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Examiners' Report
June 2011

GCE Economics 6EC02 01

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Introduction

This summer's paper was considered to be of a similar standard to previous papers. In general candidate performance was at a high level, with answers demonstrating a good grasp of the requirements of the specification. The majority of candidates knew how to recognise the evaluation command words, and made good attempts at demonstrating this higher-order skill.

Question 1 (a) (i)

(a) (i) With reference to Figure 1, explain why it is necessary to regularly update the CPI basket of goods and services.

(6)

The consumer price index is the changes in the price of a basket of 650 good. CPI is 2% ± 1%. This is achived by the bank of england MPC. The tastes and fashions change effect the basic results of the basket of goods and services. This is because a change in technology or compairments of goods. The figure shows for example people use ~~less~~ more lipgloss and ~~more~~ less lipstick thus they replace each other in the basket. This is a change in tastes. The fact disposable cameras are left out of the basket and Blu-ray disk players and let in is a change in technology. The basket should constantly change to be a accurate measure of CPI.

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Examiner Comments

2 definition, 2 tastes changing & example lipstick/gloss 2, 2 technology and 2 for example even though one didn't replace the other – implicit understanding, 2 accuracy.

(a) (i) With reference to Figure 1, explain why it is necessary to regularly update the CPI basket of goods and services.

(6)

It is necessary to regularly update the Consumer Price Index basket of goods and services because the demand for goods and service is always changing. This means that if the CPI basket of goods and services constantly stayed the same it wouldn't give an accurate outlook on the economy. This is because if the demand for one good fell sharply then the price would more than likely fall to which would then have a large impact on the CPI basket of goods and services. Figure 1 shows that the basket of goods and services contained; cereal bars, a fruit drink in a bottle, blu-ray disk players and Lip-gloss in 2010 replacing a hairdryer, fizzy canned drink, disposable camera and lipstick. These goods may have been replaced due to low demand and technology advances, e.g. a blu-ray disc player replacing a disposable camera.

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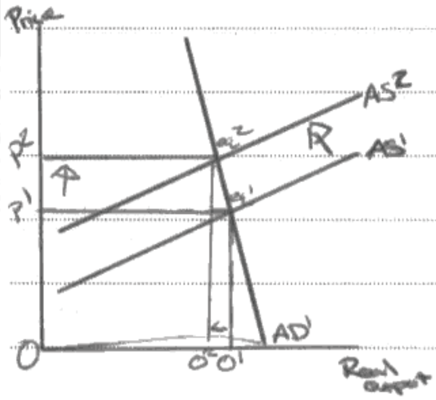
Examiner Comments

2 for accuracy and example another 2, 2 for change in technology and 2 for example even though one didn't replace the other – implicit understanding assumed.

Question 1 (a) (ii)

(ii) Using aggregate demand and aggregate supply analysis, explain the likely impact on the equilibrium price level and level of real output in the UK of the "sharp increase in oil prices" *(Extract 1, line 6)*.

(10)



"Sharp increase in oil prices" Cause AS' to Shift to AS². This is because as oil becomes more scarce and taxes increase they are demanding a higher price. This results in the price level increasing from P' to P². This causing Real output to fall from O' – O². By increasing the price it decreases the real output; because companies, firms and people have less resources at their disposal. The shift from O' – O² also represents the decrease in employment. Because as companies are charged to more they must take ~~cost~~ cuts else where. P1–P2 ~~could also represent increase inflation~~ Overall the "Sharp increase in oil prices" causes a fall in real output and an increase in price level. Mainly because we import oil rather than export it.

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Examiner Comments

Diagram 4 (awarded 1 mark for labelling axes despite price level axis being incorrectly labelled), written description of price level rise 2 and real output fall 2. No clear explanation of the effect on the factors of production.

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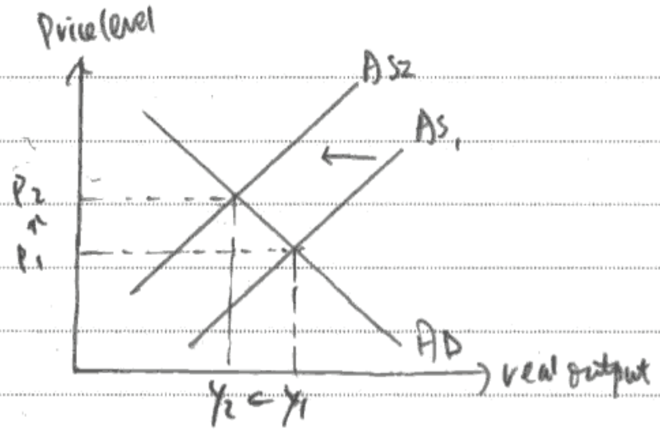
Examiner Tip

Label your diagrams accurately. Axes should be labelled Price level and Real Output. The equlibria should be indicated on the axes as well.

(ii) Using aggregate demand and aggregate supply analysis, explain the likely impact on the equilibrium price level and level of real output in the UK of the "sharp increase in oil prices" *(Extract 1, line 6)*.

(10)



From Extract 1, 'a sharp increase in oil prices of roughly 70% over the past year' indicates that oil price has gone up in great extent.
Oil is a commodity, which is a vital factors of production of many kinds of services, such as making plastic or fuel for public transport. when oil increase in price, cost of production increase, hence, there will be a negative shift in aggregate supply.
Price level will go up from P_1 to P_2, & level of real output will fall from Y_1 to Y_2.

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Examiner Comments

Diagram 4 and price level rise 2 and fall in output 2. 2 marks for explanation of effect on costs of factors of production.

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Examiner Tip

This diagram is correctly labelled.

Question 1 (a) (iii)

This question seemed to be the most problematic for candidates overall, with a considerable proportion of responses failing to make the explicit link between the pieces of information in the extracts, and their effect on the price level. Many candidates seemed to be unaware that the MPC have an inflation targeting mandate only, and instead focused their answers on what the MPC might do in order to reduce unemployment or increase real GDP, which earned them no credit unless it was linked to the price level. Evaluation seemed to be a challenge for candidates, with many simply evaluating the effectiveness of monetary policy itself to achieve its goals, rather than evaluating the usefulness of the information for the MPC. Although many candidates found this question challenging for the reasons mentioned above, it did discriminate between candidates effectively. Good candidates answered this question well and scored highly.

The role of the MPC is to ~~so~~ keep inflation within the target of 2% ± 1 CPI. This is done by setting interest rates and quantitative easing (the selling of government assets). Eg ~~interest rates are too big~~ inflation is above target the MPC will raise interest ~~rate~~ rates. ~~So~~ The effect this will have is to make borrowing more expensive, as a large number of people in the UK are reliant on mortgages and loans the increase in the price of borrowing will increase the cost of living for people and they will therefore spend less. ~~Sav~~ Saving will also become ~~more beneficial~~ more benificial as people will get a higher return. These factors will ~~p~~ cause AD to fall from AD_1 to AD_2 and therefor inflation will fall from PL_1 to PL_2.

The information provided in extract 1 includes a rise in VAT back to its pre recession rate of 17.5%. This will raise inflation as it will put up the price of all goods and services in the economy. The sharp ~~increase in the value~~ depreciation in the value of Sterling in 2008 will increase inflation as imports ~~from~~ to the UK will become exports ~~to~~ from the UK will become cheaper. The increase in the price of imports will mean that more domestic goods will be consumers as they will be cheaper and the decrease in the price of exports will mean that exports from the UK will increase. This will increase spending in the UK and therefore inflation will rise.

The sharp fall in consumer confidence will reduce inflation as ~~so~~ people will spend less. This will reduce AD and therefore reduce inflation. The reduction in investment spending will also reduce AD as investment is a component of ~~ag~~ aggregate demand. Spare capacity will mean that inflation will fall.

However the increase in ~~the~~ VAT will only have an effect in the short run ~~so~~ It also depends on how much of the VAT increase is passed onto consumers, as if its only a small amount there may be no effect. For these reasons the VAT increase may not be very useful to the MPC when making the decision on interest rates.

It also depends on the price elasticity of demand for ~~[illegible]~~ the UK's domestic goods as if its inelastic there may be no effect on imports. It also depends on the quality of british goods. These factors ~~many~~ mean that the decrease in the value of the Pound may not be useful to the MPC

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Examiner Comments

The first paragraph sets out how the MPC uses interest rates to achieve its target. With that understanding set out the second and third paragraphs achieves 4 marks each.The final two paragraphs on the second page achieve full evaluation marks in the discussions about VAT and price elasticity of demand.

(iii) Assess the usefulness of the information provided in Extracts 1 and 2 and Figure 3 to the MPC when making interest rate decisions.

(12)

Information provide in ~~fogu~~ extract 1 about ~~is~~ increase VAT to 17.5% and rise of over 70% of oil price over last year is quite useful to MPC. Since a increase in VAT will lead to and increase in cost of production for many goods and services thus reducing SRAS It also making goods become more expensive. Thus reducing ~~co~~ consumer purchasing power or their real-disposal income this will lead to ~~a~~ a fall in AD. Both of these change whether reducing SRAS (lead to cost push inflation) or reducing AD (reduce demand pull inflation) having impact on price level. Thus it will be usefull for MPC.

MPC ~~is~~ target is aiming at a stable price level (inflation) maintained at 2% (± 1%) measured by CPI

An other information provided in extract 1 also usefull for MPC is that there was a sharp depriciation of the sterling. Since a depriciation is taking place. It will make UK export become relatively ~~cheaper~~ cheaper than goods in the other ~~contry~~ countries. Thus export will rise. It also make UK imported goods become relatively more expensive. Thus UK imported will fall. This lead to (X − M) rising. Since (X − M) is a component of AD. A rise in (X − M) will lead to an increase in AD and increase in price level.

~~Howe~~ However, the effect of A depriciation could not necessary mean a increase in AD. If PED of imported goods is inelastic and PED of exported goods also inelastic. A depriciation could atualy lead to a higher spending on imported goods and lower receive from export. This could lead to (X - M) increase which lead to a fall in price level.

~~Moreover~~ In evaluation, Extract 1 and 2 and firgue 3 mention about VAT, oil price, exchange rate, unemployment, but ~~it~~ they do not mention the most important factors which is house price. Since about 80% of UK properties is ~~home~~ houseowner, UK consumers is extremely sensitive with a change in house price. Thus whenever house price change. It will lead to significant change in consumer confident and consumption as well as AD and price level. Thus it could be the most important information for MPC

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Examiner Comments

The first and third paragraphs each received 4 marks. Although not explained as clearly it might be, full marks are awarded for evaluation on the second page.

Question 1 (b) (i)

(b) (i) What relationship might be expected between average earnings growth and the unemployment rate?

(6)

As average earnings rise then people start to purchase more goods. ~~a~~ This causes a derived demand for labour as firms hire people to produce the extra goods demanded. This suggests that as average incomes rise unemployment falls.

However this may not be the case, as many people may not want to work in a relatively low income job like manual labour. In this case the demand may be met by hiring imigrants who are willing, this makes no difference on unemployment, only employment.

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Examiner Comments

First paragraph gets all 6 marks.

(b) (i) What relationship might be expected between average earnings growth and the unemployment rate?

(6)

average earnings growth is a measure of how much people earn on average. If average earnings were growing one would expect unemployment to fall as it would suggest people are earning more which could mean people becoming employed. Also if average earnings was growing people who are unemployed would have more of an inscentive to become employed. Also if the ~~ear~~ average earnings ~~is due to~~ growth is due to inflation, the phillips curve would state that unemployment would fall

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Examiner Comments

In the second sentence there are 2 marks for grow of average earnings and a fall in unemployment. A further 2 marks were awarded for the next sentence's explanation of incentive. There was a further 2 marks for reference to the Phillips curve.

Question 1 (b) (ii)

(ii) Is the relationship supported by the data in Figure 2?

(4)

Not fully as unemployment could be quite low and so would inflation. For example, in the year 2000, unemployment rate is about 5% and inflation is about 1%. This would suggest that prices are low and therefore earnings are low but so is unemployment.

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Examiner Comments

2 for relationship and 2 for data.

(ii) Is the relationship supported by the data in Figure 2?

(4)

~~Slightly~~ There is a slight relationship, as in the year 1990 unemployment figures are higher than 2005, ~~also~~ ~~whilst~~ with a higher inflation rate on average of consumer prices. However this pattern is not always followed as in 1980 unemployment levels were similar to 1990 however inflation of average consumer prices was around 11% higher.

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Examiner Comments

Both sentences achieve full marks.

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Examiner Tip

When referring to data make sure you identify the year(s) and the data point(s).

Question 1 (c)

*(c) Assess the extent to which a sharp depreciation of the pound will improve the UK current account of the balance of payments.

(12)

A sharp depreciation of the pound means that the value of the pound has fallen. The current account of the Balance of payments (B of P) is the difference between levels of imports and exports.

Imports to the UK will fall as a result of a fall in the value of the pound because goods and services abroad will become more expensive. This will then lead to more goods and services being bought in the UK that have been produced in the UK due to a fall in level imported.

However, the levels of exports will increase due to people living abroad will be able to afford more with the money they have compared to before there was a sharp depreciation of the pound. An increase in exports will benefit UK manufactures because the demand for their goods and services will increase.

The current account of the balance of payments in the UK will improve to a large extent. This is because the was a large deficit in the current account (imports outnumbered exports by a lot). A fall in ~~export~~ imports and a rise in exports will cause the deficit to be out due to the value of the pound decreasing ~~P~~ It will be more expensive to buy goods from the USA whereas Americans will be able to buy cheaper goods from the UK.

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Examiner Comments

2 marks were awarded for the definition in the first paragraph. Imports in the second and exports in the third would both have received 4 marks but the KAA cap of 8 marks was reached. There was no evaluation.

*(c) Assess the extent to which a sharp depreciation of the pound will improve the UK current account of the balance of payments.

(12)

A sharp depreciation of the pound will improve the UK current account of the balance of payments firstly as ~~if~~ the value of the pound is low, imports will be less attractive as they will be more expensive. The reason being that the amount of foreign currency you could get from the low value of the pound would be less, so imports are more costly. Secondly exports will become cheaper on the international market and therefore become more competitive. This means that exports will rise. As the current ~~of~~ account of the balance of payments is exports minus imports, it should increase. However the uk have a high propensity of imports so the increased price ~~may even~~ with have a smaller effect and may even be inflationary. Also the value of the pound has likely dropped due to the interest rate which is in the midst of seeing whether it should increase again, so the effect will only be short term. Also ~~E~~ the UK cant all of a sudden increase its exports as most will be inelastic of supply, and as many factories and equipment lie idle, investment is first needed.* Overall the drop in the value of the pound will have a positve effect but the extent is minimal. *One another point why the extent will not be as great, is that other countries that the UK trade with are experiancing ~~experiancing~~ a downturn, so demand for the goods the UK is willing to export is lower.

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Examiner Comments

This strong answer achieves full marks easily. Imports 4, exports 4 (KAA 8 max) and definition 2. The evaluation marks reached 4 rapidly but could have been awarded as follows; propensity 4, short run effect of interest rate rise 4, inelasticity of supply 2, and downturn 4.

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Examiner Tip

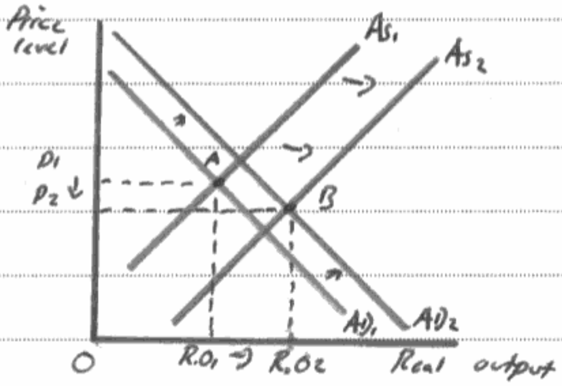
Although this is an excellent answer, using paragraphs communicates ideas far more effectively.

Question 1 (d)

*(d) Discuss the fiscal and supply side policies the UK Government could pursue to reduce the rate of unemployment. Refer to Extract 2 and Figure 3 in your answer.

(30)

Fiscal policies are those which involve a manipulation of government spending to achieve one of its macroeconomic goals. Supply side polices are those which are policies intended to increase the quantity producers are able or willing to supply at any given price level.



One part of fiscal policies could be to reduce government taxation. As a result of this consumption would increase as people have more money to spend. Consumption being the largest part of AD it would cause the AD line to shift from AD1 to AD2. As a result from this, firms would be receiving more money therefore having the ability to employ more people. Consequently the government would reduce the rate of unemployment. However, this does depend on people's marginal propencity to consume. If they would save the additional money gained from tax then it would have no immediate effect.

Another method to shift the AD line from AD1 to AD2 could be if the government enters a fiscal budget deficit. This would result in the stimulation of more jobs in the UK as the government could be spending more than it is taking in. This would ~~encourage~~ result in lowered unemployment therefore reducing the "claimant count" and the increasing the "economically active". However it could have a time lag and pass the brunt of the ~~gov~~ fiscal budget deficit onto future generations. Hopefully though, unemployment could fall below the "7%" figure of "unemployed for over a year" as shown in ~~extract~~ Figure 3.

A supply side policy the government could use could be to increase incentives for firms and workers, in a hope to increase AS from AS1 to AS2. With youth unemployment hitting "20%" this would cut the corporation tax that the government imposes. As a result it would be able to employ more people so increasing employment rates in the country, thus proving the rates of unemployment to be reduced from the 7% figure it stands at currently. However the firms may not employ more people if coorporation tax is cut, and may instead invest it in new technology or machinery, thus keeping the unemployment rates the same, or potentialy, further contributing to "Economicly Inactive" remaining the same or worsening. However, as a result the AS line would increase.

Another policy of Supply Side policies could be to improve ~~competition~~ price flexability and signalling. In doing this, the government could fail to increase the minimum wage above inflation. This would mean that firms could employ more staff for less, thus resulting in a reduction in unemployment, so therefore causing a reduction in unemployment. However, this may not be the case sometimes as firms may not want to employ more people and instead save the money or invest it elsewhere, therefore leading to a failing in the supply side policy.

One policy that may infact be detremental to unemployment rates could be improving competition. By deregulating, the government would aim to increase real output from R.O1 to R.O2 due to increase in competitiveness, forcing the firms to become more efficiant. However, this may force the firms to lay people off as they might switch to machinery to improve efficiency, so contrary the governments aim. However it may infact cause the claimant count to "fall below 1.59m" as it may encourage the firm to employ more staff, so reducing unemployment rates of 7% - Figure 3.

In conclusion, Fiscal Policies can be used to directly alter the consumption, so resulting in more revenue for firms, therefore leading to more employment. This trend is further continued through the increasing incentives, aiming to encourage more employment through lower taxes.

However these cases may not be true if instead firms pass on this savings not to ~~employment~~ but instead to investing in machinery, so resulting in a failure of the policies.

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Examiner Comments

This is not such a strong answer but it does achieve full marks despite some weaknesses.

tar to? ~~whe~~ ↓T → ↑ disposable → ↑AD → derived demand → demand deficient unemp

*(d) Discuss the fiscal and supply side policies the UK Government could pursue to reduce the rate of unemployment. Refer to Extract 2 and Figure 3 in your answer.

M-Multiplier.

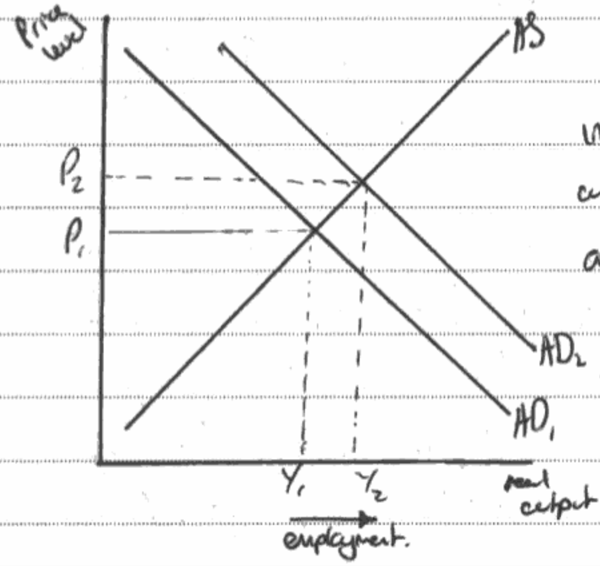
(30)

Supply side policies are government policies that aim to shift aggregate supply right to increase real output. Unemployment is people who are out of work and actively seeking work.

Fiscal policies involve Government spending and taxation. If the government were to increase ~~gov~~ spending on education ~~then~~ and training ~~to~~ current workers for different jobs. Then this will mean that the qualifications the recieve will improve and they will be able to get better jobs. This means that structural unemployment will fall as occupational immobility will ~~occurs~~ fall due to better qualifications

However, with increase in government spending comes an opportunity cost. This means that the money could be spent elsewhere such as health care in order to improve the health of people and reduce the number of unemployed. It will also mean that the government spending is not sustainable as it will result in an increase in taxation in the future which will increase production costs and will result in unemployment. Not only this but ther will be a time lag on the education as it will take several years for the education to pass through.

The other side of fiscal policy is taxation. If the government reduce taxes such as income tax then this will mean that consumers will have more disposable income. This will result in an increase in consumer spending so therefore ~~aggregate~~ aggregate demand will rise. Firms will require more labour to produce the ~~increase in~~ cope with the increase in demand therefore the derived demand for labour will increase and demand side unemployment will fall. This will ~~not~~ decrease unemployment in the short term as shown in extract 2 where ILO unemployment fell by "33,000 to 2.45 million people" in March 2010. This is due to an increase in demand as we came out of a recession.

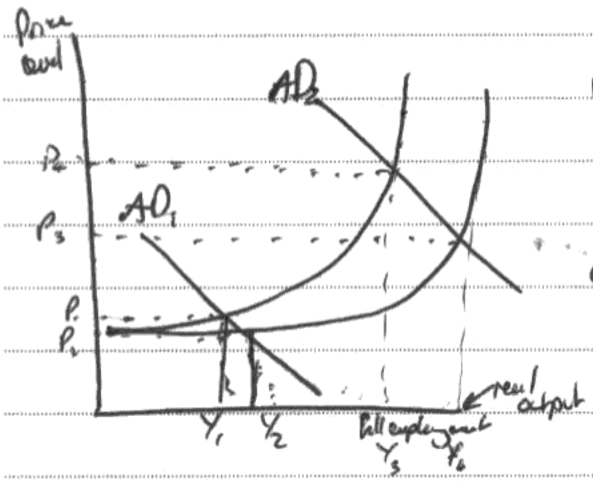


The graph shows how the increase in AD will mean that output increases from Y_1 to Y_2 and this increase is the result of a decrease in unemployment.

The extent ~~to~~ which the reduction in tax results in ~~an~~ a decrease in unemployment will be down to the multiplier effect. this equals $\frac{1}{MPW}$. The marginal propensity to withdraw will decrease as a result of the reduction in tax meaning that the multiplier will be relatively large as less will leak out.

Supply side policies can be put in place to reduce unemployment. If the government use legislation to reduce the power of the trade unions then this means that wages can fall and costs of production to firms will decrease. As a result the workers will not price themselves out of work by trade unions demanding higher wages and therefore more will be employed and real wage unemployment will fall. The decrease in costs of production will fall will mean that AS can shift right in the long run as productivity will increase. Therefore unemployment will also fall in the long term

However, the ~~decr~~ increase in long run aggregate supply could be rendered useless depending on where the UK economy is in the business cycle and therefore ~~the~~ the extent to which unemployment falls will change. For example if the UK is in a recession and the supply side policy is put in place (AD_1) then it will have little effect on unemployment as there is very little change in real output (Y_1 to Y_2)



However if it is put in place at AD_2, in a boom, the real output increases by alot meaning that so does employment, from Y_3 to Y_4. This means that the extent to how the supply side policy reduces unemployment depends on where we are in the business cycle.

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Examiner Comments

This is an excellent answer that easily achieves full marks.

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Examiner Tip

The best answers evaluate throughout. Note that this answer is also well structured and makes good use of paragraphs.

Question 2ai

(a) (i) With reference to Figure 1, explain the term "rate of interest".

(4)

'Rate of interest' - it is the rate of Bank of England, that can decide to change the rate of interest in order to have an impact on AD, it can be ~~done~~ with using monetary policy. It will change AD, because of changes in its components such as C, I, because of changes in interest rates.

According to Figure 1, in the UK in February 2001 was 5.5%, in 7 years it changed with fluctu-ations, but in the end of 2007 it is decreased due to ec. recession to 0.5%

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Examiner Comments

Bank of England 2 and data 2.

(a) (i) With reference to Figure 1, explain the term "rate of interest".

(4)

Rate of interest is the amount of extra income you will recieve from saving. Or the extra % you will pay on a loan. From the data in figure 1 you can see that between Feb 2001 and Oct 2010 interest rates have fallen by over 5%

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Examiner Comments

2 for definition and 2 for data.

Question 2 (a) (ii)

(ii) Explain how a change in interest rates might affect the level of investment.

(6)

If interest rates fall, investment is likely to increase; lower interest rates means the value of the loan used for the investment won't increase by too much. However if interest rates rise, firms are unlikely to invest because the loan will increase in value by more each month, thus will be more costly to the firm to pay back, which may decrease profits, or will take longer to pay back, meaning the firm can't benefit from the investment as much.

As interest rates fell between December 2008 and March 2009, many more firms will have increased investment to benefit from the low interest rates on any loan they took out.

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4 marks for the explanation of the effect on investment of a high cost of borrowing.

(ii) Explain how a change in interest rates might affect the level of investment.

(6)

Interest rates can have considerable influences in many components ~~of~~ especially investment. Investments may require a lot of time gaining the capital from a bank. The interest rate is the cost of borrowing that money and if interest rates are low, in theory more investment should be made as it is cheaper to borrow the money. However, in reality if interest rates are low it's because the economy is in recession or showing little growth meaning the demand isn't there for businesses to consider expansion. If interest rates are too high it can have the same affect as people can't afford the investment and demand for borrowing decreases, ~~p~~ people are unemployed and the economy can spiral into recession. Interest rates are not demand inelastic and it's setting the interest rates at the peak demand which will have the greatest, positive effect on investment

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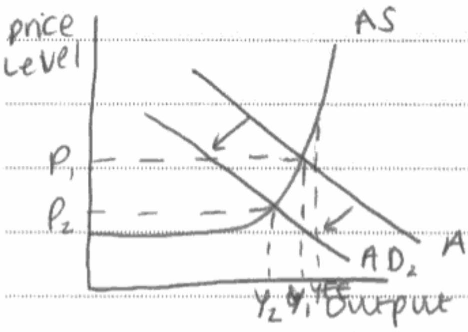
Low interest rates increase investment received 4 marks and the effects of the recession makes a total of 6 marks.

Question 2 (a) (iii)

(iii) With reference to Figure 2, assess the likely impact of a fall in house prices on the economy.

(12)

House prices are a good way of indicating the strength of the economy at a given time. As we can see from figure 2, house prices fell dramatically between April 2008 and January 2009, reaching almost −20%. A house is an expensive asset, and ~~oft~~ consumer confidence depends very much on how much their assets are worth. If a house price becomes lower than the mortgage taken out originally to pay for the house then there is said to be negative equity. This leads to a significant loss of consumer confidence over the economy which may have effects on level of consumer spending. If consumer spending was to decrease then firms will receive less revenue and eventually may lead to an increase in unemployment, as shown by the shift of ~~AD~~ the aggregate demand curve from AD_1 to AD_2



Due to this decrease in aggregate demand, ~~there~~ a decrease in price level is shown also, ~~furthe~~ emphasising the effect of a decrease in revenue received by firms. There may also be multiplier effects to consider, as ~~one~~ unemployment increases spending will decrease which eventually could lead to a further increase in unemployment. However, this multiplier effect would be restricted by the increase in government spending due to an increased demand for unemployment benefits.

There are, however time lags to consider in these situations; employers will not increase unemployment immediately after a fall in house prices, this effect may not take place until a year or more after ~~house~~ house prices began to fall.

~~However~~ Also, there are other factors in aggregate demand, for example exports that may weaken the effect of a decrease in house prices. If ~~there~~ there was a high demand for exports then unemployment would not suffer so significantly because there would still be a demand for labour.

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Examiner Comments

Data 2. Negative wealth effect received the benefit of the doubt 2 and the fall in consumer confidence, AD and output (in diagram) means this answer reaches the maximum KAA of 8 marks. Then follows several evaluation points including ones on time lags and exports, each of which would have achieved 4 marks.

(iii) With reference to Figure 2, assess the likely impact of a fall in house prices on the economy.

(12)

A fall in house prices will lead to a detoriation in the economy. This is because of wealth effect, because house prices fell by nearly 20% in January 2009 (figure 2) people perceived wealth was lowered. A reaction to this would be to lower consumption, which will AD because it's a component of AD, ~~however~~ however this will be dependant on the confidence within the economy. Confidence would have been low in this case because of the global recession, this means consumption will fall by a large amount.

The fall ~~debt~~ in house prices will also lead to a detoriation of housing market, meaning less ~~[illegible]~~ trade in this Sector. This is also part of consumption and will lower AD again. On the other hand this will not happen Straight away because it takes time for indicators to get out into the market.

Another effect of the fall in house prices is that not as much will be able to be borrowed on houses or property, ~~This~~ this means lowered investment and a shift to left for AS. This is because a certain level of investment is needed to maintain AS in its current position. This again shows a contraction in the economy.

Another effect it will have is to increase debt because of the steep increase in house prices in July 2007 (10%) people who bought a house then might be living in negative equity. This means ~~the~~ less disposable income if these people would move house again. This also links to first effect mentioned (perceived lower wealth).

This worst effect for the people is living negative equity; however the worst effect for the economy is lowered consumption. This is ~~to~~ largely because of the negative multiplier effect, a change in income will have a more than proportionate change in output.

ResultsPlus

Examiner Comments

Data 2. Was given benefit of the doubt on the negative wealth effect (2) and also for consumption and AD (4) which reaches the 8 mark the maximum for KAA. 4 marks for evaluation is achieved in the last part of the final sentence of the first paragraph. 2 marks could have been awarded for negative equity and a further 2 evaluation marks for the negative multiplier effect.

Question 2 (b) (i)

(b) (i) With reference to Figure 3, explain **two** factors that could influence the level of household saving.

(6)

You can see in 1992 saving was at 12% compared to just 0% in 2007.
Household saving is dependent on a few factors such as the security of jobs. People are much more likely to save if they are in doubt of having a job in the future.
A second factor is interest rates. People are more likely to save when there are higher interest rates as they receive a greater benefit.

ResultsPlus

Examiner Comments

Data 2, job security 2 and high interest rates 2.

(b) (i) With reference to Figure 3, explain **two** factors that could influence the level of household saving.

(6)

One factor that could influence the % of household savings, such as an increase from around 7% in 1991 to 12% in 1992 is an increase in interest rates. As they will get a higher return for their money due to higher interest rates their marginal propensity to save will increase meaning more people will save.

A second factor that could influence levels of saving is job security. Such as in 2008 - 2009 when there is a recession and job security is lower there was a huge increase in the % of income saved from 1% to 9%. As people are uncertian for the future they will save more for financial security in case of job loss.

ResultsPlus

Examiner Comments

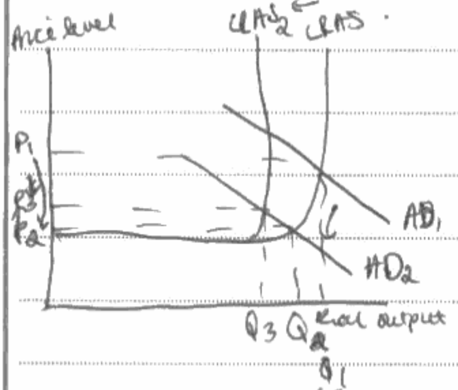
Data 2, high interest rates 3 and job security 2. Maximum 6.

Question 2 (b) (ii)

(ii) Using aggregate demand and aggregate supply analysis, explain the likely impact on the equilibrium price level and the level of real output of an increase in the savings ratio. Refer to Figure 3 in your answer.

(10)

$AD = C + I + G + (X - M)$.



An increase in savings is an increase in withdrawals from the circular flow. As it is a withdrawal, it leads to a decrease in consumption in the economy due the opportunity cost involved, and a contraction within the economy (negative multiplier effect). In 1992, when saving was at its highest at 12.2%, there will have been a sharp decrease in consumption. this will have lead to a fall in aggregate demand (consumption is a component of aggregate demand) and therefore a shift from AD_1 to AD_2. There is therefore a fall in price level (P_1 to P_2) add a fall in real output (Q_1 to Q_2) as firms receive less revenue due to the fall in consumption, and production costs are relatively high. This therefore results in an increase in unemployment (a method for a firm to cut costs) and ~~therefore~~ production reduces, productive capacity falls and output falls. A rise in unemployment means that people are likely to save more due to their uncertainty for the future and low income, and consumption and investment fall even further, causing LRAS to shift to $LRAS_2$. This causes prices for firms to rise, resulting in the multiplier effect magnifying the situation. ~~The~~ (as seen in late 1992 when % of household disposable income saving increases again) to deal with this the government may have to implement a demand or supply side policy to help encourage people to spend, or increase the level of competition and supply of labour within the market.

The extent to which AD and AS are affected also depends on the level of exports and imports (balance of payments on the current account), as, with the UK, this is ~~expo~~ import led and therefore negative. If AD falls dramatically, the firms feel the effect more as they still have to import raw materials of production. This means that costs remain high and depending on the level of exchange rate, may be a great expenditure to a firm and decrease output even more. If the exchange rate is ~~[illegible]~~ low and the rate of sterling is low, global competitiveness is increased yet cost of imports is higher - this resulting in greater national debt due to borrowing to pay for these materials and a higher interest rate as a way of helping pay off the increasing national debt (this does however depend on the interest rate before this time). If high debt is accumulated, ~~[illegible]~~ unemployment levels increase further and output decreases respectively - price levels rise and a recession occurs.

ResultsPlus

Examiner Comments

This answer easily achieves full marks.

ResultsPlus

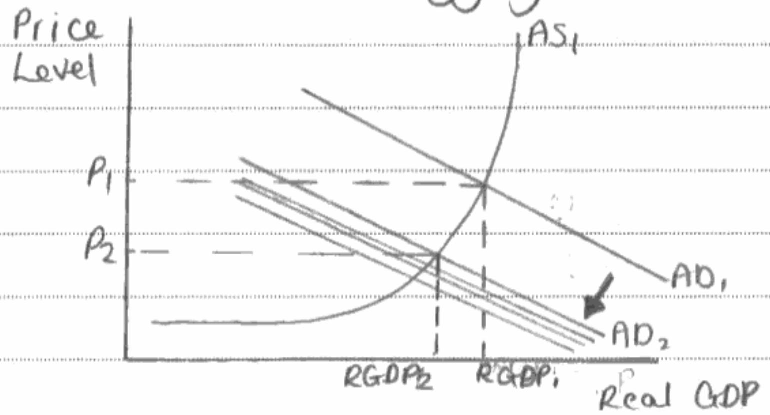
Examiner Tip

Note this graph is accurately labelled but it would have benefited from the use of a ruler.

(ii) Using aggregate demand and aggregate supply analysis, explain the likely impact on the equilibrium price level and the level of real output of an increase in the savings ratio. Refer to Figure 3 in your answer.

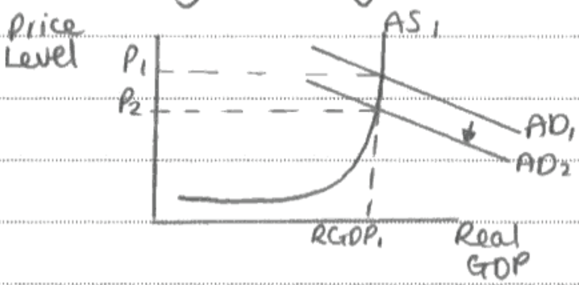
(10)

An increase in savings ratio is seen as an ~~inj~~ leakage from the circular flow, as money is taken out of the economy. ~~When~~ When savings are high, such as in the 1990s (figure 3) consumer expenditure often falls as a consequence. Consumer spending is ~~par~~ a component of aggregate demand, if it decreased it would cause a decrease in aggregate demand.

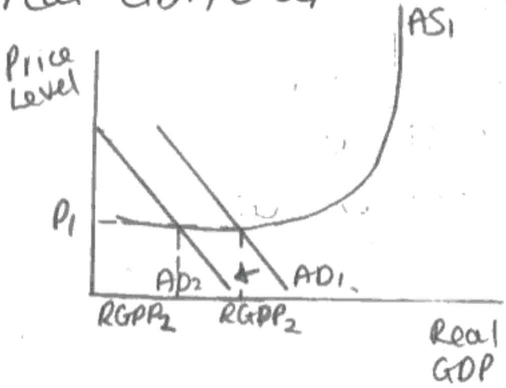


The diagram above shows that this will decrease the price level and Real GDP/output of the economy. This fall in price and real output may also be magnified by the multiplier effect, shown on the diagram above as the additional decrease of AD below AD2.

The effect on price level and real output depends on where aggregate demand and Supply meet. For example if aggregate demand intersect aggregate Supply at full capacity, a decrease in aggregate demand will only change the price level.



Whereas when aggregate demand intersects ~~the~~ aggregate supply at spare capacity, the price level will remain ~~cont~~ constant but real GDP/output will decrease.



ResultsPlus

Examiner Comments

Full marks are efficiently achieved on the first page in this answer.

Question 2 (b) (iii)

*(iii) With reference to Figure 4, discuss **two** factors that might enable a country, such as China, to achieve a rapid rate of economic growth.

(12)

Economic growth is an increase in GDP figures.
In China, rapid economic growth could be achieved through export-led growth. China can export many consumer durables like washing machines to Europe. Thus firms would increase investment to increase exports. ~~The~~ The increase in investment could cause economic growth as it's increasing the productive capacity of the economy. The extent of growth achieved would depend on the exchange rate; a depreciation in the exchange rate would decrease the ~~costs~~ price of their exports, thus increasing demand. This depends on the PED for exports - assuming PED is elastic ~~the~~ China's exports would increase and growth would be achieved.
Figure 4 shows a predicted fall in real GDP for 2010. This could be avoided and GDP could increase if the government increased spending on education and training. This would increase the human capital of the economy as workers would be better skilled; thus AS would shift outwards. Additionally this could ~~then~~ also cause an increase in investment. This depends on the size of the rise investment because this would be the short term factor. There would be a time lag before the benefits of the trained workforce contributed to economic growth. Therefore it's the rise in investment due to anticipated future benefits of more efficient workers that would cause a rapid rate of ~~economic~~ economic

growth.
In conclusion, ~~export~~ export-led growth would be the ~~to~~ most efficient way of achieving a rapid rate of economic growth particularly if China had lots of spare stock.

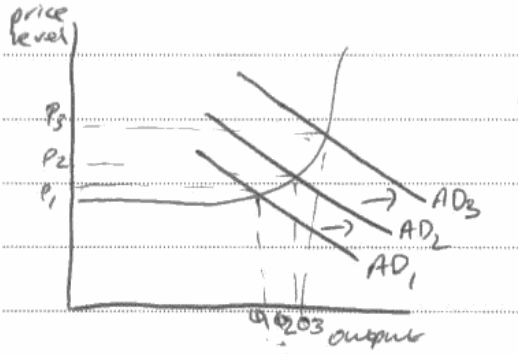
ResultsPlus
Examiner Comments

The benefit of the doubt was given to the output definition as real GDP was referred to half way down the page (2). Export-led received 4 marks and there were 4 evaluation marks for the exchange rate point. There would have been a further 4 evaluation marks for the price elasticity of demand section but the maximum for evaluation had been achieved. The data reference was wrong as there was no fall in real GDP. Similarly there would have been 4 for the investment section and 2 evaluation marks for the time lag point, however the maximum had been achieved.

*(iii) With reference to Figure 4, discuss **two** factors that might enable a country, such as China, to achieve a rapid rate of economic growth.

(12)

Figure 4 shows that real GDP growth rates increased from 2003 to 2008 and after this they started to fall to a prediction of GDP growth rates being just under 9% in 2010. A country can increase it's rate of economic growth by increasing



government spending which will increase aggregate demand from AD_1 to AD_2. Due to the multiplier this may increase from AD_2 to AD_3.

The more the government spends, i.e. the greater the injections, the bigger the multiplier will be. If government spending increases, this will mean more money circulating the economy and an increase in an element of aggregate demand will increase economic growth. However, ~~the go~~ this depends on how much the government can afford to spend. The government may have to increase tax revenue to fund ~~the~~ the increase in spending or increase their government budget deficit. There may also be an opportunity cost of where the government can't spend money in the future due ~~to~~ this increase in spending.

Secondly, economic growth can increase by increasing investment which is the largest contributor to economic growth. If firms increase investment, this will increase aggregate demand from AD_1 to AD_2 and due to the multiplier it may increase further to AD_3. An increase in investment means that firms will increase the productive capacity of the economy. There will be an increase in GDP, as shown by Figure 2 in the first half of the graph, which is an increase in the economic activity carried out in an economy in a given period.

However, this depends on how much firms can afford to invest by. If they can afford to invest a lot then the rate of economic growth will be higher compared to if they cannot afford to do so. This depends on whether firms invest from ~~p~~ profit made in the past or by borrowing. Therefore, the increase in the rate of economic growth depends on the magnitude of investment firms can afford to undertake.

Therefore, the rate depends on how much aggregate demand increases by.

ResultsPlus

Examiner Comments

The maximum of 8 marks for KAA is achieved through 4 for definition and data and another 4 for government spending. There would have been 2 for the diagram and 2 for the multiplier had the maximum not been achieved. 4 for evaluation is obtained through the taxation and future opportunity cost points (max. 12).

ResultsPlus

Examiner Tip

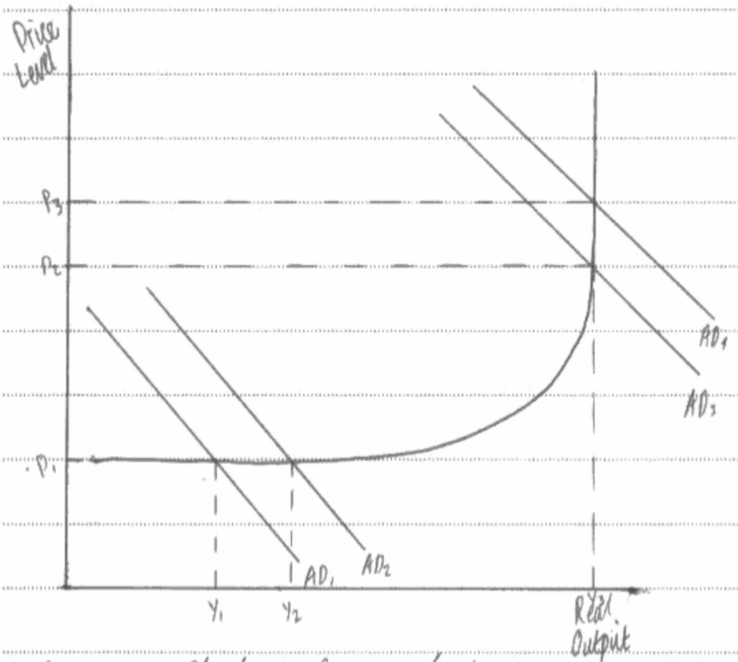
The investment point would have received 4 and there would have been 2 marks for the evaluation of magnitude.

Question 2 (c)

*(c) To what extent might rapid economic growth conflict with at least **two** other macroeconomic objectives?

(30)

Economic growth is the percentage rate of increase of real GDP so the value of goods & services are at constant prices so no effects of inflation.



Economic growth means that there is an increase in real output. However economic growth does conflict with other macroeconomic objectives.

One conflict ~~of~~ is between ~~economic growth~~ steady and sustained economic growth and concern for the environment. An increase in economic growth means that more is being produced and this causes an increase in environmental degradation, as there is an increase in pollution due to the industries and the materials that are used.

One way this can be avoided is taxation or regulation of pollution. If an industries goes over the polluting limit then ~~they~~ the firms will be taxed. ~~However~~ This means that the polluter pays and it punishes the major polluters and encourages firms to invest in cleaner technology. However there is the cost to the government of monitoring pollution and making sure firms are penalised when they exceed the limit. Also it is ~~deffic~~ difficult to measure pollution and put a monetary value on it. This means that firms may be over-taxed causing an increase in illegal activity or under-taxed meaning firms won't stop polluting if they are only fined a small amount.

Another conflict is between ~~economic growth and~~ steady and sustained growth and low and stable inflation. An increase in economic growth means an increase in inflation so the benefits of growth are cancelled out by the costs of inflation.

One way this can be avoided is by improving supply side performance as this will increase ~~in~~ LRAS but it is non-inflationary. However it also depends on where the economy is operating. If the economy is not at its full potential and ~~aggregate~~ aggregate demand were to increase from AD_1 to AD_2, this would cause large economic growth from Y_1 to Y_2 but there would be no increase in inflation. However if the economy is working at its full potential and ~~AD~~ aggregate demand increased from AD_3 to AD_4, this would mean that there was no economic growth but just an increase in the price level from P_2 to P_3 and so an increase in inflation.

Another conflict would be between steady and sustained growth and the balance of payments equilibrium. An increase in growth mean an increase in imports as the UK have a high marginal propensity to ~~con~~ import. So we spend a large proportion of a change in income on imports. Therefore this will cause an increasing trade deficit as we are importing more than we are exporting.

One way this can be avoided is by improving the competitiveness of UK exports so making them better quality and priced relative to foreign goods and so an increase in net exports.

Another way would be to introduce trade barriers so tariffs (a tax on imports) and quotas (a limit on the quantity of imports). This would cause a decrease in imports and so improving the current account deficit. However it also depends on the PED (price elasticity of demand) of imports. If they are very inelastic, a ~~tax~~ tariff or a quota may not lead to a huge reduction in the buying of imports so would continue to worsen the current account deficit.

Overall rapid economic growth conflicts with a lot of the other macroeconomic objectives so the benefits to the economy caused by economic growth will be cancelled out by the costs to the economy of other macroeconomic objectives, which are impacted by high growth.

ResultsPlus
Examiner Comments

A very good answer that easily earns 6 marks for the objectives and diagram part of KAA, despite not labelling the AS curve in the diagram. The marks were generated as follows: Environment 4 with 6 evaluation marks, inflation 4 with 4 evaluation marks and the balance of payments 4 with 6 evaluation marks. With KAA of 18 this question also easily reached 12 evaluation marks and achieved full marks.

ResultsPlus
Examiner Tip

This response was efficiently laid out. It uses paragraphs effectively to guide the reader and evaluates throughout the answer.

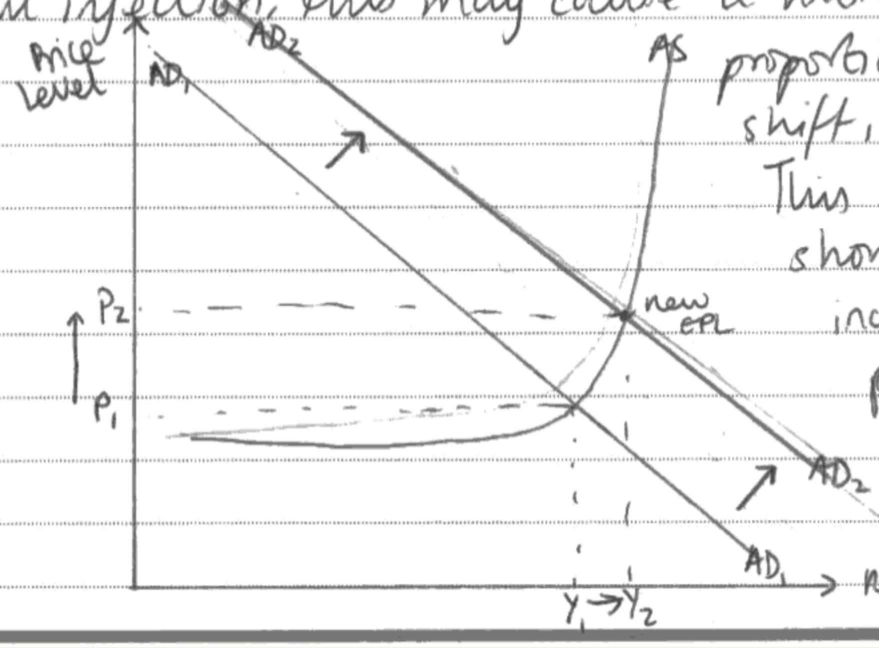
*(c) To what extent might rapid economic growth conflict with at least **two** other macroeconomic objectives?

(30)

Economic growth is an increase in the level of GDP in an economy. It is one of the government's six ~~obj~~ macroeconomic objectives. The other objectives include; low inflation, low unemployment, equity, control on green issues, and a balance of the balance of payments.

Economic growth may conflict with a balance of the balance of payments. Within the UK, ~~goods~~ consumers have a high probensity to import. Rapid economic growth will lead to higher living standards and therefore there is higher demand for goods by consumers. As many goods and services are imports, this will disrupt the balance of the Balance of Payments. Higher imports will lead to a trade deficit as more is being paid out of the economy (withdrawal) and less is proportionally coming into the circular flow. Therefore economic growth can lead to a ~~defi~~ trade deficit. However, if growth is export led growth, such as in China or India, then there will not be the same effect on the Balance of Payments. If exports are high and then imports increase as a result of economic growth then this may actually lead to a more balanced Balance of Payments.

Economic growth may also conflict with inflation. As the economy grows, living standards are likely to increase and as a result consumption will increase. Moreover, the economy becomes more attractive and therefore one may be more likely to invest in the economy. Therefore Aggregate demand may increase. Moreover, due to the multiplier effect, ~~this may~~ on from investment, an injection, this may cause a more than proportional shift in AD. This diagram shows an increase in price level from P_1 to P_2.



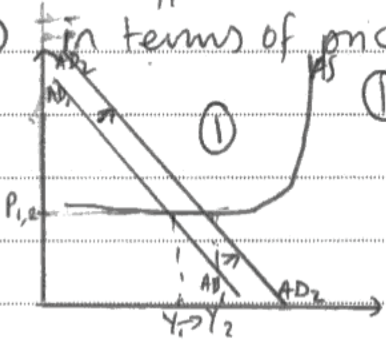
Economic growth also can conflict with green issues. As an economy grows, living standards increase and therefore one is more likely to have more disposable income to spend on travel, holidays and cars which result in high levels of pollution. Moreover, economic growth results in growing sectors within the economy which would lead to building of new factories and increasing carbon emissions. In addition, if consumers have more disposable income they are more likely to spend more on gas and oil and other finite resources, worsening the green house effect.

However, higher economic growth, leading to higher spending means that the government are likely to recieve more money through taxation, moreover they ~~are~~ will need to spend less on government spending to boost the economy as the economy is already growing and they can therefore invest more on programmes addressing green issues such as recycling or hybrid cars.

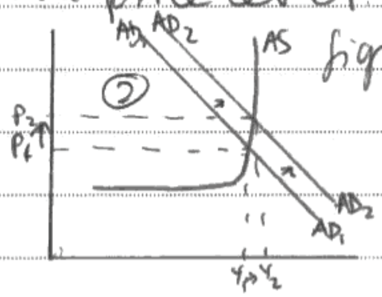
Moreover, one must consider the magnitude of the economic growth. If the growth is large then it will have a greater effect on the economy and on the other macroeconomic objectives then if it is small.

Also, one must consider the size of the multiplier when looking at the effect of economic growth. If the multiplier is large there will a greater impact than if it is small.

Futhermore, one must consider, when looking at inflation especially, the elasticity of the supply curve. If supply is ~~in~~elastic, there will be little effect on a rightward shift of AD in terms of price level as seen in diagram



① However, if supply is inelastic, there will be a greater effect on the price level. As seen in figure ②



Therefore overall economic growth can conflict to quite a large extent with other macroeconic objectives.

ResultsPlus
Examiner Comments

The entrant correctly identifies at least one objective and the diagram is well labelled which generates 6 marks. Each of the conflicting objectives mentioned (balance of payments deficit reduction, stable inflation and protection of the environment) each earned 4 marks and 4 evaluation marks. The 4 inflation evaluation marks were on the final page.

Paper Summary

There was an 11:9 split in favour of answering Question 1, which suggests the questions were similarly popular. Both questions had the same mean scores to the nearest whole mark. Questions 2aiii and 2biii were relatively straight-forward questions and gave candidates the opportunity to display their skills. Although many found 1aiii challenging for the reasons mentioned in this report, the question descriminated effectively between candidates, as some entrants answered this question well and scored highly. Question 1c had a marginally higher mean than 2aiii or 2biii offsetting the effect of 1aiii. There were many excellent answers to the 30 mark essays in both questions. Most entrants showed considerable awareness of the current state of the economy and some were truly outstanding in using this information to help them evaluate. This real interest in the economy was evident in many papers, and was easy to credit within the flexible mark scheme.

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