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Examiners' Report June 2010

GCE Economics 6EC04

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Introduction

This was the first exam paper for the new specification, but was similar in many ways to the unit 6 of the legacy specification. Candidates had a choice of longer, essay questions and then a choice of data response questions.

Question 1

This was the least popular of the three essay questions and responses were generally weaker than on the other essays.

Better answers to part (a) were able to examine some valid causes of inequality such as inheritance, education, pension rights and ownership of assets. However, others struggled to develop more than one point or wrote generalised answers relating to wages.

Answers to part (b) were more convincing with some discussion of the possible impact on tax revenues, disincentives and the effect on aggregate demand. However, evaluation was often surprisingly weak, given the topical nature of this question.

Do not use pencil. Use black ink or ball-point pen.
Put a cross in the box indicating the question from Section A that you have chosen (☒).
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) There are many reasons for wealth and income ~~income~~ inequality in Bangladesh. Bangladesh is a low economically developed country, with One reason for an inequality in wealth and income may be land ~~and~~ ownership. A country such as Bangladesh is reliant on its agricultural market and most people from a young age work on the land. Thus if ~~if~~ many people don't own bits of land to grow agricultural commodities, then they will have a low income. However this is dependant on how reliant the citizens are on agricultural work. Furthermore it also depends upon asset ownership.

A ~~second~~ second reason for an income and wealth inequality is corruption. In less economically developed ~~countries~~ countries high levels of

corruption exist, ~~as~~ for example people have to pay protection fees to local mob's. Furthermore there may be ~~any~~ corruption in large firms exploiting farmers and trade ~~union~~ union rights. However there has been an introduction of fair trade schemes, which give farmers a greater percentage of the retail price, however this may be a price discrimination technique (charging different groups of consumers different prices for the same good or service) from the supermarkets.

Another reason may be poor education and training resulting in poor human capital. Many children are forced to work from a young age or do not have access to schools, thus preventing them from gaining better jobs, thus ~~the~~ causing income inequality. However government spending may increase the provision of education and availability. There is also a time lag for education to take effect.

A fourth reason for inequality may be poor infrastructure. Infrastructure refers to the provision of ~~the~~ roads and railway lines etc. If there is poor infrastructure then it may be difficult for people to access jobs thus limiting their income. However institutes such as the World Bank can lend money for development projects.



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Examiner Comments

The answers to both parts of the question included some relevant points but the analysis was not developed fully or evaluated effectively. In part (a) there were valid points relating to land ownership, corruption and education but in all cases the analysis were rather superficial. However, there were some valid evaluative comments so this part was awarded 13/20 marks.

The answers to both parts of the question included some relevant points but the analysis was not developed fully or evaluated effectively. In part (a) there were valid points relating to land ownership, corruption and education but in all cases the analysis were rather superficial. However, there were some valid evaluative comments so this part was awarded 13/20 marks.

In part (b) there was mention of greater tax revenue but then the answer considered how this might be spent, ignoring the current context of fiscal deficits. The second point about increased equality was made fairly well and included some relevant evaluation concerning tax evasion and capital flight. However, a further point concerning incentives to work was not developed very fully. This part was awarded 14/30, a level 2 mark.



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Examiner Tip

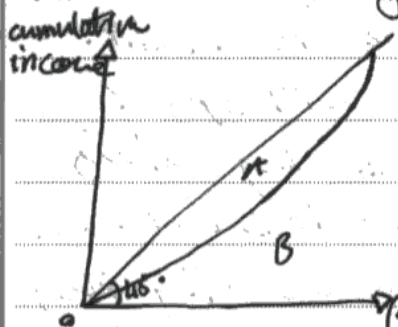
In answering part (b), it is important to consider the context in which a new, higher tax rate was introduced. In this case, it was clearly not to provide more funds for extra public expenditure but to reduce the size of the fiscal deficit.

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Chosen Question Number: Question 1 Question 2 Question 3

a) In the world ~~the~~ the richest 10% of people earn 80% of income, and the poorest 90% earn only 20% of world income. In the UK the situation is still characteristic, the richest few have more of the income and wealth than the majority of the population.



This diagram shows the equality line where 10% of people earn 10% of income and then the line showing

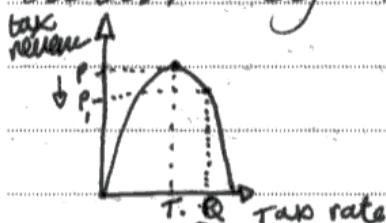
where the UK (approx.) is. There is still ~~an~~ inequality although we are a developed country and although our section A is steeper than that of Africa's (an LEDC) we are still unequal.

These causes of our wealth inequality ~~now~~ is firstly, history. Families pass down family homes through generations, therefore you get wealth though you do nothing for it. However this inequality, as not everyone

gets it should be evened out by inheritance tax. However inheritance tax does not tax sufficiently to completely equalise the effect. Raising ~~more~~ inheritance tax would be unfair on the richer in society as it is not their fault they inherit and should, perhaps, not be 'punished' by extra taxes. Furthermore increasing amount of income tax due when you inherit may be a reason for inequality as, by increasing tax you reduce the incentive to inherit.

Therefore instead more people will spend before they die, evade the tax by giving away inheritance early so it is not seen as inheritance or more detrimentally they may move abroad to avoid it altogether so that their children do not have to pay any of it to our or any other government.

This is an example of government failure as they lose revenue from tax by ~~it~~ increasing it so they end up with less money than when they started. This is shown by the Laffer curve where T



shows maximum tax revenue and from there if you try to increase the tax rate

The revenue will actually decrease $p \rightarrow p_1$.

Income inequality can be caused by education. In the UK there is a vicious cycle, those with high incomes can afford to send their children to private schools where it is assumed you are getting a high class education, which allows you to then earn a high income yourself. Where as the poorer children in society are generally in state schools where the government are in charge of their education. Although the government enforces students to obtain a secondary education until the age of 16, soon to be raised to 17 and then 18 in 2015, the quality of the education is not always high, and children end up leaving without qualifications, i.e. no GCSE's. Therefore because of their background they have less ability to earn a high income and hence inequality is rising.

Another cause recently of income inequality is unemployment. Our unemployment is rising therefore more

people are out of work and not earning. This increases inequality as the poorer people can't earn their way up and close the income gap if they don't have jobs where as those on higher incomes are still earning therefore widening the gap. To help this inequality the government give unemployment benefits, though the amount is very low and although keeps people just above the poverty line it does nothing to close the inequality as that would decrease incentives for the poor to work their way out of poverty.

b) Income tax is a progressive tax and direct tax. It is progressive as it charges the rich a higher percent of income and the poor a lower percent, in an effort to stop inequality. It is direct as this levied on each individual, it is not a choice like VAT where you can choose to pay something and therefore pay, it is usually taken from you before you receive your income so you never see that money.

The introduction of these higher tax rates, 50% on earnings over £100,000.

This may in fact increase inequality. This will encourage the very rich to avoid tax eg getting the bulk of ^{money} in bonuses, therefore not have to pay tax. Further more although the tax rate is lower for the lower incomes ~~at~~, at 20% on your first £10,000 but that is still a lot of money taken away, giving the poor less incentive to work hard if 20% it will be taken away. Between the increase in those on unemployment benefits and still below average income of those still working, inequality

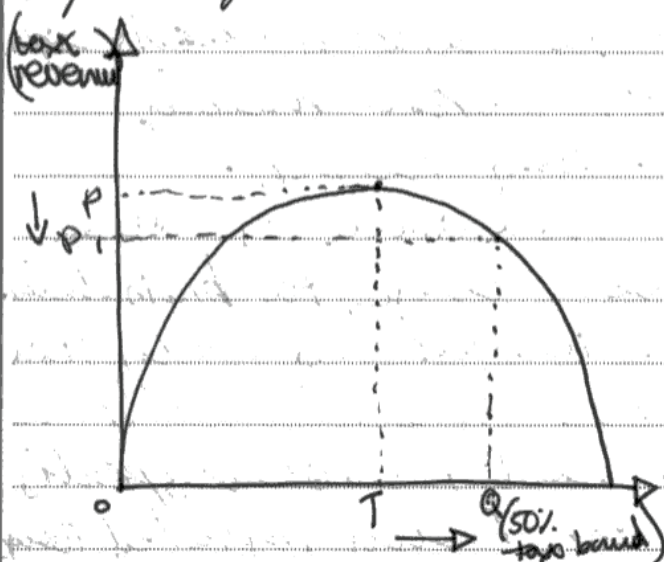
will increase. This is because the rich although can afford higher taxes, they also will still have more left at the end of the day than the poorer who will be pushed closer to subsistence line.

Along with the increased inequality and disincentive to work hard, the higher tax band may cause a brain drain. They can do the same job and earn more money through less tax abroad. This out flow of human capital that is well trained and valuable

would be catastrophic to our already frail economy which needs high productivity and therefore skilled workers to continue growing through all the spending cuts the government are introducing, which could shrink our economy causing another recession. Hence a massive negative effect of the 50% tax band is brain drain which at this point would be catastrophic for the UK.

The higher tax bands are aimed at increasing tax revenue received by the government, however due to the disincentives and brain drain

The amount received in revenue may impact tax:



if ~~tax rate~~ tax rate is at T i.e. when we are before 50% tax band, then revenue is p . However increase the rate to 50% and adverse affect on revenue.

may issue. By increasing rate to Q (50% tax band) revenue falls to P . The government ~~is~~ may therefore be being over estimating, ignoring the possible ~~of~~ negative outcomes because they want more money.

Less incentive to earn, higher inequality and brain drain all negatively impact the economy, less consumer spending as people have less disposable income, therefore a decrease in AD and due to the lower curve the government will be receiving less tax so can't increase AD with G , government spending. Therefore a

leakage in the circular flow may ensue through increased savings. Therefore at a time when the economy needs higher spending ~~more~~ ^{less} will happen, another recession may happen.

However the magnitude of these effects may not be large, the brain drain is likely to be minimized as only those on extremely high salaries will be likely to leave, consumer spending will not be too badly impacted though.

any decrease at this economic time could be catastrophic. So the most important point is the inequality it will create especially the impact on those ~~from~~ ~~poor~~ the really poor but first of all those that are they lose out the most. Through the 20% tax band a their ~~small~~ ~~mean~~.

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Examiner Comments

In the part (a), there are 3 factors identified and explained: inheritance, education and rising unemployment. The analysis is generally good and there are some sound evaluative comments so this was awarded a Level 5 mark: 18/20.

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The beginning of part (b) was less convincing with a suggestion that the 50% tax band would increase inequality. However, there was some good discussion relating to incentives to work, tax revenues, the brain drain and aggregate demand. Some evaluation was included in the answer and more especially at the end. Overall, this response was given 24/30 i.e. a Level 4 mark.

Question 2

In part (a) the best answers contained examples of countries, (presumably from case studies undertaken in class) to illustrate the points which they were making especially on the significance of price inelasticity of demand and supply and income inelasticity of demand. Evaluation was often very effective with examples of countries which had developed on the basis of primary products.

A characteristic of weaker response to this question was an absence of economic concepts.

In part (b) the best answers contained structure analysis and evaluation of several methods by which growth and development might be achieved.

However, weaker responses focused on unrealistic supply side measures which involving significant public expenditure. In these responses, much of the evaluation was brief and not developed.

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Chosen Question Number: Question 1 Question 2 Question 3

2a) Primary product ~~dependency~~ dependency is the reliance of one raw material or simple agricultural yield for ~~as~~ a major segment of a country's ~~exports~~ exports. An example would be Chile's reserves of copper which have given them steady economic growth since recently. There are many problems however with primary product dependency which I will attempt to go through.

Firstly is the lack of diversity when relying on one good. Fluctuations in global markets will slow down growth in a country who operate in a few goods markets. An example is once again Chile who had experienced about 10 good years of steady growth at an average level of 7% (about) but then experienced a huge decline in growth when the price of copper fell by around 25%. Now even though this affected economic growth it is foolish to think that economic growth has a direct effect on economic development.

A second reason as to why primary product dependency is a constraint is that ~~the~~ the terms of ~~the~~ trade ~~could~~ could decline over time due to

~~the~~ the Prebisch-Singer hypothesis. ~~the~~ This states that due to the demand for primary products being ~~inelastic~~ income inelastic and the demand for manufactured goods being income elastic, ~~the~~ the demand for ~~(primary products will always be at)~~ manufactured goods will increase at a faster rate than that for primary products and therefore the terms of trade would deteriorate over time.

~~However as Thomas Matthews says~~

Moreover, over recent years populations have been increasing at an alarming rate. With an increase in population comes an increase in the demand for food, namely basic agricultural crops as much of the population growth has occurred in developing countries who demand agricultural crops rather than manufactured goods. This means that the demand for ~~primary~~ primary products could be increasing and therefore not hamper growth. On the other hand though agricultural crops ~~are~~ are prone to natural disasters causing huge damage which could decrease yield.

~~There is also been~~

In conclusion, primary product dependency could be a ~~constraint~~ constraint on growth and development because of its fate being decided by the fluctuations in global markets. The Prebisch-Singer hypothesis is still only a hypothesis as there hasn't been

much information that proves it's true. Furthermore, ~~many~~ there have been countries that have benefitted from primary product dependency such as Botswana and its production of diamonds. This ~~has~~ has brought them sustainable growth. ~~As a result~~ This has meant that they have been able to invest in education, training and health to improve their development.

2.5) Economic growth and development can be provided in a variety of ways and with the recent boom in globalisation many doors have been opened to developing countries for them being able to grow and develop. However, globalisation is not always so fair.

First of all a way in which to provide growth and development is via aid from around the world. This aid could be governmental or non-governmental such as Oxfam or CAFOD. Aid provides developing countries with relief when dealing with a natural disaster or widespread poverty. If ~~the~~ aid is used efficiently and honestly then development can occur such as the building of infrastructure or the ~~training~~ training of

teachers who can then go on to teach children. This ^{aid} would create a multiplier effect across the country as it would provide jobs under construction or training. ~~And so~~ Even though there will be a time lag before the benefits gained can be fully appreciated, once the effects do filter through then the economy could experience substantial growth.

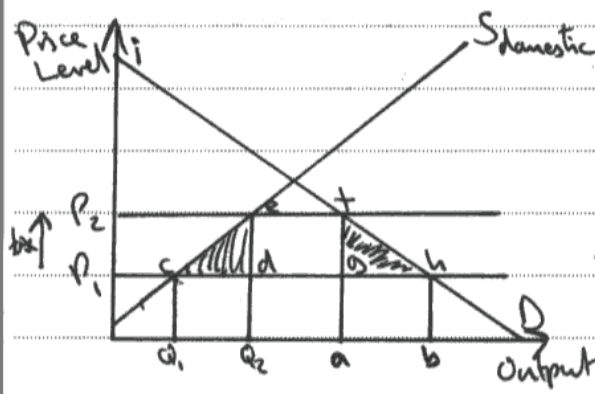
However, corruption is all too common in developing countries. Corruption is the manipulation of resources for ~~own~~ own personal use. These uses could be in the manufacture or buying of guns and other objects of war. So when aid is given it has to be made sure that it is given to the right people.

A second way in which economic growth can be achieved in a ^{developing} country is investment ~~from~~ from multinational corporations or MNCs for short. MNCs may wish to invest in a ~~so~~ developing country for a variety of reasons such as being integrated into other markets where trading blocs may ~~be~~ ^{be} a barrier to ~~trade with~~ ~~most~~ trade. ~~For~~ For the developing country, ~~these~~ MNCs may bring infrastructure or training which will contribute to the economic development and growth of the ~~economy~~ economy.

There are many other reasons as to why MNCs may invest in ~~global~~ developing markets which may be detrimental ~~to the~~ ~~developing~~ to the developing

~~countries~~ countries economy. In many developing countries there ~~isn't~~ ~~isn't~~ a national minimum wage or a strong health and safety regulations. This may mean that the MNCs will exploit this and ~~only~~ pay only minute wages to the workforce or even employ children. An example of this is the Chinese sweatshops where companies such as ~~Apple~~ Primark have been found guilty of labour exploitation.

Another way in which economic growth and development may be achieved is the government policy which the government of the developing nation under takes. An example is inward-looking growth which would allow domestic producers to grow and eventually compete globally when ready. However for domestic industry growth to occur a government has first got to remove the threat of foreign firms who are able to produce the same goods at much lower prices. The government can impose a tariff.



The global economy can supply any amount at price P_1 , whereas domestic producers can only supply at $S.D.$ ~~when~~ when a tax is imposed the global price rises to P_2 . Imports drop from $Q_1 b$ to $Q_2 a$.

Consumer surplus drops from " P_1, h_i " to " P_2, h_i " and producer surplus rises by " P_1, P_2, ce ". Tax revenue for the government ~~is~~ is given by " $defy$ ". And there is a deadweight loss as society of the two shaded triangles. This approach allows domestic producers to be more competitive. However, this approach may mean other countries impose a retaliation tariff and also there is a distortion of comparative advantage which decreases the efficiency of the country.

My final way to ~~also~~ promote growth and development is by using fair trade which aims to reduce the exploitation of the producer in ~~the~~ developing nations. This approach though is inefficient as even though consumers pay a premium for the fair trade goods, ~~only~~ only 10% of the premium goes to the producer and the rest to the ~~for~~ supermarkets.

~~To~~ To conclude, I believe that the best approach for developing countries to ~~also~~ adapt to promote development and growth is by attracting foreign direct investment but the country should first impose regulations on health health and workers rights.

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Examiner Comments

The response to part (a) considers two main points and includes a mention of the problem of natural disasters towards the end. The analysis is not well-developed, but there is some evaluation mainly relating to the significance of increasing population for the demand for agricultural products. This answer was deemed to meet the Level 3 criteria and was awarded 12/20.

Four ways by which growth and development could be achieved are identified in part (b) but some of the analysis is superficial e.g. relating to fair trade. However, there is evaluation of three of the methods. This answer achieved 22/40 i.e. just into the Level 4 category.

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Examiner Tip

The analysis of aid could have included reference to how it might reduce absolute poverty; how it might be used to improve education and enrolment rates as well as a more detailed analysis of the effects of aid when directed towards investment in physical capital.

Question 3

This was the most popular of the three essay questions. Although there some sound responses to this question, candidates seemed to have difficulty finding three points to explain the UK's fall in international competitiveness in part (a). Rises in the sterling exchange rate were usually very well explained (although the analysis of a minority of weak responses was very confused) as was relatively high inflation in the domestic economy. Only the better candidates discussed cost-raising regulations in the UK or the relatively low ratio of R&D to post-tax profits. Non-price factors such as quality, reliability on delivery, after sale services were only mentioned by candidates who presented deep analyses.

In part (b), most candidates were able to provide several methods by which the government and businesses were able to improve competitiveness. These were often analysed and evaluated quite well. However, illustrative examples were lacking (e.g. schemes for modern apprenticeships; having a target of 50% university entrance). Similarly, evaluation was often rather superficial. For example, responses merely mentioned 'time lags' in relation to education and training without any relevant detail about planning, constructing and equipping schools, colleges university buildings. Weak answers often listed proposals such as 'cut costs' or 'improve quality' without any suggestions about how these were to be achieved. Further, some answers suggested protectionism and devaluation as methods without providing any context. For example, devaluation is not a policy relevant to countries with floating exchange rates.

A minority of candidates were unable to access high marks because they ignored the requirement to examine strategies which might be used by both businesses and governments.

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Chosen Question Number: Question 1 Question 2 Question 3

(3)

The first factor which may have caused the decrease in UK's international competitiveness could be a fall in productivity. Productivity is a measurement of output per man hour. A fall in productivity is likely going to cause an increase in price of goods and services as now ^{the} ~~great~~ costs are now divided in fewer goods. A price increase the international competitiveness of such goods and services is decreased.

However the effect on the demand of ^{products} ~~UK exports~~ of rising price would depend on its ^{the} elasticity of demand. Price elasticity of demand measures the responsiveness of quantity demanded to a change in price. Hence if UK's product ^{have} an inelastic demand then the change in price would be ~~not~~ cause a proportionally smaller decrease in demand and vice-versa.

The second factor which may have caused a decrease could be an appreciation of ~~the pound~~ a UK's currency. As the pound gains strength over other currencies the competitiveness of UK's goods would fall because now UK's products become costlier abroad and hence their demand would decrease and competitiveness would decrease.

However at the same time due to the stronger currency ~~UK's imports~~ the quantity demanded of imports in the UK would increase as they become cheaper than domestic goods. This increase would cause ~~an~~ a weakening of the pound. ~~in order to buy the imports~~ Due to the fact that ~~more currency enters the global market~~ ~~in order to purchase~~

Due to the fact that in order to buy imports local currency has to be exchanged for foreign currency hence due to this increase in demand for ~~exports~~ import the supply of local currency would increase and so its price would decrease and so competitiveness would rise again.

The third factor which might have caused the decrease could be ~~a lack in spare capacity~~. Inflation.

Due to insufficient spare capacity (unused factors of production) the price level in UK's economy may have increase. ~~As~~ As the price level increases UK's exports become costlier ~~and so their demand would decrease~~ ^{in comparison to other goods} and so competitiveness would fall.

(b) The first strategy a business could implement could be to shift production to a country where labour is cheaper. By shifting production a business may be able to reduce wage costs. As wage costs decrease the price of the final product would decrease and so the product would become more competitive in the global market.

However if production shift is not done carefully it could cause a fall in competitiveness. If production is shifted in a country without ^{enter} proper education or proper health care system the company may face increasing costs due first of all to unskilled labour which requires training and second to ~~an~~ absences cause by lack of proper health. As costs increase competitiveness falls.

The second strategy a business could take in order to become more competitive could be to focus production on quality rather than price and so aim to cater a different kind of customers. By producing luxury goods businesses may be able to become more competitive ~~as~~ as more the price quality is the deciding factor.

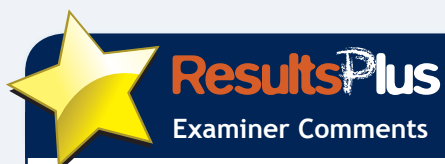
~~However~~ Another strategy a ^{government} country could undertake would be to ^{weaken} strengthen the local currency. By weakening the currency the local products would become cheaper than foreign ones and so they'd become more competitive.

However when currency is weakened imports would become costlier and so their demand would decrease.

This fall in demand for imports would counter effect the weakening done by the government as local currency supply to global market is decreased and so its price would ~~the~~ increase. As currency ~~strengthen~~ exports would become costlier and so less competitive.

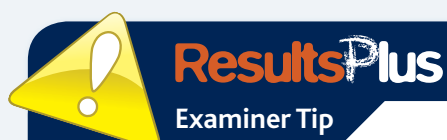
The fourth ^{strategy} factor which a government could undertake is supply side policies ^(policies aimed to expand aggregate supply). By expanding the level of spare capacity in the economy a government may be able to reduce price level and so the country's exports would become cheaper and so gain competitiveness.

However the change in price level would depend on the level of spare capacity already present in the economy. If high amounts are already present then increasing them more wouldn't have any effect. If however little or no spare capacity is present that than the change in price would be great.



This answer lacked sufficient depth of analysis and contained only limited evaluation. The answer to part (a) begins with a feasible point about a fall in productivity with some associated analysis and evaluation. The appreciation of the currency is also explained reasonably well but the final point concerning inflation is superficial e.g. there is no recognition that it is a country's inflation rate relative to that in other countries which is important. This part was awarded 13 marks.

Although the candidate attempted to include four strategies in part (b), they were not explained or evaluated very well. For example, in discussing the second strategy, there is no consideration of how quality may be improved. Similarly, it is suggested that the currency 'could be weakened' but there is no analysis of the mechanism by which this could be achieved. Therefore, this part was deemed to fit the Level 2 criteria and was awarded 14 marks.



To score highly, it is important that the analysis is detailed. For example, the last point made in this response to part (b) related to supply side policies. The analysis could have been improved by including an AD/AS diagram and considering some specific examples of supply side policies with an explanation of how they could increase international competitiveness.

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Chosen Question Number: Question 1 Question 2 Question 3

Q1) A fall in global competitiveness of UK from 9th to 12th place indicates that there is a decrease in competitiveness. ^{Global} Competitiveness is the ability to sell ^{for country} their products ~~to~~ in the world with the competition from other countries. There are several factors can affect the competitiveness of UK's goods and services.

Firstly, the high ~~ster~~ value of sterling is main reason, perhaps the value of sterling is increasing recently, may be because of strong economy or greater economic growth, leading to a large increase in demand of sterling so exchange rate increases. As exchange rate increases, the price of UK's exports become more expensive comparing with other countries, so it leads to a decrease in price competitiveness of UK's product so less people in the world want to buy them, finally there is a decrease in exports and global competitiveness decreases. However, it really depends on how much ~~of~~ the sterling increases, the greater ~~the~~ increase, the greater effect on its competitiveness. Moreover, the exchange rate may only contribute part of the drop, perhaps other factors influence the competitiveness even greater and cover the increase or decrease of exchange so ~~we~~ ^{it} ^{is} a possible reason only.

Secondly, the quality of the goods and services is another ~~one~~ factor. Perhaps the quality of the goods and services that produced by UK has decreased and on the other hand, there is more investment quality of products in other countries.

leading to a better quality of products, it attracts more people such as improve the packaging to buy their products, the demand of them increases. In contrast, the UK products are comparatively less attractive as not improvement in quality, so finally UK's products become less competitive so the ranking dropped. However, it depends on how much is spent on improving quality, as perhaps UK's products and services have remained in a really high standard already, it doesn't really need much change. On the other hand, the high investment on improvement in goods is in poor countries so finally the goods from poor countries has improved but still worse than UK's. Perhaps a lot of poor countries have been growing like China so UK's ranking dropped.

Thirdly, it can be caused by a low productivity in UK comparing with other EU countries such as France and Germany. It needs to a decrease in outputs from UK, to compete with other countries, UK needs to export more so the factories need to spend more money on supervising or appreciating the workers in order to increase the outputs. As a result, it leads to an increase in cost of production, in order to keep the profit margin, the price is raised and UK products become more expensive and become less price competitive so the international competitiveness drops. However, the cost spent on increasing the labour productivity may contribute little to increase the cost of production and UK is a well developed countries, maybe it has a good infrastructure to help improve the productivity so it really

depends on the level of productivity of UK's workers.

In conclusion, there are many factors which can affect the international competitiveness and really depends on the size of changes of them. Also, different factors may have different effects in short term and long term.

b) To increase or improve the competitiveness of a country's goods and services. Both businesses and government can try to increase the infrastructure or equipment used in production. Businesses can put more capital in improving the machine or equipment so the workers can produce goods more efficiently and ^{so specialisation} ~~reduce the time~~ can occur and productivity may be increased. Government can improve the infrastructure in the city or the area near to the factories so the lorry can transport to those areas easier ^{raw materials} ~~so transport~~ cost decreases, price of products may decrease ~~as~~ have less competitive pressure. So finally ^{countries' &} ~~the~~ products become more price competitive ~~and~~ with greater productivity so competitiveness may be improved. However, it involved great opportunity cost in improving the productivity and machine, it may hit the production line in short term. Also, improvement in infrastructure takes time to have effect and it depends on how much is spent on improvement too.

Secondly, ^{improving} education or health care can increase the competitiveness too. For businesses, they can provide more

trainings for their workers so their workers become more skilled and raise the productivity. Spent on health care can reduce the chances of having workers in production line so the productivity is not stopped and it ensures a reasonable amount of products are produced. For government, An improvement in education in a country can increase the number of skilled people, it can increase the people who can work in service and manufacturing sector. And it can improve tourism industry and comparing with other countries, ~~that~~ it has a better services provided. And goods and services become more competitive. However, it ^{hardly} may take a lot of time to have effect as education ~~is needed in country~~ ^{can not suddenly} improve the skills of people, it needs time for people to practice. Moreover, there is cost involved and can be high so maybe less ^{capital} ~~money~~ can be spent on improving other parts of the society and cause chaos within the country.

Thirdly, an improvement in quality of services and goods is really important. The businesses can improve the packaging of the products to attract people to buy them and perhaps employ kind ^{or polite} people to serve customers to improve the services. Moreover, the consumer tastes is changing all the time, ~~the~~ businesses can do more research or marketing on the taste of one customer in order to suit the favour of customers. Also, they can invent some new products to develop a new market. Finally, the products and services of a country become

more competitive and attractive comparing with other countries. Government can reduce the regulations on developing outputs so businesses have under options to ~~to~~ develop new products and have greater ranges of products, so the countries services and manufacturing sectors become more competitive. ^{Or subsidize their industries to promote growth.} However, other countries can also do the same and their products may not be so attractive at last. And it also depends on how much is spent on improvement as it may not have effect on the competitiveness.

Lately, the countries can reduce the unit cost of production such as finding cheap raw materials from other countries ~~and~~ or import from them. Also, they can set their factories in poor countries like Bangladesh or ~~the~~ China to have cheaper labour. By reducing the regulations by government, businesses find much easier to reduce cost of production as they can use ~~the~~ ^{more} raw materials in the country. Or government can subsidize the factories so the businesses has low unit cost of production, so finally less competitive pressure, lower price and finally more competitive.

However, other countries may ban the use of raw materials to reduce the chances of getting cheaper raw materials. Also, this can exploit the environment can cause external costs. There is limited raw materials, so there is chance of having competition of getting ^{cheap} raw materials with other countries.

**ResultsPlus****Examiner Comments**

The quality of this answer was significantly higher than the previous one. Each part contains sound analysis and evaluation although in part (a) the section on quality was perhaps less strong than the discussion of the other points while in part (b) the discussion of methods of cutting costs was a bit fragmented compared with the previous paragraphs. Nevertheless both parts scored Level 5 marks (18/20 and 26/30).

**ResultsPlus****Examiner Tip**

In part (b), it is best to focus on specific policies and then to analyse and evaluate these fully.

Question 4 (a)

This was intended to be a relatively straightforward question and most candidates scored some marks. There were clear indications in the first paragraph as to what was implied by 'deglobalisation'. Regrettably few candidates made any reference to actual declines in world trade or to the fall in FDI.

(a) Explain the characteristics of 'deglobalisation' (Extract 1, line 4).

(5)

Deglobalisation is the opposite of globalisation where there tends to be a fall in trade and investment flows. As Figure 2 shows, world exports have fallen more than 12% and world imports have fallen more than 10%. This is mainly because of the lack of confidence and the decline of demand for world exports and imports. Countries start to put up protectionism measures to protect domestic industries causing specialisation and the law of comparative advantage to lose its function. This would lead to a fall in world output and an increase in prices as a result. Lack of confidence would lead to a fall in investment flows as people are not confident that they will get high returns.



ResultsPlus

Examiner Comments

The candidate begins by identifying 2 features of deglobalisation - falling trade and investment flows. There is clear reference to the data in the second sentence. The answer goes on to consider the impact of protectionism on trade.



ResultsPlus

Examiner Tip

Include reference to the data - this is worth 2 marks. Far too many candidates completely ignore the data.

(a) Explain the characteristics of 'deglobalisation' (Extract 1, line 4).

(5)

Deglobalisation is the break up of interdependence between countries across the world. This happens when trade and investment flows begin to decline between countries and they begin concentrate on their domestic economy i.e. protect their infant industries. This is happening globally. This has slowly been happening since 2008, suggests extract 1, since the financial meltdown. Figure 2 also presents this 'deglobalisation' as it shows a significant decrease in exports and imports suggesting a severe fall in trade.



ResultsPlus

Examiner Comments

Clear identification of decline in trade and foreign direct investment with some further consideration of figure 2. However, there are no specific data references so the maximum mark possible is 3.



ResultsPlus

Examiner Tip

Candidate could have secured the other 2 marks by making specific reference to the data in figure 2.

Question 4 (b)

This was designed to be a relatively accessible question. Candidates could score up to 3 marks for identifying two relevant factors and another 3 for some explanation with the other two for data references. However, many weaker candidates failed to score more than 5 marks. The main reason was a lack of analysis, many simply identifying issues raised in the text and quoting some figures.

(b) Explain why some countries may experience a more severe recession than others.

(8)

Some countries may experience a more severe recession than others because of their openness to trade. The tiger economies such as Singapore have seen its economy shrink by 17% in 3 months and Taiwan's exports as a proportion of GDP are likely to shrink by 11%. These economies employ export-led growth and are exposed too heavily to the international trade multiplier, where domestic business cycles become vulnerable to changes in the level of economic activity in the rest of the world. As a result of the fall in world demand for goods and services, these countries experience a more severe recession than other countries, there has been a decline in exports.

Moreover countries which specialise in the production of a narrow range of goods and services, in accordance with their comparative advantage, increase their risk and so become vulnerable to external shocks. A decline in the demand for cars and electronics which are more elastic goods, has hurt exporters of these goods such as Japan and Germany, who will see a fall in export earnings, more and employment as a result of deepening the world recession.



ResultsPlus

Examiner Comments

This answer focuses on one issue only: dependence on FDI. It is explained and illustrated with an example of one country so the marks were allocated as follows: 1 for identification, one for example and 2 for explanation/analysis.



ResultsPlus

Examiner Tip

Use of the information in the extract would have enabled the candidate to provide a fuller response.

(b) Explain why some countries may experience a more severe recession than others.

(8)

Some countries may experience a more severe recession than others because of their openness to trade. The tiger economies such as Singapore have seen its economy sink by 17% in 3 months and Taiwan's exports as a proportion of GDP are likely to sink by 11%. These economies employ export-led growth and are exposed too heavily to the international trade multiplier, where domestic business cycles become vulnerable to changes in the level of economic activity in the rest of the world. As a result of the fall in world demand for goods and services, these countries experience a more severe recession than others. There has been a decline in exports.

Moreover, countries which specialise in the production of a narrow range of goods and services, in accordance with their comparative advantage, increase their risk and so become vulnerable to external shocks. A decline in the demand for cars and electronics such as more elastic goods, has hurt exporters of these goods such as Japan and Germany, who will see a fall in export earnings, a rise in unemployment as a result of the global recession.



ResultsPlus

Examiner Comments

The candidate has identified two reasons: openness to trade and specialism in particular products. These points are explained briefly but adequately and supported by examples of particular countries.

Question 4 (c)

There were some good answers to this question which applied theory well to the context of tourism with many answers drawing on material not only in the cextract but from their own knowledge e.g. the significance of tourism in the Maldives. However, a significant minority wrote generalised answers and did not include any effective evaluation.

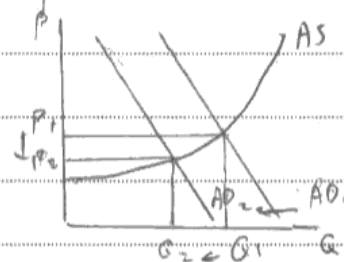
(c) Examine the possible effects of the global recession on countries with well-established tourist industries.

(10)

To begin with, tourist industries rely on the world economy much; therefore, the international tourist numbers fell by 1% in the second half of 2008, and the effect is significant, compared to a growth of more than 5% of tourist industries in the previous 4 years. In particular, the visitors in the Caribbean may fall by 33%.

One effect is that there is unemployment ^{rate} increase in tourist countries because hotels in Caribbean are half empty, which means half of the employed people are not essential to ~~int~~ satisfy the demand. The crime rate may increase, as people lose their jobs, and they want to steal ^{money} to get enough money to buy what they want. In addition, there may be fiscal deficit since the unemployment benefits increase, and the government expenditure may exceed the government revenue. Nevertheless, unemployed people may move to another sector to get a job, which could offset the rise in unemployment rate.

Another effect is that there may be negative economic growth because the aggregate demand is falling (AD1 to AD2), the price level may fall (P_1 to P_2), and the real output may fall (Q_1 to Q_2), so people enjoy less goods and services, and the living standard may decrease. Additionally, the balance of payments



may be worsened because the value of exports may fall dramatically. However, the value of imports may fall as well in the time of global recession, and there may be positive inflow of capital in the capital and financial account, which ^{might} offset the fall in exports value.



ResultsPlus

Examiner Comments

The first paragraph makes good use of the data and gains 2 marks. In the next two paragraphs, there is some analysis of the possible effects of recession on countries with well-established tourist industries which is worth 3 marks. The evaluative comments at the end of the second and third paragraphs are worth just 1 mark each because they are not developed.



ResultsPlus

Examiner Tip

Evaluative comments should be explained e.g. why might imports be expected to fall in time of global recession?

(c) Examine the possible effects of the global recession on countries with well-established tourist industries.

(10)

The possible impacts of global recession on countries with well established tourist industries may suffer during ~~recession~~ global recession as uncertainty of consumers causes them to ~~save~~ cut spending on goods that are not necessities, such as holidays and other luxury items. Therefore tourist industries will suffer a decrease in demand which may have other negative consequences such as unemployment as a result of jobs not needed as tourists are no longer visiting the resorts. The local communities may also suffer as tourist may have shopped and bought locally produced goods.

However there may be positive impacts as the balance of payments on current account may improve as less imports will be demanded to supply the needs of tourists as there will not be as many. Also on the financial account if less profits are made by the ~~Transnational~~ multinational ~~tourists~~

hotel chains lower profits may be returned to shareholders in home country. Therefore less will be flowing out of the country. Also as tourism is ~~known for~~ recognised to damaging the environment such as beaches there may be time for the natural resources to recover.

Also if the country use profits made previously to diversify their economies away from tourism they may be able to develop other industries and move away from reliance on tourists. Therefore impacts of global recession may be lower.



ResultsPlus

Examiner Comments

The discussion of the effects of the recession on tourism were analysed in a rather superficial way so the first paragraph was worth 1 mark for identification and 2 for analysis.

The paragraph on the balance of payments was less convincing because the loss of revenue from tourists was ignored. However, there was some good evaluation in relation to the environment and diversification away from tourism. (3 marks for evaluation)



ResultsPlus

Examiner Tip

There was a good opportunity to use AD/AS analysis in considering the effects of recession on tourism.

Question 4 (d)

This question was often not answered very effectively because many candidates did not consider the significance of the points mentioned in the passage for world trade. Further, few examples were given and evaluation tended to be limited. The best answers used the material convincingly and included specific reference to percentage decline in world trade.

* (d) With reference to lines 26–34 of Extract 1, evaluate reasons why the banking crisis has hit world trade so severely.

(12)

The idea that the "global recession is more severe than most first thought" is one of the reasons. Because there was probably a lot of people spending on imported goods, spending excessively, not planning, it has caused people (and governments) to reduce spending rapidly rather than it being a steady pace. If the world had seen the impending ~~stage~~ dangers of such heights there might have been gentler, more recession cuts, and policies to prevent there being ~~any~~ such a huge crisis.

Also because the supply chains are global so as soon as one country is in trouble it reverberates through the entire chain. This is ~~because also~~ the fragmentation of production around the globe and outsourcing materials ~~are~~ from all over. There is more interdependence. This means that even if one country is enjoying very strong growth eg. China they are still deeply affected by the countries in poor condition.

"Protectionism" has also been an issue. Because countries have wanted to close themselves off to 'bad' economies they have tried to stop such economies from accessing/infecting them. This is significantly bad because as the trade slows down growth slows, but when barriers are erected, growth slows even more. Barriers stop consumer goods/luxury goods that worsen the current account but it also makes getting imported capital (for growth) difficult too.

The currency is also affected by all this so again there

is uncertainty about price fluctuations across ~~some~~ borders because of currency uncertainty. However this was not such an issue for ^{monetary} trading blocks such as the eurozone because that uncertainty is eliminated.

**ResultsPlus**

Examiner Comments

This response used the material from the extract effectively and included the example of China in the discussion of global supply chains. However, there was no evaluation and so the maximum mark possible is 7/12.

**ResultsPlus**

Examiner Tip

The higher mark base questions always demand evaluation so it is important that the answer includes some comments which show signs of critical thinking.

* (d) With reference to lines 26–34 of Extract 1, evaluate reasons why the banking crisis has hit world trade so severely.

(12)

One reason why the banking crisis has hit world trade so severely is due to the effects of ~~competitive~~ globalisation. Because the world's economies were becoming so closely integrated, recession in one country would have quickly spread off recession in another country. This would have been significant for tourist-concentrated countries such as the Caribbean countries as they have multinational companies which epitomised ~~the~~ globalisation.

To evaluate, this is extremely significant as globalisation was expected to have caused a 'golden age of global trade' and hence the effects of deglobalisation are significant.

Additionally, the lack of export credits available to firms has hit world trade and this has made it difficult for them to sell their goods abroad, thereby limiting world trade as a result, ^{possibly due} possibly to the increasing apprehension of banks to lend to businesses that was a large feature of the recession.

However, ~~it is~~ to evaluate, this is less significant than the ~~concept~~ effect of globalisation because lack of financial capital is more of a short-term problem, whilst others like protectionism ~~and~~ are more of long-term significant.

Moreover, the increase in protectionist policies deployed by countries may have also heightened the effect of the banking crisis on world trade. This is because protectionism actively discourages international trade by making foreign produce less competitive in 'domestic' markets, through the use of import tariffs and this would have been especially detrimental to capital exporters such as Germany whose already-expensive goods become even more costly due to protectionism.

To evaluate, the WTO would negotiate non protectionism to ensure that trade diversion is not occurring and that it is not ~~causing~~ distorting comparative advantage, so the effect of protectionism on world trade may be limited.



ResultsPlus

Examiner Comments

This response uses the information in the passage to good effect discussing the significance of globalisation; lack of export credits and protectionism as explanations as to why the banking crisis had such a severe impact on world trade (1 mark for identification + 4 for analysis). Examples (China and Germany) are included to support the analysis (2 marks). There is also some evaluation worth 3 out of 5 marks)



ResultsPlus

Examiner Tip

Use the information provided, as this candidate has done, to answer the question.

Question 4 (e)

This question required candidates to discuss the effects of an increase in protectionism on the world economy. However, many responses were very narrow, focusing on the impact of tariffs on a particular country. Only the best answers considered issues such as the distortion of comparative advantage; reduction in specialisation and world output and the possible impact on inflation as well as some evaluative comments.

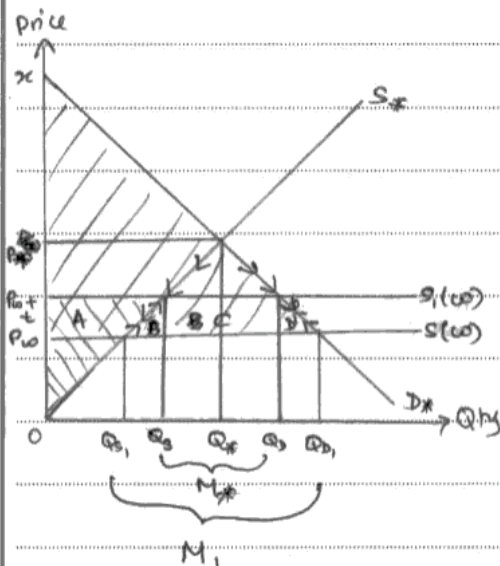
*(e) In the light of the global recession, assess the likely economic effects of an increase in protectionism on the world economy.

(15)

Protectionism would result.

There are different forms of protectionism -

(i) Import tariffs -



- Tariffs are taxes placed on imports that raises the price of imports. An

- world supply before the tariff is at $S(w)$ case, at this point the quantity

supplied would ~~rise~~ fall as producers would earn less and consumers would expand

demand as prices are lower. After the tariff is placed the price of imports could rise from P_w to $P_w + t$.

This causing quantity supplied to rise and as producers earn more and consumers to reduce demand as price rises.

This would thus cause a reduction in imports from M_x to M_1 . This would result in a net welfare loss of $-(B+D)$

as: consumer surplus change = $-(A+B+D)$

producer surplus change = $+A$

government revenue = $+C$

Thus resulting creating a loss of $SE - B+D$.

This would allow the countries to raise exports as they face less competition from ~~the~~ imports.

However, the extent to which tariffs affect exports depends on elasticity of demand. For instance if demand is inelastic then the measure would not be effective as quantity demanded for exports would be less than proportionate.

Another protectionist measure of subsidies would help to reduce the cost of production for firms and thus increase supply and overall lower the price of exports. This would increase demand for exports as they are more competitive.

However, the extent to which subsidies are effective depends on how much the subsidy is. If the subsidy is low then price may not necessarily fall by much.

Another protectionist measure is that of Quotas. This is a physical limit on imports that reduces the volume of imports entering the market.

This would allow export demand to rise as ~~there are~~ consumers may switch from imports to exports. This would result in an increase in injections to the circular flow of income, thus raising economic growth.

Thus, overall, protectionism would help countries to raise the output and of exports and thus create growth.

**ResultsPlus**

Examiner Comments

This answer contained a good tariff diagram which was explained fully. There was also some evaluation of tariffs. However, there was no direct answer to the question i.e. how an increase in protectionism would affect the world economy. Therefore, marks were allocated as follows: 2 for the diagram; 3 for explanation of the diagram and a further 2 for evaluation.

The remainder of the answer considered other types of protectionism but did not address the question directly.

**ResultsPlus**

Examiner Tip

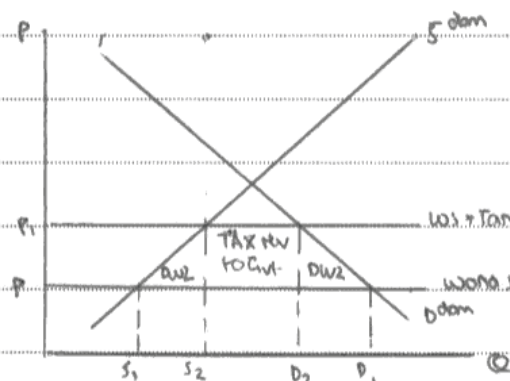
You should refer back to the question frequently while writing their answers to ensure that they have addressed the question set.

*e) In the light of the global recession, assess the likely economic effects of an increase in protectionism on the world economy.

(15)

Protectionism is defined as the use of commercial policy to ~~to~~ boost domestic sales.

From the extract, import tariffs are being utilized by some countries; these ~~limit~~ act as taxes on imports making them less price competitive.



The effect is to increase the share of the domestic market that domestic firms supply to and this would

protect jobs in the domestic market as a consequence.

However, the tariffs may cause a dependency culture as they discourage efficiency and choice and consumers may face ~~getting~~ a fall in choice and higher prices as a result of these import tariffs.

In addition, an increase in protectionism is also likely to protect generic and strategic industries who become particularly vulnerable due to the recession as was seen in the US cotton farming market recently. By protecting these industries, you protect the future job prospects in your economy.

However, this may harm to world economy as it distorts the law of comparative advantage ~~which means that the most efficient suppliers are not supplying goods they have comparative due to the possibility of trade diversion and may limit consumer welfare as a result.~~

In addition, extract 1 also mentions the use of subsidies in order to protect industries. These again would preserve employment domestically and help ward unemployment law as a result.

However, retaliation may occur ~~and~~ from other countries and this may spur of trade wars between countries which have a significantly negative impact on global world economy as it means that consumers are faced with significantly less choice and ^{again,} much higher prices in addition due to constant price wars, retaliation and counter country-retaliation.



ResultsPlus

Examiner Comments

Unlike the previous response, this answer does consider some effects on the world economy e.g. distortion of comparative advantage; retaliation and higher prices. However, the evaluation was limited and was only awarded 1 mark.

There were 2 marks for identifying the effects on the world economy; 2 for the diagram; 5 for analysis of the diagram and for the impacts on the world economy.



ResultsPlus

Examiner Tip

Evaluation could take many forms e.g. consideration of short and long run effects; the magnitude of the protectionist measures and the differential effects on countries.

Question 5 (a)

This question was generally well-answered with many candidates scoring maximum marks. However, some answers contained no references to the data and a minority of candidates confused a fiscal deficit with a balance of payments deficit on current account.

(a) With reference to Figure 1, how might the expected change in the UK's fiscal deficit **between 2007–08 and 2009–10** be explained?

(5)

Fiscal deficit occurs when a government is spending more than the tax that it receives, therefore is financed by government borrowing. One of the reasons for this could be ^{due to} increasing unemployment levels. If unemployment is rising then the government will receive less in tax and have to spend more on benefit (unemployed people). Another reason could be that the fact we were in a recession, recession starts to cause all sorts of problems, like lack of confidence, fall in value of pound & one way the government tries to get out of recession is by increasing government spending.



ResultsPlus

Examiner Comments

This answer scored 3 marks for explaining how rising unemployment resulted in increased expenditure on benefits and a reduction in tax revenues. The absence of any data references meant that the other 2 marks could not be awarded.



ResultsPlus

Examiner Tip

Always make use of the data to support your answers.

(a) With reference to Figure 1, how might the expected change in the UK's fiscal deficit **between 2007-08 and 2009-10** be explained?

(5)

In 2007-08 the ~~big~~ fiscal deficit was around 2.2% of GDP but it ~~is expected to rise~~ ^{was forecasted} to rise to 6.2% of GDP in 2008-09 and 12.4% of GDP in ~~2009~~ 2009-10. This increase in the deficit is due to ~~the~~ government spending being greater than taxation. Fiscal deficit = government spending minus taxation. During this period, the global recession occurred which resulted in many job losses. These unemployed are now claiming benefits (if applicable) and ~~so~~ so government spending has increased. Also in Extract 1, £2bn ~~has~~ ^{has} been used for training, trying to get people back into work with different skills. Also ~~due to~~ due to job losses there is now less income tax being collected meaning less taxation which adds to the deficit.

**ResultsPlus**

Examiner Comments

This answer starts by referring to the data and then offers a sound explanation of why the fiscal deficit has increased.

**ResultsPlus**

Examiner Tip

This is an effective way of tackling this question.

Question 5 (b)

As with question 4(b), this question was designed to be relatively accessible. Candidates could score up to 3 marks for identifying two relevant factors and another 3 for some explanation with the other two marks for data references. All too often, however, candidates made no reference to the data and some struggled to offer relevant reasons why the deterioration of the public finances might present problems.

(b) With reference to the information provided, explain the problems resulting from the deterioration in the public finances for the UK or any country of your choice.

(8)

The deterioration in the public finances, for example a fiscal deficit of £90 billion in 2008/09 and expected to rise to £175 billion in 2009/10, according to extract one, can have severe problems for the UK. A significant increase in national debt such as the rise from 37% in 07/08 to 79% in 2013/14, represents a large debt burden on future governments. There is an opportunity cost of future governments having to service the debt rather than invest in health and education.

Furthermore, an increase in national debt (44% in Britain for 2008) represents an increase in the size of the public sector in the economy which can lead to the crowding out of the private sector. Financial crowding out is when the state's demand for borrowed money increases interest rates and resource crowding out is equally a problem. However both had limited negative effects because the economy has recently been under-employed. Another problem that could occur are inflationary pressures because the extra government borrowing represents more injections into the economy, pushing AD and the price level up (see opposite graph).

However the most important impact of the fiscal deficits of the UK economy will be the need to cut costs and thus an annual growth in public spending of just 0.7% in real terms for five years after 2010. This means deep cuts in other Government departments and a worsening of public services and so a lower standard of living.



ResultsPlus

Examiner Comments

The candidate sets the scene by describing the expected change in the size of the fiscal deficit and the increase in the national debt. Potential problems such as financial crowding out, inflation and the need to cut public expenditure are then examined. The marks were allocated as follows: 3 marks for identification of points; 2 marks for use of data and a further 3 marks for explanation.



ResultsPlus

Examiner Tip

Again, starting with the data gives the answer a framework before considering the potential problems which a country might face when the sharp deterioration in its public finances.

Question 5 (c)

Many candidates were able to use the first paragraph of Extract 2 to help them answer this question effectively although evaluation proved beyond all but a few. This question discriminated sharply between those candidates who had kept up to date with current issues and those who had relied solely on textbooks. Many got distracted by other parts of the extract, most notably a sizable minority tried to blame the low value of sterling for the weak state of the UK economy.

(c) Evaluate the reasons why the UK economy was in a weak state following the financial crisis in autumn 2007.

(10)

The UK economy was in a weak state as it was firstly because it was exposed to the credit crisis through its own bank and this risked our financial sector which ~~is~~ supports and makes up ~~the~~ a large proportion of the UK economy. This would damage its reputation and reducing international confidence in the UK financial services.

Another reason is that we had the biggest debt relative to disposable income due to the UK housing boom which ~~decreased~~ ~~the~~ the confidence in our financial sector and its reliability. This led to low levels of confidence and drop in lending. ~~The~~ Loans and mortgages were harder to get restricting consumer spending.

UK house prices rose by the highest internationally this could have created the wealth effect and when demand fell due to low availability of

mortgages and loans and high supply of houses, prices would fall dramatically and increase debt.



ResultsPlus

Examiner Comments

This answer was not untypical of many similar responses. The candidate has identified 3 reasons why the UK economy was in a weak state and explained them well. All are clearly related to the UK economy. However, there is no evaluation so the maximum mark possible is 6 out of 10



ResultsPlus

Examiner Tip

Check the command words carefully to ensure that evaluation is included when required. In this case it is very clear that evaluation must be included.

(c) Evaluate the reasons why the UK economy was in a weak state following the financial crisis in autumn 2007.

(10)

The UK was in an especially weak state because ~~we are~~ it has a very large financial services industry, and ~~this was the problem~~ which was exposed to the US sub prime housing market. When it collapsed in 2007 UK banks therefore suffered a lot, resulting in many having to be rescued. The resulting

contraction in the banking sector therefore led to large falls in GDP (especially since banking makes up a very large percentage of GDP). This massively damaged confidence in the UK economy, resulting in falls in FDI and also in consumer spending.

However, since 2007 the banking industry has recovered surprisingly well. Furthermore, the big fall in confidence in the UK economy resulted in large falls in the value of the pound, thus limiting the ~~damage~~ impact of the global recession on UK exports. Also the government took some very strong measures to ~~the~~ help the banking sector, thus increasing confidence.

Another reason is that UK households were the most indebted in the G7. This meant that when the recession struck consumer confidence fell massively. It also reduced the boom ~~which was~~ in consumer borrowing which had fueled the UK until recently.

Finally, UK house prices had seen one of the biggest booms in the world. It was therefore thought that the UK was particularly susceptible to the could experience a large fall in house prices. This would have created a very big negative wealth effect, thus reducing consumer spending. It could have also led to a Subprime like crisis in the UK - with many households going into negative equity thus causing ~~the UK~~ and the financial crisis in UK banks.

However, house prices fell much less than what was expected, and are now rising.

**ResultsPlus**

Examiner Comments

This was a convincing response which examined the significance of the financial services industry; the large debts of households and the house price boom as reasons for the weak state of the UK economy (1 mark for identification, 2 for clear references to the UK economy and 3 for analysis). There was good evaluation at the end of the first page (2 marks) and some brief evaluation at the end of the second page (1 mark)

**ResultsPlus**

Examiner Tip

Recent knowledge about the state of the UK and global economy can be very useful in accessing the highest marks. In this case, the evaluation was based such knowledge.

Question 5 (d)

Answers to this question were frequently impressive: not only were candidates able to discuss the effectiveness of interest rate policy confidently but many also examined the role of quantitative easing. Evaluation was often stronger on this question than on parts (b) and (c).

However, weaker responses often failed to explain how the monetary transmission mechanism was supposed to work and then were unable to provide much by way of evaluation.

*d) Evaluate the likely effectiveness of monetary policy in the management of the economy in the light of the information provided.

(12)

~~The~~ Extract 2 reflects how monetary policy has been in the UK a loose monetary policy in order to recover from the recession. In less than one year, it fell from 5% to 0.5%, indeed a very significant ~~decrease~~ decrease. Monetary policy involves interest rates.

Lower interest rates is, ~~in the~~ first of all and in theory going to increase consumer spending as it is cheaper to borrow. Lower interest rates are likely to return confidence domestically and encourage borrowing amongst the population. Hopefully, the money borrowed will be spent and the economy will be easier to manage as if it was growing.

The next likely effect could be a loss of confidence for investors as interest rates ~~might~~ also ~~may~~ involve the return for savings. Foreign Direct Investment is not attracted into the UK with lower interest rates and therefore lets hope that the impact on consumer spending is bigger than the impact of investment as both are components of Aggregate Demand and ~~and~~ increasing AD will help to manage the economy.

Lower interest rates can also mean lower or smaller competitiveness. If investors lose confidence and will not

invest in the UK, the Domestic UK firms fall behind in ~~productivity~~ in competitiveness ~~as~~ as they are no longer at the same level as the rest of its developed partners.

**ResultsPlus**

Examiner Comments

Apart from the first two paragraphs, this is not an impressive response. There is confusion about the link between interest rates and foreign direct investment.

The answer does not include any evaluation worthy of credit.

Consequently marks have only been awarded for an understanding of monetary policy, a loose reference to the reduction of interest rates and the impact of lower interest rates on consumer borrowing.

**ResultsPlus**

Examiner Tip

The difference between the factors influencing 'hot' money flows and FDI should be understood.

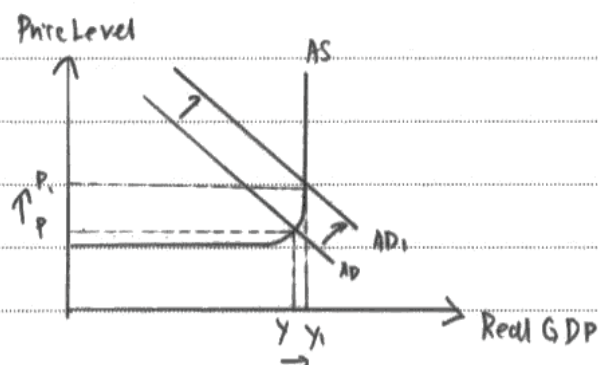
* (d) Evaluate the likely effectiveness of monetary policy in the management of the economy in the light of the information provided.

8/24
(12)

With the reference in Extract 2, line 24-25, it is mentioned that Bank of England cut interest rates progressively from 5% in early October 2008 to 0.5% in March 2009. This refers to an expansionary monetary policy.

The slash in the interest rates will encourage more Britons to borrow and spend on big-ticket items like LCD TVs, cars and houses. At the same time, this move will discourage people to save as it yields lower returns for their money. Therefore, with a slash of interest rates, consumer spending could be stimulated, hoping that it will occur to avoid UK experience a severe recession.

Besides that, the slash of interest rates will encourage more businesses to borrow and spend on capital goods and also for investment purposes. For instance, factories can benefit now as they do not need to incur a higher interest debt repayment and be able to expand their business with financial assistance from banks. As investment activities increase, this is likely going to shift AD rightward, preventing UK economy to fall in a severe recession.



However, in the midst of the recession, the slash of interest rates may still prove less effective to stimulate consumer spending. This is largely due to the cautious attitude of the many bankers in UK. Therefore, even if the consumer is willing to borrow, there will be no source of funds flowing out from the banks, since they are reluctant to lend. Also, it is ~~also~~ worth to note that the UK banks rather used the remaining funds to correct their extreme defaults in their balance sheets.

We have to bear in mind that an expansionary monetary policy is also subjected to time lags. Britons would rather safeguard themselves by not borrowing and spend until they feel confident about the market again. It also takes time for Britons to realise that interest rates are at record low levels. Therefore, it shows that not all macroeconomic variables change simultaneously. It takes at least 18 months or more to have an effect into the economy.

**ResultsPlus**

Examiner Comments

A good opening sentence in which it is obvious that the candidate understands monetary policy and has indicated the size of the reduction in interest rates which has occurred.

The next two paragraphs explain the transmission mechanism and include a diagram (although this could be criticised on the basis that the initial equilibrium does not show severe recession). The two paragraphs on the last page provide some good evaluation and were awarded 4 marks out of the 5 available.

**ResultsPlus**

Examiner Tip

To improve the evaluation of the time lags issue, the answer could have included more reasons e.g. people on fixed interest mortgages; or savers with fixed term interest bonds.

Question 5 (e)

The quality of responses to this question was rather variable. Some candidates had not allowed a sufficient of time to provide a full answer while other answers were rather narrow, focusing on the impact of price competitiveness and the balance of payments. Many students talked about the J curve effect on the current account and the Marshall-Lerner condition. However, knowledge and understanding of these concepts was incomplete and they often lumped both into the same sentence with regards to the Balance of Payments.

Only the strongest responses used aggregate demand/aggregate supply analysis effectively and included sufficient evaluation.

*e) Assess the likely economic implications of 'the 27% decline in sterling's trade-weighted index... between July 2007 and March 2009' (Extract 2, lines 17-18).

(15)

The likely economic implications of the 27% decline in sterling's trade-weighted index is that imports into the UK will be cheaper as producers there now since $\pounds 5 = \$10$ would now be around $\pounds 3.3 = \$10$ therefore importing an American good would now cost less. Exports on the other hand would be cheaper as less dollars would be able to be bought with pounds therefore the balance of payments would be negatively affected and be in more deficit than it already is which is a concern for the government.



ResultsPlus

Examiner Comments

An answer showing an alarming degree of confusion about the effects of depreciation in the value of sterling: it asserts incorrectly that price of importing goods into the UK would be lower whereas the foreign currency price of UK exports would be higher.



ResultsPlus

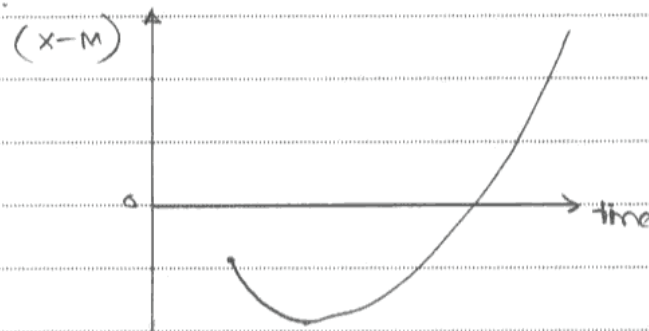
Examiner Tip

A precise understanding of the implications of exchange rate changes is essential in tackling the Unit 4 paper.

* (e) Assess the likely economic implications of 'the 27% decline in sterling's trade-weighted index... between July 2007 and March 2009' (Extract 2, lines 17-18).

(15)

- A ~~an~~ exchange rate is the value of one currency in terms of another. The sterling pound is on a free floating exchange rate.
- A depreciation of the sterling would make UK exports ^{more} ~~much~~ price competitive in the international market. If price elasticity of demand for UK goods is ~~the~~ ^{elastic}, ^{value of} demand for UK exports will rise more than proportionately. Further, imports into the UK will now be more expensive, i.e. price competitiveness of domestic goods will rise. ∴ value of ~~the~~ imports will fall. If value of exports rise and value of imports fall, the current account or Balance of Payments will improve.
- However, this effect will be subjected to time lags. In the short run, the current account will worsen due to contract restraints and reaction time lags. ∴ quantity of exports and imports will remain unchanged in the short run, giving rise to a J-curve effect.



Further, a depreciation of the sterling, ~~can~~ may result in demand pull inflation. ~~Since~~ \Rightarrow If the value of exports is greater than the value of imports AD is likely to rise since net exports $(X-M)$, is a direct component of AD. Also it may give rise to cost push inflationary pressures. If many of the raw materials are imported, cost of production will rise (since imports are more expensive), \therefore may result in cost push inflationary pressures.

- However, in the UK, since the monetary policy committee ~~has~~ ~~is~~ ~~has~~ has a inflation target of CPI $2\% \pm 1$, inflationary pressures may be kept minimal by the use of interest rates.

- Also, a depreciation of sterling, may ~~also~~ ^{also} affect speculative buyers and sellers. If speculators assume that the pound is likely to depreciate even further, they may pull out their foreign currency (FC) savings from the UK and ~~also~~ purchase a currency which is appreciating. This will increase the supply of pounds in the forex market and therefore will further depreciate the pound. This is known as the self fulfilling prophecy.

- A depreciation in the exchange rate may result in an increase in domestic employment. Since imports are more expensive, an expenditure switching effect would be observed where consumers switch to domestically produced goods. Further ~~also~~ since demand for exports

Increases as well, output in both sectors must increase. Since labour is in derived demand, ^{demand for} labour at all wage rates will increase. This will result in lower unemployment.

Increase in employment would in turn improve government finances as tax revenues (via income tax) now increase. This may help to narrow the fiscal deficit.



ResultsPlus

Examiner Comments

This is a fairly effective response starting with a definition and then an examination of the effects on the prices of exports and imports. There is some evaluation in terms of the J curve effect but the Marshall-Lerner condition is not mentioned specifically.

The possible inflationary consequences of the depreciation are considered with a little evaluation in terms of the role of the Monetary Policy Committee. There is further discussion of the possible effects in terms of speculation, employment and public finances.

The main weakness in this response was insufficient evaluation (which scored 3 out of 6 marks).



ResultsPlus

Examiner Tip

This response could have been enhanced further if an AD/AS diagram had been included to support the written analysis.

Grade boundary

Grade	Max. Mark	A*	A	B	C	D	E	N	U
Raw mark boundary	100	76	68	60	52	45	38	31	0
Uniform mark scale boundary	120	108	96	84	72	60	48	36	0

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