

A LEVEL

Exemplar Candidate Work

ECONOMICS

H460

For first teaching in 2015

Component 2 Macroeconomics

Version 3



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Introduction

We produced two 25-mark extended response questions for A Level Macroeconomics (H460/02) and asked students to answer it.

The sample answers in this resource have been extracted from original candidate work to maintain their authenticity.

To facilitate different ways for using this resource, you will find the student answers twice, once without and then with examiner comments and marks.

Please note that this resource is provided for advice and guidance only and does not in any way constitute an indication of grade boundaries or endorsed answers.



Oxford Cambridge and RSA

...day June 20XX – Morning/Afternoon

A Level in Economics

H460/02 Macroeconomics

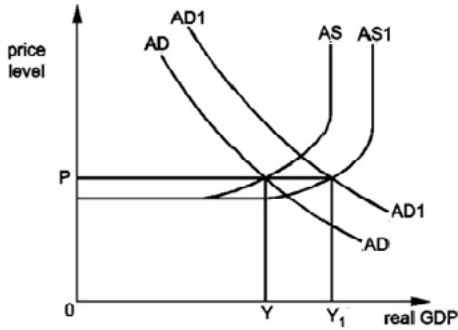
PRACTICE MARK SCHEME

MARKING INSTRUCTIONS

Descriptor	Award mark
On the borderline of this level and the one below	At bottom of level
Just enough achievement on balance for this level	Above bottom and either below middle or at middle of level (depending on number of marks available)
Meets the criteria but with some slight inconsistency	Above middle and either below top of level or at middle of level (depending on number of marks available)
Consistently meets the criteria for this level	At top of level

Levels of response – Level descriptors

	Knowledge and understanding/ Application	Analysis	Evaluation
Strong	Precision in the use of the terms in the question and applied in a focused way to the context of the question.	An explanation of causes and consequences, fully developing the links in the chain of argument.	A conclusion is drawn weighing up both sides, and reaches a supported judgement.
Good		An explanation of causes and consequences, developing most of the links in the chain of argument.	A conclusion is drawn weighing up both sides, but without reaching a supported judgement.
Reasonable	Awareness of the meaning of the terms in the question and applied to the context of the question.	An explanation of causes and consequences, which omit some key links in the chain of argument.	Some attempt to come to a conclusion, which shows some recognition of the influencing factors.
Limited	Awareness of the meaning of the terms in the question.	Simple statement(s) of cause and consequence.	An unsupported assertion.

Question	Answer	Marks	Guidance
2 *	<p>Since 2010, through fiscal policy measures, the UK government has sought to eradicate its budget deficit and reduce national debt as a percentage of GDP while hoping to also promote economic growth.</p> <p>Evaluate, with the use of an appropriate diagram(s), whether the government's fiscal policy measures will result in sustained economic growth [25]</p> <p>Level 5 (21–25 marks)</p> <p>Good - strong knowledge and understanding of fiscal policy and sustained economic growth.</p> <p>Strong analysis of the link between fiscal policy and sustained economic growth. A relevant and accurately drawn and labelled diagram is provided and linked to the analysis.</p> <p>Strong evaluation including a supported judgement on the extent to which fiscal policy will result in sustained economic growth.</p> <p>There is a well-developed and sustained line of reasoning which is coherent and logically structured. The information presented is entirely relevant and substantiated.</p> <p>Level 4 (16–20 marks)</p> <p>Good knowledge and understanding of fiscal policy and sustained economic growth.</p> <p>Strong analysis of the link between fiscal policy and sustained economic growth. A relevant and accurately drawn and labelled diagram is provided and linked to the analysis.</p> <p>Good evaluation on whether fiscal policy will result in sustained economic growth.</p> <p>There is a well-developed line of reasoning which is clear and logically structured. The information presented is relevant and in the most part substantiated.</p> <p>Level 3 (11–15 marks)</p> <p>Good knowledge and understanding of fiscal policy and sustained economic growth.</p> <p>Good analysis of the link between fiscal policy and sustained economic growth. A relevant diagram is provided and linked to the analysis.</p> <p>Reasonable evaluation on whether fiscal policy will result in sustained economic growth but without considering the extent.</p> <p>There is a line of reasoning presented with some structure. The information presented is in the most-part relevant and supported by some evidence</p>	<p>25 (AO1 x6 AO2 x6 AO3 x6 AO4 x7)</p>	<p>Indicative content</p> <ul style="list-style-type: none"> Fiscal policy covers government taxation and government expenditure (current and capital/discretionary expenditure). <p>Use and interpretation of an AD/AS diagram:</p>  <p>Reasons why it may result in sustained economic growth:</p> <ul style="list-style-type: none"> contractionary fiscal policy (through reduced government expenditure) could result in an increase in private sector investment as crowding out is reduced – interest rates on government bonds will fall resulting in a reduction in the cost of borrowing (according to the marginal efficiency of capital theory) for firms and a rise in investment. This investment and subsequent increase in GDP will improve the budget position through a fiscal dividend and reduction in the debt to GDP ratio contractionary fiscal policy/austerity measures could boost business confidence and encourage foreign direct investment resulting in higher rates of economic growth, through the accelerator (and multiplier) effect this will result in a further rise in investment. There will be a rise in both AD and AS a program of debt reduction will reduce government debt repayments and reduce the associated opportunity cost freeing them to use their (scare) resources to promote economic growth a lower budget deficit and national debt could make it easier to borrow in the future and so be more able respond to future economic shocks a reduction in welfare payments (as long as it isn't accompanied by a rise in income tax rates) will reduce the replacement ratio and incentivise more people to enter the labour market, increase the participation rate and reduce unemployment/increase employment.

Question	Answer	Marks	Guidance	
	<p>Level 2 (6–10 marks)</p> <p>Good knowledge and understanding of fiscal policy and sustained economic growth.</p> <p>Reasonable analysis of the link between fiscal policy and sustained economic growth. A diagram is included which is less than perfect.</p> <p>Reasonable evaluation on whether fiscal policy will result in sustained economic growth but without considering the extent. The information has some relevance, but is communicated in an unstructured way. The information is supported by limited evidence, the relationship to the evidence may not be clear.</p> <p>Level 1 (1–5 marks)</p> <p>Reasonable knowledge and understanding of fiscal policy and/or economic growth.</p> <p>Limited analysis of the link between fiscal policy and sustained economic growth.</p> <p>Limited or no evaluation.</p> <p>Information presented is basic and may be ambiguous or unstructured. The information is supported by limited evidence.</p> <p>0 marks no response or no response worthy of credit.</p>		<p>Reasons why it may not result in sustained economic growth:</p> <ul style="list-style-type: none">• government expenditure is an injection into the circular flow of income and a component of AD, a reduction in expenditure could reduce GDP• if taxation is increased, there will be a rise in leakages from the circular flow of income, reducing the size of the national income multiplier• a reduction in current expenditure (such as welfare) will reduce average incomes of those on the lowest incomes and reduce economic welfare• crowding in effect will be reduced resulting in a loss of investment and slowdown in economic growth. <p>Credit, where appropriate, knowledge/analysis of other, relevant factors.</p> <p>Possible routes into evaluation:</p> <ul style="list-style-type: none">• sustained economic growth, whether the government can reduce its deficit and national debt whilst still increasing the long run performance of the economy• businesses may not have the confidence to invest and create jobs• the performance of an open economy is influenced by global economic growth• the size of the national income multiplier• the extent to which government's reduce spending and increase taxation• which types of tax are raised/which areas of spending are reduced• alternative policies, such as expansionary monetary policy, would also stimulate consumption, investment and increase net exports.	
3	*		<p>Evaluate, with the use of an appropriate diagram(s), whether a depreciation of the exchange rate will inevitably improve macroeconomic performance of an economy.</p> <p>Level 5 (21–25 marks)</p> <p>Good - strong knowledge and understanding of the link between exchange rates and macroeconomic performance.</p> <p>Strong analysis of the link between exchange rates and macroeconomic performance. A relevant and accurately drawn and labelled diagram is provided and is linked to the analysis.</p>	<p>Indicative content</p> <ul style="list-style-type: none">• the exchange rate is the value of one currency in terms of another• the macroeconomic performance of an economy can be measured using the macroeconomic objectives: sustainable economic growth, price stability, low rate of unemployment, international competitiveness. 

Question	Answer	Marks	Guidance
	<p>Strong evaluation, including a supported judgement, of whether a depreciation of the pound sterling exchange rate will inevitably improve the macroeconomic performance of an economy.</p> <p>There is a well-developed and sustained line of reasoning which is coherent and logically structured. The information presented is entirely relevant and substantiated.</p> <p>Level 4 (16–20 marks)</p> <p>Good knowledge and understanding of the link between exchange rates and macroeconomic performance.</p> <p>Strong analysis of the link between exchange rates and macroeconomic performance. A relevant and accurately drawn and labelled diagram is provided and is linked to the analysis.</p> <p>Good evaluation of whether a depreciation of the exchange rate will inevitably result in an improvement in the macroeconomic performance of an economy.</p> <p>There is a well-developed line of reasoning which is clear and logically structured. The information presented is relevant and in the most part substantiated.</p> <p>Level 3 (11–15 marks)</p> <p>Good knowledge and understanding of the link between exchange rates and macroeconomic performance.</p> <p>Good analysis of the link between exchange rates and macroeconomic performance. A relevant diagram is provided and is linked to the analysis.</p> <p>Reasonable evaluation of whether a depreciation of the exchange rate will result in an improvement in the macroeconomic performance of an economy but without considering whether this is inevitable.</p> <p>There is a line of reasoning presented with some structure. The information presented is in the most-part relevant and supported by some evidence.</p> <p>Level 2 (6–10 marks)</p> <p>Good knowledge and understanding of the link between exchange rates and macroeconomic performance.</p> <p>Reasonable analysis the link between exchange rates and macroeconomic performance. A relevant diagram is provided, which is less than perfect.</p>		<p>Note: also accept a diagram showing the AD and AS curves shifting to the left that is consistent with the text. Candidates may also use an exchange rate diagram to illustrate a depreciation (this is often with the supply of a currency increasing).</p> <p>Reasons why it may improve the macroeconomic performance:</p> <ul style="list-style-type: none"> • exports will become more price competitive resulting in an increase in demand for exports. The rise in demand will increase injections into the circular flow of income and through the export led multiplier, increase AD and real GDP (short run economic growth) • a rise in demand for exports will increase demand for labour (derived demand) resulting in a fall in cyclical/demand deficient unemployment • a rise in demand for exports, and a fall in demand for imports as imports become less price competitive compared to domestically produced goods, will reduce the trade deficit on the BoP. • economic growth will, through the accelerator effect, increase the level of investment, which, as an injection into the circular flow of income and a component of AD, will increase real GDP and could also contribute to a fall in unemployment. This could be a reduction in structural employment and long run economic growth – shifting out the LRAS curve • there could also be a rise in foreign direct investment as investments become more profitable improving the financial account of the BoP and increasing the productive capacity of the economy • fiscal dividend from greater corporation, income and VAT tax receipts and fewer welfare payments (automatic stabilisers). <p>Reasons why it might not (inevitably) improve macroeconomic performance:</p> <ul style="list-style-type: none"> • demand pull inflationary pressure if the increase in AD > increase in LRAS • reduction in cyclical unemployment but no change to structural or the natural rate of unemployment • if the exchange rate depreciation is only short term this won't have long lasting effects • there needs to be sufficient demand for exports – economic performance of main trading partners • preference similarity theory suggests consumers prefer variety and may continue still to import goods and services, thus not improving the trade deficit as much.

Question	Answer	Marks	Guidance
	<p>Reasonable evaluation of whether a depreciation of the exchange rate will result in an improvement in the macroeconomic performance of an economy.</p> <p>The information has some relevance, but is communicated in an unstructured way.</p> <p>The information is supported by limited evidence, the relationship to the evidence may not be clear.</p> <p>Level 1 (1–5 marks)</p> <p>Reasonable knowledge and understanding of exchange rates and/or macroeconomic performance/objectives.</p> <p>Limited analysis of the link between exchange rates and macroeconomic performance. The diagram may not be relevant, may be inaccurate or may be missing.</p> <p>Limited or no evaluation.</p> <p>Information presented is basic and may be ambiguous or unstructured. The information is supported by limited evidence.</p> <p>0 marks no response or no response worthy of credit.</p>		<p>Credit, where appropriate, knowledge/analysis of other, relevant factors.</p> <p>Possible routes into evaluation:</p> <ul style="list-style-type: none"> • depends upon the size of the export-led multiplier • the strength of the Marshall-Lerner condition • j-curve effect on the current account • the inevitability of an improvement in the macroeconomic performance could depend on the role of the government and how the fiscal dividend is used • how long a time period is sustained economic growth • environmental considerations need to be accounted for if economic growth is to be sustained • short run versus long run economic growth • business and consumer confidence • stage of the economic cycle and rate of economic activity • spare capacity and elasticity of supply experienced by firms • demand for exports (and imports) depends on price and non-price factors.

Question	AO1	AO2	AO3	AO4	TOTAL	(Quantitative Skills)
2/3	6 (2)	6 (2)	6 (2)	7 (2)	25	(8)
TOTAL	12 (4)	12 (4)	12 (4)	14 (4)	50	(16)

QUESTION 2

Since 2010, through fiscal policy measures, the UK government has sought to eradicate its budget deficit and reduce national debt as a percentage of GDP while hoping to also promote economic growth.

Evaluate, with the use of an appropriate diagram(s), whether the government's fiscal policy measures will result in sustained economic growth. [25]

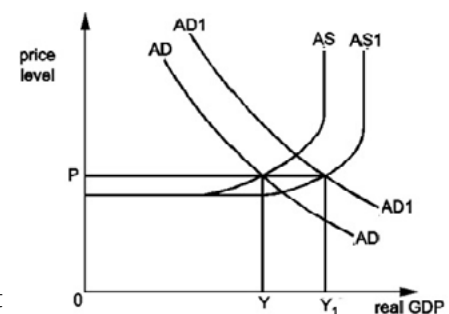
CANDIDATE RESPONSES

Candidate D – UNANNOTATED

Fiscal Policy is the use of government spending and taxation to either promote or decrease economic activity in the economy. It is both a macro and microeconomic policy instrument as it influences aggregate demand and supply as well as seeking to correct market failure and provide social cohesion. Sustained economic growth is growth that is steady (stable) and there is little volatility in both rates of growth as well as key performance indicators such as inflation and unemployment rates. In the aftermath of the financial crisis the UK government (along with other European and the American government) engaged in large amounts of discretionary spending, injecting money into the circular flow of income in an attempt to both bail out the banks and (most importantly) kick start the economy to bring it out of the 'great recession'. However, that has led to a very high debt to GDP ratio, it is currently at 80%, but has been as high as 95% in recent times. The incumbent government is seeking to reduce both the budget deficit and national debt as a proportion of GDP and is using fiscal consolidation as a way of achieving this. Fiscal consolidation involves reducing government spending and increasing taxation rates.

The argument for this programme of measures is that the size of the public sector should shrink and allow room for the private sector to step in – an argument which is consistent with the idea of crowding out/crowding in. By reducing government discretionary (and current) expenditure there will be reduced borrowing and therefore reduced (long term) interest rates on bonds which will make borrowing for firms also cheaper – thus incentivising them to invest – thus reducing the crowding out effect.

An increase in private sector investment will (hopefully) create more jobs than government expenditure – particularly if it is current expenditure on the day to day running of government departments. Job creation will reduce cyclical unemployment and then through the multiplier effect result in an increase in national income.



The diagram above illustrates an increase in both aggregate demand and aggregate supply through the increase in private sector investment. Investment is a component of aggregate demand and so will increase actual economic growth (shifting the aggregate demand curve to the right from AD to AD1) and through investment into capital stock there will be an increase in our supply-side capacity and thus shift to the right of the (long run) aggregate supply curve from AS to AS1. Overall resulting in a rise in real GDP.

Coupled with the actual reduction in borrowing costs comes the increase in confidence for both domestic and international firms. If the government has a lower debt to GDP ratio and thus lower borrowing costs it will retain its credit rating from rating agencies such as Moody and Standard and Poor. If business confidence in the UK is retained we will continue to attract foreign direct investment and see the resulting injection of long term capital this brings. Knowledge and skills transfer from overseas can help to increase skills and make economic growth more sustainable as labour productivity increases.

However, there are questions surrounding whether the reduction in borrowing costs will occur – in spite of the high debt levels, the UK has low borrowing costs – partly due to the loose monetary policy and historically low REPO rate set by the Bank of England. If this hasn't already stimulated investment and created economic activity then a reduction in debt to GDP ratio will have a limited effect on promoting sustained economic growth.

As I previously argued, the hope has been that by shrinking the size of the public sector and asking government departments to tighten their belts, the private sector would pick up the slack. The private sector is more efficient (as it is stimulated by a profit motive and rent seeking behaviour) and so will be both more statically and dynamically efficient, thus promoting both actual and potential economic growth. However, this all relies on whether those losing their jobs in the public sector can find them in the private sector – how flexible is the labour market? If workers are occupationally and geographically mobile they will be able to find work, reducing the length of frictional unemployment. However, if workers are either too specialised or unable to find work, then there could be a rise in long term and youth unemployment which could lead to hysteresis and reduce the potential output of the economy.

CANDIDATE D - UNANNOTATED (cont)

The impact of the contractionary fiscal policy measures also relies on how it is put into place – if government spending is cut, is it capital or current expenditure. If it is on welfare payments and working tax credits, the government will be harming those on lower incomes who have the highest marginal propensity to consume. They may also discourage people from entering the labour market and thus both increase the dependency ratio and reduce the size of the labour market, which will reduce potential output and not promote sustained economic growth in quite the same way.

Finally, it also depends on whether the government increase taxation and taxation receipts. A rise in taxation rates will increase leakages and reduce the size of the national income multiplier, this will reduce the effectiveness of any injection into the economy via private sector investment.

In conclusion, contractionary fiscal policy measures can result in sustained economic growth if the private sector is incentivised to invest and if there is enough confidence in the economy to continue to increase both investment and consumption. However, this does rely on how the government carries out its measures. There must also be a recognition that the government doesn't operate in isolation, fiscal policy goes hand in hand with monetary policy – if this is effective at creating growth, perhaps the government's debt to GDP ratio can be reduced without too many hard reductions in government expenditure.

QUESTION 2

Since 2010, through fiscal policy measures, the UK government has sought to eradicate its budget deficit and reduce national debt as a percentage of GDP while hoping to also promote economic growth.

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Candidate D – ANNOTATED

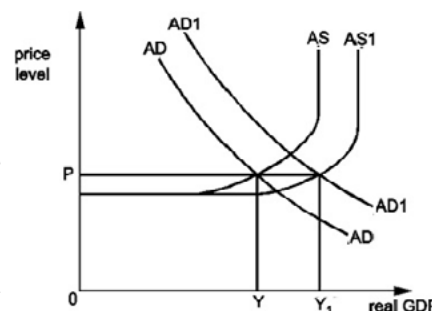
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Coupled with the actual reduction in borrowing costs comes the increase in confidence for both domestic and international firms. If the government has a lower debt to GDP ratio and thus lower borrowing costs it will retain its credit rating from rating agencies such as Moody and Standard and Poor. If business confidence in the UK is retained we will continue to attract foreign direct investment and see the resulting injection of long term capital this brings. Knowledge and skills transfer from overseas can help to increase skills and make economic growth more sustainable as labour productivity increases.



Good knowledge of fiscal policy and sustained economic growth.

Strong analysis of the reasons why fiscal policy consolidation can stimulate economic growth.

Relevant and accurately drawn diagram is used as part of the analysis.

Further analysis of how fiscal policy consolidation can result in sustained economic growth.

Candidate D – ANNOTATED (cont)

However, there are questions surrounding whether the reduction in borrowing costs will occur – in spite of the high debt levels, the UK has low borrowing costs – partly due to the loose monetary policy and historically low REPO rate set by the Bank of England. If this hasn't already stimulated investment and created economic activity then a reduction in debt to GDP ratio will have a limited effect on promoting **sustained economic growth**.

As I previously argued, the hope has been that by shrinking the size of the public sector and asking government departments to tighten their belts, the private sector would pick up the slack. The private sector is more efficient (as it is stimulated by a profit motive and rent seeking behaviour) and so will be both more statically and dynamically efficient, thus promoting both actual and potential economic growth. However, this all relies on whether those losing their jobs in the public sector can find them in the private sector – how flexible is the labour market? If workers are occupationally and geographically mobile they will be able to find work, reducing the length of frictional unemployment. However, if workers are either too specialised or unable to find work, then there could be a rise in long term and youth unemployment which could lead to hysteresis and reduce the **potential output of the economy**.

The impact of the contractionary fiscal policy measures also relies on how it is put into place – if government spending is cut, is it capital or current expenditure. If it is on welfare payments and working tax credits, the government will be harming those on lower incomes who have the highest marginal propensity to consume. They may also discourage people from entering the labour market and thus both increase the dependency ratio and reduce the size of the labour market, which will reduce potential output and not promote sustained economic growth in quite the same way.

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Reasonable evaluation of whether fiscal policy consolidation will be effective.

Further evaluation on the extent to which fiscal policy consolidation will promote sustained economic growth.

There is strong evaluation of fiscal consolidation and how it can promote sustained economic growth.

A supported judgement on the extent to which fiscal policy will result in sustained economic growth.

Level 5

25 marks

Examiner's summary comments

Level 5 (21–25 marks)

Good - strong knowledge and understanding of fiscal policy and sustained economic growth.

Strong analysis of the link between fiscal policy and sustained economic growth. A relevant and accurately drawn and labelled diagram is provided and linked to the analysis.

Strong evaluation including a supported judgement on the extent to which fiscal policy will result in sustained economic growth.

There is a well-developed and sustained line of reasoning which is coherent and logically structured. The information presented is entirely relevant and substantiated.

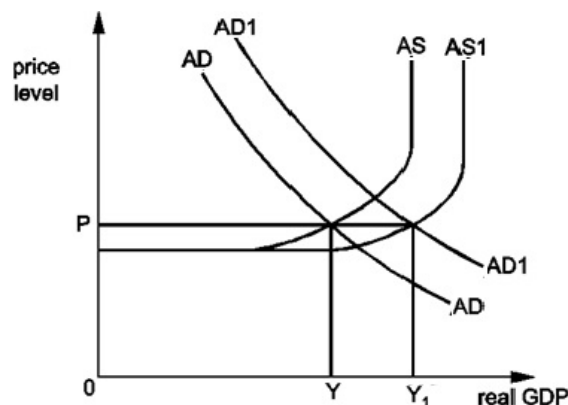
QUESTION 2

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Evaluate, with the use of an appropriate diagram(s), whether the government's fiscal policy measures will result in sustained economic growth. [25]

Candidate E – UNNANOTATED

Fiscal Policy is the use of government spending and taxation to stimulate economic activity in the economy. Sustained economic growth is growth that is steady (stable) and there are few fluctuations in key performance indicators such as: economic growth inflation and unemployment rates as well as consumer and business confidence. Since 2010 the UK government has been wishing to decrease the size of its national debt as a percentage of GDP. It is doing this by reducing government spending and increasing taxation.



The question is based on the premise that a reduction in government spending will reduce crowding out, reduce interest rates and promote private sector investment. By reducing government discretionary (and current) expenditure there will be reduced borrowing and therefore reduced (long term) interest rates on bonds which will make borrowing for firms also cheaper – thus incentivising them to invest – thus reducing the crowding out effect. Greater (net) investment will increase both aggregate demand and aggregate supply, both combining to increase real GDP. This will reduce demand deficient unemployment and increase household income. Through both the multiplier and accelerator effect, we should have even greater national income through the injection of consumption and investment. The diagram below illustrates this; the rightward shift in both aggregate demand and aggregate supply and the subsequent increase in real GDP shows that fiscal consolidation can result in economic growth and it will be sustained if the greater investment is into additional capital stock and initiatives which increase dynamic efficiency of firms.

There are real problems with reducing government spending if it is important to continue to spend on current expenditure such as job seekers allowance or housing benefits. If the private sector isn't confident enough to invest, even if borrowing costs aren't low, then employment and economic growth won't be stimulated. This could rely on the growth in the rest of the world, there needs to be sufficient demand for UK goods internationally to stimulate private sector activity, this could be the case in China or Africa, but the UK mostly trades with the EU and so (due to the weak growth here) there may not be much demand for UK goods.

Another problem is through an increase in taxation – if the government increases progressive taxation, such as income tax and/or corporation tax, there may be less consumption and investment (as firms have lower profits) and therefore less economic activity. The Laffer curve suggests that there is an optimum rate of tax to pay and past that point, government tax receipts will fall – the government needs to be careful to increase the right type of tax and at the correct level. If it puts up the top marginal rate of tax, this may have little impact on consumption, but if it reduces the lowest marginal rate of tax, it could reduce consumption of those on lower incomes as they have the largest marginal propensity to consume, this won't help to promote sustained economic growth.

Overall, fiscal policy consolidation, will promote economic growth if the net result is that there is an increase in private sector spending and if there is no loss of investment and consumption through an increase in taxation. This can all depend on how consumers and domestic and foreign firms respond to the changes, how willing they are to increase consumption and investment and therefore stimulate economic activity on the demand and supply side of the economy.

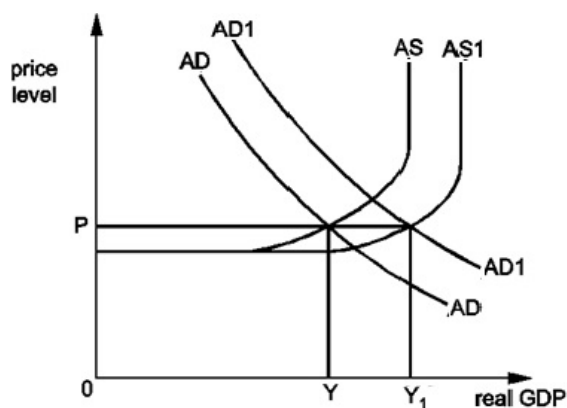
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Candidate E – ANNOTATED

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Good knowledge and understanding of fiscal policy and sustained economic growth.

Good analysis of the way in which fiscal policy can promote sustained economic growth.

An appropriate, and correctly labelled diagram, has been used.

Evaluation of why fiscal policy won't necessarily stimulate growth, it relies on external factors as well as internal government policy.

Candidate E – ANNOTATED (cont)

Another problem is through an increase in taxation – if the government increases progressive taxation, such as income tax and/or corporation tax, there may be less consumption and investment (as firms have lower profits) and therefore less economic activity. The Laffer curve suggests that there is an optimum rate of tax to pay and past that point, government tax receipts will fall – the government needs to be careful to increase the right type of tax and at the correct level. If it puts up the top marginal rate of tax, this may have little impact on consumption, but if it reduces the lowest marginal rate of tax, it could reduce consumption of those on lower incomes as they have the largest marginal propensity to consume, this won't help to promote sustained economic growth.

Overall, fiscal policy consolidation, will promote economic growth if the net result is that there is an increase in private sector spending and if there is no loss of investment and consumption through an increase in taxation. This can all depend on how consumers and domestic and foreign firms respond to the changes, how willing they are to increase consumption and investment and therefore stimulate economic activity on the demand and supply side of the economy.

Good recognition that taxation could also be affected. This, overall, gives strong analysis of the question – both sides have been considered and there is a clear and thorough chain of argument.

A judgement is provided but it isn't thoroughly supported making it good evaluation rather than strong.

Level 4

17 marks

Examiner's summary comments

Level 4 (16–20 marks)

Good knowledge and understanding of fiscal policy and sustained economic growth.

Strong analysis of the link between fiscal policy and sustained economic growth. A relevant and accurately drawn and labelled diagram is provided and linked to the analysis.

Good evaluation on whether fiscal policy will result in sustained economic growth.

There is a well-developed line of reasoning which is clear and logically structured. The information presented is relevant and in the most part substantiated.

QUESTION 2

Since 2010, through fiscal policy measures, the UK government has sought to eradicate its budget deficit and reduce national debt as a percentage of GDP while hoping to also promote economic growth.

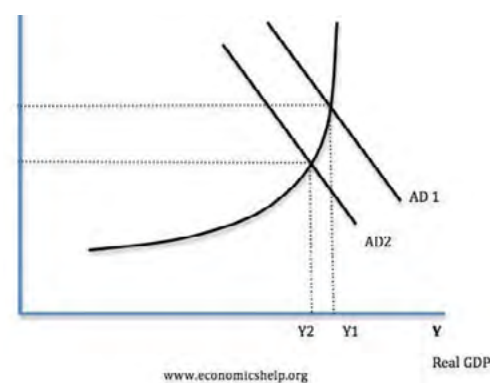
Evaluate, with the use of an appropriate diagram(s), whether the government's fiscal policy measures will result in sustained economic growth. [25]

Candidate F – UNANNOTATED

Fiscal policy is what the government uses to influence Aggregate Demand and the level of economic activity. This is done by either changing the levels of taxation or changing the amount of government spending, or both. It helps to stimulate growth in a period of recession as well as for keeping inflation low whilst and for stabilising the economy. A budget deficit is when the government is spending more money than the income it receives from tax receipts. The UK government has operated with a budget deficit for a long time and is attempting to reduce it. This can be done by increasing tax receipts or reducing spending. This is known as deflationary (contractionary) fiscal policy. This causes a fall in AD and a reduction in the budget deficit.

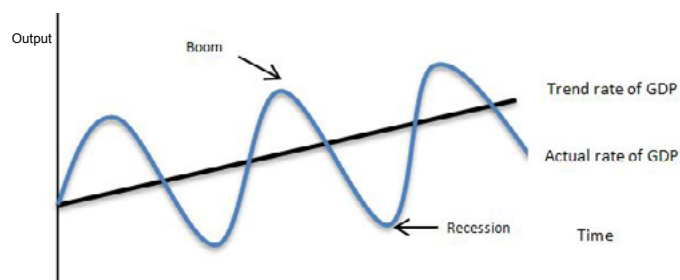
The diagram here shows the effect of deflationary fiscal policy. It causes a shift in AD from AD1-AD2. This results in a fall in the price level from P1-P2 and a fall in real GDP from Y1-Y2. This reduction in inflationary pressure is particularly useful in a boom phase of the economic cycle.

When the Economy is growing at a rate that is beginning to get out of control, therefore causing inflationary pressure, contractionary fiscal policy can be used to keep growth at a sustainable level. By reducing their spending and increasing taxes, this causes two components of Aggregate Demand, Government expenditure and consumption due to a rise in income taxes, to fall, resulting in the AD curve shifting left and as the diagram above shows, significantly reducing the Price Level, leading to less inflationary pressure, which is key during an economic boom.



However, the positive effects that come from contractionary fiscal policy being applied, have a time lag between them being imposed and the outcome occurring. There are legislative and administrative processes that need to be sorted before the increase in taxes or spending can be implemented and by then, the policy they wanted to use may not be relevant or useful to the case of sustaining economic growth.

These effects also depend on a few other factors, including the multiplier effect and the state of the economy. Firstly, if the multiplier effect is large then changes in government spending will have a bigger effect on the economy as a whole and vice versa for a small multiplier effect. The state of the economy also is important for the government's measures to be truly effective. If the economy is in a recession, then the government would be wrong to apply contractionary fiscal policy and would be better off applying expansionary fiscal policy. Whereas if the economy is in a boom, where inflationary pressure is high, that is when the government would be wise to apply deflationary fiscal policy to achieve sustained growth.



Candidate F – UNANNOTATED (cont)

One other problem with the government's fiscal policy measures is that it can potentially cause unemployment. Corporation tax has increased, meaning the firms have less income and so to keep a profit they may have to get rid of some workers because of the reduced amount of money they have to pay people. Another reason that unemployment is caused is because of the reduction in consumption by consumers as they experience an increase in income tax. This means, again, the firms are receiving a smaller amount of income and some people will have to lose their jobs for the firms to keep going. Unemployment can also be caused because as the government reduces its spending, it may well reduce the budget deficit but that means the firms that they were subsidising have a smaller or no subsidy from the government so they cannot experience economies of scale and production is costing them more, meaning they have less overall profit and must lose workers to compensate this loss. High unemployment is associated very strongly with a recession and in times of recession, the government would need to change its fiscal measures and there again is a time lag so there may be a period of sustained negative economic growth as the government tries to stimulate the economy and increase employment.

In conclusion, the government's attempt to 'eradicate' its budget deficit and reduce national debt would mean the application of contractionary fiscal policy. This is likely to lead to a smaller or non-existent budget deficit as they cut back on spending and increase taxes, and, the income they then receive from this can be spent to try and reduce the large amount of debt the UK owes. However, this all depends on the knowledge and decisions of the government as well as other factors, and there are some unwanted consequences that could potentially lead to an economy in worse condition than when the government applied the policies. The government must also consider time lag before it applies any fiscal policies.

QUESTION 2

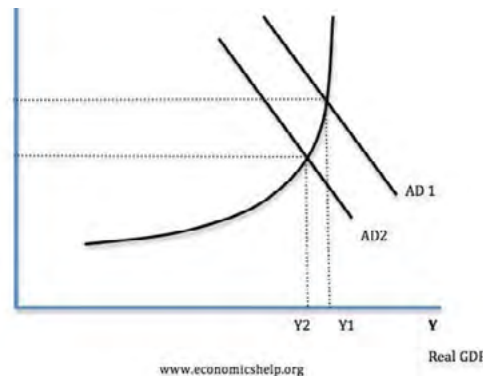
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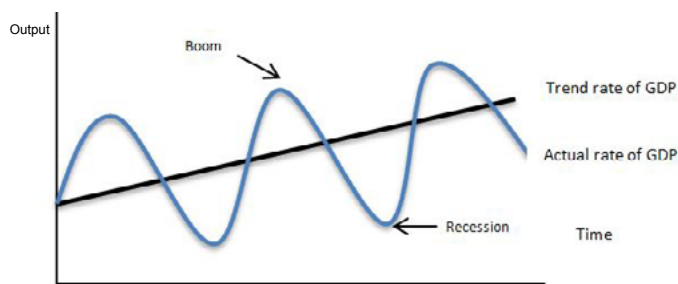
Knowledge of fiscal policy and a budget deficit. No knowledge of sustained economic growth yet.

The candidate hasn't quite grasped the point of the question, that by seeking to reduce the national debt there could be a boost to the private sector and so perhaps, more sustainable growth.

Again, an attempt at evaluation but the candidate hasn't grasped the question. They are answering a more AS version of a fiscal policy question.

There is a little more relevance to this evaluation. There is a time lag to a change in fiscal policy and the level of economic activity should be considered when making this decision.

Candidate F – ANNOTATED (cont)



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Reasonable analysis of the counter argument and some reasonable evaluation that it depends on the stage of the economic cycle.

*A summary of the previous arguments but no supported judgement of the extent to which fiscal policy measures will result in **sustained** economic growth.*

Level 2 6 marks

Examiner's summary comments

Level 2 (6–10 marks)

Good knowledge and understanding of fiscal policy and/or sustained economic growth.

Reasonable analysis of the link between fiscal policy and sustained economic growth. A diagram is included which is less than perfect.

Reasonable evaluation on whether fiscal policy will result in sustained economic growth but without considering the extent.

QUESTION 3

Since the European Central Bank embarked on their program of quantitative easing the €:£ exchange rate has fallen significantly, many hope this will spark economic recovery in the Eurozone.

Evaluate, with the use of an appropriate diagram(s), whether a depreciation of the exchange rate will inevitably improve macroeconomic performance of an economy. [25]

CANDIDATE RESPONSES

Candidate D – UNANNOTATED

The exchange rate is the value of one currency in terms of another, for example the euro to pound sterling, which is currently at 1:0.7, and a depreciation would see the value of the currency fall relative to another. The effects on the macroeconomic performance of an economy may be measured using the four macro-economic objectives. These are sustainable economic growth, low and stable inflation, international competitiveness and low unemployment. The 'inevitability' of improving the performance of these indicators seems questionable, given the openness of many economies to the world economy and subsequent vulnerability to external shocks and events.

Firstly, if the exchange rate depreciates, exports will become more price competitive and imports will become less price competitive therefore demand for exports rises and demand for imports falls. Because $(X - M)$ is a component of Aggregate demand (AD), if exports rise and imports fall, AD will rise.

As the diagram shows, this will cause a rise in real national output and the economy will see a rise in export led actual growth. There will also be benefits to employment from L_1 to L_2 , as increased injections into the circular flow of income boost profits and so firms take on more workers to exploit the increased demand. Furthermore, there is the possibility of an export led multiplier, although this largely depends upon the size of the national income multiplier and peoples marginal propensity to consume, which may be lower than usual in the EU due to current events in Greece creating economic uncertainty. As the diagram also shows, there is a negative effect on the economy of a possible rise in inflation (PL_1 to PL_2).

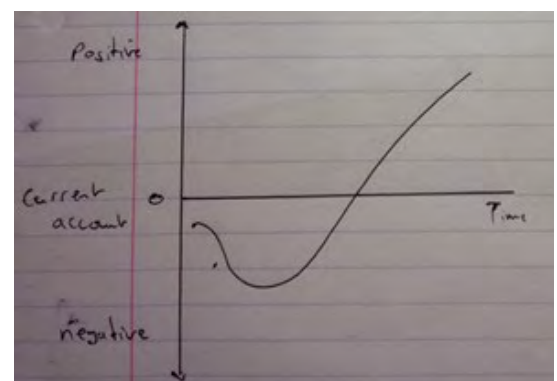
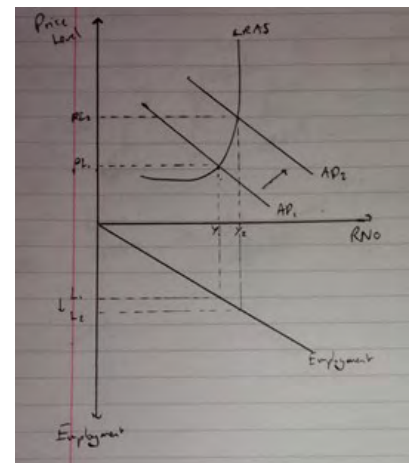
Having said this, in the UK currently, some more inflation would be desirable, therefore whether a rise in inflation is a bad thing depends upon the original position from which inflation was already.

However, the extent to which exports and imports change may depend upon protectionist policies and non- tariff barriers such as safety standards. If these exist then the growth in exports may not be as significant, therefore offsetting these effects. Nonetheless, in the EU arguably this ought not to be a problem, given that countries want trade to increase in the Free Trade Area.

As may seem clear, if exports rise and imports fall, there may arise a surplus in the current account. However, in some countries, if their deficit is already huge, then this transition may not occur. More significantly however, as the J curve demonstrates, the transition from deficit to surplus will not happen instantly because of response lags as well as price inelastic supply for domestic producers.

On top of this, an exchange rate depreciation will only cause a balance of trade improvement if the sum of the export and import demand elasticities is equal to, or greater than 1. This may vary between countries; therefore whether a depreciation would improve the balance of payments must be taken on a case by case basis. However, this also largely depends upon the time period of the exchange rate depreciation. If the depreciation is only temporary, then it may not be 'inevitable' that the macro economy will be significantly affected.

Nonetheless, what will remain constant if exports fall after a depreciation will be a loss of choice for consumers. This may lead to a fall in consumer surplus and consumer welfare, especially if imports are preferable to domestic products because they would have been cheaper. Therefore, if imports are substituted for domestic goods, this may have an adverse effect on economic growth and hence jobs, because less domestic produce will be consumed because the prices are higher.

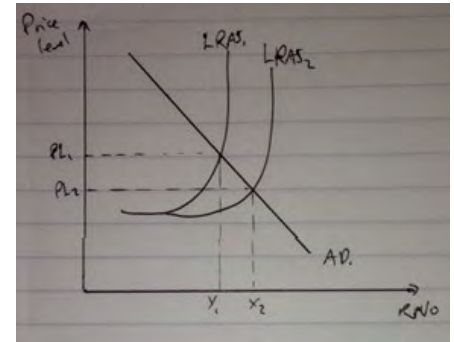


Candidate D – UNANNOTATED (cont)

In the long run, if exports rise, the government may gain tax revenue from exporting firms. They could then spend this through discretionary fiscal policy to boost the supply side of the economy (LRAS1 to LRAS2) which would have benefits to potential economic growth, as well as decreasing some inflationary pressure (PL1 to PL2).

However, this must be contrasted with the loss of revenue from falling imports which will cause tariff revenue to fall. Nonetheless, the change in exports and imports also depends upon the severity of the depreciation, and if the depreciation is miniscule, then the effects on imports and exports will also be less significant.

On balance, it can be seen that there is little or no inevitability whether a depreciation in a country's exchange rate will improve its macroeconomic performance, because there are so many variables. Not only external factors, but also the severity and duration of the depreciation must be considered, and if these are minimal, then the effects may be minimal.



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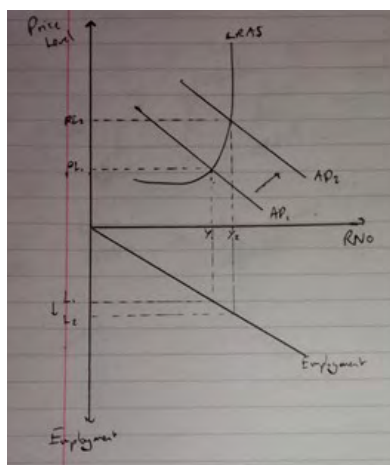
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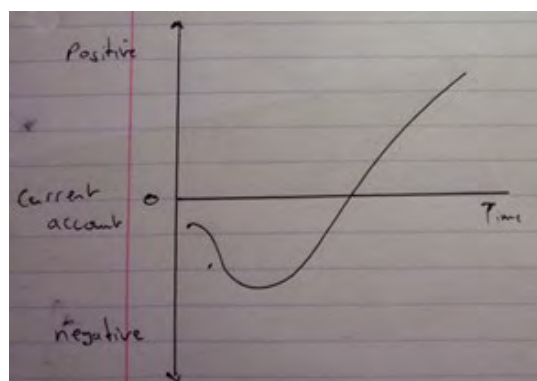
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Good knowledge of an exchange rate depreciation and how to measure the macroeconomic performance of an economy.

Reasonable analysis of the impact of an exchange rate depreciation on AD and real GDP. An appropriate diagram is included.

The diagram is well explained in context of the question. There is reasonable evaluation on the extent of the impact on AD, that it depends on the size of the export led multiplier.

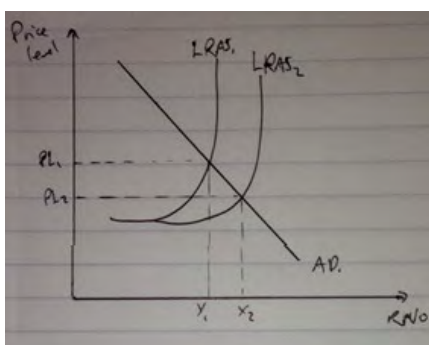
Nice use of real world economics to exemplify their point.

Candidate D – ANNOTATED (cont)

On top of this, an exchange rate depreciation will only cause a balance of trade improvement if the sum of the export and import demand elasticities is equal to, or greater than 1. This may vary between countries; therefore whether a depreciation would improve the balance of payments must be taken on a case by case basis. However, this also largely depends upon the time period of the exchange rate depreciation. If the depreciation is only temporary, then it may not be 'inevitable' that the macro economy **will be significantly affected**.

Nonetheless, what will remain constant if exports fall after a depreciation will be a loss of choice for consumers. This may lead to a fall in consumer surplus and consumer welfare, especially if imports are preferable to domestic products because they would have been cheaper. Therefore, if imports are substituted for domestic goods, this may have an adverse effect on economic growth and hence jobs, because less domestic produce will be consumed because the prices are higher.

In the long run, if exports rise, the government may gain tax revenue from exporting firms. They could then spend this through discretionary fiscal policy to boost the supply side of the economy (LRAS1 to LRAS2) which would have benefits to potential economic growth, as well as decreasing some inflationary pressure (PL1 to PL2).



However, this must be contrasted with the loss of revenue from falling imports which will cause tariff revenue to fall. Nonetheless, the change in exports and imports also depends upon the severity of the depreciation, and if the depreciation is miniscule, **then the effects on imports and exports will also be less significant**.

On balance, it can be seen that there is little or no inevitability whether a depreciation in a country's exchange rate will improve its macroeconomic performance, because there are so many variables. Not only external factors, but also the severity and duration of the depreciation must be considered, and if these are minimal, then the effects may be minimal.

Good evaluative comments on the extent to which a depreciation won't inevitably improve macroeconomic performance

Good use of the long run aggregate supply curve to evaluate the short run and long run effects of a depreciation.

Level 5

22 marks

Examiner's summary comments

Level 5 (21–25 marks)

Good - strong knowledge and understanding of the link between exchange rates and macroeconomic performance.

Strong analysis of the link between exchange rates and macroeconomic performance. A relevant and accurately drawn and labelled diagram is provided and is linked to the analysis.

Strong evaluation, including a supported judgement, of whether a depreciation of the pound sterling exchange rate will inevitably improve the macroeconomic performance of an economy.

There is a well-developed and sustained line of reasoning which is coherent and logically structured. The information presented is entirely relevant and substantiated.

QUESTION 3

Since the European Central Bank embarked on their program of quantitative easing the €:£ exchange rate has fallen significantly, many hope this will spark economic recovery in the Eurozone.

Evaluate, with the use of an appropriate diagram(s), whether a depreciation of the exchange rate will inevitably improve macroeconomic performance of an economy. [25]

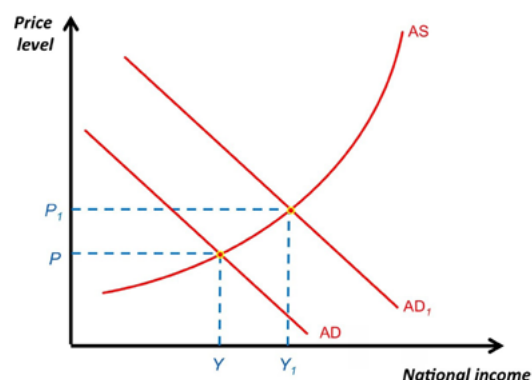
Candidate E – UNANNOTATED

The Exchange rate is the value of one currency in terms of another, and currently 1 Pound Sterling (£) is equal to 1.35 Euros (€). The Macroeconomic performance of an economy is measured using 4 main indicators; Economic Growth, Unemployment, Inflation and International Trade Competitiveness.

A depreciation in the exchange rate is generally beneficial for exporters as their products are now worth more internationally (they are now more internationally price competitive and as one of the Macroeconomic indicators it shows an increase in Economic Performance). A depreciation is also more costly for importers as they now have to pay more of their currency for the same amount of product. However as exporting firms experience better price competitiveness they are able to reinvest the profits in themselves and expand, benefitting from economies of scale and also being able to hire more workers which reduces unemployment, another Macroeconomic indicator.

In 2011, £1 was worth €1.15, this increase in the value of the pound means that UK exports are more expensive in Europe than they were a year ago, as Euro countries need to pay more exports for each pound sterling they need to buy UK exports. It also encourages UK residents to buy European goods, as a pound will buy more Euros.

As seen in the diagram below it is evident that an increase in Aggregate Demand (AD-AD₁) will lead to an increase in national income. The increase in Exports and the decrease in Imports will increase AD and therefore lead to higher economic growth (Y-Y₁).



The increase in exports and decrease in imports would improve the situation of the current account on the balance of payments as it would increase a surplus (or decrease a deficit). This improvement of the current account would allow an increase in government expenditure on things such as infrastructure (which through the multiplier effect would result in a more than proportional increase in RNO) or subsidising merit goods which would overall increase economic activity.

A negative of a depreciation in the exchange rate would be that an increase in the price of imports would lead to an rise in cost-push inflation which could have negative consequences for an economy and could even eventually lead to overheating of the economy as the inflation rate becomes too high. Also as domestic demand increases and exports increase, firms will have less incentive to cut costs and this will result in cost-push inflation.

Ultimately it is evident that a depreciation of the exchange rate will likely improve macroeconomic performance of an economy through increased AD and an improvement of the current account situation however it is not inevitable because inflation may occur and consumer confidence is not guaranteed to rise. As exchange rate is also only a demand-side measure and as such is only a short run policy and so for long-term improved performance it would require supply-side policies to work alongside the demand-side policies.

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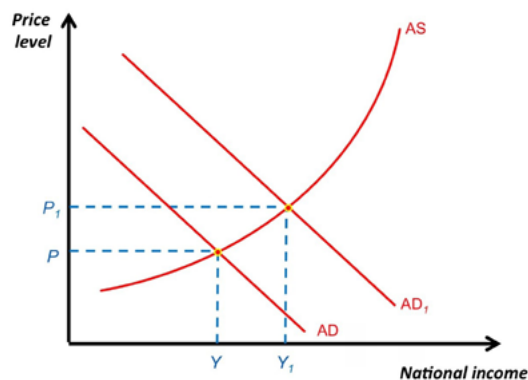
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Knowledge and understanding of exchange rates and how to measure macroeconomic performance.

Reasonable analysis of the link between depreciation and macroeconomic performance.

A relevant and accurate diagram is provided and supported by good analysis

Brief, but some analysis of the other side of the argument.

Candidate E – ANNOTATED (cont)

Ultimately it is evident that a depreciation of the exchange rate will likely improve macroeconomic performance of an economy through increased AD and an improvement of the current account situation however it is not inevitable because inflation may occur and consumer confidence is not guaranteed to rise. As exchange rate is also only a demand-side measure and as such is only a short run policy and so for long-term improved performance it would require supply-side policies to work alongside the demand-side policies.

Reasonable evaluation but the candidate doesn't consider whether the improvement in macroeconomic performance is inevitable.

Level 3

13 marks

Examiner's summary comments

Level 3 (11–15 marks)

Good knowledge and understanding of the link between exchange rates and macroeconomic performance.

Good analysis of the link between exchange rates and macroeconomic performance. A relevant diagram is provided and is linked to the analysis.

Reasonable evaluation of whether a depreciation of the exchange rate will result in an improvement in the macroeconomic performance of an economy but without considering whether this is **inevitable**.

There is a line of reasoning presented with some structure. The information presented is in the most-part relevant and supported by some evidence.

QUESTION 3

Since the European Central Bank embarked on their program of quantitative easing the €:£ exchange rate has fallen significantly, many hope this will spark economic recovery in the Eurozone.

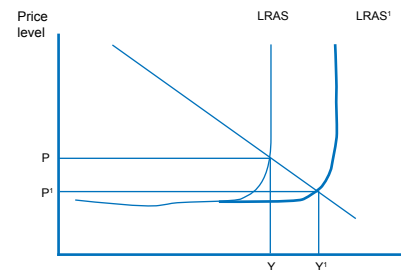
Evaluate, with the use of an appropriate diagram(s), whether a depreciation of the exchange rate will inevitably improve macroeconomic performance of an economy. [25]

Candidate F – UNANNOTATED

Exchange is the value of one currency in terms of another. Depreciation is the decrease of value of the currency in terms of another. Depreciation can lead to improvement in the macroeconomic performance because it will increase export and decrease imports which will improve the balance of payments on the current account.

Interaction between market forces of demand and supply of a currency in a foreign exchange market will determine the exchange rates of one currency to another. Depreciation leading to supply for one currency increasing in the foreign exchange market there will be excess supply which bids down the value of the currency relative to another.

The diagram illustrates a shift in the supply curve leading to an increase in output.



Furthermore, depreciation can lead to an increase in international competitiveness because the price of the export has fallen however, this depends upon the quality of the products and price elasticity of demand. Depreciation means firms can borrow money to reinvest into innovation and invention learn to greater total factor productivity and a reduction in average costs of production assuming productivity rate is greater than the wage rate. Increasing dynamic efficiency will lead to further positive contributions on the LRAS curve.

If the central bank reduces interest rate this will reduce the reward for saving and short-term investors are disincentivised to deposit money into domestic banks and hot money flows out of the economy as short-term investors seek higher relative interest rates than can be obtained. This will increase supply of the currency in the foreign exchange markets leading to a depreciation in the value of that currency in terms of another, increasing price competitiveness of exports resulting in an increase in net exports and aggregate demand so an improvement in the current account of the balance of payments.

Furthermore, depreciation can lead to an increase in employment in the domestic industry and lead to greater potential output in the future. Increase in employment in domestic industry means households will be more willing and able to purchase life-sustaining goods; this will lead to greater economic welfare as a whole.

The diagram above shows a shift in the LRAS curve to the right leading to greater productive potential of the economy; this has greater capacity to increase economic growth so it is more sustainable.

Trade supply can occur from the export-orientated growth which is the increase in the capacity of export industry and firms can exploit economies of scale leading to lower costs and specialisation arise from comparative advantage which too dramatically lowers cost of production. In the long term these will help the economy to achieve stability and macroeconomic performance may well improve.

To conclude, depreciation can benefit the macroeconomic performance which will be used to see how well the economy is doing. Because depreciation can lead to improvements in the current account of balance of payments as the value of export is greater than the value of imports leading to an increase in international competitiveness so the price for the consumer may be lower and households are more willing and able to consume products, however this does depend on the price elasticity of demand for the products.

QUESTION 3

Since the European Central Bank embarked on their program of quantitative easing the €:£ exchange rate has fallen significantly, many hope this will spark economic recovery in the Eurozone.

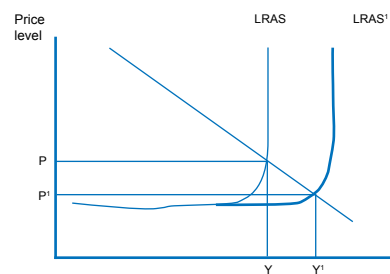
Evaluate, with the use of an appropriate diagram(s), whether a depreciation of the exchange rate will inevitably improve macroeconomic performance of an economy. [25]

Candidate F – ANNOTATED

Exchange is the value of one currency in terms of another. Depreciation is the decrease of value of the currency in terms of another. Depreciation can lead to improvement in the macroeconomic performance because it will increase export and decrease imports which will improve the balance of payments on the current account.

Interaction between market forces of demand and supply of a currency in a foreign exchange market will determine the exchange rates of one currency to another. Depreciation leading to supply for one currency increasing in the foreign exchange market there will be excess supply which bids down the value of the currency relative to another.

The diagram illustrates a shift in the supply curve leading to an increase in output.



Furthermore, depreciation can lead to an increase in international competitiveness because the price of the export has fallen however, this depends upon the quality of the products and price elasticity of demand. Depreciation means firms can borrow money to reinvest into innovation and invention learn to greater total factor productivity and a reduction in average costs of production assuming productivity rate is greater than the wage rate. Increasing dynamic efficiency will lead to further positive contributions on the LRAS curve.

If the central bank reduce interest rate this will reduce the reward for saving and short term investors are disincentivised to deposit money into domestic banks and hot money flows out of the economy as short term investors seek higher relative interest rates than can be obtained. This will increase supply of the currency in the foreign exchange markets leading to a depreciation in the value of that currency in terms of another, increasing price competitiveness of exports resulting in an increase in net exports and aggregate demand so an improvement in the current account of the balance of payments.

Furthermore, depreciation can lead to increase in employment in the domestic industry and lead to greater potential output in the future. Increase in employment in domestic industry means households will be more willing and able to purchase life sustaining goods. This will lead to greater economic welfare as a whole.

The diagram above shows a shift in the LRAS curve to the right leading to greater productive potential of the economy. This has greater capacity to increase the economic growth so it is more sustainable.

Trade supply can occur from the export orientated growth which is the increase in the capacity of export industry and firms can exploit economies of scale leading to lower costs and specialisation arises from comparative advantage which too dramatically lowers cost of production. In the long term these will help the economy to achieve stability and macroeconomic performance may well improve.

Knowledge of the exchange rate depreciation and a weak link to macroeconomic performance.

Reasonable analysis with an appropriate diagram and slightly reasonable evaluation. On price elasticity of demand.

Explanation of the link between interest rates and exchange rate values, however this isn't addressing the consequences for the macroeconomic performance.

Slightly more analysis on the macroeconomic performance to now achieve reasonable analysis (just)

Further analysis on the positive effects on the macroeconomic performance.

Candidate F – ANNOTATED (cont)

To conclude, depreciation can benefit the macroeconomic performance which will be used to see how well the economy is doing. Because depreciation can lead to improvements in the current account of balance of payments as the value of export is greater than the value of imports leading to an increase in international competitiveness so the price for the consumer may be lower and households are more willing and able to consume products, however this does depend on the price elasticity of demand for the products.

Reasonable evaluation but the candidate doesn't address whether the exchange rate depreciation will inevitably improve the macroeconomic performance which is required for good evaluation.

Level 2

10 marks

Examiner's summary comments

Level 2 (6–10 marks)

Good knowledge and understanding of the link between exchange rates and macroeconomic performance.

Reasonable analysis the link between exchange rates and macroeconomic performance. A relevant diagram is provided, which is less than perfect.

Reasonable evaluation of whether a depreciation of the exchange rate will result in an improvement in the macroeconomic performance of an economy.

The information has some relevance, but is communicated in an unstructured way.

The information is supported by limited evidence, the relationship to the evidence may not be clear.



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