Examiners' Report
June 2019

GCE Economics 9EC0 02

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Introduction

This is the third exam in the 2015 Specification series. The focus of this exam is on macroeconomics, themes 2 and 4 of the specification. Candidates' answers to the questions on this paper have generally been of an expected standard. All questions were accessible to the candidates, although inevitably candidates were scoring more highly on some than on others.

In Section A the majority of candidates answered the multiple-choice questions correctly and there does seem to have been an improvement in candidates' understanding of how to answer these types of questions. There was an improvement in candidates' understanding of quantitative skills in questions 1(b) and 4(b). In general there were a lot of good and accurate answers to the 2-mark questions in this section. The main issues occurred when candidates didn't answer the precise question set - for example talking about income inequality instead of wealth inequality in question 5. Whilst overall there seemed to be an improvement in candidates' time management, candidates should still ensure they are using their time efficiently in this section and not spending time writing things that aren't going to get any marks, for example rewriting the question or including application when it hasn't been asked for.

In Section B it is important that candidates read the question carefully and ensure they are answering the precise question set. For example question 6(c) asks for the impact on happiness, but a lot of candidates explained the likely impact on the macroeconomy – for example drawing AD/AS diagrams and discussing how it might lead to less economic growth. High quality answers to these questions were ones that clearly analysed the issues and applied them to real-world contexts, either using information from the case study or their own knowledge.

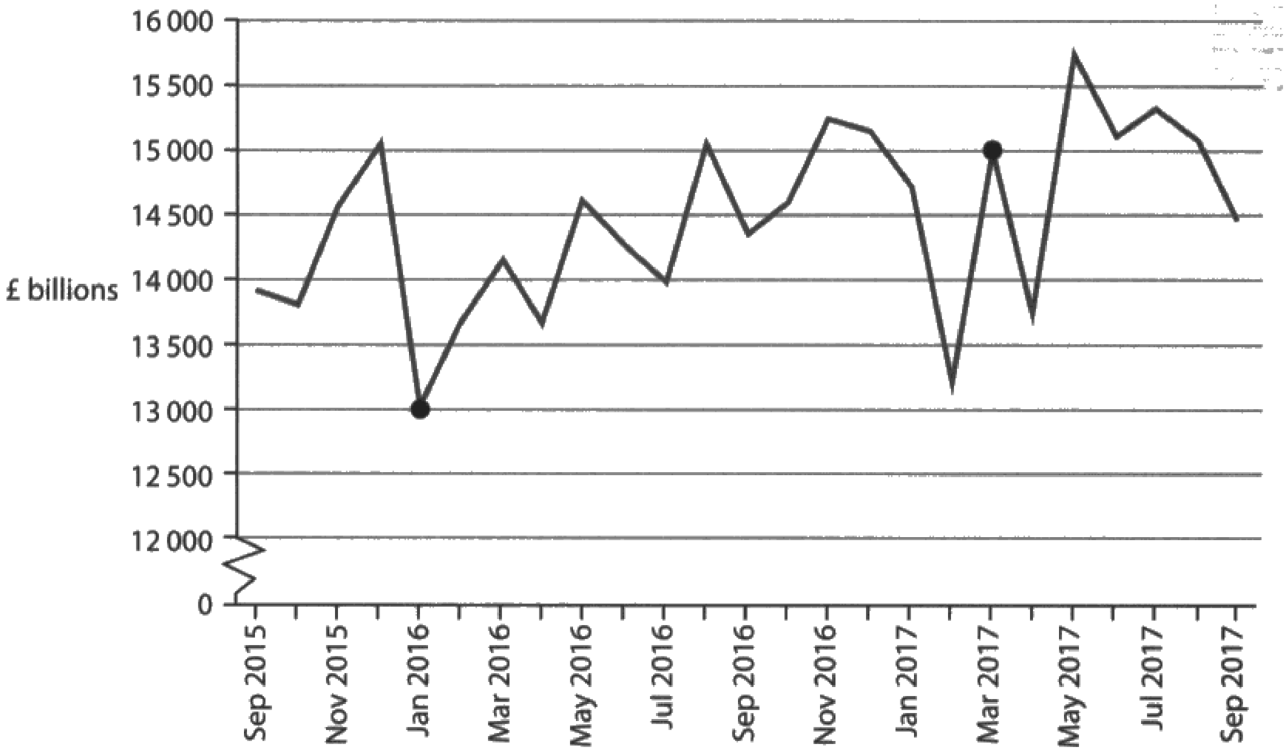
In all questions it is important for candidates to remember that when a question includes the words 'with reference to...' then candidates should actually refer to whatever they have been asked to. In shorter questions there are discrete marks for application and in levels-based questions, examiners are looking for context to enhance the answer and move it into the higher KAA levels. A common issue when marking candidates' answers was a lack of application – answers should not be entirely theoretical and should be placed within the context of the real economy of the world or particular countries and regions.

For Section C where the candidates have a choice of which question to answer, it was almost exactly 50% of candidates who answered each question. In both questions success could be found by demonstrating clearly the skills of analysis, evaluation, and application. Candidates need to ensure they go beyond simply stating issues and justify their points, as well as backing them up with application. It is also vital that candidates ensure they answer the precise question they have been set - which was a particular issue with question 7. Many candidates elected to discuss the benefits and downsides for a country's economy of joining a trading bloc instead of the impact on trading patterns. This severely limited candidates' ability to access the higher levels.

Question 1 (b)

This question required a simple calculation of the index number. There seemed to be an improvement in candidates' understanding of index numbers compared to previous exam papers. The main problem candidates found was in selecting the wrong initial data from the figure - something that is worth practising.

1 Monthly additions to UK credit card lending, £ billions, 2015 – 2017



(Source: https://www.ukfinance.org.uk/statistics/cards/)

(b) Using the chart, calculate an index number for additions to credit card lending in March 2017, using January 2016 as the base. You are advised to show your working.

(2)

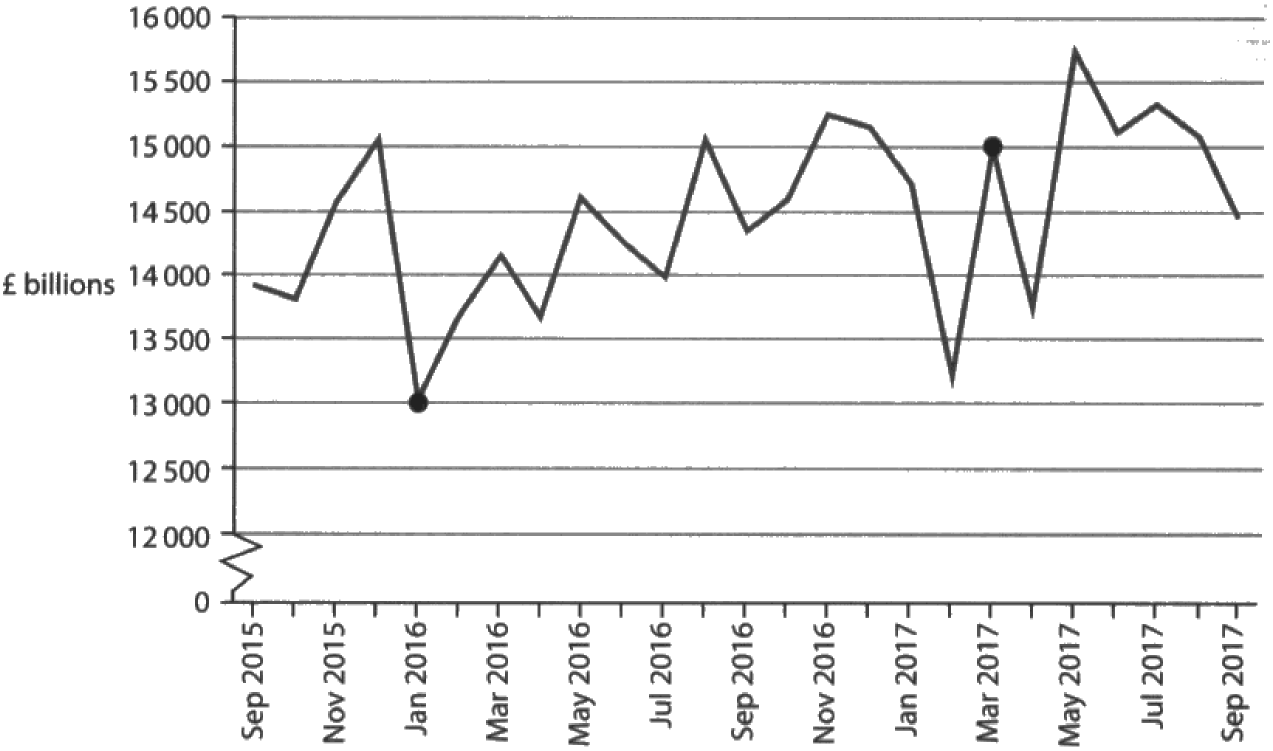
13,000 billion = 100
15,000 billion = ?

~~13.333% increase so index number = 113~~
15.4% increase
∴ ~~intex~~ index number = 115.4

ResultsPlus
Examiner Comments

This answer scores full marks having correctly calculated the index number to be 115.4

1 Monthly additions to UK credit card lending, £ billions, 2015 – 2017



(Source: https://www.ukfinance.org.uk/statistics/cards/)

(b) Using the chart, calculate an index number for additions to credit card lending in March 2017, using January 2016 as the base. You are advised to show your working.

(2)

13,000 - January 2016

15,000 - March 2017

~~13,000 100%~~

~~$\frac{13000}{100}$ 130~~

~~130 x 15000 = 1,950,000~~

~~$\frac{1950000}{100}$ = 19,500~~

~~13000~~ -

15000 - 13000

= 2000

(2000 ÷ 13000) x 100

= 15.38

~~100~~ → 15.38

~~= 115.38~~

ResultsPlus
Examiner Comments

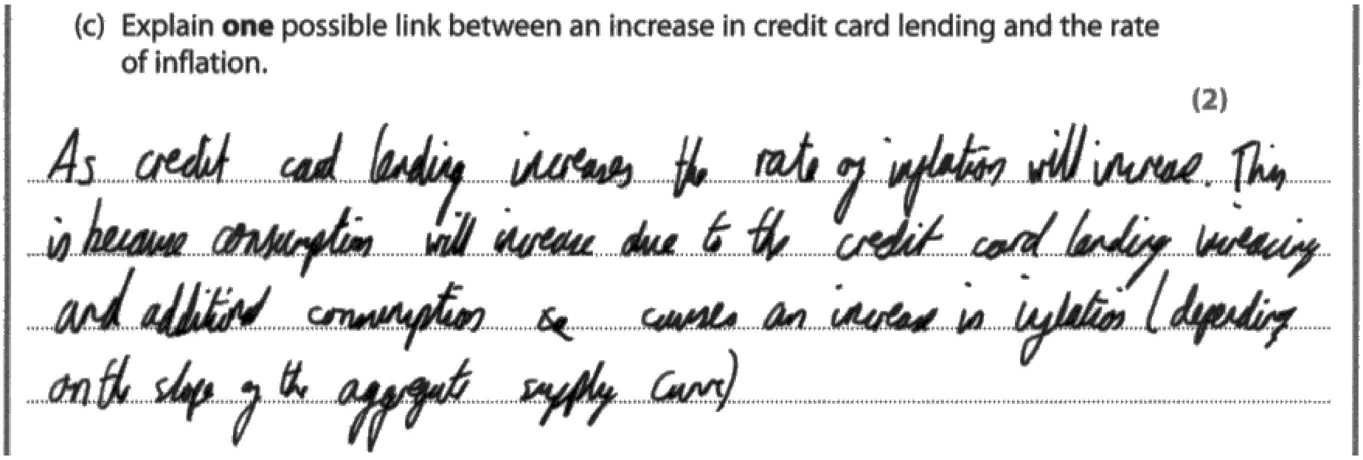
This answer scores 1/2 marks as the two correct pieces of data have been identified from the figure but the calculation is not correct.

ResultsPlus
Examiner Tip

Ensure you know key formulas such as how to calculate an index number from data.

Question 1 (c)

In this question there is 1 mark for knowledge and 1 for application. The knowledge mark comes from identifying that inflation is likely to increase and the second mark for illustrating where this comes from, e.g. from an increase in consumption/AD.



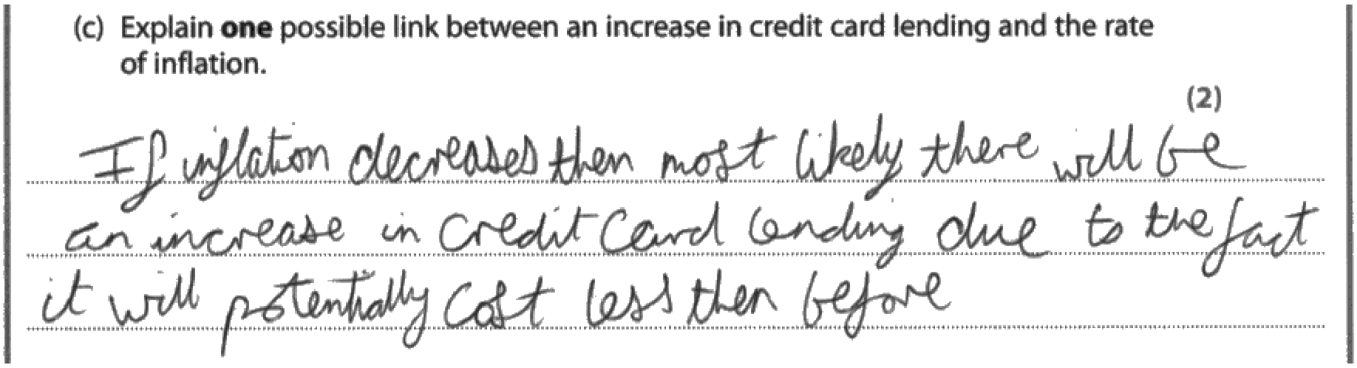
(c) Explain **one** possible link between an increase in credit card lending and the rate of inflation.

(2)

As credit card lending increases the rate of inflation will increase. This is because consumption will increase due to the credit card lending increasing and additional consumption & causes an increase in inflation (depending on the slope of the aggregate supply curve)

ResultsPlus
Examiner Comments

This answer achieves the full 2 marks. 1 mark for 'rate of inflation will increase'. 1 mark for making the link from consumption increasing.



(c) Explain **one** possible link between an increase in credit card lending and the rate of inflation.

(2)

If inflation decreases then most likely there will be an increase in Credit Card lending due to the fact it will potentially cost less then before

ResultsPlus
Examiner Comments

This answer scores zero as it doesn't clearly explain any plausible link between an increase in credit card lending and inflation.

Question 2 (a)

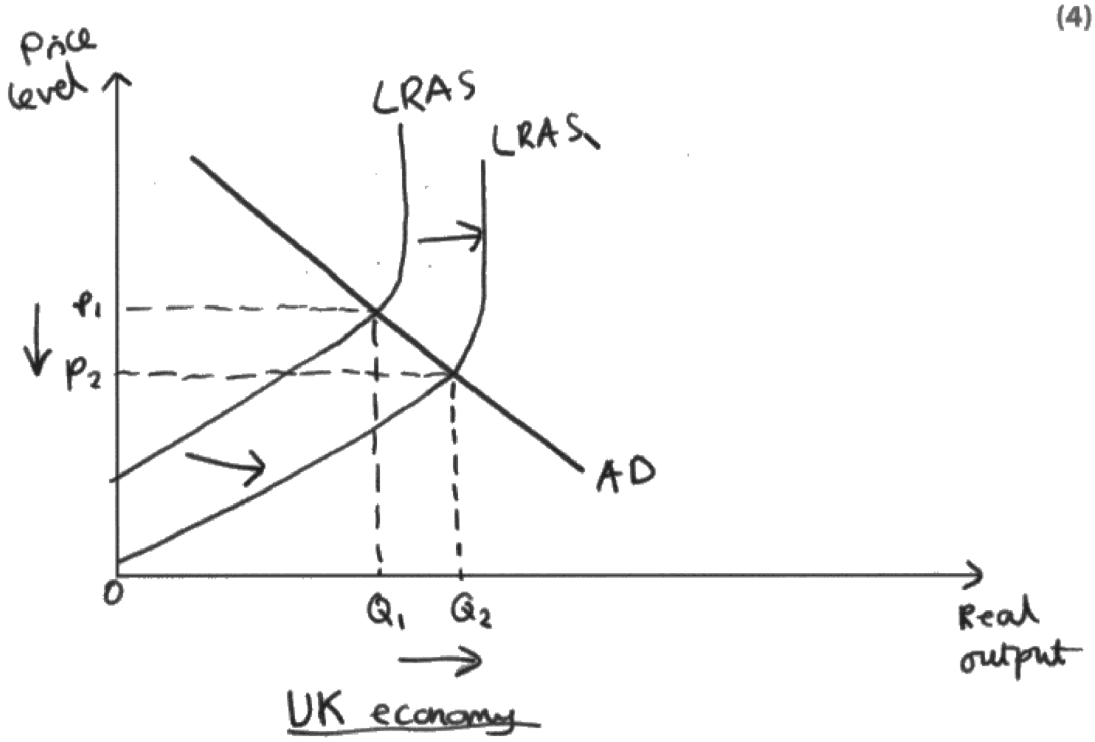
This question was generally answered well, with many candidates able to accurately draw a diagram showing either AD or AS increasing, or both. The main reason for candidates scoring 3/4 marks as opposed to 4/4 marks was labelling the vertical axis as price rather than price level.

2 The International Monetary Fund has called on the G20 group of large industrialised countries to boost government spending on infrastructure.

(Source: https://www.theguardian.com/business/2016/jul/23/
imf-calls-for-more-government-spending-as-rate-cuts-lose-their-impact)

(a) Draw an aggregate demand and aggregate supply diagram to show the likely impact of an increase in government spending on infrastructure on a country's price level and real output.

(4)



ResultsPlus
Examiner Comments

This answer scores the full 4 marks - it clearly shows AS shifting out to the right and the resultant effect on price level and real output. Everything is also correctly labelled - all axes and lines.

ResultsPlus
Examiner Tip

There is no need to write anything for these questions - just draw the diagram.

2 The International Monetary Fund has called on the G20 group of large industrialised countries to boost government spending on infrastructure.

(Source: https://www.theguardian.com/business/2016/jul/23/imf-calls-for-more-government-spending-as-rate-cuts-lose-their-impact)

(a) Draw an aggregate demand and aggregate supply diagram to show the likely impact of an increase in government spending on infrastructure on a country's price level and real output.

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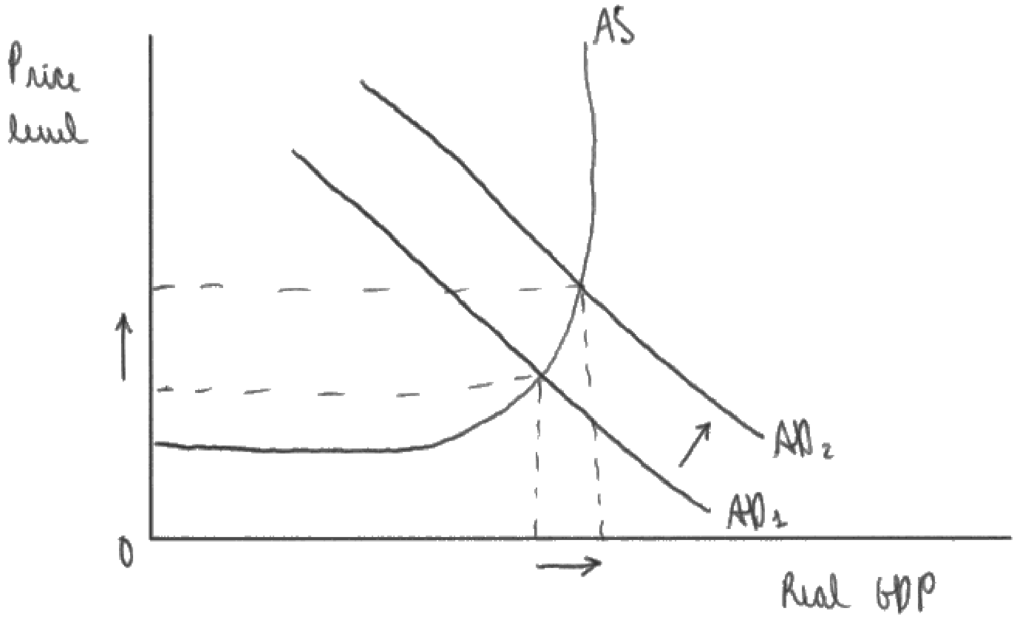
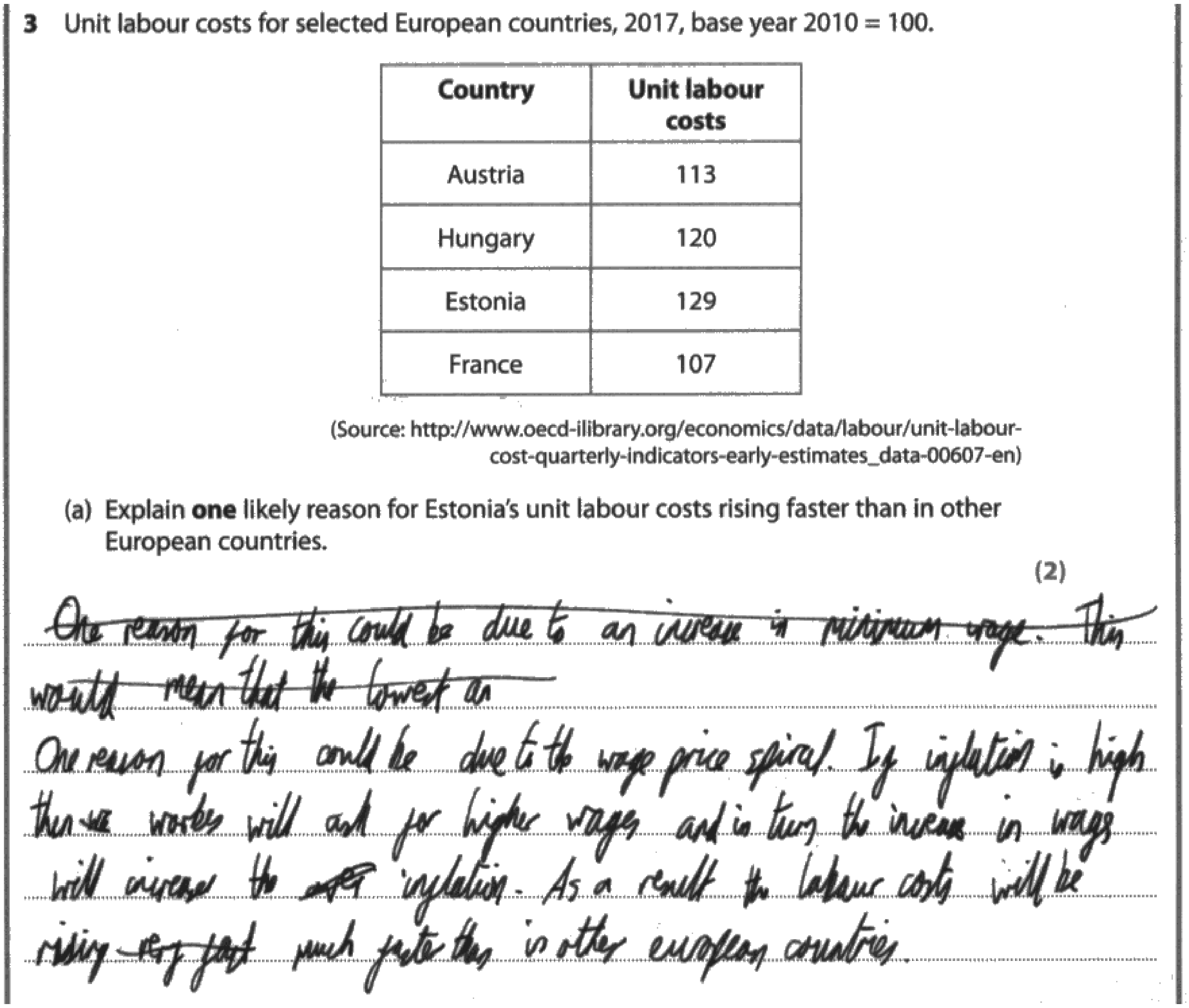


ResultsPlus
Examiner Comments

This answer also scores 4/4 marks. This time the candidate has shifted out AD, showing an increase in price level and real GDP. Again everything is correctly labelled.

Question 3 (a)

In this question there is 1 mark for knowledge and 1 for analysis. The knowledge mark comes from identification of a relevant reason for Estonia's rising labour costs. The analysis mark is awarded for 'linked development', explaining/justifying how the candidate's reason could lead to higher unit labour costs.



3 Unit labour costs for selected European countries, 2017, base year 2010 = 100.

Country	Unit labour costs
Austria	113
Hungary	120
Estonia	129
France	107

(Source: http://www.oecd-ilibrary.org/economics/data/labour/unit-labour-cost-quarterly-indicators-early-estimates_data-00607-en)

(a) Explain **one** likely reason for Estonia's unit labour costs rising faster than in other European countries.

(2)

~~One reason for this could be due to an increase in minimum wage. This would mean that the lowest an~~

One reason for this could be due to the wage price spiral. If inflation is high then ~~we~~ workers will ask for higher wages and in turn the increase in wages will increase the ~~[illegible]~~ inflation. As a result the labour costs will be rising ~~very fast~~ much faster than in other european countries.

ResultsPlus
Examiner Comments

This answer achieves full marks. The candidate has identified one reason as wage-price spiral/high inflation. They then go on to analyse it by explaining how workers will ask for higher wages.

ResultsPlus
Examiner Tip

Get straight on and answer the question, just like this candidate has done.

3 Unit labour costs for selected European countries, 2017, base year 2010 = 100.

Country	Unit labour costs
Austria	113
Hungary	120
Estonia	129
France	107

(Source: http://www.oecd-ilibrary.org/economics/data/labour/unit-labour-cost-quarterly-indicators-early-estimates_data-00607-en)

(a) Explain **one** likely reason for Estonia's unit labour costs rising faster than in other European countries.

(2)

Estonia's unit labour cost may have rised by 9 index points more than any other country in the table due to ~~an~~ a decrease in the supply of labour as a result of an increase in net emigration and an ageing population.

ResultsPlus
Examiner Comments

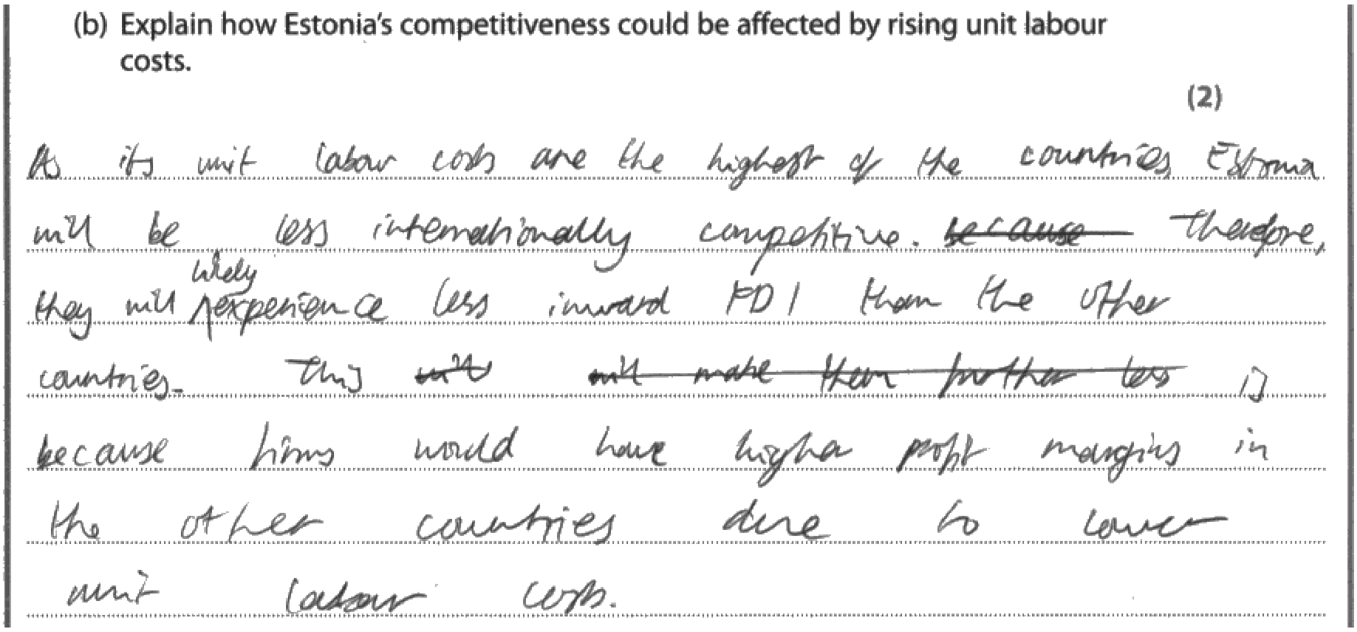
This answer achieves only the knowledge mark. The candidate has mentioned a reason in the form of an increase in emigration but they have failed to explain how this could cause Estonia's unit labour costs to rise.

ResultsPlus
Examiner Tip

The first two lines of this answer don't do anything to answer the question - candidates need to focus their time specifically on answering the question, that is what will earn them marks.

Question 3 (b)

In this question there is one knowledge mark available for an understanding that competitiveness will fall/decrease (or words to that effect). The second mark, for analysis, is for explaining how rising unit labour costs will lead to reduced competitiveness.



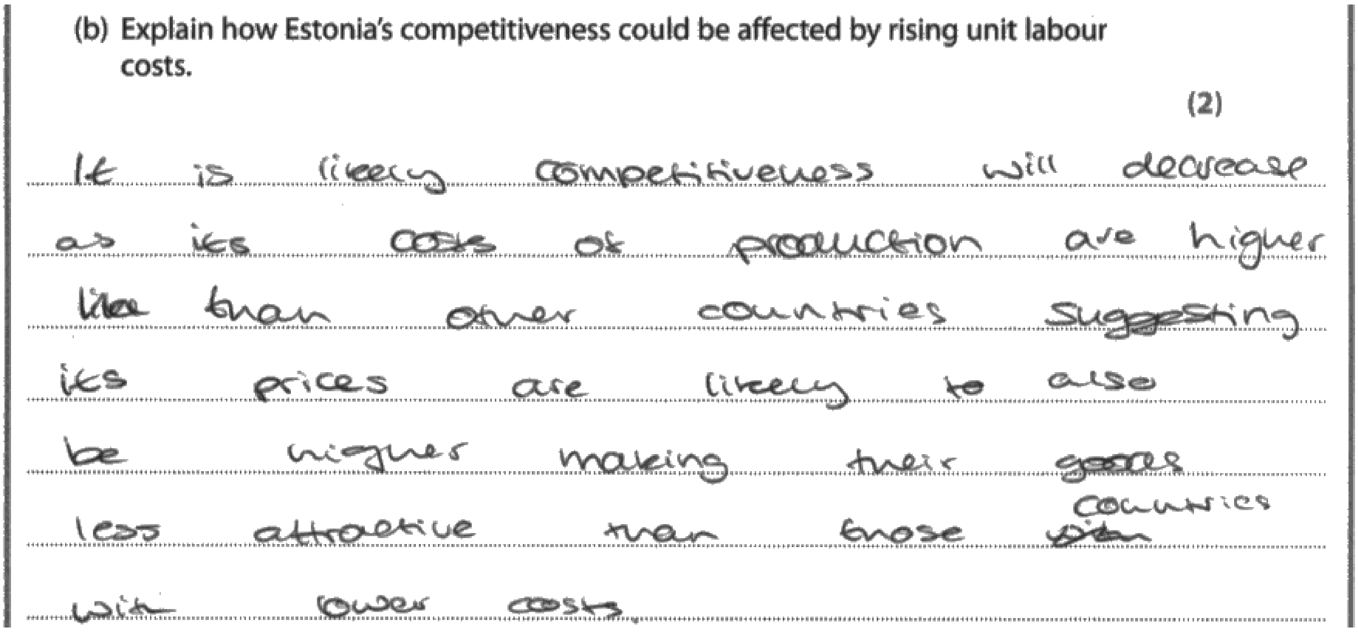
(b) Explain how Estonia's competitiveness could be affected by rising unit labour costs.

(2)

As its unit labour costs are the highest of the countries Estonia will be less internationally competitive. ~~because~~ therefore, they will likely experience less inward FDI than the other countries. This ~~will~~ ~~will make them further less~~ is because firms would have higher profit margins in the other countries due to lower unit labour costs.

ResultsPlus
Examiner Comments

This answer achieves 1/2 marks. The knowledge mark is awarded for saying that Estonia will be less internationally competitive. The rest of the answer which focuses on FDI doesn't answer the question.



(b) Explain how Estonia's competitiveness could be affected by rising unit labour costs.

(2)

It is likely competitiveness will decrease as its costs of production are higher ~~like~~ than other countries suggesting its prices are likely to also be higher making their goods less attractive than those ~~with~~ countries with lower costs

ResultsPlus
Examiner Comments

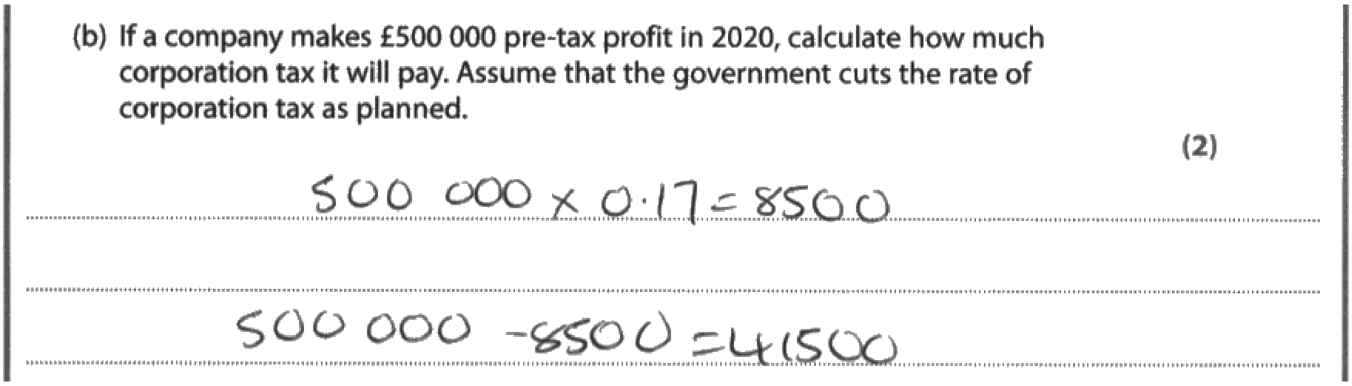
This answer achieves full marks. The candidate straight away gets the knowledge mark for saying that competitiveness will decrease. The analysis mark is awarded for the explanation of how this means higher costs of production.

ResultsPlus
Examiner Tip

Be accurate and concise in these answers - this answer isn't very long but the candidate has done what is required and so gets full marks.

Question 4 (b)

The majority of candidates were able to accurately calculate the answer here. Those who didn't get full marks generally hadn't read the question properly and so didn't calculate what they had been asked to.



(b) If a company makes £500 000 pre-tax profit in 2020, calculate how much corporation tax it will pay. Assume that the government cuts the rate of corporation tax as planned.

(2)

500 000 x 0·17 = 8500

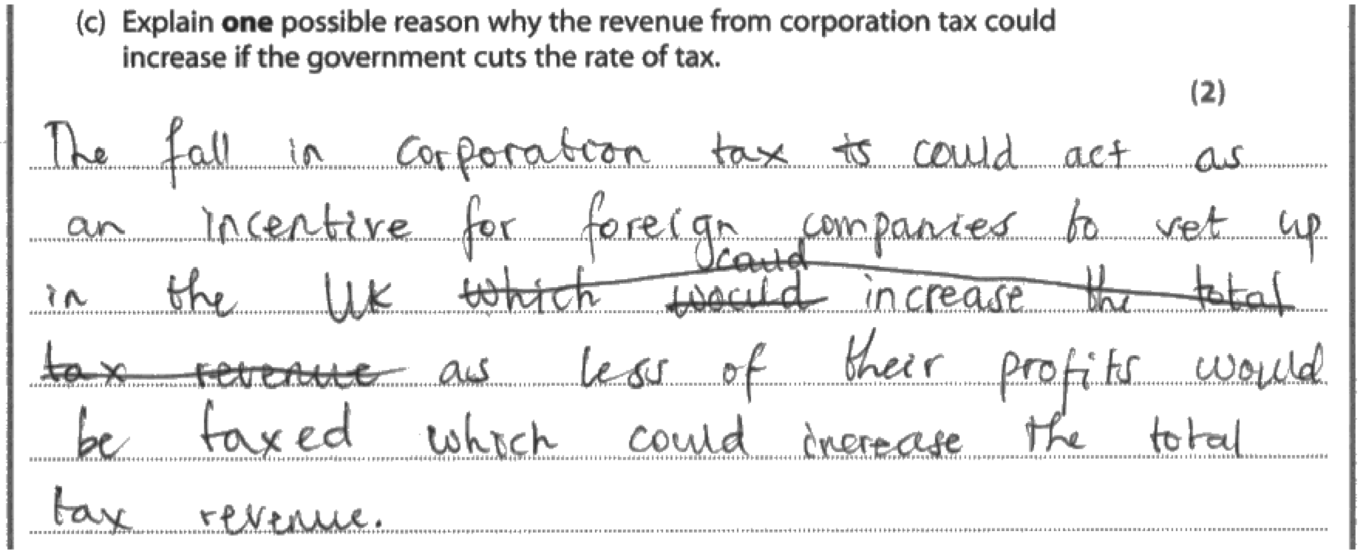
500 000 -8500 = 41500

ResultsPlus
Examiner Comments

This answer achieves 1/2 marks for correctly constructing the formula 500,000 X 0.17 but unfortunately the candidate didn't get the right answer from their calculation.

Question 4 (c)

In this question there is 1 mark for knowledge and 1 for analysis. The knowledge mark was awarded for any relevant reason, e.g. an increase in the number of firms basing themselves in the UK. The second mark, for analysis, was gained by providing the linked development to explain how/why this would cause an increase in total corporation tax receipts. In this question it was important for candidates to remember that they are writing about corporation tax, so answers discussing consumption weren't relevant to the question.



(c) Explain **one** possible reason why the revenue from corporation tax could increase if the government cuts the rate of tax.

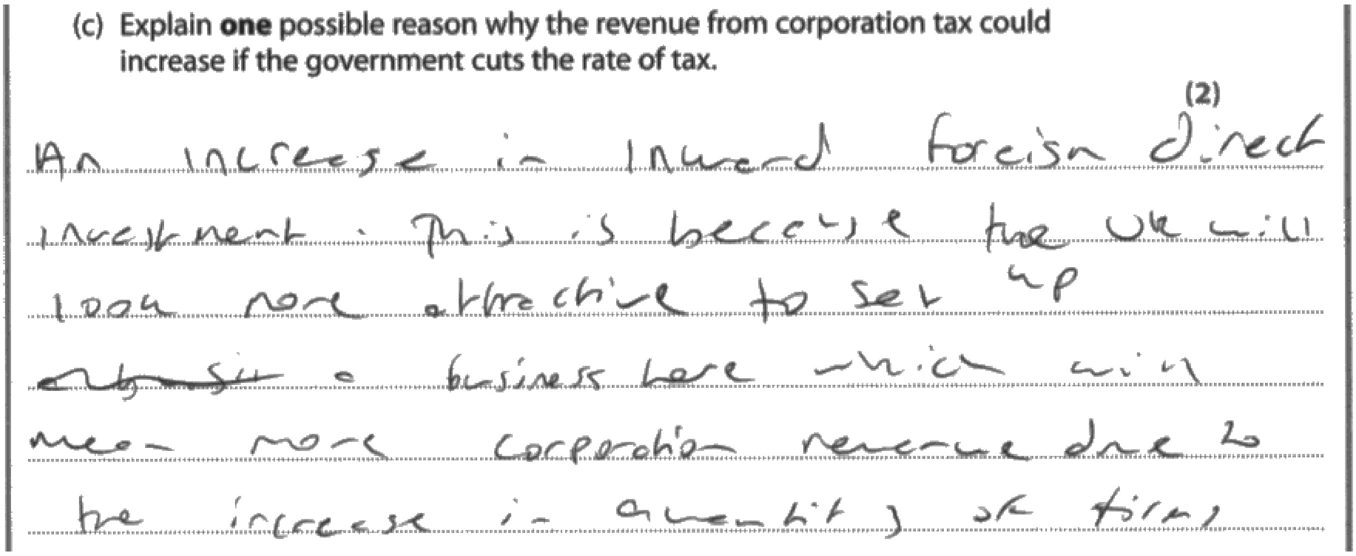
(2)

The fall in Corporation tax ~~is~~ could act as an incentive for foreign companies to set up in the UK ~~which~~ ~~would~~ could increase ~~the total tax revenue~~ as less of their profits would be taxed which could increase the total tax revenue.

ResultsPlus

Examiner Comments

This answer gains the knowledge mark for referring to 'an incentive for foreign companies to set up in the UK'. However they haven't quite explained clearly enough **how** this would lead to an increase in tax revenue, they have just said that it will.


(c) Explain **one** possible reason why the revenue from corporation tax could increase if the government cuts the rate of tax.

(2)

An increase in inward foreign direct investment. This is because the UK will look more attractive to set up ~~[illegible]~~ a business here which will mean more corporation revenue due to the increase in quantity of firms

ResultsPlus
Examiner Comments

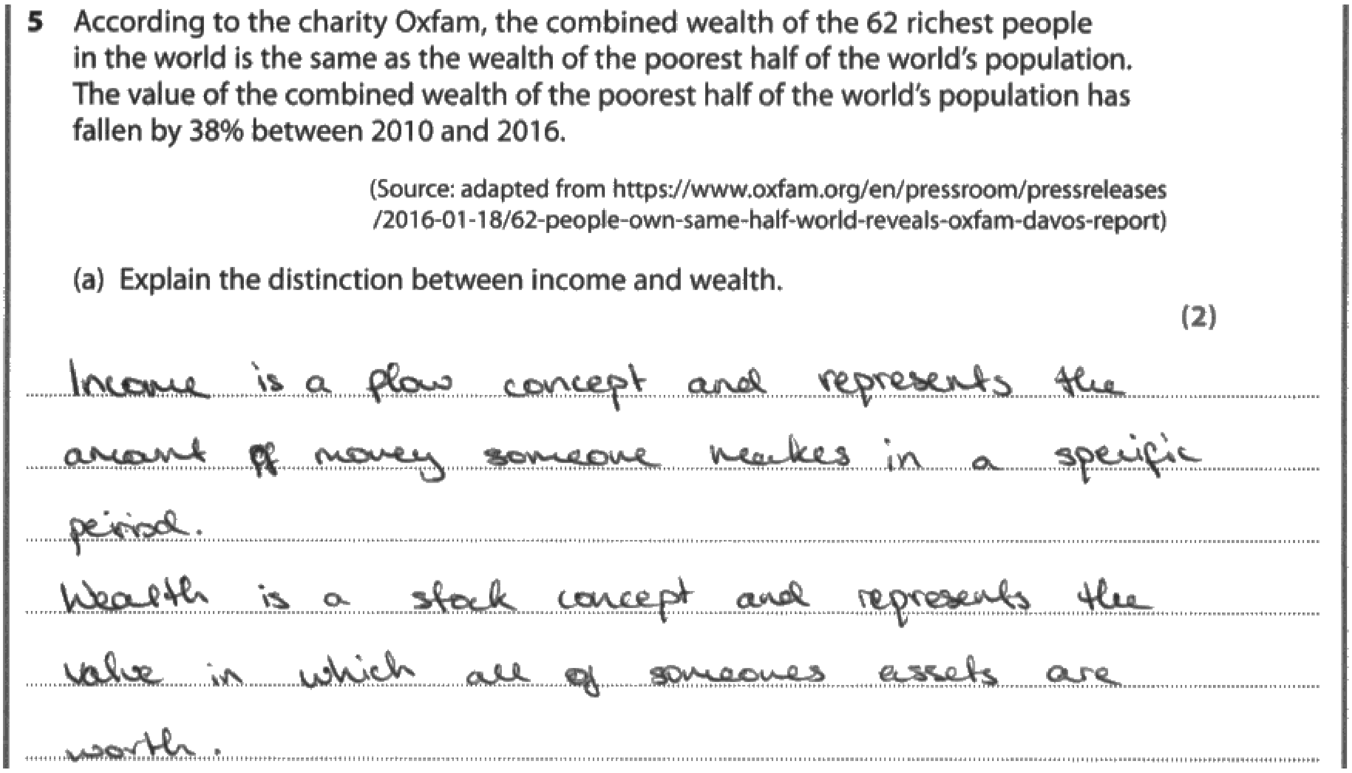
This answer scores the full 2 marks. The candidate gets the knowledge mark straight away by referring to an increase in inward foreign direct investment. The answer then goes on to explain how this would lead to an increase in corporation tax revenue for the government.

ResultsPlus
Examiner Tip

This is a good example of an answer that gets straight to the point, immediately answering the question - this will save candidates time in the exam.

Question 5 (a)

This question was answered well, with most candidates able to distinguish between the two - for example referring to income as a flow whereas wealth is a stock. Many candidates also described income as earnings/salary or similar and wealth as assets or similar.



5 According to the charity Oxfam, the combined wealth of the 62 richest people in the world is the same as the wealth of the poorest half of the world's population. The value of the combined wealth of the poorest half of the world's population has fallen by 38% between 2010 and 2016.

(Source: adapted from https://www.oxfam.org/en/pressroom/pressreleases /2016-01-18/62-people-own-same-half-world-reveals-oxfam-davos-report)

(a) Explain the distinction between income and wealth.

(2)

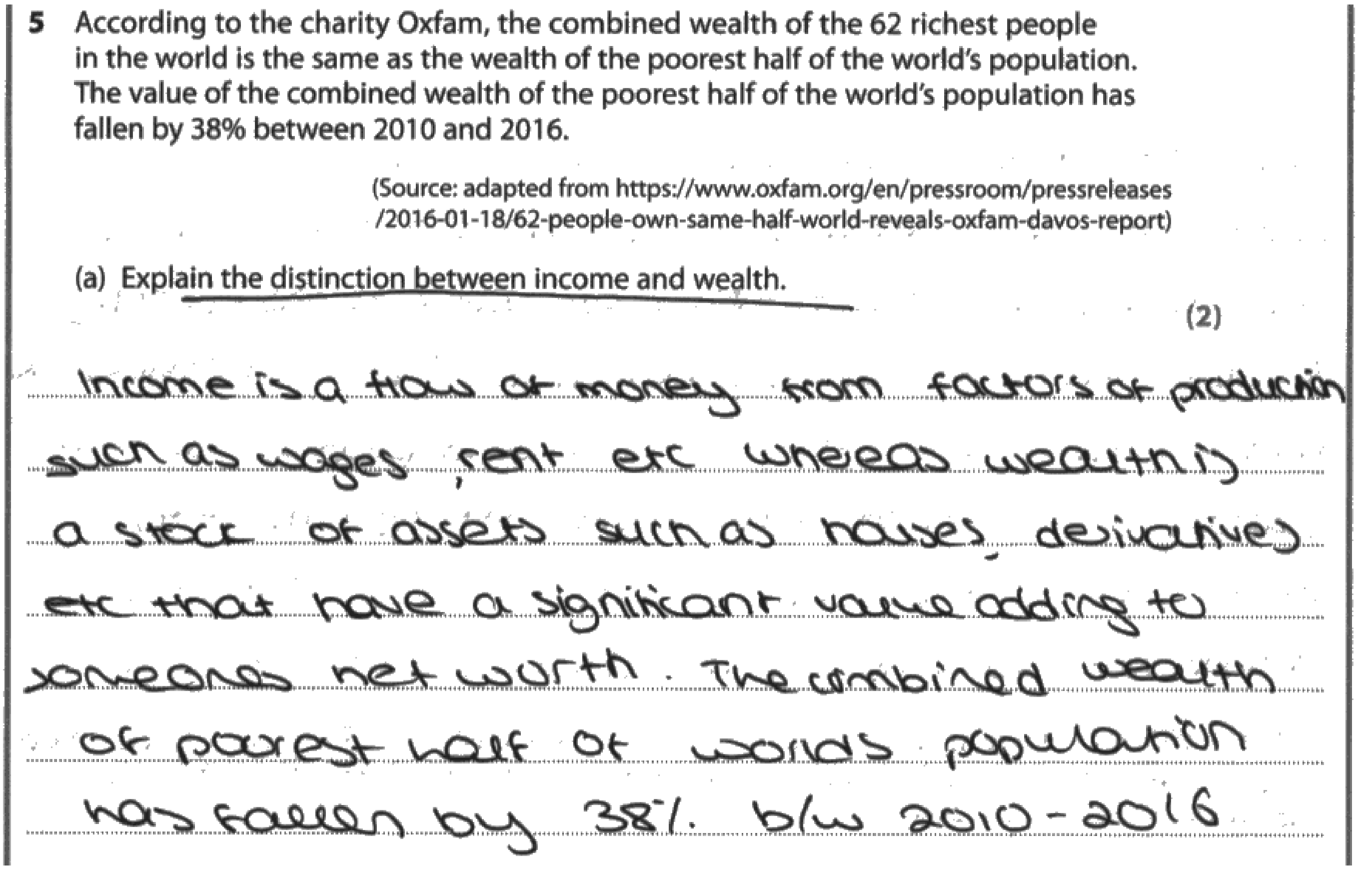
Income is a flow concept and represents the amount of money someone makes in a specific period.

Wealth is a stock concept and represents the value in which all of someones assets are worth.

ResultsPlus

Examiner Comments

This is a clear and straightforward full marks answer, with a clear explanation of both income and wealth.



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(Source: adapted from https://www.oxfam.org/en/pressroom/pressreleases /2016-01-18/62-people-own-same-half-world-reveals-oxfam-davos-report)

(a) Explain the distinction between income and wealth.

(2)

Income is a flow of money from factors of producin such as wages, rent etc whereas wealth is a stock of assets such as houses, derivatives etc that have a significant value adding to someones net worth. The combined wealth of poorest half of worlds population has fallen by 38% b/w 2010-2016

ResultsPlus
Examiner Comments

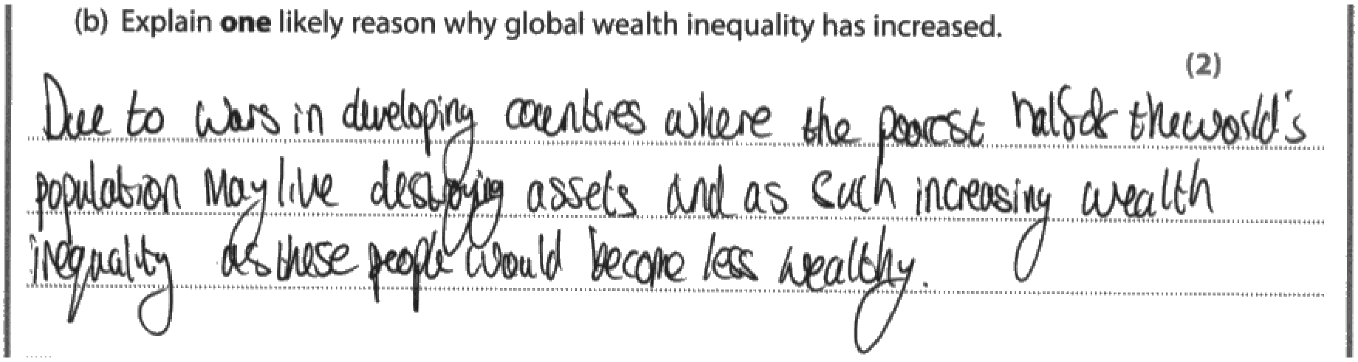
This answer also scores 2/2 marks for accurate explanations of income and wealth. You will notice that this answer is longer than the previous one - however it will still only get the maximum 2 marks.

ResultsPlus
Examiner Tip

Candidates need to avoid wasting time doing things like providing application (as in this example) when they haven't been asked to. The last sentence here isn't answering the question and so it doesn't gain the candidate any marks.

Question 5 (b)

Candidates found this question more challenging particularly in making sure their points were clearly related to increasing wealth inequality rather than income. There is one mark available for knowledge, for identifying a relevant reason. The second mark, for analysis, comes from linked development - explaining how their reason may be a cause of the increase in wealth inequality.



(b) Explain **one** likely reason why global wealth inequality has increased.

(2)

Due to wars in developing countries where the poorest half of the world's population may live destroying assets and as such increasing wealth inequality as these people would become less wealthy.

ResultsPlus
Examiner Comments

This is a short but accurate answer that identifies a relevant reason and makes a reasonable attempt to justify it. The knowledge mark comes from 'wars in developing countries' as a reason. The rest of the answer, explaining how assets of the poorest people are getting destroyed, gains the analysis mark.

ResultsPlus
Examiner Tip

Notice how brief this answer is - yet it accurately answers the question, and so achieves full marks.

(b) Explain **one** likely reason why global wealth inequality has increased.

(2)

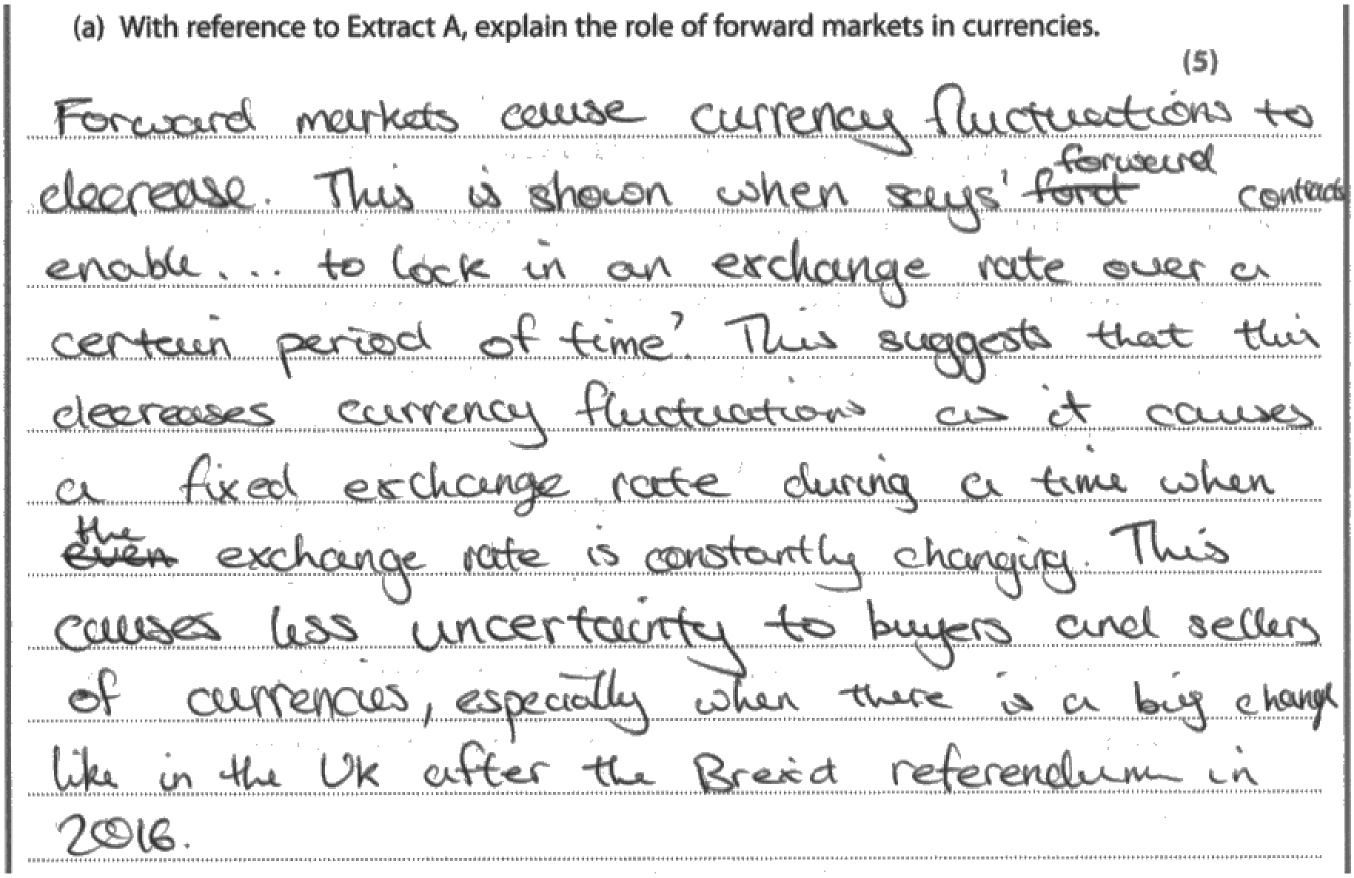
because the top companies in the world will keep gaining in power and wealth as they control so much, as their power grows overtime the money left to everyone else will decrease overtime which in turn increases inequality.

ResultsPlus
Examiner Comments

This answer scores 1/2 marks. The candidate has identified a relevant reason in the sense of 'top companies in the world' dominating but they have not explained how this causes wealth inequality to increase, and so they cannot get the analysis mark.

Question 6 (a)

In this question most candidates were able to access some of the marks. There was, in most cases, some level of understanding of what a forward market was. The better answers sought to make good use of the extract to illustrate the point they were making. However, many candidates struggled to reach full marks as their explanations of forward markets in currencies often showed a lack of clarity about how forward markets work.



(a) With reference to Extract A, explain the role of forward markets in currencies.

(5)

Forward markets cause currency fluctuations to decrease. This is shown when says' ~~ford~~ forward contracts enable... to lock in an exchange rate over a certain period of time.' This suggests that this decreases currency fluctuations as it causes a fixed exchange rate during a time when ~~even~~ the exchange rate is constantly changing. This causes less uncertainty to buyers and sellers of currencies, especially when there is a big change like in the UK after the Brexit referendum in 2016.

ResultsPlus
Examiner Comments

This answer achieves 4/5 marks. There is accurate application to the extract - both the direct quote in quotation marks as well as the reference to the Brexit referendum. There is also analysis talking about decreasing currency fluctuations. However, only 1 of the 2 knowledge marks is awarded as there isn't really a fully accurate explanation of how forward markets in currencies work.

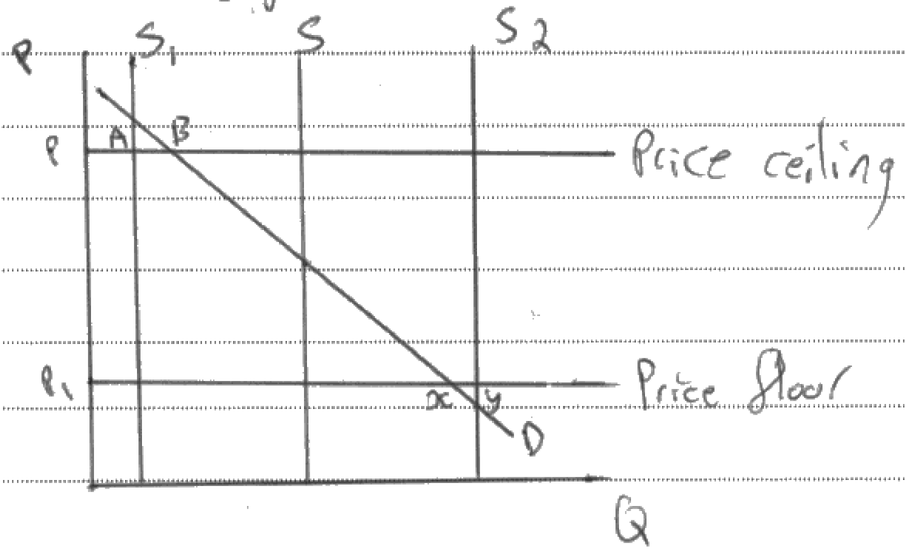
ResultsPlus
Examiner Tip

Remember there are two marks for knowledge in this question.

(a) With reference to Extract A, explain the role of forward markets in currencies.

(5)

Forward markets are ways of combatting price fluctuations in FOREX markets. As a result, businesses are more likely to invest as they do not need to risk price volatility and can easier plan investments due to stable prices



if prices rise above the ceiling (S₁) ~~the~~

ResultsPlus
Examiner Comments

This answer scores only 1 mark out of 5. There is an understanding of the benefits of a forward market, referring to combatting price fluctuations, but nothing else here is relevant to the question or the case study.

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Examiner Tip

In a question that says 'with reference to...' make sure you do as asked.

Question 6 (b)

In these 8-mark questions the marks are split equally across all four assessment objectives. So 2 marks for knowledge, 2 for application, 2 for analysis, and 2 for evaluation. This is the last of the questions in the paper to be marked on a points-based system - questions 10 marks and above are marked using levels. As such candidates need to ensure they clearly demonstrate enough things to tick off all of these marks. Many candidates on this question were able to accurately explain the impact on demand for imports and exports and then follow this through by considering the impact on factors such as economic growth, unemployment, and inflation. Good evaluation points often referred to the J-curve or Marshall-Lerner condition. Some candidates also remembered the previous question, and suggested that forward markets could limit the impact for firms, at least in the short run.

(b) **With reference to Extract A and Figure 1, examine the likely impact of the change in the sterling exchange rate on the UK economy.**

(8)

Figure 1 shows that since the brexit referendum in June 2016 the price of the pound against the dollar has fallen from around 1.49 $per £ to 1.39 $per £ in April 2017. This shows a depreciation of the sterling. One impact would be that it would make imports more expensive but exports cheaper. Extract A explains that the increase in import prices has been a 'test of nerve'. ~~for [illegible]~~ This worsening in the terms of trade will make the countries goods more competitive relative to other countries meaning exports will rise and imports will fall. This may have the impact of improving the trade balance on the current account and improving the balance of payments. However, this depends on the Marshall-Lerner condition that suggests for there to be an improvement in the current account, the price elasticities of demand for both imports and exports must be above 1. In the short run this is unlikely due to contracts and so current account may worsen.

Another impact could be an increase in inflation in the economy. As the exchange rate depreciates, it makes imports more expensive. This increases prices of goods in the UK especially as we are huge importers of food stuffs from the EU. Furthermore production costs will rise for businesses. Extract A shows that 'company suppliers are located in Europe or china'. Increased production costs mean fall in profits an higher prices.

However, this may be good for UK economy as it means that many firms will switch to domestic suppliers increasing domestic production in the UK. "one third of UK business managers are considering shifting from EU to UK suppliers'.

ResultsPlus
Examiner Comments

This answer achieves full marks. The candidate immediately gains 2 application marks for the reference to the data. Next the impact on exports and imports is discussed. There is a knowledge mark for the reference to an improvement in the current account. The excellent explanation of the Marshall-Lerner condition and the rest of the bottom of the first page gains 2 marks for evaluation. On the second page there is another knowledge mark awarded for 'increase in inflation'.

(b) With reference to Extract A and Figure 1, examine the likely impact of the change in the sterling exchange rate on the UK economy.

(8)

The downward trend of the pound sterling post Brexit vote is worrying for the economy.

The reduction in pound value will first of all increase the costs of imports. As a country specialised in financial & accounting services, imports ~~are being~~ ~~in the majority of the~~ account for a large portion of purchases, especially ~~with~~ through the use of ecommerce. As the pound dips in value, the cost of imports increase as the pound is worth less.

Secondly the weaker pound can lead to a downward spiral of it's value, further plunging the ~~value~~ exchange rate. As consumers witness the value go down, and the real price of everything go up, people will start saving more, decreasing their spending habits. Saving money counts as a leakage in the economic model, which further reduces the pound value. This in turn leads to even more people witnessing the fall of the pound & following suit. Therefore, an initial dip in the pound value can multiply over & over again, worsening the economy even more

As a reaction to the pound, falling from $1.48 to $1.29 in the span of a year, the price of exports will decrease for foreign countries, ~~increasing demand~~ ~~extend~~ extending demand for UK goods & services. This can be positive for the UK economy.

ResultsPlus
Examiner Comments

This answer scores 4/8 marks. There are 2 marks for application on the second page. There are also 2 marks for analysis, as the candidate correctly discusses the cost of imports increasing on the first page and the price of exports decreasing on the second page. However, there is no knowledge or evaluation, so the maximum they can get is 4/8 marks.

Question 6 (c)

This question focuses fairly specifically on happiness. Candidates are asked to discuss the impact of the fall in real incomes on subjective happiness. The best answers did exactly that, considering how it might mean consumers are not able to purchase as many goods and services that would make them happy and so therefore their happiness falls. Many candidates also made reference to consumers falling behind on credit card and loan repayments, making good use of the extract. Where some candidates fell down on this question was in not focusing specifically on happiness but discussing wider implications for the economy of falling real incomes.

(c) With reference to the last paragraph in Extract C, assess the impact of a fall in real incomes on subjective happiness.

(10)

Due to UK deciding to leave the EU, uncertainty over trade and FDI resulted in lower demand for UK goods reducing demand for labour and real incomes reducing as a result. Also reduction in "consumer confidence lowered by higher inflation" reduces the demand for goods and consumption leading to lower wages as demand for labour is derived.

The main impact of lower real incomes (income adjusted for inflation) is that consumer become more vunrable to any debt and loans they have to pay especially if those loans are on fixed rate of interest. This means households have to spend larger proportion of their incomes on repayments. This results in them having less disposable income to spend on goods and services. Fewer households will decide to go on vacation and as a result there will be less utility gained which reduces subjective happiness.

However, despite higher inflation the extract mentions that unemployment is on a record low "since 1975" meaning that although incomes are falling, job security is high and consumer confidence isn't as low as in the 2008 crisis. This means that fall in subjective happiness is likely to be short-term as after most households repay their loans they will still earn income to spend on goods & services.

ResultsPlus
Examiner Comments

This is a high quality answer that scores 8/10 marks. The first paragraph doesn't add much to the answer but the second paragraph is good KAA and the last paragraph is very good evaluation. In terms of KAA is it good to see a holiday as an example of something that consumers may no longer be able to afford. In terms of evaluation the candidate has made a good job of using context to back up their argument.

ResultsPlus
Examiner Tip

Note that this is a fairly brief answer, yet the candidate has done a good job of accurately answering the question and so it still scores highly.

(c) With reference to the last paragraph in Extract C, assess the impact of a fall in real incomes on subjective happiness.

(10)

A fall in real incomes ~~will~~ is likely to lower Subjective happiness, that is how happy the public feel in relation to current economic conditions.

In extract C it states that with falling incomes, consumers become vulnerable to falling behind with credit card and personal loan repayments. This suggests that they are vulnerable to accumulating greater amounts of debt. When people are in debt their purchasing power decreases and they have little to none ~~of a dispos~~ of a disposable income to spend on 'luxury' non-neccesity items. For example they may not be able to go ~~to~~ ~~an pub~~ out and have a few drinks, simply because they can not afford it, instead they have to use what income they gain ~~from~~ to repay debt. With carrying out activities such as going out of an evening, comes hapiness and happiness will fall if they can not afford to ~~Spend t~~ ~~carry~~ carry out 'luxury' leisure activities.

A fall in real incomes also

ResultsPlus
Examiner Comments

This answer scores 5/10 marks. It is Level 3 in terms of KAA, but unfortunately the candidate has not offered any counter-arguments and so they cannot gain any of the 4 evaluation marks.

ResultsPlus
Examiner Tip

In the 10 and 12 mark questions there will be 4 marks for evaluation.

Question 6 (d)

In this question the key to success was in ensuring you fully grasped both aspects of the question. Good answers began from a starting point of the central bank attempting to control inflation and then went on to explain the conflicts that can occur as the central bank attempts to keep inflation on target. For example the Bank of England's 2% target. Answers that just discussed conflicts between macroeconomic objectives without making that link to controlling inflation still received credit but they obviously haven't fully addressed what the question has asked of them.

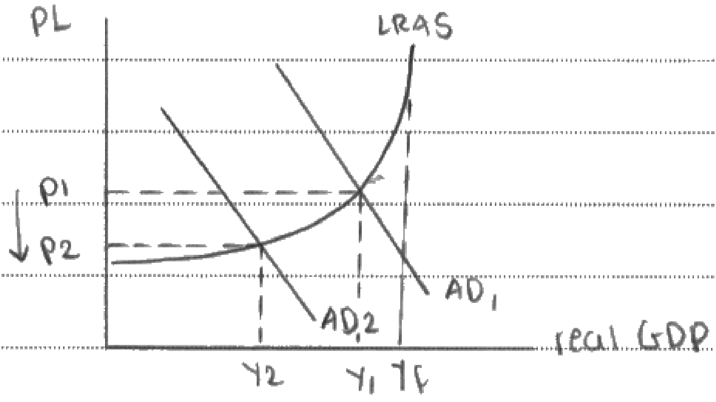
growth low unemployment
low inflation balance on CA

IR↑ depreciate £, rising
reduce to target of 2%

(d) With reference to Extract C, discuss the potential conflicts between macroeconomic objectives when the central bank attempts to control inflation.

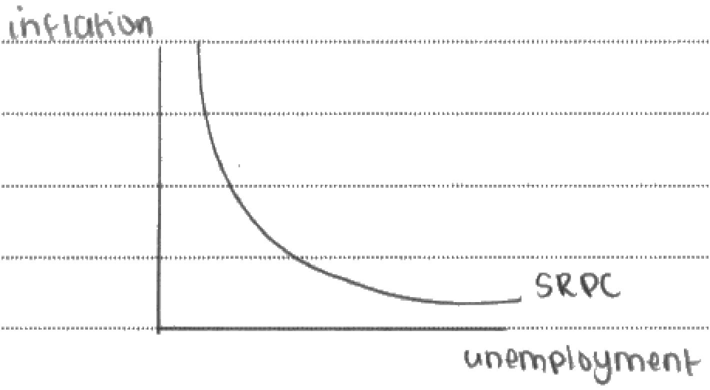
(12)

inflation is rising in the economy, the central bank can attempt to control inflation by increasing interest rates. a rise in interest rates means that the cost of borrowing will increase. This results in a fall in consumption and investment, and therefore a fall in AD ($AD_1 \rightarrow AD_2$).



reducing interest rates ~~will~~ ~~st~~ may reduce inflation ($P_1 \rightarrow P_2$), however it also reduces ~~economic~~ GDP ($Y_1 \rightarrow Y_2$). This creates a conflict between the objective of having low and stable inflation and the objective of economic growth.

another potential conflict that arises from reducing interest rates is an increase in unemployment. a fall in AD ~~due~~ will reduce inflation but it will also increase unemployment from $Y_1 \rightarrow Y_F$ to $Y_2 \rightarrow Y_F$.



the short-run phillips curve also demonstrates the conflict between low inflation and low unemployment. as inflation falls, unemployment will increase.

another way in which the central bank can control inflation is by ~~depreciating~~ appreciating the pound. This is because the value of imports will fall and the value of exports will rise, this will reduce net exports and therefore reduce demand ($AD_1 \rightarrow AD_2$). However, an appreciation of the pound will worsen the current account on the balance of payments. This is because as exports become more expensive, exports will fall, and imports will be cheaper so imports will increase. Therefore, there will be conflict between the objectives of low and stable inflation and a balance on the current account of the balance of payments.

ResultsPlus
Examiner Comments

This answer scores 6/12 marks. It just achieves Level 3 for KAA but unfortunately there is no evaluation so they have immediately missed out on those 4 marks. The candidate has answered the question and discussed different conflicts between the macroeconomic objectives, but to reach a higher mark they have to explain in a little more depth and to offer some context to evidence the points being made.

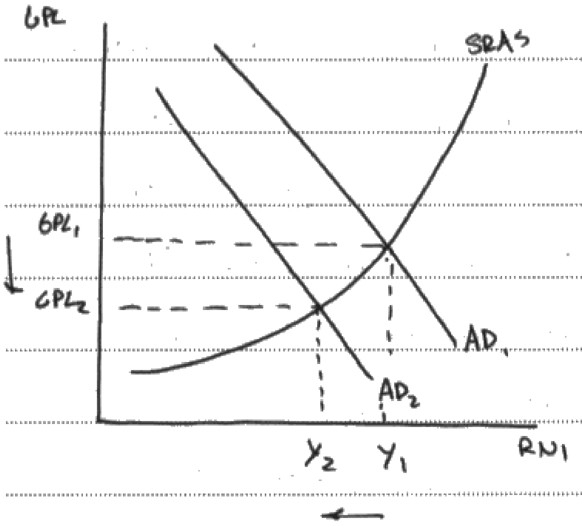
ResultsPlus
Examiner Tip

Don't forget to relate your answer to the real world - either making use of the information provided in the figures and extracts or your own knowledge.

(d) With reference to Extract C, discuss the potential conflicts between macroeconomic objectives when the central bank attempts to control inflation.

(12)

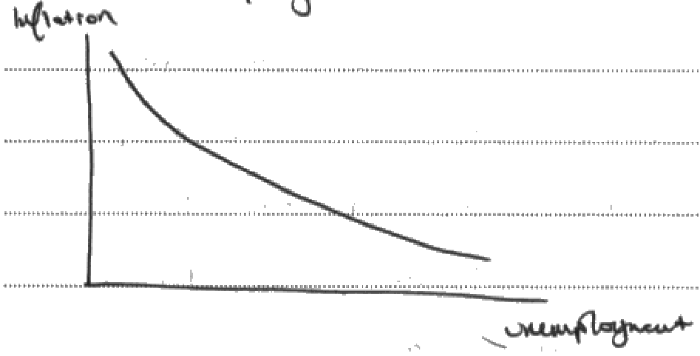
In 2017 the Bank of England told UK banks it would raise the reserve ratio, relative to all assets, from zero to 0.5%, and forecasts a further increase to 1% by the end of 2017. This is an example of contractionary ~~fiscal~~ monetary policy, which ~~and~~ is used to keep UK inflation within 1% of the 2% target. This will likely lead to banks becoming less willing to lend to consumers, which will reduce levels of consumption in the economy, a component of AD - so AD will shift inwards. As shown, this will reduce inflation from GPL₁ to GPL₂, ~~an~~ helping the UK to stay in its target. However, this comes at the cost of reduced economic growth from Y₁ to Y₂. This will likely lead to a reduction in government tax revenue,



as firms are now making less profits and less people are in employment, reducing ~~the~~ increasing the government deficit, and reducing its ability to increase ~~&~~ its discretionary spending to meet other objectives such as reduced inequality, and less environmental damage. However as far as the Bank of England is ~~a~~ concerned, this is no bad thing, as ~~it~~ its contractionary monetary policy will reduce consumer borrowing and ~~therefore~~

debt, which they believe poses a greater threat to the UK's macroeconomic objectives. As UK consumers may fall behind on loan repayments, which will lead to even greater falls in consumption and so AD in the future

Another potential conflict between objectives is that attempting to limit inflation will likely lead to increases in unemployment. This can be shown on a Phillips curve:



As shown, as the inflation rate falls, unemployment rises. This is because as inflation falls, as a result of, for example, an increase in interest rates from 0.5% to 0.75% attempting to limit inflation, demand for a firm's goods will fall. Since labour is a derived demand, this will reduce the demand for labour, increasing unemployment, damaging a government objective. However, in recent years, the relationship shown by the Philips curve has not held. Despite Mark Carney's ~~the~~ monetary policy comitte acting to keep inflation in the target, UK unemployment stands at 3.9%, the lowest since 1975. This shows that if supply-side policies are used along with monetary policy, ~~both~~ economic growth, reduced unemployment and low and stable inflation can all be achieved.

ResultsPlus
Examiner Comments

This is a high quality answer with top levels for both KAA and evaluation. The answer starts off straight away with good application to the context and then goes on to explain how this creates a conflict, with an AD/AS diagram to illustrate the point clearly. On the second page the conflict between inflation is explained clearly and has a Phillips curve to illustrate the point. This answer is also evaluated well, looking at the current situation in the UK economy.

Question 6 (e)

This question focuses on financial markets and whether the government was right to bail out the banks or not. The best answers provided clear and in-depth arguments of both the reasons why this was a good idea and why it wasn't. They also related this specifically to the context, using evidence from the case study and/or their own knowledge. Some answers also included a judgement, but candidates should note that this is not required in this question.

(e) Discuss whether providing substantial government financial support to banks is the best policy response during a financial crisis.

(15)

An argument, against financial support is that banks could become reliant on being bailed out. An example of this is RBS ~~[illegible]~~ 2008. -RBS almost liquified due to a high number of CDO's not being payed. Therefore the central bank ~~[illegible]~~ loaned them ~~[illegible]~~ '65 billions' of pounds with interest. This would see a potential problem as Banks could become reliant on being bailed out.

Moreover, ~~another~~ a way in which financial support can be the best policy is by the goverment cutting tax in terms of a financial crisis. This would see an increase in tax revenue as a cut in tax sees the richer ~~[illegible]~~ stay and pay the tax. With this increase in revenue, The goverment could increase goverment spending. This is an alternative to financial support to the bank as with gov spending it adds prosperity back into the market. And subsequently increases the level of loans being taken out. This would be a way to

Support banks as a consequence of a tax decreasing and ~~an~~ an increase in goverment spending.

However, a way that ~~goverment~~ could also introduce a beneficial way to support banks is by the government ~~gov~~/central bank decreasing the rate of inflation. This would see an increase in spending in the country and into the country from abroad. This would be a good policy to introduce during a financial crisis. As with a fall in inflation rates the economy would benefit more as it would see higher levels of consumption.

Also, the Bank of England has said that "big lenders in the UK need to find £11b of funding". This is to protect the consumer and prevent "Taxpayers bailing ~~bailing~~ out the banking sector". The Goverment would raise tax to get this income in a time of recession to get this money and in return a bank would give them bonds/shares which they can sell at a later point to recoup this money. However, for the

Consumer this is a negative as they ~~don~~ still have to pay the high tax. So an argument against this would be to see ~~them~~ the bank to 'jail' to avoid something simmilar happening again.

Thus concluding Providing government support and support from the Bank of England in my eyes is the best way to ~~to~~ respond in a financial crisis.

ResultsPlus
Examiner Comments

This answer scores 5/15 marks. It has some points which are not relevant, such as the point about inflation on the second page, but does have some understanding of the situation and offers some good application - particularly to start with.

5+2. / ✓ prevent loss of savings - equity fiscal drag mean money available - supremacy of market forces / - need lead privately - opportunity cost a - lost money - Lloyds - had to follow Austerity by new policy

(e) Discuss whether providing substantial government financial support to banks is the best policy response during a financial crisis.

(15)

11/6

The UK government had to provide '£65 billion' to bailouts RBS and Lloyds Bank in the aftermath of the 2008 financial crisis because they were on the verge of collapse, done to prevent a Lehmans Brother esque collapse of the banks. It was deemed a vital policy response because otherwise there is the 'risk that savers lose their money'. This would have devestating impacts on households and the economy would contract as people would lose confidence, as shown by the bank run on Northern Rock as people panicked to withdraw their money. It would also mean people wouldn't trust banks in the long term and so wouldn't save in banks which would stifle long term investment in the economy. The collapse of a bank would also mean the collapse in equity prices which many ordinary people have causing further loses. Furthermore, due to the fiscal drag on the labour government and budget surplus of the early 2000s, the government had to availability of funds in order to bailout the banks so it was a viable decision. However, at the time banks could not be put into 'insolvency' therefore the government had little choice, whereas now governments may allow banks to fail which shows it may not be the best course to bail them out.

Providing financial support to banks could be viewed as not the best response because there is a huge opportunity cost for the government because the spending of £65bn was taxpayers money therefore not spent on improving merit goods, and cause resentment by the public who see that a potentially squandered finances. It also means that it caused a rise in the 'national debt' meaning that the policy of Austerity had to be follow so it had adverse economic effects which has led to a rise in inequality and the underprovision of government ~~£~~ services. However, Phillip Hammond has said that all the money from Lloyds had been 'recovered' and gradually RBS is being put back in private ~~[illegible]~~ control so it is unfair to say that all money has been squandered and lost.

As a result, the supremacy of market forces ~~[illegible]~~ mean that there will be less government interference in future. This means that banks will ~~be~~ have to be more prudent and this will ~~to~~ mean there is less of a threat of financial market failure. ~~The~~ That said banks still control other peoples money meaning the risk is taken by someone else so that this could be ineffective in reducing market failure. The Bank of England will also play a role given they have demanded lenders hold £116bn so they do not have to be bailed out again. Therefore, whilst financial support to banks is a nec necessary response during a financial crisis, given the reluctace to bail out in the future it is fair to say it is not ~~the~~ best policy due to the costs and [illegible] impact of financial failure as ~~they~~ otherwise with the support of the government there is no incentive to alleviate risk and have prude policies.

ResultsPlus
Examiner Comments

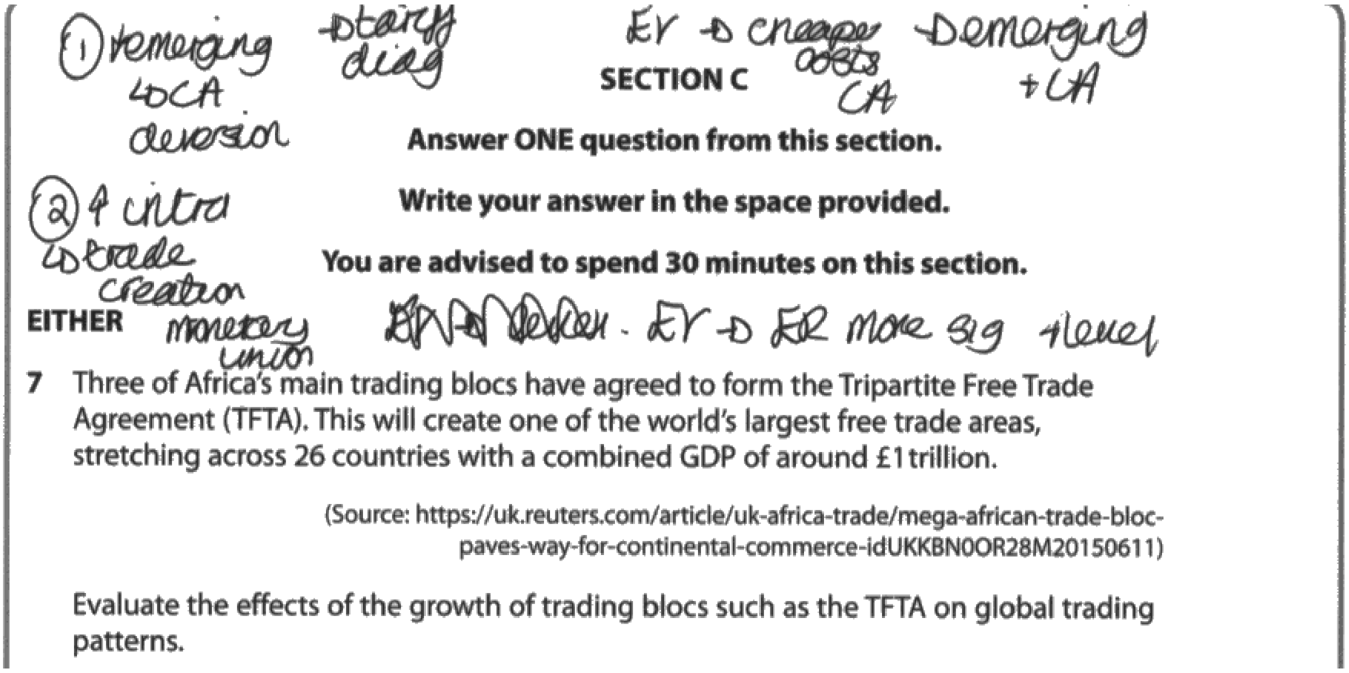
This is a high quality answer that achieves top level for both KAA and evaluation. The candidate clearly articulates the arguments on both sides of the debate with lots of context - for example talking about the run on Northern Rock. The wider implications for the UK economy had the banks not been rescued have been clearly discussed, and then for evaluation the opportunity cost for the government has been clearly explained. Depth of explanation in both KAA and evaluation was the key to success here.

ResultsPlus
Examiner Tip

To get top marks make sure you use evidence, either from the case study or your own knowledge, to back up your arguments.

Question 7

This question asks candidates to consider the impact of the growth of trading blocs on trading patterns. The question focus is specific in that candidates are expected to consider how trading patterns may change. The TFTA is given as an example of a trading bloc, and whilst many candidates made good use of this context, others chose to discuss other trading blocs such as the European Union to good effect. Unfortunately what held many candidates back from achieving more highly in this question was that they didn't focus their answers specifically on trading patterns, and instead considered the benefits and downsides for a country's economy of joining a trading bloc. Such answers generally gained some marks but obviously couldn't access the higher marks.



① remerging → CA diversion

→ stairy diag

ER → cheaper costs CA

→ Demerging + CA

SECTION C

Answer ONE question from this section.

② ↑ intra → trade creation

Write your answer in the space provided.

You are advised to spend 30 minutes on this section.

EITHER

monetary union

~~[illegible]~~ . ER → ER more sig ↑ level

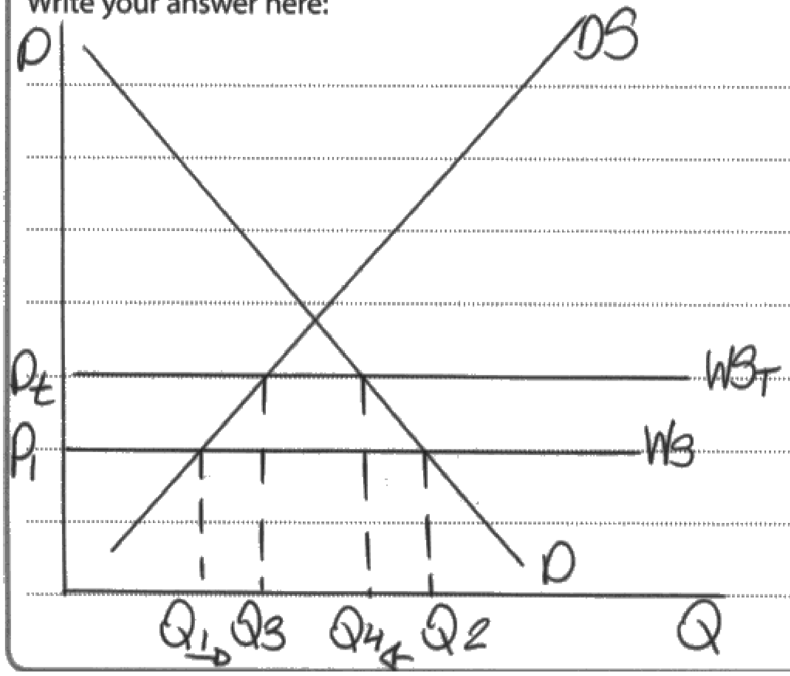
7 Three of Africa's main trading blocs have agreed to form the Tripartite Free Trade Agreement (TFTA). This will create one of the world's largest free trade areas, stretching across 26 countries with a combined GDP of around £1 trillion.

(Source: https://uk.reuters.com/article/uk-africa-trade/mega-african-trade-bloc-paves-way-for-continental-commerce-idUKKBN0OR28M20150611)

Evaluate the effects of the growth of trading blocs such as the TFTA on global trading patterns.

Chosen question number: **Question 7** ☒ **Question 8** ☒

Write your answer here:



~~Firstly, regional trade agreements~~

Firstly, trading blocs often lead to the imposition of a common external tariff on non member countries, such as in the EU's common market. This increases the price of imports from P1 to Pt, thus reducing imports from Q2 to Q4. This could lead to trade diversion, where ~~impor~~ supply from a low cost producer outside the integrated area is replaced by supply from a higher cost producer within the integrated area. Although the non member country may be more efficient, the common external tariff has reduced the demand for their imports as they are now relatively more expensive. This may ~~red~~ significantly reduce the demand for the external country's exports, such as Rwandan exports to the EU and could therefore reduce the need for investment into agro processing facilities. This would decrease their competitiveness further, as they are less productive and have higher relative export prices. This would not only reduce the ~~demand for~~ trade between the EU and Rwanda, but could also reduce Rwandan trade with other African nations - as they are less competitive.

However, this may not occur as developing countries, such as Rwanda often have a comparative advantage in the production of commodities, such as coffee, and have low unit labour costs caused by oversupply in the traditional sector, with 80% working in agriculture. This means that even with the tariff, Rwandan exports may still be more price competitive than from a less efficient source within the area. Furthermore, Rwandan coffee is known for its high quality and the conditions are not right to grow coffee everywhere, therefore ~~the new trading agreeme~~ a new trading agreement may be agreed between individual nations and the trading bloc. ~~This could increase imports trade between these count~~ Therefore, trade between ~~among~~ non member countries and trade blocs may not always decrease.

~~Moreover, the formation of a trading bloc would increase trade between members. Due to the imposition of protectionist measures such as tariffs, domestic suppliers are integrated insulated from competition and supply increases from Q_1 to Q_3. The tariff has made external countries less price competitive and~~

Moreover, a trade bloc would increase trade between members. The abolition of any tariffs and, if the area is a free trade area, non ~~trade~~ tariff barriers would increase trade between members.

This occurs because the new members are now more price competitive, possibly leading to trade creation which is when high cost domestic production is replaced by a more efficient producer within the integrated area. Trading bloc growth, such as the TFTA, would increase trade among the 26 member nations and would cause supply chains and contracts to be established between members. If this were to be extended to a monetary union, such as the European Monetary Union, it could increase trade further due to the reduction of exchange rate costs increasing certainty for suppliers - further increasing trade between member nations. Furthermore, red tape and quotas may also be abolished between members - decreasing the costs of trading and enabling domestic firms to import as many goods as they need, rather than there being a maximum limit. This would further increase trade between regions.

However, this may not be the most significant factor in determining the pattern of trade. The purchasing parity theory of exchange rates suggests that exchange rates are in equilibrium when the price level between countries is equal and they adjust to offset the differences in the cost of living in the long run.

Therefore if one country's inflation rate is 5% above another, their currency will depreciate by 5%. This would make their imports 5% more expensive and their exports 5% cheaper, thus increasing their international competitiveness and increasing demand for that country's exports. This may be more significant than trading blocs as if one currency is significantly weaker than another, this could offset the effects of a tariff and as a non member country could be more price competitive than an internal country.

On balance, the growth of trading blocs would increase trade within the blocs and decrease trade with non members. Although other factors, such as exchange rates and relative unit labour costs also affect this, I believe the most significant factor are trade blocs as they often extend to strengthening political relationships, not just economic ones - therefore establishing partnerships and supply chains. However, this is a complex issue and the exact effect depends on the goods traded and the individual countries' efficiencies and inefficiencies.

ResultsPlus
Examiner Comments

This is a high quality answer that fulfils the requirements of the criteria for KAA Level 4 and evaluation Level 3. It clearly answers the question - with a focus on the impact on trading patterns specifically. The EU has been used as a case study to good effect and key economic theories such as trade diversion have been discussed.

ResultsPlus
Examiner Tip

Where relevant, candidates should use diagrams to aid their explanation.

~~grew economys~~.

Efficient.

~~Vulnerable~~

less tax.

SECTION C

Answer ONE question from this section.

Write your answer in the space provided.

You are advised to spend 30 minutes on this section.

EITHER

7 Three of Africa's main trading blocs have agreed to form the Tripartite Free Trade Agreement (TFTA). This will create one of the world's largest free trade areas, stretching across 26 countries with a combined GDP of around £1trillion.

(Source: https://uk.reuters.com/article/uk-africa-trade/mega-african-trade-bloc-paves-way-for-continental-commerce-idUKKBN0OR28M20150611)

Evaluate the effects of the growth of trading blocs such as the TFTA on global trading patterns.

(Total for Question 7 = 25 marks)

OR

8 Japan's budget deficit for 2017/18 is expected to be 4.6% of GDP. Its national debt is forecast to increase to above 250% of GDP by 2019.

Evaluate the impact of a large fiscal deficit and national debt on a country's economy.

(Total for Question 8 = 25 marks)

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

Chosen question number: **Question 7** ☒ **Question 8** ☐

Write your answer here:

One effect of the growth of trading blocs such as the Tripartite free trade would be a growth in economial activity which in turn increases GDP, this would lead to better living standards, more money for infrastructure and education due to free flowing trade, which would greatly impact the economy of the countrys involved in many positive ways, therefore Showing that the trade bloc could potentially produce very advantageous effects for ~~E~~ LEDC's.

On the other hand the trade blocs could have very bad effects on global trading patterns, for instance with no barriers of trade it influences Strong manipulation from large firms, for instance it gives incentives for large overseas firms to globalise into the ~~given~~ given Section where free trade is available, this will inturn mean markets will be dominated by established brands and wage rates would be manipulated and pushed down, which would therefore Severely damage a countrys Standard of living and growth, therefore outlining why trading blocs can be damaging, especially to LEDC's in places Such as Africa.

Another way in why trade blocs Such as the TFTA would have an effect on global trading is the increase in efficiency. for example if barriers are removed it will prove to be much ~~easier to~~ Simpler on the logistics of goods, which would improve delivery times and dramatically improve exports and imports which would of course lead to a large increase in economic activity which will increase GDP, furthermore growing and benefiting the countrys involved in free trade.

On the other hand the effect of these trading blocs would erase the income of tariffs and Quotas aswell as taxing exported goods, this would prove to be a damaging loss of income and will have to be compensated for by the success of the free trade, and the risk this doesn't work out would be equally as high as the reward, meaning that these trade blocs could potentially leave countrys who follow the pattern temporarily financially Unstable due to the loss of income on Tariffs and Quotas, which could potentially lead to larger debts and a fall in GDP, all harmful factors to the countries economical status.

Overall the effects of the growth of trading blocs such as the TFTA on global trading patterns will most likely influence other countrys to open to free trade due to the advantages and proposals of boosting economic growth and increasing GDP as a whole.

ResultsPlus
Examiner Comments

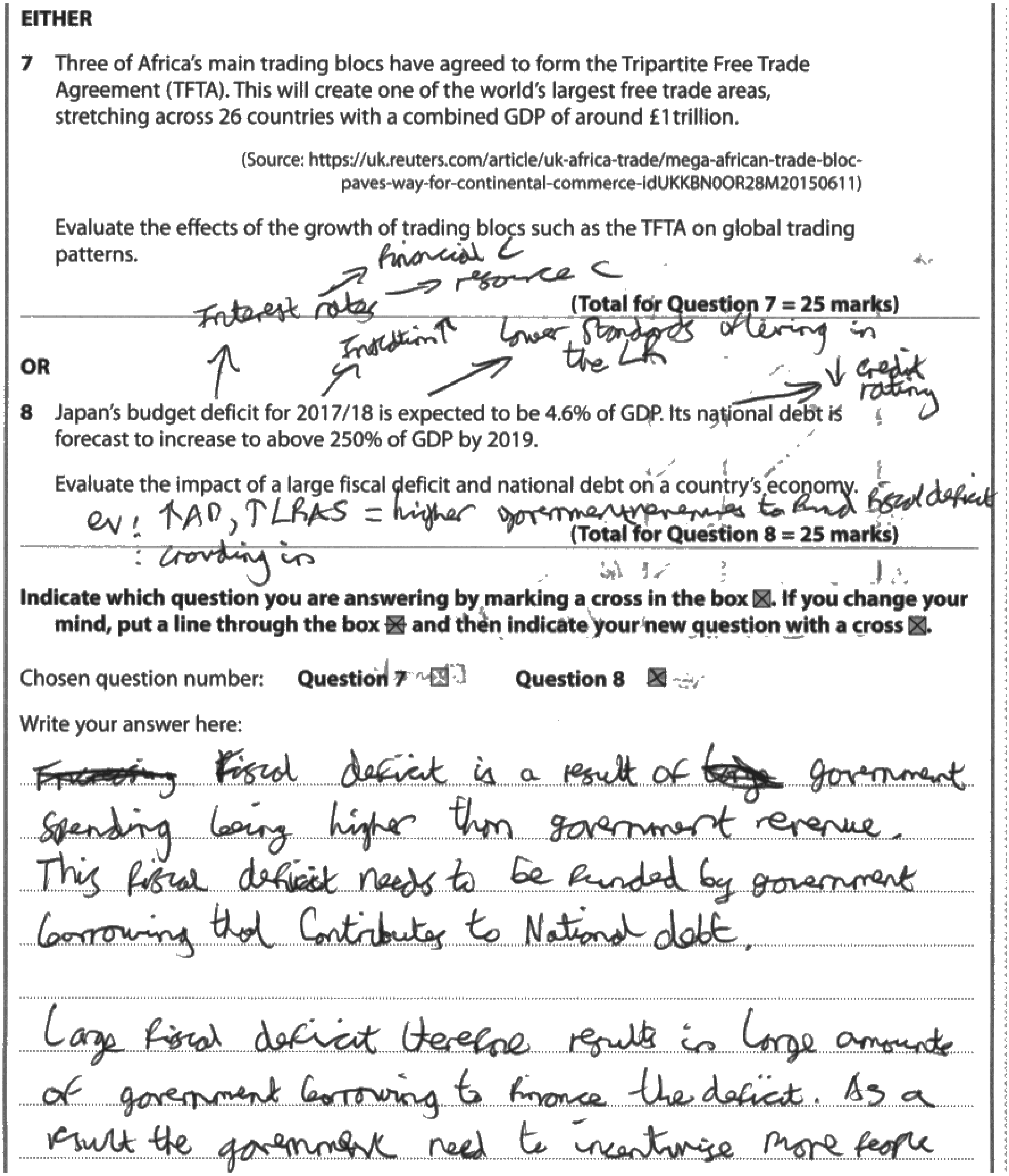
This answer achieves 9/25 marks. Right from the start the candidate makes it clear that they are discussing the benefits and downsides of the growth of trading blocs rather than the impact on trading patterns, with a discussion of the impact on GDP and living standards in a country. There are some references to trading patterns throughout the answer, both on positive and negative sides, but with the broad thrust of the answer not being focused on trading patterns it can only score fairly low for both KAA and evaluation.

ResultsPlus
Examiner Tip

Make sure you answer the question that has been set, not the question you want to answer.

Question 8

This question was generally answered more accurately than question 7 - in the sense that answers were on the whole more focused on the actual question set. Success in this question came from ensuring that clear, in-depth explanation of both KAA and evaluation points were made, with good context to back up answers. Japan was given as a context for the question, and many candidates made good use of this, often adding in their own knowledge of the Japanese economy. Other candidates talked about other countries they were familiar with, the most common being the UK.



EITHER

7 Three of Africa's main trading blocs have agreed to form the Tripartite Free Trade Agreement (TFTA). This will create one of the world's largest free trade areas, stretching across 26 countries with a combined GDP of around £1 trillion.

(Source: https://uk.reuters.com/article/uk-africa-trade/mega-african-trade-bloc-paves-way-for-continental-commerce-idUKKBN0OR28M20150611)

Evaluate the effects of the growth of trading blocs such as the TFTA on global trading patterns.

financial ↓
resource ↓
Interest rates ↑
Investment ↑
Lower standards of living in the UK
↓ credit rating

(Total for Question 7 = 25 marks)

OR

8 Japan's budget deficit for 2017/18 is expected to be 4.6% of GDP. Its national debt is forecast to increase to above 250% of GDP by 2019.

Evaluate the impact of a large fiscal deficit and national debt on a country's economy.

ev: ↑AD, ↑LRAS = higher government revenues to fund fiscal deficit
: crowding in

(Total for Question 8 = 25 marks)

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

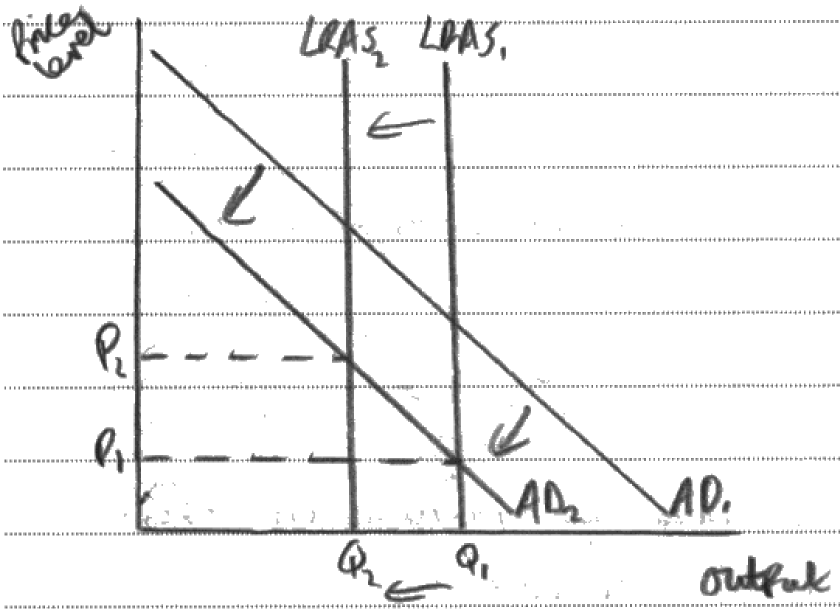
Chosen question number: **Question 7** ☐ **Question 8** ☒

Write your answer here:

~~Financing~~ Fiscal deficit is a result of ~~large~~ government spending being higher than government revenue. This fiscal deficit needs to be funded by government borrowing that contributes to National debt.

Large fiscal deficit therefore results in large amounts of government borrowing to finance the deficit. As a result the government need to incentivise more people defaults to benefits for G S to costs in LR

to buy debt (government bonds) through increasing interest rates in the economy (increased return for buying government bonds). This increase in interest rates leads to financial crowding out of the private sector as it is costs more to borrow money to fund investment and consumption in the economy. As a result, there is a significant reduction in consumption and investment in the economy as shown diagramatically:



As consumption and investment fall in the economy aggregate demand fall from AD_1 to AD_2 leading to a ~~lower econ~~ fall in economic growth from Q_1 to Q_2 as firms scale back production due to decrease demand in the economy - further leading to increases in unemployment as workers are made redundant. Furthermore, as investment falls in sector there is decreased spending of firms on research and development, training programs for workers leading to not only reduced productive potential of the Japanese economy but also a decrease in international competitiveness as relative unit labour costs rise and there is less innovation to create more productive production methods. As a result costs for Japanese producers rise relative to its trading partners leading to higher prices and hence lower price competitiveness less demand for exports and hence decreases in export-lead growth and a deteriation of the current account as the value of exports rises.

However, one may argue the effects of this depend on the state of the Japanese economy as if there is a large output gap the increased government spending and hence fiscal deficit may lead to a net resource crowding in of the private sector as the government spending represents an injection into the economy having a multiplier effect on demand for private sector goods leading to increases in revenue and profits for Japanese as the size of the private sector rises. This leads increases in competition in the Japanese economy leading to higher efficiency as costs are cut prices falls and the Japanese economy becomes more price competitive stimulating demand for exports.

Furthermore large National debt – which is set to increase to 'above 250% of GDP by 2019' will lead to falls in the standards of living in Japan as ~~interest payments of debt~~ the vast interest payments on the national debt in the future lead to lower government expenditure as Japan is force to implement fiscal austerity measures to finance the interest payments. This results in a decreased injection in the economy as government spending falls leading to a large multiplier effect on the economy and large decreases in ~~demand~~ aggregate demand in the long term. Furthermore, living standards are likely to fall as government expenditure on goods with high positive externalities such as education and healthcare leading to decreases in Japan's productive potential in the long run as they suffer from lower human capital levels and a less productive workforce. Increases in taxation to finance the interest payments are likely to ~~[illegible]~~ be further contribute to lower aggregate demand in the economy.

However, one may argue the lower fiscal deficit of 4.6% of GDP represents large government capital expenditure in the economy and ~~[illegible]~~ hence fostering economic growth as the injection has a multiplier affect in the economy. This leads to increased government revenue on taxation in the long run as incomes rises and lower spending as unemployment falls (decreased Job seekers allowance) and hence

Japan may operate at a lower fiscal deficit and hence don't have to adopt fiscal austerity measures to finance the large interest payments on the large national debt.

In conclusion the large fiscal deficit and national debt will lead to increased prosperity in Japan in the short run. But I believe this is at the cost of large decreases in the standard of living in the long run as inflation rises due to governments printing more money to finance the deficit (so the money supply increases) also FDI is deterred as the economy is seen as unstable and the deficit is unsustainable and Japan's credit rating falls in the long run leading to increased interest rates for governments to pay and less access to finance to fund development purposes.

ResultsPlus
Examiner Comments

This is a high-quality, top-level answer that clearly fulfils all the criteria for both KAA Level 4 and evaluation Level 3. The focus is on the Japanese economy, and the candidate makes good use of the context provided to back up points. A diagram is also used to good effect to illustrate the point about crowding out leading to less aggregate demand. The candidate has also ensured that they have discussed issues to do with both the fiscal deficit and the national debt.

ResultsPlus
Examiner Tip

Ensure you answer both parts of a question like this to reach the top level - e.g. in this case make sure both fiscal deficit and national debt are discussed.

SECTION C

Answer ONE question from this section.

Write your answer in the space provided.

You are advised to spend 30 minutes on this section.

Trade
Inflation
Gdp
Employment
Redistribution of income
Sustainable envim
Balanced budget

EITHER

7 Three of Africa's main trading blocs have agreed to form the Tripartite Free Trade Agreement (TFTA). This will create one of the world's largest free trade areas, stretching across 26 countries with a combined GDP of around £1 trillion.

(Source: https://uk.reuters.com/article/uk-africa-trade/mega-african-trade-bloc-paves-way-for-continental-commerce-idUKKBN0OR28M20150611)

Evaluate the effects of the growth of trading blocs such as the TFTA on global trading patterns.

(Total for Question 7 = 25 marks)

- Conclusion:
  MPW → depends on this
  MPC → and this

OR

8 Japan's budget deficit for 2017/18 is expected to be 4.6% of GDP. Its national debt is forecast to increase to above 250% of GDP by 2019.

Evaluate the impact of a large fiscal deficit and national debt on a country's economy.

- More tax (income tax)
- Inequality
- Laffer curve

~~[illegible]~~ Trade, imports
- Low exports
- low training
- less investment
- less jobs

(Total for Question 8 = 25 marks)

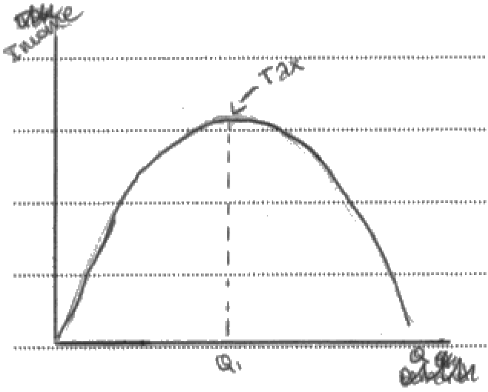
Indicate which question you are answering by marking a cross in the box ☒. If you change your mind, put a line through the box ☒ and then indicate your new question with a cross ☒.

Chosen question number: **Question 7** ☐ **Question 8** ☒

KAA

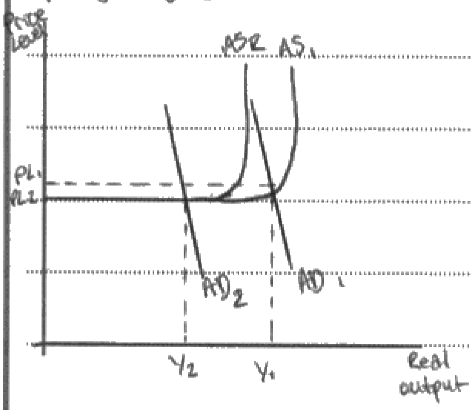
Write your answer here:

A fiscal deficit can be defined as the increase in ~~govern~~ net spending ~~[illegible]~~ by the government ~~for public sector~~ compared to ~~sper~~ net income for the government. In other words, where public spending is greater than income. The National debt however, is the accumulation of this deficit over years where interest is added on to per ~~deficit day~~ debt and must be paid off. A large fiscal deficit means the government is forced to increase its income through ~~tax~~ measures like taxation. This is predominantly done by an increase in income tax, ~~[illegible]~~ most income taxes in economies are regressive taxes where as income rises the amount of tax on income increases. This is a good way for the government to balance its budget and reduce its national debt, however it means that those on a high income are more likely to be impacted. This means high income workers in Japan may feel demotivated to work ~~and~~ which is illustrated by the Laffer curve.



The Laffer curve illustrates that as tax increases for these high income workers, they will start earning less ~~a~~ because ~~they~~ the inventives to work have reduced. This means that they may switch to low income jobs or may move to tax ~~evasion~~ avading or ~~of~~ tax avoidance. ~~which mea~~ furthermore this rise in income tax means the economy may face inequality as a result of this and therefore it may impact the amount of spending into the economy as well because there is less disposable income. A decrease in disposable income means there is less spending in the economy so firms and businesses may not be gaining much revenue. However, eventhough there are many negatives of this increased in income tax that may occur, ~~it may an~~ due to the low spending interest rates may be lowered, this leads to an increase in borrowing and therefore firms may use this to invest more and improve their businesses. It also may mean prices are reduced for consumers because disposable income has reduced. Therefore there are certain aspects which would benefit due to this fiscal deficit and national debt, however initially high income earners suffer the most.

Alternatively an increase in government spending as opposed to government revenue through taxation etc, is also a main cause of low exports compared to imports. This means the government would have spent more on importing goods compared to exporting them and the economy may continue to do so in spite of its current deficit and national debt because there are certain goods which Japan itself could not provide and therefore it must be imported. This means the government has less money to spend on education and training to increase employment, this means forms also have less money to invest, low investment means they may have to make workers redundant because of high costs. thus results in unemployment. Unemployment is likely to impact the economy as a whole because no spending in the economy means ~~geg~~ aggregate demand as well as supply will fall. the diagram illustrates this fall with a shift of both AD and LAS to the left because due to lower employment there is no income and therefore demand decreases and due to a fall in demand supply is forced to go down as firms have no sales or revenue therefore they may face being shut down. Therefore it is very negative for the economy as a ~~to~~ whole. However, it may be argued that Japan is actually a highly successful exporter of goods and thus can redeem its losses through these exports. ~~Japa~~ Some of the most popular Japanese exports consists of confectionary goods such as exotic flavoured Kit-Kats which is a twist to the original ones. Similarly Matcha is a highly popular exported good from Japan indicating that it may be an incentive to increase these exports.



To conclude the economy is mostly negatively impacted by the fiscal deficit and the national debt because it means the government has less to spend on the economy and may increase taxation; ~~the however~~ this will reduce interest rates however and people may borrow money to spend. However this can also lead to hot money outflows from the economy where people who have savings are likely to take their money to foreign banks where interests are higher in order to benefit from these ~~hig~~ higher interest rates. However it also depends on the marginal propensity to save because ~~of the~~ there are people who would rather spend which would be a positive outcome of the deficit and national debt.

ResultsPlus
Examiner Comments

This answer scores 11/25 marks. It starts off ok although does take a while to get onto analysis rather than simply knowledge. However, after a while, the candidate appears to have forgotten what the question is asking and they begin to write about imports and exports. As such there is a limit to what mark this answer can achieve.

ResultsPlus
Examiner Tip

Do not get the fiscal deficit confused with the current account deficit. Remember anything can be 'in deficit' - this word simply means that it's a negative number.

Paper Summary

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

- Ensure you manage your time effectively: it does say in the exam paper to spend 30 minutes on Section A, 1 hour on Section B, and 30 minutes on Section C. If candidates spend too long on Section A they are in danger of running out of time for the 15 and 25-mark questions at the end of the exam paper.

- Bearing this in mind, candidates can answer the paper in whichever order they see fit – some candidates may find it helpful in terms of time management to start with Section B or C instead of A.

- A multiple-choice question is worth one mark whereas questions 7 and 8 are worth 25 marks. Bear this in mind in terms of how long you are spending on individual questions – especially those in Section A.

- Maximise your efficiency by ensuring you only answer the precise question set - especially on the 2-mark questions in Section A where some candidates are defining every term in the question rather than simply answering the question.

- There are no marks for evaluation in Section A, so don't spend time doing this.

- Ensure you can complete key calculations such as index numbers and percentage change.

- When drawing diagrams remember to ensure that they are clear and have correct labels on both axes and lines.

- Ensure you carefully study and understand the figures and extracts provided in Section B. These form the context for the questions, and answers should be related to this context and not be entirely theoretical.

- Remember to keep your answers within the space provided. If you run out of space you should ask for additional paper and clearly indicate which question you are writing about.

- It is indicated on the front of the exam paper that 'there may be more space than you need'. Do not feel obliged to fill up all the space just because it is there.

- There is no need to repeat the question back to the examiner – save yourself some time and get straight on with answering the question.

- Remember that in Section B the five and eight mark questions use a points-based mark scheme whereas the other questions use the levels mark scheme.

- Ensure you answer the precise question you have been set, for example in the essays if you have been asked to write about trading patterns, then do that - not generic benefits/downsides.

- To get top marks on levels-marked questions you need to ensure you fulfil all the criteria for the top level (e.g. KAA Level 4 on essays). If you do not have good knowledge, analysis, and application then you can't access those top marks.

Grade Boundaries

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

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

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