion of GDP in an economy may have arisen due to many reasons. Firstly, there could have been a recession in that given year. Public expenditure as a proportion of GDP for Japan rose from 35% to 42%. In 2014 the Japanese economy may

have faced a slowdown and economic growth may have fallen hence leading to a recession. During a recession, firms may try to cut down costs and this means that unemployment increases significantly. The Japanese government will have to ensure the welfare of these newly unemployed citizens and will have to increase spending on welfare payments and job-seekers allowance hence increasing level of public expenditure as a proportion of GDP. To add on, another possible reason for the increase in level of public expenditure as a proportion of GDP in Japan may have been due to the Japanese government spending on nationalising of monopolies or other private firms. Nationalising is when a government acquires a private firm. ~~But~~ The Japanese government may have deemed it necessary to nationalise an essential firm like a utility provider so as to benefit the Japanese citizens and hence its public expenditure as a proportion of GDP increased.

Furthermore, public expenditure as a proportion of GDP from 1993 to 2014 may have risen due to an increase in dependent

population. This may be due to an ageing population. Currently, Japan is high on global ranks for having a large percentage of its population being senior citizens. Expenditure may have increased due to increase in this dependent demographic. The Japanese government may have to increase expenditure on old age homes over the years between 1993 to 2014 and hence the public expenditure as a proportion of GDP rose too.

In addition, the Japanese government's expenditure as proportion of GDP may have risen due to increased expenditure on subsidies provided to domestic Japanese firms. The Japanese government may have intended to increase its exports and international competitiveness and hence increased expenditure on subsidies to its local, domestic industries to achieve these goals, so expenditure increased.

Moreover, between 1993 to 2014, the Japanese government may have made reforms in its country to increase the literacy rates and this meant building more state schools. The public expenditure as a

proportion of GDP may have risen to finance this increase in building and maintenance of state schools.

Additionally, due to the aforementioned factor of ageing population and high dependency ratio the ^{Japanese} government may also have had to increase spending on building, expanding and maintaining hospitals as the old citizens need constant medical attention hence expenditure as a proportion of GDP increased.

However, public expenditure as a proportion of GDP may not have risen only due to increase in ~~GDP~~ ^{expenditure} but may have risen due to decrease in GDP. The

Japanese economy has faced fierce competition over the last few years and this may have led to a decrease in GDP so even though public expenditure was stagnant between 1993 and 2014 the ratio may have increased.

Additionally, the increase in public expenditure as a proportion of GDP may be short lived if the spending increased due to recession which is short lived. If the economy is in recovery on its way to a boom

then the figure will reduce in forthcoming years.

Moreover, the magnitude of increase in public expenditure as a proportion of GDP (between 35% to 42%) in Japan may not seem significant if ~~decrease~~ qualitative factors are taken into consideration. Public expenditure is bound to increase ~~if~~ if there was a population growth and the Japanese government may be ~~helpless~~ helpless when it comes to reducing it as it is a natural increase that was bound to happen - due to increased population.

(b) Public expenditure is the total sum a government spends in a given year. GDP is the total revenue from sales of goods and services for an economy in a given year. There are many likely positive ^{economic} effects of a reduction in the level of public expenditure as a proportion of GDP for Italy. Firstly, if public expenditure falls then aggregate demand will fall. Aggregate demand ~~is~~ is the total demand in an economy. Government expenditure is

a component of AD and a fall in government expenditure will lead to a fall in AD. This means that demand pull inflation in Italy will reduce too.

However, the fall in AD may not be significant because consumption is the largest component of AD ~~and~~ and has the greatest impact. Fall in public expenditure as a proportion of GDP may not necessarily lead to reduction in AD and demand pull inflation in Italy ^{as} it is not a major contributor in the components affecting AD.

Secondly another positive impact of fall in government expenditure as a proportion of GDP in Italy may be a ^{positive impact} ~~decrease~~ on ^{fiscal} budget ~~deficit~~. A budget deficit occurs when government expenditure is greater than government revenue.

If Italy was running a budget deficit, the decrease in public expenditure meant that the deficit reduced. This also meant that National debt in Italy reduced too. National debt is total accumulation of budget deficits over the years.

If National debt reduces the Italian government is able to pay out its debts - both internally and externally (to other economies). Repayment of internal debt will mean that PSBR will reduce. The crowding out effect will reduce too and hence there will be more money in the hands of the Italian citizens which can be used to invest in Italy's businesses, spurring growth.

Secondly, repayment of external debt by Italy to its foreign creditors will boost confidence in Italy and more investors will be willing to invest in Italy, hence boosting Italy's economic growth.

~~Moreover reduction in public expenditure as a proportion of GDP in Italy was positive as it may ~~also~~ mean that~~
However, reduction in public expenditure as a proportion of GDP may have negative economic ramifications detrimental to Italy's economy.

Firstly, reduction in public expenditure means that subsidies to infant

industries will reduce as a result too. This means that Italy's exports will reduce too leading to an adverse effect on the current account on Italy's balance of payments.

Moreover the slash in subsidies may also mean that GDP will reduce as a result as less goods will be produced and sold so GDP reduces and economic growth reduces too.

Moreover the slash in subsidies is also harmful as it will lead to the businesses practicing cost cutting measures and this may mean

laying off workers hence increasing unemployment in Italy.

In addition, reduction in level of public expenditure may mean that projects like infrastructure and development will be slashed or forgone. These projects may have been fundamental to attract FDI's and MNC's to set up in Italy but now Italy will have reduced economic growth and increased unemployment. Also, public expenditure reduction

may mean that welfare payments like job seekers allowance will reduce. This will increase the polarity between the unemployed and the working class and upper class. This means income inequality in Italy will increase and hence consumer confidence will fall in AD and potential growth.

In conclusion, it is ~~clearly~~ beneficial to look deeper into the reasons as to why the public expenditure was slashed too. Was it an austerity measure and a tool of tight fiscal policy?

Moreover, the ~~the~~ economic effects will depend on the magnitude of decrease in public expenditure as a proportion of GDP. A 5% decrease may not have significant detrimental effects.

~~But~~ ultimately, there is a time lag attached to the reduction in public expenditure. It may rise in future years and economic effects will not be significant.

Ultimately, budgets and public expenditure plans are revised on a yearly basis.

and are not a true reflection of the economy as ^{economic effects} can not be adjusted within the year so ~~it~~ depends on what steps the government will take at the end of the fiscal year.



ResultsPlus Examiner Comments

- a) This response was strong as the candidate showed good depth and breadth in their answer. There is a good understanding of the type of public expenditure in paragraph 1. The answer contains an in depth analysis of the reasons on recession, nationalisation and the aging population. However, the candidate does not refer to what subsidies were spent on and that received Level 2. A couple of well-developed evaluation points offered on page 4 allowed this response to access a Level 5 score of 14 marks.
- b) This is another good answer which covers a selection of points and addresses both positive and negative effects. The negative effects were taken as analysis and the positive effects as evaluation. The candidate shows an in depth development of points for both but has not shown a sufficient amount of breadth in evaluation to access full marks for this question. This response was thus given Level 5 score of 22 marks.



ResultsPlus Examiner Tip

- a) The majority of candidates were able to explain reasons for an increase in public expenditure but struggled to evaluate this. The focus should be on a range of reasons and not just on one area of discretionary policy. Remember to evaluate the reasons of an increase in public expenditure and not the effects of the reasons made to access the highest level.
- b) It is beneficial to support points using diagrammatic analysis as it helps add depth to arguments. Candidates need to ensure there is good balance on the positive and negative economic effects if they follow this approach for analysis and evaluation. Often arguments in this question focussed on the negative effects with less emphasis to the positive ones. To access higher levels, there has to be sufficient breadth and depth to the answers, and consistent application to the countries throughout the response.

Question 4 (a)

This question was largely well answered and candidates were able to show a good understanding of the definition of fiscal (budget) deficit. Stronger candidates defined it as "when the government expenditure exceeds tax revenue" and made use of data in a meaningful way (two points stated as % of GDP). Weaker candidates failed to mention tax revenue and did not accurately use the data, for example fiscal deficit at a high of - 2.30/- 2.30% in 2014 without quoting it as a percentage (%) of GDP.

Examiners were looking for two separate pieces of data reference. Some candidates often only gave one data reference and this was a key reason why candidates did not secure full marks.

(a) With reference to Figure 1, explain what is meant by a government fiscal (budget) deficit.

(4)
A government fiscal Budget is when, the
govt earning (taxes) exceeds govt
expenditure. i.e. spending on ^{un}employment
benefits

Indonesia is continuously experiencing
of a fiscal deficit from 2005 to

2014

i.e. in 2014 its deficit was -2.3% of
GDP

& in 2013 it was -1.9% of GDP

The lowest budget deficit was

experienced in 2009 of -0.08% of
GDP.



ResultsPlus
Examiner Comments

This response earned 2/4 marks.

The candidate starts the answer with an incorrect definition and hence, was awarded no marks for knowledge. In the next paragraph the candidate provides three different accurate data reference points and hence, gets full 2 marks for application.

(a) With reference to Figure 1, explain what is meant by a government fiscal (budget) deficit.

(4)

A fiscal budget deficit is when the government's expenditure is greater than the government's income and tax revenue.

Figure 1 shows that the Indonesian government's fiscal budget balance has been running a deficit over the period 2005 to 2014. In 2014, the deficit was -2.3% of GDP which was the largest it had been in this period.



ResultsPlus

Examiner Comments

This response earned 4/4 marks.

The first paragraph shows sound knowledge of the meaning of the term fiscal deficit and was awarded 2 marks. The second paragraph includes two relevant data references from Figure 1 and hence was awarded 2 application marks.



ResultsPlus

Examiner Tip

In the 4 mark data response question, there are always 2 marks available for knowledge (AO1) and 2 marks available for application (AO2). Do not forget to include at least two elements of application to the data provided in your response so that you can earn these latter marks. Omitting this is the most common reason for candidates not scoring full marks on 4 mark questions.

Question 4 (b)

This question was not very well answered by the majority of candidates, and the mean score was low. Although candidates were able to use the extract to identify and explain the economic effects of a ban, they were not able to consistently develop their answers to earn them a Level 3 mark for their knowledge, application and analysis. The majority of the candidates used the negative effects as their analysis and positive effects as their evaluation, and this was credited. For a 12 mark question, 8 marks are available for knowledge, application and analysis and 4 marks for evaluation.

Level 1 would be the identification of an effect, for example it reduces exports and therefore there is less economic growth. Level 2 would be identification of an effect and use of data OR a development of a point, for example it reduces exports and therefore there is less economic growth as seen from "Economic growth in Indonesia has fallen to the lowest level for almost five years" OR it reduces exports and therefore there is less economic growth which was explained using an AD/AS diagram. Level 3 would be identification of an effect, use of data AND development of the point, for example it reduces exports and therefore there is less economic growth as seen from "Economic growth in Indonesia has fallen to the lowest level for almost five years" and explaining it using an AD/AS accurately labelled diagram. This was done by the stronger candidates.

Weaker candidate's answers often lacked depth and breadth. They used sentences from the extract as their development points and this was only credited at Level 2 if mentioned along with the identification of an effect.

Evaluation was lacking. Often candidates listed basic evaluation points without development and this gave them access to Level 1 only. Only a few candidates made use of the extract provided, explaining how the ban would help promote the development of processing industries and ensure mining companies "add value" – thereby giving them access to Level 2. Typically, examiners are looking for three well developed analysis points and two well developed evaluation points in 12 mark questions.

(b) Discuss the likely economic effects of the Indonesian Government's ban on the export of unprocessed minerals.

(12)

According to extract 1, the government has banned the export of unprocessed minerals in Indonesia. This can have both advantages and disadvantages. A ban is a complete prevention of exporting a good, as opposed to exporting a limited quantity.

To begin with, the ban of these minerals resulted in unemployment for many workers, worsening the state of the economy. It also resulted in Indonesia engaging in ~~new~~ high redundancy costs and wasted resources. In addition, the ban of unprocessed minerals, according to the World Bank, reduce Indonesia's tax revenue.

ue by US\$6.5 billion between 2014 and 2017. This means future government expenditure in investment, education and infrastructure may have to be compromised, reducing the possibility of development for Indonesia. Moreover, a ban of these exports will reduce Indonesia's overall international competitiveness as it may not specialize or have a comparative advantage over any other export. This will reduce motivation and trade for the mining industry in Indonesia.

However, unprocessed minerals are primary products that have ~~not~~ price fluctuations, such as diamonds in Botswana. These price fluctuations due ~~to~~ to changing elasticities of supply and demand and weather conditions, may prevent further investments in the mining industry in Indonesia, leaving no scope for growth. In addition, as a result of the ban, the Indonesian government is putting mining regions to use by encouraging the development of processing industries which will benefit Indonesia in the long run. In addition, these actions taken by the government are all to ensure that Indonesia's mining companies 'add value' as opposed to just "exporting" their earth.

In conclusion, despite disadvantages that result from a ban such as reduced export demand, and inadequate mining regions for construction, the ban on unprocessed minerals will result in ~~a~~ efficiency and

more productivity for Indonesia in the long run.



ResultsPlus
Examiner Comments

This response received a Level 2 mark for KAA (5 marks) and a Level 2 score for evaluation (3 marks), making a total of 8/12.

The candidate develops two points in the answer. The first point on how the ban results in unemployment leading to redundancy costs and wasted resources and the second on the loss of tax revenue of US\$6.5 billion leading to lower expenditure and therefore the development in the future. This gives it a score of mid-level 2 KAA. In evaluation, the candidate gives two points of which only one – page two on development on the processing industries – is well-developed, earning only a low-level 2 for evaluation.

(b) Discuss the likely economic effects of the Indonesian Government's ban on the export of unprocessed minerals.

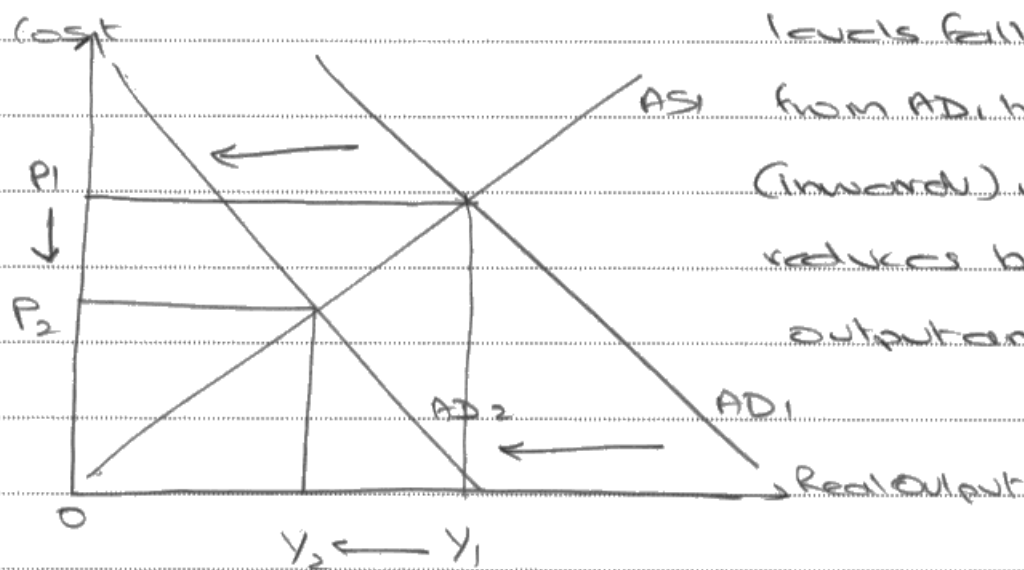
(12)

The ban of export of unprocessed minerals means that Indonesia is unable to export unprocessed minerals. The first significant economic effect would be the unfavourable balance on the current account of the balance of payment as exports are banned. The economy is unable to incur export revenue of US\$ 6 billion. This will lead to the levels of exports falling which can affect the current balance of payment on the current.

However, the current account is made up of trade in goods, trade in services, income and current transfers. Therefore, the Indonesian government may experience this unfavourable balance but very insignificantly as it depends on the proportion of unprocessed minerals being the only component in the trade in goods.

The implemented ban can lead the workers become redundant which is seen in the Indonesian economy, Extract 1, 'when the export ban on minerals came into force, tens of thousands of workers were made redundant'. This unfortunate ban clearly

will lead to a rise in unemployment. As the level of unemployment rises, the economic effects are far more adverse. Firstly, it will lead to a loss in income for these employees as the ban may lead to a requirement in these workers, possibly derived demand for them. As levels of income decrease, consumption levels also fall. As consumption is a main component of aggregate demand, it will reduce aggregate demand in the economy.



As consumption levels fall, AD shifts from AD_1 to AD_2 (inward), which reduces both real output and price.

Furthermore, this unemployment rise will also negatively affect the level of government revenue in the form of taxes, 'the government will lose US\$6.5 million in tax revenue over the period from 2014 to 2017'. This will inversely affect economic development to the Indonesian government as lack of funds

may make it difficult to invest into its economy

Although, following the redundancy, the Indonesian government can take possible measures in providing unemployed with a job seeking allowance or even unemployment benefits. This can maybe a relatively short-term cost as in the long run, its benefit may outweigh as it has forced some mining industries in committing to building expensive processing facilities. This could help the Indonesian government to reap qualitative extraction of minerals and also satisfy the aim of adding value to their exports than just exporting therefore the incurve effect may last only in the short run whereas, all maybe maybe overcome in the long run.



ResultsPlus Examiner Comments

This response received a Level 3 mark for KAA (8 marks) and a Level 2 score for evaluation (4 marks), making a total of 12/12.

The candidate has made three well developed points on current account, unemployment and loss of government revenue. All these points were well integrated with the application from the extract and the candidate also offered it in context using an AD/AS diagram hence getting Level 3 for all 8 marks.

The candidate also offers two well-developed evaluation points on the second paragraph of page 1 and the last paragraph on page 3; this gave it Level 2 of all 4 marks.



ResultsPlus Examiner Tip

Note that in a 12 mark questions, there are 8 marks available for KAA and only 4 for evaluation. This balance should be reflected in the candidates' responses, with around two-thirds of the response focusing on KAA and one-third on evaluation. To achieve a full Level 3 for analysis, candidates must identify points, integrate them with the application available from extracts consistently and develop them further through a logical chain of reasoning or using an accurately labelled diagram.

Question 4 (c)

This question was fairly well answered, given that a good proportion of the marks could be earned by simply identifying two relevant pieces of evidence from the data and supporting this with explicit reference to the data from Figure 2. Please be mindful that the questions do not always explicitly ask for reference to data; candidates must be able to identify what needs to be picked up from the relevant figures provided.

Most candidates were able to identify two valid pieces of evidence, the most common being higher interest rates and lower commodity prices. Although they could provide some further analysis they often did not relate it back to economic growth. Stronger candidates were able to identify and develop their reasons and gained all 3 marks for each point by linking it to an AD/AS analysis. Although some supported their answers with accurately labelled diagram(s), they still struggled to pick up application marks available from Figure 2 which shows Indonesian annual real GDP growth rate.

Candidates do not seem to appreciate that they do not need to evaluate their responses to 'analyse' questions.

- (c) **Apart from the ban on the export of unprocessed minerals, analyse two reasons why 'In 2014, economic growth in Indonesia fell to the lowest level for four years'. (Extract 1, line 1).**

(8)

According to the figure 2, Indonesian annual real GDP growth rate was the smallest for the last 5 years and contributed $\approx 5\%$.

The first reason for such a small economic growth is that interest rates ~~rise~~ rise to reduce the deficit in the current account BOP. If when interest rate rises, the ~~demand~~ exports become more expensive, which reduces the demand for exports. This means that Indonesia became less internationally competitive, which has led to a smaller economic growth.

The ~~is~~ second reason is the ~~reducing~~ reduction of commodity prices. As Indonesia is one of the main producers and exporters of commodities, ~~it reduces~~ the reduction

in commodities prices seriously affected Indonesian economy.



ResultsPlus
Examiner Comments

This response earned 6/8 marks.

In the first paragraph, the candidate offers an accurate data reference from Figure 2 to get 2 marks for application. The second paragraph gives the first reason as a rise in interest rates and offers some explanation. The third paragraph gives the second reason as low commodity prices and offers some explanation. Both these points get 2/3 each as they did not link it to an AD/AS analysis to get all 3 marks for each point.

(c) **Apart from the ban on the export of unprocessed minerals, analyse two reasons why 'In 2014, economic growth in Indonesia fell to the lowest level for four years'. (Extract 1, line 1).**

(8)

Economic growth is the rise in GDP in an economy. From figure 2, annual Indonesian annual real GDP growth ~~rate~~ ^{rate} is declining, from 6.5% ^{in 2011} change to 5% change in 2014. ↑
rising at a slower rate

From Extract 1, the reason for slowed ~~economic~~ economic growth is the "interest rates rises designed to reduce the deficit..." (line 3). Rise in interest rates ~~make~~ ^{increases} cost of borrowing. Thus, firms reduce their borrowing from banks, so investment falls. AD decreases, leading to constrained economic growth. Also, consumers will also borrow less, so consumption falls, AD will fall, slowing down economic growth.

Moreover, the fall in economic growth is due to "lower commodity prices" (line 4). It has caused "mining sector to contract". As Indonesia exports composed ~~at~~ of mainly of primary and commodities

goods like mining products, ~~if~~ if their export prices fall, their terms of trade will be worsened. ~~This~~ This means less imports could be purchased with the same ~~to~~ amount of exports. Net exports fall, so AD falls, leading to low economic growth.



ResultsPlus

Examiner Comments

This response earned 8/8 marks.

In the first paragraph, the candidate offers an accurate data reference from Figure 2 to get 2 marks for application. The second and third paragraph gives reasons for falling economic growth and develops their points to link it to an AD/AS analysis – hence the candidate attained all 3 marks for each point.



ResultsPlus

Examiner Tip

In the 8 mark data response question, there are always 2 marks available for application. For questions relating to economic growth, it is important that the candidates are able to link it to AD/AS analysis to get full marks for each reason that they discuss. The question does not need evaluating; spend time in developing your analytical arguments.

Question 4 (d)

This question was answered reasonably well in terms of analysis, with candidates showing some understanding of the case for the removal of the subsidy. Many candidates discussed the case for increase spending on infrastructure and education, lowering budget deficit and lower negative externalities. Many did not access Level 3 as they often were unable to develop their arguments. For a 16 mark question, 8 marks were available for knowledge, application and analysis and 8 marks for evaluation.

Stronger candidates discussed the case for the removal of the subsidy on infrastructure and education as two separate points developing them well using an AD/AS diagram. Weaker candidates tend to list reasons without development and this gets them access to Level 1. Some did not read the question carefully and answered the question as the case for subsidy and hence were able to access Level 1. Some discussed how the money saved could be used for healthcare/population issues faced by Indonesia and this was not credited, as it was not in the context of the information provided. Analysis levels for a 16 mark question are awarded in the same way as a 12 mark question (see above).

Evaluation was fairly weak and many candidates often offered one or two less developed points, showing lack of breadth. A few evaluated the case against the removal of subsidy. Although points were identified and some developed, at most times they did not evaluate the case for removing the subsidy but evaluated the effect caused by the removal of the subsidy.

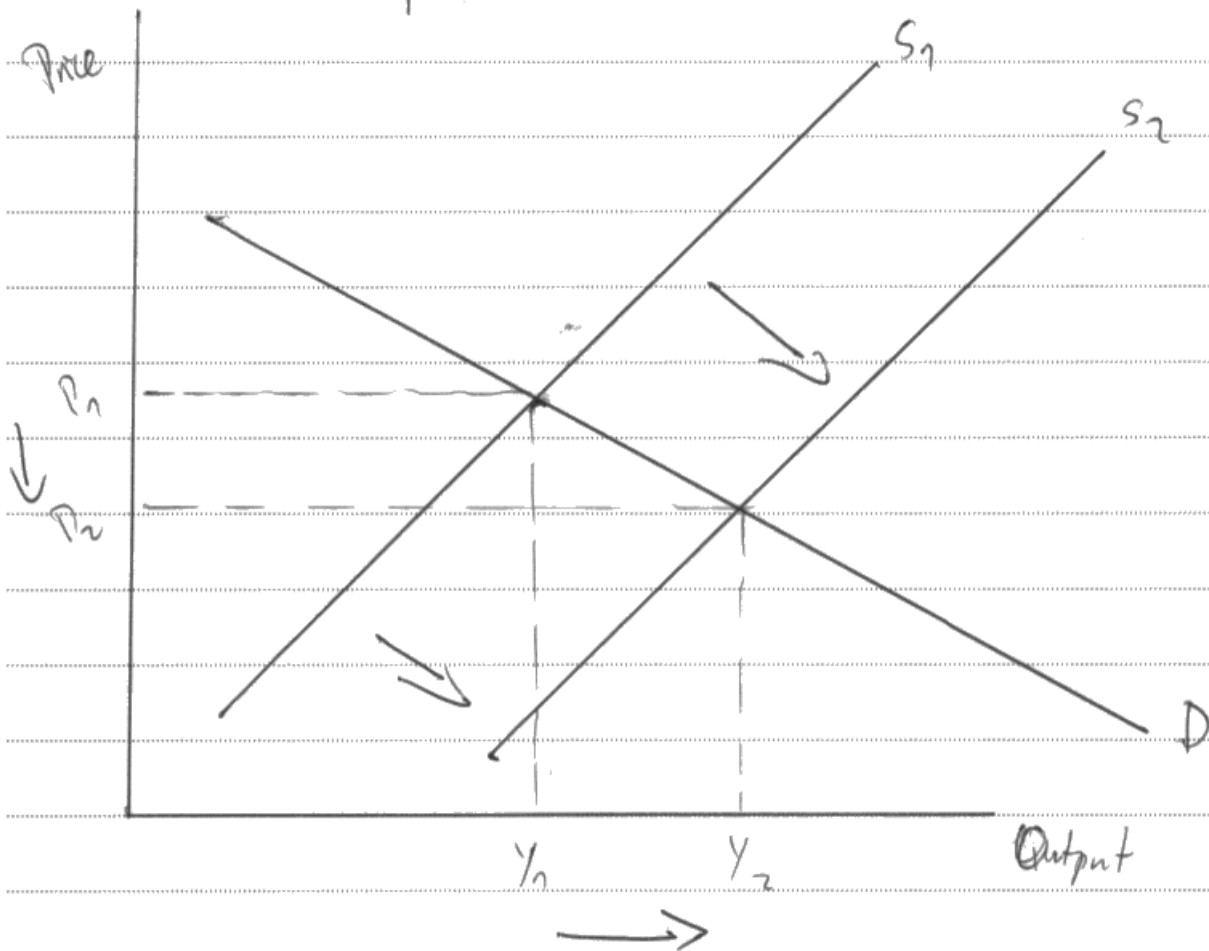
To access higher levels, candidates need to show good depth and breadth in answers. Typically, examiners are looking for three well developed analysis points and three well developed evaluation points in 16 mark questions.

(d) Assess the case for the Indonesian Government removing the subsidy on fuel.

(16)

A subsidy is a money grant paid by a government to a firm in order to decrease the costs of production. The government is likely subsidizing ~~fuel~~ ^{fuel} as Indonesia is a net importer of oil, meaning that the oil has to be transported into the country from elsewhere. This could mean that without the subsidy the price for ~~fuel~~ ^{fuel} on the domestic market would be much higher than the global ~~fuel~~ ^{fuel} prices. Removing the subsidy on fuel would cause severe changes to the Indonesian economy. As fuel will suddenly become more expensive, so will all the production processes which involve the usage of fuel. This could cause an increase in the prices of certain goods, as producers will want to retain their profit margins. This could cause inflationary pressures on the market. As the demand for fuel will decrease, there will be less imports of oil into the country. This could cause an ~~improvement~~ ^{improvement} in the balance of trade as imports will decrease. Such a subsidy is very costly to the government ^{at 21 billion \$}. So with less government spending, the government could possibly face a budget surplus where tax revenues exceed government spending. ~~The government could choose to spend the money elsewhere in the economy. The money could be spent on improvements in infrastructure to allow for a greater productive efficiency and lower costs of transport. Alternatively the money could be spent~~

on education and training. With a more educated and trained labor force, the production becomes more efficient, and so the supply increases as more can be produced with the same factors of production.



This could cause a fall in prices of certain goods and services, as well as an increased quantity produced of them. The government could choose to spend the money on specialisation of a certain industry to allow for economic growth in the long run.



This response received a Level 2 mark for KAA (6 marks) and a Level 2 score for evaluation (4 marks), making a total of 10/16.

The candidate shows understanding of the term subsidy. The answer starts with the case against subsidy where there is a well written discussion on inflationary pressures rising as fuel prices would rise. The candidate has only made one good evaluative comment and thereby gets Level 2 – 4/8 marks for evaluation.

The candidate then discusses the case for subsidy by developing two points. Improvement in balance of trade was well developed at Level 2 but the point discussing spending on other areas was very well developed and it was worthy of Level 3. However, there was a lack of breadth to the answer and hence the candidate could only access the top of Level 2 – 6/8 marks for KAA.

(d) Assess the case for the Indonesian Government removing the subsidy on fuel.

(16)

A subsidy is a monetary grant or given to producers by the government in order to reduce their costs of production.

The removal of the subsidy would mean that there would not be opportunity cost of government money as the subsidy ~~is~~ 'could help to improve infrastructure and education in the country'.

The improvement on infrastructure would reduce the costs of production for firms which the fuel industry could also gain from hence it does not have to suffer due to high costs.

Also, improved infrastructure would attract FDI to set up in Indonesia hence the government would earn more foreign currency due to the exports of FDI, and also gain in terms of tax revenue from the FDI.

If the government removes the subsidy and uses the fund on ~~education~~ education, the Indonesian economy would have a more skilled workforce which would increase efficiency and skilled labourers ~~went~~ in the fuel industry would improve their efficiency.

labourers ~~were~~ in the fuel industry would improve their efficiency and reduce their costs which is the same effect as subsidies hence the removal of subsidies would not affect the fuel industry much. Also, the Indonesian economy would benefit, not only the fuel industry as productivity and efficiency increases, AD would increase and economic growth would increase. Moreover, if the government spends on healthcare, it would lead to reduced absenteeism by workers as they are healthier hence productivity would increase and so would economic growth. Together with that, if the subsidy is removed, the firms that ~~are~~ were over-dependent on the government were now on their own and in order to keep their place in the market, they would have to become efficient and use cost-cutting measures hence undertaking research and development to improve their goods and therefore achieving dynamic efficiency.

The removal of subsidy would enable the government to spend the funds on greater projects such as on poverty.

However, fuel is an important commodity and is used in day-to-day running hence the removal of subsidy would increase the prices of fuel which would not be affordable by low income earners.

Furthermore, 'the subsidy has led to a greater usage of fuel, increasing imports'. This shows that the removal of the subsidy would reduce Indonesia's imports ~~not~~ which would ~~mean~~ mean that they would no longer have to face a BOP deficit as 'Indonesia is a net importer of oil'. The reduced imports will

reduce the adverse effect on the current account drastically and Indonesia will enjoy a BOP surplus.

Without the subsidy by the government, the firms may become inefficient as they depended on the subsidies hence their costs would increase drastically and those incapable of reducing costs would have to close down, increasing unemployment, creating a lower standard of living and increasing poverty in Indonesia. They may also not be able to undertake investments.



ResultsPlus Examiner Comments

This response received a Level 3 mark for KAA (8 marks) and a Level 2 score for evaluation (4 marks), making a total of 12/16.

The candidate shows an understanding of the term subsidy. The second paragraph explains how this lower opportunity cost 'would help improve infrastructure and education'. The candidate has integrated their point with the application from the extract and adds further development on infrastructure by discussing lower production costs and increasing FDI. This was given a Level 3. Discussion on education in the next paragraph was only seen as a Level 2 point.

There was no credit on discussion on healthcare as this is not in context. Candidates must use the information given to them in the extract. The following paragraphs on firms becoming more efficient and reduction of current account deficit were also very well-developed and awarded Level 3 each. The candidate achieved three Level 3 points and one Level 2 point and this gave it 8/8 for analysis.

The candidate, however, offers only one well-developed evaluation point at the end of page 2. The other evaluative comment on the increase in fuel prices making it unaffordable for low income earners was not sufficiently developed and was only awarded Level 1. This gave the candidate Level 2 of 4/8 marks for evaluation.



ResultsPlus Examiner Tip

Note that in 16 mark questions, there are 8 marks available for KAA and only 8 for evaluation. This balance should be reflected in the candidates' responses, with around half of the response focusing on KAA and half on evaluation. To achieve Level 3 for evaluation, candidates must show good depth and breadth to their answers. In these questions, the balance was seen as two-thirds for KAA and one-third for evaluation.

Question 5 (a)

This question was fairly well answered and candidates were able to show a good understanding of the meaning of appreciation of a currency. Stronger candidates defined it as "an increase in the value of one currency in terms of another currency" and were able to access 2 application marks by referencing both Extract 1 and Figure 2. Weaker candidates only obtained one application mark for one data reference and failed to mention the price of one currency in terms of another.

Examiners were looking for two separate pieces of data reference. Some candidates often only gave one data reference and this was a key reason why candidates did not secure full marks.

- (a) With reference to the information provided, explain what is meant by an appreciation of a currency.

~~Appreciation of a currency - increase in value of one currency in terms of another currency~~
(4)
Appreciation of a currency - increase in price of national currency in terms of other currencies.

According to the information provided in Figure 2 the Euro-US dollar exchange rate ~~currency~~ (value) has fallen from around 1.3 US dollars for 1€ ~~to~~ in January 2014 to almost 1.15 US dollars for 1€ in June 2014. Euro has ~~there~~ appreciated for 0.15 against dollar (Extract 1, line 3)



ResultsPlus Examiner Comments

This response earned 2/4 marks.

This candidate starts the answer with the correct definition and hence, was awarded 2 marks for knowledge. In the next paragraph the candidate provides inaccurate data reference points and hence, gets no marks for application.

(a) With reference to the information provided, explain what is meant by an appreciation of a currency.

(4)

Appreciation of a currency is when the value of one currency increases in terms of another. From extract one it is evident that the euro strengthened more than 5% against the US dollar between 2013 and 2014.

This means the value of the eurozone increase relative to the value of the US dollar.

From figure 2, it is clear that the value of euro-US dollar exchange rate was about 1.27 in July 13 and had increased to almost 1.39 between Jan 14 and July 14.



ResultsPlus Examiner Comments

This response earned 4/4 marks.

The answer shows good knowledge of the meaning of an appreciation of a currency and was awarded 2 marks. The candidate includes two relevant data reference points, one from Extract 1 and one from Figure 2, and was therefore awarded 2 application marks.



ResultsPlus Examiner Tip

In the 4 mark data response question, there are always 2 marks available for knowledge (AO1) and 2 marks available for application (AO2). Do not forget to include at least two elements of application to the data provided in your response so that you can earn these latter marks. Omitting this is the most common reason for candidates not scoring full marks on 4 mark questions.

Question 5 (b)

This question was reasonably well answered by the majority of candidates, better than in the previous series. Candidates were able to use the extract to identify and explain the effects of a strong euro on Eurozone economies, but were not able to consistently develop their answers to earn them a Level 3 mark for their knowledge, application and analysis. A handful of candidates used negative effects as their analysis and positive effects as their evaluation, and this was credited. For a 12 mark question, 8 marks are available for knowledge, application and analysis and 4 marks for evaluation.

Level 1 would be identification of an effect, for example exports fall leading to less economic growth. Level 2 would be identification of an effect and use of data OR development of the point, for example exports fall leading to less economic growth as seen from "Eurozone real GDP increased by 0.2% in the first quarter of 2014" OR exports fall leading to less economic growth which was explained using an AD/AS diagram. Level 3 would be the identification of an effect, use of data AND development of the point, for example exports fall leading to less economic growth as seen from the "Eurozone real GDP increased by 0.2% in the first quarter of 2014" and explaining it using an accurately labelled AD/AS diagram. This was done by stronger candidates for other points discussed on inflation and employment.

Weaker candidates' answers often lacked depth and breadth. They often did not develop their points and did not discuss the effect on the value of exports and value of imports in relative terms. For example candidates often mentioned imports were cheaper and exports more expensive, leading to a current account deficit – low Level 2.

Evaluation was fairly well written. Many candidates made use of the extract provided, explaining how the impact of the strong euro against the dollar could be offset by the euro actually being weakened 3% against the UK pound sterling, where the United Kingdom is Eurozone's largest trading partner – thereby giving candidates' access to Level 2. All struggled to add another evaluation point, which could have also been used from the next line of the extract. Typically, examiners are looking for 3 well developed analysis points and 2 well developed evaluation points in 12 mark questions.

(b) Examine the likely effects of the "the strong euro" (Extract 1, line 1) on the eurozone economies.

(12)

The strong euro has several implications for the eurozone economies. First and foremost, currency appreciation causes less demand for exports from the country, or in this case, countries whose currency appreciates. This has several effects on the eurozone economies. First of all, a ^{fall in exports} currency appreciation can cause a fall in the aggregate demand of the economy if not balanced out by a fall in imports because the balance of trade is a component of aggregate demand. Since the balance of trade is the net value of exports minus the net value of imports, appreciation could be harmful to the economy, by slowing down growth and possibly causing a decrease in the general price level, or deflationary pressure. Still, the effect that appreciation will truly have

depends on the amount the currency appreciates and the time period over which that happens. If the appreciation is very slight, it might not be enough to ^{make} ~~allow~~ consumers switch their expenditure patterns, so they might continue buying exports from eurozone countries. Furthermore, if appreciation happens very suddenly, consumers might not have enough time to switch products. Under both circumstances the balance of trade could actually increase, in the short run or long run, which could help the economy. It is important to note that currency appreciation can happen only with one particular currency, while currency depreciation happens with the other currencies. In the case of the euro, it appreciated by 5% in terms of the US dollar from 2013 to 2014, but weakened by 3% in terms of the UK pound over the same time period. While the United States is the eurozone's largest non-European trading partner, ^{accounting for 12% of exports between 2008 and 2012} the United Kingdom is the largest trading partner. Therefore, the appreciation of the euro against the dollar might not be as significant as its depreciation against the sterling, so the balance of trade could actually improve.

It is also important to mention that as the euro appreciates against the dollar, the eurozone can afford more imports from the United States, which could lead to increases in the standards of living of the eurozone countries. Still, the primary effect of currency exchange rate fluctuations are changes in balance of trade, which could go either way for eurozone countries given large amounts of trading partners.



ResultsPlus

Examiner Comments

This response received a Level 2 mark for KAA (5 marks) and a Level 2 score for evaluation (4 marks), making a total of 9/12.

The candidate develops two points in the answer. The first point on how the strong euro has an impact on exports in the first few sentences on page 1 and its impact on imports on page 2. The candidate identified deflationary pressure but did not develop it to get Level 2 for this point. This gives it a score of mid-level 2 KAA.

In evaluation, the candidate gives two well-developed points on page 1 – one on the sharp changes/magnitude in currency and the other on how the effect is not as significant as the euro has weakened by 3% against the UK pound – earning it a top Level 2 for evaluation of 4 marks.

(b) Examine the likely effects of the "the strong euro" (Extract 1, line 1) on the eurozone economies.

(12)

An appreciation of a currency is defined as when a currency's value increases from 2013 to 2014 the euro appreciated by more than 5% to the US dollar.

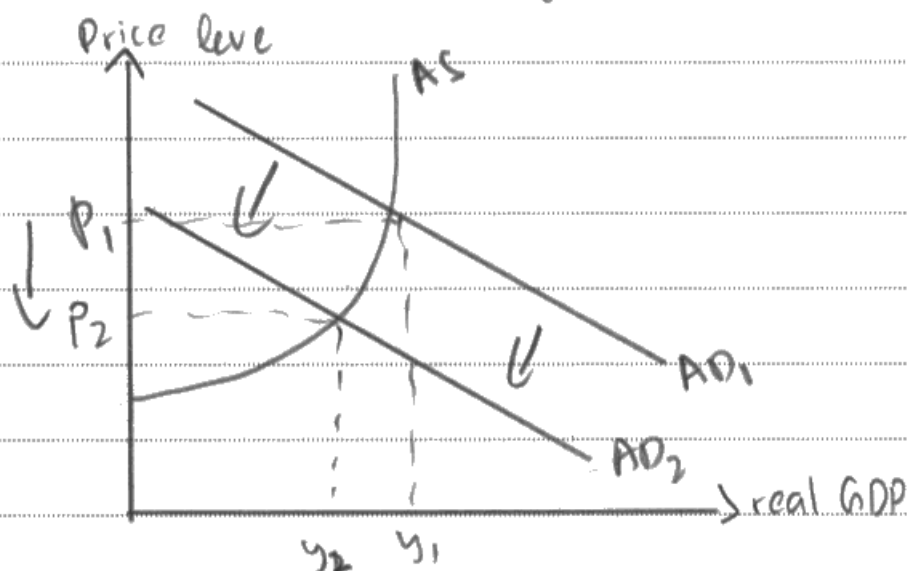
There are many likely effects of the appreciation of the euro. The first is that the international competitiveness of the ~~European Union's~~ ^{Eurozone's} exports will fall. This is because ~~USA is one of the EU's biggest trading partners and other countries~~ other countries such as USA will find the ~~EU's~~ ^{Eurozone's} exports more expensive. Moreover the US is the Eurozone's biggest non EU export partner accounting for 12% of its exports.

However this may not be the case if the Eurozone's exports are inelastic. Moreover the magnitude of the appreciation is not very large (1.28 to 1.37 according to figure 2). Furthermore, the Eurozone's biggest trading partner is the UK and the Euro has depreciated against the sterling pound causing international competitiveness to rise for the Eurozone.

Another effect of the strong Euro is that the ~~bop deficit will worsen~~. Eurozone's trade deficit will worsen. This is because with a high value of the currency, ~~exp~~ imports become much cheaper and the marginal propensity to import will rise. As a result the Trade deficit will worsen.

However according to extract 1, even with this appreciation, the Eurozone has significant exports to China and Japan which may make the trade deficit improve in the long run.

Another effect on the Eurozone economies is that inflation levels will fall and economic growth will fall. This is because of the high value of the Euro, imports have risen, causing ~~AD to fall~~. This can be AD to fall as $(X - M)$ is a component of AD. This can be shown in a diagram.



The diagram shows that due to the fall in AD, from AD_1 to AD_2 , price levels fall from P_1 to P_2 and real GDP falls from Y_1 to Y_2 .

However this may not be the case as according to extract 2, interest rates are very low, causing consumption to increase and since consumption is two-thirds of AD, AD increases causing GDP and inflation to rise.



ResultsPlus Examiner Comments

This response received a Level 3 mark for KAA (7 marks) and a Level 2 score for evaluation (4 marks), making a total of 11/12.

The candidate shows good understanding of the appreciation of currency with application and gets Level 1. The candidate has made three developed points on exports (second paragraph on page 1), trade deficit worsening (first paragraph on page 2) and low inflationary pressures (last paragraph of page 2). The candidate also extended one developed argument, on inflation, using an AD/AS diagram. Hence it was able to achieve a low-level 3 of 7 marks.

The candidate has also offered three developed evaluation points: the euro depreciating against the sterling (last paragraph of page 1), significant exports to China and Japan (second paragraph on page 2) and inflation may not fall as interest rates are low (last paragraph on page 3). This received Level 2 of the full 4 marks as the candidate was able to integrate application to their knowledge accurately.



ResultsPlus Examiner Tip

Note that in 12 mark questions, there are 8 marks available for KAA and only 4 for evaluation. This balance should be reflected in the candidates' responses, with around two-thirds of the response focusing on KAA and one-third on evaluation. To achieve full Level 3 for analysis, candidates must identify points, integrate them with the application available from extracts consistently and develop them further through a logical chain of reasoning or using an accurately labelled diagram.

Question 5 (c)

This question was well answered with candidates showing a good understanding of the impact of a cut in interest rates and supporting this with explicit reference to the data from Extract 2.

Most candidates were able to explain two transmission mechanisms, the most common being the impact on consumption, investment and exchange rate/net exports. Although they could provide some analysis they often did not relate it to a macroeconomic objective. The stronger candidates were able to identify, develop their reasons and obtained all 3 marks for each point by relating to a macroeconomic objective, usually supported with an accurately labelled AD/AS diagram. Some candidates supported their points with an accurately labelled diagram(s), but were unable to explain the transmission mechanism clearly and use the data effectively.

Candidates need to be aware that they do not need to evaluate their responses to 'analyse' questions.

(c) With reference to Extract 2 and your own knowledge, analyse **two** likely effects of the reduction in interest rates that the ECB introduced in **June 2014**.

(8)

EG \uparrow
~~Savings~~ \downarrow ~~inflation~~ \uparrow
consumption \uparrow
H/E
people save
for many reasons.

~~Hot money~~ ~~inflation~~ \uparrow
~~Hot money~~ outflow
Inflation \uparrow

Interest rates are defined as the cost of borrowing or the reward for saving. In 2014, the ECB announced that it was reducing interest rates. Two are the likely effects.

The first effect is that economic growth might increase, this is because with a low reward for saving, consumers will take out their savings and spend more. As a result since consumption

IS ~~is~~ $\frac{2}{3}$ of AD, AD will increase, causing GDP to increase resulting in economic growth.

However, people may not ~~stop~~ stop saving or withdraw their savings as people save for many reasons such as education and welfare. Moreover this may not work as the current economic growth for the Eurozone is almost stagnant according to extract 2.

Another ~~reason~~ effect is that inflation will increase as consumption increases due to the increased money supply. As a result this may ward off the impending deflation the Eurozone is experiencing.

However deflation is a vicious cycle and monetary policies such as reduced interest rates do little to prevent deflation as consumers always ~~postpone~~ postpone consumption as they expect future prices to fall.



ResultsPlus Examiner Comments

This response earned 5/8 marks.

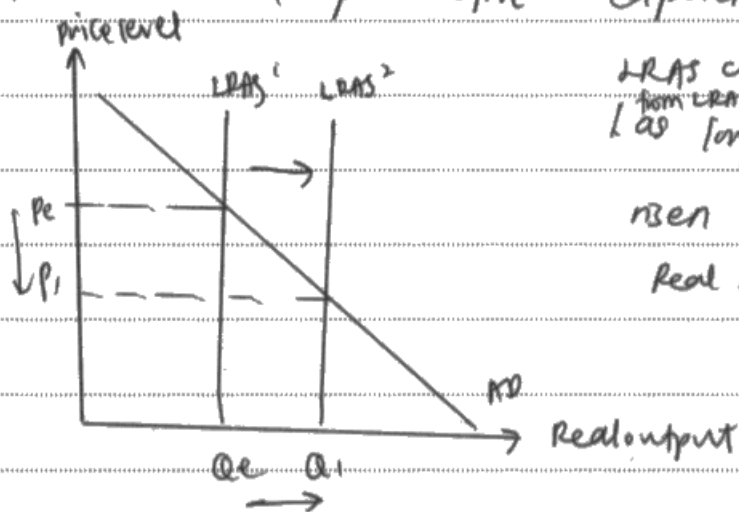
The second paragraph gives the first effect of a fall in interest rates and offers a transmission mechanism linking it to AD and the macroeconomic objective of economic growth; it gets 3 marks for this point. The candidate explains the impact on inflation but without the development of the transmission mechanism; it gets 2 marks for this point. In this answer, the candidate does not offer data reference and does not get the 2 marks for application. No marks are offered for evaluation in this question.

(c) With reference to Extract 2 and your own knowledge, analyse two likely effects of the reduction in interest rates that the ECB introduced in **June 2014**.

(8)

With reference to Extract 2, in June 2014, the ECB's main interest rate was cut to a record low of 0.15% and the deposit rate was cut to -0.1%.

Firstly, the effects of reduction in interest rates in rising in investment the eurozone economies. With reference to Extract 2, ECB hope the reduction would encourage high street banks to lend for more for business. Lower interest rates leads to fall cheaper cost of borrowing, where attracted more businesses to do loan from bank. This loan made is for investment in technology which leads them to produce at ~~for~~ maximum productive capacity. This will shift



LRAS curve to the right
from LRAS¹ to LRAS².
As long term investment has

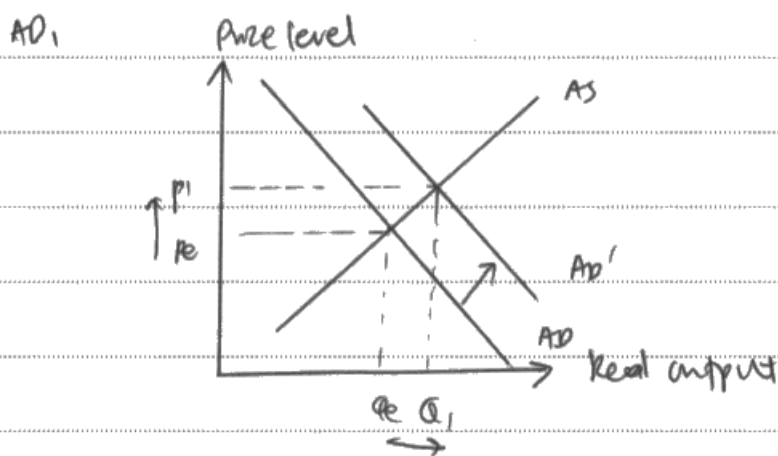
rises in eurozone economies.

Real output rises from Q_e to Q_1 .

However, the impact of reduction in interest rates depends on the magnitude of fall in interest rates. If the size of falling in its magnitude is small, so this would be less significant for business to do loan for

investment. Cutting of deposit rate to -0.1% is less less significant for them to do ~~more~~ borrowing. So, this will not improve investment in eurozone economies.

Secondly, effect of reduction in interest rate is ~~been~~ rise in consumption of euro people in eurozone. People lower interest rates will encourage many people to do borrowing from ~~as cost of~~ bank as cost of borrowing is cheaper. This will encourage them to consume more as their marginal propensity to consume (MPC) has risen. So, ~~this~~ this leads to rise in consumption of eurozone, hence increase in aggregate demand (AD) as consumption is one of AD components. So, this shifts AD curve to the right from AD to



However, this leads to conflicting ^{macroeconomic} objectives. ~~of macroeconomic~~ Rising in consumption has led to greater economic growth, but it has led to rising inflationary pressure from P_e to P_1 . So, it is not good for eurozone economy as their price level rises.



ResultsPlus

Examiner Comments

This response earned 8/8 marks.

In the first paragraph, the candidate offers an accurate data reference from Extract 2 to get 2 marks for application. The answer offers two very well-developed points on the effects of the reduction in interest rate on investment and consumption whilst linking it to an AD/AS analysis and macroeconomic objective of growth. Hence, the candidate attained all 3 marks for each point.



ResultsPlus

Examiner Tip

In the 8 mark data response question, there are always 2 marks available for application. For a questions relating to interest rates, it is important the candidates are able to explain the transmission mechanism and link it to a macroeconomic objective to get full marks for each reason they discuss. This question does not need evaluating; spend time in developing your analytical arguments.

Question 5 (d)

This question was not answered particularly well overall, with candidates only able to show some understanding of the case for quantitative easing by the ECB. Many candidates discussed the case for using this "new weapon in the battle against deflation and economic stagnation". Many did not access Level 3 as they often were unable to develop their arguments. For a 16 mark question, 8 marks were available for knowledge, application and analysis and 8 marks for evaluation.

Stronger candidates discussed the case for quantitative easing on tackling deflation and economic stagnation as two separate points and developing them well using an AD/AS diagram. Some also considered the impact on exchange rates and the ineffectiveness of interest rate as a tool. Weaker candidates listed reasons without development and this gets them access to Level 1. Some have been able to identify relevant points but struggled to add depth to their arguments. Analysis levels for 16 mark question are awarded in the same way as a 12 mark question (see above).

Evaluation was fairly weak and many candidates often offered one or two less developed points, showing lack of breadth. A few evaluated the case against the ECB using quantitative easing, discussing inflationary pressures and ineffectiveness/uncertainty. Only a few have identified that the ECB will have no control over cost push inflation/deflation.

To access higher levels, candidates need to show good depth and breadth in answers. Typically, examiners are looking for 3 well developed analysis points and 3 well developed evaluation points in 16 mark questions.

(d) Assess the case for the introduction of 'quantitative easing' (Extract 2, line 19) by the ECB.

(16)

When a reduction in interest rates fails to increase economic output and the intended effect, this gives rise to the term liquidity trap. Despite interest rates being lowered to a rate of 0.15% in June 2014 by the ECB, consumer and investment spending has ceased to ~~now~~ stimulate economic growth. If interest rates are lowered below a certain limit, consumers will not borrow. This could be due to scarcity of funds.

Reasons for a liquidity trap:-

① Eurozone real GDP increased by only 0.2% in the first quarter of 2014, fell 1.5

a five year low of 0.4% in July 2014 caused by falls in food, alcohol and energy prices.

(2) Despite an easing of fiscal austerity, improving consumer confidence and some lessening effect of the credit crunch, the Eurozone economy now seems to be expanding more slowly than in mid 2013.

(3) In August 2014, Italy slipped into recession and the French economy did not grow. The weakening outlook for Italy ~~and~~ France and Germany prompted ^a downgrade its Eurozone growth forecast to 0.8% for 2014 and 1.4% for 2015.

Due to low growth, and low consumer confidence and perhaps a scarcity of funds, there is a liquidity trap.

Quantitative Easing is to stimulate the money supply in the economy and is an example of a loose monetary stimulus which is a backup strategy to stimulate growth, output and employment. New boosting measure as a potential to battle against deflation and economic stagnation. which leaves more funds for consumers and investors to borrow.



This response received a Level 2 mark for KAA (5 marks) and no score for evaluation, making a total of 5/16.

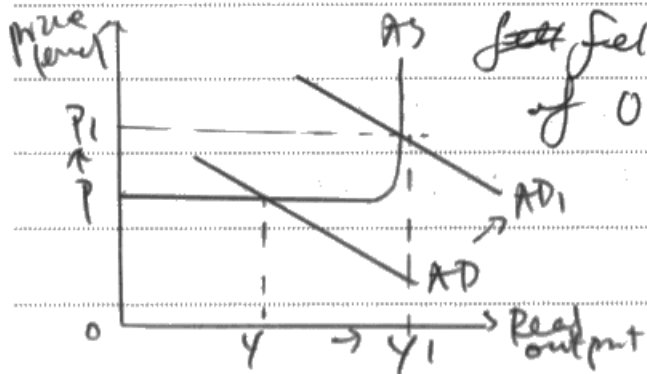
The answer starts by discussing the ineffectiveness of interest rates as instrument to stimulate growth but does not link it to the introduction of quantitative easing, giving access to Level 2. The following paragraph on liquidity trap, which a few candidates have discussed, is not of any relevance as it is not answering the question and was not awarded. However the last paragraph on page 2 explains the case for using quantitative easing as a potential measure to battle against deflation and stagnation, also giving it Level 2. This gave the candidate access to Level 2 – 5/8 marks for KAA.

The candidate has not made a single evaluative comment and hence gets 0/8 marks for evaluation.

(d) Assess the case for the introduction of 'quantitative easing' (Extract 2, line 19) by the ECB.

Quantitative easing occurs when the Central bank ⁽¹⁶⁾ purchase government bonds from commercial banks to increase their cash reserve, or in this case "asset ~~purchase~~ purchase by the ECB to increase money supply" (line 19, Extract 2). According to Extract 2, it is used "as a potential new weapon in its battle against deflation and economic stagnation." (line 20)

Firstly, quantitative easing will help to prevent deflation. According to Extract 2, "Eurozone inflation ~~fall~~ fell to a near five-year low of 0.4% in July 2014, caused by falls in food, alcohol, tobacco and energy prices." (line 7-8)



with quantitative easing, ~~as~~ as the cash ^{reserve} ~~res~~ of commercial banks increases, they ^{are} more willing

to lend money to the public for investment and consumption. Hence, more money will be lent to the public and the public will have more money to spend on assets such as property and cars and for private investment uses. As consumption and investments are components of the aggregate demand, the aggregate demand for goods and services increases and the AD curve shifts ~~to~~ ^{Outwards} from AD to AD₁, and it causes the price level to rise from P to P₁, hence leading to ~~sustained~~ ^{sustained} rise in general price level and thus increases the inflation rate and prevents the Eurozone from entering deflation.

Secondly, ~~it~~ will lead to greater economic growth. According to Extract 2, "In August 2014, Italy slipped back into recession and the French economy did not grow... downgrade its eurozone growth forecast to 0.8% for 2014 and 1.4% for 2015" (line 14-16). With quantitative easing, due to the rise in aggregate demand for goods and services, it will lead to a rise in real output level from ~~Y₀~~ ^{Y₀} to Y₁ (in the above diagram). This helps to increase eurozone's real GDP and hence helps to accelerate its economic ~~of~~ ^{growth}, and to help countries like Italy ~~to~~ to escape from recession.

Thirdly, it will lead to lower unemployment rate in the Eurozone. As labour has a derived demand, the rise in aggregate demand for goods and ~~the~~ the rise in real output level means that firms will need to employ more workers to ~~meet~~ ^{meet} the rising demand. Hence, the demand for workers increases and the unemployment rate falls. This will lead to an increase in the average income level of the Eurozone and helps to reduce its level of poverty. It will also help to raise people's standard of living.

Lastly, it will help to improve Eurozone's current account balance. ~~This~~ This is because due to the fall in ~~the~~ ^{interest} borrowing ~~rates~~ rates, it ~~to~~ encourages firms to borrow money for research and development ~~of~~ projects and to purchase new machineries and infrastructure. This will help to raise the standard of ~~the~~ Eurozone's exports and ~~that~~ helps to raise its level of international competitiveness in terms of quality. Thus, the demand for Eurozone's exports rises and its export revenue increases. This helps to improve its current account balance and brings more extent of economic growth in the future.

However, it depends on whether banks are willing to lend out the excess money and whether people are willing to borrow money. If banks are risk adverse and are afraid of bad debts, or if the public is not willing to borrow money for ~~consumption~~ ^{consumption}, ~~the~~ using quantitative easing will not have a significant impact on the aggregate demand and hence the effect on Eurozone's economy will be limited.

Furthermore, ~~Furthermore~~, quantitative easing may be the most suitable policy as according to Extract 2, "Despite an ~~existing~~ ^{easing} fiscal austerity, improving consumer confidence and some lessening of credit crunch, the Eurozone economy now seems to ~~be~~ ^{be} expanding more slowly than in mid-2013" (line 11-13). Hence, using quantitative easing may be the last hope and the most suitable policy to boost Eurozone's economic growth and inflation rate.

Lastly, there may be time ^{lags} ~~lag~~. In the short run, the effect of quantitative easing on the ~~economy~~ ^{economy} is less significant ~~and~~ ^{as} consumers need time ~~and~~ ^{to respond} and to change their consumption pattern. Hence, the effects are more significant in the long run when quantitative easing is able to make ~~full~~ ^{full} effects ~~there~~.

throughout the ~~economy~~^{economy} and lead to rise in quantity demanded for goods and rise in prices of goods.



ResultsPlus Examiner Comments

This response received a Level 3 mark for KAA (8 marks) and a Level 2 score for evaluation (6 marks), making a total of 14/16.

The candidate shows a sound understanding of what quantitative easing is. Analysis starts by presenting two in depth discussions on how quantitative easing could help prevent deflation and increase economic growth using AD/AS analysis and well integrated application, making both these Level 3 points. The next two paragraphs were not directly linked to context and thus were only awarded with Level 1. The candidate showed sufficient breadth to their analysis, of which two arguments were well developed in context, allowing them to access full Level 3 marks of 8/8 for KAA.

The candidate also offers three well-developed evaluation points on banks being risk averse, lack of consumer confidence and time lags at the end of page 3 and on page 4. This gave the candidate Level at the top of Level 2 of 6/8 marks for evaluation.



ResultsPlus Examiner Tip

Note that in 16 mark questions, there are 8 marks available for KAA and only 8 for evaluation. This balance should be reflected in the candidates' responses, with around half of the response focusing on KAA and half on evaluation. To achieve Level 3 for evaluation, candidates must show good depth and breadth to their answers. In this question, the balance was yet again seen as two-thirds for KAA and one-thirds for evaluation.

Paper Summary

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

- Candidates must read the questions carefully. In a number of different questions on this paper, especially the essays and 12/16 mark questions; misreading or misinterpreting the question was the reason for low scores. Candidates should pay particular attention to the key terms in questions to help them make correct responses.
- Application is a key assessment objective, and a skill that candidates should aim to show throughout their responses, even when a question does not explicitly ask for it. Typically in response to essay questions in Section A, reference to particular countries and examples would help to improve the quality of responses and allow candidates to add depth and breadth to their points.
- In response to the 4 mark questions in Section B, candidates must be aware of the difference between a definition (knowledge) and an example (application). They have to make two separate data references and read/quote figures accurately to access full application marks.
- Whilst it is very positive that candidates are reading the data provided in Section B carefully and attempting to use it in their responses, they should be discouraged from copying out large volumes of the data, or writing answers which mostly contain quotations from various extracts. Where an extract contains large amount of relevant content, candidates may need to be selective when deciding which parts to incorporate into their responses. In the higher mark questions, the data should be used more to support a candidate's own knowledge, analysis and evaluation, not in place of it. Data is likely to be useful to give evidence for a point already made, or to give examples of it. Where points are taken from data, candidates must provide their own economic analysis of them.
- In the 16 mark questions in Section B, candidates should remember that half of available 16 marks are awarded for evaluation. Currently many candidates are not placing enough weight upon this assessment objective in their responses. Additionally, to receive higher marks for evaluation, the key is the extent to which points are developed – the chains of economic reasoning which are built – rather than number of points which are identified.
- To access the highest level, the candidates must show sufficient depth and breadth to their analysis and evaluation points. These points must be consistently written in context of the question. Material also needs to be presented in a relevant and logical way.

Grade Boundaries

Grade boundaries for this, and all other papers, can be found on the website on this link:

<http://www.edexcel.com/iwantto/Pages/grade-boundaries.aspx>

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