

Economics

Advanced Subsidiary GCE

Unit **F582**: The National and International Economy

Mark Scheme for January 2012

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All examiners are instructed that alternative correct answers and unexpected approaches in candidates' scripts must be given marks that fairly reflect the relevant knowledge and skills demonstrated.

Mark schemes should be read in conjunction with the published question papers and the report on the examination.

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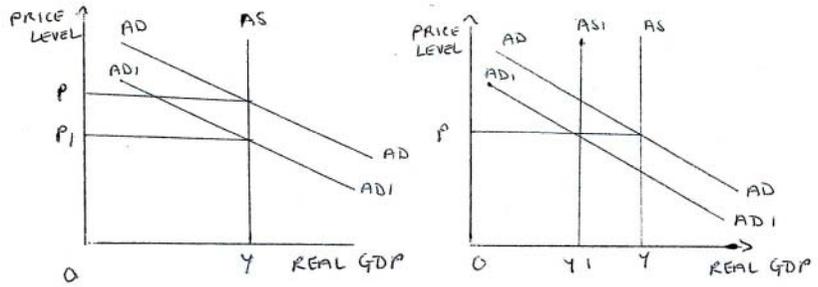
Annotations

Annotation	Meaning
	Unclear
	Benefit of Doubt
	Cross
	Effective evaluation
	Irrelevant
	Level 1
	Level 2
	Level 3
	Level 4
	Not answered question
	Noted
	Too vague
	Tick

Question		Answer	Marks	Guidance
1		<p>One mark for each correct reason up to a maximum of two reasons ie. higher investment, improved education/rise in skills, improved health care/fitter workers, increase in number of workers.</p> <p>One mark for each correct explanation of the two reasons identified e.g.:</p> <p>higher investment will enable workers to work with more capital; improved education will increase productivity; higher AD/economic growth/lower income tax may increase the number of workers employed.</p>	4	The explanation marks are dependent on correct identification.
2	(a)	<p>One mark for absence of fluctuations in the economy</p> <p>One mark for absence of booms and bust/absence of economic or trade cycle.</p> <p>Two marks for avoidance of volatility in any two of - economic growth rates, inflation, employment/unemployment, exchange rates.</p> <p>One mark for avoidance of volatility in one of the following economic growth rates, inflation, employment/unemployment, exchange rates</p>	2	Do not accept ' stable economic growth' but do accept steady or sustainable economic growth as been equivalent to avoidance of volatility in the economic growth rate.
	(b)	<p>Two marks for \$5,130 billion.</p> <p>One mark for correct working ie \$2,052 billion x 100/40 or \$5,130.</p>	2	Accept 5,130 billion

Question	Answer	Marks	Guidance
(c)	<p>Analysis:</p> <p>Up to a maximum of three marks.</p> <p>One mark for data does not generally support the view.</p> <p>One mark for the country, Venezuela, with the highest investment as a percentage of GDP had the lowest growth (actually negative growth).</p> <p>One mark for the country with the lowest investment, Brazil, had the second highest growth rate.</p> <p>One mark for any other relevant supporting comparison e.g. Chile had a higher investment (as a %) than Mexico but a lower economic growth rate or Mexico had higher investment (as a %) than Argentina but a lower economic growth rate.</p> <p>One mark for investment increases AD/may cause actual growth.</p> <p>One mark for investment increases AS/causes potential economic growth.</p> <p>Evaluation:</p> <p>Up to three marks for evaluation.</p> <ul style="list-style-type: none"> • data does not show the actual value of investment. • only a small number of countries shown. • only one year is shown. • economic growth rate is influenced by other factors • GDP data could be nominal not real • there may be a time lag between changes in investment and economic growth. 	6	<p>Note: a candidate cannot access the evaluation marks without any analytical underpinning clearly linked to the question.</p> <p>Up to three marks for one evaluative point well made e.g. economic growth rate is influenced by other factors. For instance a country could have a lower growth of investment but higher consumer spending which may lead to higher economic growth in the short run.</p>
3	(a)	2	<p>Allow one mark for productive capacity of an economy/potential output of an economy.</p> <p>No marks for micro definition i.e. referring to what a firm/producer supplies.</p>

Question	Answer	Marks	Guidance
(b)	<p>Up to four marks for an accurately drawn diagram. One mark for correct labelling of axes. One mark for correct labelling of AD/AS curves. One mark for shift of AD curve to the left.</p> <p>Fig. 2</p>	7	

Question	Answer	Marks	Guidance
	 <p>One mark for shift of AS curve to the left. One mark for old and new equilibriums.</p> <p>Up to three marks for written comments. One mark for it will be likely to reduce $C/I/X - M$/increase savings. One mark for it may reduce real GDP. One mark for relevant comment on the effect on the price level/inflation. One mark for it may cause an appreciation in the exchange rate. One mark for it may reduce employment/increase unemployment. One mark for the effect will depend on the initial level of economic activity/size of change in the rate of interest. One mark for an increase in the rate of interest will increase firms' costs and so reduce AS. One mark for a reduction in investment may reduce productive capacity and so reduce AS.</p>		

Question	Answer	Marks	Guidance
4 (a)	<p>Up to three marks for analysis:</p> <ul style="list-style-type: none"> • higher income tax rates may reduce disposable income/purchasing power. • it may reduce aggregate demand. • Firms will lower output and so need fewer workers. • lower aggregate demand may increase cyclical unemployment • may act as a disincentive to work. • higher tax rates may increase voluntary unemployment/encourage people to live off benefits. • may encourage workers to press for wage rises which may increase firms' costs of production. <p>Up to three marks for evaluation:</p> <ul style="list-style-type: none"> • the effect will be influenced by the size of the increase. • the effect will be influenced by the original rate. • workers may respond to higher income tax rates by working more hours and so AD may not fall. • higher tax income rates may be accompanied by higher government spending and so AD may not decrease/may be offset by a rise in I or (X – M). • higher income tax rates may reduce inflationary pressure and increase exports and employment. • higher income tax rates may not be a disincentive effect if unemployment benefits are low. • higher income tax rates may have less impact on structural and frictional unemployment. • higher income tax rates may not discourage consumer expenditure. • higher income tax rates may not raise unemployment if AD falls on the vertical part of the AS curve. • if income tax is progressive higher rates will affect those on higher incomes more. 	6	<p>Note: a candidate cannot access the comment (evaluation) marks without any analytical underpinning clearly linked to unemployment.</p> <p>Up to three marks for one evaluative point well made e.g. higher tax rates may provide a government with more tax revenue. The government may spend some of this on education and training which could reduce structural unemployment.</p>

Question		Answer	Marks	Guidance
	(b) (i)	One mark for decisions on government spending/government expenditure.	1	
	(ii)	One mark for reference to the rate of interest. One mark for reference to the money supply or the exchange rate. One mark for recognising it is designed to increase aggregate demand/cut in the rate of interest/increase in the money supply/lower exchange rate.	3	
5		One mark each for each of two reasons identified ie. more exports/fall in current account deficit, a rise in the interest rate, economic growth, FDI, speculation, lower income tax, low/stable inflation. Up to two marks for explanation of why reason would increase the exchange rate: <ul style="list-style-type: none"> • More exports would increase foreigners' demand for the currency and higher demand would raise the price of the currency; • A higher interest rate will encourage foreigners to place money in the country's financial institutions which in turn will also increase demand for the currency; • Economic growth may have attracted FDI which would have increased demand for the currency; • FDI may have increased as overall investment increased and this would have increased demand for the currency; • Speculators might have considered that the value of the currency might increase due to higher economic growth or expectations that it will be the 'Latin American decade'. Such expectations would cause them to buy the currency. • If income tax rates were reduced, this might have attracted FDI, thereby increasing demand for the currency. • Low inflation/lower inflation may increase confidence in Brazilian economy and attract more investors. 	6	One mark for each correct identification, Up to a maximum of two identifications, plus up to a further two marks for each of two explanations.

Question		Answer	Marks	Guidance
6	(a)	<p>One mark for setting an inflation target may convince people that inflation will be kept under control.</p> <p>One mark for recognising that if people expect inflation to be low, they will act in a way which causes inflation to be low.</p> <p>One mark for describing how people may behave e.g. consumers will not bring forward their purchases, workers may press for lower wage rises and firms may not push up their prices just to cover expected future higher costs.</p> <p>One mark for makes central bank/government more accountable/provides something for the central bank/government to aim for.</p> <p>One mark for can influence government/central bank policy/monetary /fiscal/supply side policy</p> <p>One mark for identifying a specific policy measure to influence inflation e.g. the rate of interest.</p>	3	<p>Up to three marks,</p> <p>Allow one mark for each point of description but allow development.</p>

Question		Answer	Marks	Content	Guidance
					Levels of response
	(b)	<p>This question requires a discussion of the possible costs and benefits of inflation and what factors influence whether it is harmful or beneficial. Answers may consider that the effects of inflation will depend on its rate, its rate relative to other countries, whether the inflation has been anticipated or not, whether it is accelerating or not and what has caused it.</p> <p>L4 For a discussion of whether inflation is always harmful. (13 – 18) Answers should evaluate whether inflation is always harmful.</p> <p>Examples of possible L4 answers:</p> <ul style="list-style-type: none"> • A high inflation rate is likely to cause more problems than a lower rate. For example, hyperinflation can lead to money ceasing to carry out its functions. In contrast, menu and shoe leather costs are not likely to be significant if inflation is low. • A country may be experiencing inflation but if its rate is below rival country's inflation rates, it may still be becoming more price competitive. • If the inflation rate has been correctly anticipated, measures can be taken to offset its harmful effects e.g. raising pensions in line with inflation. • A stable inflation rate is likely to cause fewer problems than an accelerating one as it will be easier for consumers, workers and firms to plan ahead. • Cost-push inflation tends to be more harmful than demand-pull inflation as it tends to be 	18	<p>Inflation can cause a range of costs including loss of international competitiveness, menu costs, shoe leather costs, random redistribution of income, inflationary noise and fiscal drag. It can also bring benefits eg encouraging firms to increase output, reducing the burden of debt and allowing firms to reduce their real wage costs without increasing unemployment.</p>	<p>Note: evaluation must be supported by relevant analysis.</p> <p>For 16 – 18 marks the discussion must:</p> <ul style="list-style-type: none"> • come to a supported conclusion e.g. inflation is likely to be harmful if it is at a higher rate than trading partners as it will reduce net exports/it may not be harmful if it is of a stable level and is of a demand-pull nature as it may be accompanied by higher output • must be based on strong analysis. <p>For 13 – 15 marks the discussion:</p> <ul style="list-style-type: none"> • may mention that there are both costs and benefits of inflation, that inflation will affect different groups differently, will be influenced by how the rate compares with other countries • must be based on preceding analysis.

Question			Answer	Marks	Guidance	
					Content	Levels of response
			<p>associated with a fall in output.</p> <ul style="list-style-type: none"> • Inflation may be harmful to some groups but beneficial to others. eg the government as a borrower and beneficiary of fiscal drag may gain whereas taxpayers and savers may lose. • Inflation can cause both costs and benefits. Whether inflation is harmful or not will depend on the relative balance of costs and benefits. • Advances in technology are reducing the significance of menu costs and shoe leather costs. <p>For 16 – 18 marks, a discussion must have some depth to the discussion the factors influencing whether inflation always harms an economy.</p> <p>For 13 – 15 marks, a discussion which does evaluate but which lacks some depth or is relatively narrowly focused.</p> <p>Complex ideas have been expressed clearly and fluently, using a style of writing appropriate to complex subject matter. Sentences and paragraphs, consistently relevant, have been well structured, using appropriate terminology. There may be few, if any errors of spelling, punctuation and grammar.</p> <p>L3 For an analysis of either the costs or the benefits of inflation. (9 – 12) Answers should analyse the effects of inflation.</p> <p>Examples of possible L3 answers:</p> <ul style="list-style-type: none"> • Interest rates do not tend to increase in line with inflation and so there may be a random redistribution of income from savers to 			

Question			Answer	Marks	Guidance	
					Content	Levels of response
			<p>borrowers.</p> <ul style="list-style-type: none"> • Inflationary noise may result in consumers, workers and firms making inefficient choices. • Inflation may reduce the international competitiveness of the country's firms and so reduce export revenue and increase import expenditure. • Firms may have to spend time and effort moving money around financial institutions in order to ensure it does not lose its real value – shoe leather costs. • Fiscal drag may occur with tax bands not being adjusted in line with inflation and so workers' pay may be dragged into higher tax bands. • Firms may have to spend time and effort adjusting prices in catalogues, labels etc. – menu costs. • A low and stable rate of demand-pull inflation may encourage firms to increase their output as they will expect to sell more at a higher price. • As the rate of interest does tend to rise in line with inflation, the real burden of debt facing eg home buyers may fall. • Firms can reduce their real wage bill by raising money wages by less than inflation. This may stop firms making workers redundant to cut costs. <p>For 11+ marks there must be some depth of analysis covering three or four effects of inflation. For 9 – 10 marks there may be some lack of depth, covering just one or two effects in sufficient detail. Relatively straightforward ideas have been expressed with clarity and fluency. Arguments are generally relevant, though may stray from the point of the</p>			<p>The analysis must focus on the actual question set bringing out why inflation causes the effect. For 11 -12 marks there should be analysis of three effects of inflation or well developed analysis of two effects. For 9 – 10 marks, there should be undeveloped analysis on two effects or somewhat undeveloped analysis on one.</p>

Question			Answer	Marks	Guidance	
					Content	Levels of response
			<p>question. There will be some errors of spelling, punctuation and grammar and these are unlikely to be intrusive or obscure meaning.</p> <p>L2 For an application of knowledge and understanding of the effects of inflation. Answers should recognise some of the costs and/or benefits of inflation.</p> <p>Examples of possible L2 answers:</p> <ul style="list-style-type: none"> • Inflation reduces exports. • Inflation causes shoe leather costs. • Inflation causes menu costs. • Inflation causes people to pay more tax. <p>For 7 – 8 marks, the answer should recognise at least three or four effects of inflation. For 5 – 6 marks, the answer should recognise one or two effects of inflation.</p> <p>Examples of L1 answers:</p> <ul style="list-style-type: none"> • Inflation is a rise in the price level. • Inflation means that the value of money falls. • Inflation is measured by the CPI/RPI. • Inflation may be caused by demand-pull or cost-push factors. <p>For 3 – 4 marks there will be good knowledge and understanding of inflation. For 1 – 2 marks there will be some awareness of the meaning of inflation.</p>			<p>To gain 8 marks a candidate needs to identify four effects of inflation or at least two effects with a hint of explanation on at least one of these. To gain 7 marks a candidate needs to identify three effects of inflation or at least one with a hint of explanation on this. To gain 6 marks a candidate needs to identify two effects. To gain 5 marks a candidate needs to identify an effect. Some simple ideas have been expressed in an appropriate context. There are likely to errors of spelling, punctuation and grammar, some of which may be noticeable and intrusive.</p>

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