Qurious Education

2016 Edexcel AS Economics Paper 2 Macroeconomics Paper

Model Answers

This document is helpful for longer essay questions/responses. Please reference the Mark Scheme for answers to Multiple Choice questions.

Examiners' Report
June 2016

GCE Economics 8EC0 02

Question 1 (a)

This is the first of several short questions where candidates simply need to define a key economic term. Most candidates were able to clearly define these terms. The main problem with a national income definition was the significant number of candidates who said this was the average income of a country, which is incorrect.

1 (a) Define the term 'national income'.

(1)

National income is the amount of good and services produced. the amount of expenditure on goods and services.

ResultsPlus
Examiner Comments

This answer is clearly a correct definition of national income and so scores 1/1.

Question 1 (c)

This is an important concept in macroeconomics and one that candidates should be familiar with. There are 2 marks available so candidates are expected to do a little bit more than just a brief mention of flows of money. Because of the nature of the circular flow of income there is more than one way that candidates can achieve the 2 marks. If discussing injections and withdrawals candidates should give an example or examples of these.

(c) Define the term 'circular flow of income'.

(2)

~~Th~~ The withrawels and injechons that take place in the cycle, businesses produce goods and services for households and households pay for them, they also provide businesses with labour while businesses give them income. When there's more injections this causes a multiplier effect.

ResultsPlus

Examiner Comments

This answer achieves the full 2 marks. It accurately describes the circular flow of income with how money flows between households and businesses in exchange for labour and goods and services.

Question 2 (a)

2 The table below shows GDP per capita at purchasing power parities (PPPs) for a selection of European countries in 2013.

Country	**GDP per capita (US$, at PPPs, 2013, rounded)**
UK	38 500
Spain	33 000
Italy	35 500

(Source: http://data.worldbank.org/indicator/NY.GDP.PCAP.PP.CD)

(a) Define the term 'purchasing power parities'.

(2)

Purchasing Power parities shows how much of a currency is needed to buy a basket of goods in one country compared to another. It can show the strength of a currency against another or the compare ~~growth~~ economic growth of 2 countries.

ResultsPlus
Examiner Comments

This accurate definition of purchasing power parities achieves the full 2 marks.

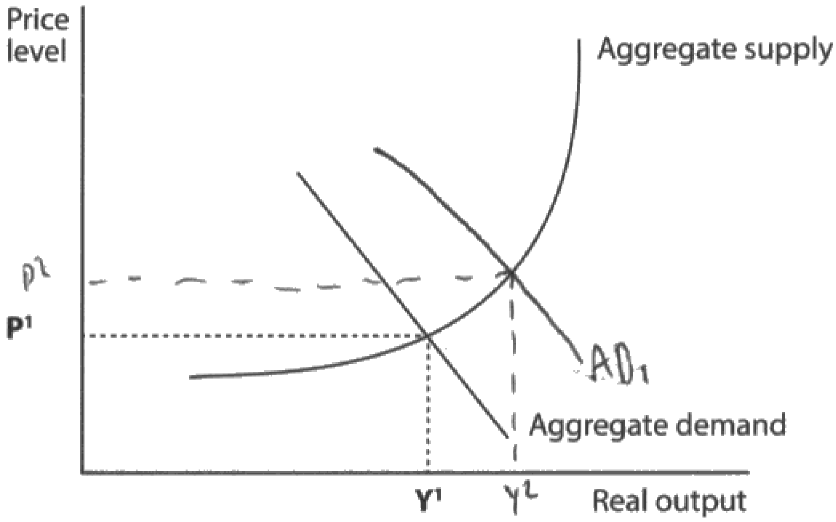
Question 2 (c)

This was a straightforward question that the majority of candidates annotated correctly. One issue that some candidates faced was where they did not show economic growth on the diagram, to get the mark there needed to be an outward shift of real output.

(c) Diagram A shows the aggregate demand and aggregate supply for a country. Illustrate actual economic growth on Diagram A.

(1)

Diagram A



ResultsPlus
Examiner Comments

This correct answer achieves 1/1- AD has been correctly shifted out and the new equilibrium point has been shown, with Y2 further out than Y1.

ResultsPlus
Examiner Tip

Do remember to use a black pen throughout your exam paper, including for diagrams.

Question 3 (a)

This is another key definition question and the majority of candidates could accurately and concisely define the claimant count, either with reference to 'unemployment benefits' or 'jobseekers allowance'. Unfortunately a number of candidates referred to 'benefits' in general, which is incorrect.

(a) Define the term 'claimant count'.

(1)

Claimant count is the number of people who aren't working that claim Job seekers allowance.

ResultsPlus
Examiner Comments

This correctly refers to 'job seekers allowance' and so achieves 1/1.

Question 3 (b)

This question was a straightforward test of quantitative skills, and most candidates could correctly do the calculations involved. With the renewed emphasis on quantitative skills it is important that candidates practice such questions as part of their economics course.

3 The table below shows claimant count data for the UK.

	Number of Claimants
August 2014	961 149
September 2014	923 240
October 2014	887 771
November 2014	848 085
December 2014	823 880
January 2015	852 934
February 2015	858 344

(Source: http://www.nomisweb.co.uk/query/construct/submit.asp?forward=yes&menuopt=201&subcomp=)

(a) Define the term 'claimant count'.

(1)

Claimant count is the number of people who aren't working that claim Job seekers allowance.

(b) Calculate the percentage change in the claimant count from August 2014 to February 2015.

(2)

$\frac{\text{new} - \text{old}}{\text{old}} \times 100$

$\frac{858{,}344 - 961{,}149}{961{,}149} \times 100 = -10.69605233\%$ } 2dp

-10.70%.

ResultsPlus
Examiner Comments

This candidates has got the correct answer of '-10.70%'.

ResultsPlus
Examiner Tip

Some margin for rounding up/down is allowed on mark schemes but do try to be as accurate as you can with calculations.

Question 4 (b)

There are a number of potential answers to this question and any 'likely reason' was awarded. However, a significant number of candidates simply said it was because the UK was exporting more and importing less. This is not a 'reason' for the trade deficit reducing- it is simply saying what a reduction in the trade deficit is.

(b) Explain **one** likely reason for the reduction in the total UK trade deficit in January 2015.

(3)

A Fall in the UK exchange rate making UK exports more competitive in exports, foreign counties have increased purchasing power therefore demand more UK goods

ResultsPlus
Examiner Comments

This answer has a clear reason and has explained it in a logical step-by-step manner. Therefore this answer achieves 3/3.

ResultsPlus
Examiner Tip

Quality not quantity is important. This answer may look fairly brief but it identifies a reason and explains how/why it would lead to a reduction in the trade deficit.

Question 5 (a)

In this question it was clear who knew their multiplier formula and who did not. Candidates need to be practicing such key calculations as part of their exam preparation.

5 In 2014 the Bank of England estimated the marginal propensity to consume of UK consumers to be 0.5.

In 2014 the Chancellor of the Exchequer announced a £15 billion investment programme into UK road infrastructure.

(Sources: http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2014/qb14q405.pdf and https://www.gov.uk/government/news/autumn-statement-2014-16-things-you-should-know)

(a) Using the information above, calculate the total increase in national income, resulting from the £15 billion investment.

(3)

$\frac{1}{1-mpc} = \frac{1}{0.5} = 2.$

£15bn x 2 = £30bn.

ResultsPlus
Examiner Comments

This candidate has the correct answer of '£30bn' and so achieves all 3 marks.

Question 6 (a)

6 (a) With reference to Figure 1, explain the term 'real income'.

(4)

Real income, is the total money that ~~a~~ a household recieves, taking ~~[illegible]~~ inflation into account.
This allows the data to be analysed more effectively because more accurate comparisons can be taken when comparing income in various years.
The graph shows that the highest levels of real income from 2006 to 2013 was in 2008 with around a £675 average weekly income. The lowest was in 2012 at £610 a week.

ResultsPlus
Examiner Comments

This answer achieves the full 4 marks. There is an accurate definition of real income for 2 knowledge marks and application from figure 1 for the other 2 marks.

ResultsPlus
Examiner Tip

Focus specifically on what the question is asking in this question. The second sentence here is not relevant to the question so the candidate is using up valuable time.

Question 6 (b)

This question demonstrates very clearly the importance of candidates carefully reading the question and making sure they understand precisely what is being asked of them. Far too many candidates gave a very generic answer talking about issues like falling aggregate demand but failed to link their writing specifically to UK consumers. Also key with this question was understanding the concept of real income, bearing in mind this is with inflation already taken into account. Finally, this is also the first question on the exam paper that tests candidates' evaluation skills, and it is important that they are aware of what key words like 'assess' mean.

Note that this response is of a very low standard and a better sample answer has not been provided for this question.

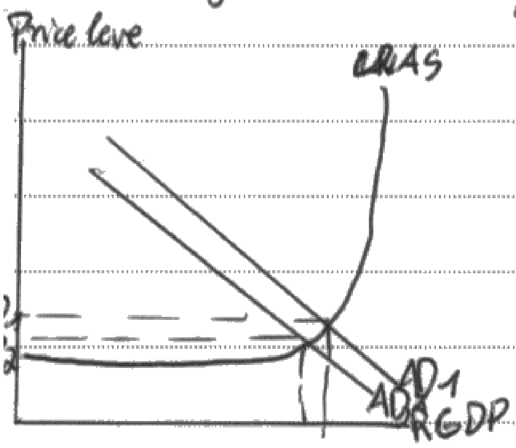
(b) Assess the likely impact of falling real incomes on UK consumers.

(10)

Faling in the real income mean that costumer ~~will~~ confidence will decrease they will gain less for they value in money which mean that they spending may decrease therefore the AD aggregade demand will decrease and shift to the left fom AD_1 to AD_2.

Another impact may be that the firm confidence ~~will~~ may decrease as they may see that high inflation is created from short run aggregat supply side which mean that supply sector is not competitive becase of higher cost which may mean that the films will be less likely to invest in the UK therefor decreasing AD from AD_1 to AD_2.

Faling in costumers incomes may also mean that becase of fault in consumption there is decrease of price pull inflation as price decrease from P1 to P2 meaning that in long run real income may increase.



It may also mean that there will be derease in the imports however more likel that the imports increase as it may be cheaper to imports good from aboard therefo it all depens on the elastisy of the demand for serten imports.

ResultsPlus
Examiner Comments

This answer is too focused on inflation and general macroeconomic effects. It fails to fully address the focus of the question- the impact on UK consumers. The most relevant paragraph is the first one, however there is some correct economics throughout. Overall this answer was awarded a low level 2 for KAA.

ResultsPlus
Examiner Tip

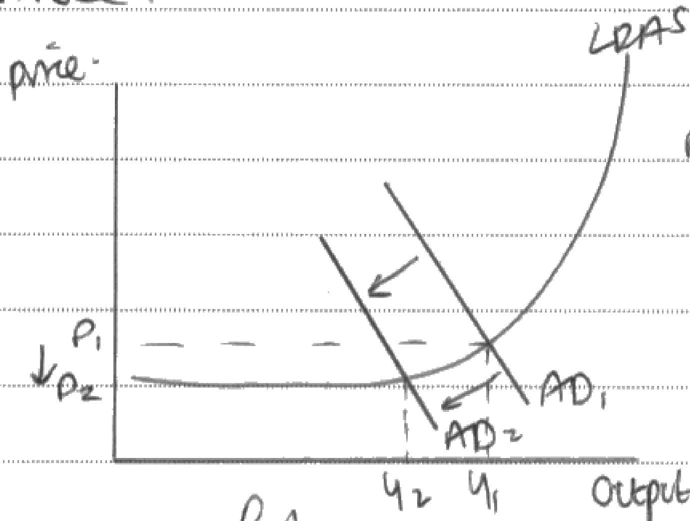
When you're half-way through writing your answer, it's always a good idea to go back to the beginning and read the question again, to make sure you haven't drifted off-topic.

Question 6 (c)

(c) With reference to Extract A, explain the likely effect of a rise in the value of the pound on aggregate demand. AO1, AO2, AO3. SPICED **(5)**

Aggregate demand is the total spending on goods and services in the economy. If there's a rise in the value of the pound, ~~the~~ ~~ex~~ ~~more~~ ~~money you recieve~~ will increase costs when converting into pound, you will get less pounds for your money.

When the pound gets stronger (a rise in the value) the cost of imports becomes cheaper and the cost of our exports ~~on oth~~ to other countries becomes dearer. This means imports increase and exports decrease, consequently decreasing net trade in the components of AD and decreasing AD. This is assuming all other components are the staying the same.



Prices decrease in the UK as a result of excess supply and there is a larger fall in GDP.

According the extract Forbes ~~fishes~~ the said the lagged effects of this increase in 2015 won't last long and won't be so severe to the economy.

ResultsPlus
Examiner Comments

This answer gains the full 5 marks, for clearly explaining the process with appropriate knowledge, application, and analysis.

ResultsPlus
Examiner Tip

In questions about aggregate demand and supply it is always good practice to draw a diagram to back up your explanation.

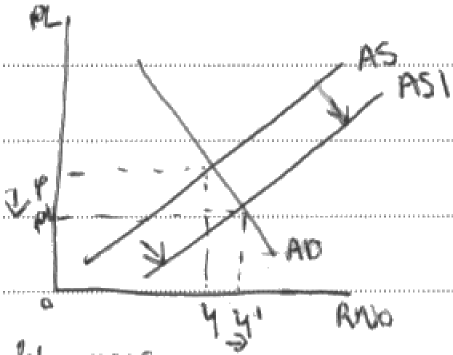
Question 6 (d)

(d) With reference to the data, explain **two** likely reasons for the UK's falling inflation rate.

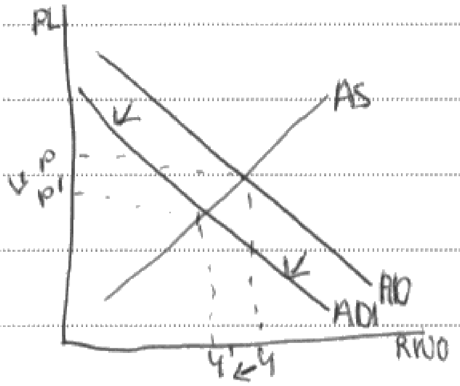
(6)

Inflation rate is the general price of goods and services in economy.

From the extract a contributing factor that caused a fall in interest rates was the decrease in commodity prices (global oil prices which roughly halved since Summer 2014), with a decrease in commodity prices means cost of production decreases so they can supply more which leads to lower prices



Another likely reason is due to falling real incomes which leads to less ~~dem~~ aggregate demand ~~less~~ as they have less ~~in~~ disposable income to buy things so it decreases the inflation rate



ResultsPlus
Examiner Comments

This answer includes two relevant reasons which are well applied and analysed, and as such earns the maximum mark of 6/6.

Question 6 (e)

(e) With reference to Extracts A and B and your own knowledge, discuss whether the MPC should be concerned about the risk of deflation in the UK economy.

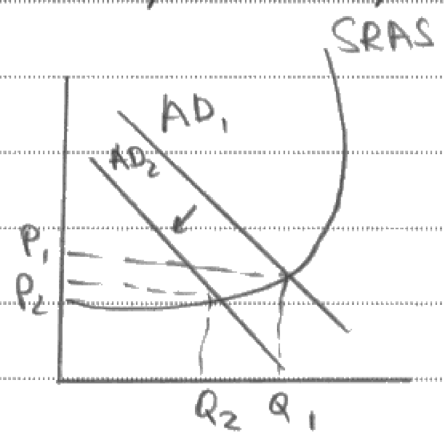
(15)

Deflation is a fall in prices over a certain period of time (usually 6 months). According to extract B, the problem with deflation is that once you have it, you can't get rid of it, because government can use a monetare policy such as decreasing the interest rate in terms to increase spending and ~~the~~ to decrease ~~t~~ savings, but they don't have the policy tools to deal with deflation when interest rates are almost as low as possible. It might be caused by an assumption of government, that with decreasing the interest rate, people will spend more, however, there might be the liquidity trap, which means that people will not to start to spend more.

Moreover, deflation leads to the recession, Because the prices are too low, so businesses have low profits and therefore can not afford to expand and develop. Likewise, since the businesses have lower profits caused by not enough of demand,

there the cyclical unemployment might increase. So, more people are unemployed and more people need to have welfare benefits from government, which increase the government spending and the budget deficit.
~~Furthermore, in the long run~~
However, in the short run, since the prices are low, the exports might increase and the trade competitiveness will also increase, which will lead to decrease in the trade deficit, which is good for an economy. So, in the long term, since there is increase in demand on the pound, the currency will appreciate and come stronger which might help to stabialise the economy and increase economic growth.
Moreover, government have an opportunity cost when deciding to increase welfare benefits, they might instead invest money in infrustructure to improve the economy by multiplier and booting or they can either give subsidies to the firms for them to recover or stabialize. However, the subsidies might not

not be high enough, so won't help. Also, the voluntary unemployment might also increase because the wages are too low because of the low profits.



However, as there is a deflation, and prices are low people will start to consume more and therefore boost an economy. On the other hand, ~~that~~ during the time of deflation people are more likely to save money, rather than spend

ResultsPlus
Examiner Comments

This answer has some good explanation of the problems the MPC has in trying to deal with deflation to start off with and also talks about the risk of deflation leading to a recession. They also have some good evaluation about how it might improve competitiveness. Unfortunately, it does drift off-topic towards the end. Overall therefore this answer is a level 3 for KAA and a level 2 for evaluation.

Question 6 (f)

Answer EITHER

(f) Evaluate whether the MPC has been successful in controlling the UK's inflation rate since 2011.

(20)

OR

(g) Evaluate demand-side policy responses to the Global Financial Crisis of 2008.

(20)

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 6 (f)** ☒ **Question 6 (g)** ☐

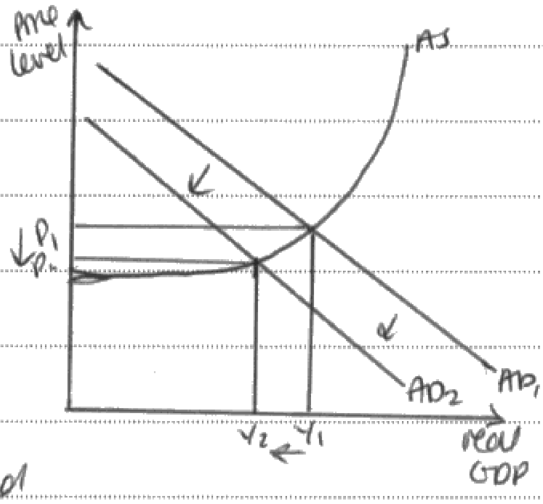
Write your answer here:

The MPC are tasked with an inflation target of 2% within a tolerance range of ±1%. Since 2011 the inflation ~~hat~~ rate has decreased from 4% in 2011 to around 0.5% in 2014. ~~This~~ This was achieved by the MPC primarily through their manipulation of interest rates through the ~~cuts in interest rates to 0.5% in order~~ financial crisis to firstly decrease inflation by increasing interest rates. Though inflation is out of tolerance level, it is ~~1~~ only 0.5% out of tolerance in 2014 than the 1% ~~upwards~~ upwards in 2011.

However, while ~~this~~ interest rates worked initially, recovery in the UK has been slow, and the inflation rate has now fallen extremely low alongside interest rates. These record low interest rates of 0.5% show the failure of the MPC to effectively ~~more~~ en stimulate consumption and AD to increase inflation to the target level away from risk of deflation, showing little control over the inflation rate and unsuccess on the MPC's part.

But, this decrease in inflation is also partly due to the state of the world economy, with the EU in deflation and oil prices sinking. This shows that the MPC cannot entirely be held responsible as they managed to maintain inflation within the target range between April 2012 and October 2014 despite the EU's deflation toward 2015.

However, this keeping in target range may be more due to consumers increasing borrowing on the low interest rates in order to buy on credit. This ~~would~~ may become a problem as national debt rises and the MPC cannot raise interest rates to deter borrowing without risking a total collapse in consumption. As shown on the diagram below, an increase in interest rates will ~~...~~ deter investment and consumption, shifting AD to the left, decreasing price level from P_1 to P_2 and decreasing output from Y_1 to Y_2. This would put downward pressure on AD and causes ~~disinflation~~ decreased inflation, and possibly deflation, which would cause the MPC to decrease interest rates again to stimulate consumption. Therefore effectively creating a loop of increased and decreased inflation and interest rates showing the unsuccess of the MPC's efforts to control inflation.



~~But~~ However, the MPC's decisions are not yet ~~to seem in effect~~ in place, as it takes time for consumers to adjust to new interest rates, and even then the banks can charge different rates. Meaning we do not yet know the confirmed ~~continued~~ effects of the MPC's interest rate cut, as the economy may well bounce back from low inflation to back within tolerance, from demand-pull inflation or cost-push inflation if oil prices rise (cost push) or investment / government spending increases (demand-pull), the MPC may be successful. Moreover, if the MPC increase interest rates by a small amount, this may have little to no effect on consumer spending and keep inflation healthy.

However, if the multiplier is large, any change in interest rates will have a significant impact on consumption, moving AD further left and increasing decreased rate of inflation toward deflation, making the MPC unsuccessful trying to control inflation.

ResultsPlus
Examiner Comments

This is a more able response than the previous one. While it has some of the same points about referring to figure 2 it takes this a step further and discusses, for example, the current state of the world economy and the multiplier effect. The evaluation in particular in this question is more developed than in the first answer. Overall therefore, this answer achieves a high level 3 for its KAA and a low level 3 for evaluation.

Question 6 (g)

This was the more popular of the two essay questions. There tended to be less answers to this question that didn't focus on answering it. However, what did hold back a lot of candidates was that the question did not ask them to evaluate demand-side policies. The question specifically refers to the Global Financial Crisis of 2008. To get top marks candidates' answers needed to be in the appropriate context. For example a discussion of using high interest rates to combat high inflation is clearly not in the context of the UK economy over the last few years. As mentioned on section (f), it is important that candidates remember that their answer should include a 'substantiated judgement' as part of the criteria for level 3 evaluation.

Answer EITHER

(f) Evaluate whether the MPC has been successful in controlling the UK's inflation rate since 2011.

(20)

OR

* UK left too early
* US slowly out, they say that why they are better (economy)

(g) Evaluate demand-side policy responses to the Global Financial Crisis of 2008.

(20)

* tax National debt + deficit

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 6 (f)** ☐ **Question 6 (g)** ☒

Write your answer here:

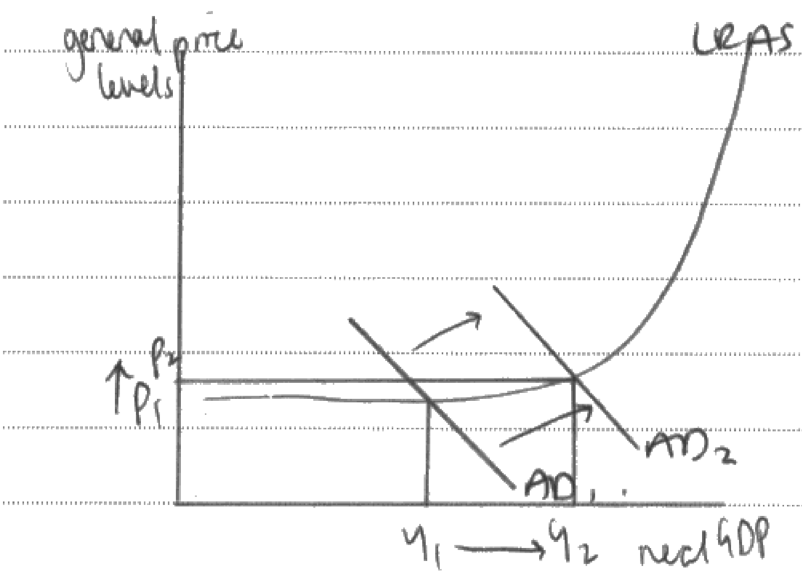
Demand-side policies are policies that stimulate aggregate demand. The policies they used in the global financial crisis of 2008 ~~to~~ were monetary (expansionary) and fiscal (expansionary). Both the US and UK used these policies.

At the start of the recession the govt ~~used~~ implemented expansionary fiscal policy. They temporarily cut taxes (VAT) to 15% from 17% and increased government spending ~~on~~ infrastructure in order to create jobs and increase confidence in ~~spe~~ consumer spending. This was effective because it stimulated a rise in confidence as products became slightly cheaper and ~~people lead~~ unemployment slowly began to reduce. Unlike the great depression, where they cut govt spending and increased taxes (to focus on balancing the budget), the aim of the 2008's crisis policies were to increase demand and actual growth. However this came with consequences of a growing budget deficit and ~~an~~ National debt.

Aswell as this the ~~govt.~~ labour govt used expansionary ~~f~~ monetary policy by lowering the base rate to 0.5, this was not effective enough so they used quantitative easing. Banks could borrow money from the Bank of England cheaper and therefore this meant the banks were more likely to say yes to loans and therefore consumers and businesses could invest in the economy, achieving ~~growth~~ potential growth and a positive output gap. This was only effective because the govt helped banks by giving the money and not letting them collapse like they did in the great depression. This lead to consumer confidence staying the same or decreasing minimaly. ~~Eventually~~

Eventually the govt increased VAT ~~ago~~ but increased it to 20% as people got richer and demanded more goods. In the end, the UK govt saw a recovery period being successful and so they quickly phased out the policies. However, this meant a reduction in confidence but by only a little. The USA on the other hand slowly phased out these policies which helped in the long run because it wasn't quickly back to normality.

In conclusion, the size of the effectiveness depends on whether the increase in govt spending and reduction of taxes was large enough to make a difference. It also depends where we are on the curve, whether the policies will cause too much inflation and not much growth - on this hand we know we are on the elastic part of the Keynesian curve ~~because~~ so as demand increases so too does GDP but not ~~[illegible]~~ price, by much.



There is a greater increase in GDP than price.

It also depends on what curve we are on to which policies we should implement.

ResultsPlus

Examiner Comments

This is a more able answer where the candidate has discussed both expansionary fiscal and monetary policies. There is also a lot of context to their points, where they have clearly tried to relate what they are writing to the Global Financial Crisis of 2008. They have also included a number of good evaluative points, including about the elasticity of the AS curve, for example. Overall this answer achieved a high level 4 for KAA and a high level 2 for evaluation.

ResultsPlus

Examiner Tip

In essay questions it is always good practice to break up your points into separate paragraphs so the structure of your argument is clearer.