RECOGNISING ACHIEVEMENT

GCE

Economics

Advanced GCE

Unit **F585:** The Global Economy

Mark Scheme for January 2013

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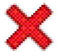
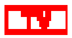
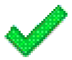
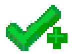
This mark scheme is published as an aid to teachers and students, to indicate the requirements of the examination. It shows the basis on which marks were awarded by examiners. It does not indicate the details of the discussions which took place at an examiners' meeting before marking commenced.

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.

OCR will not enter into any discussion or correspondence in connection with this mark scheme.

Annotations

Annotation	Meaning
	Unclear
	Benefit of doubt
	Cross
	Effective evaluation
	No Development
	Level 1
	Level 2
	Level 3
	Level 4
	Not answered question
	Noted by no credit given
	Too vague
	Tick
	Development of point

Subject specific marking instructions

Some questions may have a 'Level of Response' mark scheme.

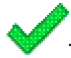
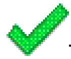
The following guidelines on the **quality of written communication** are embedded into the Levels of Response mark scheme used for question 3:

Level 4: Complex ideas have been expressed clearly and fluently using a style of writing which is appropriate to the complex subject matter. Sentences and paragraphs, consistently relevant, have been well structured, using appropriate technical terminology. There may be few, if any, errors of spelling, punctuation and grammar.

Level 3: Relatively straightforward ideas have been expressed with some clarity and fluency. Arguments are generally relevant, though may stray from the point of the question. There will be some errors of spelling, punctuation and grammar, but these are unlikely to be intrusive or obscure meaning.

Level 2: Some simple ideas have been expressed in an appropriate context. There are likely to be some errors of spelling, punctuation and grammar of which some may be noticeable and intrusive.

Level 1: Some simple ideas have been expressed. There will be some errors of spelling, punctuation and grammar.

Question			Answer	Marks	Guidance
1	(a)	(i)	Exchange rate (max 1 mark) • The price / value of one currency against another (1) Fixed rate:(max 1 mark) • where the exchange rate is set by the government / central bank (1) • where the exchange rate is pegged to another currency (1) • where the exchange rate is maintained by intervention in FOREX markets (1) • an exchange rate not determined by the market (1) • an exchange rate which is not allowed to fluctuate (1)	2	Award one mark for explicit definition of an exchange rate Award one mark for description of fixed rate Use  for each mark awarded Allow “stays equal”
		(ii)	The exchange rate which equalises the price of a basket of identical traded goods and services in two different countries (2) An attempt to measure the true value of a currency (1) in terms of the goods and services it will buy / in terms of a basket of goods and services (1)	2	Up to two marks for an accurate and precise definition or one mark for an idea of true value of a currency, plus one mark for the idea of what a currency will buy Use  for each mark awarded Do **not** allow • PPP as a measure of GDP (but one mark can be awarded for an understanding of adjustments related to differences in the cost of living) • real value/ exchange rate.

Question			Answer	Marks	Guidance
1	(b)		Disadvantages include: • need to maintain high levels of foreign currency reserves; • loss of control over domestic monetary policy; • over or under-valuation; • speculative attacks on the currency; • possible retaliation **Example 1**: High levels of foreign currency are required (1) in order to facilitate intervention in FOREX markets (1) to buy the currency in order to raise demand (1) should the currency fall below its fixed rate (1). This has a high opportunity cost (1). **Example 2**: Loss of control over domestic monetary policy (1) arises because the interest rate must be used to support the exchange rate (1) by, for example, lowering the interest rate to reduce the demand for the currency should it increase above its fixed rate (1). This means that the interest rate may not be appropriate for domestic monetary conditions (1) so, for example, may contribute to inflationary pressure (1). **Example 3**: A fixed exchange rate may become over or under valued over time (1) as it diverges from its PPP rate (1) because changes in demand and supply of the currency are not allowed to changes its value (1). **Example 4**: A fixed exchange rate is prone to speculative attack (1) as it may not reflect its PPP value (1) so may be under or overvalued (1). An overvalued currency may be sold, thus increasing its supply (1) to drive down its price (1). **Example 5**: A fixed exchange rate could lead to retaliation (1). This is because a country may stimulate aggregate demand by deliberately undervaluing their currency (1) raising X-M (1).Other countries may retaliate by devaluing their own exchange rate (1) creating a currency war (1)	6	Award one mark for each valid disadvantage and a further 2 marks for analytical explanation of the disadvantage identified. Use ✓ for each mark awarded Do **not** accept "loss of ability to devalue exchange rate" Do not accept the argument that the stability of the exchange rate attracts FDI as a disadvantage of a fixed exchange rate. Candidates adopting this approach are likely to analyse the disadvantages of FDI rather than of a fixed exchange rate.

Question			Answer	Marks	Guidance: Content	Guidance: Levels of response
1	(c)		Consequences depend on the nature of the external shock. An external shock can be a change in AD or SRAS resulting from a change in economic conditions outside the economy. Analysis of the shock should be in terms of AD/AS, though there is no requirement for this to be diagrammatic. Analysis should be developed to include impact on **two** of: • the change in AD/AS • GDP • employment/unemployment, inflation • balance of payments (current and/or capital account). Commentary could be in terms of: extent of consequences • need for a policy response in a monetary union • nature of the shock (different consequences for different shocks) • extent to which the shock is asymmetric • policy response of monetary authority.	10	If only **one** consequence is referred to candidates should be capped to the bottom of the relevant Level as follows: • commentary on one consequence = seven marks • analysis of one consequence = four marks • application of one consequence = two marks **In Level 4 award marks as follows:** • one <u>stated</u> point of evaluation = seven marks • two or more <u>stated</u> points of evaluation = eight marks • one developed comment = 9 marks • two developed comments or one comment with two points of development = 10 marks Annotate developed comment with **Level 3** Analysis of the extent of the consequences **without** analysis of the consequences themselves should be awarded level 3 only.	**Level 4 (7–10 marks)** For a commentary on the consequences of an external shock for an economy, such as Greece, which is a member of a monetary union Annotate using in the LHS margin **Level 3 (4–6 marks)** For an analysis of the consequences of an external shock for an economy, which makes clear the impact on AD or AS *Analytical responses are characterised by explicit use of the economists' toolkit of concepts and theories and through explanation of cause and consequence* Annotate using in the LHS margin

Question			Answer	Marks	Guidance	
					Content	**Levels of response**
					Level 2 Responses in this level will show a TOTAL lack of economic analysis	**Level 2 (2–3 marks)** For an application of knowledge and understanding of the consequences of an external shock for an economy Annotate using in the LHS margin **Level 1 (1 mark)** For knowledge and understanding of the nature of an external shock for an economy and / or a monetary union Annotate using in the LHS margin

Question			Answer	Marks	Guidance
2	(a)		Up to **three** marks for definitions of the terms: • budget deficit is excess of government expenditure (1) over tax receipts / government income / government revenue (1) in a given time period • national debt is the total / cumulative outstanding (1) money owed by the public sector / government (1) **One** mark for an **explicit** distinction between the two: • budget deficits add to the nation's debt and represent the increase in national debt (1). • Budget deficits are usually smaller than national debt. • National debt is the accumulation of all previous budget deficits • Budget deficit is annual. National debt is over a number of years.	4	Up to four marks Use ✓ for each mark awarded Accept national debt is the total outstanding (1) money owed by the government (1) Do not accept money owed by "the country as a whole including private sector" Award only 1 mark for "**difference"** between G & T Budget deficit must make reference to the government not the economy
	(b)		Without fiscal rules an economy may face problems such as: • persistent budget deficits which are structural in nature rather than cyclical; • unsustainable economic growth and high inflation caused by excessive use of fiscal stimulus measures; • rising levels of national debt; • lack of fiscal credibility and consequent impact on ability to borrow, interest rates, investment, long term economic growth, etc. Max three marks for each example: **Example 1:** Without fiscal rules, an economy may develop persistent budget deficits (1). These deficits may be independent of the economic cycle (1) and could become structural in nature (1). This will create problems as governments may find it difficult to find these deficits (1) without higher long term interest rates (1) which may damage long term economic performance (1).	6	Use ✓ for each mark awarded Do not credit "fiscal rules give stability because it gives goals for a government to follow."

Question			Answer	Marks	Guidance
			Example 2: Without fiscal rules, governments may make excessive use of fiscal stimulus measures (1). This will tend to make economic growth unsustainable (1) as it may do little to raise the productive capacity of the economy (1). Alternatively, it may generate inflationary pressures (1) especially if AD is the economy operates close to full capacity (1) or deficits are not fully funded (1). **Example 3:** Reduced government borrowing reduces supply of bonds (1), which raises bond prices (1), lowering yield on bonds and so long term interest rates fall (1). This stimulates investment (1) which creates the conditions for sustainable/long term/non-inflationary growth (1) **Example 4:** Reduced borrowing and debt reduces expectations of future tax rises (1) which raises consumer and business confidence (1) increasing C and I (1) which results in more stable economic growth rather than go-stop growth (1)		

Question			Answer	Marks	Guidance	
					Content	Levels of response
2	(c)		Valid application from Extract 4: • in the immediate aftermath of Argentina's default the exchange rate depreciated • 1 peso = 1 US$ to 4 peso = 1 US$ • 1 peso = 1 US$ to 1 peso = 0.25 US$ • depreciated by 75%. Valid analysis of the impact of the depreciation of the peso on Argentina's economic growth since 2003: • price of exports falls, increasing demand • price of imports rises, reducing demand • AD increases, raising GDP Valid commentary could include: • importance depends on other components of AD (SR) • depends on size of impact of (X–M) on AD • depends on size of multiplier effect • depends on Marshall-Lerner condition • role of terms of trade (terms of trade increased by 135% 2002–10) • demand for exports affected by economic growth in Asia rather than price effect • depends on influences on LRAS, including changes in capital stock and quantity and quality of labour force.	10	If analysis of the impact of depreciation does not extend to AD, then max marks are as follows: • L4 = seven marks • L3 = four marks **Level 4** In Level 4 award marks as follows: • one <u>stated</u> point of evaluation = seven marks • two or more <u>stated</u> points of evaluation = eight marks • one developed comment = 9 marks • two developed comments or one comment with two points of development = 10 marks Annotate developed evaluation with **Level 3** Analytical responses are characterised by explicit use of the **economists' toolkit of concepts and theories** and through **explanation of cause and consequence**	**Level 4 (7–10 marks)** For a commentary on the extent to which the exchange rate is the most important influence on Argentina's economic growth since 2003. Annotate using L4 in the LHS margin **Level 3 (4–6 marks)** For an analysis of the influence of the exchange rate on Argentina's economic growth since 2003 Annotate using L3 in the LHS margin

Question			Answer	Marks	Guidance	
					Content	Levels of response
					Level 2 Responses in this level will show a TOTAL lack of economic analysis	**Level 2 (2–3 marks)** For an application of knowledge and understanding of influences on Argentina's economic growth since 2003 Annotate using in the LHS margin **Level 1 (1 marks)** For knowledge and understanding of influences on Argentina's economic growth since 2003 Annotate using in the LHS margin

Question			Answer	Marks	Guidance: Content	Guidance: Levels of response
3			**Level 4 Band 3** Judgement might include: • whether FDI is the most effective way may be dependent on economic environment in individual economies • some economies may lack necessary conditions to attract FDI, so ODA may be more effective • FDI may be most effective way for countries with higher levels of development (Latin America) • ODA may be a more effective way for countries with a lower level of development or for countries which lack basic infrastructure or productive capacity (Africa)	20	**Additional example of Level 4 Band 3 response** • Erratic levels of aid will not be as effective as consistent levels of FDI	**Level 4 Band 3 (18–20 marks)** For a judgement on the factors that determine whether or not FDI, such as that to Latin America and Africa, is the most effective way of promoting development. Annotate using in the LHS margin
			Level 4 Band 2 Developed discussion might include: • increases in the savings rate to finance private sector investment - but limited by lack of financial infrastructure • promoting structural change through export promotion / import substituting industrialisation • Overseas Development Assistance (ODA) to fund capital investment, improve infrastructure or health and education - but limited by poor governance - but often 'tied' - but may come with conditions which damage development (criticism of Washington Consensus)		**Level 4 Band 2** **Marks in this level should only be awarded where candidates explain how other methods may promote development e.g. simple recognition that ODA is an alternative remains in L4 Band 1**	**Level 4 Band 2 (15–17 marks)** For a developed discussion which recognises that there may other ways of promoting development Annotate using in the LHS margin

Question			Answer	Marks	Guidance	
					Content	Levels of response

			Level 4 Band 1
			Basic discussion might include:
			• FDI may promote growth but not development because it might
			  - be capital intensive so employment effects may not be large
			  - lead to resource depletion so growth and development may not be sustainable
			• impact of FDI might be limited because
			  - it may be short-lived, dependent on global economic growth
			  - there may be little change in economic structure if concentrated in resource sector
			  - there may be more important constraints on economic development – lack of good governance, missing markets, lack of infrastructure etc
			  - it may lead to current account deficit, eg may raise imports of components
			• depends on nature of FDI
			  - mergers and acquisitions may lead to no impact on economic growth
			  - size of multiplier effects – spill over effects may be limited
						Level 4 Band 1 (11–14 marks)
						For a basic discussion of the pros and cons of FDI in promoting development
						
						Annotate using L4 in the LHS margin

Question			Answer	Marks	Guidance: Content	Guidance: Levels of response
			Level 3 Analysis of the role of FDI in promoting economic development will make reference to some, but not all, of the following: • increases investment; • potentially increases exports; • increases government tax receipts which may facilitate increased expenditure on health, education and infrastructure; • leads to an increase in AD, real GDP and employment; • generates multiplier effects; • raises HDI; • raises productive capacity of the economy; • increases LRAS; • raises the rate of economic growth; • technology transfers raise efficiency of domestic industry; • allows developing countries to change economic structure through importing capital, changing factor endowment; • allows developing economies to ‘plug’ the savings gap (Harrod-Domar model)		**Level 3** Analytical responses are characterised by explicit use of the **economists’ toolkit of concepts and theories** and through **explanation of cause and consequence** **Examples of Level 3 responses** FDI creates jobs and so reduces unemployment (L2). This means that there are higher incomes (L2) raising GDP / GDP per capita (L3). As a result of higher incomes it is likely that there will be a reduction in poverty as there is greater consumption of life sustaining goods (L3). The measured level of development will rise as GDP per capita is a component of the HDI (L3). FDI represents an increase in investment into the economy (L2), which raises the level of both AD and AS (L2). The result is an increase in real GDP, which will increase GDP per capita and living standards (L3), which directly affects the measured level of development as GDP per capita is a component of the HDI (L3).	**Level 3 (5–10 marks)** For a one-sided analysis of whether or not FDI, such as that to Latin America and Africa, promotes development Annotate using in the LHS margin

Question			Answer	Marks	Guidance	
					Content	**Levels of response**
					Level 2 Responses in this Level will show a total lack of economic analysis **Examples of Level 2 responses** FDI creates jobs and so reduces unemployment (L2). This means that there are higher incomes (L2) FDI represents an increase in investment into the economy (L2), which raises the level of both AD and AS (L2).	**Level 2 (3–4 marks)** For an application of knowledge and understanding of whether or not FDI, such as that to Latin America and Africa, promotes development Annotate using in the LHS margin **Level 1 (1–2 marks)** For knowledge and understanding of FDI or economic development Annotate using in the LHS margin

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