

OCR A-LEVEL ECONOMICS • H460

ECONOMICS



EXAM QUESTION PACK

IMPLEMENTING POLICY

SCORE

/464

PERCENTAGE

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- 1 In 2014 a new term 'lowflation' was invented by Simon Kennedy of Bloomberg News. He defined it as a situation where prices are rising but not fast enough to provide the benefits delivered by higher inflation. A number of economists and economic institutions now use the term. The International Monetary Fund, for instance, employs the term to describe disinflation with a risk of
- 5 deflation.

Lowflation may mean that inflation is below any target set by the government or central bank of a country. Table 1 shows the target rate for inflation, the inflation rate and the nominal interest rate of five countries in 2015.

Table 1 – Inflation target, inflation rate and interest rate for selected countries, 2015

Country	Inflation target (%)	Inflation rate (%)	Interest rate (%)
Mexico	3 +/- 1	2.6	6.1
Russia	4.5	15.3	10.2
South Africa	3 – 6	4.7	9.6
Turkey	5 +/- 2	7.6	11.1
UK	2 +/- 1	0.1	1.8

- The main policy tool used by central banks to keep inflation within target is the rate of interest.
- 10 In some circumstances, central banks use quantitative easing to inject money directly into the economy and to help firms find it easier and cheaper to borrow from a range of financial institutions. A possible effect of quantitative easing is to increase the amount of money in commercial banks and so banks' ability to lend. The Bank of England has also used forward guidance to influence expectations about future levels of interest rates.
- 15 As Table 1 shows the rate of inflation experienced varied between countries in 2015. A number of countries, including Japan, the UK and the USA experienced lowflation. There was concern in these countries that they might experience a deflationary spiral such as that shown in Fig. 1.

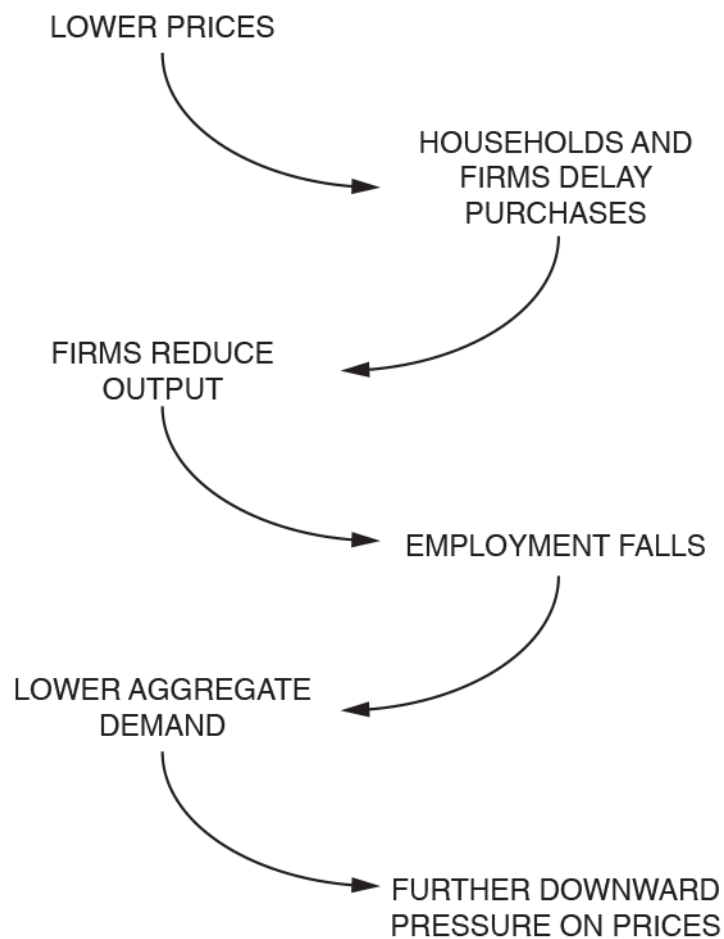


Fig. 1 – The deflationary spiral

20 Other countries experienced high inflation in 2015. A number of these were commodity exporters which were affected by the fall in the price of commodities which tend to have price inelastic demand. For instance, several oil exporting countries saw their price level rise as a result of the fall in the price of oil and the resulting impact this had on their exchange rates.

Inflation can have a number of effects on an economy. One of these is that it can redistribute income. Fig. 2 shows the Lorenz curves for three countries in 2014.

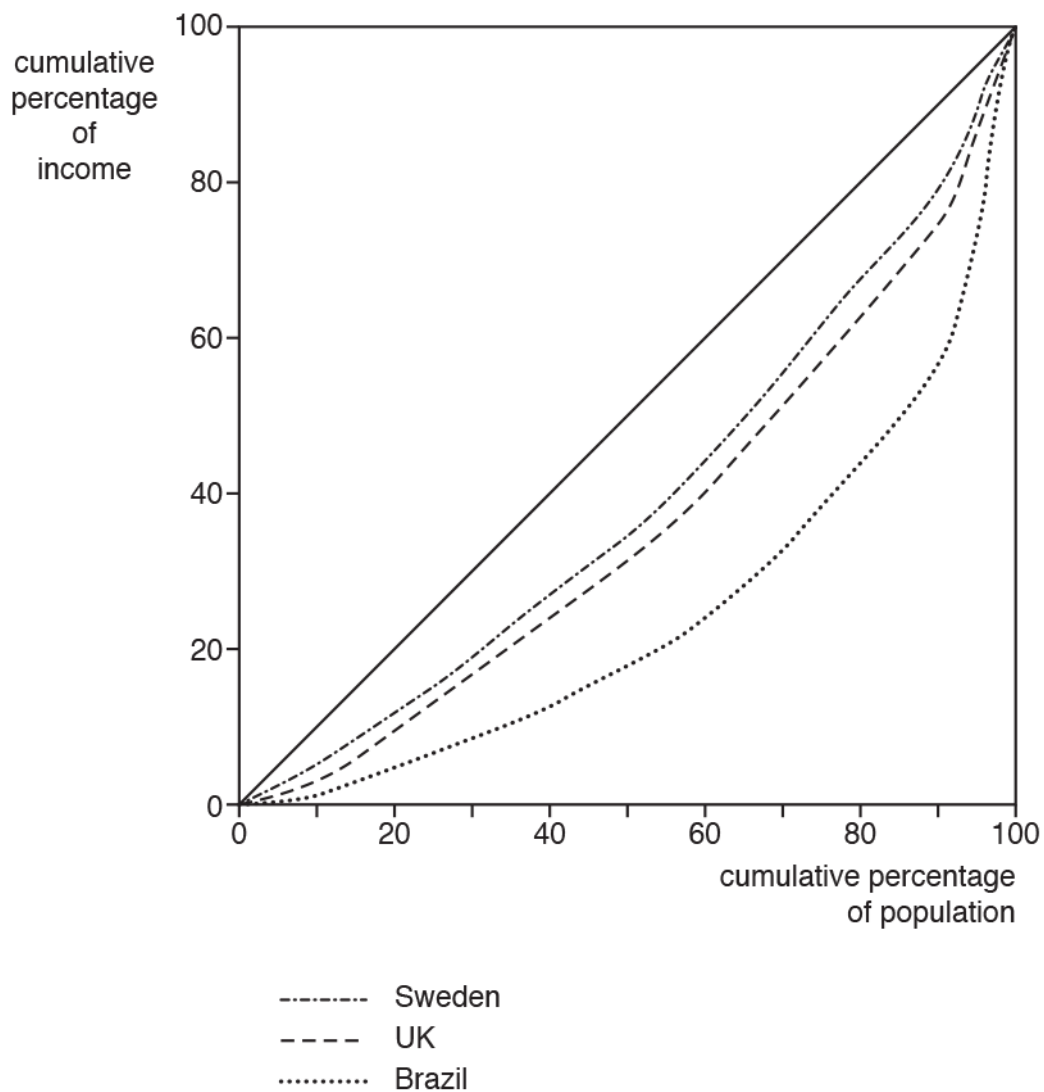


Fig. 2 – Lorenz curves for Brazil, Sweden and the UK, 2014

Please read the extract above or refer to insert H460-02 June 2017, **Lowflation**, which can be downloaded separately.

- (i) Using Table 1, calculate which country had the highest real interest rate in 2015.

Country _____

_____ [1]

- (ii) Using Table 1, explain which central bank would have been most likely to have engaged in quantitative

easing.

[3]

2 * It was estimated that Greece had an output gap equivalent to 10% of potential GDP in 2015.

Evaluate, with the use of an appropriate diagram(s), whether fiscal policy will always reduce a negative output gap.

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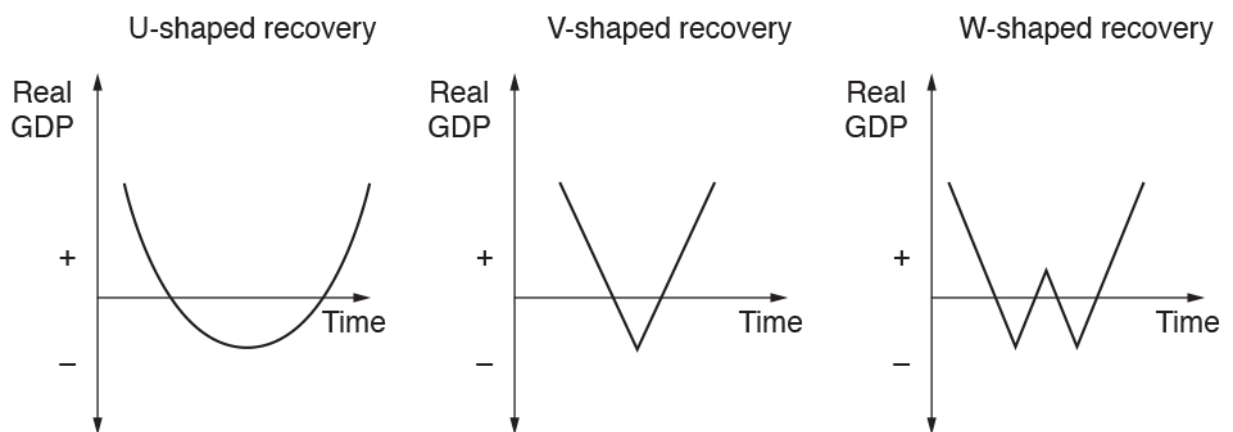
[25]

In the last two decades the Icelandic economy has experienced some significant changes in economic activity. One influencing factor has been changes in the standard rate of income tax. The rate was cut in a number of stages from 46% to 36% in 2006. Despite the lower income tax rate, government income tax revenue rose, allowing the government to spend more on the country's infrastructure. In 2009 and 2010 the income tax rate was increased.

In the period 2008 to 2011, the economy experienced a serious recession. The country's three largest banks were allowed to fail. It was the third largest bankruptcy in history and, according to the size of the economy, the biggest banking failure in history. The value of the country's stock market fell by 95%, the currency declined in value by 60%, unemployment increased by 8% and inflation rose to 12%.

From 2011 the economy has made a remarkable recovery. In 2014 its real GDP was US\$14.85bn and it grew by 4% in 2015, one of the fastest rates in Europe. Economists have developed an 'alphabet' of recoveries with the three most common types shown in Fig. 1.

Fig. 1 Different types of economic recovery



In 2015 the Icelandic government was paying back its loans to the International Monetary Fund early. It had removed capital controls and had reformed the country's financial sector. A number of the country's industries were expanding, most noticeably its tourist industry. Income from tourism can fluctuate significantly. In 2015 the total contribution of Iceland's tourist industry to the country's GDP was 23%. The impressive growth of Iceland's tourist industry was contributing to a fall in unemployment due to a rise in hotel construction, and an increase in infrastructure, although this was also putting pressure on house prices as people were buying them to rent out to tourists. In 2015 the unemployment rate was 5.3%, which was lower than in many European countries, but it was predicted to rise in 2016.

For a small country with a population of only 0.33 million in 2014, Iceland has a relatively high HDI value. Fig. 2 shows some details of the HDI values of six countries.

Fig. 2 The Human Development Index of six selected countries

Country	HDI ranking 2014	HDI value 2014	GNI per capita (US\$) 2014
Norway	1	0.944	64,992
Australia	2	0.935	42,261
Germany	6	0.916	43,918
USA	8	0.915	52,947
UK	14	0.907	39,267
Iceland	16	0.898	35,182

- 25 As Iceland's economy has grown, so has the country's aid for developing countries. In 2013, for instance, its foreign aid budget increased by 27.8%.

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Identify one piece of evidence in the stimulus material of the relationship suggested by the Laffer curve and explain why it is an example of such a relationship.

[3]

(b) * Evaluate whether an increase in the aid Iceland provides to developing countries would benefit the Icelandic economy.

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- 4 * Some economists argue that attempts by the Greek Government to reduce its budget deficit have contributed to the rise in the country's unemployment rate.

Evaluate the extent to which government policy measures to reduce a budget deficit will increase unemployment.

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[25]

5 In which circumstance would supply side policy be likely to be most effective?

- A The economy is in recession
- B The economy is operating close to full capacity
- C There is a large negative output gap
- D There is risk of deflation occurring

Your answer

☐

[1]

6 Which of the following explains how and why a central bank carries out the policy of quantitative easing?

- A Purchases financial assets to prevent inflation falling below target
- B Purchases financial assets to prevent inflation rising above target
- C Sells financial assets to prevent inflation falling below target
- D Sells financial assets to prevent inflation rising above target

Your answer

☐

[1]

7 Which of the following is most likely to reduce uncertainty amongst economic agents?

- A A central bank adopting a formal inflation target
- B A reduction in the basic rate of income tax
- C Moving from a fixed to floating exchange rate system
- D Zero hours contracts being introduced in the public sector

Your answer

☐

[1]

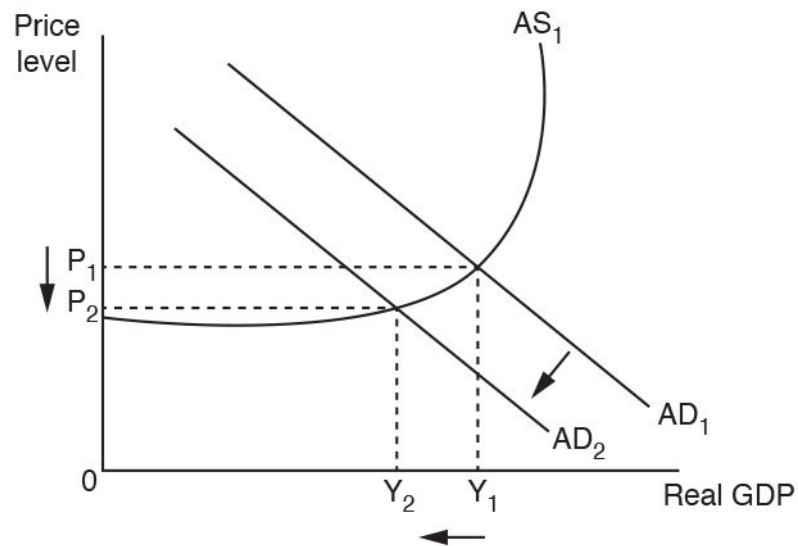
8 What does the Laffer Curve show?

- A Tax revenue will remain constant as the tax rate increases.
- B The correlation between the tax rate and tax revenue changes as the tax rate increases.
- C There is a negative correlation between the tax rate and tax revenue.
- D There is a positive correlation between the tax rate and tax revenue.

Your answer

☐

[1]



Which of the following is the most likely explanation of what is shown in the diagram above?

- A An improvement in the availability and affordability of childcare
- B An increase in the basic rate of income tax
- C A reduction in the interest rate
- D Research & development subsidies

Your answer

[1]

- 10 Please refer to insert **H460-03 June 2017, Housing**, which can be downloaded separately and is also included with Question 31.

Using the information in Extract 2, explain the impact on the government's budget position in the short run and the long run of the HS3 rail project.

[4]

- 11 In August 2016 the Bank of England's Monetary Policy Committee announced it was cutting the base rate of interest from 0.5% to 0.25% and extending its programme of quantitative easing. What is likely to happen as a result of this decision?

- A Decrease in government tax revenue
- B Decrease in inflationary pressures
- C Exchange rate depreciation
- D Increase in marginal propensity to save

Your answer

7

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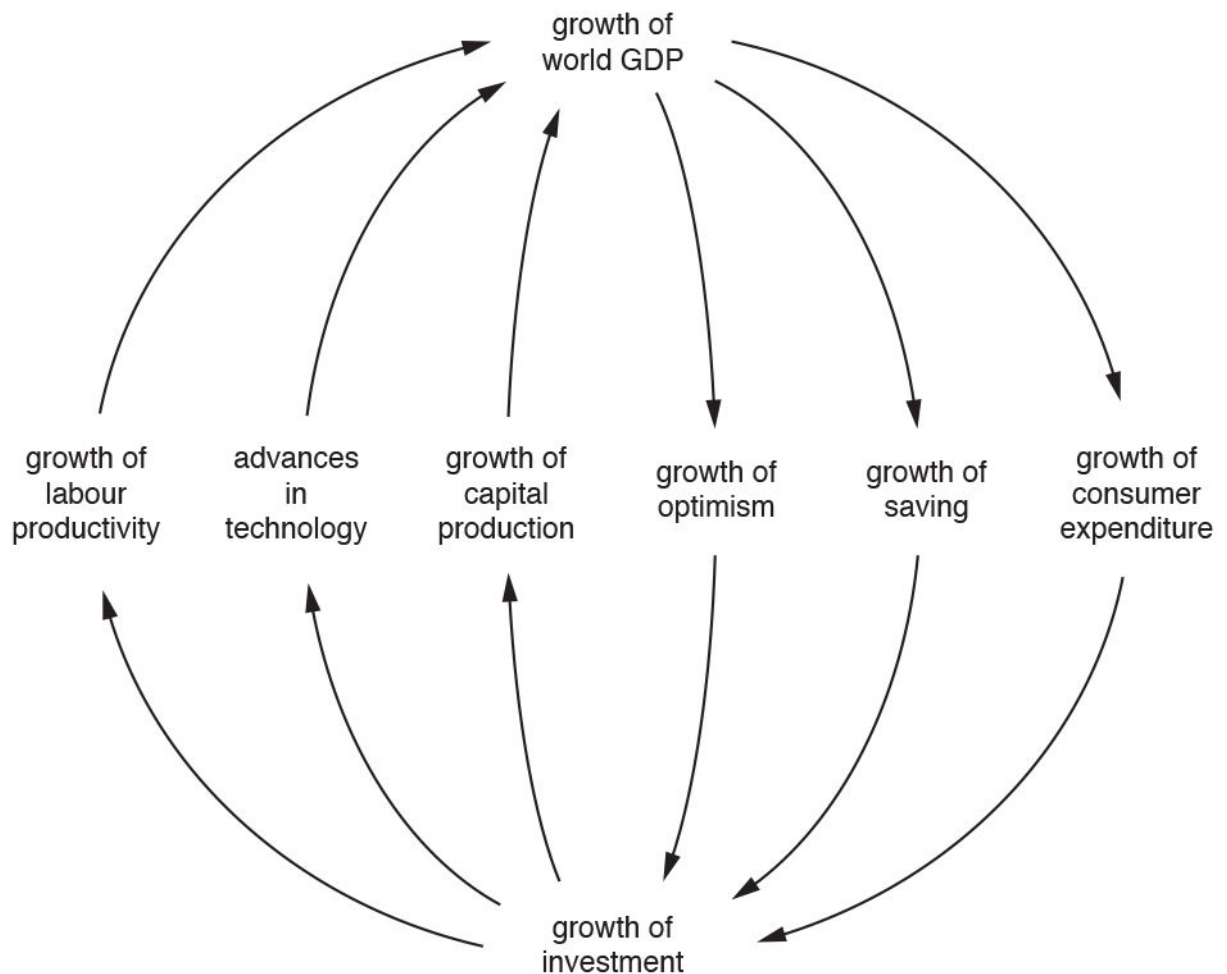
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Trade wars were threatening the process of globalisation in 2018 and were restricting the ability of countries to exploit their comparative advantage and their absolute advantage. In the years before, advances in production and communication technology had lowered production and transport costs, had increased the ability of firms to move production around the world and increased the size of firms' markets.

World trade increased by 3.2% in 2017. This contributed to a growth in world GDP. Higher GDP can result in a virtuous circle as shown in Fig. 1.

Figure 1 A virtuous circle



While the benefits of globalisation are widespread, the costs are often concentrated in particular areas and among those unskilled workers who are geographically and occupationally immobile.

- 10 One of the reasons why the US government imposed tariffs on steel imported from China was to protect the jobs of US steel workers.

Some economists are also concerned that globalisation can result in governments engaging in tax competition to keep firms and skilled workers in the country and to attract foreign MNCs and

foreign skilled workers into the country. Table 1 shows government tax revenue and expenditure
15 for selected countries in 2017.

Table 1 Government tax revenue and government expenditure 2017

Country	Government tax revenue (US\$ billion)	Government tax revenue as a % of GDP	Government expenditure (US\$ billion)
China	2672	22.4	3146
Germany	1598	43.8	1573
India	249	10.2	330
Ireland	85	26.2	87
Russia	254	17.3	288
UK	984	38.4	1076
USA	3336	22.0	3991

International competition may, on the other hand, encourage governments to spend more on education, training and health care to increase productivity and so attract foreign direct investment. Table 2 shows the corporate tax rates and the foreign direct investment attracted by the same selected countries.

Table 2 Corporate tax rates and foreign direct investment 2017

Country	Average corporate tax rate (%)	Foreign direct investment per head (US\$)
China	25.0	1098
Germany	29.8	17 963
India	34.6	287
Ireland	12.5	295 400
Russia	20.0	3378
UK	19.0	30 852
USA	40.0	12 489

- 20 The UK economy is more affected by changes in the global economy than the USA. This is because it is a more open economy. The UK has a relatively high marginal propensity to import. Between 2016 and 2017, average UK household income rose from £26 300 to £27 400 while average household spending on imports rose from £4950 to £5280.

The growth of the emerging economies, including China and India, is having an impact on the UK.

- 25 For instance, Chinese steel firms have captured some of the UK's steel industry's market at home

Please refer to insert H460-02 June 2019 which can be downloaded separately and is also included above. Using Table 2, evaluate to what extent differences in corporate tax rates explain differences in foreign direct investment in countries.

[illegible]

[8]

- 16 * In 2018 the Australian government, concerned about the possibility of an economic downturn, used a number of policy measures intended to increase private sector investment.

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[illegible]

17 * Cuts to welfare benefits of £2.5bn affected eleven million families in the UK in 2018.

Evaluate, with the use of an appropriate diagram(s), whether a cut in government spending on welfare benefits will increase income inequality.

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[25]

18 Please refer to insert H460-02 Specimen which can be downloaded separately and is included above.

* Evaluate the extent to which an emerging economy, such as India, can operate an independent monetary policy.

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[12]

- 19 * The Labour Party announced in 2014 that, if elected, it would restore the 50% income tax rate for high earners in the UK.

Evaluate, with the use of an appropriate diagram(s), whether UK macroeconomic performance would be strengthened by an increase in the top rate of income tax.

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- 20 The table below outlines the income tax rates in the UK in 2016–17. What is the average tax rate of an individual earning £46 500?

Band	Taxable income	Tax rate
Personal Allowance	Up to £11 000	0%
Basic rate	£11 001 to £43 000	20%
Higher rate	£43 001 to £150 000	40%
Additional rate	over £150 000	45%

- A 16.8%
- B 20%
- C 21.5%
- D 40%

Your answer

[1]

- 21 Which of the following would decrease if the government decided to reduce the level of welfare benefits?

- A Dependency ratio
- B Participation rate
- C Replacement ratio
- D Working age population

Your answer

[1]

Founded in 1948, the UK's National Health Service (NHS) is arguably the world's most comprehensive system of state provided free healthcare. Despite its budget today being ten times greater than it was when launched (in 1948 the NHS had a budget of £437 million, equivalent to £15 billion at today's prices), it has faced significant pressures resulting from spiraling costs in recent years. Technological advancements in medicine alongside demographic changes have contributed to ever rising demand for healthcare that has put the system under increased strain.

In 2015 the government pledged to significantly increase healthcare expenditure as part of wide ranging reforms driven by a desire to deliver its flagship '7 day NHS commitment', whereby patients would be able to access GP and hospital services in the evenings and at the weekend by 2020. The proposed changes to the budget are illustrated in Fig. 1.1.

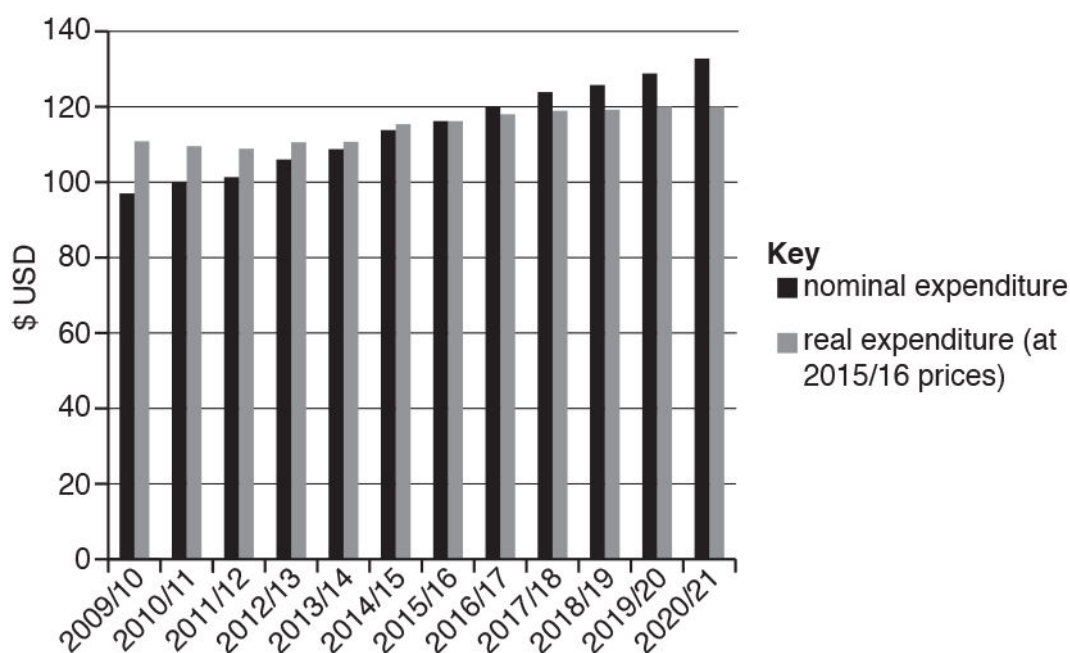


Fig. 1.1 – NHS expenditure historic (2009–2015) & projected (2016–2021)

These reforms included the introduction of new contracts for 'junior doctors', an umbrella term covering doctors for the first decade or so of their careers. The NHS employs more than 1.5 million people, putting it in the top five of the world's largest employers. Many of its employees are doctors, with more than 150 000 doctors working in the NHS in 2016. The government initially proposed increasing the basic pay of junior doctors by 13.5% but cutting back on extra payments which, up until then, had significantly boosted doctors' salaries, such as offering no additional payment for Saturday working.

In 2015 the British Medical Association (BMA), the trade union representing doctors, announced its intention to ballot its members for strike action having failed to reach an agreement with the government over the contract. Despite the government arguing the new contracts did not represent a pay cut, the BMA disputed this, whilst also

arguing the arrangements would result in its members enjoying a poorer work-life balance as a result of having to work more weekends.

Indeed, the BMA suggested the government was effectively abusing its position as a monopsony employer of doctors to introduce an unfair contract. This is a view supported by the real wage cuts experienced by doctors as a result of the fiscal austerity imposed from 2010, which goes against the traditional economic theory of derived demand.

Under the original contract, the starting salary for junior doctors started at about £23 000, with the average salary for these doctors standing at £37 000. This compares unfavourably with other high skilled professions such as law and banking in the private sector, where workers would expect to receive a salary of more than £50 000 a year early in their careers.

Following the first strike action by doctors in more than 40 years, in 2016 the BMA achieved some concessions from the government, including a pay rise for doctors working more than six weekends a year. Whilst the BMA could be said to have successfully overcome labour market failure, the debate surrounding the wages of doctors is still ongoing. An initial ballot of junior doctors suggested doctors were still unhappy with the proposals and, whilst there was generally a high level of support for doctors amongst the general public, some pointed to the vocational nature of the profession, as well as the high salaries on offer in the future (consultants can earn in excess of £100 000) as evidence that the strikes which caused such significant disruption to patients were unjustifiable.

Extract 2 – Global healthcare and economic development

Over 80% of healthcare expenditure in the UK is financed by the public sector. Whilst this is similar to many European nations it is not the same across the developed world; in countries like Singapore and the US, more than half of healthcare expenditure is accounted for by private spending. Economists would generally expect there to be a positive correlation between public healthcare expenditure and GDP per capita. The data for these variables for a range of countries is presented in Fig. 2.1.

Country	Public healthcare expenditure (as a % of GDP)	GDP per capita (\$USD)
China	3.07%	\$7925
India	1.41%	\$1582
Japan	8.53%	\$32 473
Nigeria	0.93%	\$2640
UK	7.56%	\$43 734
US	8.26%	\$55 837
Singapore	2.04%	\$52 889

Fig. 2.1 – Public healthcare expenditure and GDP per capita around the world

Indeed, underinvestment in healthcare in India has been seen as a crucial hindrance to its economic

development, with the World Health Organisation ranking India's healthcare system 112th out of 119 countries in 2000. This is partially reflected in the Human Development Index (HDI), where a score of 0.61 ranked India 130th out of 188 countries in 2015. This is significantly lower than India's ranking based on GDP per capita, where rapid economic growth rates in recent years have seen India climbing towards a position in the top half of nations.

However, some economists question the extent to which the HDI accurately measures human development, pointing to the fact that the politically volatile countries of Egypt and Iraq are placed above India in HDI rankings as evidence for this. Moreover, improvements in India's healthcare system as a whole in recent years, that have enabled it to climb up the HDI rankings, ignore the health inequality that still exists, with those in rural areas having little access to hospitals or clinics. This inequality is mirrored in education, with the average male enjoying twice as many years of schooling as the average woman in India.

Extract 3 – Wage differentials and international migration in healthcare

The dispute over junior doctors' contracts has brought into greater focus the different wages on offer in healthcare. Fig. 3.1 shows the average wages of a variety of occupations within the healthcare sector.

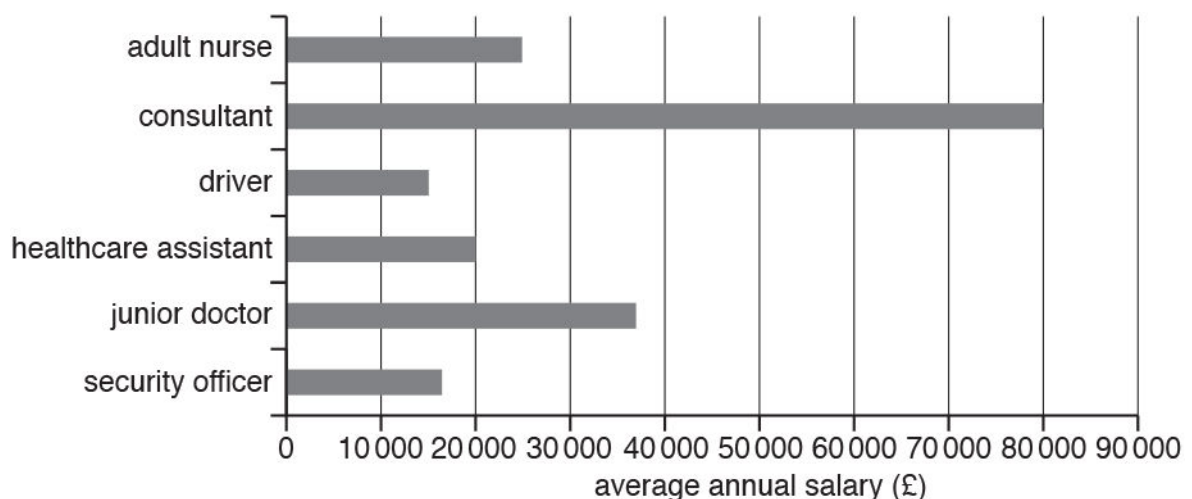


Fig. 3.1 – Average salaries in selected healthcare occupations

Throughout its history the NHS has relied on foreign workers to fulfill a range of roles. In 2016 more than a third of doctors practising in the UK were trained abroad. The main countries of origin of these doctors are detailed in Fig. 3.2.

Country	% of all UK registered doctors
UK	63.4%
India	9.7%
Pakistan	3.6%
South Africa	2.1%
Nigeria	1.6%

Ireland	1.5%
Germany	1.3%
Egypt	1.2%
Other	15.6%

Fig. 3.2 – Training location of UK registered doctors

Many of these migrant workers come from developing nations, such as India and Nigeria. Such workers are attracted by the better wages and working conditions on offer in the UK and often send a proportion of their wages back home to their family. Such remittances are particularly important to developing countries – in Tajikistan, remittances account for nearly 50% of GDP and represent a valuable inflow of foreign currency which helps to stabilise the balance of payments. However, research by the World Bank suggests that the unfairly high commission charged by banks and transfer unions on international transactions somewhat limits the benefit of remittances, with the average fee being 9%. Despite this being a well recognised problem of the global financial system, no action has been taken in the form of regulation to address it.

Please refer to insert H460-03 Practice 2 which can be downloaded separately and is included above. Using the data in Fig. 1.1, explain the trend in public healthcare spending between 2009 and 2021.

[2]

- 23 During the 2016 US Presidential Campaign, one candidate proposed a reform to America's income tax system:

Current: Tiered system of seven tax rates, the lowest being a 10% rate on taxable income between \$0 - \$9,275, the highest being a 39.6% rate on taxable income exceeding \$415,000.

Proposal: 10% on all taxable income.

This proposal represents a change in the tax system from:

- A Progressive to Proportional
- B Progressive to Regressive
- C Regressive to Progressive
- D Regressive to Proportional

Your answer

[1]

24 In 2014-15 the UK government collected £652bn in tax receipts. Government expenditure was £748bn.

What does this represent?

- A A budget deficit
- B A budget surplus
- C A current account deficit
- D A current account surplus

Your answer

☐

[1]

25 An economy experiences a period of inflation but no change in real national income. The government does not change tax rates or tax allowances. In these circumstances, which type of tax is least likely to produce an increase in tax revenue?

- A A specific tax on alcohol
- B Corporation tax
- C Income tax
- D Value added tax

Your answer

☐

[1]

The UK is under water

In the winter of 2013-2014 England saw some of the worst storms since records began. More than five million people were put at risk from flooding. Many of these were hit directly as their homes were flooded. Some businesses were also flooded and suffered a loss of customers and disruption to supplies. In the south of the country, in particular, infrastructure was badly disabled. Many business owners feared for their livelihoods. Only time will tell what the negative multiplier effect has been on those regions.

The Environment Agency was heavily criticised for its handling of the floods and much debate was had around the lack of government intervention; in particular, the merits of dredging rivers. However, in order to receive funding from the government, the Environment Agency has to demonstrate that a flood defence project will match a Cost Benefit Ratio of 1:8, i.e. for every £1 spent there needs to be at least an £8 return in avoided flood damage. In a Cost Benefit Analysis of flood defences, a business failure would be considered an economic cost, whereas prevention of business failure an economic benefit. Other considerations are the loss of agricultural output and supply-side consequences: health issues and social cohesion, as well as a loss of productivity.

It was claimed that there would have to be an annual £20m rise in the government's £600m flood defence budget, as well as any inflationary increase, just to maintain the UK's present level of protection. The government would need to consider the opportunity cost of this decision because of the trade-off between environmental protection expenditure and other forms of government spending.

Perhaps this type of extreme weather should not be a surprise to economic agents. In 2006 Lord Nicholas Stern from the London School of Economics published a report on the economics of climate change. This urged policy-makers to realise the negative externalities resulting from their patterns of production and consumption in order to reduce emissions. He considered that the total cost and risk of climate change could amount to the equivalent of losing at least 5% of global GDP each year

The storms and flooding of 2013/14 were unprecedented; costs to repair the damage were estimated at the time to be in the region of £1bn. However, Mark Carney, the Governor of the Bank of England, expressed his opinion that there would be a 'dent' in economic activity but it would not harm the overall recovery that the UK had started to experience during 2013.

Some economists argue that to truly address this market failure the government response needs to be wider than just flood prevention. It should consider the environmental damage that UK economic activity causes and how to limit such damage. The government currently uses a range of environmental taxes but their success in reducing the negative externalities of both

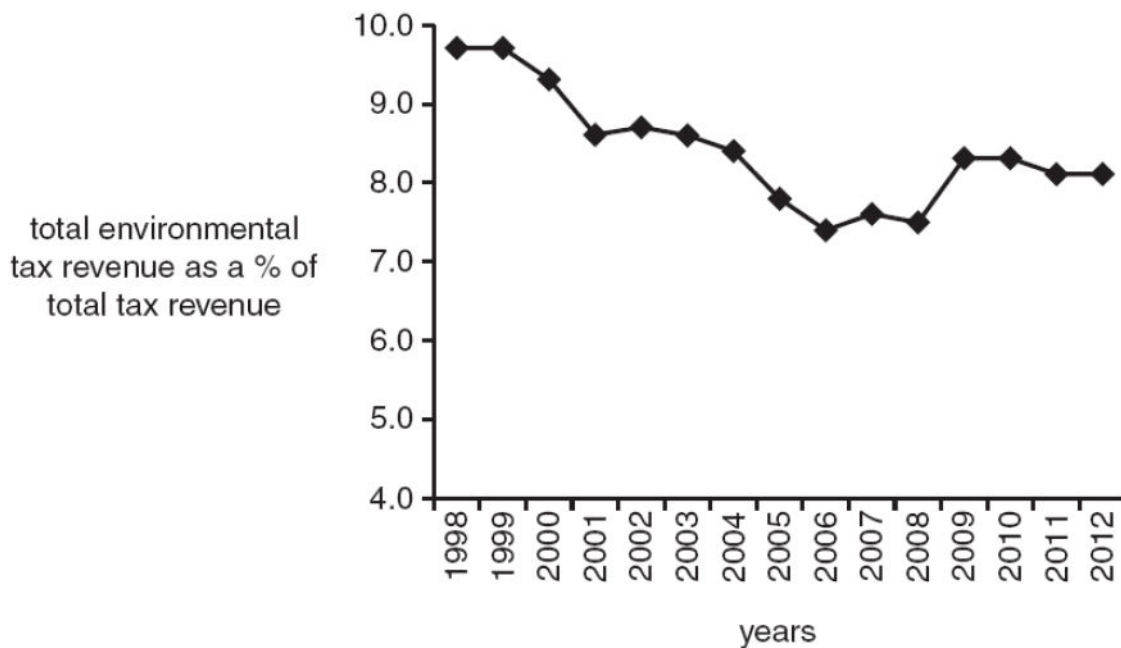
40 consumption and production has been questioned. Could further policies such as environmental standards be more effective at correcting market failure and the subsequent impact on economic efficiency for both micro and macroeconomic performance?

Extract 2

Environmental taxation in the UK

Fig. 2.1 shows UK government revenue from environmental taxation.

Fig. 2.1 – Environmental taxation as a percentage of UK government tax revenue, 1998–2012



Extract 3

How will we manage the rising demands for water?

While the UK experienced flooding, the Organisation of Economic Cooperation and Development (OECD) released a report which warned of the long term problems that will occur for the global economy due to a lack of water. The OECD Secretary-General warned that, 'Without major policy changes, we risk high costs to economic growth, human health, and the environment. But with sustainable financing, effective governance and coherent policies, governments can harness water's potential...'

5

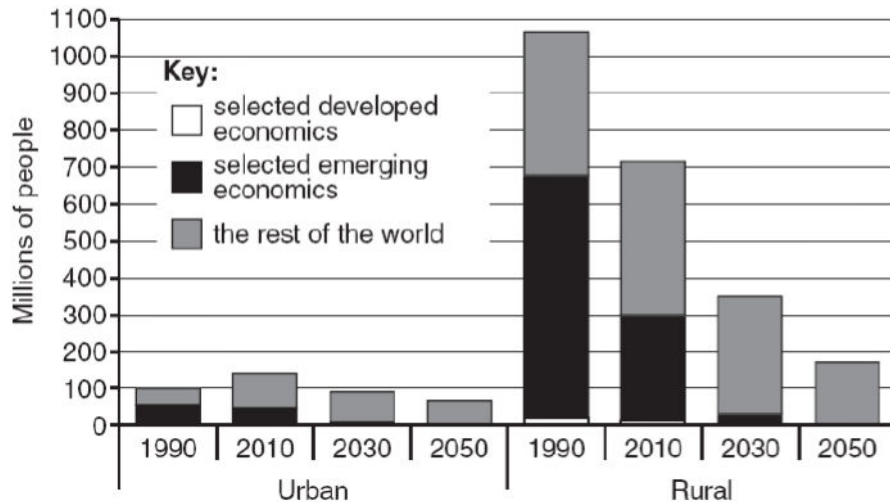
The report highlighted the global challenges posed by increasingly rapid urbanisation, population growth and changing economic dynamics for managing water supply. With water demand projected to increase by 55% by 2050, there will be increased rivalry and excludability for this increasingly scarce resource. By that date, it is predicted that:

10

- 3.9bn people – more than 40% of the world's population – will be living in river basins facing severe water stress
- 15
- more than 240m people, most of them in rural areas, will lack access to a clean water source
 - almost 1.4bn people will not have access to basic sanitation.

More information about the extent of these problems is shown in Fig. 3.1.

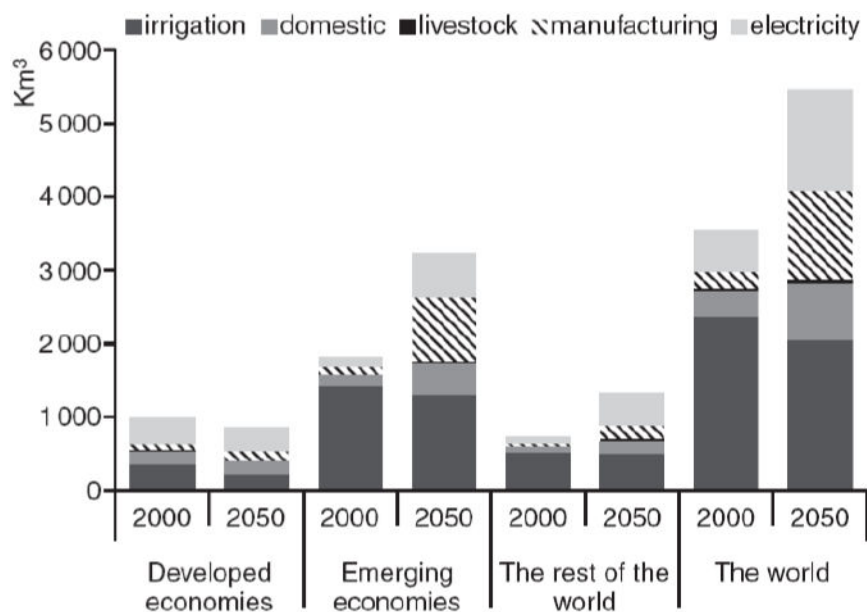
Fig. 3.1 – Population lacking access to a clean water source, 1990–2050



In addition, increased flows of nitrogen, phosphorus and pesticides from agriculture and poor wastewater treatment will contaminate ground water, rivers and oceans, harming the environment and human health.

- 20 As countries develop their economic structure will change, transitioning from relying on the primary sector, to manufacturing and then to tertiary. Over time a larger proportion of their Gross Domestic Product (GDP) is derived from manufacturing rather than agriculture and so their pattern of water demand (measured in km³) will change, as shown in Fig. 3.2.

Fig. 3.2 – Global water demand by use, 2000 and 2050*



*forecast

- 25 Lifestyles and diets are becoming more westernised in the emerging economies. Average incomes are rising as a consequence of high rates of economic growth. As a result more and more people are consuming more and more water. Farmers are competing with households, energy firms and industry for clean water, but economic production continues to pollute making it harder to access sufficient clean water. A high volume of water consumption is just one
- 30 example of how economic growth has resulted in environmental degradation.

- In 2014 the President of the World Bank gave a grave warning about the risks of natural resource conflicts, particularly water and food. While the UK saw record rainfall, California in the USA experienced the worst drought on record. It does not take much to remember the
- 35 spikes in global food prices that have occurred in recent years, as shown in Fig. 3.3. The President of the World Bank also said that there would be no solution to climate change without private sector involvement and urged companies to seize the opportunity to make profits.

Fig. 3.3 – World Bank food price index, 2008–2013

	Q1	Q2	Q3	Q4
2008	n/a	n/a	87	80
2009	90	95	93	97
2010	91	90	101	101
2011	120	123	123	115
2012	120	121	132	121
2013	116	117	112	n/a

- 40 Governments have long debated the best response to natural resource conflicts and

environmental damage. They have considered the merits of policy measures, including:

- environmental taxation
 - pollution permits
- 45
- subsidies for innovation into greener technologies
 - subsidies to encourage firms to recycle water.

Please refer to insert H460-03 Specimen which can be downloaded separately and is included above.

Using Fig. 2.1 and extract, describe the trend in environmental taxes as a percentage of total tax revenue between 1998 and 2012.

----- [2]

27 What can the government do to finance a budget deficit?

- A Devalue the exchange rate
- B Increase export subsidies
- C Issue government bonds
- D Reduce the money supply

Your answer

[1]

28 The data below shows key macroeconomic performance indicators for four countries.

	2016 Inflation Rate (CPI)	2016 Unemployment Rate (ILO)	2015 GDP Growth Rate	2016 GDP Growth Rate
Ireland	0%	8.1%	26.3%	5.2%
Malta	0.6%	5.3%	7.4%	5%
Ukraine	13.9%	8.9%	−9.8%	2.3%
United Kingdom	0.6%	4.8%	2.2%	1.8%

If an economist was judging the performance of these economies from the perspective of the UK government macroeconomic policy objectives, which would they decide performed best?

- A Ireland
- B Malta
- C Ukraine
- D United Kingdom

Your answer

[1]

In the first decade of the twenty-first century China saw a significant increase in both income and wealth. In the current decade, however, its economic growth rate has slowed. At the start of 2016, China's president, Xi Jinping, said that the government would concentrate on supply-side reform. He mentioned that the government would no longer try to promote economic growth by just relying on fiscal and monetary policy measures. It would be placing more emphasis on long-term structural change rates rather than short-term stimulus.

In the past China has used short-term demand management to increase consumer expenditure and investment. This has led to an increase in government spending which has had implications for the country's budget position. Table 1 compares the gross domestic product (GDP), government revenue and government expenditure of the six largest economies in 2014.

Country	GDP	Government revenue	Government expenditure
China	10.4	2.3	2.4
France	2.8	1.5	1.6
Germany	3.9	1.7	1.7
Japan	4.6	1.5	1.8
UK	3.0	0.9	1.1
USA	17.4	3.0	3.5

Table 1 - GDP, government revenue and government expenditure in US\$ trillion of the six largest economies in 2014

The Chinese government is hoping that supply-side policy measures will increase the country's productivity. The UK economy has introduced a number of supply-side policy measures including deregulation, privatisation and tax cuts Fig.1 compares the UK's productivity growth with that of the six other G7 members. It shows after 2007 the gap between the actual growth in productivity and the predicted growth in productivity.

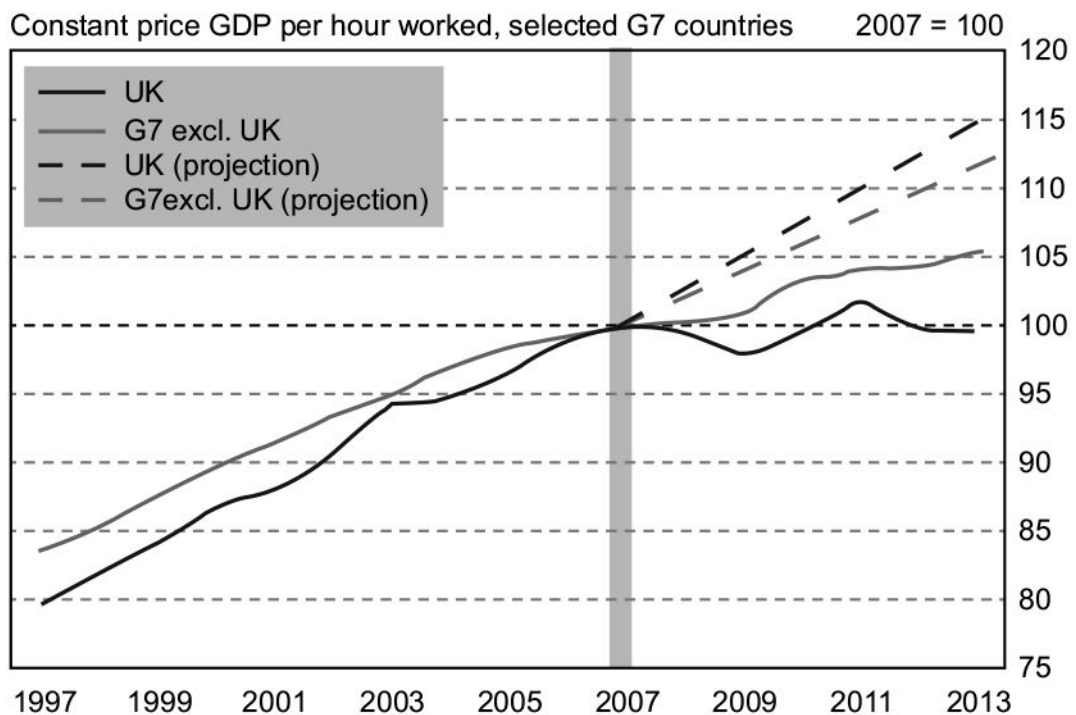


Fig. 1. A comparison of productivity growth in the UK and G7 1997 – 2013

Productivity is influenced by a number of factors including investment. In turn, there are a number of influences on investment including the level of savings. The amount of income saved varies from country to country. Some countries, including China have a relatively high average propensity to save. Others, including Denmark in recent years, have had a negative average propensity to save. Table 2 shows the average propensity to save of the G7 countries in 2014.

Country	Average propensity to save
Canada	0.05
France	0.15
Germany	0.09
Italy	0.05
Japan	0.02
UK	0.06
USA	0.05

Table 2 - The average propensity to save in the G7 countries in 2014

Using Table 1, calculate whether Japan or the UK had the larger budget deficit as a percentage of GDP. State which country had the larger budget deficit as a percentage of GDP and give the budget deficit as a percentage of GDP.

Country -----

Percentage of GDP -----

[2]

(b) * Evaluate whether supply-side policy measures will increase investment.

[12]

30 * The Venezuelan Government’s attempts to promote economic growth are thought to have contributed to the country’s inflation rate, which was predicted to reach 480% in 2016.

Evaluate, with the use of an appropriate diagram(s), whether macroeconomic policy measures can only promote economic growth at the cost of higher inflation.

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31 * The central bank of Kenya cut the country’s interest rate twice in 2016. The first time it was followed by a fall in the value of the country’s currency, the Shilling, but the second time its exchange rate appreciated.

Evaluate, with the use of an appropriate diagram(s), whether a reduction in a country’s rate of interest would reduce its exchange rate.

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For some years now the UK has had a deficit on both its budget balance and on the balance of the current account of its balance of payments. In 2015 the budget deficit fell to 4.1% of GDP. This was the lowest deficit, in percentage terms, since 2007 but it was noticeably higher than the historical average of 2.5% of GDP. In October 2016 the Chancellor of the Exchequer announced that he was abandoning the objective of achieving a budget surplus by 2020. He also said he was prepared to borrow for public sector investment in infrastructure.

Changes in the budget position can influence activity in the labour market. Fig. 1 shows the stocks of employment, unemployment, economic inactivity and migration and the flows between them. For instance, the stock of unemployment (the number of people unemployed at any particular time) is affected by flows into and out of unemployment (some people becoming unemployed while others stop being unemployed).

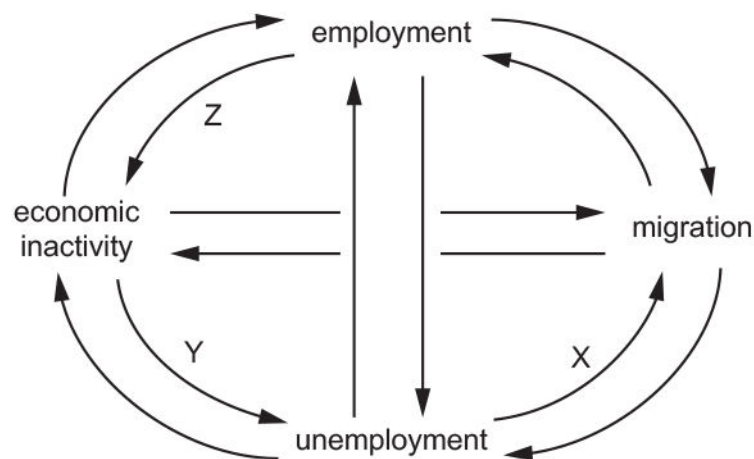


Fig. 1 Stocks and flows in the labour market

The budget position, in turn, is influenced by a range of factors including the level of economic activity, the rate of interest and any tax reforms undertaken. A number of European countries have recently introduced flat rate tax systems. Fig. 2 shows when a flat tax was introduced in a number of European countries and how the rate of income tax changed due to the introduction and the rate in 2016.

Country	Tax rate(s) before introduction (%)	Year introduced	Initial tax rate after introduction (%)	Tax rate in 2016 (%)
Estonia	16–35	1994	26	21
Lithuania	18–33	1994	33	15
Latvia	25–10	1995	25	25
Russia	12–30	2001	13	13
Georgia	12–20	2005	12	20
Macedonia	15–24	2007	12	10
Czech Republic	12–32	2008	10	10

Fig. 2 Flat rate taxes on personal income (%) in selected countries

Changes in economic activity at home and abroad, the rate of interest and the exchange rate can also influence the current account position of the balance of payments. In 2015 the UK's current account deficit was £96.2 billion. This was the largest deficit as a percentage of GDP (5.2%) since annual records began in 1948 and the largest of the G7 countries. Fig. 3 shows some details of the UK's balance of payments position in 2014.

Current account balance	−£92.9 bn
Trade in goods	−£123.7 bn
Trade in services	£89.1 bn
Secondary income	−£25.2 bn
Capital account	−£0.8 bn

Fig. 3 Selected details of the UK's balance of payments 2014

The current account deficit has increased every year since 2011. One significant cause of this has been the rise in the deficit on primary income. Throughout the nineteenth century and the first half of the twentieth century the UK invested heavily abroad which resulted in a high yield of profits, interest and dividends. In more recent decades the UK has seen a net inflow of foreign investment. Multinational companies from a range of countries, including the USA, Germany, India and China have entered in a number of UK industries.

Identify **one** example of discretionary fiscal policy in the stimulus material and explain how it could affect aggregate demand.

[2]

- (b) Using information from the stimulus material, calculate the UK's budget deficit in pounds in 2015.

[2]

(c) * Evaluate whether the introduction of a flat rate tax system would benefit an economy.

[12]

33 * The Venezuelan Government’s attempts to promote economic growth are thought to have contributed to the country’s inflation rate, which was predicted to reach 480% in 2016.

Evaluate, with the use of an appropriate diagram(s), whether macroeconomic policy measures can only promote economic growth at the cost of higher inflation.

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[25]

34 * The central bank of Kenya cut the country's interest rate twice in 2016. The first time it was followed by a fall in the value of the country's currency, the Shilling, but the second time its exchange rate appreciated.

Evaluate, with the use of an appropriate diagram(s), whether a reduction in a country's rate of interest would reduce its exchange rate.

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[25]

- A Imposing a tariff
- B Increasing interest rates
- C Privatisation
- D Quantitative easing

[1]

36 In response to a global recession, Central Banks in ten closely linked economies reduce interest rates by an average of 1.5%. What is the likely impact on one of these economies where its Central Bank decided to reduce interest rates by 0.5%?

- A Hot money will flow in, causing the exchange rate to appreciate
- B Hot money will flow in, causing the exchange rate to depreciate
- C Hot money will flow out, causing the exchange rate to appreciate
- D Hot money will flow out, causing the exchange rate to depreciate

Your answer

[1]

37 When will supply side policy be ineffective?

- A The marginal propensity to save is high
- B The real interest rate is close to zero
- C There is a large negative output gap
- D There is significant demand-pull inflation

Your answer

[1]

38 Using the table below, what was the inflation rate in 2017?

Year	Consumer Price Index
2014	98.2
2015	100.0
2016	103.4
2017	101.9
2018	103.6

- A -1.50%
- B -1.45%
- C 1.47%
- D 1.90%

Your answer

[1]

The commitments made by the UK’s main political parties in the 2019 General Election campaign marked an end to the austerity economics that had dominated macroeconomic policy for the previous decade.

Following the global financial crisis in 2008, many of the world’s advanced economies introduced a range of stimulus measures designed to promote economic recovery and end a period of recession. However, as the Greek economy began to collapse at the end of 2009, in part as a result of a national debt/GDP ratio of more than 120%, policy makers around the world began to fear their own economies were at risk because of unsustainably high levels of borrowing. With the UK’s national debt/GDP ratio standing at 69% and forecast to increase to over 100% in the coming years, the Conservative-Liberal coalition came to power in 2010 to eliminate the budget deficit by implementing austerity – a deficit reduction programme focused on significant reductions in public spending and increases in tax revenue. The policy was seen to be crucial in promoting future economic growth and stability. Fig. 1.1 illustrates the impact austerity had on the size of the budget deficit and national debt.

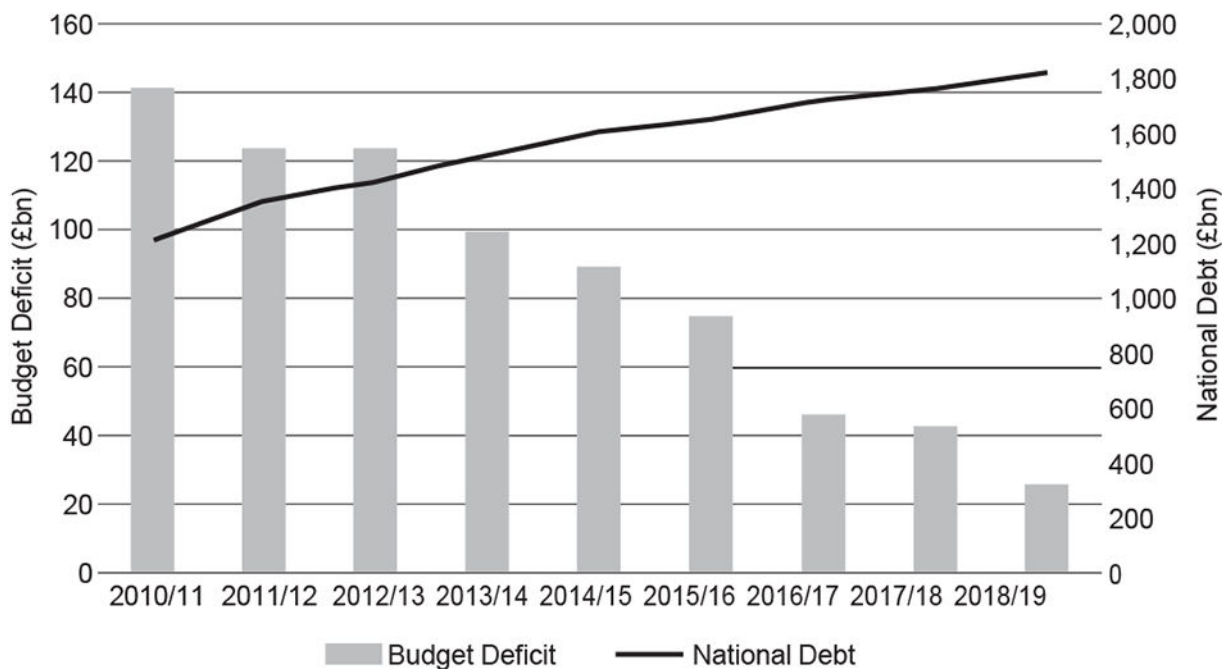


Fig. 1.1 – UK Government’s Budget Deficit National Debt 2010–2019

However, in the 2019 General Election campaign both the Conservative government and its main challenger, the Labour Party, made significant public spending commitments that represented a significant shift away from austerity. The Conservatives promised an £11bn increase in public expenditure by 2024, including pledges to increase expenditure on the NHS, police and schools, whilst also committing to tax cuts for low paid workers. These plans were modest in comparison to the spending commitments by Labour, who pledged to increase public expenditure by £153bn.

Individual policies included a 5% pay rise for public sector workers, a green transformation fund to spend on projects such as insulating 27 million homes, compensating the 'WASPI' (Women Against State Pension Inequality) women who had seen an unexpected cut to their state pension entitlements as a result of the state pension age for women being increased to match that for men and the building of social housing.

25

Both parties moved away from targeting to eliminate the overall budget deficit and instead sought to make a distinction between current and capital expenditure, arguing that achieving a current budget balance should be the new target. Labour committed to meeting this target within five years whilst the Conservatives aimed to achieve it in three.

Whilst the victory of the Conservative Party in the election meant the likely change in direction of macroeconomic policy was not as sharp as it might otherwise have been, it is undoubtedly the case that, after almost a decade of policy designed primarily to eliminate the budget deficit, government borrowing was set to increase. Whilst some economists point to low costs of borrowing for the government and the relatively low national debt/GDP ratio in the UK in comparison to many other developed economies as evidence that increased government spending can be justified providing it is on capital expenditure, others argue that this risks the hard-earned reputation of fiscal responsibility being destroyed.

30

35

Extract 2 – Ownership of public utilities

Amongst the most eye-catching proposals in the Labour Party's manifesto was its commitment to bringing a range of public utilities under government control. The proposal was to nationalise a range of key industries that had been privatised under the Conservative government in the 1980s and early 1990s, which sparked fierce debate over whether the interests of consumers

would be best served by these companies operating in the private or public sector.

5

Two such industries are the water and electricity industry, which were privatised in 1989 and 1990 respectively. The government at the time saw privatisation as essential to boost the performance of the UK economy, arguing the discipline of the marketplace would create competition that would drive efficiency, raise revenue for the government and ultimately bring prices down for consumers. However, thirty years on, some argue privatisation has failed to achieve its stated aims. Fig. 2.1 illustrates what has happened to the price of water and electricity since privatisation.

10

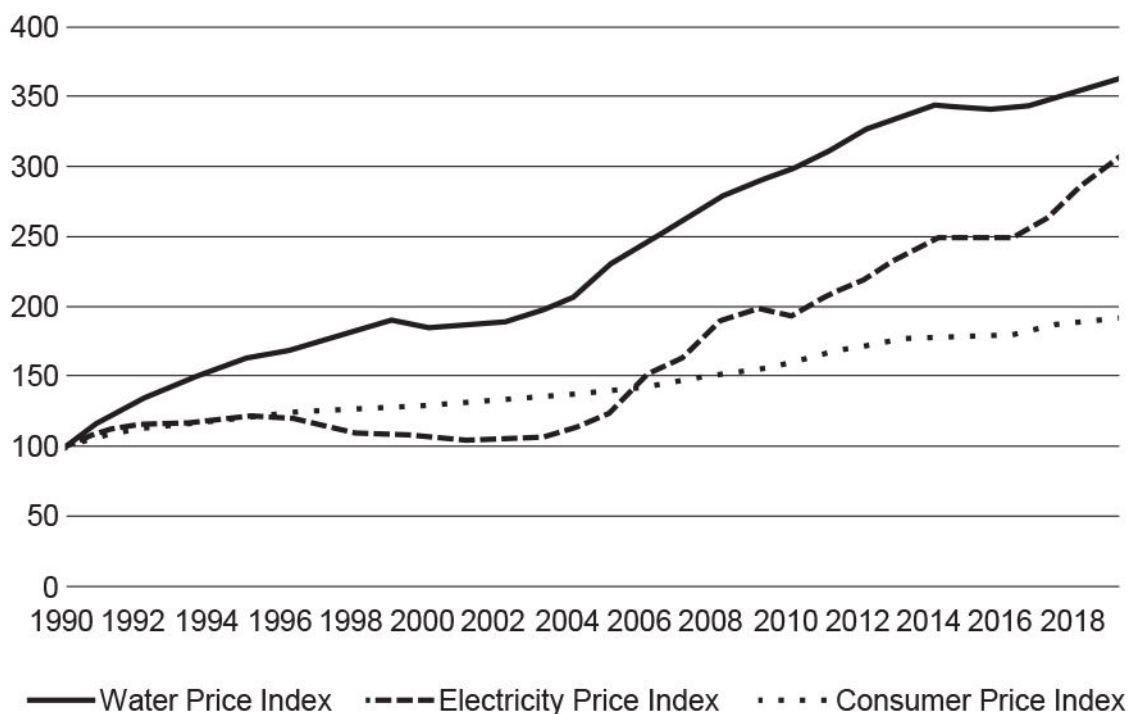


Fig. 2.1 – Electricity, Water and Consumer Price Index 1990–2018 (Base Year 1990 = 100)

The Labour Party also argued that bringing these utilities into the public sector would enable the significant investment to occur that private firms had not been incentivised to undertake, pointing to the slow renewal of London's water mains by Thames Water and the patchy investment in universal national high-speed broadband coverage by BT as evidence of this. They suggested that the different incentives and objectives that exist between public sector and private sector firms provided a strong case for nationalisation of these private sector monopolies.

15

The Conservative government however argued the £170bn bill that would be incurred from nationalising the public utilities could not be justified, and that both efficiency and consumer welfare would be better served from these industries remaining in the private sector but with tighter regulation, such as the energy price caps introduced at the start of 2019.

20

Extract 3 – Do we need to stop flying to save the planet?

A rare area of agreement between the political parties in the General Election campaign was the need to take action to tackle climate change. Since 1970, global CO₂ emissions have increased by around 90% and the resultant impact of global warming, be it rising sea levels or more intense heatwaves, is becoming increasingly damaging to communities around the world.

In June 2019, the UK became the first major nation to pledge to have net zero carbon emissions by 2050. This was praised by environmentalists who hoped this would encourage other countries to follow the UK's lead by making similar commitments. The commitment was maintained by the Conservative Party in the 2019 General Election whilst the Labour Party went further, setting a

5

target of net zero carbon emissions by 2030.

In order for these targets to be achieved, significant change will need to be seen in a number of industries. Fig. 3.1 illustrates the causes of fossil fuel emissions by sector.

10

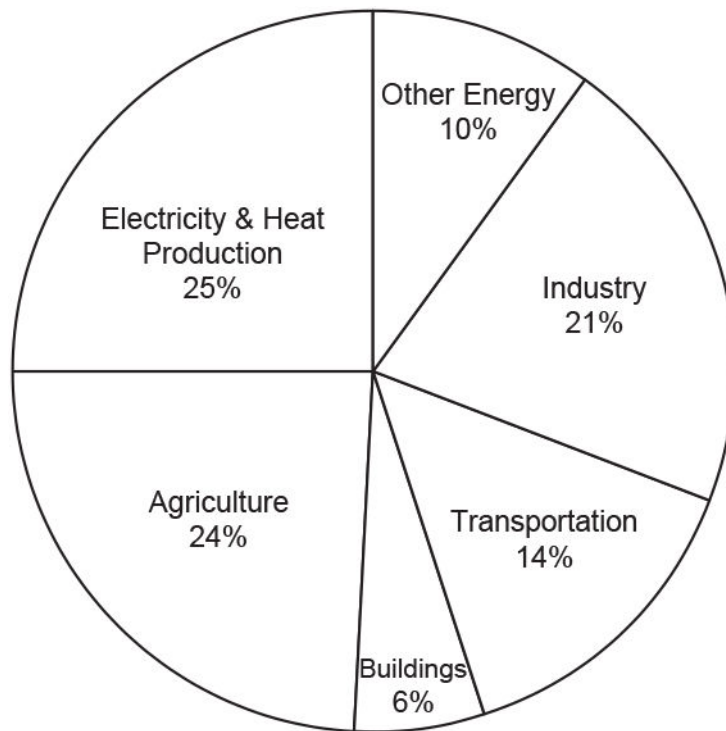


Fig. 3.1 – Fossil fuel emissions by sector

One of the areas most targeted for reducing emissions is the aviation sector. Increasing incomes around the world have significantly increased the demand for air travel, which has particularly harmful impacts on emissions – a journey by plane generates more than twenty times the amount of CO₂ emissions compared to travelling the same distance by train. The relationship between passenger journeys by air and carbon emissions is shown in Fig. 3.2.

15

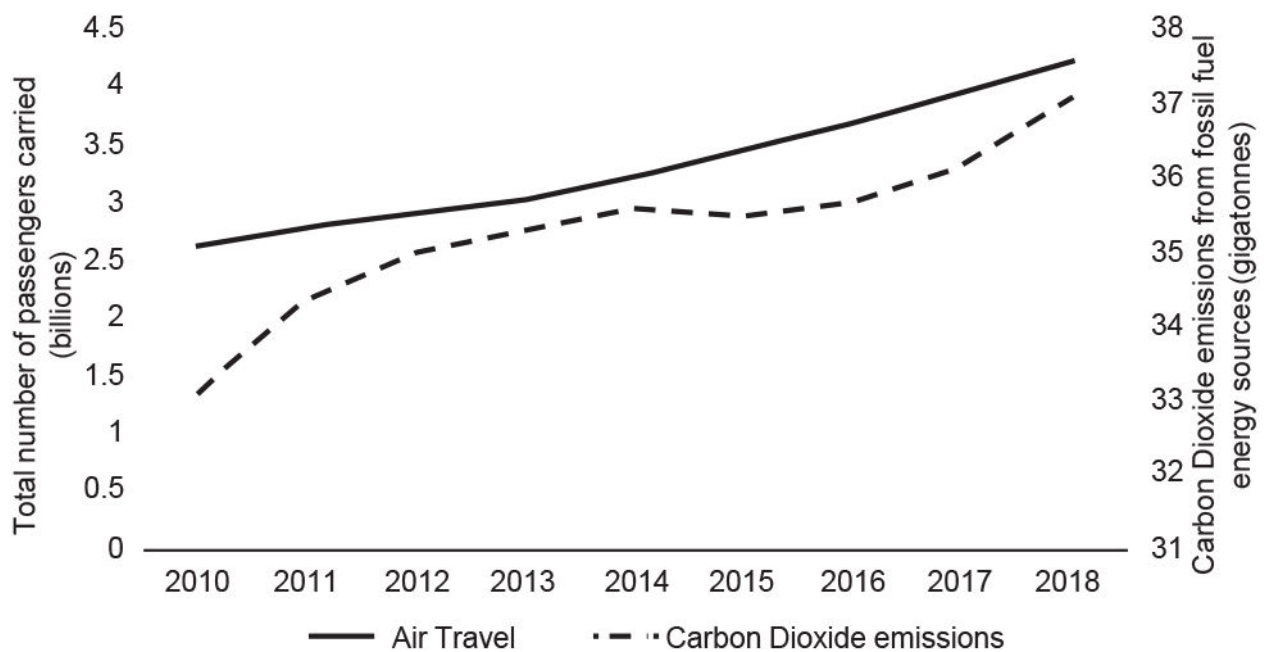


Fig. 3.2 – Air passenger journeys and carbon emissions 2010–2018

A proposal made by some environmental lobbyists is for the government to legislate to limit all individuals to one return flight per year. It is argued this would help reduce the negative externalities associated with air travel and make a substantial contribution to addressing the challenge of climate change. However, business groups remain concerned about the detrimental impact such an action would have on the UK's status as a global centre of financial services, more broadly suggesting it would limit the potential gains from globalisation that are needed to generate future economic growth. Such groups argue such extreme action is not necessary when there remain less damaging alternative policy solutions to reduce global emissions.

20

Please refer to insert H460-03 October 2020 which can be downloaded separately and is included above. Using Fig. 1.1, explain the relationship between the budget deficit and national

[2]

40 Please refer to insert H460-03 October 2020 which can be downloaded separately and is included with Q31.
Explain, using an example from Extract 1, what is meant by capital expenditure.

[2]

The global economy is changing. It is becoming more integrated and China is moving towards becoming the world's largest economy. Lower costs of transport continue to increase the volume of international trade. Producing in different countries and buying products from anywhere in the world are being made easier by advances in communications.

- 5 World trade grew by 4.4% in 2017 and is predicted to grow by 4.7% in 2018. China is accounting for a higher proportion of this global trade and a higher proportion of global output. The country has experienced a significant rise in its GDP per head in recent years. This has had an impact on its citizens' life expectancy. Fig. 1 shows the average income and life expectancy in a number of countries.

Country	GDP per head (\$)	Life expectancy (years)
Bangladesh	4200	73.7
China	16700	75.8
Egypt	12700	73.2
Germany	50800	80.9
Guinea	2200	62.1
Japan	42900	85.5
UK	44300	80.9
USA	59800	80.1

Fig. 1 GDP per head and life expectancy in selected countries 2017

- 10 Developments in the Chinese economy can be illustrated by both movements in the country's production possibility points and in the position of the production possibility curve as shown in Fig. 2.

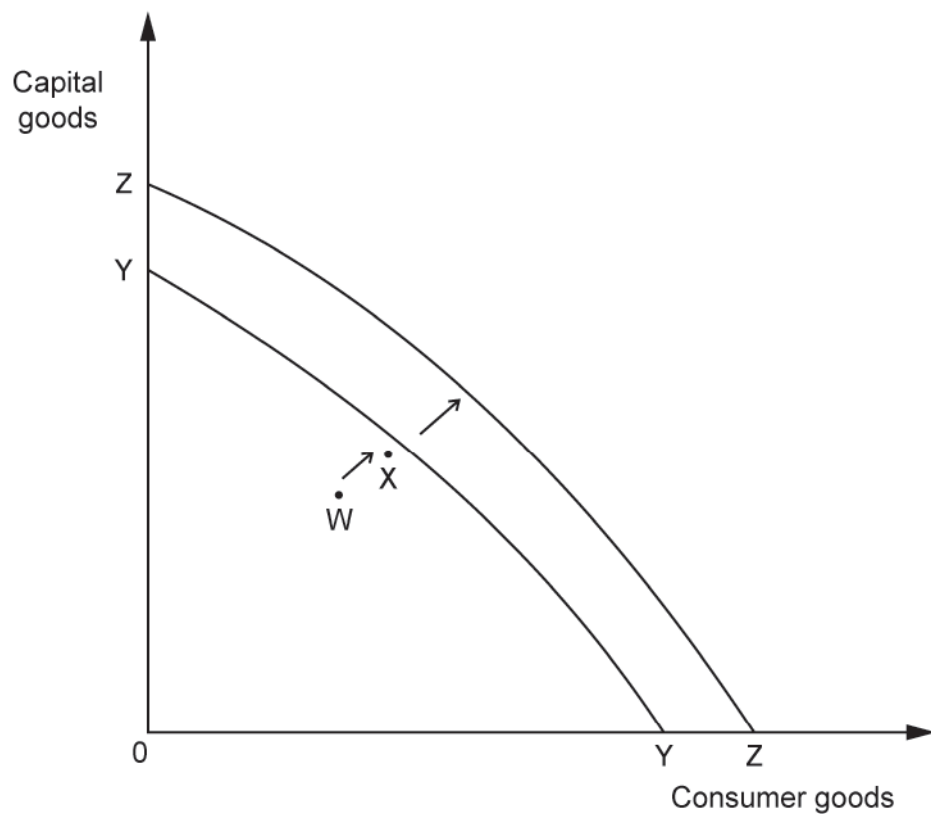


Fig. 2 A country's production possibility curve and points

The Bangladeshi economy has also grown in recent years, but its growth has been more erratic. In 2017, the country's main export destinations were the USA, Germany, UK and France. Its main
 15 sources of imports were China, India, Singapore and Japan. In 2017, the value of its exports to the UK was £2251 m while the value of its imports from the UK were £190 m. Bangladesh is also a recipient of UK overseas aid. In 2016, the UK government spent £13.4bn on overseas aid, in line with its target of 0.7% of GDP. Bangladesh was the 11th largest recipient, receiving £170 m. Fig. 3 provides some more information on the Bangladeshi economy.

	\$ billion
Consumer expenditure	191
Exports	50
Government spending	13
Investment	76
Imports	68
Tax revenue	25

Fig. 3 Details on the Bangladeshi economy 2017

20 Bangladesh's finance minister suggested in 2017 that he would cut the country's corporate tax

rates as they are much higher than most other countries. He argued that such a move would increase the country's rate of economic growth.

Some economists suggest that low-income countries are likely to grow more rapidly than high-income countries. Fig. 4 shows GDP per head and economic growth rates of a number of countries.

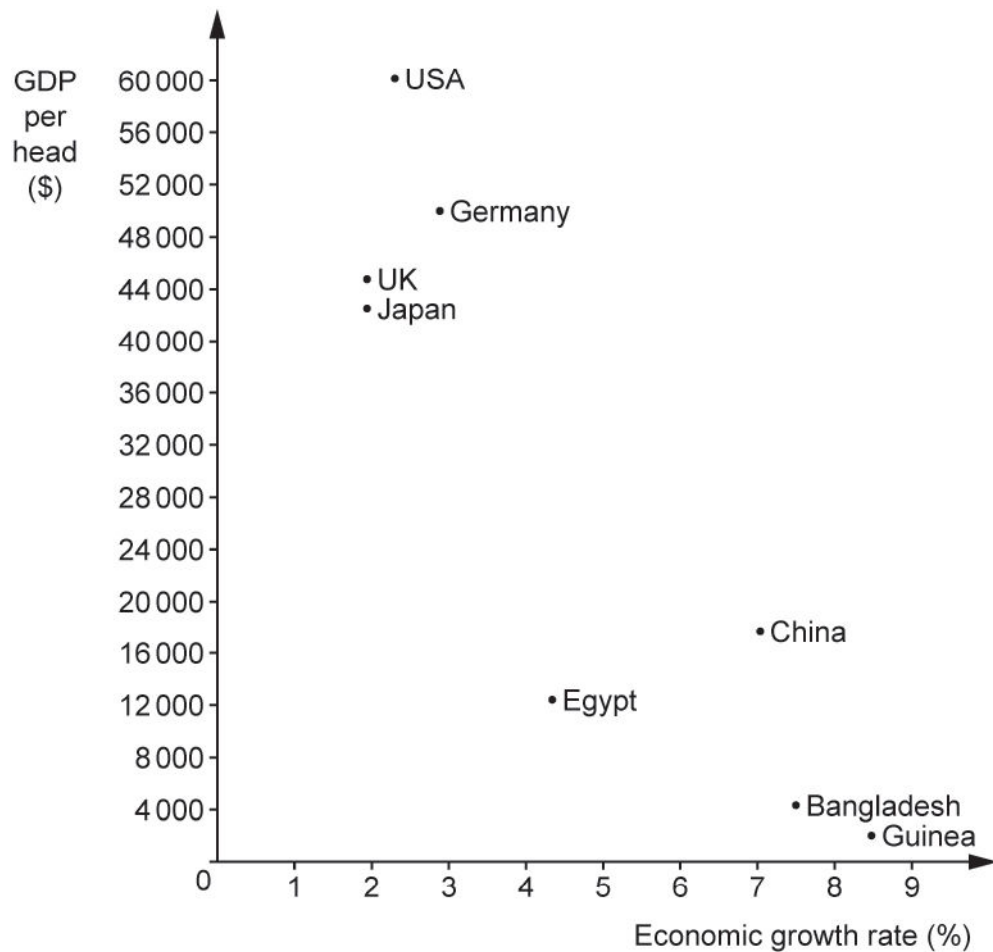


Fig. 4 GDP per head and economic growth rate of selected countries 2017

- 25 People in low-income countries may have a greater incentive to work hard to improve their living standards. Perhaps more significantly, the countries may be able to take advantage of technology transfer from high-income countries and their relatively low wages may attract foreign direct investment. The countries may also have greater potential to reallocate resources from low to high value activities.
- 30 To date, Asian countries have been more successful in narrowing the income gap than African countries. A number of African countries have poor infrastructure, low labour productivity, rapidly growing populations and a lack of economic and political stability.

Please refer to insert H460-02 October 2020 which can be downloaded separately and is included above.

Using information from Fig. 3, explain whether Bangladesh had a budget deficit or a budget surplus in 2017.

[2]

- (b) Using information from the stimulus material, evaluate whether a cut in corporate tax rates in Bangladesh would benefit the UK economy.

[8]

42 * In recent years, the UK government has cut both corporation and income tax rates. The 2013 cut in the top rate of income tax from 50% to 45% has been estimated to have reduced government tax revenue by £8.6bn between 2013/14 and 2017/18.

Evaluate whether a cut in direct tax rates will always reduce tax revenue.

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[25]

- [25]

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44(a) **Are we moving towards a cashless society?**

- Recent years have seen a change in both the amount consumers spend and how they make their payments. How much consumers spend is influenced by a variety of factors. These include changes in income and changes in confidence. During an economic boom, consumer expenditure is likely to be high. Indeed, an economic boom is often consumer-led. In contrast,
- 5 consumer expenditure can fall to a low level during a recession. Fig. 1 shows how consumer expenditure can vary as income changes.

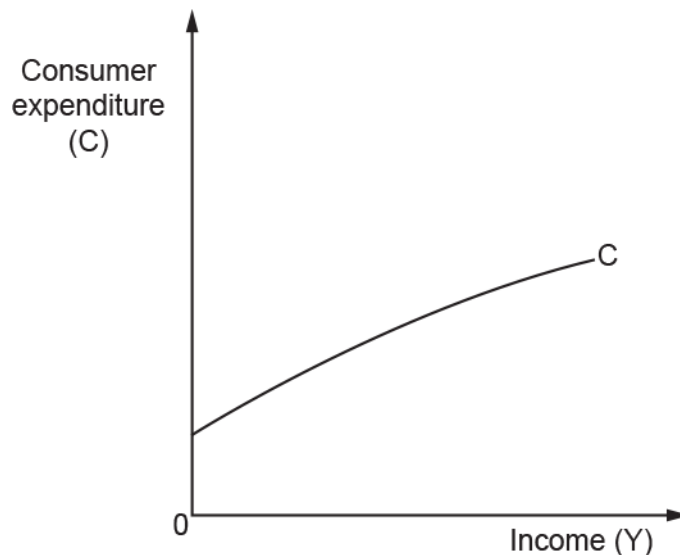


Fig. 1 The relationship between changes in income and changes in consumer expenditure

Changes in injections and leakages can alter a country's income. It has been estimated, for instance, that an injection of \$200m of government spending in the Swiss economy would cause a rise in GDP of \$300m.

- 10 The proportion of payments made in cash in Switzerland is declining. It is also falling in the UK. In 2005, 70% of payments in the UK were made in cash. By 2015, this had fallen to 50% and is forecast to decline to 30% by 2025. The extent to which cash is used influences the number of banknotes printed and in circulation. Fig. 2 shows the value of banknotes in circulation in the UK over a five year period.

Year	£5	£10	£20	£50	Total
2014	1 540	7 182	36 483	11 025	56 230
2015	1 601	7 371	38 912	11 788	59 672
2016	1 645	7 767	41 037	13 157	63 606
2017	1 912	8 006	43 357	15 601	68 876
2018	1 910	7 789	42 692	16 508	68 899

Fig. 2 The value of banknotes in circulation (£million) 2014 –2018

- 15 Some central banks favour ending the use of cash. One reason is because of the role that cash plays in a number of criminal activities including money laundering and drug dealing. A more significant motive is probably to enable central banks to charge negative interest rates when needed to stimulate economic activity. If people and banks can take money out of their deposits and hold them as cash, negative interest rates are likely to have less power to encourage an
- 20 increase in spending.

Negative interest rates involve commercial banks having to pay to hold deposits at the central bank. As commercial banks often have excess funds held at the central bank, a negative interest rate may encourage them to lend the funds instead. If commercial banks pass on the negative rates to their customers, people will have to pay to save. Negative interest rates would have an

25 impact on borrowing, the cost of servicing government debt and probably on the exchange rate.

A number of central banks, including the Bank of Japan, the Swiss National Bank, Denmark's National Bank and the European Central Bank (ECB) have used negative interest rates in a bid to avoid deflation. These banks received some criticism for the effect that the negative interest rates had on confidence, saving and bank profitability.

- 30 The Bank of England has yet to introduce a negative interest rate. Fig. 3 shows how the UK interest rate has changed in recent years.

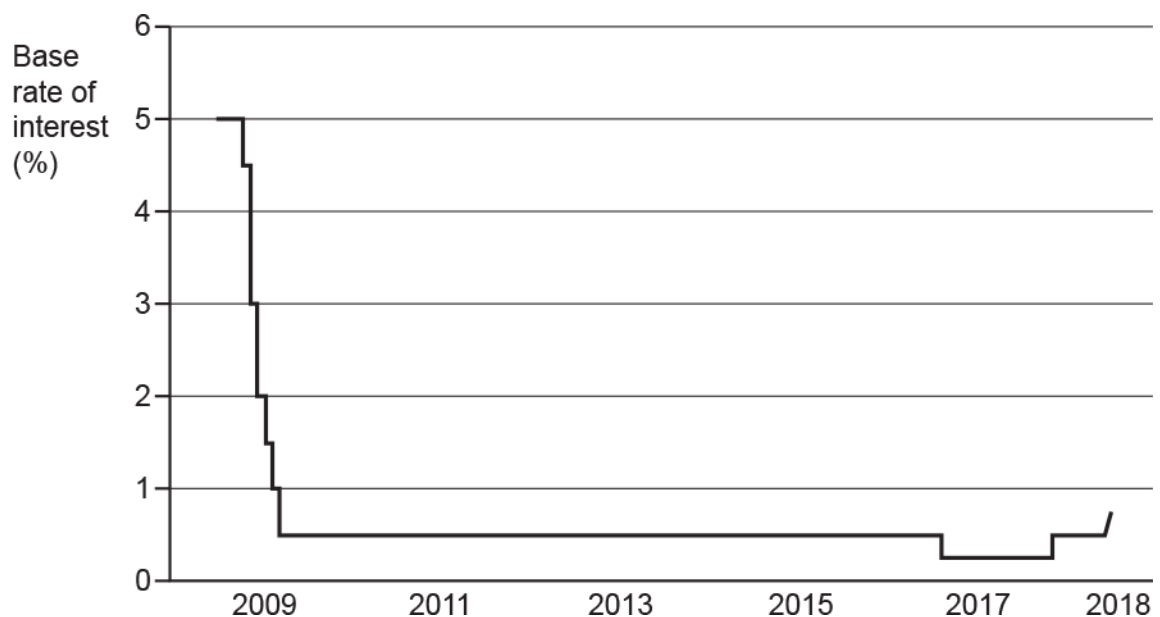


Fig. 3 UK interest rates 2009–2018

While the ECB has stopped producing its €500 note, the Bank of England has not yet scrapped any notes. Getting rid of cash is likely to affect the poor most. Nearly 1.5 million UK adults do not have a bank account and most of these are poor. Some of them are unemployed. The number of

35 people unemployed may increase during a recession. The impact on unemployment will depend

on a number of factors. These include firms' stock levels, the length of the recession, how easily firms can adjust working hours and the number of people they employ and whether the numbers in the labour force stay the same.

Using **Fig. 3**, explain what is likely to have happened to UK share prices at the start and the end of the period shown.

[4]

- (b) Using information from the stimulus material, evaluate whether a negative interest rate would help the government achieve its macroeconomic objectives.

[12]

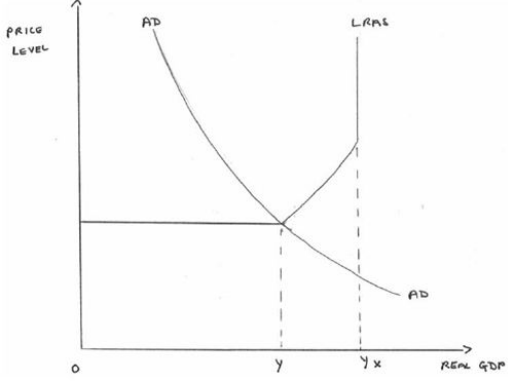
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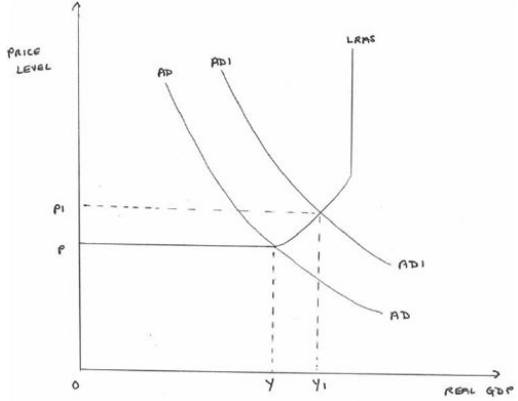
Mark Scheme

Question			Answer/Indicative content	Marks	Guidance
1		i	Using Table 1, calculate which country had the highest real interest rate in 2015. South Africa (4.9%)	1 (AO2 x 1)	Candidates do not have to give the figure – South Africa is sufficient. Examiner's Comments This was a well answered question with most candidates recognising that the real rate of interest is adjusted for inflation.
		ii	Using Table 1, explain which central bank would have been the most likely to have engaged in quantitative easing. 1 mark for identifying a country – UK/Russia 1 mark for explanation linked to inflation rate – in the case of the UK , inflation rate was below target/very low. In the case of Russia , the high inflation rate might have been the consequence of quantitative easing. 1 mark for explanation linked to interest rates – in the case of the UK , a cut in such a low rate of interest might not have had much impact. In the case of Russia , the country had the lowest rate of real interest/the highest nominal rate of interest might have been the consequence of trying to control inflation.	3 (AO1 x 1) (AO2 x 2)	Examiner's Comments There were some good answers based on which country is most likely to have engaged in quantitative easing post- and pre-2015. A number of candidates recognised that the UK's inflation rate was low and below target and that the UK's interest rate was low. Others explained that Russia's high inflation rate might have been the result of quantitative easing in the past.
			Total	4	

Mark Scheme

Question	Answer/Indicative content	Marks	Guidance
2	Evaluate, with the use of an appropriate diagram(s), whether fiscal policy will always reduce a negative output gap. Level 5 (21–25 marks) Good – Strong knowledge and understanding of fiscal policy and a negative output gap. Strong analysis of how fiscal policy may reduce a negative output gap. It will have consistently well-developed links through a coherent chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct with no significant errors that affect the validity of the analysis. Any diagrams must be integral to the analysis. Strong evaluation of whether fiscal policy will always reduce a negative output gap weighing up both why it might and why it might not and reaching a supported judgment. <i>There is a well-developed and sustained line of reasoning which is coherent and logically structured. The information presented is entirely relevant and substantiated.</i> Level 4 (16–20 marks) Good knowledge and understanding of fiscal policy and a negative output gap. Strong analysis of how fiscal policy may reduce a negative output gap. It will have consistently well-developed links through a coherent chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct with no significant errors that affect the validity of the analysis. Any diagrams must be integral to the analysis. Good evaluation of whether fiscal policy will always reduce a negative output gap weighing up both why it might and why it might not without reaching a supported	25 (AO1 x 6) (AO2 x 6) (AO3 x 6) (AO4 x 7)	<i>Indicative content</i> A negative output gap exists when actual output is below potential output. The diagram below shows that the real GDP of Y is below the potential output of YX.  A government may rely on automatic stabilisers to reduce a negative output gap. When a negative output gap increases, government spending on benefits will increase as there will be higher unemployment. Tax revenue will fall as spending and incomes may decline or rise more slowly. Higher government spending and lower tax revenue will increase aggregate demand. Automatic stabilisers, however, may not be sufficient to reduce a negative output gap and a government may decide discretionary fiscal policy. It may decide actively to increase government spending and to cut taxes. Such discretionary fiscal policy may increase aggregate demand by a multiple amount. For instance, if the multiplier is 3, an injection of extra government spending of \$20bn will cause GDP to increase by \$60bn. Lower direct taxes will increase disposable income, encouraging an increase in consumer expenditure and investment. The extra demand for consumer and capital goods will increase aggregate demand and may close the output gap as shown below.

Mark Scheme

Question	Answer/Indicative content	Marks	Guidance
	judgment. <i>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.</i> Level 3 (11–15 marks) Good knowledge and understanding of fiscal policy and a negative output gap. Good analysis of how fiscal policy may reduce a negative output gap. There is correct analysis in the form of developed links. These links are developed through a chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct and linked to the analysis. Reasonable evaluation of whether fiscal policy will always reduce a negative output gap considering both sides. <i>There is a line of reasoning presented with some structure. The information presented is in the most-part relevant and supported by some evidence.</i> Level 2 (6–10 marks) Good knowledge and understanding of fiscal policy and a negative output gap. Reasonable analysis of how fiscal policy may reduce a negative output gap. There is correct analysis largely in the form of single links. These address the question but are not developed into a clear chain of reasoning. Any relevant diagram(s) may be imperfectly labelled or not linked to the analysis. Reasonable evaluation of whether fiscal policy will always reduce a negative output gap considering both sides. The information has some relevance, but is communicated in an unstructured way. The information is supported by limited evidence, the relationship to the evidence		 It is difficult for a government to estimate the size of the multiplier so it may inject too little and so may not fully close the gap. It may also inject too much which can turn a negative output gap into a positive output gap. There is also no guarantee that lower taxes and/or increased government spending will raise demand for domestically produced products. Households and firms may not spend more if they are lacking confidence. During a recession it may be particularly difficult to reduce a negative output gap. If consumers and firms spend more they may buy imported consumer goods and services and imported capital goods. Aggregate demand may also not increase as a result of increased government spending if crowding out occurs. If a government borrows to finance extra spending, it may reduce the funds available for the private sector to borrow and may push up the rate of interest which may further discourage private sector borrowing and spending. There is the possibility that public sector spending will just crowd out private sector spending, leaving aggregate demand unchanged. Keynesian economists, however, argue that crowding in is more likely to occur than crowding out. They think that higher government borrowing and spending will raise incomes which will generate more saving. The higher saving will provide the funds for both the public and private sectors.

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Question			Answer/Indicative content	Marks	Guidance										
			may not be clear. Level 1 (1–5 marks) Reasonable knowledge and understanding of fiscal policy and a negative output gap. Limited or no analysis of how fiscal policy may reduce a negative output gap. There is little evidence of reasoning that addresses the question asked. There is a lack of a clear structure. The relevant diagram(s) may not be present or are incorrectly labelled. Limited evaluation of whether fiscal policy will always reduce a negative output gap in the form of an unsupported statement or no evaluation. <i>Information presented is basic and may be ambiguous or unstructured. The information is supported by limited evidence.</i> 0 marks no response or no response worthy of credit. <table><tr><th>Descriptor</th><th>Award mark</th></tr><tr><td>Consistently meets the criteria for this level</td><td>At top of level</td></tr><tr><td>Meets the criteria but with some slight inconsistency</td><td>Above middle and either below top of level or at middle of level (depending on number of marks available)</td></tr><tr><td>Just enough achievement on balance for this level</td><td>Above bottom and either below middle or at middle of level (depending on number of marks available)</td></tr><tr><td>On the borderline of this level and the one below</td><td>At bottom of level</td></tr></table>	Descriptor	Award mark	Consistently meets the criteria for this level	At top of level	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)	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)	On the borderline of this level and the one below	At bottom of level		The stimulus to aggregate demand provided by expansionary fiscal policy may be offset by a global recession which may reduce the country’s exports. Neo-classical economists argue that seeking to reduce a negative output gap by increasing aggregate demand may increase output and employment in the short run but will just generate inflation in the long run. They suggest that an economy has the potential to move automatically towards the full employment level through adjustments in wages and prices. What might be needed are supply-side policy measures to ensure that market forces can operate efficiently. Automatic stabilisers are unlikely to be sufficient to reduce all of a negative output gap. Whether discretionary fiscal policy will be successful will depend on a number of factors. The larger the size of the multiplier and the greater the information about its size that the government has, the greater the chance it will have of being successful. The outcome will also depend on how households and firms respond to changes in government spending and taxation. The larger the size of the output gap, the more pessimistic households and firms are likely to be about the future and so the harder it will be to encourage them to spend more. There is also the risk that expansionary fiscal policy may just result in inflation if it causes aggregate demand to increase more than aggregate supply. Examiner’s Comments There was good use made of aggregate demand and aggregate supply diagrams, both Keynesian and Neo-classical versions, in response to this question. Again, in some cases, there were some inaccuracies and carelessness in the labelling of the diagrams. The analysis of how fiscal policy might reduce a negative output gap by changing taxes and government spending and the difference between automatic stabilisers and discretionary fiscal policy was
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Mark Scheme

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					generally good. There was, however, a need for greater clarity in places. A number of candidates, for instance, appeared to confuse the likely effect of a higher disposable income on the total amount of consumer expenditure with the likely effect on the marginal propensity to consume. There was some strong evaluation shown with some particularly interesting discussion on crowding out and crowding in. It was disappointing, however, that a number of candidates lost focus and wrote about how expansionary fiscal policy would not increase output and would cause only inflation when there is full employment.
			Total	25	

Mark Scheme

Question			Answer/Indicative content	Marks	Guidance
3	a		Identify one piece of evidence in the stimulus material of the relationship suggested by the Laffer curve and explain why it is an example of such a relationship. Tax revenue rising when the tax rate is cut (1). The Laffer curve shows tax revenue rising at first and then falling as the tax rate rises / beyond a certain tax rate a cut in tax can raise tax revenue / shows an optimum tax rate to maximise tax revenue / accurate Laffer curve diagram (1). The Laffer curve suggests that a cut from a high tax rate may encourage people to work longer hours/be more willing to work/a cut in higher tax rates may encourage effort/may reduce tax evasion / a high tax rate discourages effort (1) and reduce tax evasion / a high rate encourages tax evasion (1).	3 (AO1 x 1) (AO2 x 2)	1 mark for identifying the evidence (first line opposite). Then up to 2 marks for the explanation. These two marks may be gained by: explaining/showing the Laffer curve (second paragraph opposite) and explaining one reason for the relationship between changes in tax rates and tax revenue (third paragraph) or by: explaining two reasons for the relationship (third paragraph). Accept reverse explanation e.g. how a rise in tax rates may disincentivise and encourage tax evasion Examiner's Comments There were some excellent answers to this question. Some responses identified the relevant piece of information from the stimulus material but did not explain why it is an example of a Laffer curve relationship. As previously mentioned. Some candidates confused the Laffer curve with the Phillips curve and a number of candidates mistakenly interpreted the Phillips curve as showing the relationship between economic growth and employment. There were also some candidates who confused the Laffer curve with the Lorenz curve.

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Question		Answer/Indicative content	Marks	Guidance
	b	Evaluate whether an increase in the aid Iceland provides to developing countries would benefit the Icelandic economy. Level 3 (9–12 marks) Good knowledge and understanding of how an increase in the aid Iceland provides to developing countries may affect the Icelandic economy. Good – strong analysis of how an increase in Iceland's aid may affect net exports, employment, inflation and economic growth in Iceland. Good analysis will be in the form of developed links. These links are developed through a chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct and linked to the analysis. Strong analysis will have consistently well-developed links through a coherent chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct with no significant errors that affect the validity of the analysis. Any diagrams must be integral to the analysis. Good-strong evaluation of whether increasing aid will be likely to reduce a deflationary spiral, weighing both why it might and why it might not. Strong evaluation should include a supported judgement. <i>There is a well-developed line of reasoning which is clear and logically structured. The information presented is relevant and substantiated.</i> Level 2 (5–8 marks) Good knowledge and understanding of how an increase in the aid Iceland provides to developing countries may affect the Icelandic economy. Reasonable analysis of how an increase in Iceland's aid may affect new exports, employment, inflation and economic	12 (AO1 x 1) (AO2 x 1) (AO3 x 5) (AO4 x 5)	<i>Indicative content</i> Increasing aid would involve an opportunity cost. The extra spending could have been used to, for instance, increase the provision of education and health care in Iceland. This might reduce Iceland's potential economic growth. The aid might also increase the price and quality competitiveness of developing countries' industries which might reduce Iceland's exports and employment in the future. Increasing aid, however, may result in a rise in Iceland's exports and economic growth. The aid could be tied to the purchase of Iceland's products. Even, if untied, it may result in Iceland selling more exports. This is because it may help to increase incomes in developing countries which may result in them purchasing more imports. The developing countries may have comparative advantages in different products to Iceland. If the aid causes productivity to rise and costs to fall in developing countries, this could result in the price of some of Iceland's imports falling. Such a reduction could improve living standards, reduce costs of production and inflation in Iceland. Whether the economic performance and standard of living rises in the developing countries will be influenced by what form the aid comes in and how efficiently the aid is used. Tied aid has been falling in recent years but the tendency is for aid recipients to form stronger trade links with their donors. There is the potential for both the recipients and for Iceland to benefit from an increase in the aid that Iceland gives. Examiner's Comments There was some interesting discussion provided to this answer with some good application of relevant economic theory and an awareness of the nature of aid. There were some particularly good comments on the possible short and long

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Question	Answer/Indicative content	Marks	Guidance
	growth in Iceland. There is correct analysis largely in the form of single links. These address the question but are not developed into a clear chain of reasoning. Any relevant diagram(s) may be imperfectly labelled or not linked to the analysis. Reasonable evaluation of whether an increase in Iceland's aid to developing countries would benefit the Icelandic economy, considering both why it might and why it might not. <i>There is a line of reasoning presented with some structure. The information presented is in the most-part relevant and supported by some evidence.</i> Level 1 (1–4 marks) Limited – reasonable knowledge and understanding of how an increase in the aid Iceland provides to developing countries may affect the Icelandic economy. Limited analysis of how an increase in Iceland's aid may affect net exports, employment, inflation and economic growth in Iceland. Limited evaluation of whether an increase in Iceland's aid to developing countries would benefit the Icelandic economy, in the form of an unsupported statement or no evaluation. <i>The information is basic and communicated in an unstructured way. The information is supported by limited evidence and the relationship to the evidence may not be clear.</i> 0 marks no response or no response worthy of credit. Note: although a diagram is not required, it may enhance the quality of the answer and should be rewarded at the appropriate level.		run effects on Iceland's budget and current account balances. Some candidates, however, confused aid with foreign direct investment with a number of other candidates wandered off the central point and wrote about the effects of immigration.

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Consistently meets the criteria for this level	At top of level														
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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)														
On the borderline of this level and the one below	At bottom of level														
			Total	15											

Mark Scheme

Question	Answer/Indicative content	Marks	Guidance
4	Evaluate the extent to which government policy measures to reduce a budget deficit will increase unemployment. Level 5 (21–25 marks) Good–Strong knowledge and understanding of the policy measures a government may use to reduce a budget deficit. Strong analysis of how government policy measures to reduce a budget deficit may affect unemployment. It will have consistently well-developed links through a coherent chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct with no significant errors that affect the validity of the analysis. Any diagrams must be integral to the analysis. Strong evaluation of the extent to which government policy measures to reduce a budget deficit will increase or reduce unemployment, weighing up both why it might and why it might not and reaching a supported judgement. <i>There is a well-developed and sustained line of reasoning which is coherent and logically structured. The information presented is entirely relevant and substantiated.</i> Level 4 (16–20 marks) Good knowledge and understanding of the policy measures a government may use to reduce a budget deficit. Strong analysis of how government policy measures to reduce a budget deficit may affect unemployment. It will have consistently well-developed links through a coherent chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct with no significant errors that affect the validity of the analysis. Any diagrams must be integral to the analysis.	25 (AO1 x 6) (AO2 x 6) (AO3 x 6) (AO4 x 7)	<i>Indicative content</i> The extent to which government policy measures to reduce a budget deficit will cause unemployment will depend on what the measures are, how firms and households react and whether the government is seeking to reduce the deficit in the short run or the long run. If a government is seeking to reduce a budget deficit in the short run, it may raise tax rates and cut government spending. Higher tax rates reduce disposable income and so are likely to reduce consumer expenditure and investment and so aggregate demand. Lower government spending directly reduces aggregate demand. Lower AD may reduce the output of firms and so may result in an increase in cyclical unemployment. Higher income tax rates may reduce the incentive to work and so may lead to higher voluntary unemployment. Lower government spending on education and training may reduce occupational mobility and increase structural unemployment. Reduced subsidies given to firms may discourage firms from expanding. If output increases by less than any rise in the labour force, a rise in unemployment will occur. Higher tax rates, however, do not always result in reduced spending by firms and households. If they are optimistic about the future, they may continue to spend at the same rate by reducing their saving and/or by borrowing. It is also possible that cuts in government spending on unemployment benefits may put greater pressure on the unemployed to search for employment. If they are successful frictional and voluntary unemployment will fall. A government might try to reduce a budget deficit by raising the retirement age. This would lower the amount the government spends on pensions. If people work longer they may enjoy higher incomes and may spend more, increasing tax revenue. If the budget deficit is reduced, government borrowing may be reduced. The lower demand for funds to borrow may reduce

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	Good evaluation of the extent to which government policy measures to reduce a budget deficit will increase or reduce unemployment, weighing up both why it might and why it might not, weighing up both sides but without reaching a supported judgement. <i>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.</i> Level 3 (11–15 marks) Good knowledge and understanding of the policy measures a government may use to reduce a budget deficit. Good analysis of how government policy measures to reduce a budget deficit may affect unemployment. There is correct analysis in the form of developed links. These links are developed through a chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct and linked to the analysis. Reasonable evaluation of the extent to which government policy measures to reduce a budget deficit will increase or reduce unemployment, considering both why it might and why it might not. <i>There is a line of reasoning presented with some structure. The information presented is in the most-part relevant and supported by some evidence.</i> Level 2 (6–10 marks) Good knowledge and understanding of the policy measures a government may use to reduce a budget deficit. Reasonable analysis of how government policy measures to reduce a budget deficit may affect unemployment. There is correct analysis largely in the form of single links. These address the question but are not developed into a clear chain of reasoning.		the rate of interest and make more funds available for the private sector to borrow. In such a circumstance, the level of AD may remain unchanged, with government spending being replaced by private sector spending. Trying to reduce a budget deficit in the long run may involve higher government spending now. For instance, a government might spend more on education and training. This may raise labour productivity, increase output and so raise tax revenue. By increasing AD and workers' skills, it is also likely to reduce cyclical and structural unemployment. Measures to speed up the deficit reduction are likely to reduce unemployment. Measures to reduce a structural deficit are more likely to increase unemployment but this may not be the case if they increase confidence in the financial stability of government finances and the economy. Those countries with low government debt may attract more FDI. Cuts in tax rates might reduce a budget deficit if they reduce tax evasion, act as a stimulus to effort and enterprise and attract FDI. The Laffer curve suggests that tax cuts can increase output and tax revenue. Lower tax rates may reduce voluntary, search and cyclical unemployment. Unemployment is more likely to increase if the government policy measures taken to reduce a budget deficit involve increases in tax rates and cutting government spending and firms and households react by cutting back on their spending. Examiner's Comments This was the more popular question in Section B. The strong responses often considered the short run and long run effects of government policy measures on unemployment. However, some candidates wrote about a deficit on the current account of the balance of payments rather than a budget deficit. A number of candidates wrote about how government policy measures may affect employment but did not link measures to reducing a budget

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Question			Answer/Indicative content	Marks	Guidance
			Any relevant diagram(s) may be imperfectly labelled or not linked to the analysis. Reasonable evaluation of the extent to which government policy measures to reduce a budget deficit will increase or reduce unemployment, considering both why it might and why it might not. <i>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.</i> Level 1 (1–5 marks) Reasonable knowledge and understanding of the policy measures a government may use to reduce a budget deficit. Limited or no analysis of how government policy measures to reduce a budget deficit may affect unemployment. There is little evidence of reasoning that addresses the question asked. There is a lack of a clear structure. The relevant diagram(s) may not be present or are incorrectly labelled. Limited evaluation of the extent to which government policy measures to reduce a budget deficit will increase unemployment in the form of an unsupported statement or no evaluation. <i>Information presented is basic and may be ambiguous or unstructured. The information is supported by limited evidence.</i> 0 marks no response or no response worthy of credit. Note: although a diagram is not required, it may enhance the quality of the answer and should be rewarded at the appropriate level.		deficit, other responses sought to evaluate whether the government policy measures would succeed in reducing a budget deficit but did not consider whether they would increase unemployment. For instance, some candidates wrote about how raising corporation tax may encourage some UK firms to move abroad but did not mention the effect on unemployment. There was some confusion shown about people who leave the labour force being unemployed.

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			On the borderline of this level and the one below	At bottom of level		
			Total		25	
5			B		1 (AO3)	Rationale A There is likely to be significant spare capacity, meaning demand side policies would be more effective. B Correct: Demand side policies would be inflationary, making policies to increase the productive capacity of the economy effective. C Policy should focus on using the existing spare capacity rather than creating more. D Demand-side policies will be needed to prevent deflation occurring.
			Total		1	

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Question			Answer/Indicative content	Marks	Guidance
6			A	1 (AO1)	Rationale A Correct: this should stimulate spending and as a result boost aggregate demand. B Quantitative easing is designed to increase the rate of inflation. C Quantitative easing involves the purchase of financial assets. D Financial assets are purchased to increase the rate of inflation.
			Total	1	
7			A	1 (AO1)	Rationale A Correct: an inflation target means economic agents can predict future prices with more certainty. B This will have no direct impact on uncertainty, and could even worsen it if it means the budget deficit increases. C This is likely to increase uncertainty as it increases the likelihood of exchange rate volatility. D This will increase uncertainty as individuals are less able to predict future income.
			Total	1	
8			B	1 (AO1)	Rationale A Changing the tax rate is likely to change tax revenue. B Correct: Tax revenue will initially increase as the tax rate increases but once it reaches a certain point any rise beyond that will result in tax revenue falling. C This is only true at higher tax rates – the upper portion of the Laffer curve. D This is only true at lower tax rates – the lower portion of the Laffer curve.
			Total	1	

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Question			Answer/Indicative content	Marks	Guidance
9			B	1 (AO3)	Rationale A This is a supply side policy that should shift AS to the right. B Correct: This will reduce disposable income and cause consumption to fall. C This is expansionary monetary policy that should shift AD to the right. D This is a supply side policy that should shift AS to the right.
			Total	1	

Mark Scheme

Question			Answer/Indicative content	Marks	Guidance
10			Using the information in Extract 2, explain the impact on the government's budget position in the short run and the long run of the HS3 rail project. <i>Award up to 2 marks for identifying and explaining the short term implications on the government budget:</i> - The HS3 rail project will come at significant cost to the government/taxpayers (1) - This is likely to increase the budget deficit/decrease the budget surplus/worsen the budget position (1) <i>Award up to 2 marks for identifying and explaining the long term implications on the government budget:</i> - Job creation will reduce the rate of unemployment, increasing tax revenue/reducing expenditure on welfare benefits - This will cause a budget surplus/decrease budget deficit/improve the budget position	4 (AO1 x 1) (AO2 x 1) (AO3 x 2)	Only one of the two marks for the link to the budget position can be awarded if there is no explicit use of the terms deficit or surplus. Answers must clearly identify why tax revenue will increase/government expenditure will fall in the long run. Accept other valid explanations of how the HS3 project may increase tax revenue or reduce government expenditure in the long run. Examiner's Comments The majority of candidates scored highly on this question, with excellent use of the extract combined with accurate technical terminology. Weaker answers lacked precision, referring to the budget having a 'big hit' or being made 'much better' rather than using the terms deficit and surplus. Centres should remind candidates to be guided by the command word in the question – some wasted time offering evaluation that could not be credited.
			Total	4	

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Question			Answer/Indicative content	Marks	Guidance
11			C	1 (AO3)	Rationale A Tax revenue will be more obviously affected by fiscal policy, but if anything tax revenue may rise as consumption increases. B Aggregate demand will increase, increasing inflationary pressures. C Correct: hot money will flow out of the UK as foreign investors get a better return abroad. D MPS will fall as the return from saving falls.
			Total	1	

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Question	Answer/Indicative content	Marks	Guidance
12	Evaluate, using the information in Extract 2, the extent to which hosting an Olympic Games has a positive impact on the government's macroeconomic policy objectives. Level 3 (11–15 marks) Good knowledge and understanding of macroeconomic policy objectives applied to the Olympic Games. Good – strong analysis of the impact of hosting an Olympics on the government's macroeconomic policy objectives. Good analysis will be in the form of developed links. These links are developed through a chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct and linked to the analysis. Strong analysis will have consistently well-developed links through a coherent chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct with no significant errors that affect the validity of the analysis. Any diagrams must be integral to the analysis. Good - strong evaluation of the extent to which hosting the Olympic Games helps the government achieve its macroeconomic policy objectives, weighing up both sides/comparing alternatives. Strong evaluation should include a supported judgement. <i>There is a well-developed line of reasoning which is clear and logically structured. The information presented is relevant and substantiated.</i> Level 2 (6–10 marks) Good knowledge and understanding of the macroeconomic policy objectives applied to the Olympic Games. Reasonable analysis of the impact of	15 (AO1 x 2) (AO2 x 3) (AO3 x 4) (AO4 x 6)	Guidance: • Limited Analysis – Undeveloped analysis of one macroeconomic objective (economic growth, price stability, low unemployment, satisfactory balance of payments position, fair distribution of income) • Reasonable Analysis – Undeveloped analysis of two objectives or developed analysis of one objective • Good Analysis – Developed analysis of one objective and undeveloped analysis of another objective or highly developed analysis of one objective • Strong Analysis – Developed analysis of two objectives • Generic macroeconomic analysis using AD/AS that is not directly linked to the hosting of the Olympic Games cannot be credited. • Whilst most candidates will start their answers with the positive impact hosting the Olympics has on the government's macroeconomic policy objectives, the reverse approach is equally valid – the harms of hosting the Olympics can be credited as analysis if presented first. • A number of limited analytical/evaluative points can be awarded up to Reasonable, but to be awarded Good or Strong there needs to be greater depth of explanation. • Strong evaluation requires an explained judgement. An explained judgement without Good evaluation can be credited as evaluation. Knowledge & Understanding: Knowledge & Understanding marks should be awarded for recognition of the costs or benefits of

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	hosting an Olympics on the government's macroeconomic policy objectives. There is correct analysis largely in the form of single links. These address the question but are not developed into a clear chain of reasoning. Any relevant diagram(s) may be imperfectly labelled or not linked to the analysis. Reasonable evaluation of the extent to which hosting the Olympic Games helps the government achieve its macroeconomic policy objectives. <i>There is a line of reasoning presented with some structure. The information presented is in the most-part relevant and supported by some evidence.</i> Level 1 (1–5 marks) Limited – reasonable knowledge and understanding of at least one macroeconomic policy objective applied to the Olympic Games. Limited analysis of the impact of hosting an Olympics on the government's macroeconomic policy objectives. There is little evidence of reasoning that addresses the question asked. There is a lack of a clear structure. Limited evaluation of the extent to which hosting the Olympic Games helps the government achieve its macroeconomic policy objectives in the form of an unsupported statement or no evaluation. <i>The information is basic and communicated in an unstructured way. The information is supported by limited evidence and the relationship to the evidence may not be clear.</i> 0 marks no response or no response worthy of credit.		hosting the Olympic Games that are mentioned in the case study: ◦ Japanese economy could be boosted by \$249bn from hosting Tokyo 2020 ◦ Olympics expenditure represents expansionary fiscal policy ◦ Unemployment falls because of job creation in construction ◦ Balance of payments improves in the short run because of tourist expenditure and in the long run because of FDI ◦ Multiplier generated from Olympics expenditure ◦ Size of injection will depend on the stage of the economic cycle the economy is at ◦ Impact overstated because of the substitution effect associated with Olympics expenditure/employment/tourism ◦ Consumer confidence and propensity to consume increases because of feel good factor ◦ The impact will depend upon how well known/popular the country was to start with Analysis and Evaluation requires candidates to go beyond what is given in the case study. Analysis may include: • Infrastructure spending increases the derived demand for labour, reducing unemployment • Hosting the Olympics can generate indirect employment – e.g. more jobs working for airlines/in restaurants

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					- Increased employment increases consumption, which increases aggregate demand and causes economic growth - Increased employment reduces income inequality, particularly if those employed in construction were previously unemployed - Lower unemployment reduces government expenditure on welfare payments, improving fiscal position - Increased government revenue from tax revenue generated from Olympics can provide the funds for the government to increase expenditure. - Government spending is a component of AD, so will increase economic growth - Infrastructure spending shifts LRAS to the right, increasing the productive capacity of the economy and causing economic growth and reducing inflationary pressures - Improvements in infrastructure, such as better transport links, may increase occupational mobility and therefore reduce unemployment/increase economic growth - In the short run an appreciation of the exchange rate improves the balance of payments because of the J-curve effect - Improved balance of payments can contribute to AD increasing, causing economic growth - Tourism expenditure represents an export, so improves the current account of the balance of payments - FDI improves the financial account of the balance of payments

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					Evaluation may include: • Demand pull inflation caused from increases in AD resulting from rising consumption/balance of payments improvement • Employment may only be temporary, meaning individuals will be unemployed again when the Olympics ends • The host city may benefit more than the country as a whole • Exchange rate appreciation will worsen the balance of payments in the long run – Figure 2.2 shows hosts experience an appreciating exchange rate. • Opportunity cost of infrastructure spending on wasted infrastructure could harm long run growth, as could the increased government debt that results • If infrastructure development is not in areas of need then the spending does not contribute to non-inflationary growth, as it doesn't meaningfully add to productive capacity • Financial crowding out – government borrowing for the Olympics raises interest rates decreasing private sector investment • The data in Figure 2.1 suggests that growth does not increase significantly in host countries <u>Examiner's Comments</u> Candidates were well versed in the government's macroeconomic objectives and were able to use the stimulus material as a basis for their analysis. Many presented a clear chain of reasoning linking expansionary fiscal policy to

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					aggregate demand and economic growth, with the stronger answers integrating the multiplier into their analysis to explain the impact on the derived demand for labour. Evaluation was typically presented using an aggregate demand and supply diagram and/or the Phillips curve to argue demand-pull inflation was likely to occur. The best answers went beyond a consideration of unemployment, growth and inflation to look at other macroeconomic objectives, including the balance of payments and environmental sustainability. Some could not be credited for this because they incorrectly concluded from the case study that hosting the Olympics caused an exchange rate depreciation, whilst very few were able to use the Marshall-Lerner condition or the J-curve effect in their answers. Candidates who did not achieve top marks would have benefited from considering the impact expenditure has on long run aggregate supply. The majority of candidates attempted a judgement but few of these were convincing, tending to repeat the prior analysis rather than reaching a clear position.
			Total	15	

Mark Scheme

Question	Answer/Indicative content	Marks	Guidance
13	Evaluate the effectiveness of changes in the tax and benefit system in reducing the level of income inequality in the U.K. Level 5 (21–25 marks) Good - Strong knowledge and understanding of the tax and benefit system in reducing income inequality. Strong analysis will have consistently well-developed links through a coherent chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct with no significant errors that affect the validity of the analysis. Any diagrams must be integral to the analysis. Strong evaluation of the effectiveness of the tax and benefit system in reducing income inequality, weighing up both sides/comparing alternatives and reaching a supported judgment. <i>There is a well-developed and sustained line of reasoning which is coherent and logically structured. The information presented is entirely relevant and substantiated.</i> Level 4 (16–20 marks) Good knowledge and understanding of the tax and benefit system in reducing income inequality. Strong analysis will have consistently well-developed links through a coherent chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct with no significant errors that affect the validity of the analysis. Any diagrams must be integral to the analysis. Good evaluation will weigh up both sides/comparing alternatives but without reaching a supported judgment.	25 (AO1 x 6) (AO2 x 6) (AO3 x 6) (AO4 x 7)	The UK tax most associated with reducing income inequality is income tax. This is a progressive tax because of the tax free allowance and marginal tax rates greater than average tax rates. As a result, the percentage of income paid in tax increases as income increases. The benefit system is made up of a wide range of benefits. Some are universal and some are means tested. Both are payments by the UK government either in a direct fashion e.g. job seekers allowance or by the direct state provision of goods and services e.g. NHS. Tax and benefits can be argued to be effective. In the case of the tax system it is the progressive nature that is very important. The existence of no tax on the first tranche of a person's income prevents those on low income having the pay income tax. Tax rates at different bands help to reinforce the progressive nature. The tax system in the UK is comprehensive and means that the majority of income earned is subject to the relevant taxation. The benefit system has the advantage of being able to be directed to those in most need. This is particularly the case when benefits are directed and means tested (Low income groups such as single parents, the unemployed and pensioners can have their income guaranteed or supplemented by the state system of benefits). There is a wide range of state benefits and each particular benefit may have its advantages and drawbacks. On the other hand, it can be argued that universal benefits are an inefficient method of redistributing income. Some of the recipients may not be in need of state transfers e.g. some pensioners in receipt of

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Question	Answer/Indicative content	Marks	Guidance
	<i>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.</i> Level 3 (11–15 marks) Good knowledge and understanding of the tax and benefit system in reducing income inequality. Good analysis of the effectiveness of the tax and benefit system in reducing income inequality. There is correct analysis in the form of developed links. These links are developed through a chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct and linked to the analysis. Reasonable evaluation of the effectiveness of the tax and benefit system in reducing income inequality, considering both sides/comparing alternatives. <i>There is a line of reasoning presented with some structure. The information presented is in the most-part relevant and supported by some evidence.</i> Level 2 (6–10 marks) Good knowledge and understanding of the tax and benefit system in reducing income inequality. Reasonable analysis of the effectiveness of the tax and benefit system in reducing income inequality. There is correct analysis largely in the form of single links. These address the question but are not developed into a clear chain of reasoning. Any relevant diagram(s) may be imperfectly labelled or not linked to the analysis. Reasonable evaluation of the effectiveness of the tax and benefit system in reducing income inequality, considering both		the universal state pension and similarly the receipt of child benefit. The system of tax and benefit may be subject to inefficiency, fraud, avoidance and evasion. The existence of these factors reduced the ability of the system to redistribute income. The progressive nature of the income tax system can lead to poverty and unemployment traps. Marginal tax rates can act as a disincentive to join/start employment. Similarly, the lack of integration between the tax and benefit system can act as a disincentive. As a result, some low income groups may suffer from marginal tax rates of 100%. Income inequality may be caused by a variety of factors. The best solution for redistributing income may depend on the cause of inequality. For instance, if inequality of income is caused by inequality of wealth or opportunity then a different set of policies may be more relevant. There are alternatives to the tax and benefit system which can be argued to be more effective. Policies such as the introduction of the National Living Wage, promoting economic growth to generate employment and regional policies such as recent focus on the Northern Powerhouse. Focus could also be directed to inefficiencies in the working of labour markets. For example, policies designed to improve factor mobility both geographically and occupationally.

Mark Scheme

Question			Answer/Indicative content	Marks	Guidance						
			sides/comparing alternatives. <i>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.</i> Level 1 (1–5 marks) Reasonable knowledge and understanding of the tax and benefit system in reducing income inequality. Limited or no analysis of the effectiveness of the tax and benefit system in reducing income inequality. There is little evidence of reasoning that addresses the question asked. There is a lack of a clear structure. The relevant diagram(s) may not be present or are incorrectly labelled. Limited evaluation of the effectiveness of the tax and benefit system in reducing income inequality, in the form of an unsupported statement or no evaluation. <i>Information presented is basic and may be ambiguous or unstructured. The information is supported by limited evidence.</i> 0 marks no response or no response worthy of credit. Note: although a diagram is not required, it may enhance the quality of the answer and should be rewarded at the appropriate level. <table><tr><th>Descriptor</th><th>Award mark</th></tr><tr><td>Consistently meets the criteria for this level</td><td>At top of level</td></tr><tr><td>Meets the criteria but with some slight inconsistency</td><td>Above middle and either below top of level or at middle of level (depending on number of marks available)</td></tr></table>	Descriptor	Award mark	Consistently meets the criteria for this level	At top of level	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)		
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Question			Answer/Indicative content	Marks	Guidance
			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)		
			On the borderline of this level and the one below At bottom of level		
			Total	25	

Mark Scheme

Question	Answer/Indicative content	Marks	Guidance
14	Evaluate the effectiveness of changes in the tax and benefit system in reducing the level of income inequality in the U.K. Level 5 (21–25 marks) Good - Strong knowledge and understanding of the tax and benefit system in reducing income inequality. Strong analysis will have consistently well-developed links through a coherent chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct with no significant errors that affect the validity of the analysis. Any diagrams must be integral to the analysis. Strong evaluation of the effectiveness of the tax and benefit system in reducing income inequality weighing up both sides/comparing alternatives and reaching a supported judgment. <i>There is a well-developed and sustained line of reasoning which is coherent and logically structured. The information presented is entirely relevant and substantiated.</i> Level 4 (16–20 marks) Good knowledge and understanding of the tax and benefit system in reducing income inequality. Strong analysis will have consistently well-developed links through a coherent chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct with no significant errors that affect the validity of the analysis. Any diagrams must be integral to the analysis. Good evaluation will weigh up both sides/comparing alternatives but without reaching a supported judgment.	25 (AO1 x 6) (AO2 x 6) (AO3 x 6) (AO4 x 7)	The UK tax most associated with reducing income inequality is income tax. This is a progressive tax because of the tax free allowance and marginal tax rates greater than average tax rates. As a result, the percentage of income paid in tax increases as income increases. The benefit system is made up of a wide range of benefits. Some are universal and some are means tested. Both are payments by the UK government either in a direct fashion e.g. job seekers allowance or by the direct state provision of goods and services e.g. NHS. Tax and benefits can be argued to be effective. In the case of the tax system it is the progressive nature that is very important. The existence of no tax on the first tranche of a person's income prevents those on low income having the pay income tax. Tax rates at different bands help to reinforce the progressive nature. The tax system in the UK is comprehensive and means that the majority of income earned is subject to the relevant taxation. The benefit system has the advantage of being able to be directed to those in most need. This is particularly the case when benefits are directed and means tested (Low income groups such as single parents, the unemployed and pensioners can have their income guaranteed or supplemented by the state system of benefits). There is a wide range of state benefits and each particular benefit may have its advantages and drawbacks. On the other hand, it can be argued that universal benefits are an inefficient method of redistributing income. Some of the recipients may not be in need of state transfers e.g. some pensioners in receipt of

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			sides/comparing alternatives. <i>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.</i> Level 1 (1–5 marks) Reasonable knowledge and understanding of the tax and benefit system in reducing income inequality. Limited or no analysis of the effectiveness of the tax and benefit system in reducing income inequality. There is little evidence of reasoning that addresses the question asked. There is a lack of a clear structure. The relevant diagram(s) may not be present or are incorrectly labelled. Limited evaluation of the effectiveness of the tax and benefit system in reducing income inequality in the form of an unsupported statement or no evaluation. <i>Information presented is basic and may be ambiguous or unstructured. The information is supported by limited evidence.</i> 0 marks no response or no response worthy of credit. Note: although a diagram is not required, it may enhance the quality of the answer and should be rewarded at the appropriate level. <table><tr><th>Descriptor</th><th>Award mark</th></tr><tr><td>Consistently meets the criteria for this level</td><td>At top of level</td></tr><tr><td>Meets the criteria but with some slight inconsistency</td><td>Above middle and either below top of level or at middle of level (depending on number of marks available)</td></tr></table>	Descriptor	Award mark	Consistently meets the criteria for this level	At top of level	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)		
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Question			Answer/Indicative content	Marks	Guidance
			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) On the borderline of this level and the one below At bottom of level		
			Total	25	

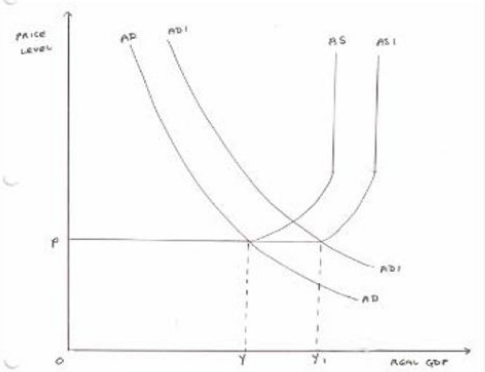
Mark Scheme

Question	Answer/Indicative content	Marks	Guidance
15	Using Table 2, evaluate to what extent differences in corporate tax rates explain differences in foreign direct investment in countries. Level 2 (5–8 marks) Good knowledge and understanding of corporate tax rates and foreign direct investment. Good – strong analysis of what the table shows and how a low corporate tax rate may attract FDI and vice versa. Good analysis will be in the form of developed links. These links are developed through a chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct and linked to the analysis. Strong analysis will have consistently well-developed links through a coherent chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct with no significant errors that affect the validity of the analysis. Any diagrams must be integral to the analysis. Reasonable – strong evaluation of whether a low corporate tax rate will attract FDI/a high corporate tax rate will discourage FDI, considering both why differences in corporate tax rates may explain differences in FDI and why they might not, underpinned by appropriate theoretical analysis. Good evaluation will weigh up the reasons why it might and the reasons why it might not but without reaching a supported judgement. Strong evaluation should include a supported judgement. Level 1 (1–4 marks) Limited – reasonable knowledge and understanding of corporate tax rates and foreign direct investment. Limited – reasonable analysis of what the table shows and how a low corporate tax rate may attract FDI and vice versa. Limited analysis will have little evidence of	8 (AO1 x 1) (AO2 x 1) (AO3 x 3) (AO4 x 3)	<i>Indicative content</i> An inverse relationship is the expected one. Foreign firms are likely to be attracted by a low corporation tax rate as more of any profit earned can be kept by the firm. This could be paid to shareholders or used to reinvest. This is shown by: • The two countries with the lowest corporation tax rates, Ireland and the UK, attracted the most foreign direct investment per head. • India, which has the 6th highest corporation tax had the lowest FDI per head. • With an analysis of why. However, this is not shown by: • The USA, who has the highest corporation tax rate but the middle level of FDI. • The level of FDI is influenced by a number of factors and not just the rate of corporation tax. For instance, firms may be attracted by the presence of skilled labour and good infrastructure. To finance a good education system and provision of, for instance, good roads, a government may impose relatively high tax rates. • A growing economy may also attract FDI as foreign firms may expect a growing market for their products. • Foreign MNCs will be encouraged to set up in countries where they expect to receive high net profit. Possible judgement. • A low corporation tax may attract FDI but on its own it is unlikely to be sufficient. • A low corporation tax rate will not attract FDI if it is anticipated that it will not be possible to earn a high enough

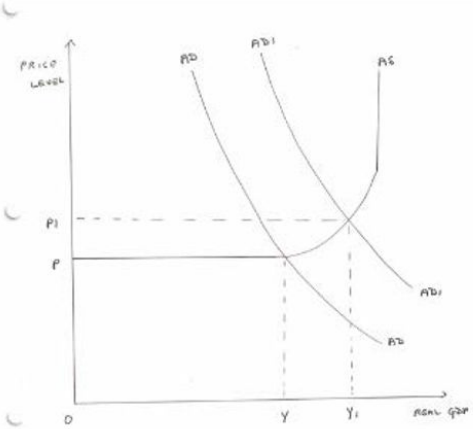
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			reasoning that addresses the question asked. There is a lack of a clear structure. Reasonable analysis will have correct analysis largely in the form of single links. These address the question but are not developed into a clear chain of reasoning. Any relevant diagram(s) may be imperfectly labelled or not linked to the analysis. Limited evaluation of how differences in corporate tax rates may affect foreign direct investment in countries in the form of an unsupported statement or no evaluation. 0 marks No response worthy of credit. Note: although a diagram is not required, it may enhance the quality of the answer and should be rewarded at the appropriate level. <table><tr><th>Descriptor</th><th>Award mark</th></tr><tr><td>Consistently meets the criteria for this level</td><td>At top of level</td></tr><tr><td>Meets the criteria but with some slight inconsistency</td><td>Above middle and either below top of level or at middle of level (depending on number of marks available)</td></tr><tr><td>Just enough achievement on balance for this level</td><td>Above bottom and either below middle or at middle of level (depending on number of marks available)</td></tr><tr><td>On the borderline of this level and the one below</td><td>At bottom of level</td></tr></table>	Descriptor	Award mark	Consistently meets the criteria for this level	At top of level	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)	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)	On the borderline of this level and the one below	At bottom of level		net profit because of low demand and/or high average cost of production. A 40% corporation tax on a £50 million profit is more attractive than a 10% corporation tax on a £5 million profit. • The FDI per head may be distorted by population figures. NB Do not award lower corporation tax lowers costs of production. Examiner's Comments This question was answered well by most candidates. Where it was not answered well, it was due to a lack of use of the data. There was also confusion from some who related lower corporation tax to a fall/lower costs of production, rather than retaining more profit. Exemplar 2 <i>region There is more incentive for foreign investor to invest in those region, such as Ireland, where has the lowest tax rate and highest FDI per head. India, the second highest rate has the lowest FDI per head. With a reduction in production cost, foreign investor can have a more competitive production with a lower</i> In Exemplar 2 the candidate correctly identified Ireland and India, and the inverse relationship was implicit, so they got good analysis here, but the response was not given strong analysis because they confused the idea that lower corporation tax would lead to lower production costs.
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On the borderline of this level and the one below	At bottom of level														
			Total	8											

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Question	Answer/Indicative content	Marks	Guidance
16	Evaluate, with the use of an appropriate diagram(s), whether an increase in private sector investment will help a government achieve its macroeconomic objectives Level 5 (21–25 marks) Good - Strong knowledge and understanding of investment and macroeconomic policy objectives. Strong analysis of whether an increase in private sector investment will help a government achieve its macroeconomic objectives Strong analysis will have consistently well-developed links through a coherent chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct with no significant errors that affect the validity of the analysis. Any diagrams must be integral to the analysis. Strong evaluation of whether an increase in private sector investment will help a government achieve its macroeconomic objectives weighing up both why they might and why they might not and reaching a supported judgment. <i>There is a well-developed and sustained line of reasoning which is coherent and logically structured. The information presented is entirely relevant and substantiated.</i> Level 4 (16–20 marks) Good knowledge and understanding of investment and macroeconomic policy objectives. Strong analysis of whether an increase in private sector investment will help a government achieve its macroeconomic objectives Strong analysis will have consistently well-developed links through a coherent chain of reasoning which addresses the	25 (AO1 x 6) (AO2 x 6) (AO3 x 6) (AO4 x 7)	<i>Indicative content</i> The reasons why it will help. An increase in private sector investment means that firms are purchasing more capital goods. This will increase aggregate demand. Investment is an injection into the circular flow of income, so there will be a multiplier effect. Aggregate demand will rise by a greater amount than the initial increase in investment. The higher demand will be likely to cause capital goods and consumer goods firms to increase their output. The country's economic growth rate may rise and unemployment may fall. In the longer run higher investment will increase aggregate supply as well as aggregate demand. This could allow an economy to grow without the economy experiencing inflation as shown in the diagram below.  As new AS capital goods are put into use, the price and quality competition of the country's products may rise. This could increase net exports and reduce a current account deficit. The reasons why it will not help If the capital goods are purchased from abroad, this may increase a current account deficit. The higher aggregate demand may also result in demand-pull inflation. If the economy is operating close to full capacity, extra demand for capital goods and consumer goods may pull up prices. The diagram below shows the rise

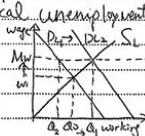
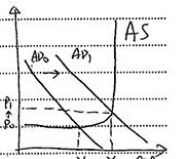
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	question. Any relevant diagram(s) are predominantly correct with no significant errors that affect the validity of the analysis. Any diagrams must be integral to the analysis. Good evaluation of whether an increase in private sector investment will help a government achieve its macroeconomic objectives and will weigh up both sides but without reaching a supported judgment. <i>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.</i> Level 3 (11–15 marks) Good knowledge and understanding of investment and macroeconomic policy objectives. Good analysis of whether an increase in private sector investment will help a government achieve its macroeconomic objectives There is correct analysis in the form of developed links. These links are developed through a chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct and linked to the analysis. Reasonable evaluation of whether an increase in private sector investment will help a government achieve its macroeconomic objectives, considering both why it might and why it might not. <i>There is a line of reasoning presented with some structure. The information presented is in the most-part relevant and supported by some evidence.</i> Level 2 (6–10 marks) Good knowledge and understanding of investment and macroeconomic policy objectives.		in aggregate demand from AD to AD₁, causing the price level to rise from P to P₁.  There is also the possibility that private sector investment may replace public sector demand. If private sector firms are borrowing more, this may raise the rate of interest. A higher rate of interest will increase the cost of servicing government debt. This may put pressure on the government to cut its spending. The impact on unemployment is uncertain. Firms in the private sector may be more willing than public sector firms to dismiss workers. New capital equipment may also be a substitute rather than a complement to labour. Some jobs may be lost as a result of advances in technology incorporated into new capital equipment. The effect is, however, uncertain. New technology can create new industries and new jobs. For instance, there is now a thriving games industry with games designers and testers. Possible judgment. It is generally considered that increases in private sector investment will help a government achieve its macroeconomic objectives. This is more likely if the increase is not offset by a decrease in public sector investment and if it generates extra jobs.

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	Reasonable analysis of whether an increase in private sector investment will help a government achieve its macroeconomic objectives There is correct analysis largely in the form of single links. These address the question but are not developed into a clear chain of reasoning. Any relevant diagram(s) may be imperfectly labelled or not linked to the analysis. Reasonable evaluation of whether an increase in private sector investment will help a government achieve its macroeconomic objectives considering both why it might and why it might not. <i>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.</i> Level 1 (1–5 marks) Reasonable knowledge and understanding of investment and macroeconomic policy objectives. Limited or no analysis of whether an increase in private sector investment will help a government achieve its macroeconomic objectives There is little evidence of reasoning that addresses the question asked. There is a lack of a clear structure. The relevant diagram(s) may not be present or are incorrectly labelled. Limited evaluation of whether an increase in private sector investment will help a government achieve its macroeconomic objectives in the form of an unsupported statement or no evaluation. <i>Information presented is basic and may be ambiguous or unstructured. The information is supported by limited evidence.</i> 0 marks No response worthy of credit.		Examiner's Comments Candidates who tackled this question completed this soundly using solid economic models and were able to clearly link this back to economic objectives. The better answers analysed how an increase in private sector investment could help achieve macroeconomic objectives through an increase in AD and LRAS. Diagrams were accurately labelled and integrated into answers. Evaluation, which tended to focus on inflation, could have been improved by looking at the limitations of investment. Candidates need to take care reading the question as it clearly states increase in private sector investment not the government investing. Weaker answers tended to focus on government spending or on policies to increase private sector investment and evaluate the effectiveness of those policies. There were also candidates who had missing links in their analysis. For example, saying that private sector investment causes employment without explaining how or why, this often meant that they did not get beyond L3.

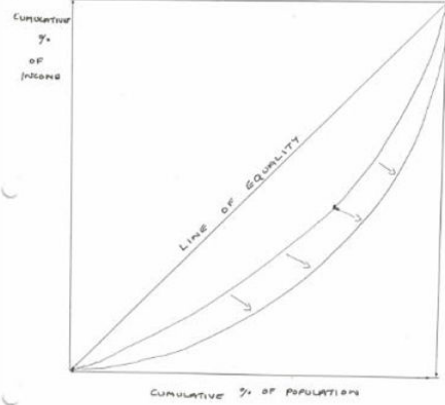
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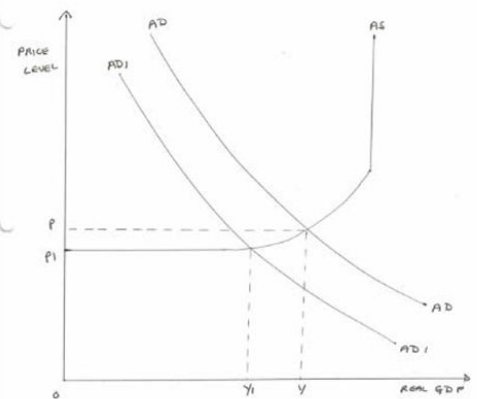
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Question			Answer/Indicative content	Marks	Guidance
					Increase in transaction turnover, which increases the revenue and profit tax, also improves the budget position of govt and flexibility of fiscal policy. Also investment in infrastructure can bring a long lasting effect to the AS growth. Firstly increase in investment increases firm size which increases the profit tax, govt can have more revenue to balance the budget (such as UK 2020 deficit). Govt can save the budget and prepare for any future supply side policy such as education. Also private sector investment can bring a long lasting effect to the AS. For example, Emirates has built public aviation school which provides training of pilots in UAE, dubai. This can continuously produce skillful labor, which is a high quality FOP to shift AS to the right. This increases PLP potential output & outward shift of PPF (production possibility frontier). Similarly $(F_1 \rightarrow F_2)$, which is Economic LR growth. In this response the candidate used a brief introduction, which clearly showed they knew what the question was asking of them. The analysis is developed with clear chains of reasoning focused on the question set, the diagrams are predominantly correct and integrated into the answer. There is use of their own knowledge which enhanced the explanation. Overall this section was awarded strong analysis and went on to be awarded strong evaluation.
			Total	25	

Mark Scheme

Question	Answer/Indicative content	Marks	Guidance
17	Evaluate, with the use of an appropriate diagram(s), whether a cut in government spending on welfare benefits will increase income inequality. Level 5 (21–25 marks) Good-Strong knowledge and understanding of welfare benefits and income inequality. Strong analysis of how a cut in government spending on welfare benefits may affect income inequality. It will have consistently well-developed links through a coherent chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct with no significant errors that affect the validity of the analysis. Any diagrams must be integral to the analysis. Strong evaluation of whether a cut in government spending on welfare benefits may affect income inequality, weighing up both why it might and why it might not and reaching a supported judgment. <i>There is a well-developed and sustained line of reasoning which is coherent and logically structured. The information presented is entirely relevant and substantiated.</i> Level 4 (16–20 marks) Good knowledge and understanding of welfare benefits and income inequality. Strong analysis of how a cut in government spending on welfare benefits may affect income inequality. It will have consistently well-developed links through a coherent chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct with no significant errors that affect the validity of the analysis. Any diagrams must be integral to the analysis.	25 (AO1 x 6) (AO2 x 6) (AO3 x 6) (AO4 x 7)	<i>Indicative content</i> Reasons why it will increase income inequality. A cut in government spending on welfare benefits may reduce the income of various categories of the poor. These include the unemployed, the sick and the old. If this occurs, both absolute and relative poverty will increase. Income will become more unevenly distributed. This increase in income inequality can be illustrated on a Lorenz curve diagram. The curve will move further away from the line of income equality.  Lower government spending may reduce aggregate demand by a multiple amount. If the income of the poor falls, consumer expenditure may also fall. Lower aggregate demand may reduce output and employment.

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	Good evaluation of whether a cut in government spending on welfare benefits may affect income inequality, weighing up both why it might and why it might not without reaching a supported judgment. <i>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.</i> Level 3 (11–15 marks) Good knowledge and understanding of welfare benefits and income inequality Good analysis of how a cut in government spending on welfare benefits may affect income inequality. There is correct analysis in the form of developed links. These links are developed through a chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct and linked to the analysis. Reasonable evaluation of whether a cut in government spending on welfare benefits may affect income inequality, considering both sides. <i>There is a line of reasoning presented with some structure. The information presented is in the most-part relevant and supported by some evidence.</i> Level 2 (6–10 marks) Good knowledge and understanding of welfare benefits and income inequality. Reasonable analysis of how a cut in government spending on welfare benefits may affect income inequality. There is correct analysis largely in the form of single links. These address the question but are not developed into a clear chain of reasoning. Any relevant diagram(s) may be imperfectly labelled or not linked to the analysis. Reasonable evaluation of whether a cut in government spending on welfare benefits		 A rise in unemployment may also increase income inequality. There may also be a longer term effect on income inequality. The poor may experience worse health which will reduce their earning potential. Their children may spend less time in education and may have lower aspirations. Reasons why it may not reduce income inequality. It is possible, however, that lower welfare benefits may have an incentive effect. They may encourage the unemployed to make more effort to find work. If this occurs, income inequality may be reduced. If a reduction in pensions encourages people to work past retirement age, the size of the labour force will increase. A higher labour force will increase the country's productive potential. If this potential is used, tax revenue will rise and so of this may be spent on, for instance, education and job creation schemes, which may reduce poverty and income inequality. A cut in government spending on welfare benefits may also enable tax rates to be cut or government borrowing to be reduced. The effect of lower tax rates on income inequality will be influenced by which tax rates are cut. A rise in the threshold at which income tax is paid, for

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Question			Answer/Indicative content	Marks	Guidance								
			may affect income inequality, considering both sides. <i>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.</i> Level 1 (1–5 marks) Reasonable knowledge and understanding of welfare benefits and income inequality. Limited or no analysis of how a cut in government spending on welfare benefits may affect income inequality. There is little evidence of reasoning that addresses the question asked. There is a lack of a clear structure. The relevant diagram(s) may not be present or are incorrectly labelled. Limited evaluation of whether a cut in government spending on welfare benefits may affect income inequality, in the form of an unsupported statement or no evaluation. <i>Information presented is basic and may be ambiguous or unstructured. The information is supported by limited evidence.</i> 0 marks No response worthy of credit. <table><tr><th>Descriptor</th><th>Award mark</th></tr><tr><td>Consistently meets the criteria for this level</td><td>At top of level</td></tr><tr><td>Meets the criteria but with some slight inconsistency</td><td>Above middle and either below top of level or at middle of level (depending on number of marks available)</td></tr><tr><td>Just enough achievement on balance for this level</td><td>Above bottom and either below middle or at middle of level (depending on number of marks)</td></tr></table>	Descriptor	Award mark	Consistently meets the criteria for this level	At top of level	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)	Just enough achievement on balance for this level	Above bottom and either below middle or at middle of level (depending on number of marks)		instance, may reduce income inequality. Lower government borrowing may result in crowding in. If private sector investment increases, more jobs may be created which, again, may reduce income inequality. Possible judgement. How welfare cuts will affect income inequality will depend on a number of factors. One how the replacement rate is affected. If the proportion of out of work benefits received compared to take home pay is still close, it may not have much effect. Another factor is the number of jobs available. The unemployed may be more incentivised to seek employment but if there are few job vacancies, they will not be successful. In addition, the outcome will be influenced by who receives the welfare benefits. Some go to people who live in rich households. Examiner's Comments This question was answered by about half of the candidates. The better answers showed their ability to relate a cut in welfare benefits to income equality, many making good use of an AD/AS diagrams reflecting a fall in government expenditure and the impact that and cuts in welfare benefits would have on inequality. Evaluation of the incentive to work impact was also clearly explained and most frequently used. The Lorenz diagram was also used, but often it could have been labelled and explained appropriately. The weaker answers were often when the use of the diagram could have been better. Candidates should avoid drawing a diagram and then simply stating 'as shown in the diagram'. Diagrams need to be integrated into the answer to show strong analysis. Several candidates lost sight of the question and started to analyse and evaluate the cut in government spending
Descriptor	Award mark												
Consistently meets the criteria for this level	At top of level												
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)												
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Mark Scheme

Question			Answer/Indicative content	Marks	Guidance
			available) On the borderline of this level and the one below At bottom of level		on other macroeconomic objectives. Exemplar 5 benefits as they no longer fulfil criteria. This could lead to absolute poverty for some people if they do not receive any form of income and are unable to get a job. Along with this, relative poverty could increase as people will receive less than 60% of average household income which may prevent some people participating in society. Overall this can create large-scale unhappiness that could lead to civilised depression which is not the rise which the majority of people from being unable to get jobs. In turn this will worsen inequality. This Lorenz curve indicates the effect of worsening inequality due to the reduction in welfare benefits. The lowest 40% of the population owned only 10% of the wealth before whereas after this figure changes to the lowest 60% of the population only receiving 10%. The government will fail to see some people on benefits suffer from hysteresis as their skills no longer are useful in the current day. In this response the candidate makes good use of the diagram and clearly explains the relevance to the question and overall even though it is not a perfect explanation there is enough for strong analysis. In questions where candidates are required to use a diagram it is crucial that they do so correctly.
			Total	25	

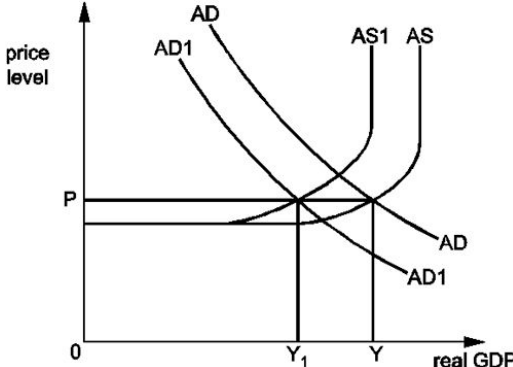
Mark Scheme

Question	Answer/Indicative content	Marks	Guidance
18	Level 3 (9–12 marks) Good knowledge and understanding of an independent monetary policy in the context of an emerging economy. Strong analysis of the reasons why and why not an emerging economy may be able to operate an independent monetary policy. Strong evaluation including a supported judgement on the extent to which an emerging economy can operate an independent monetary policy. <i>There is a well-developed line of reasoning which is clear and logically structured. The information presented is relevant and substantiated.</i> Level 2 (5–8 marks) Good knowledge and understanding of an independent monetary policy and/or an emerging economy. Good analysis of the reasons why and why not an emerging economy may be able to operate an independent monetary policy. Reasonable evaluation as to whether an emerging economy can operate an independent monetary policy without considering its extent. <i>There is a line of reasoning presented with some structure. The information presented is in the most-part relevant and supported by some evidence.</i> Level 1 (1–4 marks) Reasonable knowledge and understanding of monetary policy and/or an emerging economy. Reasonable analysis of the reasons why and why not an emerging economy may be able to operate an independent monetary policy.	12 (AO1 x 1) (AO2 x 1) (AO3 x 5) (AO4 x 5)	<i>Indicative content</i> - monetary policy covers a government/central bank's decisions on the interest rate, money supply and exchange rate. Reasons why it might not: - developed countries' central banks may ignore the side effects of their monetary policy measures on emerging economies - an emerging economy may not be able to move its interest rate/growth of the money supply in a different direction due to the risk it will lead to destabilising outflows/inflows of hot money, e.g. if the US and UK raise interest rates, emerging economies will be forced to raise their interest rates to avoid an outflow of hot money; an outflow of money would increase the supply of the currency; a fall in the exchange rate can push up the rate of inflation as it will raise the price of imports - an emerging economy may be a member of a trade bloc which may require some co-ordination of monetary policy measures. Reasons why it might: - an emerging economy may be able to operate an independent monetary policy if it is prepared to operate a freely floating exchange rate; higher interest rates may result in a lower exchange rate which may encourage an inflow of hot money; with speculators expecting the exchange rate to rise in the future - capital controls may be imposed; these limit the amount of currency coming into and going out of the country - some countries discourage the movement of destabilising hot money flows by developing their financial

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Question			Answer/Indicative content	Marks	Guidance
			Little or no evaluation. <i>The information is basic and communicated in an unstructured way. The information is supported by limited evidence and the relationship to the evidence may not be clear.</i> 0 marks no response or no response worthy of credit. Note: although a diagram is not required, it may enhance the quality of the answer and should be rewarded at the appropriate level.		sector. Credit, where appropriate, knowledge/analysis of other, relevant factors. Possible routes into evaluation: • a fall in the exchange rate may not always encourage financial investors to buy the currency as they may expect a further depreciation • there may be greater cooperation between central banks but central banks are likely to put national self-interest before global interest • fiscal and structural reforms may reduce the emerging economy's reliance on hot money flows • even some developed economies are restricted in their ability to operate an independent monetary policy.
			Total	12	

Mark Scheme

Question	Answer/Indicative content	Marks	Guidance
19	Level 5 (21–25 marks) Good knowledge and understanding of income tax in the context of improving UK macroeconomic performance. Strong analysis of the link between a cut in the top rate of income tax 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 UK macroeconomic performance would be strengthened by an increase in the top rate of income tax. <i>There is a well-developed and sustained line of reasoning which is coherent and logically structured. The information presented is entirely relevant and substantiated.</i> Level 4 (16–20 marks) Good knowledge and understanding of income tax in the context of improving UK macroeconomic performance. Strong analysis of the link between a cut in the top rate of income tax and macroeconomic performance would be strengthened by an increase in the top rate of income tax. Good evaluation of whether UK macroeconomic performance would be strengthened by an increase in the top rate of income tax. <i>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.</i> Level 3 (11–15 marks) Good knowledge and understanding of income tax in the context of improving UK macroeconomic performance. Good analysis of the link between a cut in	25 (AO1 x 6) (AO2 x 6) (AO3 x 6) (AO4 x 7)	<i>Indicative content</i> Use and interpretation of an AD/AS diagram:  - an increase in the top rate of tax may reduce the size of the country's labour force and may reduce consumer expenditure and investment - the effect will be to lower output. The impact on this price level will depend on the relative size of the two shifts. Note: also accept a diagram showing the AD and AS curves shifting to the right that is consistent with the text. Reasons why it may improve the UK's macroeconomic performance: - if the economy is operating close to full employment and aggregate supply does not decrease, a reduction in aggregate demand may reduce demand-pull inflation - a higher top rate of tax may not reduce the size of the labour force as some workers may work longer hours to maintain living standards - higher tax revenue may reduce budget deficit which may give foreign and domestic firms more confidence in the economic prospects of the country. An increase in business confidence may increase investment which, in turn, may increase international price competitiveness and economic growth

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Question	Answer/Indicative content	Marks	Guidance
	the top rate of income tax and macroeconomic performance. A relevant diagram is provided and is linked to the analysis. Reasonable evaluation of how a cut in the top rate of income tax may influence macroeconomic performance but without considering the extent. <i>There is a line of reasoning presented with some structure. The information presented is in the most-part relevant and supported by some evidence.</i> Level 2 (6–10 marks) Good knowledge and understanding of income tax and/or macroeconomic performance. Reasonable analysis the link between a cut in the top rate of income tax and macroeconomic performance. A relevant diagram is provided, which is less than perfect. Reasonable evaluation of how a cut in the top rate of income tax may affect macroeconomic performance but without considering the extent. <i>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.</i> Level 1 (1–5 marks) Reasonable knowledge and understanding of income tax and/or macroeconomic performance. Limited analysis of the link between a cut in the top rate of income tax and macroeconomic performance. The diagram may not be relevant, may be inaccurate or may be missing. Limited or no evaluation.		• if any extra revenue earned is spent by the government, aggregate demand will increase. For instance, if tax revenue increases by £200bn and government spending increases by £200bn, there will be a net injection of spending into the circular flow. £40bn of the income taken in tax may have been spent, so part of the tax revenue will replace another leakage from the circular flow. An injection of government spending in such a case will be matched by a fall in leakages of £160bn, giving a net injection of £40bn • if the government spends some of the tax revenue on education, training and infrastructure projects, productivity may rise. This will increase aggregate supply and may raise the quality and price competitiveness of the country's products. A more educated and skilled labour force may attract foreign direct investment. As a result there may be actual and potential economic growth and an improvement in the country's current account position Reasons why it might not improve macroeconomic performance: • an increase in the top rate of tax may discourage some people of working age from entering the labour force • it may reduce the quantity of hours supplied by workers • investment may be reduced as foreign and domestic firms may want to be based in other countries where their top workers will be taxed less and where domestic demand may be higher • a reduction in investment will lower both aggregate demand and aggregate supply • aggregate demand may fall if the higher tax rate reduces consumer expenditure. A higher tax rate will reduce the disposable income of the rich which will lower their purchasing power. Such a fall in spending may

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Question			Answer/Indicative content	Marks	Guidance
			<i>Information presented is basic and may be ambiguous or unstructured. The information is supported by limited evidence.</i> 0 marks no response or no response worthy of credit.		cause GDP to fall by a multiple amount. If aggregate supply falls by more than aggregate demand, the economy may experience cost-push inflation. With less investment and the withdrawal of some possibly highly productive and innovative workers, costs of production may rise. Cost-push inflation may reduce the price competitiveness of domestic products. This combined with a possible reduction in the quality of products produced may decrease exports and increase imports. As a result the current account position of the balance of payments worsens. Credit, where appropriate, knowledge/analysis of other, relevant factors. Possible routes into evaluation: • outcome will be influenced by the level of economic activity • the effect will depend on the relative sizes and directions of the shifts of the AD and AS curves • the larger the size of the multiplier, the greater the effect is likely to be • the proportion of people who will be moved into paying the 50% income tax rate • it will depend on the other tax rates as this will influence the marginal rate of tax at the top end • it depends on the direction/influence of other policy measures.
			Total	25	

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Question			Answer/Indicative content	Marks	Guidance
20			A	1 (AO3)	Rationale A Correct: $[(£11,000 \times 0) + (£32,000 \times 0.2) + (£3,500 \times 0.4)] / £46,500 \times 100 = 16.8\%$ B This is the tax rate paid on the majority of this individual's income, but this is not the same as the average tax rate. C Assumes that all income other than that paid at the higher rate is paid at the basic rate (ie. ignores the personal allowance). D This is the marginal tax rate.
			Total	1	
21			C	1 (AO1)	Rationale A The dependency ratio will be unchanged because there will be no change in the size of the working age population or the number of dependents. B The participation rate is likely to increase as individuals outside of the labour force reliant on welfare payments enter the labour market as the opportunity cost of not participating has increased. C Correct: The gap between the wage on offer in the labour market and the level of unemployment benefits will have increased, causing the replacement ratio to fall. D The size of the working age population will not change – there is no direct link to population demographics.
			Total	1	

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Question			Answer/Indicative content	Marks	Guidance
22			Using the data from Fig. 1.1, explain the trend in public healthcare spending between 2009 and 2021. There has been an increase in nominal expenditure on healthcare every year (1) There were some years in which real expenditure on healthcare fell such as 2010-11 and 2011-12/real expenditure predicted to be unchanged between 2018/19 – 20/21 (1), although generally it increased (1)	2 (AO2 x 2)	No credit should be awarded to answers that simply say that healthcare expenditure has increased – the candidate must distinguish between real and nominal expenditure.
			Total	2	
23			A	1 (AO1)	Rationale A Correct: moving from a system which takes a higher proportion of income from those on high income to a system which takes the same proportion of income from all earners. B The proposal is not regressive as it does not take a higher proportion of income from those on low income. C The current system is not regressive and the proposed system is not progressive as it does not take a higher proportion of income from those on high income. D The current system is not regressive as it does not take a higher proportion of income from those on low income.
			Total	1	

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Question			Answer/Indicative content	Marks	Guidance
24			A	1 (AO1)	Rationale A Correct: there is a budget deficit as government spending exceeds government revenue B Government revenue does not exceed government expenditure. C The current account records international transactions, not government revenue and expenditure. D The current account records international transactions, not government revenue and expenditure.
			Total	1	
25			A	1 (AO3)	Rationale A Correct: A specific tax is a flat rate tax. As prices rise the tax per unit and tax revenue will remain unchanged in nominal terms and will fall in real terms. B Corporation tax is a percentage tax. With real national income being unchanged, it is likely to keep pace with inflation, yielding higher nominal tax revenue. It may also yield higher tax real tax revenue if there is fiscal drag. C Income tax is also a percentage tax. As with corporation tax, it will be likely to yield higher nominal tax revenue. It may also yield higher tax real tax revenue if there is fiscal drag. D Value added tax is a percentage tax. As prices rise so will nominal tax revenue.
			Total	1	

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26			Up to two marks: One mark for a relevant description which does not make reference to specific figures. For second mark, must be comparative and use % rate.	2 (AO2 x 2)	<i>Indicative content</i> In 1998 environmental taxation was 9.6% of total taxation revenue but it fell to 8.1% in 2012. There is a downward trend in environmental taxation as a percentage of total taxation revenue from 9.6% in 1998 to 8.1% in 2012. Environmental taxation as a percentage of total taxation revenue was at its highest in 1998 at 9.6% but the lowest percentage was in 2006 at 7.4%.
			Total	2	
27			C	1 (AO1)	Rationale A This is likely to reduce a balance of payments deficit but would not directly impact upon the fiscal position B This is likely to reduce a balance of payments deficit but would not directly impact upon the fiscal position C Correct – this represents government borrowing. The government can use the funds generated from the sale of the bonds to finance the deficit D Increasing the money is a method of financing a budget deficit
			Total	1	

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Question			Answer/Indicative content	Marks	Guidance
28			B	1 (AO3)	Rationale A Whilst the economic growth rate was highest in Ireland in 2016 this followed a period of exceptionally high growth in 2015, suggesting there is a question mark over the sustainability of growth. There is a risk of deflation and the unemployment rate is high. B Correct: Malta has significantly higher growth than the UK, whilst the unemployment rate is relatively similar and inflation is the same. C Inflation is well above target with very high unemployment. D The growth rate is less than half of that seen in Malta, which has similar inflation and only slightly lower unemployment.
			Total	1	

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Question			Answer/Indicative content	Marks	Guidance
29	a		Using Table 1, calculate whether Japan or the UK had the larger budget deficit as a percentage of GDP. State which country had the larger budget deficit and give the budget deficit as a percentage of GDP. UK (1) 6.67% (1).	2 (AO2 x 2)	Calculation $0.2/3.0 = 6.67$. Accept: 6.7.
	b		Evaluate whether supply-side policy measures will increase investment. Level 3 (9–12 marks) Good knowledge and understanding of supply-side policy measures and investment. Good – strong analysis of how supply-side policy measures may increase investment. Good analysis will be in the form of developed links. These links are developed through a chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct and linked to the analysis. Strong analysis will have consistently well-developed links through a coherent chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct with no significant errors that affect the validity of the analysis. Any diagrams must be integral to the analysis. Good - strong evaluation of whether supply-side policy measures will increase investment, weighing up both why it might and why it might not. Strong evaluation should include a supported judgment. <i>There is a well-developed line of reasoning which is clear and logically structured. The information presented is relevant and substantiated.</i> Level 2 (5–8 marks) Good knowledge and understanding of supply-side policy measures and investment. Reasonable analysis of how supply-side policy measures may increase investment. There is correct analysis largely in the form of single links. These address the question	12 (AO1 x 1) (AO2 x 1) (AO3 x 5) (AO4 x 5)	<i>Indicative content</i> Reasons why supply-side policy measures may not increase investment: Deregulation may reduce firms' costs of production which may increase firms' profits and their ability and incentive to invest. It may also increase the number of firms in the market affected, increase competition and efficiency. This may increase profits and investment. Privatisation may not only reduce costs of production. It may also mean that more funds are available for investment. Investment by state owned enterprises may be constrained by limits being placed on government spending. Cuts in corporate tax will increase firms' retained profits. These can be used for investment. The lower tax will also reduce the opportunity cost of investment and increase the incentive to invest. Lower income tax may encourage investment as firms would expect it would cause an increase in demand for products. Increased spending on education and training may result in higher investment. This is because if labour becomes more skilled, firms may think that workers will be able to make more effective use of new capital equipment. Reasons why supply-side policy measures may not increase investment: There is, however, no guarantee that supply-side policy measures will increase investment. Deregulation and privatisation may increase profits but these profits may not be used for investment. They might, instead, be distributed to shareholders. Privatisation may not always increase competition. A private sector monopoly

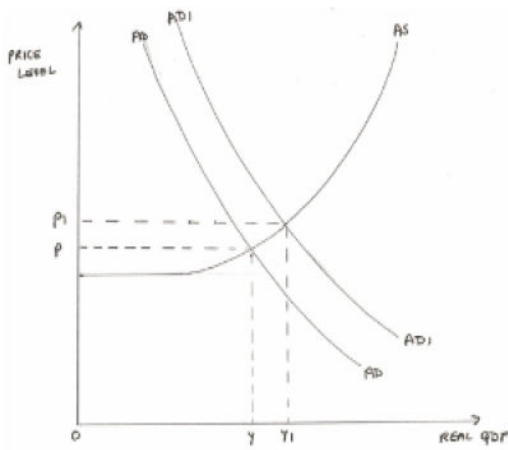
Mark Scheme

Question			Answer/Indicative content	Marks	Guidance						
			but are not developed into a clear chain of reasoning. Any relevant diagram(s) may be imperfectly labelled or not linked to the analysis Reasonable evaluation of whether supply-side policy measures will increase investment, considering both why it might and why it might not. <i>There is a line of reasoning presented with some structure. The information presented is in the most-part relevant and supported by some evidence.</i> Level 1 (1–4 marks) Limited – reasonable knowledge and understanding of supply-side policy measures and investment. Limited analysis of how supply-side policy measures may increase investment. Little evidence of reasoning that addresses the question asked. There is a lack of a clear structure. Limited evaluation of whether supply-side policy measures will increase investment in the form of an unsupported statement or no evaluation. <i>The information is basic and communicated in an unstructured way. The information is supported by limited evidence and the relationship to the evidence may not be clear.</i> 0 marks no response or no response worthy of credit. Note: although a diagram is not required, it may enhance the quality of the answer and should be rewarded at the appropriate level. <table><tr><th>Descriptor</th><th>Award mark</th></tr><tr><td>Consistently meets the criteria for this level</td><td>At top of level</td></tr><tr><td>Meets the criteria</td><td>Above middle and</td></tr></table>	Descriptor	Award mark	Consistently meets the criteria for this level	At top of level	Meets the criteria	Above middle and		may become complacent and may not undertake much investment. Cuts in income tax and corporation tax may not stimulate higher consumer expenditure and investment if households and firms lack confidence in future economic prospects. Increased spending on education and training does not always develop the appropriate skills. Supply-side policy measures will also not encourage investment if firms are currently not making full use of their capital equipment and/or if there is a lack of aggregate demand. Possible routes into evaluation: Supply-side policy measures have the potential to increase investment but their success is dependent on how economic agents react and whether there is also sufficient aggregate demand. Supply-side policy measures also take time to have an effect and some are expensive.
Descriptor	Award mark										
Consistently meets the criteria for this level	At top of level										
Meets the criteria	Above middle and										

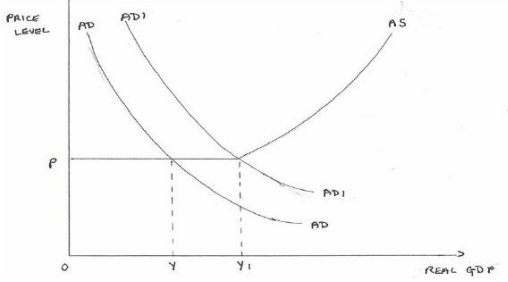
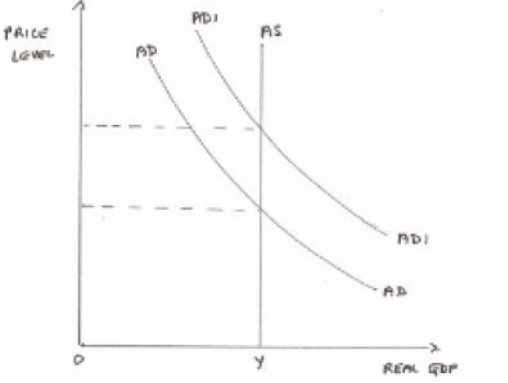
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			but with some slight inconsistency Just enough achievement on balance for this level On the borderline of this level and the one below	either below top of level or at middle of level (depending on number of marks available) Above bottom and either below middle or at middle of level (depending on number of marks available) At bottom of level	
			Total	14	

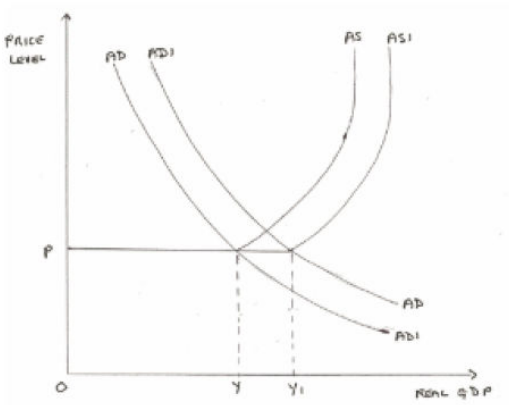
Mark Scheme

Question	Answer/Indicative content	Marks	Guidance
30	Evaluate with the use of an appropriate diagram(s), whether macroeconomic policy measures can only promote economic growth at the cost of higher inflation. Level 5 (21–25 marks) Good-Strong knowledge and understanding of macroeconomic policy measures designed to promote economic growth. Strong analysis of how macroeconomic policy measures designed to promote economic growth may affect inflation. Strong analysis will have consistently well-developed links through a coherent chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct with no significant errors that affect the validity of the analysis. Any diagrams must be integral to the analysis. Strong evaluation of whether macroeconomic policy measures designed to promote economic growth will always increase inflation, weighing up both why it might and why it might not and reaching a supported judgment. <i>There is a well-developed and sustained line of reasoning which is coherent and logically structured. The information presented is entirely relevant and substantiated.</i> Level 4 (16–20 marks) Good knowledge and understanding of government policy measures designed to promote economic growth. Strong analysis of how macroeconomic policy measures designed to promote economic growth may affect inflation Strong analysis will have consistently well-developed links through a coherent chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct with no significant	25 (AO1 x 6) (AO2 x 6) (AO3 x 6) (AO4 x 7)	Whether macroeconomic policy measures designed to promote economic growth will increase the inflation rate will depend on the level of economic activity, the type of economic growth being targeted and the type of measures adopted. A government may be seeking to increase short run (actual) economic growth to reduce a negative output gap. It may try to do this by using expansionary fiscal and/or monetary policy measures. Such measures may increase aggregate demand as shown in the diagram below. In this case the rise in AD, increases both output and the price level.  A higher inflation rate may be a price the government is prepared to pay if the inflation rate is still within the government's target range and is lower than rival countries. If the economy is operating at a low level of economic activity, output may increase without putting upward pressure on the price level. The diagram below shows AD increasing without having any effect on the price level.

Mark Scheme

Question	Answer/Indicative content	Marks	Guidance
	errors that affect the validity of the analysis. Any diagrams must be integral to the analysis. Good evaluation of whether macroeconomic policy measures designed to promote economic growth will always increase inflation, weighing up both why it might and why it might not and will weigh up both sides but without reaching a supported judgment. <i>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.</i> Level 3 (11–15 marks) Good knowledge and understanding of government policy measures designed to promote economic growth. Good analysis of how macroeconomic policy measures designed to promote economic growth may affect inflation. There is correct analysis in the form of developed links. These links are developed through a chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct and linked to the analysis. Reasonable evaluation of whether macroeconomic policy measures designed to promote economic growth will always increase inflation, considering both why it might and why it might not. <i>There is a line of reasoning presented with some structure. The information presented is in the most-part relevant and supported by some evidence.</i> Level 2 (6–10 marks) Good knowledge and understanding of the consequences of macroeconomic policy measures designed to promote economic growth. Reasonable analysis of how macroeconomic policy measures designed		 If there are a high number of workers unemployed, it may be possible for firms to employ more workers without having to raise the wage rate. Neoclassical economists, however, argue that the economy moves towards the full employment rate and so any increases in AD will be purely inflationary as shown below.  Some measures designed to increase short run economic growth, for example, rises in state pensions, may only shift the AD curve. A number of measures, however, designed to increase AD may also shift the aggregate supply curve. For example, the prime aim of an interest rate cut may be to encourage consumers to spend more but it may also increase investment. In such a case, the effect on inflation will depend on the relationship between the increase in AD and AS. If AD increases more than AS, the price level will rise but if the increase in AD is matched by an increase in AS, this have no effect on the inflation rate.

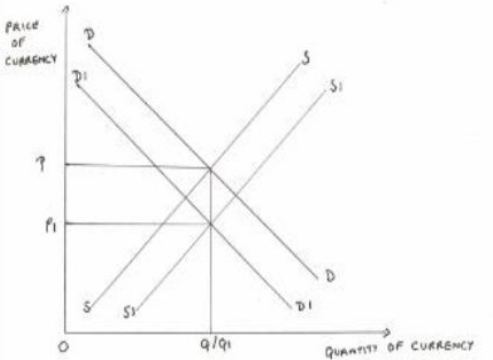
Mark Scheme

Question	Answer/Indicative content	Marks	Guidance
	to promote economic growth may affect inflation. There is correct analysis largely in the form of single links. These address the question but are not developed into a clear chain of reasoning. Any relevant diagram(s) may be imperfectly labelled or not linked to the analysis. Reasonable evaluation of whether macroeconomic policy measures designed to promote economic growth will always increase inflation, considering both why it might and why it might not. <i>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.</i> Level 1 (1–5 marks) Reasonable knowledge and understanding of the consequences of macroeconomic policy measures designed to promote economic growth. Limited or no analysis of how macroeconomic policy measures designed to promote economic growth may affect inflation There is little evidence of reasoning that addresses the question asked. There is a lack of a clear structure. The relevant diagram(s) may not be present or are incorrectly labelled. Limited evaluation of whether macroeconomic policy measures designed to promote economic growth will always increase inflation in the form of an unsupported statement or no evaluation. <i>Information presented is basic and may be ambiguous or unstructured. The information is supported by limited evidence.</i> 0 marks no response or no response worthy of credit.		Government policy measures designed to increase long run economic growth are likely to reduce the inflation rate. To raise long run economic growth, a government is likely to employ supply-side policy measures such as a cut in corporation tax or a rise in government spending on training. If successful these measures will increase aggregate supply and will, over time, permit AS to increase in line with AD.  Policy measures designed are likely to enable an economic growth to be achieved without raising the price level. Whether policy measures designed to increase AD will raise the inflation rate will be influenced by the level of economic activity and whether they also increase AS.

Mark Scheme

Question			Answer/Indicative content	Marks	Guidance										
			<table><tr><th>Descriptor</th><th>Award mark</th></tr><tr><td>Consistently meets the criteria for this level</td><td>At top of level</td></tr><tr><td>Meets the criteria but with some slight inconsistency</td><td>Above middle and either below top of level or at middle of level (depending on number of marks available)</td></tr><tr><td>Just enough achievement on balance for this level</td><td>Above bottom and either below middle or at middle of level (depending on number of marks available)</td></tr><tr><td>On the borderline of this level and the one below</td><td>At bottom of level</td></tr></table>	Descriptor	Award mark	Consistently meets the criteria for this level	At top of level	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)	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)	On the borderline of this level and the one below	At bottom of level		
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On the borderline of this level and the one below	At bottom of level														
			Total	25											

Mark Scheme

Question	Answer/Indicative content	Marks	Guidance
31	Evaluate with the use of an appropriate diagram(s), whether a reduction in a country's rate of interest would reduce its exchange rate. Level 5 (21–25 marks) Good-Strong knowledge and understanding of how an exchange rate is determined. Strong analysis of how a reduction in the rate of interest may affect the exchange rate. It will have consistently well-developed links through a coherent chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct with no significant errors that affect the validity of the analysis. Any diagrams must be integral to the analysis. Strong evaluation of whether a reduction in a country's rate of interest will always reduce its exchange rate weighing up both why it might and why it might not and reaching a supported judgment. <i>There is a well-developed and sustained line of reasoning which is coherent and logically structured. The information presented is entirely relevant and substantiated.</i> Level 4 (16–20 marks) Good knowledge and understanding of how an exchange rate is determined. Strong analysis of how a reduction in the rate of interest may affect the exchange rate. It will have consistently well-developed links through a coherent chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct with no significant errors that affect the validity of the analysis. Any diagrams must be integral to the analysis. Good evaluation of whether a reduction in	25 (AO1 x 6) (AO2 x 6) (AO3 x 6) (AO4 x 7)	A fall in the rate of interest may reduce the inflow of hot money and encourage an outflow of hot money. Households and firms may move money from the country's banks to banks in other countries offering a higher rate of interest. If the country's households and firms are putting more money in foreign banks. The supply of the domestic currency used to purchase foreign currency will increase. If foreigners are buying less of the currency, demand for the currency will decrease. The diagram below shows how these changes in the foreign exchange market would cause a fall in the value of a floating exchange rate.  A central bank may lower its interest rate with the specific intention of lowering the exchange rate possibly with the intention of reducing a current account deficit. A reduction in the rate of interest may, however, not result in a fall in the value of a fixed exchange rate. It would be likely to put downward pressure on the value but a government may seek to maintain the value by instructing its central bank to purchase its currency, using reserves of foreign currency. There is the possibility that, whatever the type of exchange rate system being operated, the demand for the currency may not decrease and the supply of the currency may not increase. There are a number of reasons for this. One is that, despite the reduction, the rate of interest may still be higher than in other countries.

Mark Scheme

Question	Answer/Indicative content	Marks	Guidance
	a country's rate of interest will always reduce its exchange rate, weighing up both why it might and why it might not without reaching a supported judgment. <i>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.</i> Level 3 (11–15 marks) Good knowledge and understanding of how an exchange rate is determined. Good analysis of how a reduction in the rate of interest may affect the exchange rate. There is correct analysis in the form of developed links. These links are developed through a chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct and linked to the analysis. Reasonable evaluation of whether a reduction in a country's rate of interest will always reduce its exchange rate, considering both sides. <i>There is a line of reasoning presented with some structure. The information presented is in the most-part relevant and supported by some evidence.</i> Level 2 (6–10 marks) Good knowledge and understanding of how an exchange rate is determined. Reasonable analysis of how a reduction in the rate of interest may affect the exchange rate. There is correct analysis largely in the form of single links. These address the question but are not developed into a clear chain of reasoning. Any relevant diagram(s) may be imperfectly labelled or not linked to the analysis. Reasonable evaluation of whether a reduction in a country's rate of interest will always reduce its exchange rate,		Placing money in the country's banks might also offer a better return if the country's economic prospects are good and causing the exchange rate to rise. For example, if the rate of interest in the UK is 4% and the exchange rate is £1 = \$1, an American with a deposit of £100 would earn \$4 when the interest is converted into \$s. If the exchange rate rises to £1 = \$1.5, the deposit holder would receive more interest - \$6. A lower rate of interest may attract foreign direct investment (FDI) if it is thought that the increase might stimulate a rise in consumer expenditure. If more FDI is attracted, demand for the currency will rise and the supply of the currency would fall. In such a circumstance, the value of the currency will rise and not fall. Changes in the rate of interest is only one influence on the demand for and supply of a currency. If it is thought that the central bank has reduced the rate of interest due to concerns about a recession, it may be expected that the economic prospects are not good and the exchange rate will fall. If it is expected that the exchange rate will fall, currency traders will act in a way that will bring about the fall. They will sell the currency and so bring about the very movement they were expecting. In contrast, if it thought that the central bank has reduced the rate of interest because it has succeeded in reducing the inflation rate, it may lead to an expectation that the exchange rate will increase. Whether a lower rate of interest will reduce the exchange rate will be influenced by how its new rate compares with that of other countries, the exchange rate system being operated and how the change is perceived.

Mark Scheme

Question			Answer/Indicative content	Marks	Guidance										
			considering both sides. <i>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.</i> Level 1 (1–5 marks) Reasonable knowledge and understanding of how an exchange rate is determined. Limited or no analysis of how a reduction in the rate of interest may affect the exchange rate. There is little evidence of reasoning that addresses the question asked. There is a lack of a clear structure. The relevant diagram(s) may not be present or are incorrectly labelled. Limited evaluation of whether a reduction in a country’s rate of interest will always reduce its exchange rate in the form of an unsupported statement or no evaluation. <i>Information presented is basic and may be ambiguous or unstructured. The information is supported by limited evidence.</i> 0 marks no response or no response worthy of credit. <table><tr><th>Descriptor</th><th>Award mark</th></tr><tr><td>Consistently meets the criteria for this level</td><td>At top of level</td></tr><tr><td>Meets the criteria but with some slight inconsistency</td><td>Above middle and either below top of level or at middle of level (depending on number of marks available)</td></tr><tr><td>Just enough achievement on balance for this level</td><td>Above bottom and either below middle or at middle of level (depending on number of marks available)</td></tr><tr><td></td><td></td></tr></table>	Descriptor	Award mark	Consistently meets the criteria for this level	At top of level	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)	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)				
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Mark Scheme

Question			Answer/Indicative content	Marks	Guidance
			On the borderline of this level and the one below At bottom of level		
			Total	25	

Mark Scheme

Question			Answer/Indicative content	Marks	Guidance
32	a		Identify one example of discretionary fiscal policy in the stimulus material and explain how it could affect aggregate demand. Public sector investment in infrastructure (1) would increase AD as G is a component of AD (1).	2 (AO1 x 1) (AO2 x 1)	
	b		Using information from the stimulus material, calculate the UK's budget deficit in pounds in 2015. £75.85bn (2) Correct working (1).	2 (AO2 x 2)	Correct working: $GDP = £96.2bn \times 100/5.2 = £1,850bn$. Deficit = 4.1% of £1,850.
	c		Evaluate whether the introduction of a flat rate tax system would benefit an economy. Level 3 (9–12 marks) Good knowledge and understanding of a flat tax. Good – strong analysis of how a flat tax may affect an economy. Good analysis will be in the form of developed links. These links are developed through a chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct and linked to the analysis. Strong analysis will have consistently well-developed links through a coherent chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct with no significant errors that affect the validity of the analysis. Any diagrams must be integral to the analysis. Good – strong evaluation of whether a flat tax would benefit an economy, weighing both why it might and why it might not. Strong evaluation should include a supported judgment. <i>There is a well-developed line of reasoning which is clear and logically structured. The information presented is relevant and substantiated.</i> Level 2 (5–8 marks)	12 (AO1 x 1) (AO2 x 1) (AO3 x 5) (AO4 x 5)	A flat tax is a tax with just one tax rate. A pure flat tax system would have the same rate for all taxes, including income tax, corporation tax and sales tax. As Fig.2 shows the introduction of a flat rate tax may reduce tax rates. This was the case in most of the countries shown although Latvia's and Lithuania's tax rates were initially set at the highest former rate. It may also mean that the tax system is no longer progressive. This was the case with all the countries shown except Latvia where the tax system was initially regressive. Flat taxes can create more certainty but countries may change the rate over time. Three of the countries shown did not change the tax rate, three lowered it and one, Georgia, increased it. A flat income tax, especially one set at a low rate, might encourage workers to work more hours and might encourage some of those who are economically inactive to enter the labour force. This could increase the country's productive potential. Flat taxes can reduce costs for workers, firms and the government. Firms will be more straightforward to complete and to interpret. Fewer individuals will have to employ accountants to help them with their tax returns. The time and effort spent by firms to make their returns will decline and so will their costs. Lower costs may increase their international

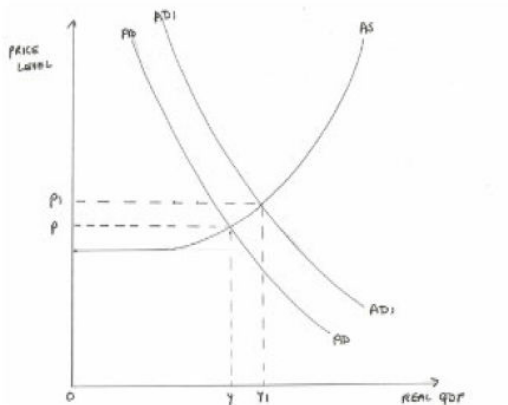
Mark Scheme

Question			Answer/Indicative content	Marks	Guidance				
			Good knowledge and understanding of a flat tax. Reasonable analysis of how a flat tax may affect an economy. There is correct analysis largely in the form of single links. These address the question but are not developed into a clear chain of reasoning. Any relevant diagram(s) may be imperfectly labelled or not linked to the analysis Reasonable evaluation of whether a flat tax would benefit an economy, considering both why it might and why it might not. <i>There is a line of reasoning presented with some structure. The information presented is in the most-part relevant and supported by some evidence.</i> Level 1 (1–4 marks) Limited – reasonable knowledge and understanding of a flat tax. Limited analysis of how a flat tax may affect an economy. Little evidence of reasoning that addresses the question asked. There is a lack of a clear structure. Limited evaluation of whether a flat tax would benefit an economy, in the form of an unsupported statement or no evaluation. <i>The information is basic and communicated in an unstructured way. The information is supported by limited evidence and the relationship to the evidence may not be clear.</i> 0 marks no response or no response worthy of credit. Note: although a diagram is not required, it may enhance the quality of the answer and should be rewarded at the appropriate level. <table><tr><th>Descriptor</th><th>Award mark</th></tr><tr><td></td><td></td></tr></table>	Descriptor	Award mark				competitiveness. A simpler tax system, with lower costs of compliance, may also attract foreign direct investment. Multinational companies can contribute to employment, economic growth and exports. A flat tax may also reduce tax evasion, as long as it is not set too high. It will reduce tax loopholes and make it less likely that mistakes will be made in completing and assessing tax forms. If more revenue is raised, the government could spend more on, for instance, education and health care. Such spending can increase labour productivity, international competitiveness and economic growth. A flat tax, however, does not redistribute income and wealth. In the absence of allowances and exceptions, it may also be inequitable. For instance, a single sales tax of 15% would fall more heavily on the poor as it would take a larger proportion of their income. A flat tax has the potential to increase efficiency and increase tax revenue and economic growth but there are equity issues.
Descriptor	Award mark								

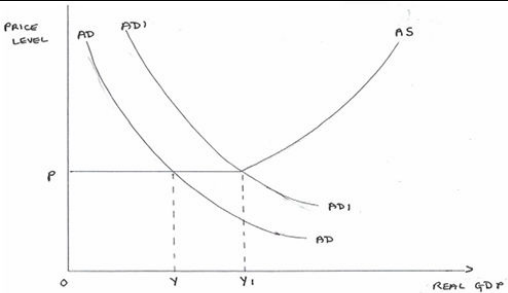
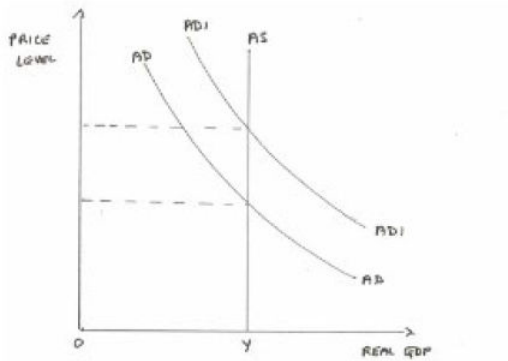
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			Consistently meets the criteria for this level		
			Meets the criteria but with some slight inconsistency		
			Just enough achievement on balance for this level		
			On the borderline of this level and the one below		
			Total	16	

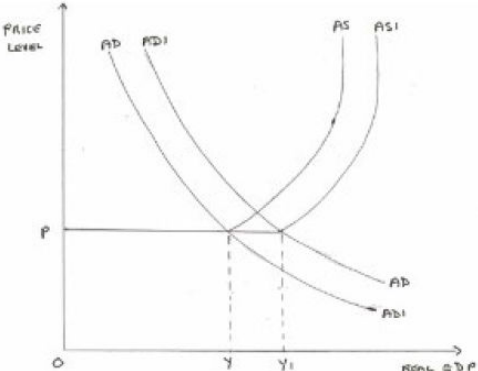
Mark Scheme

Question	Answer/Indicative content	Marks	Guidance
33	Evaluate with the use of an appropriate diagram(s), whether macroeconomic policy measures can only promote economic growth at the cost of higher inflation. Level 5 (21–25 marks) Good-Strong knowledge and understanding of macroeconomic policy measures designed to promote economic growth. Strong analysis of how macroeconomic policy measures designed to promote economic growth may affect inflation. Strong analysis will have consistently well-developed links through a coherent chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct with no significant errors that affect the validity of the analysis. Any diagrams must be integral to the analysis. Strong evaluation of whether macroeconomic policy measures designed to promote economic growth will always increase inflation, weighing up both why it might and why it might not and reaching a supported judgment. <i>There is a well-developed and sustained line of reasoning which is coherent and logically structured. The information presented is entirely relevant and substantiated.</i> Level 4 (16–20 marks) Good knowledge and understanding of government policy measures designed to promote economic growth. Strong analysis of how macroeconomic policy measures designed to promote economic growth may affect inflation Strong analysis will have consistently well-developed links through a coherent chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct with no significant	25 (AO1 x 6) (AO2 x 6) (AO3 x 6) (AO4 x 7)	Whether macroeconomic policy measures designed to promote economic growth will increase the inflation rate will depend on the level of economic activity, the type of economic growth being targeted and the type of measures adopted. A government may be seeking to increase short run (actual) economic growth to reduce a negative output gap. It may try to do this by using expansionary fiscal and/or monetary policy measures. Such measures may increase aggregate demand as shown in the diagram below. In this case the rise in AD, increases both output and the price level.  A higher inflation rate may be a price the government is prepared to pay if the inflation rate is still within the government's target range and is lower than rival countries. If the economy is operating at a low level of economic activity, output may increase without putting upward pressure on the price level. The diagram below shows AD increasing without having any effect on the price level.

Mark Scheme

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	errors that affect the validity of the analysis. Any diagrams must be integral to the analysis. Good evaluation of whether macroeconomic policy measures designed to promote economic growth will always increase inflation, weighing up both why it might and why it might not and will weigh up both sides but without reaching a supported judgment. <i>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.</i> Level 3 (11–15 marks) Good knowledge and understanding of government policy measures designed to promote economic growth. Good analysis of how macroeconomic policy measures designed to promote economic growth may affect inflation. There is correct analysis in the form of developed links. These links are developed through a chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct and linked to the analysis. Reasonable evaluation of whether macroeconomic policy measures designed to promote economic growth will always increase inflation, considering both why it might and why it might not. <i>There is a line of reasoning presented with some structure. The information presented is in the most-part relevant and supported by some evidence.</i> Level 2 (6–10 marks) Good knowledge and understanding of the consequences of macroeconomic policy measures designed to promote economic growth.		 If there are a high number of workers unemployed, it may be possible for firms to employ more workers without having to raise the wage rate. Neoclassical economists, however, argue that the economy moves towards the full employment rate and so any increases in AD will be purely inflationary as shown below.  Some measures designed to increase short run economic growth, for example, rises in state pensions, may only shift the AD curve. A number of measures, however, designed to increase AD may also shift the aggregate supply curve. For example, the prime aim of an interest rate cut may be to encourage consumers to spend more but it may also increase investment. In such a case, the effect on inflation will depend on the relationship between the increase in AD and AS. If AD increases more than AS, the price level will rise but if the increase in AD is matched by an increase in AS, this has no effect on the inflation rate.

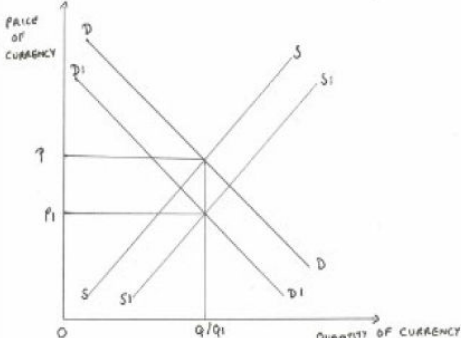
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	Reasonable analysis of how macroeconomic policy measures designed to promote economic growth may affect inflation. There is correct analysis largely in the form of single links. These address the question but are not developed into a clear chain of reasoning. Any relevant diagram(s) may be imperfectly labelled or not linked to the analysis. Reasonable evaluation of whether macroeconomic policy measures designed to promote economic growth will always increase inflation, considering both why it might and why it might not. <i>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.</i> Level 1 (1–5 marks) Reasonable knowledge and understanding of the consequences of macroeconomic policy measures designed to promote economic growth. Limited or no analysis of how macroeconomic policy measures designed to promote economic growth may affect inflation. There is little evidence of reasoning that addresses the question asked. There is a lack of a clear structure. The relevant diagram(s) may not be present or are incorrectly labelled. Limited evaluation of whether macroeconomic policy measures designed to promote economic growth will always increase inflation in the form of an unsupported statement or no evaluation. <i>Information presented is basic and may be ambiguous or unstructured. The information is supported by limited evidence.</i> 0 marks no response or no response worthy of credit.		Government policy measures designed to increase long run economic growth are likely to reduce the inflation rate. To raise long run economic growth, a government is likely to employ supply-side policy measures such as a cut in corporation tax or a rise in government spending on training. If successful these measures will increase aggregate supply and will, over time, permit AS to increase in line with AD.  Policy measures designed are likely to enable an economic growth to be achieved without raising the price level. Whether policy measures designed to increase AD will raise the inflation rate will be influenced by the level of economic activity and whether they also increase AS.

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Mark Scheme

Question	Answer/Indicative content	Marks	Guidance
34	Evaluate with the use of an appropriate diagram(s), whether a reduction in a country's rate of interest would reduce its exchange rate. Level 5 (21–25 marks) Good-Strong knowledge and understanding of how an exchange rate is determined. Strong analysis of how a reduction in the rate of interest may affect the exchange rate. It will have consistently well-developed links through a coherent chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct with no significant errors that affect the validity of the analysis. Any diagrams must be integral to the analysis. Strong evaluation of whether a reduction in a country's rate of interest will always reduce its exchange rate weighing up both why it might and why it might not and reaching a supported judgment. <i>There is a well-developed and sustained line of reasoning which is coherent and logically structured. The information presented is entirely relevant and substantiated.</i> Level 4 (16–20 marks) Good knowledge and understanding of how an exchange rate is determined. Strong analysis of how a reduction in the rate of interest may affect the exchange rate. It will have consistently well-developed links through a coherent chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct with no significant errors that affect the validity of the analysis. Any diagrams must be integral to the analysis.	25 (AO1 x 6) (AO2 x 6) (AO3 x 6) (AO4 x 7)	A fall in the rate of interest may reduce the inflow of hot money and encourage an outflow of hot money. Households and firms may move money from the country's banks to banks in other countries offering a higher rate of interest. If the country's households and firms are putting more money in foreign banks, the supply of the domestic currency used to purchase foreign currency will increase. If foreigners are buying less of the currency, demand for the currency will decrease. The diagram below shows how these changes in the foreign exchange market would cause a fall in the value of a floating exchange rate.  A central bank may lower its interest rate with the specific intention of lowering the exchange rate possibly with the intention of reducing a current account deficit. A reduction in the rate of interest may, however, not result in a fall in the value of a fixed exchange rate. It would be likely to put downward pressure on the value but a government may seek to maintain the value by instructing its central bank to purchase its currency, using reserves of foreign currency. There is the possibility that, whatever the type of exchange rate system being operated, the demand for the currency may not decrease and the supply of the currency may not increase.

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Question	Answer/Indicative content	Marks	Guidance
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Mark Scheme

Question			Answer/Indicative content	Marks	Guidance								
			always reduce its exchange rate, considering both sides. <i>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.</i> Level 1 (1–5 marks) Reasonable knowledge and understanding of how an exchange rate is determined. Limited or no analysis of how a reduction in the rate of interest may affect the exchange rate. There is little evidence of reasoning that addresses the question asked. There is a lack of a clear structure. The relevant diagram(s) may not be present or are incorrectly labelled. Limited evaluation of whether a reduction in a country’s rate of interest will always reduce its exchange rate in the form of an unsupported statement or no evaluation. <i>Information presented is basic and may be ambiguous or unstructured. The information is supported by limited evidence.</i> 0 marks no response or no response worthy of credit. <table><tr><th>Descriptor</th><th>Award mark</th></tr><tr><td>Consistently meets the criteria for this level</td><td>At top of level</td></tr><tr><td>Meets the criteria but with some slight inconsistency</td><td>Above middle and either below top of level or at middle of level (depending on number of marks available)</td></tr><tr><td>Just enough achievement on balance for this level</td><td>Above bottom and either below middle or at middle of level (depending on number of marks available)</td></tr></table>	Descriptor	Award mark	Consistently meets the criteria for this level	At top of level	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)	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)		
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Mark Scheme

Question			Answer/Indicative content	Marks	Guidance
			On the borderline of this level and the one below	At bottom of level	
			Total	25	
35			C	1 (AO1)	Rationale A This is a protectionist policy. B This is monetary policy. C Correct: This will create a profit incentive, which is likely to improve productivity and increase the productive capacity of the economy. D This is monetary policy.
			Total	1	
36			A	1 (AO1)	Rationale A Correct: Foreign investors will get a relatively greater return from investing in the economy because the interest rate has fallen by less than in other economies, which will cause hot money to flow into the economy. This increases the demand for the currency, causing the value of it to appreciate. B The exchange rate will appreciate as a result of hot money flowing in. C Although the interest rate has fallen, it has fallen by less than in other countries, meaning hot money will flow in. D Although the interest rate has fallen, it has fallen by less than in other countries, meaning hot money will flow in.
			Total	1	

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Question			Answer/Indicative content	Marks	Guidance
37			C	1 (AO1)	Rationale A This will reduce the effectiveness of expansionary fiscal policy. B This will reduce the effectiveness of expansionary monetary policy. C Correct: In this circumstance there is significant spare capacity, rendering supply side policy ineffective as it would simply create more spare capacity. Demand side policy would be more effective. D This suggests supply side policy would be very effective because the economy is likely to be operating close to full capacity.
			Total	1	
38			B	1 (AO2)	Rationale A Calculates the inflation rate as $101.9 - 103.4 = -1.50\%$ B Correct: Inflation rate = $(101.9 - 103.4) / 103.4 \times 100 = -1.45\%$ C Calculates the inflation rate as $(103.4 - 101.9) / 101.9 \times 100 = 1.47\%$ D Calculates the inflation rate as $101.9 - 100 = 1.90\%$
			Total	1	

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Question			Answer/Indicative content	Marks	Guidance
39			Using Fig 1.1, explain the relationship between the budget deficit and national debt between 2010 and 2019. - The budget deficit was falling whilst national debt was rising (1) - Budget deficit has decreased by £115bn and national debt has increased by £600bn. (1) - This is because government debt is an accumulation of previous deficits, each year there is a budget deficit national debt increases / A budget deficit increases national debt because the government has to borrow to finance a deficit, which increases debt (1) - As the budget deficit decreased the national debt increased at a slower rate (1)	2 (AO2 x 2)	A simple statement that there is an inverse relationship should not be credited. Use of the data requires calculations – simply stating the size of the budget deficit and national debt at the start and end of the period is not enough. For the mark to be awarded the change in the budget deficit and national debt must both be calculated. Accept budget deficit decreases in the range of £110bn – £120bn and national debt increases in the range of £550bn - £725bn. <u>Examiner's Comments</u> Most candidates were able to identify the relationship between national debt and the budget deficit but few were able to explain it. Centres are advised to remind candidates that they need to 'use' the data given in the figures rather than just quoting it.
			Total	2	

Mark Scheme

Question			Answer/Indicative content	Marks	Guidance
40			Explain, using an example from Extract 1, what is meant by capital expenditure. <i>Award 1 mark for an explanation of capital expenditure:</i> • Investment • Spending that has a long-term benefit • Spending that increases productive capacity <i>Award 1 mark for an example of capital expenditure from Extract 1:</i> • Green transformation fund • Insulating 27 million homes • Building of social housing • Building new hospitals/schools/police stations	2 (AO1 x 1) (AO2 x 1)	Spending on NHS/schools/police must be explicitly linked to capital rather than current expenditure to be credited. <u>Examiner's Comments</u> Candidates who did not secure any marks on this question demonstrated a lack of understanding of the concept of capital expenditure in a macroeconomic context and instead described what capital as a factor of production represents. Candidates are reminded that in this paper it is crucial they use the stimulus material to support their responses – a number lost the second mark because they gave an example of capital expenditure that was not provided in the extract.  Misconception Not all expenditure on schools/NHS/police is capital expenditure. For example, increasing doctors' wages represents expenditure on schools but is current expenditure.
			Total	2	

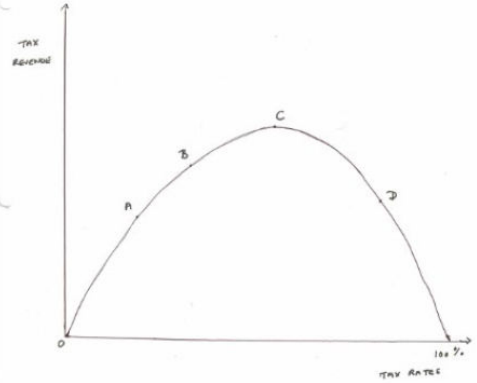
Mark Scheme

Question			Answer/Indicative content	Marks	Guidance
41	a		Using information from Fig.3, explain whether Bangladesh had a budget deficit or a budget surplus in 2017. Budget surplus (1) tax revenue £25 m exceeded government spending £13 m (1).	2 (AO2 x 2)	Annotate with  Examiner's Comments Weaker responses confused budget deficit with a current account deficit.
	b		Using information from the stimulus material, evaluate whether a cut in corporate tax rates in Bangladesh would benefit the UK economy. Level 2 (5–8 marks) Good knowledge and understanding of corporate tax. Good – strong analysis of the ways in which a cut in corporate tax rates in Bangladesh may affect the UK economy. Good analysis will be in the form of developed links. These links are developed through a chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct and linked to the analysis. Strong analysis will have consistently well-developed links through a coherent chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct with no significant errors that affect the validity of the analysis. Any diagrams must be integral to the analysis. Reasonable – strong evaluation of whether a cut in corporate tax rates in Bangladesh will benefit the UK economy, considering the impact on the UK's trade position, underpinned by appropriate theoretical analysis. Good evaluation will weigh up the reasons why it might and the reasons why it might not but without reaching a supported judgement. Strong evaluation should include a supported judgement. Level 1 (1–4 marks) Limited – reasonable knowledge and understanding of corporate tax. Limited – reasonable analysis of the ways in which a cut in corporate tax rates in	8 (AO1 x 1 AO2 x 1 AO3 x 3 AO4 x 3)	For a mark at the top of each level evidence must be provided from the stimulus material and / or the candidate's own knowledge. <i>Indicative content</i> A cut in corporate tax rates may stimulate investment and economic growth. UK multinationals with branches in Bangladesh may gain higher profits to send back to the UK. This will increase primary income coming into the current account. There is also the possibility that the UK may benefit from any growth of the Bangladeshi economy as it may be able to export more goods and services. Indeed, Bangladesh's economic growth. The growth of the Bangladeshi economy may reduce the need for the UK government to provide it with overseas aid. This, however, is more likely to change the destination of where aid goes rather than reduce the aid budget. This is because the UK government is committed to giving 0.7% of its GDP in aid. Some UK firms may be encouraged to relocate to Bangladesh to take advantage of the lower corporate tax rates. The rates, however, may still be higher than those in the UK and may not offset other causes of higher production costs such as poor infrastructure. It may be the case that a cut in corporate tax rates may not stimulate growth. Lower tax revenue may mean that the government will spend less on education which could reduce the country's productivity. The UK economy may not gain much from the growth of the Bangladeshi economy. Bangladesh is not currently a significant trading partner of the UK. Other countries, such as China, may

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Question			Answer/Indicative content	Marks	Guidance										
			Bangladesh may affect the UK economy. Limited analysis will have little evidence of reasoning that addresses the question asked. There is a lack of a clear structure. Reasonable analysis will largely be in the form of single links. There address the question but are not developed into a clear chain of reasoning. Any relevant diagram(s) may be imperfectly labelled or not linked to the analysis. Limited evaluation of whether a cut in corporate tax rates in Bangladesh will benefit the UK economy in the form of an unsupported statement or no evaluation. 0 marks No response worthy of credit. Note: although a diagram is not required, it may enhance the quality of the answer and should be rewarded at the appropriate level. <table><tr><th>Descriptor</th><th>Award mark</th></tr><tr><td>Consistently meets the criteria for this level</td><td>At top of level</td></tr><tr><td>Meets the criteria but with some slight inconsistency</td><td>Above middle and either below top of level or at middle of level (depending on number of marks available)</td></tr><tr><td>Just enough achievement on balance for this level</td><td>Above bottom and either below middle or at middle of level (depending on number of marks available)</td></tr><tr><td>On the borderline of this level and the one below</td><td>At bottom of level</td></tr></table>	Descriptor	Award mark	Consistently meets the criteria for this level	At top of level	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)	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)	On the borderline of this level and the one below	At bottom of level		benefit more. The UK has a trade deficit with Bangladesh. With higher investment, Bangladesh's products may become more competitive. Bangladesh may not only sell more to the UK but it may out-compete the UK in some of the UK's export markets. There is also the possibility that the UK may benefit from any growth of the Bangladeshi economy as it may be able to export more goods and services. Indeed, Bangladesh's economic growth may lead to higher consumer spending. Some of this may go on imports from other countries. For instance, UK based car firms may sell more to Bangladesh if they are price and quality competitive. As GDP per head rises, spending on services increases. The UK has a comparative advantage in a range of financial services including financial services and education. Whether the UK will benefit from a cut in Bangladeshi corporate tax rates will depend on whether such a cut will stimulate economic growth in Bangladesh and how a more prosperous Bangladesh would affect the UK's current account. At present the effect may not be very great as Bangladesh is not a major trading partner of the UK. Examiner's Comments Generally answered well, although confusion of 'costs of production' see below and the benefit to the UK economy was not always made clear.
Descriptor	Award mark														
Consistently meets the criteria for this level	At top of level														
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)														
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)														
On the borderline of this level and the one below	At bottom of level														
			Total	10											

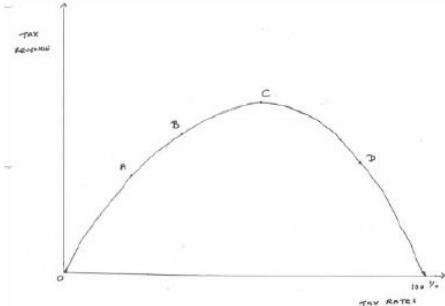
Mark Scheme

Question	Answer/Indicative content	Marks	Guidance
42	In recent years, the UK government has cut both corporation and income tax rates. The 2013 cut in the top rate of income tax from 50% to 45% has been estimated to have reduced government tax revenue by £8.6bn between 2013/14 and 2017/18. Evaluate whether a cut in direct tax rates will always reduce tax revenue. Level 5 (21–25 marks) Good -Strong knowledge and understanding of direct tax rates. Strong analysis of the relationship between tax rates and tax revenue. It will consistently well-developed links through a coherent chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct with no significant errors that affect the validity of the analysis. Any diagrams must be integral to the analysis. Strong evaluation of whether a cut in direct tax rates will always reduce tax revenue, weighing up both why it might and why it might not and reaching a supported judgement. <i>There is a well-developed and sustained line of reasoning which is coherent and logically structured. The information presented is entirely relevant and substantiated.</i> Level 4 (16–20 marks) Good knowledge and understanding of direct tax rates. Strong analysis of the relationship between tax rates and tax revenue. It will have consistently well-developed links through a coherent chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct with no significant errors that affect the validity of the analysis. Any diagrams must be integral to the analysis.	25 (AO1 x 6 AO2 x 6 AO3 x 6 AO4 x 7)	<i>Indicative content</i> The Laffer curve suggests there is an optimum tax rate. The diagram shows that zero tax revenue is earned if tax rates are 0% or 100%. The tax revenue varies between these two rates, peaking at a rate of C.  The Laffer curve suggests to policy makers that raising the tax rate from a low rate of A to a rate of B would raise tax revenue. The curve is probably even better known for the suggestion that a cut from a high tax rate such as D towards the optimum tax rate would raise tax revenue. It might at first seem strange that charging a lower tax rate may increase tax revenue. There are, however, a number of reasons why this may occur. One is that it will increase the incentive to work, invest and save. For instance, some of the unemployed may be more willing to accept a low-paid job as net income will rise. Those already employed may be encouraged to work longer hours. A lower tax rate may also reduce tax evasion and may encourage workers and firms from other countries to move to the country. The Laffer curve was first drawn by a US economics professor, Arthur Laffer, on a napkin in a Washington hotel, trying to convince two presidential aides of the benefits of cutting tax rates. Significant cuts in income tax and corporate tax rates were made in the UK and USA in the 1980s and 1990s and

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Question	Answer/Indicative content	Marks	Guidance
	Good evaluation of whether a cut in direct tax rates will always reduce tax revenue, weighing up both why it might and why it might not, weighing up both sides but without reaching a supported judgement. <i>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.</i> Level 3 (11–15 marks) Good knowledge and understanding of direct tax rates. Good analysis of the relationship between tax rates and tax revenue. There is correct analysis in the form of developed links. These links are developed through a chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct and linked to the analysis. Reasonable evaluation of whether a cut in direct tax rates will always reduce tax revenue, considering both why it might and why it might not. <i>There is a line of reasoning presented with some structure. The information presented is in the most-part relevant and supported by some evidence.</i> Level 2 (6–10 marks) Good knowledge and understanding of direct tax rates. Reasonable analysis of the relationship between tax rates and tax revenue. There is correct analysis largely in the form of single links. These address the question but are not developed into a clear chain of reasoning. Any relevant diagram(s) may be imperfectly labelled or not linked to the analysis. Reasonable evaluation of whether a cut in direct tax rates will always reduce tax revenue, considering both why it might and		some further cuts have been made since. The first decade of the twenty first century also saw the introduction of flat rate tax systems in a number of east European countries. Policy makers, however, have to be cautious about basing their actions on the Laffer curve. This is for a number of reasons. One is that it is a simplification. It assumes a single tax rate at any one time whereas, apart from a flat rate tax system, there are a number of different rates. There are also debates about the shape of the Laffer curve and whether it is possible to determine where the optimum tax rate is. Some studies have indicated that cuts in income tax rates may encourage some workers to work fewer hours. This is because, satisfied with their previous disposable income, they respond to a lower tax rate by taking more leisure. Tax rates are also one of only a number of influences on where workers and firms locate. For instance, a multinational company may be more attracted by a skilled labour force. The Laffer curve supports the view that cutting a high tax rate may increase tax revenue. However, while the Laffer curve may suggest there is an optimum tax rate, it is both difficult to determine where this might be and over what range a cut in a tax rate might increase tax revenue. A cut in direct tax rates to zero will obviously reduce tax revenue to zero. A cut in income tax will not be likely to raise tax revenue if workers cannot change the hours they work. It may reduce tax revenue if the increase in net pay results in workers working fewer hours. The income effect may exceed the substitution effect with workers 'buying' more leisure time. A lower corporation tax may reduce tax revenue if other countries' governments cut their tax rates more. A cut in direct tax rates may also reduce tax revenue if it leads to MNCs to set up in other countries. They may think that government spending on, for instance,

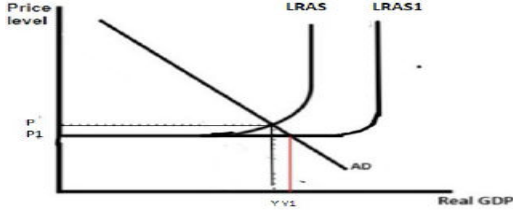
Mark Scheme

Question		Answer/Indicative content	Marks	Guidance								
		why it might not. <i>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.</i> Level 1 (1–5 marks) Reasonable knowledge and understanding of direct tax rates. Limited or no analysis of the relationship between tax rates and tax revenue. There is little evidence of reasoning that addresses the question asked. There is a lack of a clear structure. The relevant diagram(s) may not be present or are incorrectly labelled. Limited evaluation of whether a cut in direct tax rates will always reduce tax revenue in the form of an unsupported statement or no evaluation. <i>Information presented is basic and may be ambiguous or unstructured. The information is supported by limited evidence.</i> 0 marks No response worthy of credit. Note: although a diagram is not required, it may enhance the quality of the answer and should be rewarded at the appropriate level. <table><tr><th>Descriptor</th><th>Award mark</th></tr><tr><td>Consistently meets the criteria for this level</td><td>At top of level</td></tr><tr><td>Meets the criteria but with some slight inconsistency</td><td>Above middle and either below top of level or at middle of level (depending on number of marks available)</td></tr><tr><td>Just enough</td><td>Above bottom and</td></tr></table>	Descriptor	Award mark	Consistently meets the criteria for this level	At top of level	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)	Just enough	Above bottom and		infrastructure and education. May decrease. Firms may expect profits to be higher in countries where costs are low because of high productivity resulting from a good supply of educated workers. The Laffer curve, however, suggests that a cut in direct tax rates may raise tax revenue. If the rate is currently below the optimum rate, a cut from e.g. B to A will lower tax revenue. If, however, the tax rate is above the optimum rate, however, a cut from e.g. D to C will raise tax revenue.  There are a number of reasons why a cut in direct tax rates may raise tax revenue. One is that it can create an incentive effect. Workers may work longer hours and firms may expand due to a higher financial reward. Lower direct tax rates may reduce tax avoidance and tax evasion. This is because firms will lose less income by not paying tax advisors and by not declaring their earnings. Lower direct rates may also have a 'trickle down effect'. Lower corporation tax may encourage firms to hire more workers and pay higher wages. Such an effect will increase both income and consumer expenditure and so direct and indirect tax revenue may increase. Whether a cut in direct tax rates will reduce tax revenue will depend on how high the rates were originally, the extent of the cut and on how firms and households respond. Examiner's Comments Question 4 was chosen by most candidates and was generally answered
Descriptor	Award mark											
Consistently meets the criteria for this level	At top of level											
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)											
Just enough	Above bottom and											

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Question			Answer/Indicative content		Marks	Guidance
			achievement on balance for this level	either below middle or at middle of level (depending on number of marks available)		well. The stronger candidates made good use of the laffer curve and how the optimum tax rate could be analysed from a reduction in tax revenue and an increase in tax revenue depending on the starting point. Evaluation could also be shown through the limitations of the laffer curve and if more consumer spending occurred tax revenue would increase through indirect taxation, which was valid. Weaker responses tried to adapt the question to say if the government increased indirect taxes or imposed more tariffs the revenue would not go down, which did not directly address the question. The laffer curve was used, but often not understood. There was also some confusion with direct and indirect taxes.
			On the borderline of this level and the one below	At bottom of level		
			Total		25	

Mark Scheme

Question	Answer/Indicative content	Marks	Guidance
43	In March 2018 the French government announced that children would have to start school at age 3 rather than age 6 from September 2019. Evaluate, with the use of an appropriate diagram(s), whether a fall in the compulsory school starting age will benefit an economy. Level 5 (21–25 marks) Good -Strong knowledge and understanding of aggregate demand and aggregate supply. Strong analysis of how a fall in the school starting age will affect an economy. It will have consistently well-developed links through a coherent chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct with no significant errors that affect the validity of the analysis. Any diagrams must be integral to the analysis. Strong evaluation of whether a fall in the school starting age will benefit an economy, weighing up both why it might and why it might not and reaching a supported judgement. <i>There is a well-developed and sustained line of reasoning which is coherent and logically structured. The information presented is entirely relevant and substantiated.</i> Level 4 (16–20 marks) Good knowledge and understanding of aggregate demand and aggregate supply. Strong analysis of how a fall in the school starting age will affect an economy. It will have consistently well-developed links through a coherent chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct with no significant errors that affect the validity of the analysis. Any diagrams must be integral to the analysis.	25 (AO1 × 6 AO2 × 6 AO3 × 6 AO4 × 7)	For a mark at the top of each level the response should be in context. A fall in the compulsory school starting age will mean that children will start school at a younger age and therefore will have more years of schooling, should the leaving age remain the same. Analysis of how a fall in the school starting age will affect an economy might include: • A lowering of the age at which children have to start school may raise the size of the labour force due to parents being able to seek work when their children are younger, at least in the short run. • If children's skills and qualifications increase as a result of them starting their education earlier, they may go on to further education and improve the quality/skills of the labour force which could lead to a rise in the productivity of labour. If workers are more productive, the long run aggregate supply curve will shift to the right as shown in the diagram.  • The country's output would rise. A more skilled and qualified labour force is likely to experience lower structural unemployment and higher incomes. A better-quality labour force may increase net exports as a result of greater price and quality competitiveness. It may also attract multinational companies to set up in the country. As well as providing employment, MNCs may bring in new production methods and management techniques. Evaluation of whether a fall in the school starting age will benefit an economy might

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Question	Answer/Indicative content	Marks	Guidance
	Good evaluation of whether a fall in the school starting age will benefit an economy, weighing up both why it might and why it might not without reaching a supported judgement. <i>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.</i> Level 3 (11–15 marks) Good knowledge and understanding of aggregate demand and aggregate supply. Good analysis of how a fall in the school starting age will affect an economy. There is correct analysis in the form of developed links. These links are developed through a chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct and linked to the analysis. Reasonable evaluation of whether a fall in the school starting age will benefit an economy, considering both sides. <i>There is a line of reasoning presented with some structure. The information presented is in the most-part relevant and supported by some evidence.</i> Level 2 (6–10 marks) Good knowledge and understanding of aggregate demand and aggregate supply. Reasonable analysis of how a fall in the school starting age will affect an economy. There is correct analysis largely in the form of single links. These address the question but are not developed into a clear chain of reasoning. Any relevant diagram(s) may be imperfectly labelled or not linked to the analysis. Reasonable evaluation of whether a fall in the school starting age will benefit an economy, considering both sides.		include: • If the government provides state education, a lowering of the school leaving age will increase government spending. This will involve an opportunity cost. This may take three main forms. The government may have to sacrifice spending on, for instance healthcare. There is the possibility that tax payers may have to bear the opportunity cost. This is because the government may raise tax rates or widen the tax base to finance the extra spending. Higher tax rates may have a disincentive effect. • It is also possible that the government may borrow to raise the finance. In this case, funds used by the government will not be available to other borrowers. Higher government borrowing could also raise the rate of interest. • Higher government spending may increase aggregate demand which may create inflationary pressure, at least in the short run. • There is no guarantee that requiring all children to start school earlier will increase their skills and qualifications. A supported judgement might include: • Until recently, the trend has been to increase the school leaving age. More countries may now consider lowering the starting age as they may consider that the benefits will exceed the costs. A lower compulsory age may improve macroeconomic performance and the quality of people's lives. • It will depend on the quality of education provided. In turn, this will be influenced by the quality of the extra resources used. • It will depend on how productive parents joining the workforce are, when their children start school early/if they join the workforce.

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			<i>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.</i> Level 1 (1–5 marks) Reasonable knowledge and understanding of aggregate demand and aggregate supply. Limited or no analysis of how a fall in the school starting age will affect an economy. There is little evidence of reasoning that addresses the question asked. There is a lack of a clear structure. The relevant diagram(s) may not be present or are incorrectly labelled. Limited evaluation of whether a fall in the school staring age will benefit an economy, in the form of an unsupported statement or no evaluation. <i>Information presented is basic and may be ambiguous or unstructured. The information is supported by limited evidence.</i> 0 marks no response or no response worthy of credit. <table><tr><th>Descriptor</th><th>Award mark</th></tr><tr><td>Consistently meets the criteria for this level</td><td>At top of level</td></tr><tr><td>Meets the criteria but with some slight inconsistency</td><td>Above middle and either below top of level or at middle of level (depending on number of marks available)</td></tr><tr><td>Just enough achievement on balance for this level</td><td>Above bottom and either below middle or at middle of level (depending on number of marks</td></tr></table>	Descriptor	Award mark	Consistently meets the criteria for this level	At top of level	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)	Just enough achievement on balance for this level	Above bottom and either below middle or at middle of level (depending on number of marks		
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Question			Answer/Indicative content		Marks	Guidance
				available)		
			On the borderline of this level and the one below	At bottom of level		
			Total			

Mark Scheme

Question			Answer/Indicative content	Marks	Guidance
44	a		Using Fig. 3, explain what is likely to have happened to UK share prices at the start and the end of the period shown. Share prices are likely to have been low initially/and then increased at the start (1) and fallen at the end (1) The interest rate is high at 5% at the beginning so the return for savings is higher (1) When the rate of interest falls, there may be a higher return from buying shares than holding money in a bank (1) a lower rate of interest is likely to raise AD and increase profits (1) when the rate of interest rises, dividend payments may be lower (1).	4 (AO1 × 2 AO2 × 2)	Annotate with 
	b		Using information from the stimulus material, evaluate whether a negative interest rate would help the government to achieve its macroeconomic objectives. Level 3 (9–12 marks) Good knowledge and understanding of a negative interest rate and macroeconomic objectives. Good – strong analysis of how a negative interest rate may help the government achieve its macroeconomic objectives. Good analysis will be in the form of developed through a chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct and linked to the analysis. Strong analysis will have consistently well-developed links through a coherent chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct with no significant errors that affect the validity of the analysis. Any diagrams must be integral to the analysis. Good – strong evaluation of whether a negative interest rate will help the government achieve its macroeconomic objectives, weighing both why it might and why it might not. Strong evaluation should include a supported judgement.	12 (AO1 × 1 AO2 × 1 AO3 × 5 AO4 × 5)	For a mark at the top of each level evidence must be provided from the stimulus material and / or the candidate's own knowledge. A negative interest rate is one that is set below zero Analysis of how a negative interest rate can help a government achieve its macroeconomic objectives might include: • A negative interest rate may encourage commercial banks to lend more. This is because the banks will try to reduce the deposits, they hold at the central bank to the minimum required. If the banks lend more to households and firms, consumer expenditure and investment will increase. • Households and firms may also be more willing to spend because the commercial banks may pass on the negative interest rates to their customers. This will mean that borrowers will gain. In addition, households and firms may spend more because they will lose by saving. • The government may also spend more due to the reduction in the cost of servicing past debt and the reduction in the cost of current borrowing. The government may spend on measures,

Mark Scheme

Question	Answer/Indicative content	Marks	Guidance
	<i>There is a well-developed line of reasoning which is clear and logically structured. The information presented is relevant and substantiated.</i> Level 2 (5–8 marks) Good knowledge and understanding of a negative interest rate and macroeconomic objectives. Reasonable analysis of how a negative interest rate will help the government achieve its macroeconomic objectives. There is correct analysis largely in the form of single links. These address the question but are not developed into a clear chain of reasoning. Any relevant diagram(s) may be imperfectly labelled or not linked to the analysis. Reasonable evaluation of whether a negative interest rate will help the government achieve its macroeconomic objectives, considering both why it might and why it might not. <i>There is a line of reasoning presented with some structure. The information presented is in the most-part relevant and supported by some evidence.</i> Level 1 (1–4 marks) Limited – reasonable knowledge and understanding of a negative interest rate and macroeconomic objectives. Limited analysis of how a negative interest rate may help the government's macroeconomic objectives. Little evidence of reasoning that addresses the question asked. There is a lack of a clear structure. Limited evaluation of whether a negative interest rate will help the government achieve its macroeconomic objectives in the form of an unsupported statement or no evaluation. <i>The information is basic and</i>		such as investment subsidies, to increase economic growth. • If consumer expenditure, investment and government spending do increase, aggregate demand will rise. This will increase output and employment if the economy had some spare capacity. • Another way that a negative interest rate may stimulate economic growth and reduce unemployment is by lowering the exchange rate. This is because it may lead to less financial investment coming into the country and more going out of the country. The return on saving in the country's financial institutions would fall. So foreigners are likely to demand less of the currency and people in the country are likely to sell more of the currency. A lower exchange rate will reduce export prices and raise import prices which may increase net exports and improve the balance of payments. Evaluation of whether negative interest rates will not help a government achieve its macroeconomics objectives might include: • A negative interest rate may not stimulate economic growth and reduce unemployment. The commercial banks may not pass on the cut to their customers. The functions of commercial banks may be adversely affected. While households and firms may want to borrow more, the banks may experience difficulty attracting the funds to lend. • More significantly perhaps, even if households and firms are faced with a negative interest rate, they will not increase their spending and investment if they lack confidence. Indeed, a negative interest rate may suggest to households and firms that the central bank and the government are concerned about the country's economic prospects. Households and

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			<i>communicated in an unstructured way. The information is supported by limited evidence and the relationship to the evidence may not be clear.</i> 0 marks no response or no response worthy of credit. Note: although a diagram is not required, it may enhance the quality of the answer and should be rewarded at the appropriate level. <table><tr><th>Descriptor</th><th>Award mark</th></tr><tr><td>Consistently meets the criteria for this level</td><td>At top of level</td></tr><tr><td>Meets the criteria but with some slight inconsistency</td><td>Above middle and either below top of level or at middle of level (depending on number of marks available)</td></tr><tr><td>Just enough achievement on balance for this level</td><td>Above bottom and either below middle or at middle of level (depending on number of marks available)</td></tr><tr><td>On the borderline of this level and the one below</td><td>At bottom of level</td></tr></table>	Descriptor	Award mark	Consistently meets the criteria for this level	At top of level	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)	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)	On the borderline of this level and the one below	At bottom of level		firms may also not change their saving and spending intentions if they think a negative interest rate will only last for a short time. • A negative interest rate may not lower the exchange rate if other central banks also operate negative interest rates. Even if they do not, a lower exchange rate may not increase net exports. For instance, it may not be possible to sell more exports if incomes are falling in other countries. • A negative interest rate may help the government achieve its macroeconomic objectives as it may encourage spending and discourage saving. As it is likely to be introduced, however, at a time when the country is experiencing low aggregate demand, and possibly deflation, it may be difficult to encourage a rise in consumer expenditure and investment. The existence of cash reduces the prospect of success. This is because households and firms can switch from holding money in bank deposits to holding it as cash. • A negative interest may stimulate C and I leading to an increase in AD causing inflation which conflicts with government macroeconomics objectives. A supported judgement might include: • It depends upon the length of time the interest rates are negative if only temporary there may be little impact and it takes time for people and firms to react to any changes. • The levels of savings initially, if for instance during a recession people have few savings then they will not be encouraged to spend more.
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			Total	14											