

Mark Scheme for June 2011

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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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Question	Answer	Marks	Guidance										
1 (a)	<p>The economic cycle is the regular fluctuations in economic activity / GDP, characterised by four distinct stages:</p> <table border="1" data-bbox="304 316 1115 730"> <thead> <tr> <th data-bbox="304 316 510 352">Stages</th> <th data-bbox="517 316 1115 352">Description</th> </tr> </thead> <tbody> <tr> <td data-bbox="304 357 510 491">recession</td> <td data-bbox="517 357 1115 491">GDP falls, unemployment rises / low employment, inflation rate falls, output gap rises (negative output gap), low business and consumer confidence</td> </tr> <tr> <td data-bbox="304 496 510 560">recovery</td> <td data-bbox="517 496 1115 560">GDP growth turns from negative to positive but is below trend</td> </tr> <tr> <td data-bbox="304 564 510 699">boom</td> <td data-bbox="517 564 1115 699">GDP growth is above trend, inflation rate rises, output gap closes (positive output gap), unemployment falls / high employment, high business and confidence</td> </tr> <tr> <td data-bbox="304 703 510 730">slowdown</td> <td data-bbox="517 703 1115 730">GDP growth rate falls towards trend</td> </tr> </tbody> </table> <p>One mark for a definition of the economic cycle – regular fluctuations in economic activity / GDP or variation of actual GDP around trend</p> <p>Two marks for a list of all four stages of the economic cycle OR a correctly labelled diagram of the economic cycle (maximum of one mark for 2 or 3 stages only in list or diagram)</p> <p>One mark for a each description of the four stages of the economic cycle</p> <p>Maximum four marks</p>	Stages	Description	recession	GDP falls, unemployment rises / low employment, inflation rate falls, output gap rises (negative output gap), low business and consumer confidence	recovery	GDP growth turns from negative to positive but is below trend	boom	GDP growth is above trend, inflation rate rises, output gap closes (positive output gap), unemployment falls / high employment, high business and confidence	slowdown	GDP growth rate falls towards trend	4	<p>Any of the following terms is acceptable:</p> <ul style="list-style-type: none"> • upturn • downturn • slump • bust <p>Do not credit the following:</p> <ul style="list-style-type: none"> • double dip • depression • seasonal changes • downfall <p>Use green ticks  for each mark awarded</p>
Stages	Description												
recession	GDP falls, unemployment rises / low employment, inflation rate falls, output gap rises (negative output gap), low business and consumer confidence												
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1 (b)	<p>Up to two marks for identifying reasons why convergence of economic cycles is important:</p> <ul style="list-style-type: none"> • single interest rate won't suit all economies; • interest rate will be too high for some / too low for others; • ECB monetary policy will be ineffective / too loose / too tight; • it will be difficult for ECB to set the 'right' interest rate; • a requirement for an optimal currency area; • loss of exchange rates <i>within</i> the euro area. <p>Up to two marks for basic elaboration of any of the above points</p> <ul style="list-style-type: none"> • economies in the boom phase of the economic cycle will need higher interest rates, economies in recession phase will need lower interest rates; • consequence may be reduction in competitiveness for some economies; • single interest rate may not control eurozone inflation; • unable to respond to lack of competitiveness by exchange rate depreciation. <p>Up to four marks for analysis of the consequences of any of the above points</p> <ul style="list-style-type: none"> • impact of interest rates changes on propensities to consume and save; • consequences for C and I; • impact of changes on AD; • impact of changes in AD on the economic performance / competitiveness of economies at different stages of the economic cycle. 	6	<p>1 reason, with basic elaboration and well developed analysis can score full marks (e.g. 1+1+4)</p> <p>No credit for distinction between cyclical and structural (nominal and real) convergence or definition of monetary union</p> <p>No credit for reasons, elaboration or analysis which is expressed in terms of EU rather than eurozone</p> <p>Use green ticks  for reasons (two max)</p> <p>Use green tick plus  for elaboration and analysis</p> <p>In going beyond elaboration marks to award analysis marks look for chains of reasoning</p> <ul style="list-style-type: none"> • e.g. the impact of a single interest rate / changes in ECB interest rate on components of AD and consequently on economic performance of economies at different stages in the economic cycle

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1 (c)	<p>Candidates should analyse and comment on the implication of high rates of economic growth for at least two of the following:</p> <ul style="list-style-type: none"> • employment/unemployment – higher employment, higher standard of living; • inflation – increases; • competitiveness – worsens due to inflation; • current a/c of BoP – worsens; • government’s fiscal position – improves; • impact on FDI – high growth attracts FDI, inflows on financial a/c of BoP; • reduction in negative output gap, emergence of positive output gap; • increase in negative externalities – lack of environmental sustainability. <p>Commentary could mention any of the following:</p> <ul style="list-style-type: none"> • some consequences are positive, some are negative – max bottom L4 where this is the only point of commentary; • consequences depend on the stage of the economic cycle; • consequences depend on increases in productivity/productive capacity; • consequences depend on size of the output gap; • consequences depend on nature of growth – SR growth due to increased AD without adequate expansion of AS is likely to result in significant inflation and BoP problems 	10	<p>In Level 4 award marks as follows: 1 <u>stated</u> point of evaluation = seven marks 2 or more <u>stated</u> points of evaluation = eight marks <u>Developed</u> evaluation of 1 or more points MUST be awarded nine or ten marks</p> <p>Show development with </p> <p>For Level 3 marks to be awarded it is important that these consequences are explained rather than just stated.</p> <p>If only one consequence is referred to candidates should be capped to the bottom of the relevant level, ie seven marks in L4, 4 marks in L3 and 2 marks in L2</p> <p>Watch out for answers that focus on Irish economy 2008 onwards.</p>	<p>Level 4 [7 – 10] Comment on the likely consequences of Ireland’s high rate of economic growth.</p> <p>Annotate using  in LHS margin</p> <p>Level 3 [4 – 6] For an analysis of the likely consequences with no attempt to say what determines the consequences.</p> <p>Annotate using  in LHS margin</p> <p>Level 2 [2 – 3] For an application of knowledge and understanding of the consequences with NO use of economic concepts/theory or reasoning.</p> <p>Annotate using  in LHS margin</p> <p>Level 1 [1] For knowledge and understanding of high rates of economic growth only</p> <p>Annotate using  in LHS margin</p>

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2 (a)	<p>Up to two marks for definitions of the terms</p> <ul style="list-style-type: none"> • short run economic growth relates to increases in GDP (one mark) or is the rate of actual economic growth (one mark) • long run economic growth relates to increases in an economy's productive capacity (one mark) or is the rate of potential economic growth (one mark) <p>Up to two marks for distinctions between the two</p> <ul style="list-style-type: none"> • short run growth is generated by increases in AD or SRAS (one mark), long run economic growth is determined by increases in the quantity or quality of the factors of production / LRAS (one mark) • short run growth refers to a movement towards the PPC (one mark), long run growth involves a shift of the PPC (one mark) 	4	<p>Use green ticks  for definitions</p> <p>Use green tick plus  for distinctions</p> <p>Distinctions should relate to the causes or consequences of short and long run economic growth</p>

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2 (b)	<p>Spain suffered a reduction in competitiveness as shown by the indicators in Figs 2.2 and 2.3. This is because output prices and unit labour costs have risen more than other economies in the euro area and elsewhere.</p> <p>The consequences (Implications) of this reduction in competitiveness include:</p> <ul style="list-style-type: none"> • reduction the demand for their exports; • increase in the demand for imports; • worsening of the current account of the balance of payments; • reduction in net trade and AD (although not consistent with rates of economic growth in stimulus material); • multiplier consequences and impact on employment; • cost-push inflation/shift of SRAS; • capital flight / loss of FDI. <p>NOTES:</p> <ul style="list-style-type: none"> • trends in output prices impact on SRAS but many candidates will analyse impact on AD, ie (X-M) – this is OK • do not credit falling import prices (import prices become RELATIVELY cheaper not ABSOLUTELY) • do not credit BoP without reference to the current account • analysis can focus on explaining why BoP on current account deteriorates rather than impact on AD 	6	<p>Examples of analysis:</p> <ul style="list-style-type: none"> • Higher priced exports will reduce export demand leading to a reduction in AD / deterioration in BoP on current account • Rising unit labour costs shift SRAS to the left causing rise in price level, reduction in real GDP, reduction in employment <p>Examples of application:</p> <ul style="list-style-type: none"> • Rising unit labour costs means that the price of Spanish goods has increased • This will lead to a fall in exports and a rise in imports • Unexplained AD / AS diagrams <p>Examples of knowledge and understanding:</p> <ul style="list-style-type: none"> • Competitiveness is an economy's ability to sell their goods / services at a relatively low price and / or relatively high quality • Spain's unit labour costs have risen by 13% and its output prices by 20% since 1999 causing a reduction in its competitiveness 	<p>Level 3 [5 – 6] For an analysis of the implications of a loss of competitiveness. Analysis begins when candidates explain the impact on current account or AD or employment / unemployment or other macroeconomic issues</p> <p>Annotate using  in LHS margin</p> <p>Level 2 [3 – 4] For application of knowledge and understanding of the implications of the trends in Figs 2.2 and 2.3. Responses in this level will state impacts rather than explain them or simply recognise that exports are likely to fall and imports rise</p> <p>Annotate using  in LHS margin</p> <p>Level 1 [1 – 2] For knowledge of competitiveness and understanding that Spain's competitiveness has worsened.</p> <p>Annotate using  in LHS margin</p>

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<p>2 (c)</p>	<p>Accept any valid policy, including:</p> <ul style="list-style-type: none"> • measures to increase productivity; • reduction in labour costs; • investment in education and training; • subsidy of training or new technology; • measures to improve labour market flexibility; • measures to improve contestability of / improve competition in product markets; • reduction in rate of inflation through contractionary fiscal policy; • measures to improve non-price competitiveness; • withdrawal from the euro area. <p>Accept any valid comment, including:</p> <ul style="list-style-type: none"> • time taken to have an impact; • need for higher government expenditure; • trade union resistance; • possible unemployment in the short term; • why the chosen policy may be better than alternatives; • until labour costs may not fall if there is an increase in wage rates as well as an increase in productivity <p>NOTES</p> <p>Do not accept policies which would not be possible for Spain to implement as a member of the EU such as:</p> <ul style="list-style-type: none"> • export subsidies; • tariffs on imports; 	<p>10</p>	<p>In Level 4 award marks as follows: 1 <u>stated</u> point of evaluation = seven marks 2 or more <u>stated</u> points of evaluation = eight marks <u>Developed</u> evaluation of 1 or more points MUST be awarded nine or ten marks</p> <p>Show development with </p> <p>There should be explicit explanation of how the policy will improve competitiveness for Level 3 marks to be awarded.</p> <p>The policy should be clearly identified.</p> <p>If there is reference to “supply side policies” only responses should be capped to the bottom of the relevant level, ie 4 marks in L3 and 7 marks in L4. If more than one policy is identified, consider all and credit the best.</p>	<p>Level 4 [7 – 10] For a commentary on a policy to improve competitiveness.</p> <p>Annotate using  in LHS margin</p> <p>Level 3 [4 – 6] For an analysis of HOW the policy might improve competitiveness. Alternatively, an analysis of why the policy might NOT improve competitiveness ONLY</p> <p>Annotate using  in LHS margin</p> <p>Level 2 [2 – 3] For an application of knowledge and understanding of a policy to improve competitiveness but lacking explicit economic analysis of how it would work.</p> <p>Annotate using  in LHS margin</p> <p>Level 1 [1] For knowledge and understanding of a policy to improve competitiveness only – ie simple statement of what the policy might be.</p> <p>Annotate using  in LHS margin</p>

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3	<p>Discussion might include:</p> <ul style="list-style-type: none"> • short term consequences of greater openness in terms of reduced employment; • declining terms of trade for agricultural commodity exporters; • greater dependence on other economies in terms of net external demand; • lack of access to developed economy markets; • primary commodity dependence and volatile export prices; • other 'keys' to economic development – domestic savings; • inequality in the distribution of gains 	20	<p>Example of Level 4 Band 3 response <i>“The extent to which greater openness to international trade is the key to economic and human development depends on governments putting measures in place to tackle income inequalities that might arise from the resulting economic growth.”</i></p> <p>Stated judgements = max 19 marks One or more developed judgements MUST be awarded 19 or 20 marks</p> <p>Annotate judgement using </p> <p>Example of Level 4 Band 2 response <i>“The Prebisch-Singer hypothesis states that developing economies, due to their dependence on primary sector production, will face declining terms of trade in the long run as primary products are income inelastic. As they have to export more primary goods to pay for imports of capital they are trapped in a low level of development.”</i></p> <p>Example of Level 4 Band 1 response <i>“Whilst a greater openness to international trade might be an advantage to an economy because the price of imports will fall raising consumer surplus, domestic suppliers may suffer because of increased competition so that there is a reduction in producer surplus.”</i></p>	<p>Level 4 Band 3 [18-20] For a judgement on the factors that determine whether greater openness to international trade is the KEY to promoting economic and human development. <i>In this Band, candidates can consider other “KEYS” to economic and human development or identify why greater openness ON ITS OWN is not the key to economic and human development</i></p> <p>Level 4 Band 2 [15-17] For a discussion of the advantages and disadvantages of greater openness to international trade <u>with EXPLICIT reference to the context of development</u> <i>Undeveloped discussion should be awarded marks at the bottom of Band 2</i></p> <p>Annotate using  in LHS margin</p> <p>Level 4 Band 1 [11-14] For a discussion of the advantages and disadvantages of greater openness to international trade <u>WITHOUT reference to the context of development</u>. <i>Undeveloped discussion should be awarded marks at the bottom of Band 1</i></p>

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	<p>Analysis of the impact of greater openness will need to make use of some, but not all, of the following concepts:</p> <ul style="list-style-type: none"> • demand and supply diagram showing impact of removal of a tariff and / or quota; • theory of comparative advantage and efficiency gains from specialisation; • greater competition and impact on technological progress through increasing the incentives to innovate; • transfer of technology; • access to a larger variety of intermediate inputs; • economies of scale; • AD / AS diagram to show impact of greater openness to international trade. 		<p>Level 3 Candidates are expected to show the impact of openness on economic and human development by making reference to some, but not all, of the following:</p> <ul style="list-style-type: none"> • higher level of GDP; • increased GDP per capita; • higher levels of employment; • greater tax revenues and ability to increase expenditure on health, education and infrastructure; • reduction in poverty; • change in the economic structure. <p>Level 2 Responses in this level will show a TOTAL lack of economic analysis of the impacts but will make some valid general points.</p> <p>Examples of Level 2 response <i>“The advantage of removing tariffs is that consumer choice will increase”</i> <i>“However, USA firms are now undercutting domestically produced Chinese chicken causing a negative impact of greater openness to international trade.”</i></p> <p>Example of Level 1 response <i>“Greater openness to international trade involves reductions in the barriers to trade, e.g. reduction in tariffs and quotas.”</i></p>	<p>Annotate using  in LHS margin</p> <p>Level 3 [5-10] For a one-sided analysis of the impact of greater openness to international trade on economic and/or human development..</p> <p>Annotate using  in LHS margin</p> <p>Level 2 [3-4] For an application of knowledge and understanding of the impact of greater openness to international trade on economic and/or human development.</p> <p>Annotate using  in LHS margin</p> <p>Level 1 [1-2] For knowledge and understanding of economic or human development and openness to international trade</p> <p>Annotate using  in LHS margin</p>

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