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

Mark schemes should be read in conjunction with the published question papers and the Report on the Examination.

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The economic cycle is the regular fluctuations in economic activity / GDP, characterised by four distinct stages:

<table>
<thead>
<tr>
<th>Stages</th>
<th>Description</th>
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</thead>
<tbody>
<tr>
<td>recession</td>
<td>GDP falls, unemployment rises / low employment, inflation rate falls, output gap rises (negative output gap), low business and consumer confidence</td>
</tr>
<tr>
<td>recovery</td>
<td>GDP growth turns from negative to positive but is below trend</td>
</tr>
<tr>
<td>boom</td>
<td>GDP growth is above trend, inflation rate rises, output gap closes (positive output gap), unemployment falls / high employment, high business and confidence</td>
</tr>
<tr>
<td>slowdown</td>
<td>GDP growth rate falls towards trend</td>
</tr>
</tbody>
</table>

One mark for a **definition** of the economic cycle – regular fluctuations in economic activity / GDP or variation of actual GDP around trend

Two marks for a **list of all four** stages of the economic cycle

OR a correctly labelled **diagram** of the economic cycle

(maximum of one mark for 2 or 3 stages only in list or diagram)

One mark for a **each description** of the four stages of the economic cycle

Maximum four marks

Any of the following terms is acceptable:
- upturn
- downturn
- slump
- bust

Do not credit the following:
- double dip
- depression
- seasonal changes
- downfall

Use green ticks ✅ for each mark awarded
<table>
<thead>
<tr>
<th>Question</th>
<th>Answer</th>
<th>Marks</th>
<th>Guidance</th>
</tr>
</thead>
</table>
| **1 (b)** | Up to two marks for **identifying reasons** why convergence of economic cycles is important:  
- single interest rate won’t suit all economies;  
- interest rate will be too high for some / too low for others;  
- ECB monetary policy will be ineffective / too loose / too tight;  
- it will be difficult for ECB to set the ‘right’ interest rate;  
- a requirement for an optimal currency area;  
- loss of exchange rates within the euro area.  
Up to two marks for **basic elaboration** of any of the above points  
- economies in the boom phase of the economic cycle will need higher interest rates, economies in recession phase will need lower interest rates;  
- consequence may be reduction in competitiveness for some economies;  
- single interest rate may not control eurozone inflation;  
- unable to respond to lack of competitiveness by exchange rate depreciation.  
Up to four marks for **analysis** of the consequences of any of the above points  
- impact of interest rates changes on propensities to consume and save;  
- consequences for C and I;  
- impact of changes on AD;  
- impact of changes in AD on the economic performance / competitiveness of economies at different stages of the economic cycle. | **6**  
1 reason, with basic elaboration and well developed analysis can score full marks (e.g. 1+1+4)  
No credit for distinction between cyclical and structural (nominal and real) convergence or definition of monetary union  
No credit for reasons, elaboration or analysis which is expressed in terms of EU rather than eurozone  
Use green ticks ☑️ for reasons (two max)  
Use green tick plus ☑️ for elaboration and analysis  
In going beyond elaboration marks to award analysis marks look for chains of reasoning  
- e.g. the impact of a single interest rate / changes in ECB interest rate on components of AD and consequently on economic performance of economies at different stages in the economic cycle. |
<table>
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<tr>
<td>1 (c)</td>
<td>Candidates should analyse and comment on the implication of high rates of economic growth for at least two of the following: • employment/unemployment – higher employment, higher standard of living; • inflation – increases; • competitiveness – worsens due to inflation; • current a/c of BoP – worsens; • government’s fiscal position – improves; • impact on FDI – high growth attracts FDI, inflows on financial a/c of BoP; • reduction in negative output gap, emergence of positive output gap; • increase in negative externalities – lack of environmental sustainability. Commentary could mention any of the following: • some consequences are positive, some are negative – max bottom L4 where this is the only point of commentary; • consequences depend on the stage of the economic cycle; • consequences depend on increases in productivity/productive capacity; • consequences depend on size of the output gap; • consequences depend on nature of growth – SR growth due to increased AD without adequate expansion of AS is likely to result in significant inflation and BoP problems</td>
<td>10</td>
<td>In Level 4 award marks as follows: 1 stated point of evaluation = seven marks 2 or more stated points of evaluation = eight marks Developed evaluation of 1 or more points MUST be awarded nine or ten marks Show development with ✅ For Level 3 marks to be awarded it is important that these consequences are explained rather than just stated. If only one consequence is referred to candidates should be capped to the bottom of the relevant level, ie seven marks in L4, 4 marks in L3 and 2 marks in L2 Watch out for answers that focus on Irish economy 2008 onwards.</td>
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<tr>
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</table>
| 2 (a)    | Up to two marks for definitions of the terms  
- short run economic growth relates to increases in GDP (one mark) or is the rate of actual economic growth (one mark)  
- long run economic growth relates to increases in an economy’s productive capacity (one mark) or is the rate of potential economic growth (one mark)  
Up to two marks for distinctions between the two  
- short run growth is generated by increases in AD or SRAS (one mark), long run economic growth is determined by increases in the quantity or quality of the factors of production / LRAS (one mark)  
- short run growth refers to a movement towards the PPC (one mark), long run growth involves a shift of the PPC (one mark) | 4 | Use green ticks ✔️ for definitions  
Use green tick plus ✔️ for distinctions  
Distinctions should relate to the causes or consequences of short and long run economic growth |
Spain suffered a reduction in competitiveness as shown by the indicators in Figs 2.2 and 2.3. This is because output prices and unit labour costs have risen more than other economies in the euro area and elsewhere.

The consequences (Implications) of this reduction in competitiveness include:

- Reduction the demand for their exports;
- Increase in the demand for imports;
- Worsening of the current account of the balance of payments;
- Reduction in net trade and AD (although not consistent with rates of economic growth in stimulus material);
- Multiplier consequences and impact on employment;
- Cost-push inflation/shift of SRAS;
- Capital flight / loss of FDI.

NOTES:

- Trends in output prices impact on SRAS but many candidates will analyse impact on AD, ie (X-M) – this is OK
- Do not credit falling import prices (import prices become RELATIVELY cheaper not ABSOLUTELY)
- Do not credit BoP without reference to the current account
- Analysis can focus on explaining why BoP on current account deteriorates rather than impact on AD

Examples of analysis:

- Higher priced exports will reduce export demand leading to a reduction in AD / deterioration in BoP on current account
- Rising unit labour costs shift SRAS to the left causing rise in price level, reduction in real GDP, reduction in employment

Examples of application:

- Rising unit labour costs means that the price of Spanish goods has increased
- This will lead to a fall in exports and a rise in imports
- Unexplained AD / AS diagrams

Examples of knowledge and understanding:

- Competitiveness is an economy’s ability to sell their goods / services at a relatively low price and / or relatively high quality
- Spain’s unit labour costs have risen by 13% and its output prices by 20% since 1999 causing a reduction in its competitiveness

<table>
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<tr>
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<tbody>
<tr>
<td>2 (b)</td>
<td>Spain suffered a reduction in competitiveness as shown by the indicators in Figs 2.2 and 2.3. This is because output prices and unit labour costs have risen more than other economies in the euro area and elsewhere. The consequences (Implications) of this reduction in competitiveness include:</td>
<td>6</td>
<td>Examples of analysis:</td>
<td>Level 3 [5 – 6] For an analysis of the implications of a loss of competitiveness. Analysis begins when candidates explain the impact on current account or AD or employment / unemployment or other macroeconomic issues</td>
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<td>2 (c)</td>
<td>Accept any valid policy, including: • measures to increase productivity; • reduction in labour costs; • investment in education and training; • subsidy of training or new technology; • measures to improve labour market flexibility; • measures to improve contestability of / improve competition in product markets; • reduction in rate of inflation through contractionary fiscal policy; • measures to improve non-price competitiveness; • withdrawal from the euro area. Accept any valid comment, including: • time taken to have an impact; • need for higher government expenditure; • trade union resistance; • possible unemployment in the short term; • why the chosen policy may be better than alternatives; • until labour costs may not fall if there is an increase in wage rates as well as an increase in productivity.</td>
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<td></td>
<td>10</td>
<td>In Level 4 award marks as follows: 1 stated point of evaluation = seven marks 2 or more stated points of evaluation = eight marks Developed evaluation of 1 or more points MUST be awarded nine or ten marks.</td>
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<td>There should be explicit explanation of how the policy will improve competitiveness for Level 3 marks to be awarded.</td>
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<td>The policy should be clearly identified.</td>
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<td>If there is reference to “supply side policies” only responses should be capped to the bottom of the relevant level, ie 4 marks in L3 and 7 marks in L4. If more than one policy is identified, consider all and credit the best.</td>
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<td>Level 2 [2 – 3] For an application of knowledge and understanding of a policy to improve competitiveness but lacking explicit economic analysis of how it would work. Annotate using [\text{L2}] in LHS margin.</td>
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<tr>
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<td></td>
<td>Level 1 [1] For knowledge and understanding of a policy to improve competitiveness only – ie simple statement of what the policy might be. Annotate using [\text{L1}] in LHS margin.</td>
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NOTES
Do not accept policies which would not be possible for Spain to implement as a member of the EU such as: • export subsidies; • tariffs on imports;
<table>
<thead>
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</table>
| 3        | Discussion might include:  
- short term consequences of greater openness in terms of reduced employment;  
- declining terms of trade for agricultural commodity exporters;  
- greater dependence on other economies in terms of net external demand;  
- lack of access to developed economy markets;  
- primary commodity dependence and volatile export prices;  
- other ‘keys’ to economic development – domestic savings;  
- inequality in the distribution of gains | 20 | Example of Level 4 Band 3 response  
“The extent to which greater openness to international trade is the key to economic and human development depends on governments putting measures in place to tackle income inequalities that might arise from the resulting economic growth.”  
Stated judgements = max 19 marks  
One or more developed judgements MUST be awarded 19 or 20 marks  
Annotate judgement using | Level 4 Band 3 | [18-20] |
|          | For a judgement on the factors that determine whether greater openness to international trade is the KEY to promoting economic and human development.  
In this Band, candidates can consider other ‘KEYS’ to economic and human development or identify why greater openness ON ITS OWN is not the key to economic and human development. | | | |
### Analysis of the impact of greater openness

Will need to make use of some, but not all, of the following concepts:

- Demand and supply diagram showing impact of removal of a tariff and / or quota;
- Theory of comparative advantage and efficiency gains from specialisation;
- Greater competition and impact on technological progress through increasing the incentives to innovate;
- Transfer of technology;
- Access to a larger variety of intermediate inputs;
- Economies of scale;
- AD / AS diagram to show impact of greater openness to international trade.

### Levels of Response

<table>
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<tr>
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<tr>
<td><strong>Level 3</strong></td>
<td>Candidates are expected to show the impact of openness on economic and human development by making reference to some, but not all, of the following:</td>
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<tr>
<td></td>
<td>- Higher level of GDP;</td>
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<td></td>
<td>- Increased GDP per capita;</td>
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<td>- Higher levels of employment;</td>
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<td></td>
<td>- Greater tax revenues and ability to increase expenditure on health, education and infrastructure;</td>
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<td>- Reduction in poverty;</td>
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<td>- Change in the economic structure.</td>
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**Level 2**

Responses in this level will show a TOTAL lack of economic analysis of the impacts but will make some valid general points.

### Examples of Level 2 response

- "The advantage of removing tariffs is that consumer choice will increase"  
- "However, USA firms are now undercutting domestically produced Chinese chicken causing a negative impact of greater openness to international trade."

### Example of Level 1 response

- "Greater openness to international trade involves reductions in the barriers to trade, e.g. reduction in tariffs and quotas."

### Annotate using

- **Level 3** in LHS margin
- **Level 2** in LHS margin
- **Level 1** in LHS margin
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