Qurious Education

2017 Edexcel 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 2017

GCE Economics 9ECO 02

Question 1 (b)

The circular flow of income shows all the flows of money within an economy between firms and households. There are injections such as government spending, investment and exports, and leakages ~~imports~~ out of the circular flow of income such as savings, imports and taxes. The decrease in unemployment from 8% in 2013 to 5.5% in 2015 could lead to an decreased ~~increased~~ leakage of savings out of the circular flow of income, as individuals feel more secure in their job, so spend more money, leading to a positive multiplier within the circular flow of income

ResultsPlus
Examiner Comments

This answer scores the full 4 marks available. The application is referring to a fall in unemployment. The knowledge for referring to specific injections/ leakages and the impact on the circular flow of income. Finally, the analysis is towards the end of the answer for explaining why falling unemployment would increase the circular flow via a higher multiplier.

Question 2 (a)

Most candidates found this to be a straightforward question. There are 2 marks available for knowledge, 1 mark for the reason and 1 mark for an explanation of that reason. If candidates failed to score full marks on this question it was generally either because they misread the data or they failed to explain their reason for the second mark. Most candidates explained the impact of falling interest rates reducing the incentive to save.

2 The table below shows marginal propensity to save data for an economy.

Year	Marginal propensity to save (mps)
2010	0.11
2011	0.09
2012	0.07
2013	0.05
2014	0.05
2015	0.04

(a) Explain **one** possible reason for the changes in the marginal propensity to save as shown in the table.

(2)

One reason why mps is reducing is due to interest rates falling. This will disincentivise people to save as the return is not great. Therefore they will consume more, increasing marginal propensity to consume.

ResultsPlus

Examiner Comments

This answer scores the full 2 marks. The candidate has identified falling interest rates and clearly explained why it would lead to a lower MPS.

ResultsPlus

Examiner Tip

Be clear and concise in these short questions.

Question 2 (b)

In this question, like 2(a), the marks are again split as 1 for identifying the impact on the multiplier and 1 for explaining it. Many candidates achieved the full 2 marks here. The main problem that let candidates down was not being clear about their multiplier formulas and therefore making mistakes when they tried to use them.

(b) Explain the likely effect of a fall in the marginal propensity to save on the value of the multiplier if other things remain equal.

(2)

The multiplier equals $\frac{1}{mps + mpt + mpm}$ the multiplier will get bigger as mps falls as 1 is divided by a smaller number.

ResultsPlus
Examiner Comments

This answer scores the full 2 marks. The candidate has used the multiplier formula to explain why the multiplier would increase when MPS falls.

ResultsPlus
Examiner Tip

Ensure you know key formulas like the multiplier. In particular, remember that there are several different ways of calculating the multiplier.

Question 3 (b)

The consumer prices index measures the rate of inflation through regular surveys accounting the prices of items that are in the given economy's average basket of goods. The changes are then adjusted in relation to the good's "weight" - how much of a person's income is spent on it. Food for example will be weighted higher proportionally compared to hn bags as more income is spent on food. The changes in prices are then calculated and adjusted then compared to a base year which is set at an index number of 100.

ResultsPlus
Examiner Comments

This answer scores 3/4 marks. There are several points that earn the two knowledge marks available. There is also an explanation of weights for the analysis mark. However, there is no application, so only a maximum of 3/4 marks can be achieved.

ResultsPlus
Examiner Tip

Remember to apply the data when asked to do so.

Question 4 (a)

One likely reason for the change in UK income inequality since 2007 may be due to the implementation of the national minimum wage. By having a national minimum wage people are able to have higher relative incomes meaning the UK income inequality is becoming relatively more equal. This can be shown through the decreasing Gini coefficient e.g. 2007 = 0.36 whereas in 2013 it equalled approximately 0.34.

ResultsPlus
Examiner Comments

This answer scores the full 4 marks. The candidate has correctly referred to the chart and explained how the national minimum wage could explain why income inequality has fallen.

Question 5 (b)

This question asks for two limitations of the HDI to compare levels of development. Many candidates wasted valuable time explaining what the HDI is and how it is calculated rather than getting on and answering the question. A wide variety of limitations could be discussed here. The fact that it doesn't take into account income inequality was a popular one. Candidates also needed to remember to refer to the data they had been provided with about Vietnam and India as part of their answer.

HDI consists of factors such as, life expextancy, average years in school, adult literacy, and newly GNI per capita. The limitations are that it doesn't include ~~for~~ welfare factors, such as internet access, and speed of wifi, or how corrupt the government is. even though vietnam may have a higher HDI (0.666) then India, it may not have better welfare factors such as the speed of internet. so although it's a good unit of measure it does take into account the modern lifestyles that a country is able to offer.

ResultsPlus
Examiner Comments

This answer also scores 3/4 marks. In contrast to the earlier answer, there is application. There is also some knowledge and analysis. However, the candidate has only discussed one limitation so only 1/2 for knowledge can be awarded, hence a maximum mark of 3/4.

Question 6 (a)

This answer is a straightforward percentage change calculation. Most candidates were able to answer this question easily and achieve the full 5 marks. Some candidates forgot the minus (or a reference to decrease or similar) and as such scored 4/5 marks. This question also demonstrates the need for candidates to know key calculations such as percentage change.

(a) With reference to Figure 1, calculate the percentage change in the value of the euro in pounds from the start of 2009 to the start of 2015.

(5)

$$\frac{0.75 - 0.95}{0.95} \times 100 = -21.1\%$$

ResultsPlus
Examiner Comments

This candidate has calculated the correct answer and as such achieves full marks.

ResultsPlus
Examiner Tip

Always ensure you know how to calculate percentage change and other similar calculations.

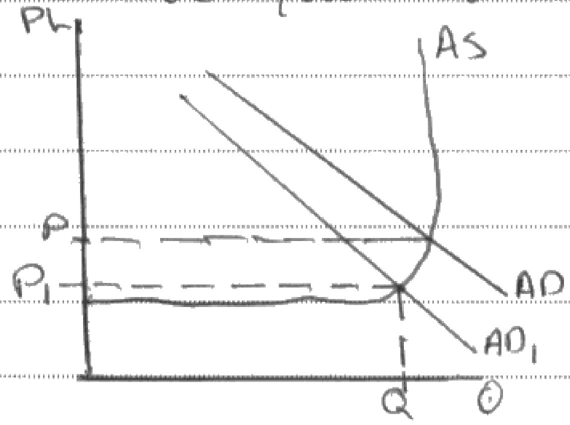
Question 6 (b)

Inflation rate is defined as the rate at which prices are increasing. From the data ~~[illegible]~~ provided ~~[illegible]~~ I can see there has been a heavy fall in the Rate of inflation between the years of 2011 to 2015 dropping from Just above 3% in 2011 to below 0.25% in 2015.

One factor which may explain this change would be a heavy appreciation in exchange rates. If the cost of the ~~pound~~ Euro increases, this would increase imports as more can be bought with the euro as it ~~was~~ ~~[illegible]~~ is Stronger, also exports would decrease as it now costs more to purchase from europe due to ~~to~~ the strong euro. This would then lead to a ~~fall in~~ decrease in the net exports, which is a component of AD. If AD decreases so does the price level leading to a decrease in the rate of inflation.

Another factor maybe a reduction in government spending. if government reduce their spending on the country this will lead to a fall in price level. This is because government

Spending is a Component of Aggregate demand (AD), if government spending decreases then ~~Ag~~ AD will also fall leading to the fall in price level and ~~thus~~ ~~a~~ a fall in inflation rate. As shown in the diagram as any component of AD falls AD shifts to the left from AD to AD1 dropping the price level from p to p1



ResultsPlus
Examiner Comments

This answer scores 6/8 marks. The candidate offers 2 good reasons, along with analysis and application. Unfortunately there is no evaluation, so they cannot gain more than 6 marks.

ResultsPlus
Examiner Tip

Always remember to evaluate in these 8-mark 'examine' questions.

Question 6 (c)

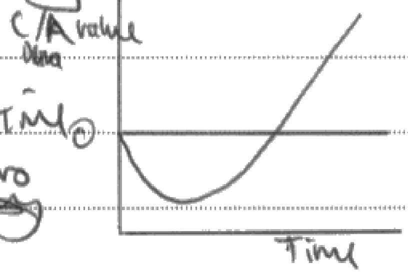
This is the first of the 'levels' marked questions on this paper. This means examiners are not looking to award specific marks for knowledge, application, etc. but that the focus shifts to the level descriptors. Candidates need to ensure they are familiar with these descriptors and that they understand what is required to reach the top levels. For this question specifically, candidates needed to explain how an appreciation would affect the balance of payments of Eurozone countries. So the focus should be on changing prices of imports and exports. The majority of candidates picked up on this but the stronger ones were able to clearly explain the process and put their answer in context. There are 6 marks for KAA here and 4 for evaluation.

(c) Since mid-2015 the euro has appreciated. Assess the likely impact of an appreciation of the euro on the current account of the balance of payments for Eurozone countries.

(10)

An appreciation of the Euro means that it has increased in value therefore is worth more ~~in~~ in comparison to other currencies globally.

One impact this could cause to the current account is a worsening. This is because if the Euro is increasing in value as it did by 3% against the US dollar in 2015 after the ECB Monetary stimulus announcement, this means the price of imports will fall and price of exports will rise. This then means for the Eurozone countries they will be less internationally competitive due to their relative Export prices being higher. This impacts on the current account as higher export price means lower demand and therefore ~~possibly lower~~ a worsening of the current account as the opposite happens to imports as ~~imp~~ demand will rise so causing more money to leave the Eurozone countries than come in. This may be unlikely as if the Marshall Lerner condition is applied it states that the combined Price Elasticity of Demand for exports must be over 1 in order for any change to occur to the current account. Also ~~this~~ a change in currency value takes time for consumption to adjust to it as the J curve states that there will be a time lag between the appreciation of the £ ~~currency~~



and its impact on ~~demand~~ price and demand for imports and exports, this could take around 3-5 years so in the short term the current account won't change, but it is likely to in the Long ~~Run~~ Term as more factors of production are varied and change.

ResultsPlus
Examiner Comments

This answer scores full marks. The candidate has very clearly explained the impact of an appreciation on the balance of payments, in the process demonstrating accurate knowledge and understanding and linking this in context – which clearly fits the KAA criteria for level 3. They have also convincingly evaluated their argument using the Marshall-Lerner condition and the J-curve.

ResultsPlus
Examiner Tip

This answer is relatively concise yet it achieves very highly – remember the emphasis of the levels mark scheme is very much on quality over quantity.

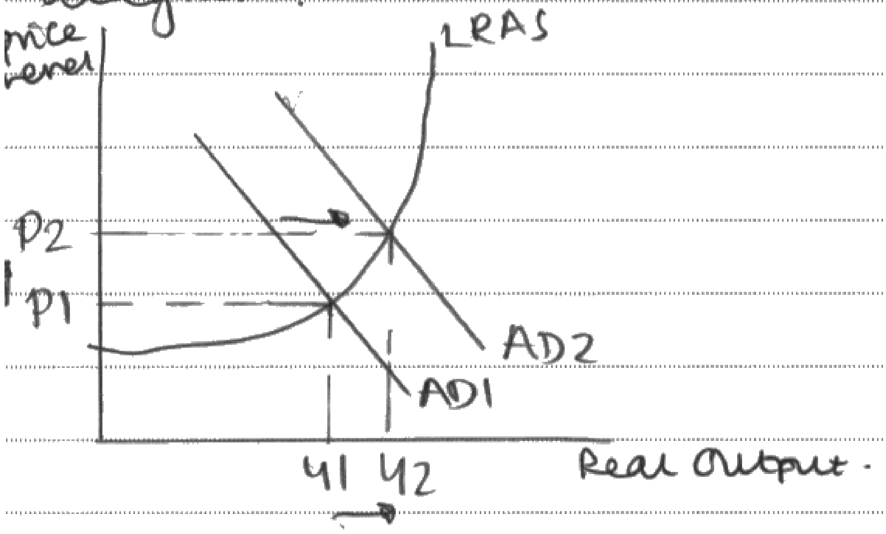
Question 6 (d)

This question is focused on the effectiveness of quantitative easing in impacting upon Eurozone inflation. The stronger answers showed an understanding of what quantitative easing is and how it works, whilst the weaker ones were not at all certain about the process. This was the main obvious issue in this question. Evaluation was generally present and relevant; although sometimes candidates need to be sure they are explaining/justifying their evaluation points – not just stating them.

(d) Discuss the likely success of the ECB's quantitative easing programme in moving Eurozone inflation closer to 'the central bank's ceiling of 2%' (Extract A, line 17).

(12)

The ECB has followed a relatively aggressive scheme of asset purchases with €1.1 trillion estimated to be spent on the scheme by the end of 2016, with an additional €60bn extension of 6 months. This scheme is likely to be successful in stimulating aggregate demand and reaching the inflation target due to the transmission theory of QE. The purchase of the government bonds of European countries by the ECB using electronically generated money has the effect of increasing their price, and as a result reducing the yield on these bonds for investors. As a result, investors may turn to corporate bonds, which would ~~do~~ have the same effect: increasing their prices and decreasing their yields. This will eventually encourage banks to make credit more widely available at a cheaper cost to firms and households (as the rates of negative interest have not already encouraged this enough). this will disincentivise saving and ~~will~~ should encourage the consumption of big ticket items such as cars and electronics as it is cheaper to borrow. the rate of return upon investment will also be higher for firms and will encourage them to invest in capital. this should increase AD as consumption and investment are key components (consumption can account for up to 70%) and so will cause an inflation rate rise, as shown by the following AD/AS diagram:



However, in practice the policy may not have moved inflation as close to the 2% target as the ECB may have liked. The economists even reduced their inflation targets as the stimulus was 'weaker than expected' with consumer prices rising just 1% in 2016 and 1.6% in 2017. Perhaps the stimulus would have been more successful if it increased the 'size of monthly asset purchases rather than just extending the scheme.

Moreover, the QE scheme may have had the opposite effect as Italian and Spanish bond yields actually jumped by 0.25%, suggesting they are now more attractive for investors to buy, reducing the credibility available for firms and households and therefore likely increases in AD and ultimately, inflation.

ResultsPlus
Examiner Comments

This is a very high quality answer that clearly demonstrates a solid understanding of quantitative easing, as well as its effect on AD and therefore inflation (including an AD/AS diagram). The answer is also in context, both in the KAA and the evaluation. Overall this answer scores full marks – 12/12.

ResultsPlus
Examiner Tip

Where relevant, always draw diagrams to aid your explanation.

Question 6 (e)

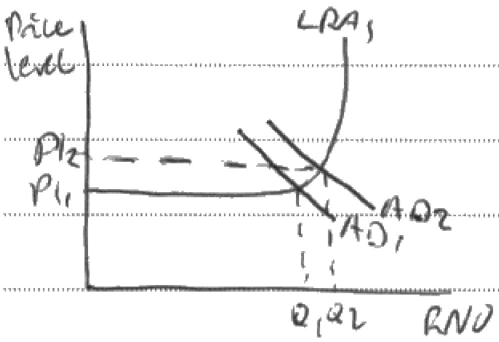
There are two parts to this question, and it is important that candidates discuss both fiscal and supply-side policies. Candidates also need to remember that the question specifically asks how they could be used to increase economic growth, so this needs to be part of the explanation of the policies. The policies also need to be evaluated, and here the number of marks for evaluation has increased to 6.

(e) Discuss 'looser fiscal policy' and 'supply-side reforms' (Extract A, lines 20 and 21) that may be used by governments of Eurozone countries to increase economic growth.

(15)

Fiscal Policy is a Policy which the government can implement to either shift out aggregate demand or shift ~~it~~ ~~outwards~~ inwards. This is done through changes in taxation and government spending. Supply side policy also uses taxation and ~~out~~ government spending but is used to either shift out or in ~~to~~ LRAS.

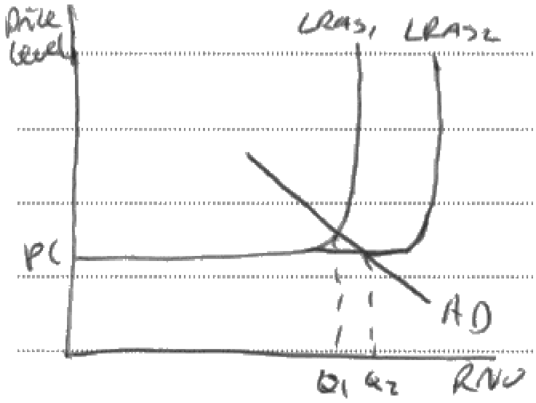
Extract A talks about looser fiscal policy and supply side policies meaning that the policies ~~to need~~ needed to be implemented in order to boost AD and LRAS. With ~~If there~~ expansionary fiscal policy this means that taxation will be lowered e.g income tax and corporation ~~corporation~~ tax. This would cause ~~shift~~ a increase in consumption and investment as households



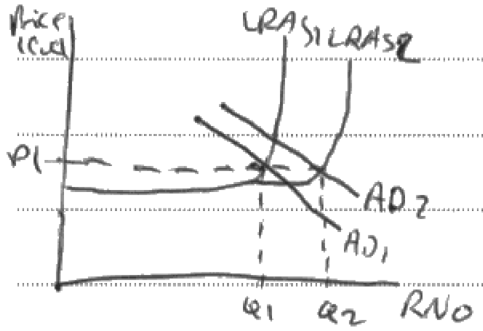
would have more disposable income and firms would have more profit meaning they can invest more. ~~B~~ Consumption and Investment are the two biggest components of AD so would cause AD to shift out there ~~there~~ for increasing economic growth. The government would also increase it's government spending which could be an ~~Subsidist~~ subsidising firms giving them more money to invest there for also causing economic growth. The government could also spend more on health-care there for allowing more people to stay at work as less people will be ill there for causing increases in consumption. Government spending also makes up AD so increases in government spending will cause economic growth.

On the other hand expansionary fiscal policy conflicts with other macroeconomic objectives such as inflation as economic growth causes a increase in inflation and ~~doesn't~~ could cause inflation to go over the target. Also government spending on things such as healthcare have a time lag and opportunity cost to the government as this money could be spent elsewhere such as education.

Supply side policies are also used to increase economic growth. ~~as supp~~ A supply side policy which is lowering taxation such as corporation tax is good for firms as it gives them lower costs and they have excess money which they can invest allowing them to be more productive in the ~~long~~ long run. This along with increasing government spending on such things as ~~infrastructure~~ infrastructure and education would benefit firms as a increase in infrastructure would cause transport costs to decrease e.g. new ~~motorways~~ motorways and a increase in education would cause the labour force to become more productive therefore ~~cause~~ together causing a ~~big~~ big



increase in LRAS. This helps firms achieve economies of scale as firms can now produce more for a cheaper price. This then causes economic growth as this cheaper price in transfered onto the consumers which would then cause a increase in consumption as



goods and services are now cheaper. therefore causing a shift out in aggregate demand.

On the other hand there is a time lag with supply side policies and a high administrative cost to the government. All of the government spending would cause a budget deficit which is fine in the short run but in the ~~longer~~ Longrun could be destabilising as if your national debt gets too high the amount of interest each year you'd have to pay on your debt will start to take up more and more of the governments budget which therefore has huge opportunity cost and could cause government failure.

ResultsPlus

Examiner Comments

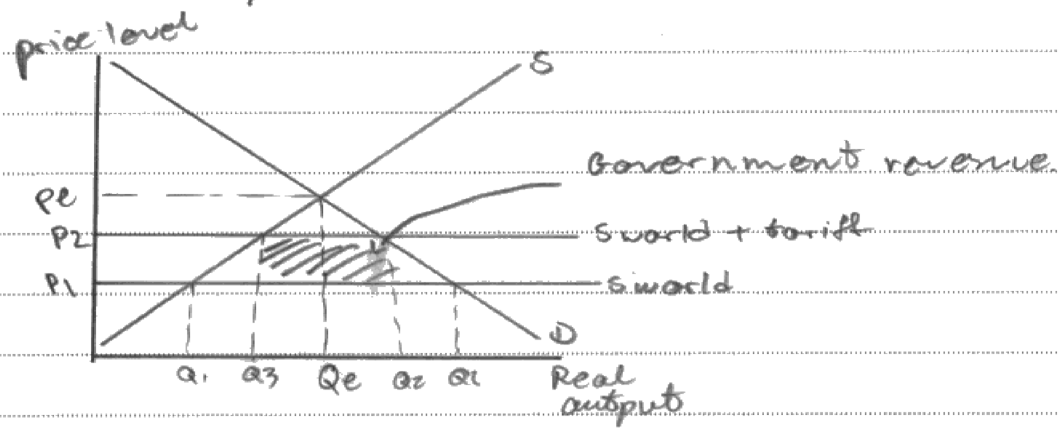
This is a high quality answer that clearly addresses the demands of the question. It starts off with an explanation of fiscal policy, both in terms of less tax and then increased government spending. There is also an AD/AS diagram to back up the explanation. This explanation is a solid level 3 answer. This is followed up by some brief evaluation that is only really worthy of level 1. The candidate then goes on to discuss the supply side of the economy, talking about infrastructure and education. However, this is much less well-explained than the previous part and is only a level 2 response. This is evaluated with a discussion about time lags and a good, detailed evaluation in relation to the budget deficit. Overall this answer is level 3 for KAA and level 2 for evaluation.

Question 7

Write your answer here:

One effect of an increase in protectionism is that by increasing tariffs on imports governments can have an increase in government revenue. An increase in tariffs means that countries will have to pay a higher level of tax on imports. Developing countries such as Kenya could use this revenue from tariffs to develop industries. For example Kenya has increased spending on solar panels and it has led to a decrease in imports of fuel oil ~~to~~ from 51% to 14%.

Government revenues from tariffs could ~~develop~~ be used to develop infant industries in developing countries such as Kenya and its investment in solar panels.



However an increase in protectionism will lead to retaliation. This is because other countries will not see an incentive to trade as it will be more expensive. This will not have a beneficial effect for countries such as Kenya which rely on ~~the~~ primary products such as 21% of tea exports from Kenya. This means that exports will fall and it will decrease injections into the country and it will reduce economic growth ~~and international competitiveness~~

Another effect of increase in protectionism will be that it will lead to a decrease in the level of international competitiveness. This is because protectionist measures ~~a~~ such as regulations/ ~~rat~~ red tape lead to increased transaction costs. This will make it more difficult for countries to trade and so it will have a negative effect on international competitiveness. This is as countries will stop ~~exporting~~ importing goods from ~~a~~ Kenya, but it ~~However~~ will also reduce Kenya's ability to export its goods.

This might however not be the case as the quality of the goods may override the extra costs of trading. Although there might be more protectionism the level of exports might not decrease as quality is more important.

In conclusion protectionist measures could be beneficial for developing countries as it would allow them to protect infant industries and ensure that government revenues will be used to improve domestic industries. This will be beneficial as it can lead to increased economic growth.

ResultsPlus
Examiner Comments

This answer initially focuses on the extra government revenue that a tariff would generate and includes a tariff diagram to back up this point. This is followed by some good evaluation discussing the risk of retaliation. There is also good context in relation specifically to Kenya. The competitiveness point is relevant but not as well-explained as the earlier point and it is followed by an attempt at some relevant evaluation. The answer concludes with a reasonable attempt at a judgement. However the rest of the evaluation is not sufficient to push this answer into level 3 for evaluation. Overall this answer achieves a low level 4 for KAA and level 2 for evaluation.

ResultsPlus
Examiner Tip

Remember to use relevant diagrams to explain your analysis, like this answer has done.

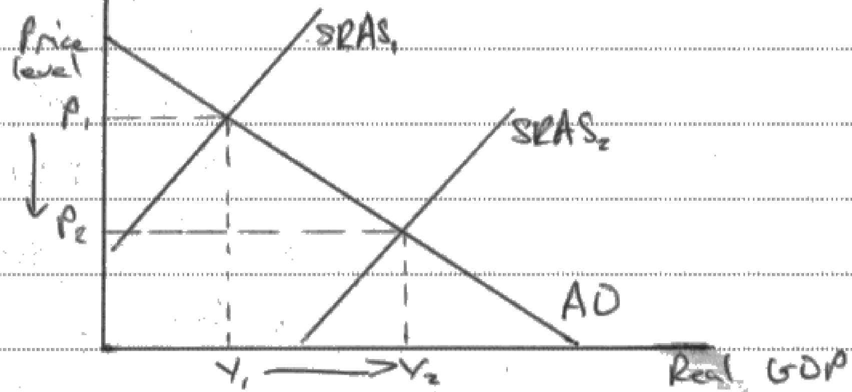
Question 8

This was the less popular of the two essay questions, although it was still completed by several thousand candidates. The focus here is on the significant fall in oil prices and how this might affect the macro economy. It is another broad, open question that candidates can approach from a number of different angles. For example, they could consider oil importers and oil exporters and how they would be affected differently. Similarly to question 7, the focus here is on evaluating consequences – so the evaluation needs to be of the consequence. It was also important for candidates to remember that they are asked specifically for macroeconomic consequences and as such microeconomic consequences are not relevant in this question.

Write your answer here:

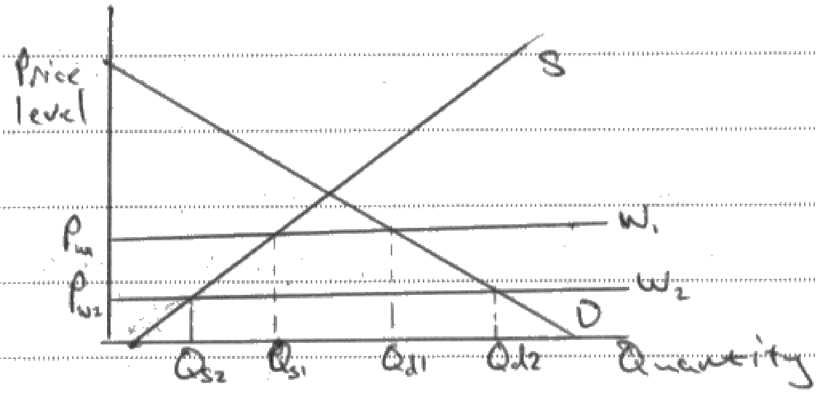
Oil is a key cost of production for most industries worldwide for activities such as transport and energy production, and so when there is such a significant drop in the price of oil, there should be a ~~sig~~ large increase in worldwide aggeragate supply but also a large fall in the economies of key oil producers.

A fall from \$147 to \$27 of oil barrels from 2008-16 ~~will~~ causes a right shift in short run aggerate supply as cost of production fall, ~~sig~~ especially for developing economies like India and China.



As shown, the large shift causes world price level ~~and growth~~ to decrease and growth to increase, causing rapid development across much of the world and falling prices in the developed world. This added ~~gdp~~ growth for development should cause ~~a~~ the quality of life of LEDCs to improve to a great extent by increasing demand for labour and therefore wages, ~~as~~ as well as reducing the cost of products, allowing a much higher consumer surplus. It should also provide the investment needed to kick many developing countries out of the development trap if used wisely. However, it is not certain wheather this benifit will be experienced equally, and it may not have a large trickle down benifit for the poorest people in those countries.

~~1~~ The fall in price will also lead to a lower world price of oil, increasing the current account deficits of oil consuming countries as they consume more oil.



The diagram shows an increase in imports of oil from Q_{s1} to Q_{d1} to the larger quantity of imports of Q_{s2} to Q_{d2}. This ~~greater trade~~ higher level of imports leads to lower net exports and a lower current account, as well as a reduction in that county's aggerate demand and therefore growth rate. This could be potentially dangerous following the 2008 global recession, as a significant fall in growth could lead to further recessions, especially in economically weak countries like Greece. However, the growth of alternative fuels ~~and~~ energy sources like natural gas has lowered the dependency of the world on oil and so ~~increased~~ ~~reduced~~ increased the price elasticity of demand. This change should reduce the effect of ~~a~~ lowering the increase to imports of oil, and so ~~the~~ many nation's current accounts will decrease by a lesser amount.

Overall, a fall in oil prices should cause an ~~[illegible]~~ increase in world growth due to supply increases, especially in developing countries like China or ~~[illegible]~~ Vietnam. However, while that occurs developing nations will likely suffer more from the worsening of ~~the~~ their current accounts, which is already a very prominent problem in the UK, US and fragile economies like Spain and would be made worse by the cut in oil prices.

ResultsPlus
Examiner Comments

This is a good answer which starts off discussing the impact of the drop in the oil price on aggregate supply, coupled with a relevant diagram. It drifts off-topic towards the end of the point. The next point is better, clearly explaining what the impact on the current account would be. However, the diagram is not relevant to the point being made. There is some good evaluation regarding alternative fuels to oil and also an attempt at a judgement. Overall this answer is nearly there, but not quite. It achieves level 3 for KAA and level 2 for evaluation.