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Q16a State one method, other than the output method, of measuring GDP

Commentary on the answer
Correct method given.
1 mark

Q16b Explain what is meant by ‘GDP’ per capita

Commentary on the answer
The candidate offers a partially correct answer. As per the mark scheme the formula was only credited with one mark.

A large number of candidates simply spelt out GDP as ‘Gross domestic product’ and ‘per capita’ as per head. The command word ‘explain’ led the expectation that the concept of GDP would be explored, e.g. ‘total output’ and the mechanics of dividing by the population.
1 mark
Q16c  Using Fig. 2, calculate Germany’s unemployment rate in 2014.  [2]

\[
\begin{align*}
42.75 + 2.25 &= 45 \\
\frac{2.25 \times 100}{45} &= 5.0\% 
\end{align*}
\]

Commentary on the answer
The candidate correctly calculates Germany’s unemployment rate.
2 marks

Q16d  Using information from the case study, compare how Germany and the UK are likely to be affected by a slowdown in the growth of the Chinese economy  [4]

A slowdown in growth may lead to less Chinese investment in Germany and Britain. However, as they are investing $4.8 billion in the UK, compared with $1.6 billion in Germany, the UK economy is going to feel this slowdown more, whereas a lack of investment can lead to decreases in Aggregate Demand, as it is a component of it, and in the long run a decrease in Aggregate Supply. All of which reduce the Real GDP level, and therefore growth. Germany will still feel its effect, but there will be less of a need to fall, as the Chinese are investing less.
Q16e Show, using a diagram, the effect of an increase in China’s exports on China’s exchange rate. [4]

Commentary on the answer

Commentary on the answer

One mark for correct labelling of the diagram
One mark for the original equilibrium
One mark for the rightward shift of the demand curve
One mark for the new equilibrium point

4 marks
Q16f    Using information from the case, explain one reason why total saving was expected to rise in the USA in 2016.  [2]

As the interest rate had been raised and therefore the reward for saving was higher and therefore people have more of an incentive to save.

Commentary on the answer

The candidate correctly identifies a reason from the case study and explains it appropriately. They use good economic terms to concisely answer the question.

2 marks
Q16g   Evaluate whether a large cut in direct taxes will always increase investment. [10]

Yes, you could argue that a large cut in direct taxes will always increase investment as: A cut in corporation tax will lead to higher post-tax profits and therefore firms are more likely to reinvest. Furthermore, a large cut in income tax will lead to higher post-tax income, causing the level of consumption to rise. This rise in consumption boosts firms' sales and therefore confidence, encouraging them to invest.

However, you could argue that it doesn't as: firms and consumers are low on confidence, because there is uncertainty about the economy and the level of inflation. Then firms won't put off investing until it is more secure to do so. Finally, it depends on the average propensity to save; if it is high then consumers will save but spend that much more, and firms won't gain that confidence and therefore invest.

Commentary on the answer

The candidate has correctly identified a direct tax and analyses the consequence of this for firms' profits and investment. They also analyse the consequences of a cut in income tax. A valid counter argument is given which weighs up both sides but no supported judgement is provided.

Level 3: strong analysis and good evaluation

8 marks
In 2015, the Turkish economy experienced an unemployment rate of 9.3% and an inflation rate of 7.4%. Evaluate, using an appropriate diagram(s), the extent to which it is possible for a government to reduce unemployment without causing a rise in the price level.

The unemployment rate is the amount of the workforce that are out of work yet are able, willing and have been looking for work. Inflation is the general sustained rise in price levels across an economy.

Rising the level of Aggregate Demand (AD) in an economy is a possible solution to lower unemployment rates. However, as we can see from the diagram, a rise in AD from AD₁ to AD₂ will cause growth, as real GDP increases from y₁ to y₂, indicating a drop in unemployment, but it will also cause demand-pull inflation. Therefore, demand-side policies such as fiscal and monetary policy are unlikely to work well as they will cause demand-pull inflation, thus suggesting that governments should focus on supply-side policies. For example, policies such as increased spending on education and training, lowering unemployment benefits or upping the tax-free income would all be effective in shifting the Aggregate Supply Curve to the right. The current Conservative government...
Exemplar Candidate Work

AS Level Economics

Up to the tax free income to £11,000 incentivising people to get into work. 

As the Better educated people are more productive, and therefore, as we can see from the diagram, AD, would shift from AS1 to AS2. This causes unemployment to fall as a rise in real GDP indicates a rise in the national level of income and producers would be incentivised to invest as the cost of production were gone down due to more productive workers.

However, on the other hand, a rise in employment will also cause a rise in consumption, which will cause AD to rise as it is now the largest component of it. As you can see from the diagram, a rise in AD may cancel out any drops in the price level, keeping inflation at a consistent same level.
Furthermore, the Phillips curve as drawn below indicates that as unemployment falls, inflation will rise, meaning that to achieve the two objectives can be a challenge.

Moreover, it also depends on the level of spare capacity. If the economy is not at full employment, then demand side will work and supply side policies won’t.

Q17 As I said earlier I believed that to have both low unemployment and inflation, then supply side policies should be used. I believe this as it increases real GDP and lowers the price level, achieving both objectives. However, in the USA, run education and training are unlikely to work as it takes many many years to take effect. Therefore, other supply side policies such as lowering the unemployment benefits as these increase the supply of labour, lowering their wage allowances and increasing therefore increasing production. However, it depends on the type of unemployment; there may be structural, where people lack the skills or these may be an immobility of labour due to a poor transport network.
Commentary on the answer

The candidate provides a structured and logical answer. They address the reasons why government can lower unemployment without increasing the price level and then balance this with a strong counter argument.

Their analysis of how unemployment could be lowered includes an explained diagram and coherent links in their chain of argument. They use economic terms, such as demand pull inflation and macroeconomic policies, appropriately which adds substance to their analysis. They evaluate throughout the essay, initially by explaining the benefits of supply side policies instead of monetary or fiscal policies. This evaluation is supported and comprehensive.

The Phillips curve shows they have a strong understanding of the trade off between unemployment and inflation.

The final paragraph is saved from just being a summary by their consideration of which type of unemployment is in question.

Level 4: good knowledge, strong analysis and strong evaluation

20 marks
Q18 The UK government planned to reduce the budget deficit of £87.3bn in 2014-15 to £75.3bn in 2015-16, mainly through reduced government spending. Evaluate, using an appropriate diagram, the effect of a reduction in the budget deficit on an economy.

A budget deficit occurs when government spending exceeds tax revenue. This is yearly. There are two main reasons why a budget deficit occurs:
- Firstly, there is a cyclical budget deficit arising due to automatic stabilizers in a recession. Secondly, there is a structural budget deficit arising when the government cut taxes to stimulate the economy.

When a government runs a large budget deficit, this needs to be financed usually in the form of borrowing. Of course, this money needs to be paid back in the form of interest. When governments borrow large sums of money, it can put upward pressure on the rate of interest. This in turn means private sector firms face an increase in the cost of borrowing and businesses will need to borrow less as a result. Government debt will fall. This will enable future governments to generate surpluses and pay off the debt. Therefore, by reducing the budget deficit, in the future, the government is not putting large sums of debt to spend on schools and hospitals.
Strong health service.

A reduction in the budget deficit will put downward pressure on the interest rate. As the government will borrow less to fund the deficit, the PSNCR will be lower. This will mean private sector firms face a lower cost of borrowing and could lead to higher investment in the private sector. Private sector firms are crucial to the economy as they are profit driven so have an incentive to minimize costs and innovate to remain competitive. If interest rates are lower, firms are more likely to borrow to fund investment. Investment is a component of aggregate demand so investment should increase as shown in the diagram below.

As shown in the diagram below, as AP increased from AP1 to AP2, firms have an incentive to
18

From Y1 to Y2, this leads to short-term economic growth. Labour is in derived demand, derived from the demand for goods and services. As more goods are demanded, unemployment will decrease; however, a rise in the price level pushes up the cost of production, causing the price level to rise from P1 to P2. This leads to demand-pull inflation.

But this may not happen as the UK currently has a negative output gap, meaning there is discomfort.

18

Spares capacity for a rise in AD to be met by left side of demand.

However, a reduction in the budget deficit will not always benefit the economy. A lot will depend on how the deficit is reduced. George Osborne and the current Conservative Government are planning to do this by implementing austerity measures, cuts to government spending, and cuts in the welfare bill, such as...
18. In the long run as there will be a lower quality education more people will lose the skills and qualifications required to get a good job. As a consequence, the long-term productivity will fall if the economy shifts from PPC1 to PPC2.

However, a reduction in the UK budget deficit will be more beneficial to the economy if it was done by clamping down on tax evasion, rather than making cuts like Google.

18. And Starbucks pay their taxes properly and do not avoid paying the total tax revenue will rise meaning the government doesn't need to impose such
Exemplar Candidate Work

Overall a reduction in the budget deficit will benefit the economy of the government. The need to borrow as much which will reduce national debt. When national debt falls it ensures future generations are not burdened. Another man advance of reducing the budget deficit is it will put downward pressure on the rate of interest. This leads to crowding out of private sector firms. This should help the economy grow and improve economic help to shrink debt as a percentage of GDP.

18 Overall state of the economy.

It is also important that the economy is growing at a stable rate with unemployment falling at a 4% rate level. The government will also need to tackle the problem of low inflation with inflation at 0.5% as of March 2016. This is well below the benchmark of 2.00%.
Commentary on the answer

The candidate has a strong understanding of the term ‘budget deficit’ and they provide strong analysis of the benefits of a reduction in the deficit, recognising that it will free up finances to fund education and the health service.

They also analyse the PSNCR and the concept of crowding in which adds sophistication to their answer. An AD/AS diagram that is fully embedded into their explanation furthers analysis.

Their answer is balanced as they allow enough time for a thorough counter argument. They explain the consequences for income inequality and the long run consequences of less spending on education due to austerity measures.

The penultimate paragraph is a summary of previous arguments but there is sufficient strong evaluation throughout the answer to justify full marks.

20 marks
Q16a    State one method, other than the output method, of measuring GDP.  [1]

Commentary on the answer
The answer is incorrect.
0 marks

Q16b    Explain what is meant by ‘GDP’ per capita.  [2]

Commentary on the answer
The candidate has some understanding that it is output per person but hasn't explained GDP.
1 mark
Q16c Using Fig. 2, calculate Germany’s unemployment rate in 2014. [2]

Commentary on the answer
The candidate has used the incorrect figure for the labour force; they have divided the number of unemployed in Germany by the number of employed rather than initially adding the two pieces of information to provide the figure for the labour force (45m).

0 mark

The calculation of the rate of unemployment produced a wide range of solutions with around half the candidates answering correctly. Centres may wish to develop candidates’ understanding of how the economic data from countries is derived.

Q16d Using information from the case study, compare how Germany and the UK are likely to be affected by a slowdown in the growth of the Chinese economy. [4]

Commentary on the answer
The candidate explains that the Chinese slowdown will reduce demand for UK exports but there isn’t any comparison between the UK and Germany or an explanation of why the UK will be affected more than Germany.

1 mark
Q16e Show, using a diagram, the effect of an increase in China’s exports on China’s exchange rate. [4]

Commentary on the answer

One mark for a correctly labelled diagram (quantity of exports was credited with BOD)

One mark for the original equilibrium

2 marks
Q16f Using information from the case, explain one reason why total saving was expected to rise in the USA in 2016. [2]

Commentary on the answer

The candidate correctly identifies the reason (increase in interest rates) and explains (with good use of economic terms) the consequence for savings.

2 marks

Q16g Evaluate whether a large cut in direct taxes will always increase investment. [10]
Commentary on the answer

Due to the initial definition it is assumed that the candidate understands that firms will experience a cut in corporation tax and households a cut in income tax.

There is good enough analysis with some developed links of the consequences of a cut in indirect taxation.

The candidate makes an attempt to evaluate but it is a series of statements rather than really weighing up both sides and there isn't a supported judgement.

Level 3: good analysis and good evaluation

7 marks

Q17 In 2015, the Turkish economy experienced an unemployment rate of 9.3% and an inflation rate of 7.4%. Evaluate, using an appropriate diagram(s), the extent to which it is possible for a government to reduce unemployment without causing a rise in the price level. [20]
**LRAS****1** is the curve which shows where the economy is working at before the implementation of any supply-side policies. **LRAS****2** is **LRAS** when the government has implemented policy. It shows a movement along the **AD** curve, so has a positive impact when trying to achieve the objective of real sustainable growth. However, it also shows a decrease in the price level so deflation occurs.

Deflation means the objective of a low and stable inflation rate is not achieved. Deflation also causes consumption to decrease as consumers put off buying things as they believe prices will become lower. In the long run, this does not increase **AD** and may shift **AD** left. Supply-side policies such as training are not always immediately effective as there may be a long lag time. If **schools** are training students to increase opportunity and decrease occupational immobility the students will not enter the job market straight away, so training and education
is only a long term solution. As our goods become less expensive, our exports may go up, lessening the balance of payments deficit. The objective of low unemployment is achieved; however, policies such as an expansionary fiscal policy may decrease unemployment through an incentive to work as there are lower taxes. However, fiscal policy causes inflation as it shifts AD to the right. Monetary policy may be used to devalue the pound and increase the derived demand for labour through an increase in demand for labour. However, this would also cause inflation as consumption would increase due to the incentive to borrow from low interest rates. (X-M) would also increase, shifting AD and causing inflation and also making it.

Overall, if the government uses supply-side policies, it can reduce unemployment without causing inflation; however, there is a trade-off with objectives. Low unemployment and growth is achieved at the expense of a low and stable inflation rate and an unbalanced balance of payments. The amount of growth and
Commentary on the answer

The candidate understands that supply side policies increase the long run aggregate supply curve and shouldn't result in an increase in the price level. They have provided reasonable analysis of this although it lacks economic vocabulary (referring to supply side policies generically rather than choosing specific ones) and a comprehensive chain of reasoning. They provide reasonable evaluation on deflation, recognising that this will miss the objective of low and stable inflation – however this is a little off the point of the question.

There is some further, limited, analysis on fiscal policy and there is an attempt at evaluation as they understand that a reduction in taxes could increase AD and cause inflationary pressure.

Their analysis of monetary policy misses links, there is no explanation of why a devaluation of the pound will increase demand for labour and therefore this remains as reasonable analysis.

The candidate's final paragraph includes evaluation as they consider both sides of the argument but there isn't a sense of weighing things up or a supported judgement.

Level 2: reasonable knowledge, reasonable analysis, reasonable evaluation

10 marks
Q18 The UK government planned to reduce the budget deficit of £87.3bn in 2014-15 to £75.3bn in 2015-16, mainly through reduced government spending. Evaluate, using an appropriate diagram, the effect of a reduction in the budget deficit on an economy.

18. The Exchange Rate is the value of a currency in comparison to another currency (i.e. 1.4$ USD is equal value to £1 GBP).

Inflation is the increase in the general price level of an economy, and Real GDP is the total national output of all goods and services.

A reduction in the budget deficit can be achieved by a cut in Government spending; as Government Spending is a component of Aggregate Demand (C + I + G + (X - M)), a decrease in it will cause a leftward shift in AD from AD1 to AD2. This leads to a fall in real GDP from Y1 to Y2, and a fall in the general price level from P1 to P2. As a result, the level of employment decreases in the economy and deflation occurs; and a new macroeconomic equilibrium is achieved at E2 from the previous position at P1.

A fall in government spending to reduce the budget deficit leads to an appreciation in the exchange rate, causing the relative value of the pound to increase against other currencies (such as the dollar). As the value of the pound will increase, the price of imports from other countries in pounds will decrease, while the price of exports from the UK will increase, resulting in an increase in demand for foreign imports and a fall in demand for UK exports. Though this would lead to an increase in material standards in the economy (as goods from abroad are cheaper i.e. electronics from China), this could also lead to a fall in price competitiveness and an increase in the deficit of the balance of trades and furthermore a worsening in the situation of the current
account, harming the balance of payments within the UK economy. However, this fails to account for the concept of non-price competitiveness – the idea of consumers in other countries pursuing exports from other countries due to their quality.

The effect of a reduction in the budget deficit in the UK depends on the spare capacity of the economy – should the economy be at maximum productive capacity a fall in real GDP would not be as harmful to the economy as being at a lower productive capacity, which may lead to a fall in the price level in the UK with a lower fall in real GDP; this would encourage consumption in an economy and increase aggregate demand – potentially negating the leftward initial shift.

In addition, this is under the assumption of using only a reduction of government spending; in order to reduce a budget deficit, then the government could also implement higher direct taxes in the form of either regressive, progressive or flat taxes; this would decrease consumption and cause further decreases in aggregate demand and should this be levied on firms as corporation tax, it may cause a fall in the profits of a firm; as a firm’s primary economic goal is profit, they perhaps could choose to increase their prices in order to maintain their profit levels – this is known as cost-push inflation. The effectiveness of a direct tax is also debatable based on the marginal propensity to save/consume – if the MPC is low compared to the MPS then then AD may not be impacted as much as the level of consumption will not fall at the same level; consumers may opt to reduce their savings in place of reducing their expenditure.

Overall, a reduction in the budget deficit via reduced government spending should lead to a fall in the real GDP in an economy, in addition to the general price level (causing a worsening in the position of the balance of payments and the current account), as long as there is (to an extent) spare capacity
Commentary on the answer

The candidate takes a little time to get into the question but they do provide reasonable analysis of the reduction in government spending on unemployment.

Unfortunately they lose focus of the question at times (diverging to exchange rates) however, they bring it back to the topic of budget deficit reduction and provide sufficient analysis and evaluation to justify level 3.

There is reasonable analysis in the fourth paragraph, they produce a nice explanation of how an increase in direct taxation could reduce the deficit and offer reasonable evaluation of the consequences for those on lower incomes. There is a little further evaluation at the end, they recognise the significance of how much spare capacity the economy has.

Level 3: good knowledge, good analysis, good evaluation

13 marks
D/E GRADE CANDIDATE

Q16a  State one method, other than the output method, of measuring GDP.  [1]

Commentary on the answer
Commentary on the answer
Incorrect answer
0 marks

Q16b  Explain what is meant by ‘GDP’ per capita.  [2]

Commentary on the answer
The answer is credited with one mark for the formula as per the mark scheme.
1 mark
Q16c  Using Fig. 2, calculate Germany’s unemployment rate in 2014.  [2]

Commentary on the answer
The candidate has made an attempt to use the correct formula but hasn’t fully understood how to elicit the correct data from the case study.

0 marks

Q16d  Using information from the case study, compare how Germany and the UK are likely to be affected by a slowdown in the growth of the Chinese economy.  [4]

Commentary on the answer
The beginning of the answer is too vague, the candidate doesn't clearly answer this question. The final sentence recognises that there will be a fall in GDP for Germany and the UK – enough for one mark.

1 mark
Q16e  Show, using a diagram, the effect of an increase in China’s exports on China’s exchange rate.  

Commentary on the answer 
One mark for the labelling of the diagram (BOD for exports) 
One mark for the original equilibrium 
2 marks 

Q16f  Using information from the case, explain one reason why total saving was expected to rise in the USA in 2016.  

Commentary on the answer 
Correct identification of the reason but the explanation is too vague. 
1 mark
Q16g  Evaluate whether a large cut in direct taxes will always increase investment. [10]

A large cut in direct taxes often lead to investment, this is because with the profit that is being made, the factors of production are able to increase, this is due to the fact that however, it could not always lead to an increase in investment because firms may use this as an attempt in gaining profit for themselves. This may be because the firms a profit will be used on. As well as this, an cut in tax could lead to not lead to an investment because there may be a decrease in the amount of taxes paid. With this, however, a decrease in direct taxes could lead to an increase in other taxes disallowing the extra firms to increase investment.

Commentary on the answer

There is basic analysis (one chain in their reasoning) of the link between a cut in direct taxation and investment and a limited evaluative point about why investment may not occur.

Level 1: limited analysis and limited evaluation

2 marks
Q17 In 2015, the Turkish economy experienced an unemployment rate of 9.3% and an inflation rate of 7.4%. Evaluate, using an appropriate diagram(s), the extent to which it is possible for a government to reduce unemployment without causing a rise in the price level. [20]
would be a long period in which the price level adjusted to the unemployment rate. However, this is a possibility of this not happening. Money is because an increase in the number of people willing to work increases the efficiency of the firms will increase allowing more to be produced and the prices of products will stay the same or decrease.

However, this is likely to not occur as the remaining costs remain at an increase in efficiency will cause labour force to demand for more higher wages if these firms must provide higher wages then there will be an increase in unemployment because they are unable to provide for both.

In addition, fixed exchange rates could allow the price level to stay the same. With the increase in employment and efficiency, the exports could increase, however if they change their exchange rates from a floating exchange rate (meaning the exchange rate is based on the amount used on the foreign exchange market) to a fixed exchange rate the price levels of certain goods will stay the same. However, this could not occur.
Commentary on the answer

The candidate has a muddled understanding of unemployment, price level and supply side policies. Their point about fixed exchange rates isn’t answering the question.

There is a very basic attempt at analysis only.

Level 1: limited knowledge, limited analysis, no evaluation

2 marks
Q18 The UK government planned to reduce the budget deficit of £87.3bn in 2014-15 to £75.3bn in 2015-16, mainly through reduced government spending. Evaluate, using an appropriate diagram, the effect of a reduction in the budget deficit on an economy. [20]

The budget deficit is how much an economy is in debt. This may be because of lending to other countries or the EU or because the economy borrowed too much from other countries.

The government receives revenue from taxes. However, as the UK has a mixed economy, the government provides public services. These cost a lot of money to function, more than the government gets from tax revenue. Therefore, this increases the budget deficit, as the economy is unable to cover the current debt, so they have to make it bigger in order to pay some of it back.

Government spending is a component of aggregate demand. Aggregate demand is consumption + investment + government spending + (exports - imports). If aggregate demand increases, it shows economic growth.
Commentary on the answer

There is some, limited, analysis of the consequences of a reduction in government spending on education and health care and they understand the opportunity cost of some government spending which is enough for limited evaluation. However, the candidate has a basic grasp of the concepts and there is little use of economic terminology to aid a coherent chain of reasoning.

Level 1: limited knowledge, limited analysis, limited evaluation

4 marks
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