GCE

Economics

Advanced GCE **2887**

The UK Economy

Mark Scheme for June 2010

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General Instructions on Marking Scripts

You should refer to the *Instructions for Examiners* documentation for detailed guidance.

For many question papers there will also be subject, or paper-specific, instructions which supplement these general instructions. The paper-specific instructions follow these generic ones.

1 Before the Standardisation Meeting

Before the Standardisation meeting you must mark at least 10 scripts from several centres. For this preliminary marking you should use **pencil** and follow the **mark scheme**.

Bring these **marked scripts** to the meeting.

2 Marking and Annotation of Scripts After the Standardisation Meeting

2.1 Scripts must be marked in **red**, including those initially marked in pencil for the Standardisation meeting.

2.2 All scripts must be marked in accordance with the version of the mark scheme agreed at the Standardisation meeting.

2.3 **Annotation of scripts**

Examiners should use annotation to show clearly where a mark is earned or why it has not been awarded. This will help examiners, checkers and those who review the marking of scripts.

Annotation consists of:

- ticks and crosses to show where marks have been earned or not earned
- specific words or phrases as agreed at Standardisation and as contained and included in the final mark scheme to show why a mark has been earned or indicate why a mark has not been earned (eg to show there is an omission)
- standard abbreviations, eg for *follow through*, *special case*, etc.

As scripts may be returned to centres, you should use the minimum of comments and make sure that these are related to the award of a mark or marks and are matched to statements in the mark scheme.

Do **not** include general comments on a candidate’s work.

Record any annotation in the body of the answer, or in the margin next to the point where the decision is made to award, or not award, the mark.

2.4 **Recording of marks**

2.4.1 Give a clear indication of how marks have been awarded, as instructed in the mark scheme.

2.4.2 Record numerical marks for responses to part-questions **unringed** in the right-hand margin. Show the total for each question (or, in specific cases, for each page) as a single **ringed** mark in the right-hand margin at the end of each question.

2.4.3 Transfer ringed totals to the front page of the script, where they should be totalled.

2.4.4 Show evidence that you have seen the work on every page of a script on which the candidate has made a response.

2.4.5 Cross through every blank page to show that you have seen it.

3 Handling of unexpected answers

The Standardisation meeting will include discussion of marking issues, including:

- consideration of the mark scheme to reach a decision about the range of acceptable responses and the marks appropriate to them
- comparable marking standards for optional questions
- the handling of unexpected, yet acceptable, answers.

If you are not sure how to apply the mark scheme to an answer, you should telephone your Team Leader.

1 (a) Explain what is meant by:

(i) stagflation (line 5); [2]

A situation in which the economy is experiencing both rising rates of inflation (1 mark) and rising unemployment levels (1 mark), or low economic growth/recession (1 mark).
1 mark if only one correct element offered.

(ii) factory-gate inflation (line 10). [2]

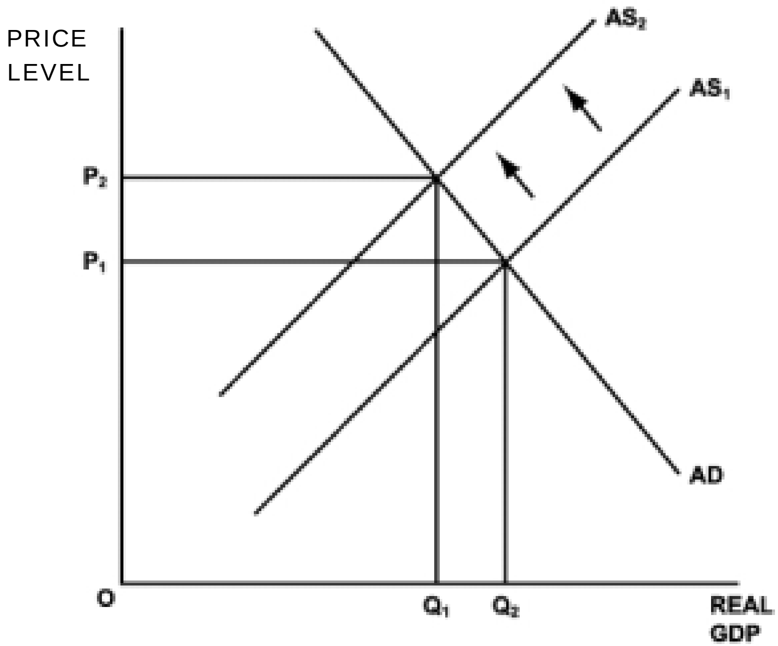
A sustained increase in the price of manufacturing output over a period of time (2 marks).
1 mark for something less precise e.g. increased output prices.

(b) Explain what is meant by 'Unless retailers absorb the cost increases they are experiencing, this will cause more pain for hard-pressed households' (lines 10–12). [2]

Retailers are facing rising input costs and in order to maintain profit margins they will need to raise their selling prices by at least the same amount (1 mark). In order to prevent the consequent fall in sales they may choose to squeeze margins in order to keep their prices down and remain competitive (1 mark), pain will be felt by households in terms of higher prices and reduced living standards (1 mark).
Any two points.

(c) With the aid of a diagram, explain the impact of a significant increase in the price of oil on the UK economy. [4]

Up to 2 marks for a correct diagram. 1 mark for correct labels,
1 mark for correct shift of AS curve and new equilibrium.
Up to 3 marks for a correct explanation. 1 mark for explaining AS shifts upward to the left as costs have increased. 1 mark for explaining this will lead to a rise in the general level of prices. 1 mark for explaining the reduction in output and employment. 1 mark for suggesting that the demand for oil is so complex that it will impact directly and indirectly on the costs of all producers. Any three points.
NB. 4 marks only in total, 2+2 or 1+3.



(d) Comment on the view that 'households will see their real incomes falling and their expectations about future price rises will impact on their wage demands' (lines 30–32). [4]

The cost of living for all households is rising so the purchasing power of their incomes is falling (1 mark). In order to restore real incomes workers will demand higher wages (1 mark). However, in the light of increasing uncertainty about employment prospects (1 mark), wage demands may be subdued due to the fear of job losses (1 mark). Candidates may also question whether households in the future will be experiencing a fall in real incomes (1 mark).

(e) Discuss the extent to which a rise in unemployment in the UK may be reduced by a return of migrants to eastern Europe. [6]

Clearly, as more migrant workers return home, the labour force will probably shrink in size. The supply of available labour is reducing therefore softening the impact of the reduction in demand for labour. However, those returning to eastern Europe will be doing so because they have been made redundant most likely; so there are no new opportunities in these areas. Plus the rate of job losses may be greater than the rate at which job vacancies are becoming available. In addition, there is no guarantee that the unemployed can fill the posts on offer, which is one of the reasons why so many migrants came to the UK in the first place; to fill the skills gap. In conclusion, as the article suggests, migrant workers returning home may, at best, partially relieve the over-supply of people in the labour markets. However, there is no guarantee this will significantly increase the employment opportunities of the current pool of unemployed.

Level 3 **5–6 marks** If L1 + L2 are covered and there is some judgement offered as to the extent to which the statement is correct.
Level 2 **3–4 marks** if L1 is covered, plus some reference to another possible scenario that although there may be a smaller pool of labour, the rate of decline in vacancies may be greater than the rate of emigration.
Level 1 **1–2 marks** for an account of how the reduction in labour force may be beneficial to employment prospects.

2 (a) Explain how, in theory, changes in the Bank of England base rate will influence 'hot money' flows and the value of sterling. [10]

Candidates will be expected to provide a full explanation of the theoretical link between a change in UK base rate interest and the consequent impact on hot money flows. To begin with I would expect an explanation of the term hot money flows, i.e. money placed on very short term deposit, which remains very liquid, and can be moved elsewhere very quickly in response to more attractive investment conditions. The Bank of England base rate sets the tone for all lending and savings rates in the economy, so as base interest rates rise or fall, so the attraction to place money on short term deposit in London will increase or decline, respectively. In order to deposit money in UK banks, investors must convert their assets into Sterling. Therefore a rise in base rates will increase the demand for Sterling and as a consequence, ceteris paribus, the price of Sterling will increase in terms of foreign currency, and vice versa. So increased base rates lead to an appreciating value of Sterling, and reduced base rates lead to a Sterling depreciation.

Level 3 **7–10 marks** For an explanation of how, in theory, changes in UK Bank of England base rates will influence 'hot money' flows and the value of Sterling.
Level 2 **4–6 marks** For an application of knowledge and critical understanding of how, in theory, changes in UK Bank of England base rates will influence 'hot money' flows and the value of Sterling.
Level 1 **1–3 marks** For a knowledge of how, in theory, changes in UK Bank of England base rates will influence 'hot money' flows and the value of Sterling.

(b) Discuss the extent to which international financial flows can impact on the sterling exchange rate. [15]

International financial flows of money have increased very considerably over the last ten years. Hot money flows represent just one reason why financial assets cross international boundaries on a daily basis. However there are a great many more reasons including many other kinds of portfolio investment and indeed with increasing globalization, the wish to engage in FDI. Consequently these financial movements are having potentially more impact on currency values than was the case in the past. However, the value of Sterling is also influenced by the amount of trade in goods and services, which has itself increased markedly in recent years, and of course due to currency speculation.

Therefore at any one time there are a multitude of influences on the supply of and demand for Sterling and consequently its value. International financial money flows can in this day and age be hugely influential. On the other hand, at different times other reasons may be far more influential, e.g. Speculation or a growing trade gap etc.

Level 4 **9–15 marks** For a discussion of the extent to which international financial flows can impact on the sterling exchange rate.

Level 3 **6–8 marks** For analysis of the extent to which international financial flows can impact on the sterling exchange rate.

Level 2 **3–5 marks** For application of knowledge and critical understanding of the extent to which international financial flows can impact on the sterling exchange rate.

Level 1 **1–2 marks** For a descriptive knowledge of the extent to which international financial flows can impact on the sterling exchange rate.

3 (a) Explain the main determinants of the size of the credit creation multiplier. [10]

A likely approach to answering this question would be for candidates to explain what is meant by the credit multiplier, i.e. the ratio between an initial new deposit and the final amount of liability that the original asset can back. I anticipate that a number of candidates may wish to illustrate the process. However, this is not necessary given the focus is on determinants of the multiplier size. The most important influences therefore are an individual bank's decision regarding its prudent or otherwise approach to risk and liquidity. The more careful banker will hedge toward greater liquidity and consequently operate with a higher liquidity ratio and a lower level of profitable lending. Conversely, the more prodigal banker will be prepared to sacrifice liquidity for a greater ratio of lending and increased profit. The choice banks make on this matter will of course vary over time dependant on a number of influencing factors, e.g. the prevailing approach to risk adopted by the bank, government monetary policy, the state of the domestic and world economy, financial shocks such as the collapse of the US sub-prime market etc.

Level 3 **7–10 marks** For an explanation of the main determinants of the size of the credit multiplier.

Level 2 **4–6 marks** For an application of knowledge and critical understanding of the main determinants of the size of the credit multiplier.

Level 1 **1–3 marks** For a knowledge of the main determinants of the size of the credit multiplier.

(b) Discuss how significant a major expansion of the money supply may be to the performance of the UK economy. [15]

This question is one that could be tackled in a number of ways but it is the candidate's ability to demonstrate the relevant skills that should determine our assessment of their answers. It will in all cases be necessary for candidates to firstly demonstrate the impact that a growth in money supply may have on the UK economy. This may be done using a quantity Theory of Money approach, a Keynesian Monetary Transmission approach or any other relevant theory. The focus then must move onto the relevant criteria by which we may judge UK economic performance, e.g. the PIs. Finally, after analysing the potential consequences, the best candidates will offer some judgement with regard to degree of significance. e.g. A major expansion of the money supply has the potential to be either positive or negative; it is all dependent upon the circumstances prevailing in the economy at the time, and a value judgement of the outturn.

Level 4 **9–15 marks** For a discussion of how significant a major expansion of the money supply may be to the performance of the UK economy.

Level 3 **6–8 marks** For analysis of how significant a major expansion of the money supply may be to the performance of the UK economy.

Level 2 **3–5 marks** For application of knowledge and critical understanding of how a major expansion of the money supply may be to the performance of the UK economy.

Level 1 **1–2 marks** For a descriptive knowledge of how a major expansion of the money supply may be to the performance of the UK economy.

4 (a) Explain the most significant influences on the rate of economic growth in the UK economy. [10]

The expected approach to this question is that candidates may begin by demonstrating an understanding of the rate of economic growth and identifying some of the key influences. These may include the discovery of a new source of resources, increases in productivity, investment activity, technological breakthrough, foreign investment, to name just a few.
Hopefully the better answers will offer some analysis of at least two such influences. We may also reward influences on short run economic growth-changes in AD. Candidates may also refer to the recent slow down in economic growth due, in part, to AD factors.
If a candidate only considers one influence they may still score a L3 mark but should be restricted to a maximum of 7.

Level 3 7–10 marks For an explanation of the most significant influences on economic growth in the UK economy.

Level 2 4–6 marks For an application of knowledge and critical understanding of the most significant influences on economic growth in the UK economy.

Level 1 1–3 marks For a knowledge of the most significant influences on economic growth in the UK economy.

(b) Discuss to what extent the government's main policy instruments can be used to achieve a high and sustainable economic growth rate. [15]

Candidates are likely to begin by explaining the key instruments in terms of fiscal, monetary and supply-side policies. In the course of which they will hopefully apply the policies to the question. Analysis may be demonstrated in a number of ways, the most likely being an AD/AS approach. The key to a successful answer will be the candidate's ability to demonstrate their evaluative skills. The extent to which governments can achieve this elusive goal must be directly tackled in order to achieve a mark of the highest order. As often the case, it is a judgement that is likely to be of a qualified nature in that, under certain circumstances, it may be that some governments may be highly influential, whilst in other circumstances, they may fail miserably. Equally an argument may be offered surrounding the difficulty that exists in judging what constitutes a high and sustainable growth rate and indeed how we, in fact, accurately measure the rate.

Level 4 9–15 marks For a discussion of the extent to which the government may use its main PIs to achieve a high and sustainable economic growth rate.

Level 3 6–8 marks For analysis of the extent to which the government may use its main PIs to achieve a high and sustainable economic growth rate.

Level 2 3–5 marks For application of knowledge and critical understanding of the extent to which the government may use its main PIs to achieve a high and sustainable economic growth rate.

Level 1 1–2 marks For a descriptive knowledge of the extent to which the government may use its main PIs to achieve a high and sustainable economic growth rate.

Specification 2887 June 2010

Question	AO1	AO2	AO3	AO4
1ai	2			
1aii	2			
1b		2		
1c		1	3	
1d			2	2
1e			2	4
2a	3	3	4	
2b	2	3	3	7
3a	3	3	4	
3b	2	3	3	7
4a	3	3	4	
4b	2	3	3	7
Total	**9**	**9**	**14**	**13**

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