Qurious Education

2018 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 2018

GCE Economics A 8EC0 02

Question 1 (a)

This question requires a short but precise definition of gross domestic product (GDP). It is important that candidates are clear in their answers.

(a) Define the term 'Gross Domestic Product'.

(1)

The total value of goods and services produced in an economy over time.

ResultsPlus
Examiner Comments

This candidate gives an accurate definition of Gross Domestic Product and as such achieves the 1 mark available.

Question 1 (b)

This is a GDP per capita calculation question that candidates were able to answer relatively easily. Candidates need to be careful to read the question and the data carefully, as some candidates lost marks because they selected the wrong two pieces of data.

(b) Calculate the UK's GDP per capita in 2015. You are advised to show your working.

(2)

GDP per capita means GDP per head of the population

$$\frac{1,872,714,000,000}{65,100,000} = £28,766.73$$

Question 2 (a)

This question requires an accurate definition of a recession. Candidates were not asked to state the characteristics of a recession in this question.

2 (a) Define the term 'recession'.

(1)

Recession occurs when there is negative GDP growth for two consecutive quarters.

ResultsPlus
Examiner Comments

This candidate has an accurate definition of recession and as such achieves the 1 mark available.

Question 2 (b)

This question required candidates to explain only one characteristic of a recession. Many candidates listed several characteristics and did not often explain the characteristic they had identified.

(b) Explain **one** characteristic of a recession.

(2)

There is usually high level of unemployment during a recession. As AD of the economy is low, firms aren't earning that much profit so they might make workers redundant to reduce cost of production, so unemployment rises.

ResultsPlus
Examiner Comments

This candidate gets 2/2 marks. They have identified and explained a characteristic of a recession.

Question 3 (a)

In this question the marks are split as 1 for knowledge, 1 for application and 1 for analysis. The knowledge comes from identifying one factor that the MPC considers, the application for using the data, and analysis for some development building on the knowledge/factor identified.

3 UK base interest rate, January 2008 to January 2017

(Source: Bank of England, http://www.bankofengland.co.uk/boeapps/iadb/Repo.asp)
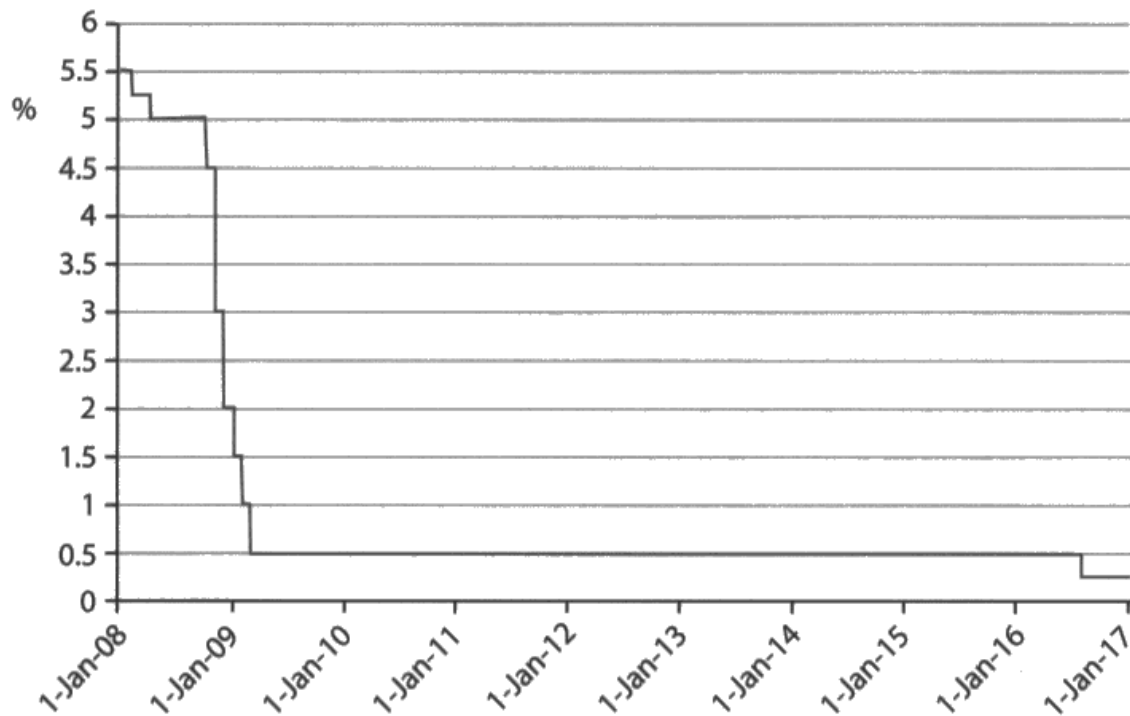
(a) With reference to the chart above, explain **one** factor that the Monetary Policy Committee (MPC) of the Bank of England may have considered when reducing the base interest rate.

(3)

Interest rates the cost of borrowed money, we can see that it
has been decreased from 5.5% in 2008 to 0.25% in 2007, that is
a 5.25% drop. The MPC will have to consider the level of
spare capacity in the economy such as unemployment rate when
setting interest rate, this is because it reflects the level of AD we
are at, so when unemployment is high, interest rates will drop to
boost out AD.

Question 4 (a)

This question requires a clear definition of aggregate demand. Many were not able to provide an accurate definition and hence did not get the mark for this question.

(a) Define the term 'aggregate demand'.

(1)

Aggregate demand is the total demand in an economy. It is calculated this way Consumer spending + government spending + investment + (exports - imports).
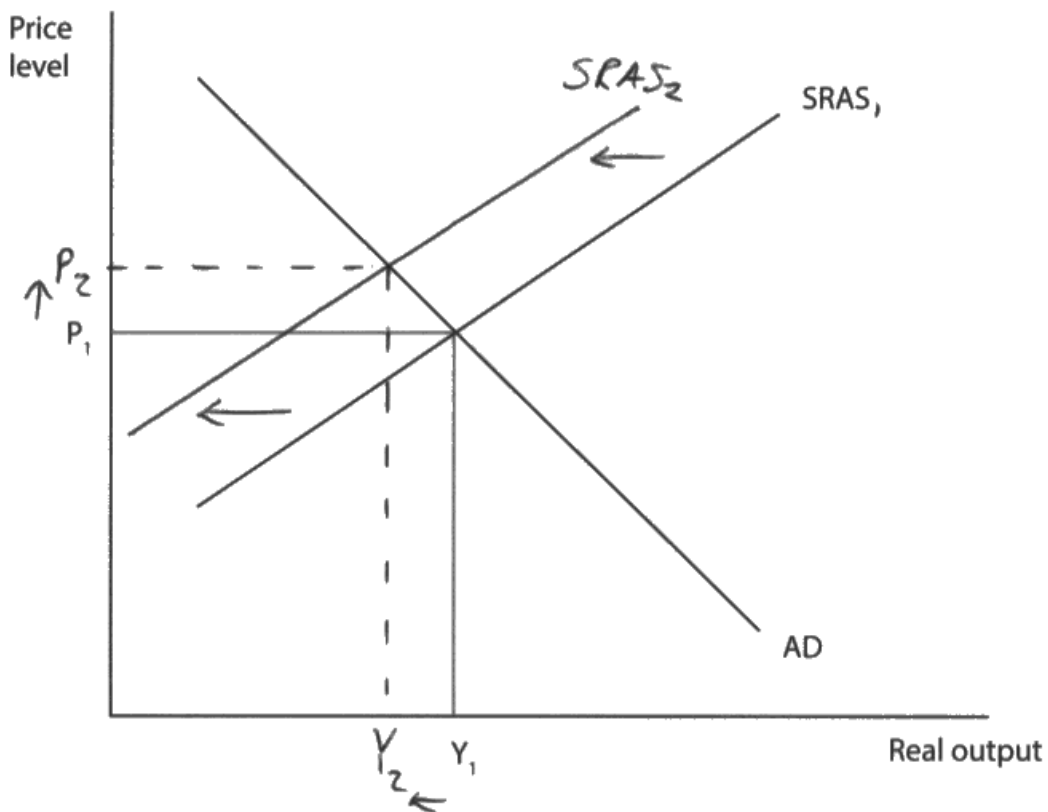
ResultsPlus
Examiner Comments

This candidate achieves the 1 mark as they go beyond mentioning that aggregate demand is the total demand, and provided the AD equation.

Question 4 (b)

This question requires candidates to draw the effect of a rise in the cost of raw materialsin context of an AD/AS diagram. Marks were awarded as 1 mark for the leftward shift in SRAS and 1 mark for a new equilibrium showing higher price level and lower real output. Most candidates achieved the 2 marks on this question.

4   The diagram below shows the aggregate demand (AD) and short-run aggregate supply (SRAS) for the UK.

This candidate achieves 2/2 marks. The shift in SRAS is correct and they have illustrated the new equilibrium and the change in price level and real output with the dotted lines.

Question 5 (b)

This question asked candidates to calculate the forecast UK government spending on social protection as a percentage of total forecast UK government spending in 2016/17. Many candidates were able to answer this question relatively easily. However, some candidates lost marks because they selected the wrong two pieces of data.

(b) In 2016/17 total forecast UK government spending amounted to £772 billion and total forecast tax receipts amounted to £716 billion.

Calculate forecast UK government spending on social protection as a percentage of total forecast UK government spending in 2016/17. You are advised to show your working.

(2)

240 billion out of 772 billion

$$\left(\frac{240}{772}\right) \times 100 = 31.088$$

31%

ResultsPlus
Examiner Comments

This candidate achieves 2/2 marks. They have correctly calculated an answer of 31%.

Question 5 (c)

This question requires a definition of budget deficit. A few candidates were not able to provide an accurate definition, as they confused budget deficit with current account deficit; hence did not get the mark for this question.

(c) Define the term 'budget deficit'.

(1)

When government spending is greater than government tax revenue

ResultsPlus
Examiner Comments

This candidate gives an accurate definition of budget deficit and as such achieves the 1 mark available.

Question 6 (a)

The marks for this question are split in half between knowledge and application. Candidates achieved 2 marks for an explanation of one reason and 2 marks for some relevant application from Figure 1. Candidates lost marks where they were only defining the two measures and not explaining why they differ.

6 (a) With reference to Figure 1, explain **one** reason why the <u>claimant count</u> and the ILO measure of <u>unemployment</u> differ.

(4)

Unemployment is when people who are willing, able and actively seeking for jobs but are unemployed. The claimant count measures the number of people claiming unemployment benefits. For example, in 2010, ILO measure of unemployment was 2.5 million, however, claimant count was only 1.5 million, a difference of 1 million could be seen. This is because the number of people receiving unemployed benefits is smaller than the number of unemployed people. This is because getting benefits require background check and proofs of seeking for employment, which makes it harder. Moreover, some people could be in short-term unemployment, they might not need to live on benefits.

ResultsPlus
Examiner Comments

This candidate achieves 4/4 marks. They have both of the application marks – mentioning both ILO and Claimant Count figures. They also attained 2 knowledge marks for explaining why these measures differ.

Question 6 (b)

(b) With reference to Extract A, assess the likely <u>macroeconomic effects of an increase in house prices.</u> Use an aggregate demand and aggregate supply diagram in your answer.

K A A E
2 2 2 A

(10)
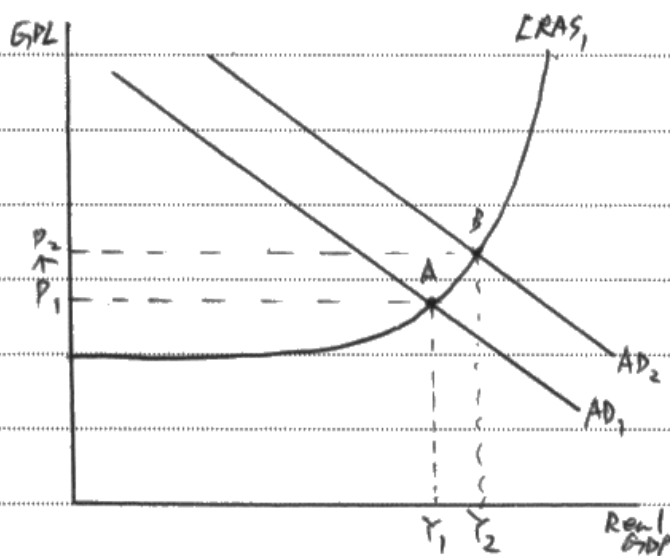
"The average UK house price was £214 000 in June 2016. £24 000 more than it was at its peak in September."

One of the macroeconomic effects is that consumption will increase and therefore AD will shift out. According to extract A, "annual growth increased from 5.2% in July 2016 to 5.6% in August 2011". The higher growth in house prices will will increase consumption as house owners will experience an increase in wealth - the wealth effect. If they take an equity out of their house, they can get hold of more money/cash, which will then be used to buy goods/services. This increase in consumption will therefore shift out AD. However, there are regional variations so the effect on the economy may remain unchanged or insignificant. For example, "annual average growth in London rose by 9.6%", however, "Wales average house prices actually fall by 0.5%", changes in growth in different regions may therefore offset each other.

Another macroeconomic effect is inflation. For example, those who own a house will experience a larger wealth,*

* the higher consumption translates to higher general price level. An outward shift of AD from AD_1 to AD_2 will result in a new macroeconomic equilibrium where output has increased $Y_1 \to Y_2$ and GPL has increased P_1 to P_2. Therefore, it puts an inflationary pressure on goods/services. However, it depends on the size of the output gap (negative) or where we are in the economy. If we are in a recession ie output gap is large, an outward shift of AD will only increase output, and will have no effect on the GPL. If, however, the output gap is small (boom time), then an increase in AD will lead to a high inflation rate.

ResultsPlus
Examiner Comments

This is a more able response, scoring the full 10 marks. It clearly and logically explains different effects of an increase in house prices and also offers two relevant evaluations of these points. The candidate uses the data from the extract to support their arguments.

Question 6 (c)

This question asked candidates for one specific factor, so it is important for candidates to make the most of their time in the exam and not explain two factors. Several possibilities could be explained here, such as real income and unemployment. Popular application amongst candidates included the use of Figure 2. Candidates should remember that in these shorter questions examiners are looking for specific pieces of application.

(c) With reference to the information provided, explain **one** likely factor, other than changes in house prices, that could influence the level of savings of UK households.

(5)

One factor that could influence the level of saving in UK house is unemployment rates. When unemployment levels are high, houses tend to increase savings due to a lack of consumer confidence. They prefer to save rather than spend as they may face financial difficulty in the future, so it would be better to be prepared. Conversely, when unemployment levels are low, consumer confidence increases leading to a higher level of spending as people believe the economy is in a good position. ~~Evidence~~

Evidence of this can be seen in figure 1 & 2. When unemployment claimants in 2010 were at 1.5 million, household saving was at 11.5%. Then when unemployment claimants dropped to 0.8 million in 2015, household saving decreased to 5.9%.

This answer provides exactly what the examiner is looking for and gets 5/5 marks. A relevant point in the form of unemployment rates which is clearly analysed in the first paragraph along with application from the extract in the second paragraph.

Question 6 (d)

This question asks candidates for two factors. It is important that candidates focus specifically on their factors and answer the question in terms of the multiplier. Too much time was wasted on explaining and drawing the circular flow of income diagram without any link to a rise in the value of the multiplier. Each reason needed to be identified and analysed. There are two marks for application, which most candidates attained through the use of an accurately written multiplier formula.

$$\frac{1}{MPW}$$

(d) Explain two factors that might cause a rise in the value of the multiplier.

(6)

One factor is a fall in the marginal propensity to save (e.g. from 0.11 in in 2010 to 0.055 in 2015). This reduces the total withdrawals from the circular flow of income, increasing the multiplier ($= \frac{1}{MPT + MPS + MPM}$) as more money is more money is circulated around.

Another factor is a fall in the marginal propensity to import. If there is a fall in real incomes then consumers may import less, reducing its withdrawal from the circular flow of income. This increases the value of the multiplier, as more money is

This candidate gets 6/6 marks for this answer. They identify two factors - a fall in the marginal propensity to save and a fall in the marginal propensity to import. They get 2 application marks for the use of multiplier formula and their explanation is well made, which gives the other 2 marks for analysis.

Question 6 (e)

(e) With reference to Extract B and Figure 1, discuss the likely impact of migration on employment **and** unemployment in the UK. eval: ~~as they~~ don't work

(15)

~~Employm~~ Unemployment is the number of ~~people~~ ~~with~~ economically active people who are willing and able to work but unable to find employment.

Inward migration of 650,000 people in 2016 is likely to cause an increase in employment, particularly as the reason for 312,000 migrants was employment. Many of the migrants will possess ~~skills~~ high quality skills that ~~can improve~~ many complement the skills of native workers, increasing ~~their~~ labour productivity. This may lead to ~~an increase~~ ~~in~~ a shift of LRAS₁ to LRAS₂ as the quantity and quality of labour improves. This increases long-term ~~gro~~ trend growth ~~which as~~ well as actual economic growth, leading to an increase in employment.
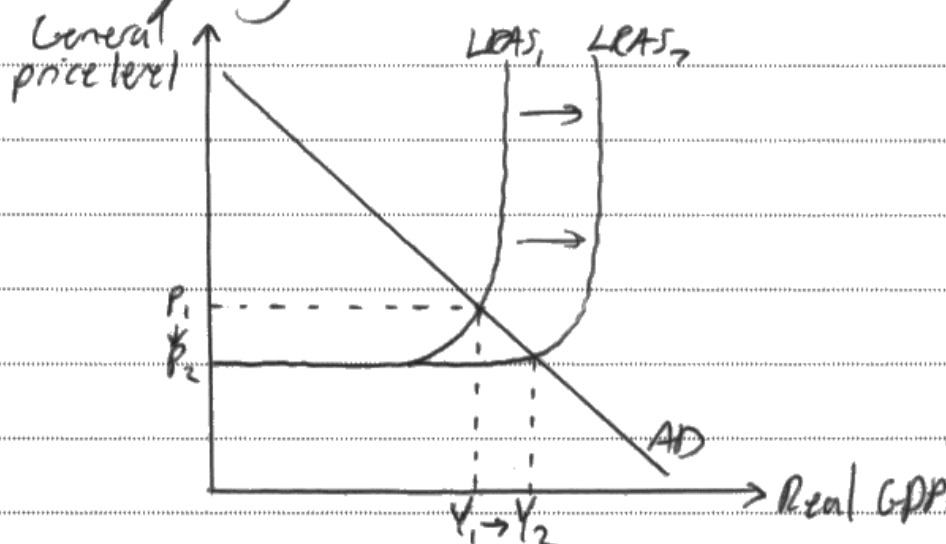
~~Workers may also~~

Migrants may also take jobs that natives are unwilling to do. For example, many Polish migrants work ~~as farm~~ on farms in the UK, ~~increasing~~ that UK workers may be unwilling to do. ~~This increase output.~~

Unemployment in the long-run may also fall in the UK following an increase in immigration. ~~Many immigrants many~~ Some immigrants may set up businesses of their own, possibly ~~using th~~ risking their own capital. This may provide jobs for ~~other~~ natives, reducing unemployment. For example, some Polish immigrants have ~~set~~ created Polish shops which may employ UK workers.

However, if the skills of the immigrants do not complement the skills of UK workers then competition in the labour force may increase. This may lead to an increase in unemployment, particularly as 130,000 of the 630,000 people moving to the UK did not have ~~the~~ a definite job. ~~This may lead to~~ Furthermore, asylum applicants cannot usually accept offers of employment while their case is being processed so they are almost forced to take unemployment

benefits.

In addition, the ~~statistic~~ percentage of those unemployed may fall due to the ~~statistic~~ population increasing due to immigration while th actual figure may not change. This statistical phenomenon may be used deceptively to ~~g~~ argue that unemployment has fallen when it has not in reality.

Question 6 (f)

EITHER

(f) Evaluate government policies, apart from migration policies, that could be used to increase the employment rate in the UK.
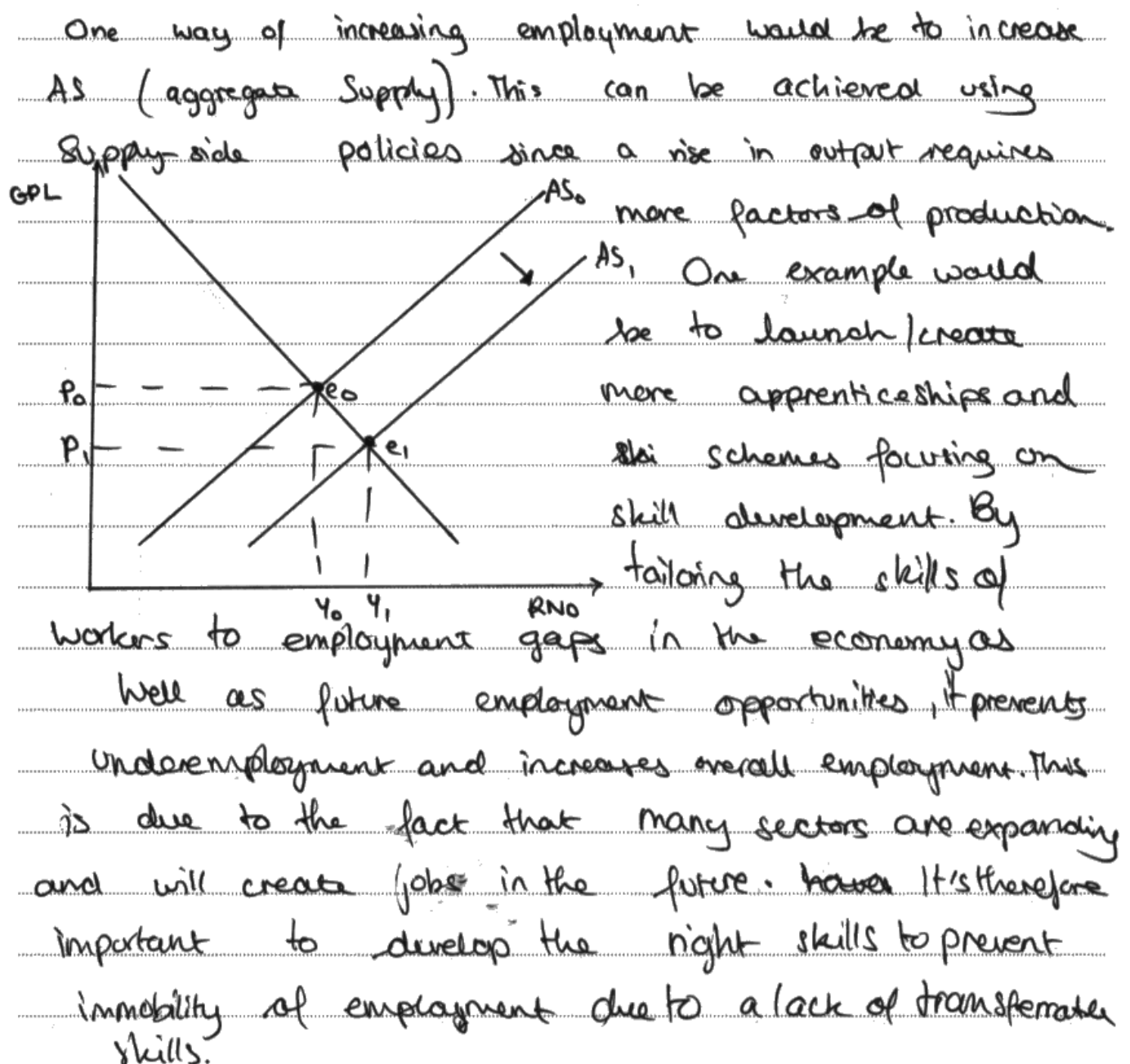
(20)

OR

(g) Evaluate the likely impact of high inflation on the UK government's macroeconomic objectives.

(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:

One way of increasing employment would be to increase AS (aggregate supply). This can be achieved using supply-side policies since a rise in output requires more factors of production.

One example would be to launch/create more apprenticeships and schemes focusing on skill development. By tailoring the skills of workers to employment gaps in the economy as well as future employment opportunities, it prevents underemployment and increases overall employment. This is due to the fact that many sectors are expanding and will create jobs in the future. However It's therefore important to develop the right skills to prevent immobility of employment due to a lack of transferable skills.

However this can prove costly and problematic should the government have too many information gaps. It's possible schemes could be launched into sectors that prove useless long term e.g. coal mining which was made up a significant proportion of employment in the north and no longer does leaving miners stranded with the need to be retrained or face long term unemployment.
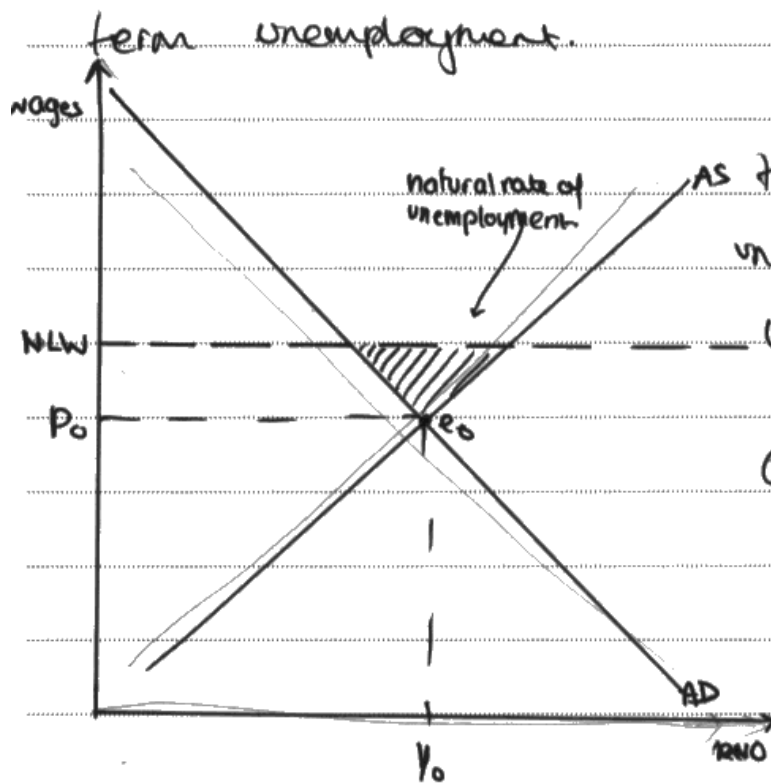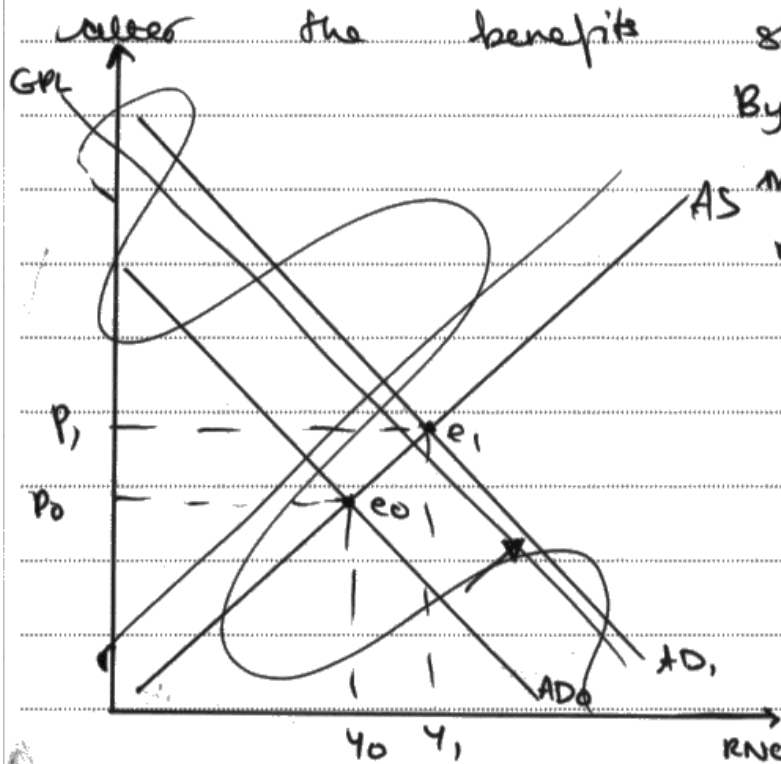

One other alternative that is likely to prove unpopular with workers, would be to reduce the national living wage. Currently in the UK, the rate of unemployment is roughly 4.6%. Since there exists a minimum wage legislation it's impossible to reach employment equilibrium due to this minimum price. By you lowering the minimum wage it would lead to greater demand for workers since the cost of production through wages, falls. This would lead to a decrease in the rate of unemployment since more people would be able to find work. However this brings about the issue

of morality since this would result in a lowering in living standards as well as greater inequality, conflicting with one of the UK's macroeconomic objectives. Not only this but it may not actually work should the benf benefits unemployed workers received be greater or preferable to seeking low paid employment.

One other scheme would therefore be to alter the benefits system in the UK. By reducing benefits or making accessibility more difficult (e.g. raising the number of job interviews a person saver they must get) would encourage employment instead. This By tapering benefits to those who find themselves in employment it allows for a more gentle transition for people incentivising them to keep working rather than return on benefits.
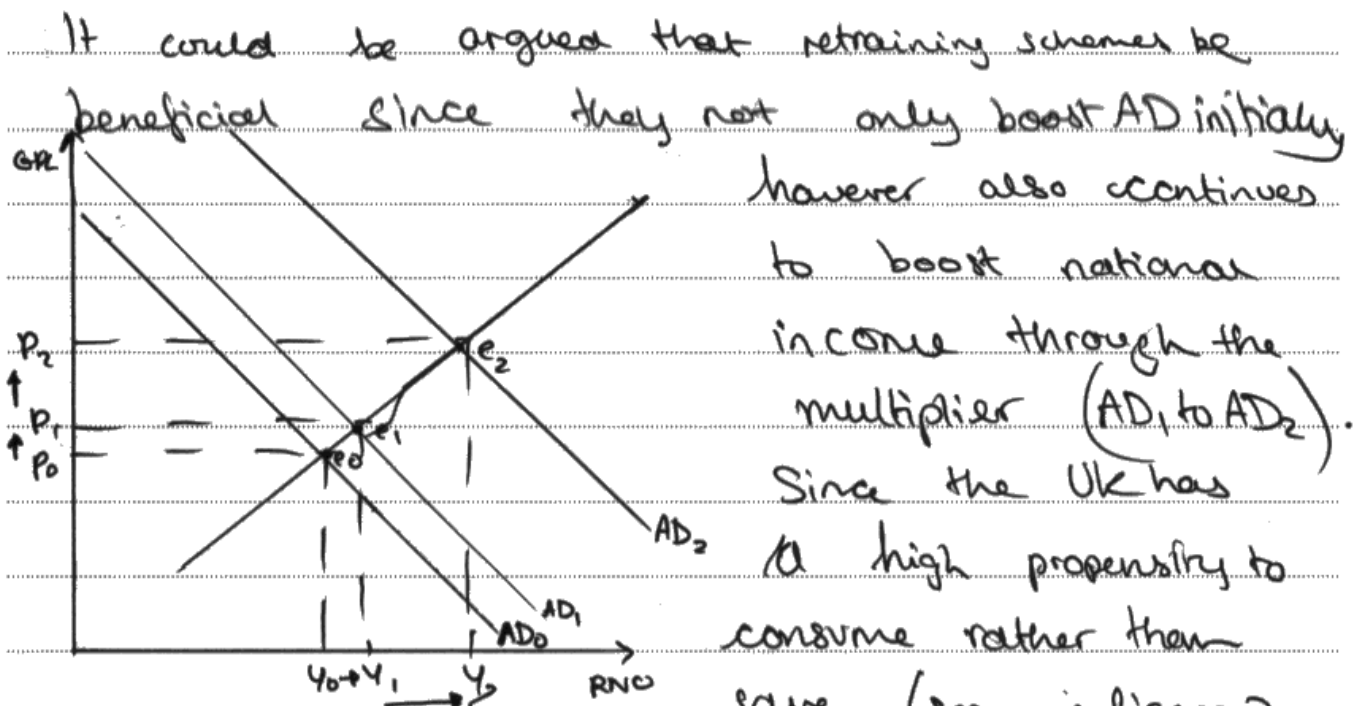
A benefit drawback of apprenticeship and retraining schemes would
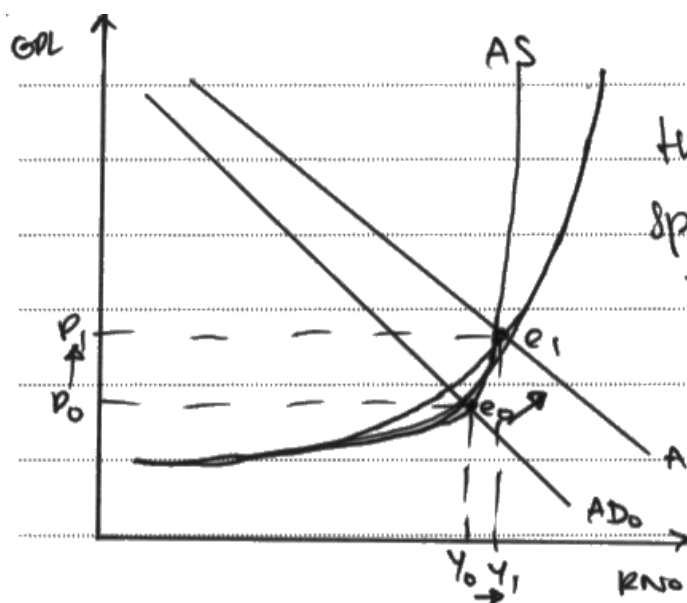
be the inflation caused through a rise in government spending. Since this would increase AD there would be a rise in the general price level however since there is already

~~very~~ conflicting with yet another macroeconomic ~~policy~~ objective, low inflation. For this reason a reduction to the benefits scheme may prove more beneficial since this would actually lower in inflation through a reduction in government spending. However as can be seen in figure 1, there were around 1m people each year who were classed as unemployed yet did not claim benefits. For this reason it can be argued that a policy ~~of~~ affecting benefit schemes would not truly address the issue of unemployment since it would not affect ~~that the~~ roughly half of these unemployed according to the figures for 2016, wherein those not claiming benefits made up half of the total

It could be argued that retraining schemes be beneficial since they not only boost AD initially however also continues to boost national income through the multiplier $(AD_1$ to $AD_2)$. Since the UK has a high propensity to consume rather than save (seen in figure 2

where percentage of savings they fell to soley 5.8% approx.), it's likely the multiplier would be high. Since this would benefit increase economic growth it could be argued to have added benefits however it would add to the its inflation rate and cause widening inequality which could be viewed negatively.

Therefore I would suggest the most effective method to increase the area employment rate be to alter/reduce benefits to ~~incentivise~~ offer retraining schemes and apprenticeships since it would not be restricted to only half of those unemployed on the ILO measure though this would depend on existing underemployment

This is a more able response which clearly fits the criteria for the top levels of both KAA and Evaluation. There is a thorough explanation of government policies that could be used to increase the employment rate. There is a clear explanation of improving access to apprenticeship schemes, reducing national minimum wage and reducing benefits. This is supported by well-developed evaluative arguments about information gaps and inequality.

Question 6 (g)

(f) Evaluate government policies, apart from migration policies, that could be used to increase the employment rate in the UK.

(20)

OR

(g) Evaluate the likely impact of high inflation on the UK government's macroeconomic objectives.

(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:

Inflation is the sustained rise in the general price over a period of time.

Macroeconomic objectives are the targets related to the key indicators of the macroeconomic performance.

Inflation far above the target of 2% (±1%) can have a negative impact on economic growth, ~~inequality~~ standards of living and the current account.

Price level — LRAS, SRAS2, SRAS1, AD, Y2, YF, Real GDP
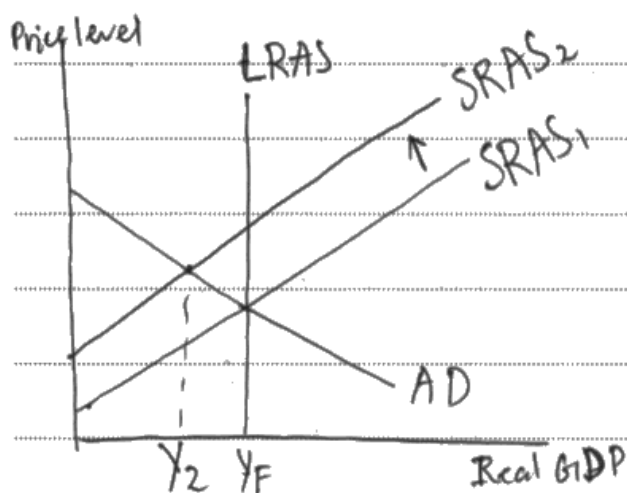
Economic growth may be negatively affected.

As inflation is high, workers may demand higher wages to prevent their real incomes from falling. It increases the costs of production of firms, leading to SRAS decreasing from SRAS1 to SRAS2.

As a result, ~~than~~ the real output decreases from Y_F to Y_2 and ~~unemployment~~ employment decreases from Y_F to Y_2.

~~The impact on economic growth may be different from between different regions.~~

However,
The impact depends on the magnitude of inflation. If there is a slight difference of 1% ~~in~~ ~~compar~~ with the target, then ~~the~~ workers may not demand higher wages, which means no change to the costs of production. As a result, economic growth may not decrease.

Inflation has a negative impact on ~~the~~ the standard of living. People on fixed incomes such as pensioners ~~m~~ will ~~have~~ experience a fall in their standard of living because their wages don't rise at all and are only eroded by inflation. Lower real income means that people can buy less goods and services and can't afford their usual lifestyle, therefore the ~~that~~ standard of living falls.

However, the impact may differ between the short run and the long run. In the short run, pensioners may ~~be~~ see their standard of living falling ~~drastica~~ significantly, but in the long run their standard of living may rise, ~~as~~ because government may decide to increase state pensions.

High inflation can negatively affect the current account. High inflation means that the prices of exports rise fast, meaning that ~~at~~ exports are more expensive for foreign parties and less competitive internationally. Consequently, the total value of exports may fall if demand for exports inelastic, leading to ~~the~~ trade in goods and services decreasing. ~~As a result, the current account deficit increases~~ Moreover, ~~expo~~ imports becomes cheaper for domestic consumers, which leads to the total value of imports increasing if demand for them is elastic. It leads to the fall in trade in goods and services. As a result, the current account deficit increases.

However, the impact depends on the relative inflation rates. If ~~foreign~~ foreign goods' prices rise at a faster rate than the price of exports then ~~them~~ exports may not be less competitive and significantly more expensive, meaning the total value of exports may not fall. As a result, the current account deficit may not increase.

Secondly, the impact depends on the price elasticity of demand for exports. If demand is price inelastic then ~~the total ver~~ the higher price doesn't lead to a fall in the total value of exports. Consequently, the total value of exports may increase, leading to the current account deficit decreasing.

In conclusion, the inflation has a potential to negatively affect the economic growth, the standard of living and the current account. However, the impact depends on time, the state of economy and relative inflation rates.