OCR A-LEVEL ECONOMICS

ECONOMICS



EXAM QUESTION PACK

UNIT F585 OLD SPECIFICATION PAPERS

STEMUP

These questions belong to AQA, not to us.

The examination questions, mark schemes and examiner reports in this pack were written and published by AQA. They are past assessment materials, reproduced here so that students can revise from them.

What we do not own

STEMUP is not affiliated with AQA and does not own, and makes no claim to own, any of the question, mark scheme or examiner report material in this pack. AQA has not endorsed, approved or been involved in the production of it. AQA and the qualification titles used here belong to their respective owners and appear for identification only.

Where to find the originals

AQA publishes its past papers, mark schemes and examiner reports free of charge. Always check the current specification at aqa.org.uk before you revise, because content and wording can change between series.

If you hold the rights to any material in this pack and would like it amended or removed, contact admin@stemup.co.uk and we will act on it.

OCR
Oxford Cambridge and RSA

To be opened on receipt

A2 GCE ECONOMICS

F585/01/SM The Global Economy

STIMULUS MATERIAL

JUNE 2016

6373300301

INSTRUCTIONS TO CANDIDATES

- This copy must **not** be taken into the examination room.
- You should make yourself familiar with the stimulus material before you take the question paper. A clean copy of the stimulus material will be given to you with the question paper.

INFORMATION FOR CANDIDATES

- The following stimulus material has been adapted from published sources. It was correct at the time of publication and all statistics have been taken directly from the published material.
- This document consists of **16** pages. Any blank pages are indicated.

© OCR 2016 [T/500/7921]
DC (NF/SW) 126443/7 **R**
OCR is an exempt Charity

STEMUP.CO.UK

Introduction

Until 2008, globalisation was increasing at a rapid rate, with rises in global trade, Foreign Direct Investment (FDI) and migration of workers being some of the most obvious indicators. The increasing volume of world trade owed much to reductions in trade barriers. The process of globalisation as a whole, however, has been driven by a range of factors. Globalisation has attracted much controversy, but economists are generally agreed that specialisation and trade can bring benefits to all of the world's economies. The global financial and economic crises of 2007–08 appeared to threaten the march of globalisation, but such fears were short-lived.

While the volume of world trade has increased, balance of payments imbalances have emerged. These imbalances can be seen not only in the current account positions of economies such as the USA and China, but also in the current account performance of other developed and developing economies. These current account imbalances have not always responded to changes in exchange rates, leading some economists to seek explanations for the imbalances in international financial flows. Such flows have responded to macroeconomic imbalances between economies.

Developing economies dependent on exports of commodities benefitted greatly from the growth of the world economy prior to the global economic and financial crises of 2007–08. As commodity prices increased significantly, economies of countries such as Zambia were able to put measures in place to improve a number of indicators of development. It was feared that the sharp decline in commodity prices in 2008–09, which led to a fall in Zambia's terms of trade, would have a significant impact on its economy. The recovery of world economic growth and trade, however, dispelled such fears.

The greater global mobility of labour has also increased international financial flows in the form of remittances. For many developing economies these are now more significant than flows of Official Development Assistance (ODA) and play an important role in reducing poverty and promoting development. However, their impact on development also brings costs.

Zambia's macroeconomic performance has benefitted not just from the increase in global commodity prices in the first decade of the 21st century. It has also undergone a shift in the composition of its aggregate demand which may enable it to increase long run economic growth. Private sector investment is now much more important and has replaced a dependence on public sector investment and public and private sector consumption. This is likely to have a favourable effect on the supply-side performance of the economy. Nevertheless, the growth of private sector investment has recently slowed down, as fears of 'resource nationalisation' have deterred FDI. Reforms to the supply-side of the economy are seen by some as the key to promoting long run economic growth in Zambia.

© OCR 2016

STEMUP.CO.UK

Pre-release stimulus material

Extract 1: Globalisation and world trade

Extract 2: Globalisation and balance of payments imbalances

Extract 3: Primary commodity dependence and the terms of trade

Extract 4: Migration and remittances

Extract 5: Structural issues in the Zambian economy

© OCR 2016

STEMUP.CO.UK

Extract 1

Globalisation and world trade

Since the start of the 21st century trade in goods and services has become more globalised, as have capital and labour markets. The closer links between the world's economies are seen in a number of indicators. These indicators include:

- the value of trade in goods and services as a percentage of world GDP is increasing
- FDI as a percentage of world GDP has increased six-fold since 1980
- the number of migrant workers has trebled since the 1960s.

It is argued that globalisation brings significant benefits both to individual economies and to the global economy as a whole. It opens up markets throughout the world, promoting specialisation and division of labour as economies focus production according to their comparative advantage. Economies can access larger markets than would be the case without globalisation. They can access more capital goods and more advanced technology, as well as larger markets for their exports. At the same time they can benefit from cheaper imports. Economic theory provides strong support for the process of globalisation in terms of the benefits of increased economic efficiency.

One of the many factors promoting globalisation has been a reduction of trade barriers, including import tariffs. Access to a wider range of goods and services at lower prices not only provides benefits to consumers but also encourages domestic industries to increase their competitiveness. Exports create jobs and, for many developing countries, are a source of economic growth. Fig. 1.1 shows the change in trade in goods and services (exports plus imports) as a percentage of GDP for four different economies:

- Malawi – a low income economy
- Zambia – a lower-middle income economy
- Brazil – an upper-middle income economy
- Australia – a high income economy.

© OCR 2016

STEMUP.CO.UK

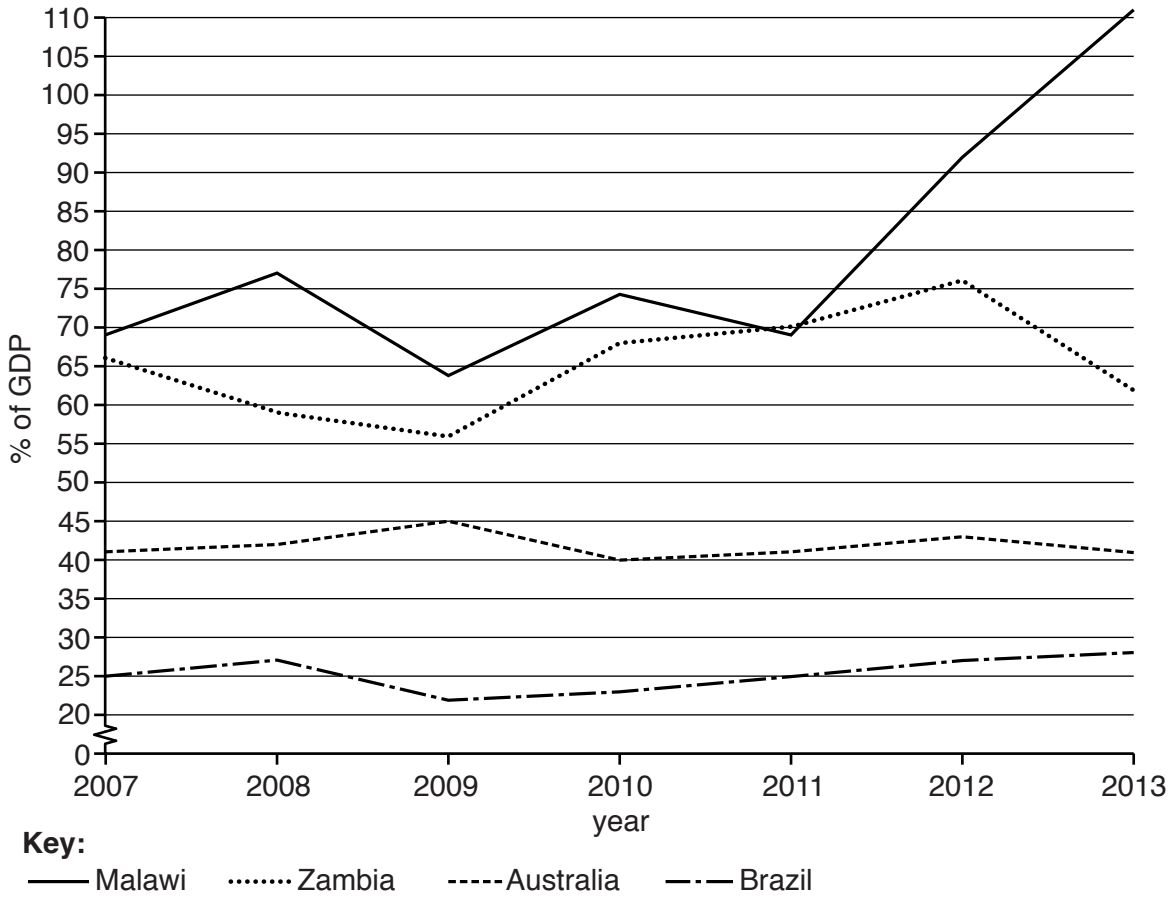


Fig. 1.1 Trade as a percentage of GDP for four selected economies

In 2007–08, financial and economic crises in high income developed economies reduced the growth in world trade as their effects spread to the global economy. There was a fear that the sharp increase in unemployment, particularly in developed economies, would lead to protectionist measures. However, fears of global trade wars quickly subsided and the growth in world trade recovered in 2010.

© OCR 2016

STEMUP.CO.UK

Extract 2

Globalisation and balance of payments imbalances

While globalisation has brought about an increase in the volume of world trade, it has also increased balance of payments imbalances. Much of the discussion about these global imbalances has focused on China's current account surplus and the USA's current account deficit. Fig. 2.1 shows the trend in the balance of payments on the current account of China and of the USA.

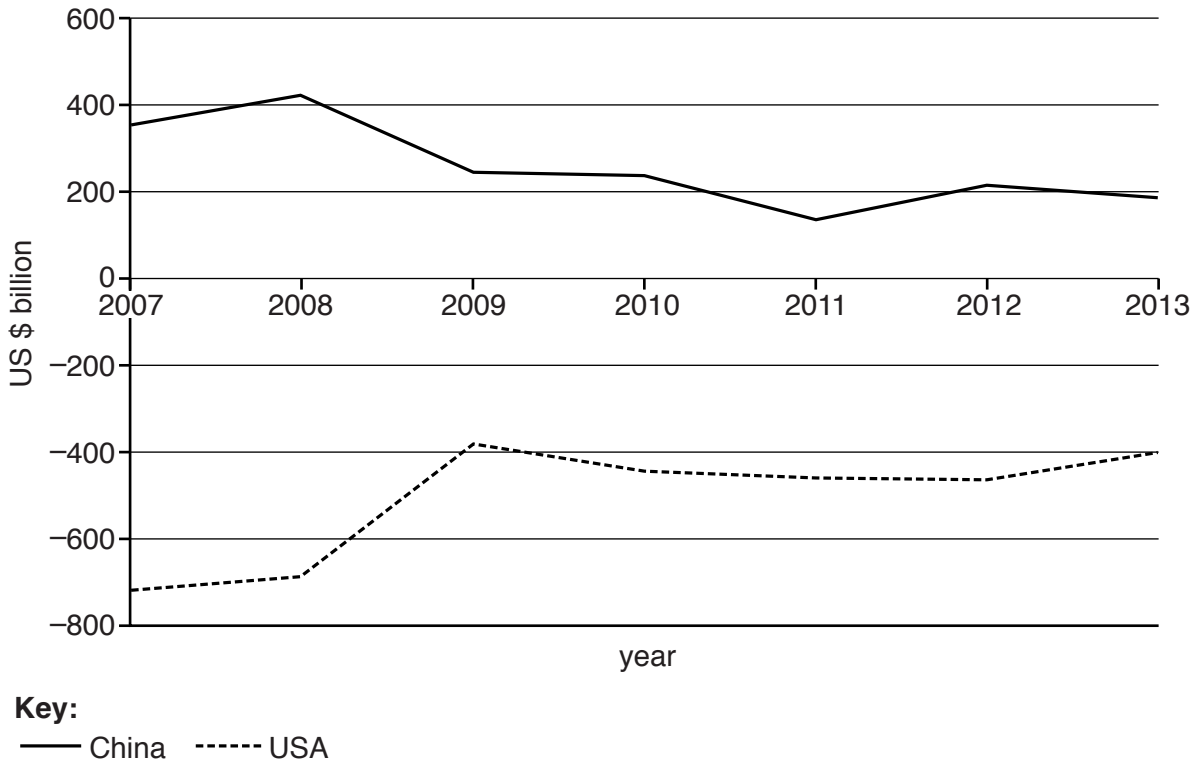


Fig. 2.1 Current account balances of China and of the USA

The period between 2007 and 2013 saw fluctuations in the current account deficit of the USA and in its effective exchange rate index*. Changes in its effective exchange rate (see Fig. 2.2) did not always have the expected impact on the USA's current account deficit.

* *the effective exchange rate index is a weighted average value of a country's currency relative to all major currencies, with the weights determined by the importance of trade conducted in each currency*

© OCR 2016

STEMUP.CO.UK

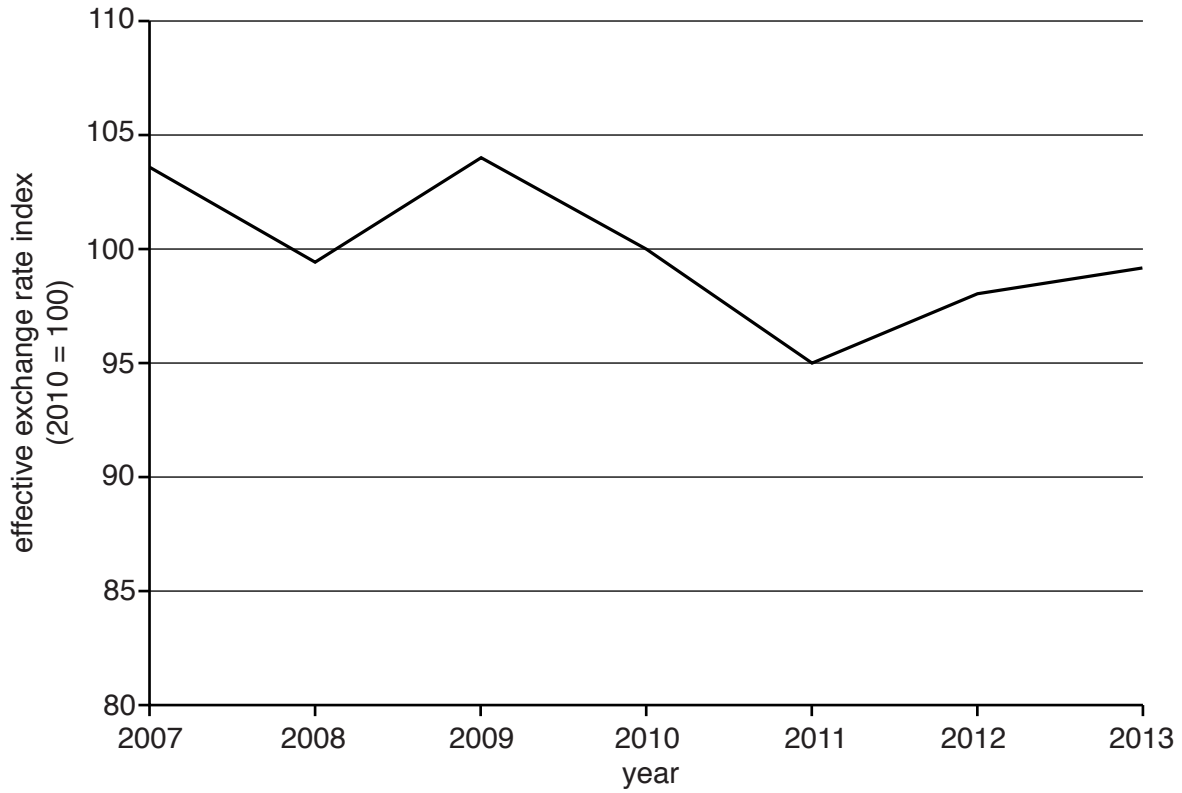


Fig. 2.2 Effective exchange rate index of the US dollar (2010 = 100)

The other part of the picture of global imbalances is reflected in international financial flows from developing to developed economies. Savings from poor countries have flooded into the USA seeking returns in US government bonds and in the US housing market. These international financial flows help fund consumer spending in the USA and they provide an outlet for excess savings in developing economies where financial markets are not always developed. These international financial flows are recorded on the financial account of the balance of payments of individual economies. Countries with a current account deficit experience inflows on the financial account of the balance of payments, and countries with a current account surplus experience outflows. So international finance flows from poor to rich countries such as the USA.

© OCR 2016

STEMUP.CO.UK

Extract 3

Primary commodity dependence and the terms of trade

A number of developing countries are heavily dependent on exports of commodities for foreign exchange earnings. For example, approximately three quarters of Zambia's export revenue comes from copper. Rises in commodity prices can bring significant benefits to economies such as that of Zambia, including increases in tax revenue which can be used to improve development (see Fig. 3.1).

Indicator/Year	2000	2007	2013
Life expectancy at birth (years)	42	50	58
Primary school enrolment (%)	84	119[1]	108[1]
Mean years of schooling	5.9	6.4	6.5
Expected years of schooling	10.4	12.2	13.5
GNI per capita, PPP (US$)	2138	1922	2898

Fig. 3.1 Key development indicators for Zambia

However, fluctuations in commodity prices can also have a significant impact on the terms of trade of a developing country such as Zambia. The trend in Zambia's terms of trade, for example, is shown in Fig. 3.2.

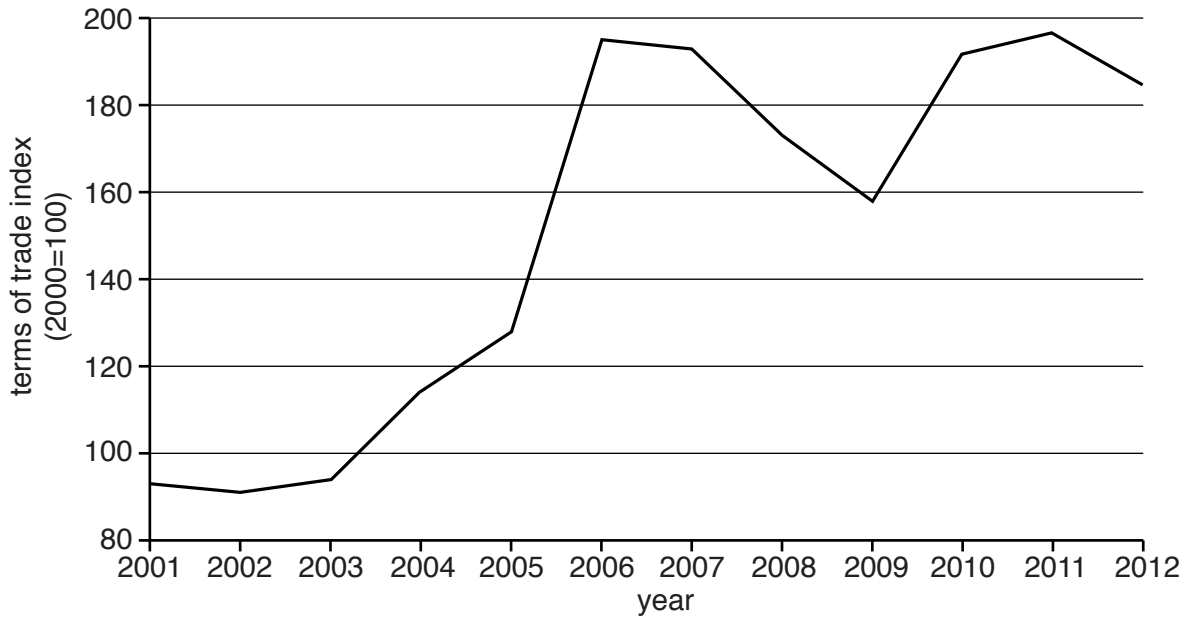


Fig. 3.2 Zambia's terms of trade

[1] *primary school enrolment measures the number of people in primary education as a percentage of the primary school age population; this figure exceeds 100% because it includes adults enrolled in primary education*

STEMUP.CO.UK

Despite the fact that copper accounts for over 75% of Zambia's export revenue, it still only contributes 10% to government tax revenue. The Zambian government has expressed concerns that multinational companies engaged in the extraction of copper, and international commodity traders, have been evading paying tax. As a result, the Zambian government temporarily suspended exports of copper in 2011 as it considered rules to improve revenue collection from the sector. This was seen by many as part of a trend in Africa towards so-called 'resource nationalisation' as African governments sought a larger share of the profits from mines, as well as expanding state control. The Zambian government has been in talks with multinational companies to acquire a 51% stake in mining operations to ensure that the benefits of resource extraction are more widely distributed among the population of Zambia. Some economists are worried that greater state involvement and higher taxes might discourage investment in mining and in other sectors of the economy, resulting in a reduction in the growth of output.

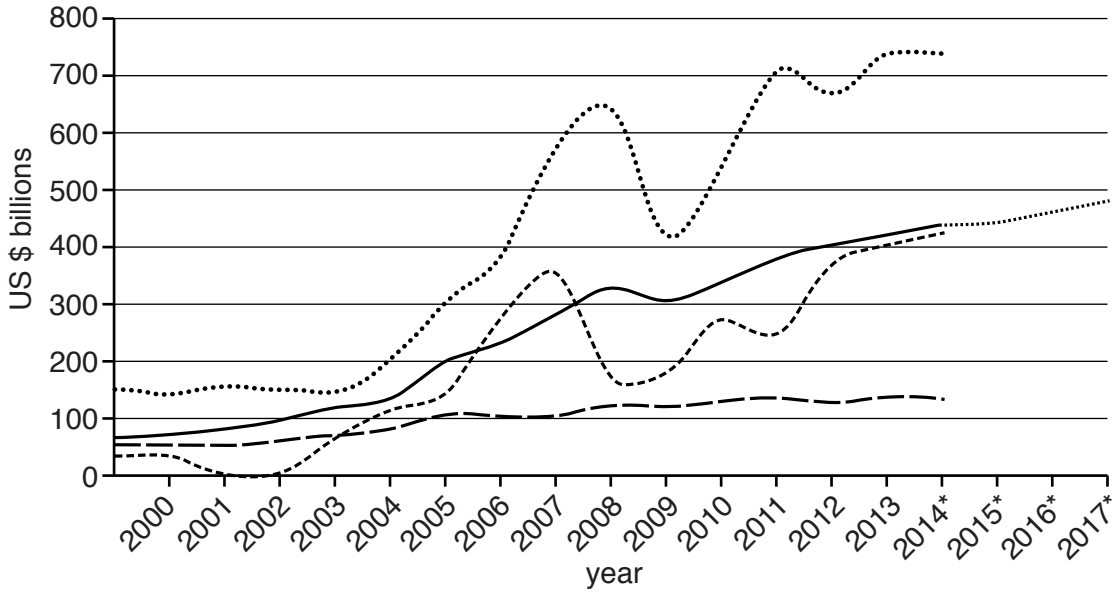
© OCR 2016

STEMUP.CO.UK

Extract 4

Migration and remittances

As globalisation has increased there has been a surge in international financial flows to both developed and developing countries. One of these financial flows, remittances, has become increasingly important for developing economies. An estimated 232 million people worked outside their home country in 2013. These workers often sent some of their earnings home in the form of remittances. In 2013 over US$400 billion of remittances were received by developing countries, far exceeding the amount received in ODA (Official Development Assistance). Remittances accounted for more than 10% of GDP in many developing countries. The extent of remittances relative to other international financial flows is shown in Fig. 4.1.



* *estimates*

Key:

FDI

remittances

ODA

debt and portfolio investment

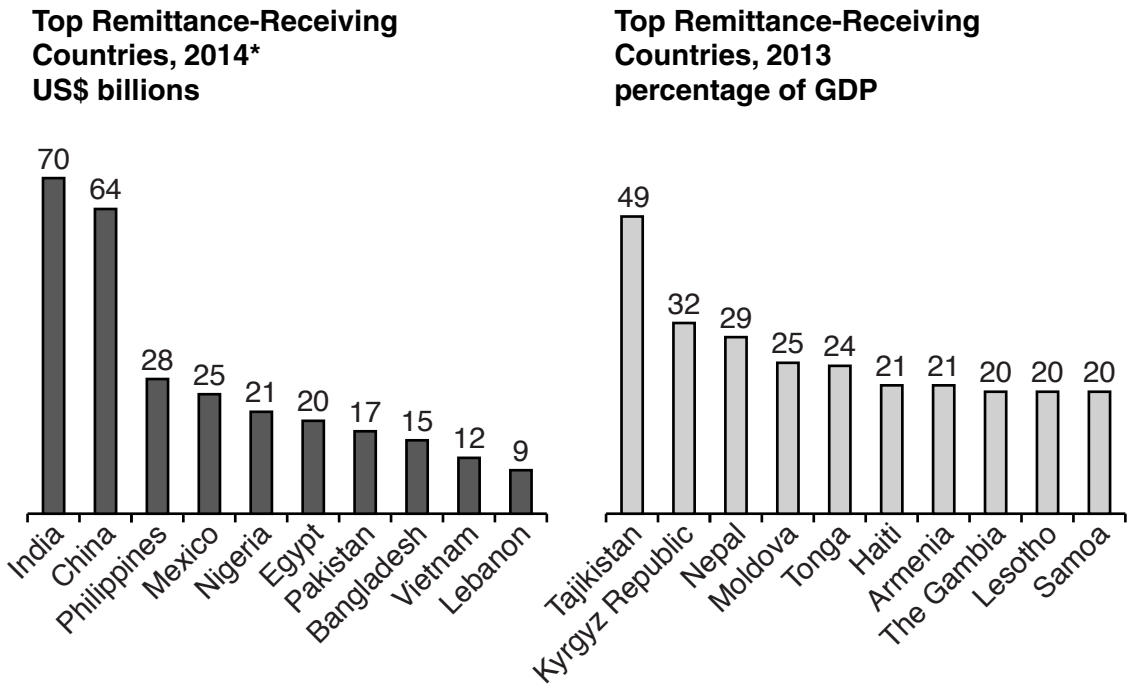
Fig. 4.1 International financial flows to developing economies

Remittances are a much more stable form of international financial flow than some other financial flows and they bring many benefits to developing economies. It is suggested that migration and remittances can be significant in reducing poverty and increasing development. However, to set against this is the impact of the loss of skilled labour. According to the World Bank, smaller developing countries tend to have the highest rates of skilled emigration. Almost all doctors trained in Grenada, Dominica and Ghana, for example, now live and work abroad.

© OCR 2016

STEMUP.CO.UK

Fig. 4.2 shows the top ten recipients of remittances in US$ billion and as a percentage of GDP.



* estimate

Fig. 4.2 Top ten recipients of remittances

© OCR 2016

STEMUP.CO.UK

Extract 5

Structural issues in the Zambian economy

Compared with the rest of Africa the Zambian economy has enjoyed much more stable economic growth and was less affected by the global financial and economic crises of 2007–08. Since 2009, economic growth in Zambia has averaged over 6% per annum and inflation has fallen from around 10% to 6.5% in 2013. The tripling of global copper prices from 2009 to 2011 had a significant impact on production in the mining sector.

Zambia has gone some way in reducing its dependence on private and public sector consumption towards a greater reliance on private sector investment. However, the growth rate of private sector investment fell after 2010. In comparison, the growth of public sector investment has increased since 2010. The composition of aggregate demand and the contribution made to GDP growth by consumption, investment and net trade in Zambia is shown in Fig. 5.1.

Components of aggregate demand	**Percentage of GDP (current price)**		**Percentage changes (volume)**			**Percentage contribution to real GDP growth**		
	2001	**2009**	**2010**	**2011**	**2012**	**2010**	**2011**	**2012**
Gross capital formation	**18.9**	**21.1**	**14.7**	**4.6**	**6.5**	**4.0**	**1.4**	**1.9**
Public	11.0	3.5	13.0	30.0	25.0	0.6	1.5	1.5
Private	7.9	17.6	15.0	–0.5	1.8	3.4	–0.1	0.4
Consumption	**97.3**	**76.3**	**8.2**	**7.1**	**7.9**	**6.8**	**6.0**	**6.6**
Public	10.1	19.3	4.9	3.4	3.4	0.9	0.6	0.5
Private	87.2	57.0	9.1	8.1	9.0	5.9	5.4	6.1
External sector	**–16.2**	**2.6**	n/a	n/a	n/a	**–4.2**	**–0.9**	**–1.8**
Exports	28.1	34.6	6.8	5.6	6.0	2.7	2.2	2.4
Imports	–44.3	–32.0	13.7	5.7	7.8	–6.9	–3.1	–4.2
Real GDP growth rate	n/a	n/a	n/a	n/a	n/a	**6.6**	**6.5**	**6.7**

Fig. 5.1 The composition of aggregate demand in Zambia and contributions to real GDP growth

© OCR 2016

STEMUP.CO.UK

An assessment of the key structural issues facing the Zambian economy is shown in Fig. 5.2. This highlights the aspects on which government economic policies need to be focused in order to promote long run economic growth in Zambia.

A good business environment and increased private investment underpinned Zambia's resilience to the global financial and economic crises. The Zambian government is committed to accelerating private sector investment in order to increase and diversify economic growth. Its Private Sector Development Reform Programme (PSDRP) aims to reduce the cost of doing business and to ensure a stable environment for private investment and economic growth. To maintain annual economic growth of at least 7%, a substantial improvement in the business and investment climate is required to make it easier for private sector companies to 'do business' in Zambia. However, there remain a number of constraints on the supply-side of the economy including:

- poor access to credit
- poor infrastructure
- excessive bureaucracy
- regulation and licensing requirements.

The mining sector is expected to grow substantially. Zhonghui Mining Group of China plans to invest more than US$3 billion in copper mining in Zambia. There are various other mining projects awaiting an environmental impact assessment. About US$1 billion of investment at the Konkola Copper Mines (KCM) aims to increase the output of processed copper. KCM plans to spend about US$170 million on a plant with a capacity to process 12 million tonnes of copper ore each year. Vale Mining Company of Brazil and South African-based Rainbow Minerals have jointly agreed to spend more than US$1 billion over five years to develop the Konkola North copper mine.

Two economic zones are being developed in Lusaka, Zambia's capital. It is hoped that these zones will help expand Zambia's manufacturing base and reduce the country's dependency on imports.

Fig. 5.2 Demand and supply-sides of the Zambian economy

© OCR 2016

STEMUP.CO.UK

BLANK PAGE

© OCR 2016

STEMUP.CO.UK

BLANK PAGE

© OCR 2016

STEMUP.CO.UK

OCR
Oxford Cambridge and RSA

Copyright Information

OCR is committed to seeking permission to reproduce all third-party content that it uses in its assessment materials. OCR has attempted to identify and contact all copyright holders whose work is used in this paper. To avoid the issue of disclosure of answer-related information to candidates, all copyright acknowledgements are reproduced in the OCR Copyright Acknowledgements Booklet. This is produced for each series of examinations and is freely available to download from our public website (www.ocr.org.uk) after the live examination series.

If OCR has unwittingly failed to correctly acknowledge or clear any third-party content in this assessment material, OCR will be happy to correct its mistake at the earliest possible opportunity.

For queries or further information please contact the Copyright Team, First Floor, 9 Hills Road, Cambridge CB2 1GE.

OCR is part of the Cambridge Assessment Group; Cambridge Assessment is the brand name of University of Cambridge Local Examinations Syndicate (UCLES), which is itself a department of the University of Cambridge.

© OCR 2016

STEMUP.CO.UK

OCR
Oxford Cambridge and RSA

Monday 20 June 2016 – Afternoon

A2 GCE ECONOMICS

F585/01/SM The Global Economy

STIMULUS MATERIAL

Duration: 2 hours

6 3 7 3 1 4 2 2 3 6

INSTRUCTIONS TO CANDIDATES

- This is a clean copy of the Stimulus Material which you have already seen.
- You may **not** take your previous copy of the Stimulus Material into the examination.
- You may **not** take notes into the examination.

INFORMATION FOR CANDIDATES

- This document consists of **16** pages. Any blank pages are indicated.

INSTRUCTION TO EXAMS OFFICER / INVIGILATOR

- Do not send this Stimulus Material for marking; it should be retained in the centre or recycled. Please contact OCR Copyright should you wish to re-use this document.

© OCR 2016 [T/500/7921]
DC (CW/SW) 126444/1 **R**

OCR is an exempt Charity

STEMUP.CO.UK

Introduction

Until 2008, globalisation was increasing at a rapid rate, with rises in global trade, Foreign Direct Investment (FDI) and migration of workers being some of the most obvious indicators. The increasing volume of world trade owed much to reductions in trade barriers. The process of globalisation as a whole, however, has been driven by a range of factors. Globalisation has attracted much controversy, but economists are generally agreed that specialisation and trade can bring benefits to all of the world's economies. The global financial and economic crises of 2007–08 appeared to threaten the march of globalisation, but such fears were short-lived.

While the volume of world trade has increased, balance of payments imbalances have emerged. These imbalances can be seen not only in the current account positions of economies such as the USA and China, but also in the current account performance of other developed and developing economies. These current account imbalances have not always responded to changes in exchange rates, leading some economists to seek explanations for the imbalances in international financial flows. Such flows have responded to macroeconomic imbalances between economies.

Developing economies dependent on exports of commodities benefitted greatly from the growth of the world economy prior to the global economic and financial crises of 2007–08. As commodity prices increased significantly, economies of countries such as Zambia were able to put measures in place to improve a number of indicators of development. It was feared that the sharp decline in commodity prices in 2008–09, which led to a fall in Zambia's terms of trade, would have a significant impact on its economy. The recovery of world economic growth and trade, however, dispelled such fears.

The greater global mobility of labour has also increased international financial flows in the form of remittances. For many developing economies these are now more significant than flows of Official Development Assistance (ODA) and play an important role in reducing poverty and promoting development. However, their impact on development also brings costs.

Zambia's macroeconomic performance has benefitted not just from the increase in global commodity prices in the first decade of the 21st century. It has also undergone a shift in the composition of its aggregate demand which may enable it to increase long run economic growth. Private sector investment is now much more important and has replaced a dependence on public sector investment and public and private sector consumption. This is likely to have a favourable effect on the supply-side performance of the economy. Nevertheless, the growth of private sector investment has recently slowed down, as fears of 'resource nationalisation' have deterred FDI. Reforms to the supply-side of the economy are seen by some as the key to promoting long run economic growth in Zambia.

© OCR 2016

STEMUP.CO.UK

Pre-release stimulus material

Extract 1: Globalisation and world trade

Extract 2: Globalisation and balance of payments imbalances

Extract 3: Primary commodity dependence and the terms of trade

Extract 4: Migration and remittances

Extract 5: Structural issues in the Zambian economy

© OCR 2016

STEMUP.CO.UK

Extract 1

Globalisation and world trade

Since the start of the 21st century trade in goods and services has become more globalised, as have capital and labour markets. The closer links between the world's economies are seen in a number of indicators. These indicators include:

- the value of trade in goods and services as a percentage of world GDP is increasing
- FDI as a percentage of world GDP has increased six-fold since 1980
- the number of migrant workers has trebled since the 1960s.

It is argued that globalisation brings significant benefits both to individual economies and to the global economy as a whole. It opens up markets throughout the world, promoting specialisation and division of labour as economies focus production according to their comparative advantage. Economies can access larger markets than would be the case without globalisation. They can access more capital goods and more advanced technology, as well as larger markets for their exports. At the same time they can benefit from cheaper imports. Economic theory provides strong support for the process of globalisation in terms of the benefits of increased economic efficiency.

One of the many factors promoting globalisation has been a reduction of trade barriers, including import tariffs. Access to a wider range of goods and services at lower prices not only provides benefits to consumers but also encourages domestic industries to increase their competitiveness. Exports create jobs and, for many developing countries, are a source of economic growth. Fig. 1.1 shows the change in trade in goods and services (exports plus imports) as a percentage of GDP for four different economies:

- Malawi – a low income economy
- Zambia – a lower-middle income economy
- Brazil – an upper-middle income economy
- Australia – a high income economy.

© OCR 2016

STEMUP.CO.UK

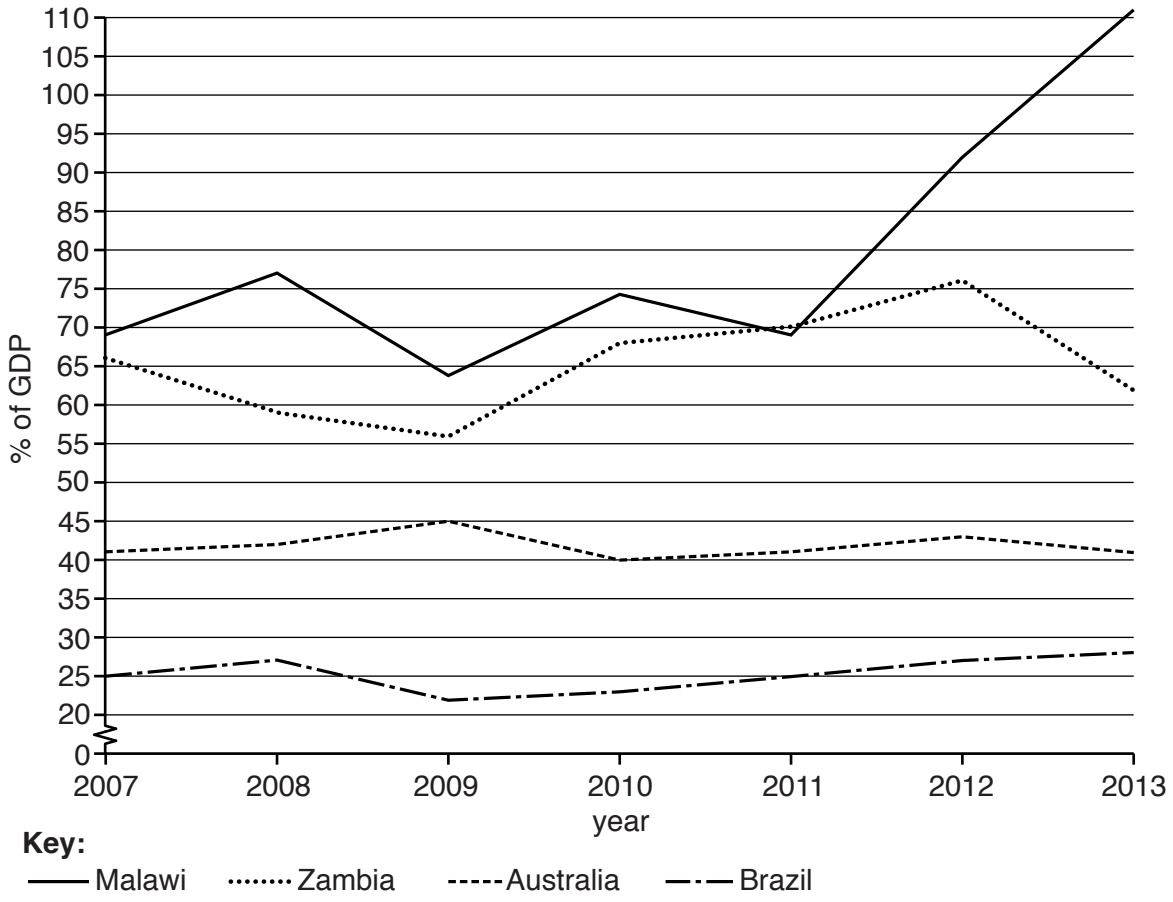


Fig. 1.1 Trade as a percentage of GDP for four selected economies

In 2007–08, financial and economic crises in high income developed economies reduced the growth in world trade as their effects spread to the global economy. There was a fear that the sharp increase in unemployment, particularly in developed economies, would lead to protectionist measures. However, fears of global trade wars quickly subsided and the growth in world trade recovered in 2010.

© OCR 2016

STEMUP.CO.UK

Extract 2

Globalisation and balance of payments imbalances

While globalisation has brought about an increase in the volume of world trade, it has also increased balance of payments imbalances. Much of the discussion about these global imbalances has focused on China's current account surplus and the USA's current account deficit. Fig. 2.1 shows the trend in the balance of payments on the current account of China and of the USA.

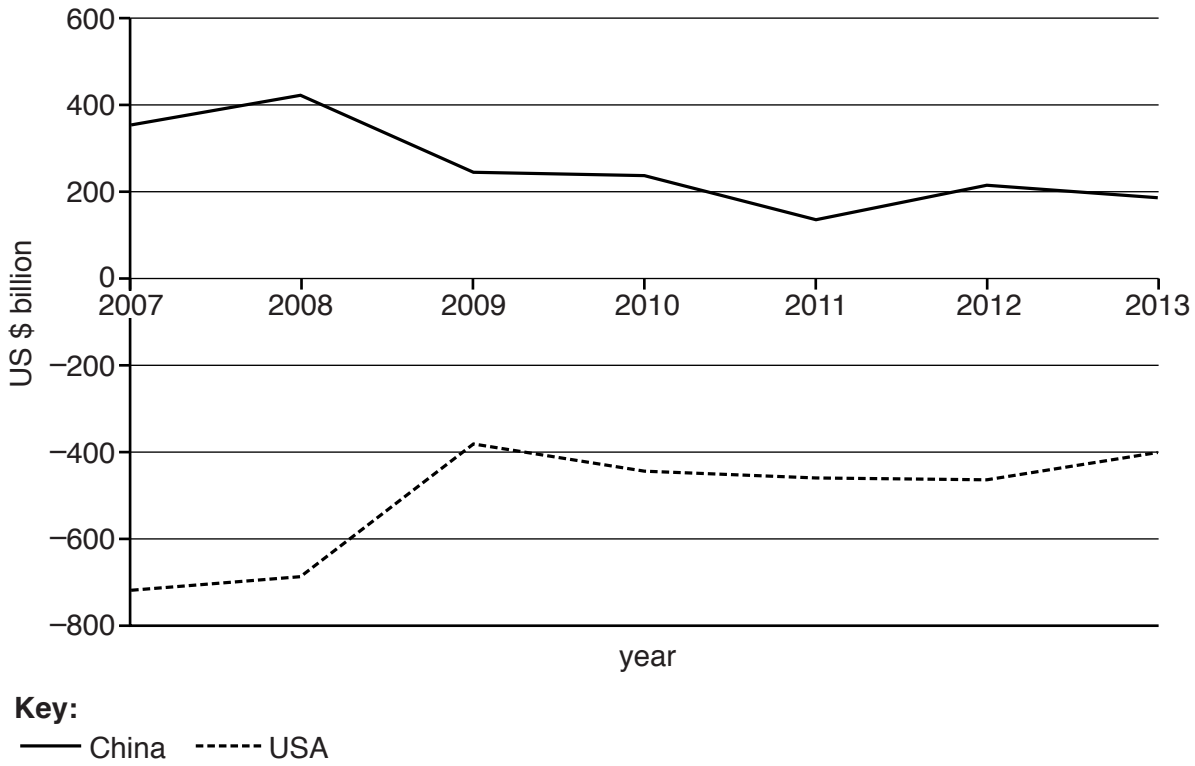


Fig. 2.1 Current account balances of China and of the USA

The period between 2007 and 2013 saw fluctuations in the current account deficit of the USA and in its effective exchange rate index*. Changes in its effective exchange rate (see Fig. 2.2) did not always have the expected impact on the USA's current account deficit.

* *the effective exchange rate index is a weighted average value of a country's currency relative to all major currencies, with the weights determined by the importance of trade conducted in each currency*

© OCR 2016

STEMUP.CO.UK

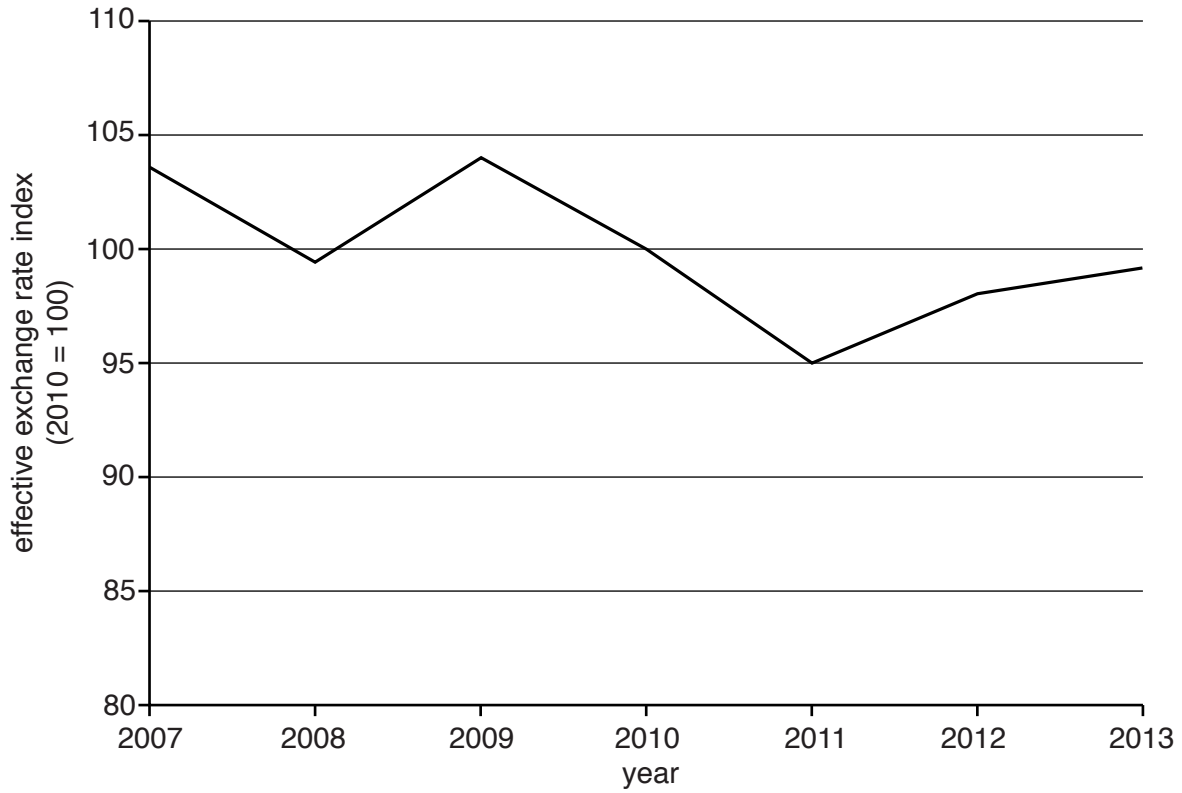


Fig. 2.2 Effective exchange rate index of the US dollar (2010 = 100)

The other part of the picture of global imbalances is reflected in international financial flows from developing to developed economies. Savings from poor countries have flooded into the USA seeking returns in US government bonds and in the US housing market. These international financial flows help fund consumer spending in the USA and they provide an outlet for excess savings in developing economies where financial markets are not always developed. These international financial flows are recorded on the financial account of the balance of payments of individual economies. Countries with a current account deficit experience inflows on the financial account of the balance of payments, and countries with a current account surplus experience outflows. So international finance flows from poor to rich countries such as the USA.

© OCR 2016

STEMUP.CO.UK

Extract 3

Primary commodity dependence and the terms of trade

A number of developing countries are heavily dependent on exports of commodities for foreign exchange earnings. For example, approximately three quarters of Zambia's export revenue comes from copper. Rises in commodity prices can bring significant benefits to economies such as that of Zambia, including increases in tax revenue which can be used to improve development (see Fig. 3.1).

Indicator/Year	2000	2007	2013
Life expectancy at birth (years)	42	50	58
Primary school enrolment (%)	84	119[1]	108[1]
Mean years of schooling	5.9	6.4	6.5
Expected years of schooling	10.4	12.2	13.5
GNI per capita, PPP (US$)	2138	1922	2898

Fig. 3.1 Key development indicators for Zambia

However, fluctuations in commodity prices can also have a significant impact on the terms of trade of a developing country such as Zambia. The trend in Zambia's terms of trade, for example, is shown in Fig. 3.2.

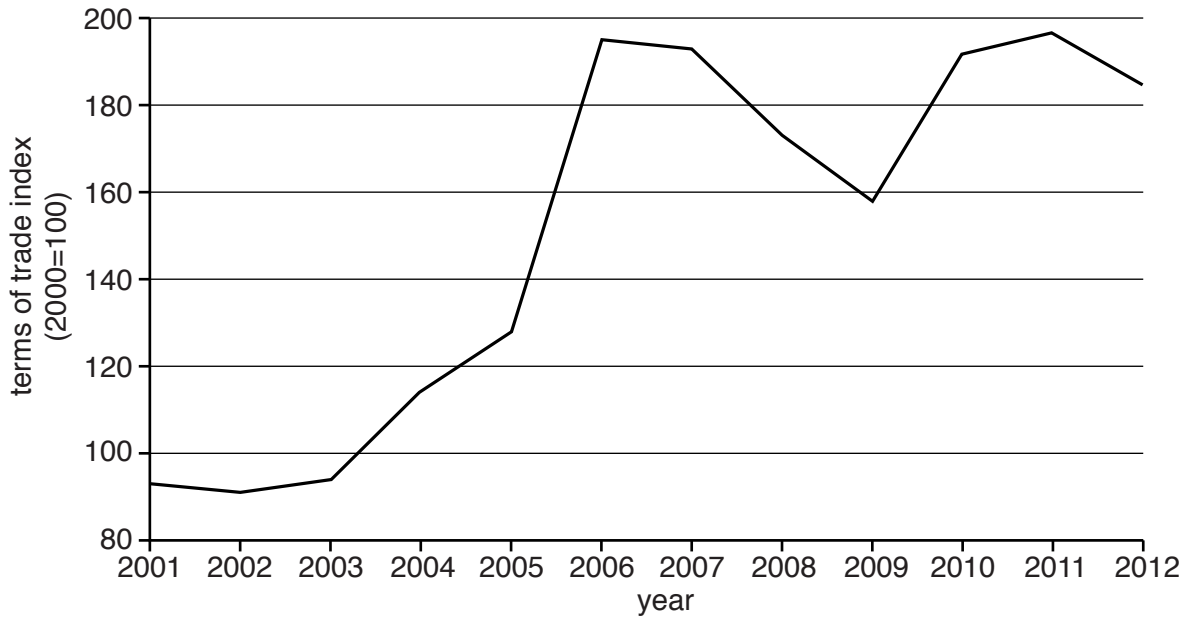


Fig. 3.2 Zambia's terms of trade

[1] *primary school enrolment measures the number of people in primary education as a percentage of the primary school age population; this figure exceeds 100% because it includes adults enrolled in primary education*

STEMUP.CO.UK

Despite the fact that copper accounts for over 75% of Zambia's export revenue, it still only contributes 10% to government tax revenue. The Zambian government has expressed concerns that multinational companies engaged in the extraction of copper, and international commodity traders, have been evading paying tax. As a result, the Zambian government temporarily suspended exports of copper in 2011 as it considered rules to improve revenue collection from the sector. This was seen by many as part of a trend in Africa towards so-called 'resource nationalisation' as African governments sought a larger share of the profits from mines, as well as expanding state control. The Zambian government has been in talks with multinational companies to acquire a 51% stake in mining operations to ensure that the benefits of resource extraction are more widely distributed among the population of Zambia. Some economists are worried that greater state involvement and higher taxes might discourage investment in mining and in other sectors of the economy, resulting in a reduction in the growth of output.

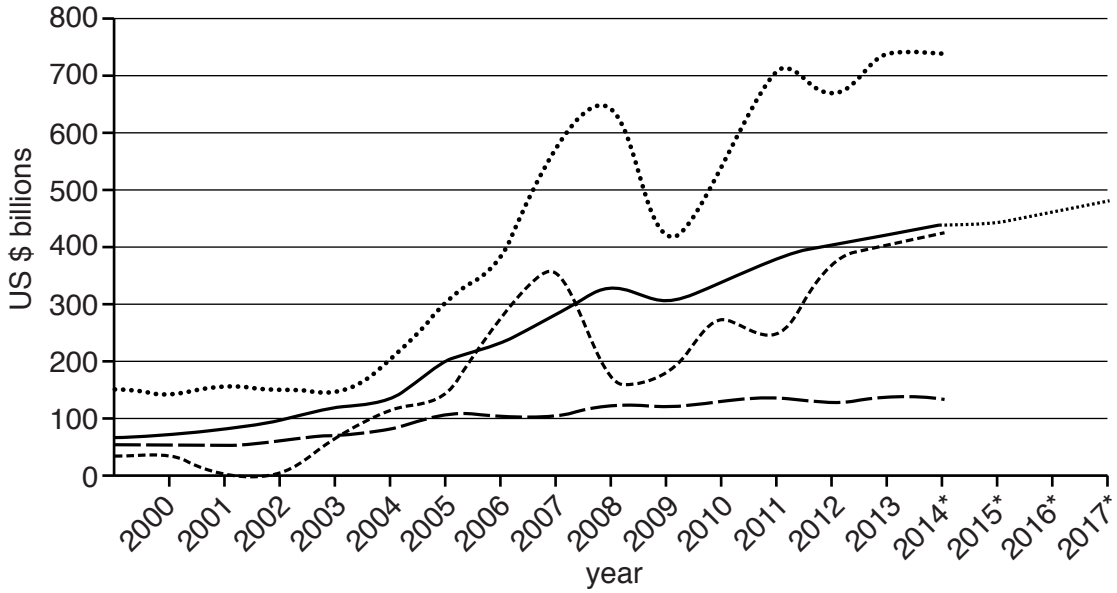
© OCR 2016

STEMUP.CO.UK

Extract 4

Migration and remittances

As globalisation has increased there has been a surge in international financial flows to both developed and developing countries. One of these financial flows, remittances, has become increasingly important for developing economies. An estimated 232 million people worked outside their home country in 2013. These workers often sent some of their earnings home in the form of remittances. In 2013 over US$400 billion of remittances were received by developing countries, far exceeding the amount received in ODA (Official Development Assistance). Remittances accounted for more than 10% of GDP in many developing countries. The extent of remittances relative to other international financial flows is shown in Fig. 4.1.



* *estimates*

Key:

FDI

remittances

ODA

debt and portfolio investment

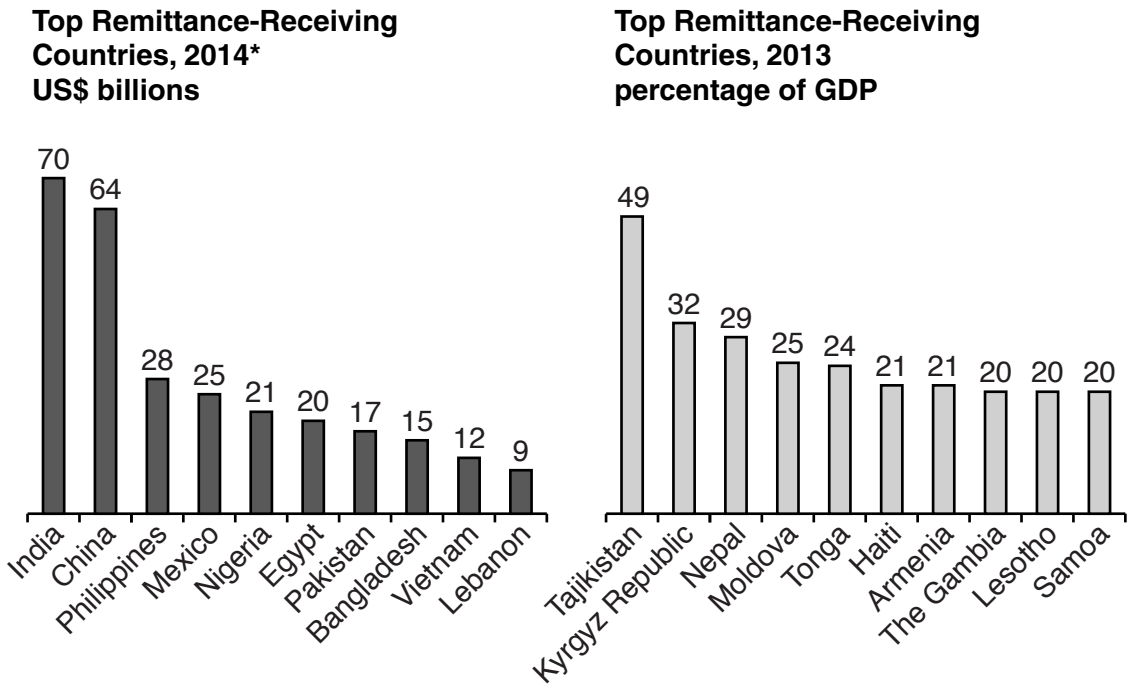
Fig. 4.1 International financial flows to developing economies

Remittances are a much more stable form of international financial flow than some other financial flows and they bring many benefits to developing economies. It is suggested that migration and remittances can be significant in reducing poverty and increasing development. However, to set against this is the impact of the loss of skilled labour. According to the World Bank, smaller developing countries tend to have the highest rates of skilled emigration. Almost all doctors trained in Grenada, Dominica and Ghana, for example, now live and work abroad.

© OCR 2016

STEMUP.CO.UK

Fig. 4.2 shows the top ten recipients of remittances in US$ billion and as a percentage of GDP.



* estimate

Fig. 4.2 Top ten recipients of remittances

© OCR 2016

STEMUP.CO.UK

Extract 5

Structural issues in the Zambian economy

Compared with the rest of Africa the Zambian economy has enjoyed much more stable economic growth and was less affected by the global financial and economic crises of 2007–08. Since 2009, economic growth in Zambia has averaged over 6% per annum and inflation has fallen from around 10% to 6.5% in 2013. The tripling of global copper prices from 2009 to 2011 had a significant impact on production in the mining sector.

Zambia has gone some way in reducing its dependence on private and public sector consumption towards a greater reliance on private sector investment. However, the growth rate of private sector investment fell after 2010. In comparison, the growth of public sector investment has increased since 2010. The composition of aggregate demand and the contribution made to GDP growth by consumption, investment and net trade in Zambia is shown in Fig. 5.1.

Components of aggregate demand	**Percentage of GDP (current price)**		**Percentage changes (volume)**			**Percentage contribution to real GDP growth**		
	2001	**2009**	**2010**	**2011**	**2012**	**2010**	**2011**	**2012**
Gross capital formation	**18.9**	**21.1**	**14.7**	**4.6**	**6.5**	**4.0**	**1.4**	**1.9**
Public	11.0	3.5	13.0	30.0	25.0	0.6	1.5	1.5
Private	7.9	17.6	15.0	–0.5	1.8	3.4	–0.1	0.4
Consumption	**97.3**	**76.3**	**8.2**	**7.1**	**7.9**	**6.8**	**6.0**	**6.6**
Public	10.1	19.3	4.9	3.4	3.4	0.9	0.6	0.5
Private	87.2	57.0	9.1	8.1	9.0	5.9	5.4	6.1
External sector	**–16.2**	**2.6**	n/a	n/a	n/a	**–4.2**	**–0.9**	**–1.8**
Exports	28.1	34.6	6.8	5.6	6.0	2.7	2.2	2.4
Imports	–44.3	–32.0	13.7	5.7	7.8	–6.9	–3.1	–4.2
Real GDP growth rate	n/a	n/a	n/a	n/a	n/a	**6.6**	**6.5**	**6.7**

Fig. 5.1 The composition of aggregate demand in Zambia and contributions to real GDP growth

© OCR 2016

STEMUP.CO.UK

An assessment of the key structural issues facing the Zambian economy is shown in Fig. 5.2. This highlights the aspects on which government economic policies need to be focused in order to promote long run economic growth in Zambia.

A good business environment and increased private investment underpinned Zambia's resilience to the global financial and economic crises. The Zambian government is committed to accelerating private sector investment in order to increase and diversify economic growth. Its Private Sector Development Reform Programme (PSDRP) aims to reduce the cost of doing business and to ensure a stable environment for private investment and economic growth. To maintain annual economic growth of at least 7%, a substantial improvement in the business and investment climate is required to make it easier for private sector companies to 'do business' in Zambia. However, there remain a number of constraints on the supply-side of the economy including:

- poor access to credit
- poor infrastructure
- excessive bureaucracy
- regulation and licensing requirements.

The mining sector is expected to grow substantially. Zhonghui Mining Group of China plans to invest more than US$3 billion in copper mining in Zambia. There are various other mining projects awaiting an environmental impact assessment. About US$1 billion of investment at the Konkola Copper Mines (KCM) aims to increase the output of processed copper. KCM plans to spend about US$170 million on a plant with a capacity to process 12 million tonnes of copper ore each year. Vale Mining Company of Brazil and South African-based Rainbow Minerals have jointly agreed to spend more than US$1 billion over five years to develop the Konkola North copper mine.

Two economic zones are being developed in Lusaka, Zambia's capital. It is hoped that these zones will help expand Zambia's manufacturing base and reduce the country's dependency on imports.

Fig. 5.2 Demand and supply-sides of the Zambian economy

© OCR 2016

STEMUP.CO.UK

BLANK PAGE

© OCR 2016

STEMUP.CO.UK

BLANK PAGE

© OCR 2016

STEMUP.CO.UK

OCR
Oxford Cambridge and RSA

Copyright Information

OCR is committed to seeking permission to reproduce all third-party content that it uses in its assessment materials. OCR has attempted to identify and contact all copyright holders whose work is used in this paper. To avoid the issue of disclosure of answer-related information to candidates, all copyright acknowledgements are reproduced in the OCR Copyright Acknowledgements Booklet. This is produced for each series of examinations and is freely available to download from our public website (www.ocr.org.uk) after the live examination series.

If OCR has unwittingly failed to correctly acknowledge or clear any third-party content in this assessment material, OCR will be happy to correct its mistake at the earliest possible opportunity.

For queries or further information please contact the Copyright Team, First Floor, 9 Hills Road, Cambridge CB2 1GE.

OCR is part of the Cambridge Assessment Group; Cambridge Assessment is the brand name of University of Cambridge Local Examinations Syndicate (UCLES), which is itself a department of the University of Cambridge.

© OCR 2016

STEMUP.CO.UK

OCR
Oxford Cambridge and RSA

Monday 20 June 2016 – Afternoon

A2 GCE ECONOMICS

F585/01 The Global Economy

Candidates answer on the Question Paper.

OCR supplied materials:
- Clean copy Stimulus Material (F585/01/SM)

Other materials required:
- Calculators may be used

Duration: 2 hours

F585/01

10830214533

Candidate forename		Candidate surname	

Centre number						Candidate number				

INSTRUCTIONS TO CANDIDATES

- Refer to the Stimulus Material in a separate booklet. You must **not** bring your original copy into the examination.
- Write your name, centre number and candidate number in the boxes above. Please write clearly and in capital letters.
- Use black ink. HB pencil may be used for graphs and diagrams only.
- Answer **all** the questions.
- Read each question carefully. Make sure you know what you have to do before starting your answer.
- Write your answer to each question in the space provided. If additional space is required, you should use the lined pages at the end of this booklet. The question number(s) must be clearly shown.
- Do **not** write in the bar codes.

INFORMATION FOR CANDIDATES

- The number of marks is given in brackets **[ ]** at the end of each question or part question.
- The total number of marks for this paper is **60**.
- The quality of your written communication will be taken into account in the marking of your answer to Question 3. All answers should be in continuous prose.
- This document consists of **16** pages. Any blank pages are indicated.

A calculator may be used for this paper

© OCR 2016 [T/500/7921]
DC (NF) 68393/5

OCR is an exempt Charity

STEMUP.CO.UK

Answer **all** questions.

1 **(a)** Other than the reduction of trade barriers, describe **two** factors which have promoted globalisation.

1 .....

.....

.....

.....

.....

.....

.....

.....

.....

2 .....

.....

.....

.....

.....

.....

.....

.....

.....

[4]

© OCR 2016

(b) Using the theory of comparative advantage, analyse how an economy can benefit from trade.

.... **[6]**

© OCR 2016

STEMUP.CO.UK

(c) Comment on the extent to which the overall trend in the US current account balance between 2007 and 2013 (Fig. 2.1) can be explained by the depreciation of the effective exchange rate of the US dollar over the same period (Fig. 2.2). **[10]**

© OCR 2016

STEMUP.CO.UK

© OCR 2016

STEMUP.CO.UK

2 **(a)** With reference to Fig. 3.1, state and explain how the Human Development Index (HDI) value of Zambia is likely to have changed between 2007 and 2013.

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

..... **[4]**

© OCR 2016

STEMUP.CO.UK

(b) Analyse the significance for the economy of Zambia of the fall in its terms of trade between 2007 and 2009 (Fig. 3.2).

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

..... **[6]**

© OCR 2016

STEMUP.CO.UK

(c) Comment on the extent to which increased financial flows from remittances help to promote development. **[10]**

© OCR 2016

STEMUP.CO.UK

© OCR 2016

STEMUP.CO.UK

3 Discuss the extent to which supply-side policies are the key to promoting economic growth in a developing economy such as Zambia. **[20]**

© OCR 2016

STEMUP.CO.UK

© OCR 2016

STEMUP.CO.UK

© OCR 2016

© OCR 2016

STEMUP.CO.UK

END OF QUESTION PAPER

© OCR 2016

ADDITIONAL ANSWER SPACE

If additional answer space is required, you should use the following lined pages. The question number(s) must be clearly shown in the margins.

© OCR 2016

OCR
Oxford Cambridge and RSA

Copyright Information

OCR is committed to seeking permission to reproduce all third-party content that it uses in its assessment materials. OCR has attempted to identify and contact all copyright holders whose work is used in this paper. To avoid the issue of disclosure of answer-related information to candidates, all copyright acknowledgements are reproduced in the OCR Copyright Acknowledgements Booklet. This is produced for each series of examinations and is freely available to download from our public website (www.ocr.org.uk) after the live examination series.

If OCR has unwittingly failed to correctly acknowledge or clear any third-party content in this assessment material, OCR will be happy to correct its mistake at the earliest possible opportunity.

For queries or further information please contact the Copyright Team, First Floor, 9 Hills Road, Cambridge CB2 1GE.

OCR is part of the Cambridge Assessment Group; Cambridge Assessment is the brand name of University of Cambridge Local Examinations Syndicate (UCLES), which is itself a department of the University of Cambridge.

© OCR 2016

OCR
Oxford Cambridge and RSA

GCE

Economics

Unit **F585:** The Global Economy

Advanced GCE

Mark Scheme for June 2016

STEMUP.CO.UK

OCR (Oxford Cambridge and RSA) is a leading UK awarding body, providing a wide range of qualifications to meet the needs of candidates of all ages and abilities. OCR qualifications include AS/A Levels, Diplomas, GCSEs, Cambridge Nationals, Cambridge Technicals, Functional Skills, Key Skills, Entry Level qualifications, NVQs and vocational qualifications in areas such as IT, business, languages, teaching/training, administration and secretarial skills.

It is also responsible for developing new specifications to meet national requirements and the needs of students and teachers. OCR is a not-for-profit organisation; any surplus made is invested back into the establishment to help towards the development of qualifications and support, which keep pace with the changing needs of today's society.

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

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

Mark schemes should be read in conjunction with the published question papers and the report on the examination.

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

© OCR 2016

Annotations

Please annotate **every** response, even if no credit is given.

Annotation	Meaning
	Unclear
BOD	Benefit of Doubt
	Cross
EE	Effective evaluation
ND	No development
L1	Level 1
L2	Level 2
L3	Level 3
L4	Level 4
NAQ	Not answered question
SEEN	Noted but no credit given
TV	Too vague
	Tick
	Development of point

Highlighting is also available to highlight any particular points on the script.

'**SEEN**' or **'BP'** to be inserted on <u>every</u> blank page

STEMUP.CO.UK

Subject-specific Marking Instructions

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

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

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

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

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

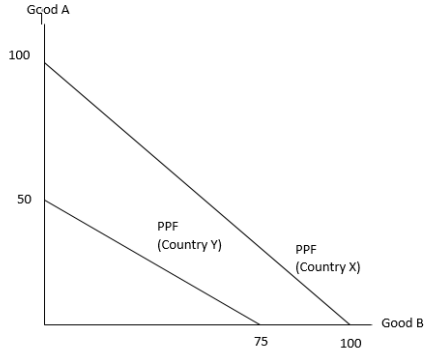
Level 1: Some simple ideas have been expressed. There will be some errors of spelling, punctuation and grammar

STEMUP.CO.UK

Question and Answer			Mark	Guidance
1	a	**Other than the reduction of trade barriers, describe two factors which have promoted globalisation.**		
		Exemplar responses: Reductions in the cost of communications (1) allowing businesses to manage global supply chains more effectively (1) A fall in the (real) cost of transport / improvements in transport (1) which has made it more viable for businesses to source goods globally / labour to be more mobile (1) A reduction in the restrictions on the movement of international finance (1) allowing FDI to move more freely between economies (1) Growth of trading blocs (1) which has facilitated the free movement of labour / capital (1) Containerisation (1) making international trade cheaper / reducing the cost of inter-modal transport (1) Growth of MNCs (1) creating global supply chains / global licensing / global franchising / access to global brands (1) Liberalisation of domestic markets (1) allowing MNCs to locate production / create global supply chains (1)	4	One mark for each relevant factor which has promoted globalisation (max 2 marks): • reductions in the cost of / better communications • improvements in technology / rise of the internet • fall in the real price of transport / improvements in transport infrastructure / containerisation • liberalisation of domestic markets • reduction in the restrictions on the movement of international finance • freer movement of labour • growth of trading blocs • growth of MNCs One mark for a description of how each factor has promoted globalisation (max 2 marks): • increased trade between nations • reductions in cost of trade • allowed firms to source goods globally • access to global brands • facilitated global joint ventures • facilitated global licensing, franchising and supplier agreements • facilitated FDI / location of production globally • allowed businesses to manage global supply chains more effectively Annotate with 

STEMUP.CO.UK

<table>
<tr><th colspan="3">Question and Answer</th><th>Mark</th><th>Guidance</th></tr>
<tr><td>1</td><td>b</td><td colspan="3">Using the theory of comparative advantage, analyse how an economy can benefit from trade.</td></tr>
<tr><td></td><td></td><td>Knowledge
Comparative advantage exists when one country produces a good or service at a lower (relative) opportunity cost than another. (1) Countries should specialise in the production of goods or services in which they have a comparative advantage (lowest relative opportunity cost). (1)

Application and analysis
 

<u>No diagram but explanation of relative opportunity cost (1)</u>
• a country has a comparative advantage when the sacrifice in production of one good required to raise the output of another good is less than that in other countries
<u>Correct PPF diagram / matrix only with no explanation (1)</u>
<u>Correct PPF diagram / matrix explained (2)</u>
• Country X has the comparative advantage in Good A
• Country Y has the comparative advantage in Good B

By trading (1) at mutually beneficial terms of trade (1) comparative advantage allows an economy to consume beyond its PPF / on TPF (1), increases economic welfare (1), a country can consume goods at a lower opportunity cost than if it they were to produce them itself (1)</td><td>6</td><td>Up to 2 marks for knowledge of comparative advantage and understanding of its implication in terms of specialisation.

Up to 4 further marks for application of the theory of comparative advantage and analysis of the benefits of trade it predicts.

Annotate with ✓

Analysis should include PPF / TPF diagram (s), 2x2 matrix or any other relevant theoretical framework of comparative advantage.

Example of relevant 2x2 matrix

<table>
<tr><td>Country</td><td>Good A</td><td>Good B</td></tr>
<tr><td>X</td><td>100</td><td>100</td></tr>
<tr><td>Y</td><td>50</td><td>75</td></tr>
</table>

NOTE: No credit should be given for diagrams or matrices which show reciprocal absolute advantage. An example of reciprocal absolute advantage is shown below

<table>
<tr><td>Country</td><td>Good A</td><td>Good B</td></tr>
<tr><td>X</td><td>100</td><td>100</td></tr>
<tr><td>Y</td><td>150</td><td>75</td></tr>
</table>

The question asks candidates to use comparative advantage theory to analyse how an economy benefits from trade, therefore do not reward:
• lower prices
• increase in (productive / allocative) efficiency
• economies of scale
• increase in world output
• increase in AD / AS / shift in PPF</td></tr>
</table>

STEMUP.CO.UK

<table>
<tr><th colspan="3">Question and Answer</th><th>Mark</th><th colspan="2">Guidance</th></tr>
<tr><td></td><td></td><td></td><td></td><td>Content</td><td>Levels of response</td></tr>
<tr><td>1</td><td>c</td><td colspan="4">Comment on the extent to which the overall trend in the US current account balance between 2007 and 2013 (Fig. 2.1) can be explained by the depreciation of the effective exchange rate of the US dollar over the same period (Fig. 2.2.).</td></tr>
<tr><td></td><td></td><td>Level 1
• the EER of the US$ measures the ER of the US$ against a basket of other currencies, weighted by trade
• there are three parts to the current account balance – trade balance, investment income balance, transfers balance

Level 2
• the US current account deficit improved from 2007 – 2013 (by over 40%)
• the EER index depreciated by around 5%

Level 3
• US import prices would rise, lowering the demand for imports
• US export prices would fall, raising the demand for exports
• a reduction in imports and an increase in exports would reduce the current account deficit

Level 4
• balance got worse before it got better (2009 – 13) suggesting depreciation of EER had little effect / J curve effect / Marshall – Lerner condition did not hold
• unlikely to explain the trend because it implies highly elastic PED for X and M (5% depreciation, 40% improvement in balance)
• fall in imports may be better explained by negative / low economic growth in US and high YED for imports / high mpm
• trend may also be due to an imbalance between savings and investment (S<I)
• most of the improvement occurs 2008 – 09 when the EER appreciated</td><td>10</td><td>Level 3
Analytical responses are characterised by explicit use of the economists' toolkit of concepts and theories and through explanation of cause and consequence

Level 4
Award marks as follows:
• one stated comment = seven marks
• two or more stated comments = eight marks
• one developed comment = nine marks
• two developed comments or one comment with two points of development = ten marks
Annotate developed evaluation with ✓+

Generic comments <u>only</u> about J curve / M-L / incomes abroad / size of the depreciation <u>without reference to time periods</u> max 7 marks</td><td>Level 1 [1]
For knowledge and understanding of the effective exchange rate or current account balance only

Annotate using L1

Level 2 [2 – 3]
For an application of knowledge and understanding of the overall trend in the US current account deficit

Annotate using L2

Level 3 [4 – 6]
For an analysis of the effect of the depreciation of the EER on the current account deficit.

Annotate using L3

Level 4 [7 – 10]
For a commentary on the extent to which the overall trend can be explained by the depreciation of the EER

Annotate using L4</td></tr>
</table>

STEMUP.CO.UK

Question and Answer			Mark	Guidance
2	**a**	**With reference to Fig. 3.1, state and explain how the Human Development Index (HDI) value of Zambia is likely to have changed between 2007 and 2013.**		
		Zambia's HDI is likely to have improved over the period 2007 to 2013 (1) This is because over the period 2007 to 2013: • all indicators included in the HDI improved (1) • there was an improvement in life expectancy (1) • there was an increase in mean and / or expected years of schooling (1) • there was an increase in GNI per capita, PPP (1)	4	One mark for stating that the HDI is likely to have improved Max three marks for use of the data in Fig. 3.1 to justify why this might be the case Annotate using ✓ **No marks are to be awarded for comparisons over the period <u>2000 to 2007</u> or <u>2000 to 2013</u>** The measurement of the HDI was changed in the 2010 Human Development Report which make a difference to candidates' answers. Pre 2010 HDI • life expectancy at birth • adult literacy (2/3^{rds}), primary, secondary and tertiary enrolment rates (1/3rd) • GDP per capita at PPP Post 2010 HDI • life expectancy at birth • mean and expected years of schooling • GNI per capita at PPP

STEMUP.CO.UK

Question and Answer			Mark	Guidance
2	b	**Analyse the significance for the economy of Zambia of the fall in its terms of trade between 2007 and 2009 (Fig. 3.2)**		
		Knowledge • terms of trade are the average price of exports relative to the average price of imports (1) • Zambia's declining ToT are caused by a fall in the world price of copper (1) **Application and analysis** • the fall in copper prices will reduce Zambia's export revenue (1) if the demand for copper is price inelastic (1) because there will be a less than proportionate increase in export volumes (1) which will cause a reduction in AD (1) and lead to a fall in real GDP / economic growth / employment / improvement in current account of BoP (1) • declining ToT means that Zambia's exports will 'buy' fewer imports (1) which may reduce Zambia's ability to buy imported capital and intermediate goods in production (1) which reduces the growth of the productive capacity of the economy (1) reduces its LRAS (1) and leads to lower long run economic growth (1) • declining ToT means that Zambia will earn less foreign currency (1)) if the demand for copper is price inelastic (1) because there will be a less than proportionate increase in export volumes (1), this may mean Zambia has to borrow more to repay debt (1) and may have to postpone development projects in order to finance debt repayment (1) • lower tax revenue / revenue of mining companies resulting from fall in export revenue (1) leads to fall in infrastructure investment / expenditure on healthcare or education / fall in FDI (1) causing fall in AD (1) and LRAS (1) and lead to a fall in real GDP / economic growth / employment (1) • particularly significant since Zambia is so dependent on exports of copper / sustained deterioration in ToT could adversely affect development (development trap) (1)	6	Up to 2 marks for knowledge of terms of trade and understanding of reasons for the fall in Zambia's terms of trade Up to 6 marks for the impact on the economy of Zambia **Max 6 marks** Annotate with ✓ **Also accept** • the fall in copper prices will raise Zambia's export revenue (1) if the demand for copper is price elastic (1) because there will be a more than proportionate increase in export volumes (1) which will cause an increase in AD (1) and lead to a rise in real GDP / economic growth / employment / (worsening current account of BoP) (1) particularly significant since Zambia is so dependent on exports of copper / sustained deterioration in ToT could positively affect development (avoid development trap) (1) **Do not credit answer which:** • **analyse the effects of declining ToT due to high import prices** • **analyse the effects of declining ToT where candidates put this down to a rise in export prices**

STEMUP.CO.UK

<table>
<tr><th colspan="3">Question and Answer</th><th>Mark</th><th colspan="2">Guidance</th></tr>
<tr><td></td><td></td><td></td><td></td><td>Content</td><td>Levels of response</td></tr>
<tr><td>2</td><td>c</td><td colspan="4">Comment on the extent to which increased financial flows from remittances help to promote development.</td></tr>
<tr><td></td><td></td><td>Level 1
• transfers of money by a foreign worker to their home country

Level 2
• represent at least 10% of GDP of developing countries
• more stable / highest (except FDI) flow of international finance

Level 3
• increase household income increasing consumption and AD / injection into circular flow, leading to higher GDP / GDP per capita and raise the level of development / HDI
• those in receipt of remittances / tax revenue from remittances may use the money to finance health and education which will increase life expectancy, literacy rates, mean and expected levels of schooling raising the level of development / HDI
• remittances provide finance for business starts ups which will increase LRAS and create high GDP / GDP per capita raising the level of development / HDI

Level 4
• depends on the size of remittances (absolute and relative)
• remittances may be saved / used to repay household debt / spent on imports with little effect on real GDP / employment
• outward migration / brain drain may limit long term growth by reducing labour supply / might reduce work incentives leading to reduction of LRAS
• remittances create AD led growth so is unsustainable as it leads to demand-pull inflation
• may lead to appreciation of the ER (higher demand for currency) causing higher export prices / reducing value of remittances
• value of remittances reduced by transaction costs
• flows of remittances depends on economic growth abroad</td><td>10</td><td>Level 2
Responses in this level will show a TOTAL lack of economic analysis

Level 3
Analytical responses are characterised by explicit use of the economists' toolkit of concepts and theories and through explanation of cause and consequence

Level 4
Award marks as follows:
• one stated comment = seven marks
• two or more stated comments = eight marks
• one developed comment = nine marks
• two developed comments or one comment with two points of development = ten marks
Annotate developed evaluation with  </td><td>Level 1 [1]
For knowledge and understanding of development only

Annotate using L1

Level 2 [2 – 3]
For an application of knowledge and understanding of a range of impacts of increased financial flows from remittances and / or application of stimulus material

Annotate using L2

Level 3 [4 – 6]
For an analysis of how increased financial flows from remittances help to promote development.

Annotate using L3

Level 4 [7 – 10]
For a commentary on the extent to which increased financial flows from remittances help to promote development.

Annotate using L4</td></tr>
</table>

STEMUP.CO.UK

Question and Answer		Marks	Guidance	
			Content	Levels of response
3	**Discuss the extent to which supply-side policies are the key to promoting economic growth in a developing economy such as Zambia.**			
	Level 1 (Knowledge and understanding) • short-run economic growth occurs when there is an increase in real GDP caused by an increase in AD and / SRAS • long-run economic growth occurs when there is an increase in the productive potential of the economy caused by an increase in LRAS / quantity and / or quality of the factors of production (land, labour and capital) • supply-side policies aim to improve the economic performance of individual markets and improve incentives to individual workers and firms within markets. **Level 2 (Application)** • economic growth in developing economies / Zambia is constrained by poor infrastructure, lack of training and education / access to capital markets, inefficient state enterprises, lack of energy supply, lack of incentives 'to do business' / invest / seek employment, unstable macroeconomic environment • relevant supply-side policies for a developing economy / Zambia, therefore, might include: - creating a stable macroeconomic environment (low inflation) - privatisation / deregulation - labour market incentives (lower taxes) - environment 'to do business' and incentives to increase investment (lower corporation tax, less regulation) - improved access to capital markets - improved infrastructure - improved training and education - trade liberalisation	20	*Quality of Written Communication* is assessed in this question. Please see page 5 for guidelines. **Level 2** Responses in this level will identify relevant supply-side policies but will not explain **HOW** they promote economic growth. They will, therefore, show a **TOTAL** lack of economic analysis and include only a series of assertions or generalisations.	**Level 1** **[1 – 2]** For knowledge and understanding of economic growth only Annotate using L1 **Level 2** **[3 – 4]** For an application of knowledge and understanding of the constraints on economic growth in developing economies, the nature of supply-side policies and relevant supply-side policies which might promote economic growth in developing economies. Annotate using L2

STEMUP.CO.UK

Question and Answer		Marks	Guidance	
			Content	Levels of response
	Level 3 (Analysis) Relevant analysis of the impact of supply-side policies on economic growth: • supply-side policies raise LRAS by increasing productive capacity and/or lower the costs of production shifting SRAS to the right • increase in SRAS / LRAS and allows non-inflationary growth • lower costs of production • higher labour productivity / MRP, reduced unit labour costs • increase in international competitiveness allowing an increase in AD • generation of new comparative advantage and increased benefits of trade, by avoiding development trap of declining terms of trade and low value added in primary sector • increase in quantity and quality of land, labour and capital shift the PPC outwards • supply-side policies may encourage savings, creating loanable funds for investment / link to Harrod-Domar model • investment in infrastructure may increase geographical mobility of labour, encourage rural-urban migration / link to Lewis model **Level 4 Band 1** Basic discussion of the effectiveness of supply-side policies which focuses on general points and lacks context relevant to a developing economy or recognises that there are alternatives: • supply-side policies take time to work • supply-side policies might require an increase in government expenditure • economic growth can also be achieved through demand-side policies • supply-side policies may be ineffective because of poor governance / corruption		**Level 3 responses** *Likely to include an AD/AS diagram showing rightward shift of AS and increase in real GDP or use of development theories/models, including Rostow, etc* **Award a maximum of 7 marks if the analysis is of supply-side policies in general ie there is no prior application of specific supply-side policies** **Level 4 Band 1** *Responses in this Band will be characterised by weak supporting analysis **or** will not provide context relevant to a developing economy **or** will not have identified specific supply-side policies **or** will include only generic points of evaluation of supply-side policies*	**Level 3 [5 – 10]** For an analysis of how supply-side policies promote economic growth in a developing economy such as Zambia Annotate using L3 **Level 4 Band 1 [11 – 14]** For a basic discussion of the extent to which supply-side policies are the key to promoting economic growth in a developing economy such as Zambia, with no appropriate context. Annotate using L4

STEMUP.CO.UK

Question and Answer		Marks	Guidance	
			Content	Levels of response
	Level 4 Band 2 • growth in developing economies may be constrained by a lack of demand, rather than a lack of productive capacity and therefore there may need to be a change in nature of AD / structure of the economy / increase in AD • lack of effective demand is evident from widespread under-employment in developing economies – especially in rural areas • investment may be constrained by a lack of savings – micro credit schemes may be more effective, especially in rural areas • multiplier effects may be limited due to inadequate forward and backward linkages – especially true if FDI, rather than domestic investment, is encouraged • growth effects may be limited by shortages of skilled labour – especially where there has been net outward migration in the past • some supply-side policies may be more important / effective than others depending on what might be considered to be the most important constraint on economic growth • supply-side policies to encourage investment / FDI may not be effective as a result of policies such as resource nationalisation • government investment in infrastructure / education / health may not be possible if there is an existing budget deficit / low tax base / high tax evasion / low incomes so may require government borrowing which may cause crowding out		**Level 4 Band 2** *Discussion in this Band should be based on strong supporting analysis **AND** context relevant to a developing economy (which may include consideration of the typical constraints on economic growth in developing economies) **AND** specific examples of supply-side policies*	**Level 4 Band 2 [15 – 17]** For a well-developed discussion of the extent to which supply-side policies are the key to promoting economic growth in a developing economy such as Zambia, including appropriate context Annotate using L4

STEMUP.CO.UK

Question and Answer		Marks	Guidance	
			Content	Levels of response
	Level 4 Band 3 • supply-side policies might be limited in effectiveness on their own / without effective demand – creation of productive potential is insufficient on its own • supply-side policies need to be of the 'right' kind – this might be different for different economies / depend on the particular constraints on economic growth faced by a developing economy • policies which focus on developing forward and backward linkages might be better than those which rely solely on large scale investments in infrastructure, for example • without measures to open access to global markets, supply-side policies might not generate economic growth		**Level 4 Band 3** *Judgements should be based on well-developed analytical discussion*. Stated judgements = 18 marks One or more developed judgements MUST be awarded 19 or 20 marks	**Level 4 Band 3 [18 – 20]** For a judgement on the extent to which supply-side policies are the key to promoting economic growth in a developing economy such as Zambia. Annotate using EE

STEMUP.CO.UK

OCR (Oxford Cambridge and RSA Examinations)
1 Hills Road
Cambridge
CB1 2EU

OCR Customer Contact Centre

Education and Learning
Telephone: 01223 553998
Facsimile: 01223 552627
Email: general.qualifications@ocr.org.uk

www.ocr.org.uk

For staff training purposes and as part of our quality assurance programme your call may be recorded or monitored

Oxford Cambridge and RSA Examinations
is a Company Limited by Guarantee
Registered in England
Registered Office; 1 Hills Road, Cambridge, CB1 2EU
Registered Company Number: 3484466
OCR is an exempt Charity

OCR (Oxford Cambridge and RSA Examinations)
Head office
Telephone: 01223 552552
Facsimile: 01223 552553

© OCR 2016

PART OF THE CAMBRIDGE ASSESSMENT GROUP

LLOYD'S REGISTER QUALITY ASSURANCE · ISO9001 · UKAS MANAGEMENT SYSTEMS 001

STEMUP.CO.UK

ERRATUM NOTICE

A2 GCE ECONOMICS

F585/01/SM The Global Economy

PRE-RELEASE STIMULUS MATERIAL JUNE 2015

FOR THE ATTENTION OF THE EXAMINATIONS OFFICER AND THE HEAD OF DEPARTMENT

TO BE OPENED UPON RECEIPT

Please note there is an error in **both the electronic and hard copy versions** of the pre-release Stimulus Material which has already been issued to centres on the OCR website:

In Fig. 4.2 on page 10, the right bar for 2011 currently shows the same values as the bar for 1990. The bar should show the following percentages: 36% (trade between developed countries), 38% (trade between developed and developing countries), 24% (trade between developing countries), 2% (unspecified destinations).

Please instruct candidates to amend their hard copy of the pre-release Stimulus Material.

Website pre-release Stimulus Material
A corrected version will be uploaded to the OCR website shortly. It will be available in the pre-release materials section of the GCE Economics page of the OCR website.

Hard copy pre-release Stimulus Material
The hard copy pre-release version will not be corrected and OCR will continue to send out this erratum notice.

Hard copy day of the exam Stimulus Material
The version for use with the question paper on the day of the exam will be corrected and OCR will not be sending an erratum notice.

OCR apologises for any inconvenience caused.

Any enquiry about this notice should be referred to the Customer Contact Centre on 01223 553 998 or general.qualifications@ocr.org.uk

© OCR 2015 Ref: June15/erratum

STEMUP.CO.UK

OCR
Oxford Cambridge and RSA

Thursday 11 June 2015 – Afternoon

A2 GCE ECONOMICS

F585/01 The Global Economy

Candidates answer on the Question Paper.

OCR supplied materials:
- Clean copy Stimulus Material

Other materials required:
- Calculators may be used

Duration: 2 hours

F585/01

2717902769

Candidate forename		Candidate surname	

Centre number						Candidate number				

INSTRUCTIONS TO CANDIDATES

- Refer to the Stimulus Material in the separate booklet. You must **not** bring your original copy into the examination.
- Write your name, centre number and candidate number in the boxes above. Please write clearly and in capital letters.
- Use black ink. HB pencil may be used for graphs and diagrams only.
- Answer **all** the questions.
- Read each question carefully. Make sure you know what you have to do before starting your answer.
- Write your answer to each question in the space provided. If additional space is required, you should use the lined pages at the end of this booklet. The question number(s) must be clearly shown.
- Do **not** write in the bar codes.

INFORMATION FOR CANDIDATES

- The number of marks is given in brackets **[ ]** at the end of each question or part question.
- The total number of marks for this paper is **60**.
- The quality of your written communication will be taken into account in the marking of your answer to question 3. All answers should be in continuous prose.
- This document consists of **16** pages. Any blank pages are indicated.

A calculator may be used for this paper

© OCR 2015 [T/500/7921]
DC (LEG/CGW) 93089/3

OCR is an exempt Charity

STEMUP.CO.UK

Answer **all** questions.

1 (a) (i) Other than recovery, name **two** stages of the economic cycle.

1 .....

.....

2 .....

.....

[2]

(ii) State and explain the likely impact of an economic recovery on unemployment.

.....

.....

.....

.....

.....

.....

.....

..... **[2]**

© OCR 2015

STEMUP.CO.UK

(b) Using a diagram, analyse how a rise in long term unemployment might impact on the future potential output of the UK economy.



.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

..... **[6]**

© OCR 2015

STEMUP.CO.UK

(c) Comment on the effectiveness of both increasing tax allowances on investment and cutting corporation tax as a way of increasing the international competitiveness of the UK economy. **[10]**

© OCR 2015

STEMUP.CO.UK

© OCR 2015

STEMUP.CO.UK

2 **(a)** Using an example with which you are familiar, compare the level of economic integration between the European Union and one other regionally integrated area.

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

..... **[4]**

© OCR 2015

STEMUP.CO.UK

(b) Analyse the trade creation and trade diversion effects of a customs union.

.... **[6]**

© OCR 2015

STEMUP.CO.UK

(c) Comment on the extent to which the theory of comparative advantage explains the patterns of global trade in Figs 4.2, 4.3 and 4.4. **[10]**

© OCR 2015

STEMUP.CO.UK

© OCR 2015

STEMUP.CO.UK

3 "As a number of countries have become more open to global economic forces over the past 20 years, the percentage of the developing world living in extreme poverty ... has been cut in half."

Discuss the extent to which globalisation has been largely beneficial to developing economies. **[20]**

© OCR 2015

STEMUP.CO.UK

© OCR 2015

STEMUP.CO.UK

© OCR 2015

© OCR 2015

STEMUP.CO.UK

END OF QUESTION PAPER

© OCR 2015

ADDITIONAL ANSWER SPACE

If additional answer space is required, you should use the following lined page(s). The question number(s) must be clearly shown in the margin.

© OCR 2015

STEMUP.CO.UK

OCR
Oxford Cambridge and RSA

Copyright Information

OCR is committed to seeking permission to reproduce all third-party content that it uses in its assessment materials. OCR has attempted to identify and contact all copyright holders whose work is used in this paper. To avoid the issue of disclosure of answer-related information to candidates, all copyright acknowledgements are reproduced in the OCR Copyright Acknowledgements Booklet. This is produced for each series of examinations and is freely available to download from our public website (www.ocr.org.uk) after the live examination series.

If OCR has unwittingly failed to correctly acknowledge or clear any third-party content in this assessment material, OCR will be happy to correct its mistake at the earliest possible opportunity.

For queries or further information please contact the Copyright Team, First Floor, 9 Hills Road, Cambridge CB2 1GE.

OCR is part of the Cambridge Assessment Group; Cambridge Assessment is the brand name of University of Cambridge Local Examinations Syndicate (UCLES), which is itself a department of the University of Cambridge.

© OCR 2015

OCR
Oxford Cambridge and RSA

GCE

Economics

Unit **F585:** The Global Economy

Advanced GCE

Mark Scheme for June 2015

STEMUP.CO.UK

OCR (Oxford Cambridge and RSA) is a leading UK awarding body, providing a wide range of qualifications to meet the needs of candidates of all ages and abilities. OCR qualifications include AS/A Levels, Diplomas, GCSEs, Cambridge Nationals, Cambridge Technicals, Functional Skills, Key Skills, Entry Level qualifications, NVQs and vocational qualifications in areas such as IT, business, languages, teaching/training, administration and secretarial skills.

It is also responsible for developing new specifications to meet national requirements and the needs of students and teachers. OCR is a not-for-profit organisation; any surplus made is invested back into the establishment to help towards the development of qualifications and support, which keep pace with the changing needs of today's society.

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

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

Mark schemes should be read in conjunction with the published question papers and the report on the examination.

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

© OCR 2015

Annotations

Please annotate **every** response, even if no credit is given.

Annotation	Meaning
	Unclear
BOD	Benefit of Doubt
	Cross
EE	Effective evaluation
ND	No development
L1	Level 1
L2	Level 2
L3	Level 3
L4	Level 4
NAQ	Not answered question
SEEN	Noted but no credit given
TV	Too vague
	Tick
	Development of point

Highlighting is also available to highlight any particular points on the script.

'**SEEN**' to be inserted on <u>every</u> blank page

STEMUP.CO.UK

Subject-specific Marking Instructions

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

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

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

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

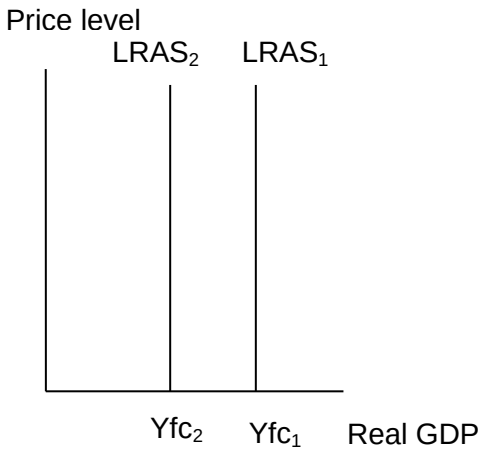
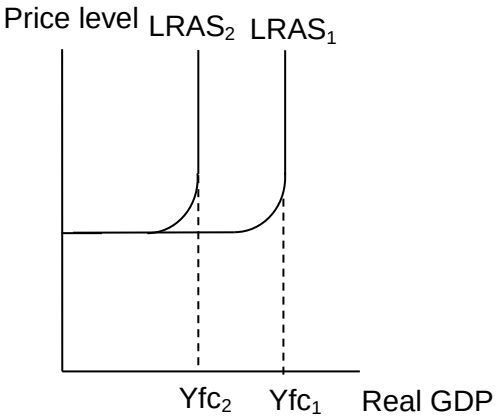
Level 2: Some simple ideas have been expressed in an appropriate context. There are likely to be some errors of spelling, punctuation and grammar of which some may be noticeable and intrusive.

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

STEMUP.CO.UK

Question			Answer/Indicative content	Mark	Guidance
1	a	i	**Other than recovery, name two stages of the economic cycle.** Stages of the economic cycle • boom • slowdown/downturn • recession/slump/bust/depression	2	One mark for each stage of the economic cycle Use green ticks ✓ for each mark awarded Maximum two marks
		ii	**State and explain the likely impact of an economic recovery on unemployment.** Award one mark for the ***impact*** and one mark for the ***explanation:*** • unemployment may fall (one mark) because as output/GDP/AD rises there is an increased demand/need for labour (one mark) • there may be no effect on the level of unemployment (one mark) because business confidence may be fragile / low so firms respond to increased output/GDP/AD by using existing resources more intensively (one mark) • unemployment might rise (one mark) because during an economic recovery there may still be firms going out of business / rationalisation despite an increase in output/GDP/AD (one mark) • there may be no effect on the level of unemployment (one mark) because firms may have hoarded labour during the recession they may be able to raise output in the recovery phase without employing new labour (one mark)	2	There are three valid impact of an economic recovery on unemployment: • unemployment may fall • unemployment may rise • there may be no effect on unemployment Award one mark for any of these impacts and a further mark for an explanation. Use green ticks ✓ for each mark awarded Maximum two marks

STEMUP.CO.UK

Question			Answer/Indicative content	Mark	Guidance
	b		**Using a diagram, analyse how a rise in long term unemployment might impact on the future potential output of the UK economy.** **Award two marks for diagram as follows:** • one mark for leftward shift of LRAS/AS (one mark) • clearly showing impact on potential output e.g. Yfc_1 to Yfc_2 as on diagrams opposite (one mark) **Award one mark for a statement of the impact on future potential output** • future potential output could be reduced (one mark) **Award up to three further marks for an explanation of the impact on future potential output** • the economy's LRAS/AS shifts left (one mark) • as a result of long-term unemployment, people lose skills (one mark) • this creates a hysteresis effect as people find it harder to find employment/become unemployable/trapped in unemployment (one mark) • this reduces the economy's human capital (one mark) • this reduces the quality/productivity of the labour force (one mark) • as a result of unemployment people lose the motivation to seek work (one mark) • this creates a hysteresis effect as people find it harder to find employment (one mark) • this reduces the quantity of the labour force.(one mark) Use green ticks ✓ for each mark awarded	6	Accept either of the diagrams below   Use green ticks ✓ for each mark awarded Both curves must be labelled either LRAS or AS Maximum six marks

STEMUP.CO.UK

Question			Answer/Indicative Content	Marks	Guidance	
					Content	Levels of response
	c		**Comment on the effectiveness of increasing tax allowances on investment and cutting corporation tax in increasing the international competitiveness of the UK economy** **Commentary on effectiveness of the two policies in increasing international competitiveness may include:** • increases in cost and price competitiveness alone may be insufficient (basic L4) – a lack of international competitiveness can be caused by non-price factors including product quality, design and reliability (developed L4), factors which might be more important in oligopolistic markets where there is likely to be a high degree of non-price competition (developed L4) • investment may be determined by other factors such as business confidence (basic L4) – a reduction in corporation tax may enable firms to increase investment but they may be unwilling to increase investment if AD is not expected to rise (developed L4) as a result of recession / increase in interest rates … (developed L4) **Analysis of how higher tax allowances and reduced corporation tax may increase international competitiveness may include:** • investment in human/physical capital will increase productivity (basic analysis) – increased output per unit of labour/capital which will reduce unit (labour costs) enabling firms to reduce prices and increase the price competitiveness of their goods and services in international markets (good analysis) • investment in human/physical capital will shift the AS curve to the right (basic analysis), which will reduce the price level and increase the price competitiveness of UK goods and services in international markets (good analysis) • investment in the form of R&D will increase product innovation (basic analysis), so that UK firms are better able to compete in international markets by supplying goods and services that meet consumers' needs and are of a higher quality (good analysis)	10	In Level 4 award marks as follows: • <u>one</u> **stated** comment = seven marks • <u>two</u> or more **stated** comments = eight marks • <u>one</u> **developed** comment = nine marks • <u>two</u> **developed** comments or <u>one</u> comment with <u>two</u> points of development = ten marks Also accept in L4 • An increase in tax allowances may be less effective if combined with a reduction in corporation tax (basic L4). This is because the higher tax allowances create less of an incentive to increase investment (developed L4). This is because the benefit of tax relief on investment is lower if the tax on profit itself is lower (developed L4).	**Level 4: (7 – 10 marks)** For a commentary on the effectiveness of increasing tax allowances on investment and cutting corporation tax in increasing the international competitiveness of the UK economy **NB If only one policy correctly analysed and commented upon then cap at 9** *Annotate using* L4 *in LHS margin* *Show development with* ✓+ **Level 3: (4 – 6 marks)** For an analysis of how increasing tax allowances on investment ***and*** cutting corporation tax may increase the international competitiveness of the UK economy **NB If only one policy correctly analysed cap at 5**

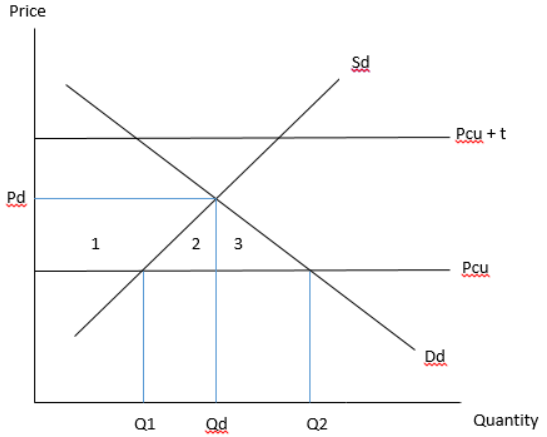
STEMUP.CO.UK

Question			Answer/Indicative Content	Marks	Guidance	
					Content	Levels of response
			Application of knowledge and understanding of how higher tax allowances on investment and reduced corporation tax may increase international competitiveness may include: • higher tax allowances on investment create an incentive for firms to increase investment (in order to reduce their tax liability) • reduced corporation tax means firms are more able to finance investment as they retain more of their profits • investment tax allowances and reduced corporation tax make it less likely that investment is reduced by higher interest rates (lowers the interest elasticity of investment) **Knowledge and understanding of international competitiveness** • international competitiveness is the ability of an economy's firms to compete in international markets and, thereby, sustain increases in national output and income			*Annotate using* L3 *in LHS margin* **Level 2: (2 – 3 marks)** For an application of how increasing tax allowances on investment and cutting corporation tax may increase the international competitiveness of the UK economy *Annotate using* L2 *in LHS margin* **Level 1: (1 mark)** For knowledge and understanding of international competitiveness *Annotate using* L1 *in LHS margin*

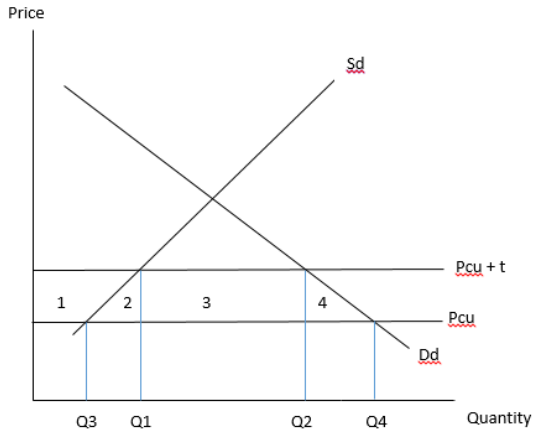
STEMUP.CO.UK

Question			Answer/Indicative content	Mark	Guidance
2	a		**Using an example with which you are familiar, compare the level of economic integration between the European Union and one other regionally integrated area.** **One mark for knowledge of one other regionally integrated area** • North American Free Trade Area (NAFTA) • Association of Southeast Asian Nations (ASEAN) • Mercosur • Caricom • Tripartite Free Trade Area (TFTA) • Commonwealth of Independent States Free Trade Area (CISFTA) • Eurasian Economic Community (EAEC) • Central American Integration System (SICA) **One mark for a statement about the difference in the level of economic integration** • level of economic integration in the EU is higher / similar **Two further marks for developed comparison** • EU has free movement of goods and services as do TFTA / Caricom / CISTFA / EAEC / SICA, but ASEAN and NAFTA have exemptions on free trade for some goods and services (for NAFTA = agricultural goods) • EU has a common external tariff as do Mercosur / Caricom / EAEC / SICA, whereas NAFTA / ASEAN / TFTA / CISFTA do not • EU has free movement of labour as does Caricom / EAEC, whereas NAFTA / ASEAN / TFTA / CISFTA do not and Mercosur / SICA is moving towards free movement • EU has free movement of capital as does NAFTA / Caricom / EAEC, whereas ASEAN / TFTA / CISFTA do not and Mercosur / SICA is moving towards free movement • EU has common policies as does EAEC, whereas NAFTA / ASEAN / TFTA / CISFTA / SICA do not and Mercosur / Caricom are moving towards co-ordinating / harmonising some policies • some members of the EU share a common currency / monetary policy as do some members of Caricom, whereas NAFTA / ASEAN / Mercosur / TFTA / CISFTA / EAEC / SICA do not	4	Use green ticks ✓ for each mark awarded Maximum four marks in total Accept common external “barriers” or “policy” in place of common external tariff

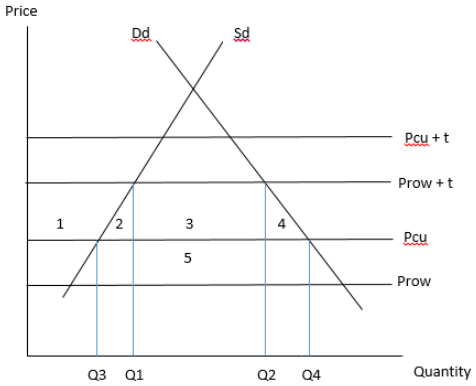
STEMUP.CO.UK

Question	Answer/Indicative content	Mark	Guidance
b	**Analyse the trade creation and trade diversion effects of a customs union.** **One mark for knowledge and understanding of a customs union** • an agreement between two or more countries to abolish tariffs on trade and to place a common external tariff on trade with non-members (one mark) **Up to three marks for application and analysis of trade creation** • *trade creation occurs when a customs union results in high-cost domestic production being replaced by imports from a more efficient source within the customs union (one mark)* • trade creation arises because the removal of tariffs on trade between members of the customs union reduces the price at which goods and services can be traded within the customs union (one mark), leading to a reduction in domestic production in some countries and increased trade with members of the customs union.(one mark) **Up to three marks for application and analysis of trade diversion** • trade diversion occurs when a customs union results in trade switching from a low-cost supplier outside the customs union to a less efficient source within the customs union (one mark) • trade diversion arises because prices of goods and services from outside the customs union will be higher than those within the customs union (one mark) leading to greater trade with members of the customs union and less trade with non-members (one mark) • trade diversion reduces employment in countries outside the customs union (one mark) **Up to three marks for wider effects of trade creation <u>and</u> diversion** • fall in the price of goods and services in the customs union (one mark) • increase in consumer surplus (one mark) • decrease in producer surplus (one mark) • reduction in tariff revenue (one mark) • rise or fall in economic welfare depending on size of increase in CS, reduction in PS and reduction in tariff revenue (one mark) • reduction in domestic employment (one mark)	6	Where candidates make use of a diagram, this can be rewarded with up to two application marks. Explanation of a diagram can be awarded up to 2 further marks for analysis **Trade creation (pure)**  Award 1 mark for this diagram if accurate and fully labelled Award 2 further marks for explanation of this diagram: • Before formation of a CU, price is Pd and quantity Qd (ie domestic production only) • After formation of a CU, tariff is removed so price falls from Pd to Pcu • There is an increase in consumer surplus (this might also be shown on the diagram = area 1+2+3) • There is a reduction in producer surplus (this might also be shown on the diagram = area 1) • There is an increase in economic welfare / allocative efficiency (this might also be shown on the diagram = area 2+3)

STEMUP.CO.UK

Question	Answer/Indicative content	Mark	Guidance
			Trade creation (partial)  Award 1 mark for this diagram if accurate and fully labelled Award 2 further marks for explanation of this diagram which might include: • Before formation of a CU, price is Pcu + t and imports Q1Q2 • After formation of a CU, tariff is removed so price falls Pcu • There is an increase in consumer surplus (this might also be shown on the diagram = area 1+2+3+4) • There is a reduction in producer surplus (this might also be shown on the diagram = area 1) • There is a loss of tariff revenue (this might also be shown in the diagram = area 3) • There is an increase in economic welfare / allocative efficiency (this might also be shown on the diagram = area 2+4)

STEMUP.CO.UK

Question	Answer/Indicative content	Mark	Guidance
	DO NOT ACCEPT THE IDEA THAT TRADE DIVERSION <u>INCREASES</u> PRICES IN THE CU		**Trade creation and diversion (also accept as trade diversion)**  Award 1 mark If this diagram is used in addition to a TC diagram Award 2 marks if this diagram is used on its own Award 2 further marks for explanation of this diagram which might include: • Before formation of a CU, price is Prow + t and imports Q1Q2 • After formation of a CU, tariff on CU trade is removed so price falls to Pcu and CET keeps ROW price at Prow + t • There is an increase in trade from Q1Q2 to Q3Q4 • Domestic production of Q3 is reduced to Q4 and replaced with trade with CU (trade creation = Q3Q1 + Q2Q4) • Imports of Q1Q2 from ROW are placed by trade with CU (trade diversion = Q1Q2) • There is an increase in consumer surplus (this might also be shown on the diagram = area 1+2+3+4) • There is a reduction in producer surplus (this might also be shown on the diagram = area 1) • There is a loss of tariff revenue (this might also be shown in the diagram = area 3+5) • There is an increase in economic welfare / allocative efficiency (this might also be shown on the diagram = area 2 + 4 - 5) Use green ticks ✓ for each mark awarded

STEMUP.CO.UK

Question			Answer/Indicative Content	Marks	Guidance	
					Content	Levels of response
	c		**Comment on the extent to which the theory of comparative advantage explains the patterns of global trade in Figs. 4.2, 4.3 and 4.4** **Commentary on extent to which the theory of CA explains the patterns of global trade:** • trade between developed economies remains significant, but developed economies are likely to have similar relative opportunity costs and factor endowments • intra-regional trade may reflect transport costs which cancel out differences in opportunity cost or regional integration (e.g. (EU) • intra-industry trade reflects market structure and product differentiation rather than relative opportunity costs • comparative advantage is difficult to measure • changing patterns of trade may be due to changes in absolute advantage caused by development **Analysis of how CA explains patterns of global trade:** • increased trade between developed and developing countries might reflect changing comparative advantage as high wage economies have lost CA in labour intensive manufacturing • economic development has changed comparative advantage of developing economies • high percentage of trade between regions suggests regions have different factor endowments **Application of the patterns of global trade from Figs:** • % of world trade accounted for by trade between developed economies has fallen, between developed and developing countries has risen, between developing countries has risen • with exception of Asia, most trade is inter-regional although there are high levels of intra regional trade in North America and the EU • there are high levels of intra-industry trade in the economies shown in Fig. 4.4 with the exception of the two African economies **Knowledge of comparative advantage:** • where one country produces a good or service at a lower relative opportunity cost than others	10	In Level 4 award marks as follows: • <u>one</u> **stated** comment = seven marks • <u>two</u> or more **stated** comments = eight marks • <u>one</u> **developed** comment = nine marks • <u>two</u> **developed** comments or <u>one</u> comment with <u>two</u> points of development = ten marks	**Level 4: (7 – 10 marks)** For a commentary on the extent to which the theory of comparative advantage explains the patterns of global trade in Figs. *Annotate using* L4 *in LHS margin* *Show development with* ✓+ **Level 3: (4 – 6 marks)** For an analysis of how comparative advantage may or may not explain the patterns of global trade in Figs. 4.2, 4.3 and 4.4 *Annotate using* L3 *in LHS margin* **L3 can be awarded for analysis of why CA does not explain the pattern of trade** **Level 2: (2 – 3 marks)** For an application of the patterns of global trade in Figs. 4.2, 4.3 and 4.4 *Annotate using* L2 *in LHS margin* **If use of figures, but no explanation why, keep in L2** **Level 1: (1 mark)** For knowledge and understanding of comparative advantage *Annotate using* L1 *in LHS margin*

STEMUP.CO.UK

Question			Answer/Indicative Content	Marks	Guidance	
					Content	Levels of response
3			**Discuss the view that the impact of globalisation on developing economies is largely beneficial.** **Judgements on the extent to which globalisation is largely beneficial to developing economies might include** • least developed economies are unlikely to find that globalisation is largely beneficial as the structure of their economies is more likely to be dominated by primary sector production • developing economies that have a comparative advantage in the manufacturing sector are more likely to benefit from globalisation • developing economies are more likely to benefit from globalisation if there is investment in human capital in order to ensure that more people are able to benefit from economic growth and that income inequalities do not rise • in order to benefit from globalisation, there may need to be more done to open up markets in developing economies (particularly in agriculture) • developing economies/governments which manage globalisation are more likely to experience benefits e.g. China **Discussion of whether globalisation is beneficial for developing economies could include** • greater trade creates losers as well as winners and developing economies may not be able to compete in global markets (Band 1) particularly because of infant industries which lack economies of scale and therefore LRAC is higher than in more developed economies (Band 2)	20	**Also accept the following as judgement:** • Income inequality may only be in the short run. In the long run it may become more equal.	**Level 4 Band 3: (18 – 20 marks)** For a discussion of whether globalisation is beneficial for developing economies supported by good analysis of benefits and costs and including a judgement on the extent to which it is largely beneficial *Annotate using* EE *in LHS margin* **Level 4 Band 2: (15 – 17 marks)** For a discussion of whether globalisation is beneficial for developing economies supported by good analysis of benefits and costs *Annotate using* ✓+ *in LHS margin* **Level 4 Band 1: (11 – 14 marks)** For a discussion of whether globalisation is beneficial for developing economies supported by basic analysis of benefits and costs *Annotate using* L4 *in LHS margin*

STEMUP.CO.UK

Question			Answer/Indicative Content	Marks	Guidance	
					Content	Levels of response
			• developing economies have comparative advantage in primary products which are low value (Band 1), and could cause a development 'trap' if there are declining terms of trade (Band 2) • globalisation exposes developing economies to external economic shocks because of their greater integration into the global economy (Band 1), which may result in volatility of export revenue (particularly in the case of primary products which have price inelastic supply) and low AD in the case of a global recession (Band 2) • gains in employment from greater FDI may be small (Band 1), particularly if FDI is capital intensive or there are small multiplier effects where multinationals do not develop supply chains within developing economies or where profits are repatriated resulting in a smaller increase in GNP than GDP (Band 2) • gains from FDI may be temporary as MNCs are footloose (Band 1), so as rising GDP per capita eventually results in higher wage rates MNCs may seek out a lower cost base for production leading to capital outflows and reduced AD (Band 2) • FDI may result in environmental degradation which creates negative externalities or resource depletion (Band 1), with the result that there is increased market failure as a result of MSC > MPC and unsustainable growth as the long run growth potential is reduced (Band 2) • whilst trade, FDI and greater capital flows may generate higher levels of GDP and GDP per capita it may also increase income inequalities as economic activity is concentrated in urban areas (Band 1), where the supply of educated labour is inelastic raising wage rates above those in rural areas creating rural-urban migration which may damage agricultural development and leading to a rise in informal sector employment (Band 2)			

STEMUP.CO.UK

Question			Answer/Indicative Content	Marks	Guidance	
					Content	Levels of response
			• increased capital flows may create instability for developing economies as well as benefits (Band 1), both when capital inflows create inflationary pressures in economies which lack productive capacity and when capital flight results in the need to raise interest rates to prevent currency depreciation both of which will tend to depress investment by small domestic firms (Band 2) **Analysis of the benefits of globalisation for developing economies could include** • greater trade and access to global markets could raise exports (basic analysis), AD and real GDP / economic growth which would increase real GDP per capita / living standards / HDI and growth and development would not be constrained by a small and low income domestic market (good analysis) • trade allows a developing economy to specialise according to its comparative advantage (basic analysis), improving resource allocation/consume outside its PPC/ shift AS to the right/import capital goods raising GDP (good analysis) • trade reduces domestic prices (basic analysis), as a result of increased supply and competition which increases consumer surplus and increases access to basic life-sustaining goods (good analysis) • increased competition from international trade will improve the supply side of developing economies (basic analysis) by encouraging greater productive efficiency through innovation and R&D to raise demand for their exports and greater labour productivity to reduce unit labour costs which will increase long-run economic growth (good analysis) • FDI results in higher AD/AS (basic analysis), raising real GDP/economic growth/employment/improved BoP current account (good analysis)		**Basic analysis should be awarded 5 – 7 marks** **Good analysis should be awarded 8 – 10 marks**	**Level 3: (5 – 10 marks)** For an analysis of the benefits of globalisation for developing economies *Annotate using* L3 *in LHS margin* **The following can be seen as the beginning of analysis:** • greater trade and access to global markets could raise exports • trade allows a developing economy to specialise according to its comparative advantage • trade reduces domestic prices • FDI results in higher AD/AS • FDI improves BoP financial account • FDI plugs the savings gap caused by a low level of domestic savings • FDI may facilitate structural change and reduce the dependence on primary sector • labour migration may increase employment opportunities abroad

STEMUP.CO.UK

Question			Answer/Indicative Content	Marks	Guidance	
					Content	Levels of response
			• FDI improves BoP financial account (basic analysis), resulting in the ability to sustain current account deficits without experiencing currency depreciation (good analysis) • FDI plugs the savings gap caused by a low level of domestic savings (basic analysis), which constrains investment and economic growth and development because of high capital-output ratios in developing economies (good analysis) • FDI may facilitate structural change and reduce the dependence on primary sector (basic analysis), where value added is low and may therefore increase incomes as labour moves from the primary to the secondary sector (good analysis) • labour migration may increase employment opportunities abroad (basic analysis), which could lead to remittances and a reduction in poverty (good analysis) • trade and FDI may generate higher tax revenue from increased employment, profits and expenditure resulting from higher real GDP (basic analysis), which will allow governments to increase expenditure on education, health and social welfare which contributes to higher levels of development through reduced poverty/inequality, increased life expectancy, greater economic opportunities reflected in higher HDI (good analysis) • FDI may generate more employment(basic analysis), which will increase incomes leading to greater ability to buy life sustaining goods and services, thereby reducing poverty and increasing the standard of living (good analysis)			• trade and FDI may generate higher tax revenue from increased employment, profits and expenditure resulting from higher real GDP • FDI may generate more employment

STEMUP.CO.UK

Question			Answer/Indicative Content	Marks	Guidance	
					Content	Levels of response
			Application of knowledge and understanding of how globalisation might be beneficial for developing economies might include statements about • greater trade in goods and services • greater transfer of financial capital • inward investment by foreign multinationals • technology transfers • higher GDP/economic growth/employment reduced poverty **Knowledge and understanding of developing economies might include their common characteristics:** • low living standards • low levels of labour productivity • an economic structure dominated by primary sector production • a lack of power in international markets and dependence • a high degree of market failure • persistent and unsustainable current account deficits		**Level 2 responses** are characterised by valid but generalised statements without a reasoned chain of argument and are not underpinned by economic concepts	**Level 2: (3 – 4 marks)** For an application of knowledge and understanding of how globalisation might be beneficial for developing economies might include statements about *Annotate using* L2 *in LHS margin* **Level 1: (1 mark)** For knowledge and understanding of developing economies *Annotate using* L1 *in LHS margin*

STEMUP.CO.UK

OCR (Oxford Cambridge and RSA Examinations)
1 Hills Road
Cambridge
CB1 2EU

OCR Customer Contact Centre

Education and Learning
Telephone: 01223 553998
Facsimile: 01223 552627
Email: general.qualifications@ocr.org.uk

www.ocr.org.uk

For staff training purposes and as part of our quality assurance programme your call may be recorded or monitored

Oxford Cambridge and RSA Examinations
is a Company Limited by Guarantee
Registered in England
Registered Office; 1 Hills Road, Cambridge, CB1 2EU
Registered Company Number: 3484466
OCR is an exempt Charity

OCR (Oxford Cambridge and RSA Examinations)
Head office
Telephone: 01223 552552
Facsimile: 01223 552553

© OCR 2015

PART OF THE CAMBRIDGE ASSESSMENT GROUP

LLOYD'S REGISTER QUALITY ASSURANCE · ISO9001 · UKAS MANAGEMENT SYSTEMS 001

STEMUP.CO.UK

OCR

Tuesday 3 June 2014 – Morning

A2 GCE ECONOMICS

F585/01/SM The Global Economy

STIMULUS MATERIAL

10991296O4

Duration: 2 hours

INSTRUCTIONS TO CANDIDATES

- This is a clean copy of the Stimulus Material which you have already seen.
- You may **not** take your previous copy of the Stimulus Material into the examination.
- You may **not** take notes into the examination.

INFORMATION FOR CANDIDATES

- This document consists of **16** pages. Any blank pages are indicated.

INSTRUCTION TO EXAMS OFFICER / INVIGILATOR

- Do not send this Stimulus Material for marking; it should be retained in the centre or recycled. Please contact OCR Copyright should you wish to re-use this document.

© OCR 2014 [T/500/7921]
DC (NH/SW) 87034

OCR is an exempt Charity

STEMUP.CO.UK

Introduction

The International Monetary Fund (IMF) has a number of roles and responsibilities, including surveillance. In 2012 the IMF concluded its annual assessment of the UK economy which, whilst supporting the UK Government's policy of austerity, made policy recommendations which it thought were necessary to secure a sustained economic recovery in the UK. These policy recommendations focused on the need to ensure that fiscal austerity did not reduce aggregate demand and hold back economic growth. The IMF thought that the UK output gap needed to be closed and was concerned that fiscal tightening might have a long term impact on the productive potential of the economy. It recommended that the UK Government should consider policies of balanced budget fiscal expansion and a loosening of monetary policy. The UK Government responded to this assessment of its economic policy by saying that expansionary policies should not conflict with the objectives of reducing the budget deficit and national debt. Later in 2012 the IMF published research which suggested that fiscal multipliers in a number of countries were much higher than previously thought and estimated these to be in the range of 0.9 to 1.7.

In comparison to its lukewarm support of fiscal austerity in the UK, the IMF was full of praise for the results of fiscal austerity in Latvia. IMF support for Latvia had previously been conditional upon a substantial tightening of fiscal policy. Despite Latvia operating a fixed exchange rate against the euro, the IMF claimed that Latvia had been able to restore its international competitiveness through cutting wages and prices. Fiscal austerity had helped achieve this improved international competitiveness through large cuts in public sector wages and the deflationary consequences of fiscal tightening on the private sector. The consequence was that, even though Latvia's nominal effective exchange rate (NEER) had been broadly stable, its real effective exchange rate (REER), adjusted for changes in unit labour costs, had depreciated by around 20% since the end of 2007. Not all economists, however, agreed that such 'internal devaluation' was the best way for an economy such as Latvia's to deal with its external imbalances. These economists drew a comparison with Iceland which operated a floating exchange rate. Its exchange rate had depreciated by 50% since the end of 2007.

Nevertheless, the IMF was strong in its support of Latvia's intention to adopt the euro. It felt that this would bring benefits to the Latvian economy in both the short run and the long run.

The trend towards fiscal austerity raised fears that the global economy was heading towards recession. The United Nations Conference on Trade and Development (UNCTAD) expressed a view that fiscal austerity in developed economies would put at risk the gains in economic development in the developing world through its impact on international trade. However, the experience of resource-rich economies in sub-Saharan Africa seemed to contradict this view. Commodity exports had grown strongly despite the downturn in economic growth in developed economies. Trade in commodities remained an important contributor to economic development for resource-rich economies in sub-Saharan Africa. Despite this, there were some concerns about the extent to which economic development in such economies could be promoted solely by a reliance on international trade.

© OCR 2014

STEMUP.CO.UK

Pre-release stimulus material

Extract 1: IMF surveillance report on the UK economy

Extract 2: Fiscal austerity and the UK output gap

Extract 3: IMF praise for fiscal austerity in Latvia

Extract 4: Latvia and Iceland – internal devaluation versus exchange rate devaluation

Extract 5: Economic development in resource-rich economies in sub-Saharan Africa

© OCR 2014

STEMUP.CO.UK

Extract 1

IMF surveillance report on the UK economy

One of the IMF's main roles is 'surveillance'. This takes the form of an annual assessment of the economic situation in each member country. Officials from the IMF conduct a detailed analysis and then make forecasts of economic performance which are followed by in-depth discussions with a country's government and central bank. The IMF believes that such 'surveillance' encourages member countries to adopt sound economic policies.

The IMF's 2012 annual assessment of the UK made comments on the country's economic situation (Fig. 1.1). The IMF also made policy recommendations which it thought were necessary to secure a sustained recovery in the UK (Fig. 1.2).

1. **Current policies are aimed at assisting economic rebalancing and financial sector stability.**
   Strong fiscal consolidation is under way and reducing the high structural deficit over the medium term remains essential. The UK has made substantial progress towards achieving a more sustainable budgetary position and reducing fiscal risks. Bold monetary stimulus has helped support the economy, as has the free operation of automatic fiscal stabilisers.

2. **But the economy has been flat.**
   The rebalancing from public sector to private sector demand-led growth has not fully materialised. UK output remains more than four percentage points below its 2008 peak. Encouragingly, labour market performance has been better, with fewer employment losses than in the aftermath of previous major UK recessions. But unemployment at 8.2%, with a large number of young people without a job, is still much too high.

3. **The recovery is expected to gain pace, but much productive capacity could remain idle for an extended period.**
   Despite the projected modest increase in growth in the second half of 2012, the UK output gap is projected to remain sizeable for an extended period, raising the risk of hysteresis as sustained cyclical weakness may reduce the economy's future productive capacity.

4. **Inflation is falling.**
   Inflation has been on a downward trend since peaking in September 2011. This trend will continue as the large output gap exerts disinflationary pressure. Thus inflation is expected to decline below the two percent target over the next 18–24 months. This is dependent on an unchanged macroeconomic stance and an absence of a sustained increase in commodity prices.

5. **Risks are large and tilted clearly to the downside.**
   Setbacks in the euro area are the key risk to economic prospects and financial stability in the UK as trade and financial links are substantial. Another risk is that the adverse impact of measures to reduce public and private sector debt may be even larger than expected and the anticipated rebalancing of demand is even slower to materialise. Commodity price volatility also remains a risk for both inflation and growth.

Fig. 1.1 – Selected comments from the IMF on the economic situation in the UK

© OCR 2014

STEMUP.CO.UK

1. **Policies to bolster demand should help close the output gap faster.**
   It needs to be recognised that policy options in this regard come with risks, including uncertainty about their effectiveness. However, these risks need to be weighed against that of weak demand leading to long run slow growth, high unemployment and a negative impact on consumer and investor confidence.

2. **A more expansionary monetary policy is required via further quantitative easing and possibly cutting the interest rate.**
   Weak nominal wage growth and broadly stable inflation expectations suggest underlying inflationary pressure is weak, providing space for a more expansionary monetary policy.

3. **A more expansionary fiscal policy should be considered if downside risks materialise and the recovery fails to take off.**
   Balanced budget fiscal expansion should be pursued to increase growth. For example, cuts in spending on items such as public employee wages could be used to finance higher spending on items such as infrastructure.

Fig. 1.2 – Selected IMF fiscal and monetary policy recommendations for the UK

The IMF annual assessment of the UK's economic situation reignited debate about the effectiveness of the Coalition Government's Deficit Reduction Plan. There was a stark contrast between the statements of the Managing Director of the IMF, Christine Lagarde, and the UK Chancellor of the Exchequer, George Osborne.

"Unfortunately the economic recovery in the UK has not yet taken hold and uncertainties abound. The stresses in the euro area affect the UK through many channels. Growth is too slow and unemployment... is too high. Policies to bolster demand before low growth becomes entrenched are needed."

Christine Lagarde

"The IMF couldn't be clearer today. Britain has to deal with its debts and the Government's fiscal policy is the appropriate one and an essential part of our road to recovery. I welcome the IMF's continuing support for the UK Government's Deficit Reduction Plan."

George Osborne

© OCR 2014

STEMUP.CO.UK

Extract 2

Fiscal austerity and the UK output gap

The first official estimate of UK Gross Domestic Product (GDP) for the second quarter of 2012 sharpened the focus on the UK's weak economic performance. Figures released by the Office for National Statistics (ONS) showed that GDP had declined by 0.7% between April and June. This represented the biggest quarterly fall in UK output since early 2009.

Predictably, some economists saw this as further evidence of a need for the UK Government to change the direction of economic policy away from austerity and towards the direct stimulation of economic growth. Others doubted the reliability of the estimates of GDP, pointing out that unemployment continued to fall, tax revenues were increasing and that business surveys showed rising rather than falling economic activity. They argued that the Government should not be distracted from its commitment to reduce the budget deficit and national debt. The head of the Organisation for Economic Co-operation and Development (OECD), Angel Gurria, echoed the assessment of the IMF that measures to promote growth should concentrate on balanced budget fiscal expansion.

The extent of the UK's weak economic performance can be seen in Fig. 2.1. This compares the change in GDP from the start of the 2008 recession with the next most recent recession (1990–93) and what is considered to be the worst recession (1930–34).

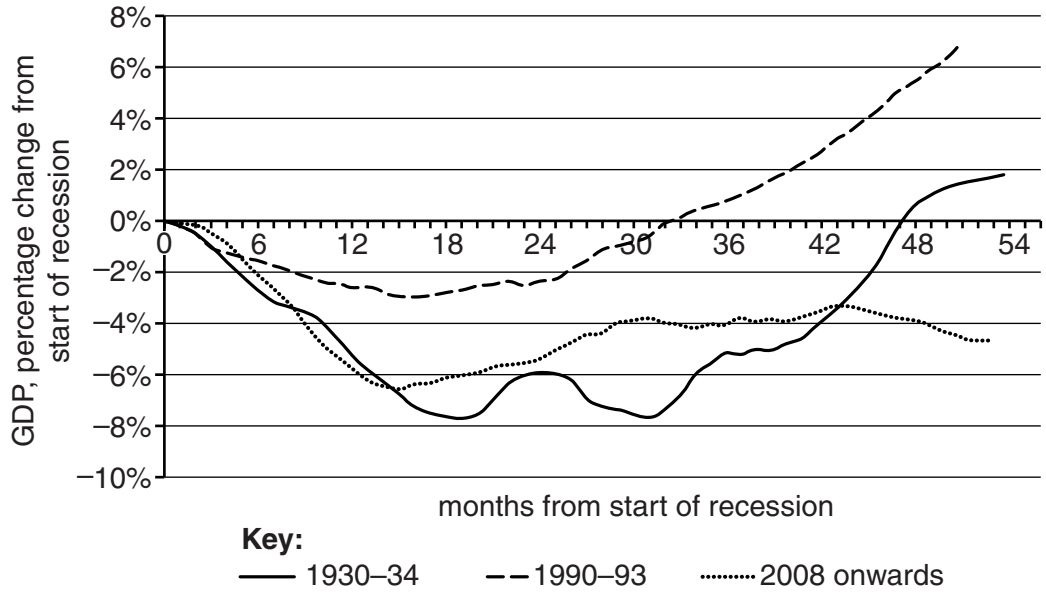


Fig. 2.1 – A comparison of the change in GDP in three UK recessions

The case for more fiscal and monetary stimulus would be a strong one if the UK output gap was large. In all previous recessions, UK output had returned to its pre-recession level within 48 months of the start of the recession. This was clearly not the case with the recession which started in 2008. There was agreement that the UK's output gap in 2012 was negative. However, estimates of the size of the output gap varied from –2.5% of GDP (Office of Budget Responsibility) to –9% of GDP (Centre for Business Research, University of Cambridge).

© OCR 2014

STEMUP.CO.UK

BLANK PAGE

Turn over for Extract 3

STEMUP.CO.UK

Extract 3

IMF praise for fiscal austerity in Latvia

In December 2008 the IMF announced plans to lend €1.7 billion to Latvia to help to stabilise its economy. This financial assistance was supplemented by loans from the European Union (EU), the World Bank and several Nordic countries to provide a package totalling €7.5 billion. The assistance was part of an agreement to defend Latvia's currency peg to the euro (a fixed exchange rate) and the country's commitment to join the euro. The Latvian currency, the lat, had come under pressure as a result of a current account deficit on the balance of payments of almost 25% of GDP in 2007. This deficit was financed by increasing levels of private sector external debt. The credit and growth boom that followed Latvia's accession to the EU simply could not be sustained. Very high wage growth, far in excess of productivity growth, had severely undermined Latvia's international competitiveness and contributed to the economy's large external imbalances. Latvia was once the fastest growing economy in the EU. By the end of 2008 it was the worst-performing economy.

In exchange for financial assistance from the IMF and other lenders, Latvia agreed to a 'strong package of policy measures' including:

- large cuts in public sector wages
- substantial tightening of fiscal policy
- structural reforms to raise international competitiveness.

IMF staff visited Latvia in May 2012, as part of its surveillance role, in order to monitor the outcome of its programme of assistance and the policy measures adopted by the country. In a press release, the IMF concluded that:

"The Latvian authorities have made good progress toward the programme's strategy of euro adoption. Impressive fiscal consolidation during the programme means the Maastricht fiscal criteria should be easily met. Joining the euro would be beneficial for the Latvian economy."

The IMF's assessment of the outcome of its programme of assistance and the policy measures adopted by Latvia were held up as examples of the success of fiscal austerity measures. Latvia had rejected devaluation of the exchange rate in place of a policy of 'internal devaluation' to restore international competitiveness. Latvia is one of four economies, known as the BELLs (Bulgaria, Estonia, Latvia and Lithuania), which adopted and stuck to a fixed currency peg with the euro and have been regarded as success stories of fiscal austerity. The fiscal tightening in Latvia initially produced a loss of output of around 20% and an increase in unemployment from 6% to 18.4%. However, by 2011 the country's current account deficit had become a surplus and GDP growth, at 5.5%, was one of the highest in the Europe.

In a speech in Riga, Latvia's capital, in June 2012, Christine Lagarde, Managing Director of the IMF, was full of praise for the country's policy of austerity. She praised the Latvian government's economic policy as a "success story" that "could serve as an inspiration for European leaders grappling with the euro crisis". Fig. 3.1 gives extracts from her speech.

© OCR 2014

STEMUP.CO.UK

It is a great pleasure to be here today in this beautiful city of Riga to celebrate the remarkable achievements of Latvia over the past few years.

Let me begin with the context. As you all know too well, Latvia has been tested severely over recent years. It lost a fifth of its output in just two years, 2008 and 2009. Unemployment rose to almost 20%, and double this rate among young people. Poverty increased and people from all walks of life endured great suffering.

And yet, while challenges remain today, you have pulled through. You have returned to strong growth and reduced unemployment, even if it remains far too high at around 16%. You have lowered budget deficits and kept government debt ratios to some of the lowest in the European Union. You have become more competitive in world markets through wage and price cuts. You have restored confidence and brought down interest rates through good macroeconomic policies.

How did you do it?

If we want to single out one factor for Latvia, it would be its impressive determination. This had a number of dimensions:

- *instead of spreading the pain over many years, the country stood together and did what needed to be done up front. The achievement was incredibly impressive – in the first year of its programme, Latvia implemented fiscal adjustment of more than 8% of GDP. Total adjustment for the whole programme is even higher, at around 15% of GDP.*

- *Latvia also had a clear goal: euro adoption. This meant that everybody knew where they were going, and Latvia has stayed the course.*

- *to cushion the hardship, the government agreed to protect the poorest and most vulnerable people by strengthening the social safety net. So, even in an atmosphere of major budget cuts, Latvia expanded and improved unemployment assistance.*

Speaking for the IMF, I am proud to have been part of Latvia's success story, alongside our European Commission and Nordic partners.

Fig. 3.1 – Selected quotes from a speech by Christine Lagarde

© OCR 2014

STEMUP.CO.UK

Extract 4

Latvia and Iceland – internal devaluation versus exchange rate devaluation

Some economists are sceptical about the success of Latvia's internal devaluation in delivering a sustained economic recovery and correcting external imbalances.

Although Latvia's GDP has grown since 2010, it is not clear that such growth can be sustained. This is because of the sharp change in the composition of GDP growth which has resulted from internal devaluation. High levels of private sector indebtedness remain in Latvia and, as a result, growth in both investment and consumer expenditure remain weak (see Fig. 4.1). Fiscal tightening has limited the contribution of government expenditure to GDP growth. Latvia's economic growth is, therefore, very heavily dependent on growth in net trade. Whether Latvia can sustain economic growth solely from exports depends not only on the growth in world trade but also on Latvia's international competitiveness.

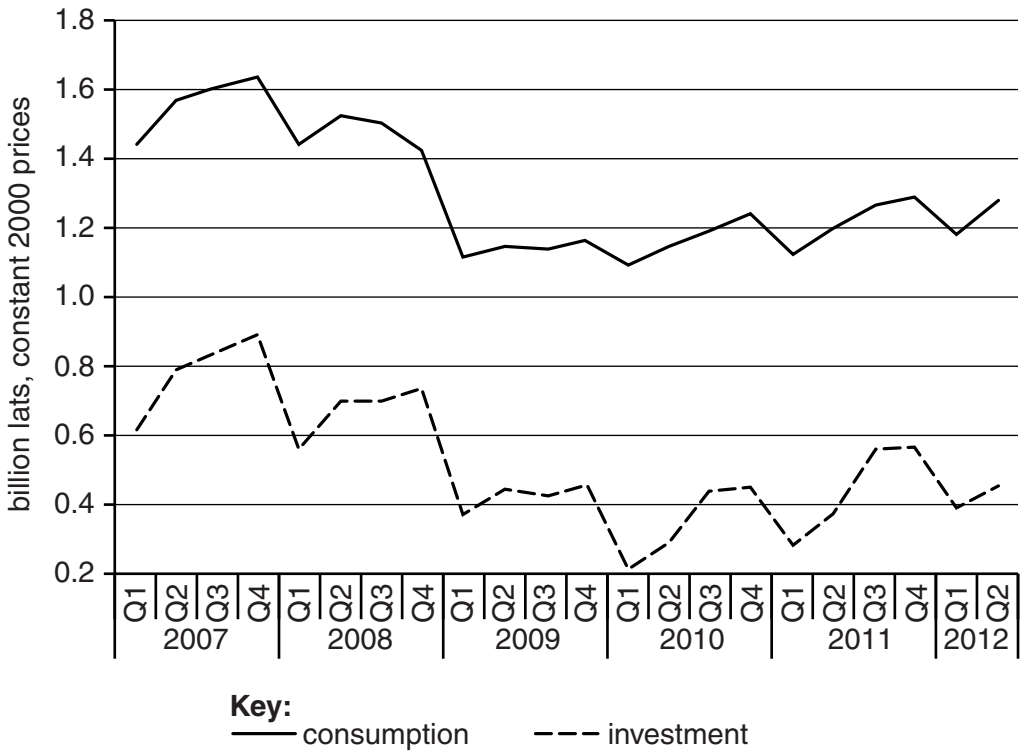


Fig. 4.1 – Latvian investment and consumer expenditure (billion lats, constant 2000 prices)

Internal devaluation puts downward pressure on nominal wages and prices and has been responsible for restoring some of Latvia's international competitiveness which was lost prior to 2007. However, most of the reduction in nominal wages occurred in the public sector and not in the private sector. In addition, for reductions in unit labour costs to be sustained, there needs to be improvements in productivity as well as a reduction in nominal wages. The improvement in Latvia's current account balance has been short lived. The surplus recorded in 2010 disappeared and by 2012 a deficit on the current account re-emerged.

© OCR 2014

STEMUP.CO.UK

Economists who are sceptical about the success of Latvia's internal devaluation in delivering a sustained economic recovery and correcting external imbalances draw a comparison with the experience of Iceland. Unlike Latvia, Iceland has a floating exchange rate. Iceland's nominal effective exchange rate (NEER) index depreciated by almost 50% after the end of 2007. In comparison, Latvia's NEER was broadly unchanged (see Fig. 4.2). Latvia was more dependent on a change in its real effective exchange rate (REER), which depreciated by around 20% measured in terms of unit labour costs. This compares to a 45% depreciation in Iceland's REER based on changes in unit labour costs. In addition, Iceland's fiscal tightening was not as aggressive as Latvia's. Fig. 4.3 shows the different outcomes from 2007 until 2012 in the two economies of the different approaches to the problem of external imbalances.

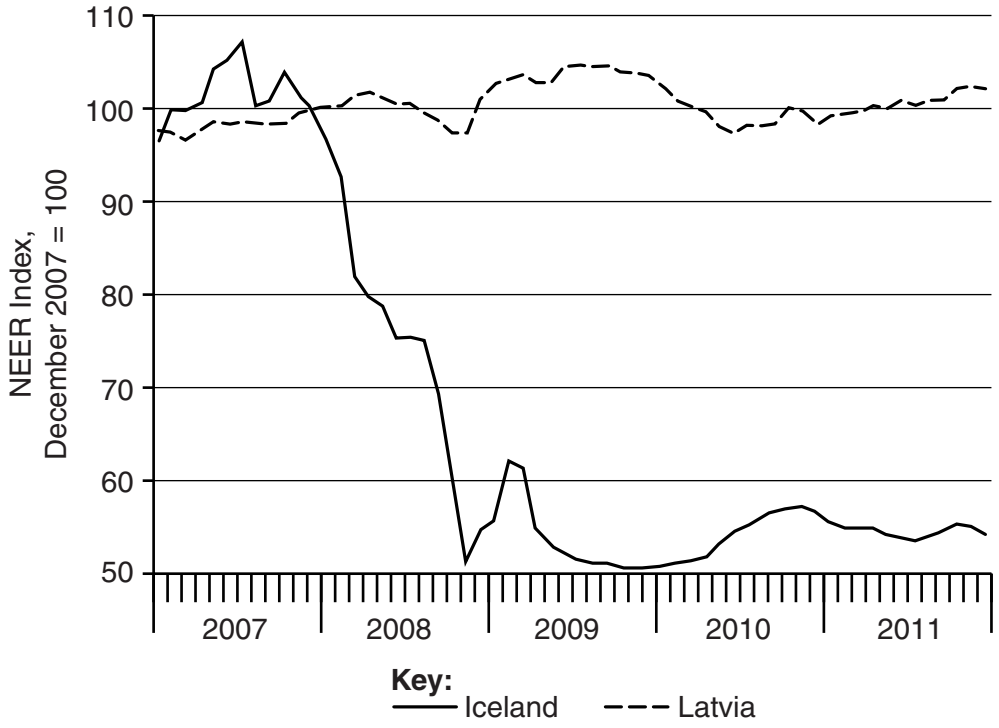
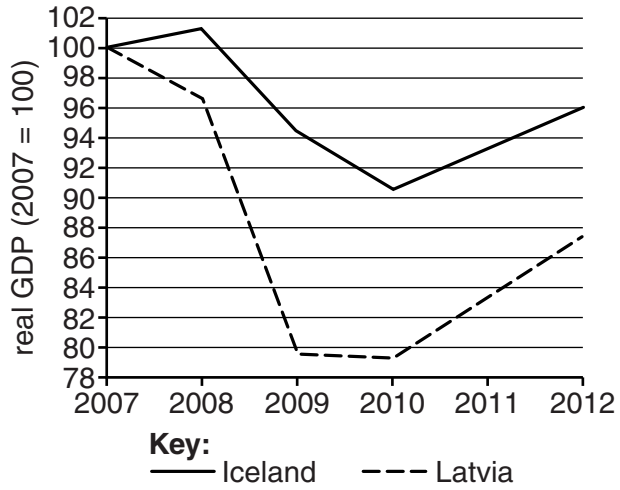
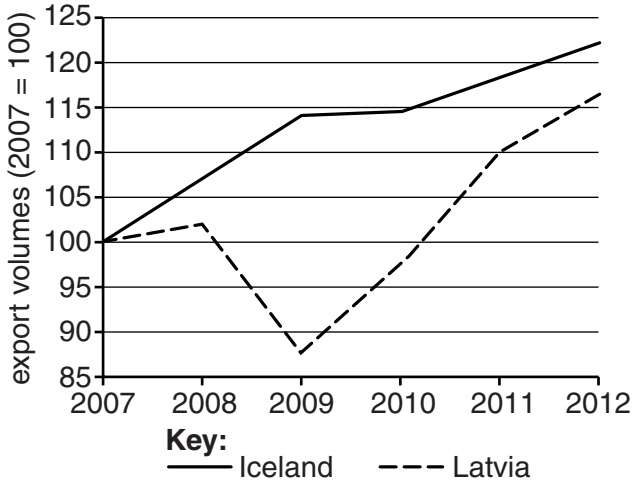


Fig. 4.2 – Nominal Effective Exchange Rate Indices for Iceland and Latvia, 2007–11

STEMUP.CO.UK





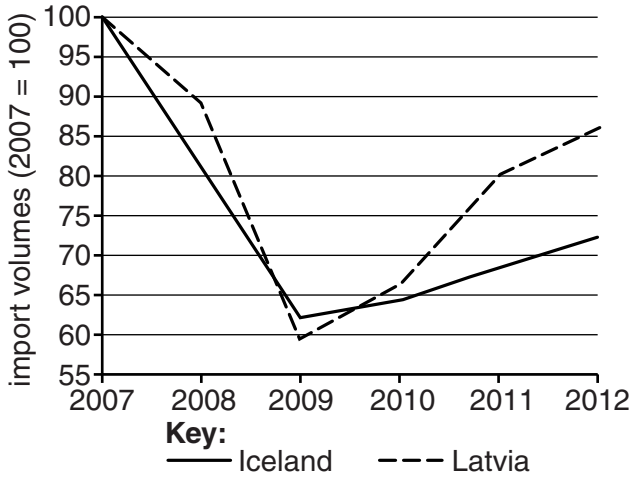


Fig. 4.3 – A comparison of key economic indicators in Iceland and Latvia, 2007–12

STEMUP.CO.UK

Extract 5

Economic development in resource-rich economies in sub-Saharan Africa

At the end of 2011 the United Nations Conference on Trade and Development (UNCTAD) warned that fiscal austerity policies being implemented by European countries were driving the global economy towards a recession. In a policy brief published in December 2011, UNCTAD stated that:

"A fragile global economy has a significant interest in the implementation of expansionary, rather than contractionary, fiscal policies in key economies. Only the former can open a path towards lower fiscal deficits and falling public debt ratios. A 'lost decade' for the world economy would risk the development gains achieved during recent years."

This contrasted with an assessment by the IMF in April 2012 of the economic outlook in sub-Saharan Africa (SSA). According to the IMF the fall in economic activity in Europe had not had a significant impact on growth in most of SSA. This was because most countries in SSA had diversified their exports to emerging markets and intra-regional trade had increased. In addition, around 80% of exports from SSA were commodities. Between 2005 and 2010 the region's commodity exports had grown in total by 16.6%, but exports of commodities to Europe had only grown by 2.6%.

Exhaustible natural resources account for a large share of output and export earnings in many SSA countries. Fig. 5.1 shows the major natural resource exports in the region.

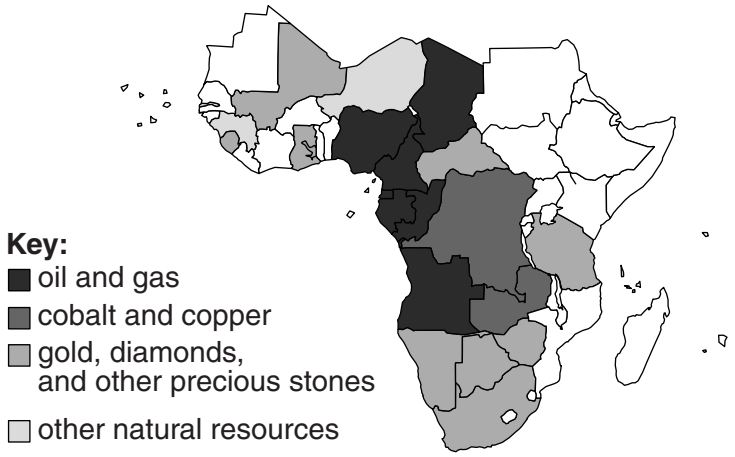


Fig. 5.1 – Major natural resource exports in sub-Saharan Africa

Rising world commodity prices, coupled with new resource discoveries, have stimulated growth in these economies during the past decade. Ensuring that these resources will lead to long-term economic development entails many policy challenges. Some of these challenges include the natural resource sector's tax/licensing regime and the state's role in the sector. Other policies will be needed to cope with declining government revenues as resources are depleted. Yet another set of policy concerns stem from the high volatility of resource prices. This volatility requires an appropriate framework for macroeconomic management because of the resulting large fluctuations in export revenues, budget receipts, and, in some cases, foreign direct investment (FDI).

Countries which export natural resources experienced faster economic growth than other SSA economies during 2000–12, but the improvement in their social indicators was not noticeably faster. Strong output growth following the discovery of natural resources changed the composition of output quite markedly among resource exporters, but the effect on the composition of employment has been modest. In part, this reflected the normally capital-intensive nature of resource production, but it also indicated the emergence of a sharply dualistic economic structure in which low-productivity sectors (such as agriculture and many services) remained largely untransformed. Gross National Income (GNI) per capita in SSA was, on average, higher in natural resource exporters than in non-resource exporters. This income advantage, however, was not reflected in significantly higher scores on the human development index (HDI).

© OCR 2014

STEMUP.CO.UK

BLANK PAGE

© OCR 2014

STEMUP.CO.UK

BLANK PAGE

© OCR 2014

STEMUP.CO.UK

Copyright Information

OCR is committed to seeking permission to reproduce all third-party content that it uses in its assessment materials. OCR has attempted to identify and contact all copyright holders whose work is used in this paper. To avoid the issue of disclosure of answer-related information to candidates, all copyright acknowledgements are reproduced in the OCR Copyright Acknowledgements Booklet. This is produced for each series of examinations and is freely available to download from our public website (www.ocr.org.uk) after the live examination series.

If OCR has unwittingly failed to correctly acknowledge or clear any third-party content in this assessment material, OCR will be happy to correct its mistake at the earliest possible opportunity.

For queries or further information please contact the Copyright Team, First Floor, 9 Hills Road, Cambridge CB2 1GE.

OCR is part of the Cambridge Assessment Group; Cambridge Assessment is the brand name of University of Cambridge Local Examinations Syndicate (UCLES), which is itself a department of the University of Cambridge.

© OCR 2014

STEMUP.CO.UK

OCR

Tuesday 3 June 2014 – Morning

A2 GCE ECONOMICS

F585/01 The Global Economy

Candidates answer on the Question Paper.

OCR supplied materials:
- Clean copy Stimulus Material

Other materials required:
- Calculators may be used

Duration: 2 hours

Candidate forename		Candidate surname	

Centre number						Candidate number				

INSTRUCTIONS TO CANDIDATES

- Refer to the Stimulus Material in the separate booklet. You must **not** bring your original copy into the examination.
- Write your name, centre number and candidate number in the boxes above. Please write clearly and in capital letters.
- Use black ink. HB pencil may be used for graphs and diagrams only.
- Answer **all** the questions.
- Read each question carefully. Make sure you know what you have to do before starting your answer.
- Write your answer to each question in the space provided. If additional space is required, you should use the lined pages at the end of this booklet. The question number(s) must be clearly shown.
- Do **not** write in the bar codes.

INFORMATION FOR CANDIDATES

- The number of marks is given in brackets **[ ]** at the end of each question or part question.
- The total number of marks for this paper is **60**.
- The quality of your written communication will be taken into account in the marking of your answer to question 3. All answers should be in continuous prose.
- This document consists of **16** pages. Any blank pages are indicated.

A calculator may be used for this paper

© OCR 2014 [T/500/7921]
DC (SJF) 75994/2

OCR is an exempt Charity

STEMUP.CO.UK

Answer **all** questions.

1 **(a)** **(i)** Other than surveillance, state **two** roles of the International Monetary Fund (IMF).

1 .....

.....

2 .....

.....

[2]

(ii) What is meant by the term 'balanced budget fiscal expansion'?

.....

.....

.....

.....

.....

.....

.....

..... **[2]**

© OCR 2014

(b) In Extract 2, one estimate of the UK's output gap is minus 9% of GDP.

Analyse why this output gap supports the case for a more expansionary fiscal policy in the UK.

.... **[6]**

© OCR 2014

STEMUP.CO.UK

(c) Comment on the extent to which fiscal expansion necessarily conflicts with the UK Government's Deficit Reduction Plan. **[10]**

© OCR 2014

STEMUP.CO.UK

© OCR 2014

STEMUP.CO.UK

2 **(a)** Explain **two** ways in which a fixed exchange rate, such as Latvia's peg to the euro, might be maintained when it comes under pressure to devalue.

1 .....

.....

.....

.....

.....

.....

.....

.....

2 .....

.....

.....

.....

.....

.....

.....

.....

[4]

© OCR 2014

(b) Analyse **two** potential benefits for an economy of adopting the euro.

1 .....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

2 .....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

[6]

© OCR 2014

STEMUP.CO.UK

(c) Comment on the view that exchange rate devaluation might be a better way to deal with a country's external imbalances than internal devaluation. **[10]**

© OCR 2014

STEMUP.CO.UK

© OCR 2014

STEMUP.CO.UK

3 Discuss the extent to which economic development in the resource-rich economies of sub-Saharan Africa is likely to be promoted by international trade. **[20]**

© OCR 2014

STEMUP.CO.UK

© OCR 2014

STEMUP.CO.UK

© OCR 2014

© OCR 2014

STEMUP.CO.UK

END OF QUESTION PAPER

© OCR 2014

ADDITIONAL ANSWER SPACE

If additional answer space is required, you should use the following lined page(s). The question number(s) must be clearly shown in the margins.

© OCR 2014

STEMUP.CO.UK

Copyright Information

OCR is committed to seeking permission to reproduce all third-party content that it uses in its assessment materials. OCR has attempted to identify and contact all copyright holders whose work is used in this paper. To avoid the issue of disclosure of answer-related information to candidates, all copyright acknowledgements are reproduced in the OCR Copyright Acknowledgements Booklet. This is produced for each series of examinations and is freely available to download from our public website (www.ocr.org.uk) after the live examination series.

If OCR has unwittingly failed to correctly acknowledge or clear any third-party content in this assessment material, OCR will be happy to correct its mistake at the earliest possible opportunity.

For queries or further information please contact the Copyright Team, First Floor, 9 Hills Road, Cambridge CB2 1GE.

OCR is part of the Cambridge Assessment Group; Cambridge Assessment is the brand name of University of Cambridge Local Examinations Syndicate (UCLES), which is itself a department of the University of Cambridge.

© OCR 2014

STEMUP.CO.UK

OCR
Oxford Cambridge and RSA

GCE

Economics

Unit **F585:** The Global Economy

Advanced GCE

Mark Scheme for June 2014

STEMUP.CO.UK

OCR (Oxford Cambridge and RSA) is a leading UK awarding body, providing a wide range of qualifications to meet the needs of candidates of all ages and abilities. OCR qualifications include AS/A Levels, Diplomas, GCSEs, Cambridge Nationals, Cambridge Technicals, Functional Skills, Key Skills, Entry Level qualifications, NVQs and vocational qualifications in areas such as IT, business, languages, teaching/training, administration and secretarial skills.

It is also responsible for developing new specifications to meet national requirements and the needs of students and teachers. OCR is a not-for-profit organisation; any surplus made is invested back into the establishment to help towards the development of qualifications and support, which keep pace with the changing needs of today's society.

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

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

Mark schemes should be read in conjunction with the published question papers and the report on the examination.

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

© OCR 2014

Annotations
Please annotate **every** response, even if no credit is given.

Annotation	Meaning
BP	Blank Page – this annotation **must** be used on all blank pages within an answer booklet (structured or unstructured) and on each page of an additional object where there is no candidate response.
	Unclear
BOD	Benefit of Doubt
	Cross
EE	Effective evaluation
ND	No development
L1	Level 1
L2	Level 2
L3	Level 3
L4	Level 4
NAQ	Not answered question
SEEN	Noted but no credit given
TV	Too vague
	Tick
	Development of point

Highlighting is also available to highlight any particular points on the script.
'**SEEN**' to be inserted on <u>every</u> blank page

STEMUP.CO.UK

Subject-specific Marking Instructions

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

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

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

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

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

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

STEMUP.CO.UK

Question			Answer	Mark	Guidance
Other than surveillance, state two roles of the International Monetary Fund (IMF).					
1	a	i	Award one mark for any of the following roles and responsibilities of the IMF: • to promote international monetary co-operation (1) • to facilitate the expansion of international trade (1) • to facilitate the balanced growth of international trade (1) • to provide exchange stability (1) • to assist in setting up a multilateral system of payments (1) • to make resources available to members experiencing balance of payments difficulties (1) Also accept ways in which the IMF fulfils these roles and responsibilities, such as: • lending, • technical assistance (including training).	2	One mark for each correct identification up to a maximum of two identifications. Do **not** award marks for the function of the IMF mentioned in the stimulus material (surveillance) as it is made clear that this function is the means by which the IMF fulfils its roles and responsibilities. Do not include things the IMF does as part of its surveillance function, including: • giving policy advice, • conducting annual assessments of economic performance / policy. Use green ticks ✓ for each mark awarded
What is meant by the term 'balanced budget fiscal expansion'?					
1	a	ii	One mark for knowledge and understanding of balanced budget : • an increase in government spending matched by an equal increase in taxation, • a reallocation of government spending from one area to another (public sector wages to infrastructure). One mark for knowledge and understanding of the effects of fiscal expansion: • increasing GDP/output/economic activity/growth/national income, • increasing AD.	2	Do not accept reference to: • reducing the budget deficit • eliminating the budget deficit (i.e. making G = T) Max one mark for cuts in public sector wages used to finance infrastructure improvements. Use green ticks ✓ for each mark awarded

STEMUP.CO.UK

Question			Answer	Mark	Guidance
Analyse why this output gap supports the case for a more expansionary fiscal policy in the UK.					
1	b		Knowledge and understanding of the nature of the output gap in the context of recent UK macroeconomic performance: • the output gap is the difference between the actual and potential output of an economy (1) • a more expansionary fiscal policy would involve an increase in government expenditure and/or a reduction in taxation (1) Up to 2 marks for application of the nature of a negative output gap • estimates of the UK output gap in the stimulus material suggest actual output is below potential output (1) • this would be associated with unemployment or waste of resources (1)/ less inflationary pressure (1) / high level of spare capacity in the economy or AD/AS diagram with negative output gap labelled (1) /estimates suggest a large amount of output is being lost or recession (1) /budget deficit (1) • UK economy is taking longer to recover from recession than in any previous recession (1) Up to 4 marks for an analysis of the consequences of expansionary fiscal policy • fiscal expansion raises AD as G is a component of AD and/or lower taxation raises disposable income which is likely to increase C (1) **and** • the increased AD will increase real GDP which will require firms to hire additional labour (1) which prevents long term unemployment reducing future productive capacity through a loss of skills/hysteresis (1) **or** • the increased AD will increase real GDP which will generate short run economic growth (1) which may raise consumer/business confidence and therefore help sustain an economic recovery (1) **or** • if the negative output gap is large, the increase in AD will not cause an increase in the price level/inflation (1) this is because the economy is operating on the elastic section of AS (1) **or** • increased economic activity would reduce unemployment reducing government expenditure on JSA and raising tax VAT / income tax / corporation tax receipts (1) reducing the budget deficit (1).	6	Use green ticks ✓ for each mark awarded Maximum six marks Do not award marks for: the output gap is the difference between potential and actual GROWTH It is possible that candidates may approach this question with the aid of an AD/AS diagram. Accept: Decrease income tax leading to an increase in incentive to work or lower corporation tax leads to an incentive to firms to invest/expand (1) leading to lower unemployment/rightward shift in AD/AS (1) Disinflationary pressure Award 1 mark for an explained AD/AS diagram showing an increase in AD along the elastic section of AS.

STEMUP.CO.UK

Question			Answer	Marks	Guidance	
					Content	Levels of response
Comment on the extent to which fiscal expansion necessarily conflicts with the UK Government's Deficit Reduction Plan.						
1	c		**Level 4:** Fiscal expansion may not conflict with the UK Government's Deficit Reduction Plan: • fiscal expansion and deficit reduction may only conflict in the short term (statement) • fiscal expansion may raise taxation receipts and reduce government expenditure in the long term by raising the level of GDP (statement); higher GDP reduces employment and so reduces expenditure on JSA (development); this also raises income tax because of higher employment, (further development); and corporation tax and/or VAT receipts because of spending and firm's profits (further development) • it is possible to conduct fiscal expansion without increasing the deficit if balanced budget fiscal expansion is used (statement); this happens because the multiplier effects of increased G are bigger than the multiplier effects of increased tax (development); this is because increased taxation will have a small multiplier effect since only part of the increase in taxation would have been spent on consumption i.e. mpc < 1 (further development) • fiscal expansion may not conflict by reducing the crowding out effect on private sector investment which results in higher taxation receipts – (an example of contractionary fiscal expansion) **Level 3:** • Fiscal expansion would involve raising government expenditure and/or reducing taxation • which results in an increase in the budget deficit , • (and therefore) fiscal expansion conflicts with the Government's Deficit Reduction Plan. **Level 2:** The Government's Deficit Reduction Strategy involves raising taxation (bottom L2) and cutting government expenditure (top L2) **Level 1:** A budget deficit arises when government expenditure > receipts from taxation	10	In Level 4 award marks as follows: • one stated point of evaluation = seven marks • two or more stated points of evaluation = eight marks • one developed comment = 9 marks • two developed comments **or** one comment with two points of development = 10 marks L3 can only be awarded if there is a clear understanding of fiscal expansion and/or Government's budget deficit reduction plan. An alternative L3 response would show how a conflict arises because fiscal expansion increases AD whereas the budget deficit reduction plan reduces AD.	**Level 4: (7 – 10 marks)** For a commentary on the extent to which fiscal expansion necessarily conflicts with the UK Government's Deficit Reduction Plan *Annotate using* L4 *in LHS margin* Annotate developed comment with ✓+ **Level 3: (4 – 6 marks)** For an analysis of how fiscal expansion may or may not conflict with the UK Government's Deficit Reduction Plan *Annotate each L3 point using* L3 *in LHS margin to indicate bottom, mid and top L3.* **Level 2: (2 – 3 marks)** For an application of knowledge and understanding of how fiscal expansion may and/or may not conflict with the UK Government's Deficit Reduction Plan *Annotate using* L2 *in LHS margin* **Level 1: (1 mark)** For knowledge and understanding of fiscal expansion or deficit reduction plan *Annotate using* L1 *in LHS margin*

STEMUP.CO.UK

Question			Answer	Mark	Guidance
Explain <u>two</u> ways in which a fixed exchange rate, such as Latvia's peg to the euro, might be maintained when it comes under pressure to devalue.					
2	a		Two ways of maintaining a fixed exchange rate when it comes under pressure to devalue include: Buying the currency on the FOREX markets (by selling foreign currency reserves) (1) in order to increase the demand for the currency/reduce the supply of the currency (1) Increasing the interest rate (to attract hot money flows) (1) in order to increase the demand for the currency/reduce the supply of the currency (1)	4	Award marks as follows: One mark for each correct identification up to a maximum of two identifications, plus a further one mark for each of two explanations. One mark for each way of maintaining a fixed exchange rate plus one further mark for an explanation of either how this can be achieved or the consequence Maximum two marks per way, use green ticks ✓ for each mark awarded Accept two ways to improve international competitiveness for identification marks e.g. • raise productivity • lower unit costs • invest in infrastructure • improve quality of exports These must be then linked to demand for currency for second mark e.g. raises demand for exports, raising demand for currency. Award one mark for "make their exports more attractive" only if it is linked to demand for the currency. Reference to supply-side policies **only** without a specific measure **should not be rewarded**.

STEMUP.CO.UK

Question			Answer	Mark	Guidance
Analyse <u>two</u> potential benefits for an economy of adopting the euro.					
2	b		Benefits for an economy of adopting the euro include: • reduced transaction costs (1) Adopting the euro eliminates the costs of changing currencies (1) which makes trade cheaper with other members of the euro (1) which is likely to reduce the price level / increase trade and investment (1) • elimination of exchange rate uncertainty (1) Adopting the euro means that businesses no longer run the risk that exchange rate movements will reduce profit margins on trade with other members of the euro (1) which reduces the costs of trade as they no longer have to 'hedge' transactions and this is likely to reduce the price level / and increase trade and investment (1) • increased price transparency (1) Prices in the euro area will be easier for consumers and producers to compare (1) which makes it harder for firms to engage in price discrimination and is likely to allow firms to access inputs at lower cost which could reduce the price level / increase competition/stimulate trade (1) • imposes discipline on domestic firms (1) As rising costs cannot be compensated for by a depreciation of the exchange rate against other euro members (1) domestic firms will strive to match the productivity improvements of other euro members which will reduce the growth of unit labour costs / reduce domestic inflationary pressures (1) • financial support from member states (1) this arises in cases of financial difficulty where member states may grant loans (under the EFSF) based on the condition of implementing policy measures (1) which help to promote economic stability and could be important in preventing capital outflows/attracting FDI (1)	6	One mark for each correct identification, up to a maximum of two identifications (application), plus up to a further two marks for each of two appropriate analyses. NB: these additional marks MUST only be awarded for analytical statements/explanations. Use green ticks ✓ for each mark awarded Maximum three marks for each benefit Award marks as follows: • identification of price transparency / reduced ER risk / reduced transaction costs / discipline on domestic firms/ financial support from ECB (1), • explanation of what that means or why it happens (1), • link to an economic benefit which does NOT have to include reference to AD / AS and can be micro rather than macro (1). Other benefits such as; stronger currency, FDI, business confidence, economies of scale, greater competition, greater trade/exports can be awarded one mark for identification in each case but to access further marks there must be a link to: transaction costs, exchange rate certainty, price transparency, discipline on domestic firms, financial support from member states. Accept: loans from ECB Do not accept: free trade, reduced red tape and tariffs or barriers to trade as a benefit.

STEMUP.CO.UK

Question			Answer	Marks	Guidance	
					Content	Levels of response
Comment on the view that exchange rate devaluation might be a better way to deal with a country's external imbalances than internal devaluation.						
2	c		**Level 4:** Reasons why exchange rate devaluation may not be better: • the PED of exports and imports is price inelastic, • there is a J curve effect in the short run, • the Marshall Lerner condition is not satisfied, • external imbalances are caused by a lack of non-price competition, • it causes a reduction in FDI (profit on exports for MNCs worth less in foreign currency), • may have no impact on root cause of external imbalances (low growth in productivity, high labour costs), • External devaluation is a short term policy, • External devaluation can result in cost-push inflationary pressure whereas internal devaluation won't. **Level 3** Top L3: • It may be better as it directly improves international competitiveness (price of X & M) whereas internal devaluation is an indirect method (price level and labour costs). • Internal devaluation may not work because	10	**In Level 4 award marks as follows:** • one stated point of evaluation = seven marks • two or more stated points of evaluation = eight marks • one developed comment = 9 marks • two developed comments **or** one comment with two points of development = 10 marks Annotate developed comment with ✓+ Max 7 marks if there is no analysis of why exchange rate devaluation is better than internal devaluation but there is a recognition that the success of both depends on PED of X and M or creates cost-push inflation. Also accept in L4: • a comment that neither approach is best. If developed this comment can achieve 9 marks, • alternative approaches to correct an external imbalance which might be considered to be better than either external or internal devaluation. **Level 3 responses** will use a reasoned chain of argument underpinned by economic concepts	**Level 4: (7 – 10 marks)** For a commentary on the view that exchange rate devaluation might be a better way to deal with a country's external imbalances than internal devaluation. *Annotate using* L4 *in LHS margin* *Show development with* ✓+ **Level 3: (4 – 6 marks)** For an analysis of how exchange rate devaluation might be a better way to deal with a country's external imbalances than internal devaluation. *Annotate using* L3 *in LHS margin*

STEMUP.CO.UK

Question			Answer	Marks	Guidance	
					Content	Levels of response
			nominal wages may be 'sticky' and a reduction in public sector wages may have little or no effect on the international competitiveness of traded goods. In comparison external devaluation directly changes the price of traded goods. • External devaluation raises AD/GDP/employment whereas internal devaluation reduces AD/GDP/employment. Middle L3: Use of data to support the argument that external devaluation is better, e.g.it is better because it avoids the costs of internal devaluation. Bottom L3: External devaluation raises exports and reduces imports/ increases net trade (which will reduce a current account deficit/external imbalance). **Level 2:** General comparison of the two approaches with no analytical support, e.g: • exchange rate devaluation can correct an external balance reduces the price of exports and increases the price of imports, • use of data to show how Iceland's economic performance after devaluation was better than Latvia's without supporting analysis. **Level 1:** • External imbalances are generally characterised by large unsustainable current account deficits. • Exchange rate devaluation involves a reduction in the price of the currency. • Internal devaluation puts downward pressure on nominal wages and prices.		*Alternative route into L3 is analysis of how internal devaluation corrects an external imbalance by either reducing AD leading to a reduction in the price level and a fall in the demand for labour which reduces the wage rate or an increase in AS caused by lower wage rates/unit labour costs or the impact of lower wages/unit labour costs or the price of, and demand for, exports linked to current account balance.* **Level 2 responses** are characterised by valid but generalised statements without a reasoned chain of argument and are not underpinned by economic concepts.	**Level 2: (2 – 3 marks)** For an application of knowledge and understanding of how exchange rate devaluation may work to correct an external imbalance by raising import prices and reducing the price of exports *Annotate using* L2 *in LHS margin* **Level 1: (1 mark)** For knowledge and understanding of external imbalances / exchange rate devaluation / internal devaluation *Annotate using* L1 *in LHS margin*

STEMUP.CO.UK

Question			Answer	Mark	Guidance	
					Content	Levels of response
Discuss the extent to which economic development in the resource-rich economies of sub-Saharan Africa is likely to be promoted by international trade.						
3			**Level 4 Band 3 responses:** • the extent to which international trade promotes economic development in resource-rich economies depends on the ability of governments to extract tax revenue from the activities of MNCs and on good governance, • the benefits from trade are dependent on the terms of trade, which in turn depend on global commodity prices. • The benefits from trade are dependent on the role of the government and **Level 4 Band 2 responses:** • higher GDP does not guarantee that economic development takes place as the benefits of economic growth may be unequally distributed or may be concentrated in just one sector of the economy; resulting in few multiplier effects from the resource exporting sector so that the benefits of economic growth are not widely spread, • the depletion of natural resources may lead to unsustainable development, so that there is an increase in the living standards of the current generation at the expense of future generations, • the production of natural resources may be capital intensive, especially in extractive industries; this may mean that the employment effects are small or that the benefits of higher output accrue to MNCs in the form of profit rather than higher levels of household income, • volatile commodity prices may limit the benefits of international trade as export revenue may be volatile, especially since natural resources are likely to have inelastic PEDs.	20	**Level 4 Band 3 marks can only be awarded once there is evidence of developed discussion (Level 4 Band 2)** **Developed discussion** is where evaluation is supported by a reasoned chain of argument underpinned by economic concepts which establish cause or consequence	**Level 4 Band 3: (18 – 20 marks)** For a *developed* discussion which includes a *judgement* on the extent to which economic development in resource-rich economies in sub-Saharan Africa is likely to be promoted by international trade. *Annotate using* EE *in LHS margin* *Annotate with* SEEN *conclusions which repeat previous arguments* **Level 4 Band 2: (15 – 17 marks)** For a *developed* discussion of the extent to which economic development in resource-rich economies in sub-Saharan Africa is likely to be promoted by international trade. *Annotate using* ✓+ *in LHS margin*

STEMUP.CO.UK

Question	Answer	Mark	Guidance	
			Content	Levels of response
Discuss the extent to which economic development in the resource-rich economies of sub-Saharan Africa is likely to be promoted by international trade.				
	Level 4 Band 1 responses: • higher GDP does not guarantee that economic development takes place as the benefits of economic growth may be unequally distributed or may be concentrated in just one sector of the economy, • the depletion of natural resources may lead to unsustainable development, • the production of natural resources may be capital intensive, especially in extractive industries, • there may be little or no change in the structure of the economy, • although there might be an increase in GDI the increase in GNI may be smaller or insignificant due to the repatriation of profit, • volatile commodity prices may limit the benefits of international trade as export revenue may be volatile, • Risk of dumping. **Level 3:** • through international trade resource-rich economies in sub-Sahara Africa will be able to increase their exports; since exports are a component of AD, this will increase AD; higher AD will increase the output of these economies, leading to higher GDP; resulting in higher levels of employment or living standards or raising GDP per capita, • higher GDP per capita and levels of employment will reduce levels of poverty and increase the availability of life-sustaining goods, • a higher level of economic activity will increase government tax revenue from taxes on income and profit; this higher tax revenue will allow governments to increase the provision of health and education, • higher GDP per capita, better health and education provision will raise the HDI, which indicates higher		**Top Level 4 Band 1** is characterised by a wider range of basic discussion points **Low Level 4 Band 1** is characterised by a narrow range of basic discussion points, not in context of a resource rich country **Level 3 responses** will use a reasoned chain of argument underpinned by economic concepts such as: • AD/AS/circular flow of income, • comparative advantage & specialisation, • economies of scale, • long term capital inflows. Using these concepts a L3 response will then go on to analyse the implications for: GDP per capita/living standards/poverty; health and education; measures of development including HDI. Award 5-7 marks for one point which is supported by the use of economic concepts Award 8-10 marks for 2 or more points supported by the use of economic concepts	**Level 4 Band 1: (11 – 14 marks)** For a *basic and undeveloped* discussion of the extent to which economic development in resource-rich economies in sub-Saharan Africa is likely to be promoted by international trade. *Annotate using* L4 *in LHS margin* **Level 3: (5 – 10 marks)** For an analysis of how economic development in resource-rich economies in sub-Saharan Africa may or may not be promoted by international trade. *Annotate using* L3 *in LHS margin*

STEMUP.CO.UK

Question			Answer	Mark	Guidance	
					Content	Levels of response
Discuss the extent to which economic development in the resource-rich economies of sub-Saharan Africa is likely to be promoted by international trade.						
			levels of economic development, • there may be multiplier effects from the natural resource sector to other sectors of the economy so that the benefits of economic development are more widely distributed. **Level 2:** Through international trade resource-rich economies in sub-Saharan Africa will be able to increase their exports. This will increase their GDP which will lead to economic development. This is shown by the fact that natural resource exporters had higher rates of economic growth than other sub-Saharan economies. However, export revenue will fall as these economies run out of resources to export and there may not be an increase their HDI. Exporting natural resources may not increase employment, so economic development might not take place. **Level 1:** Economic development is the process of improving peoples' economic well-being and quality of life. It is a broad concept which includes more than just levels of income. It focuses on the outcomes of economic activity and resource allocation. Economic development seeks to achieve an increase in: the availability and distribution of basic life-sustaining goods; standards of living; economic and social choices. Economic development is measured using HDI.		L3 marks should be awarded for a response where there is analysis of only one side of the argument: e.g. Prebisch-Singer, depletion of natural resources, environmental degradation/negative externalities(divergence MSC-MPC), concentration of wealth, ownership of natural resources (property rights), volatility of commodity prices **Level 2 responses** are characterised by valid but generalised statements without a reasoned chain of argument and are not underpinned by economic concepts	**Level 2: (3 – 4 marks)** For an application of knowledge and understanding of how economic development in resource-rich economies in sub-Saharan Africa may and/or may not be promoted by international trade. *Annotate using* L2 *in LHS margin* **Level 1: (1-2 marks)** For knowledge and understanding of economy development or international trade. *Annotate using* L1 *in LHS margin*

STEMUP.CO.UK

OCR (Oxford Cambridge and RSA Examinations)
1 Hills Road
Cambridge
CB1 2EU

OCR Customer Contact Centre

Education and Learning
Telephone: 01223 553998
Facsimile: 01223 552627
Email: general.qualifications@ocr.org.uk

www.ocr.org.uk

For staff training purposes and as part of our quality assurance programme your call may be recorded or monitored

Oxford Cambridge and RSA Examinations
is a Company Limited by Guarantee
Registered in England
Registered Office; 1 Hills Road, Cambridge, CB1 2EU
Registered Company Number: 3484466
OCR is an exempt Charity

OCR (Oxford Cambridge and RSA Examinations)
Head office
Telephone: 01223 552552
Facsimile: 01223 552553

© OCR 2014

PART OF THE CAMBRIDGE ASSESSMENT GROUP

UKAS MANAGEMENT SYSTEMS 001

STEMUP.CO.UK

OCR
RECOGNISING ACHIEVEMENT

To be opened on receipt

A2 GCE ECONOMICS

F585/01/SM The Global Economy

STIMULUS MATERIAL

JUNE 2013

F530070113

INSTRUCTIONS TO CANDIDATES

- This copy must **not** be taken into the examination room.
- You should make yourself familiar with the stimulus material before you take the question paper. A clean copy of the stimulus material will be given to you with the question paper.

INFORMATION FOR CANDIDATES

- The following stimulus material has been adapted from published sources. It was correct at the time of publication and all statistics have been taken directly from the published material.
- This document consists of **12** pages. Any blank pages are indicated.

© OCR 2013 [T/500/7921]
DC (NF/SW) 56832/5

OCR is an exempt Charity

STEMUP.CO.UK

Introduction

In 2011, there was much speculation about the death of the European Union's (EU) single currency, the euro. Some members of the eurozone, such as Greece and Ireland, had built up such high levels of public debt that there was increasing concern that they might have to default. The prospect of years of austerity needed to restore wage and price competitiveness had led to protests in Greece and political instability in Ireland. There was increasing reluctance in France and Germany to continue to bail out countries in debt and the future of the euro looked uncertain.

The history of the birth and growth of the euro dates back to 1999 when the eurozone came into existence. At that time, it was felt that setting criteria for the entry of member states into the eurozone would help create the conditions for the operation of a single currency in Europe. These criteria were designed to create fiscal and monetary convergence of the economies joining the eurozone and included a number of conditions necessary for entry. By 2011, there were 17 members of the eurozone, including five countries which had joined the EU in 2004.

Whilst some countries in the eurozone had clearly not enjoyed the expected benefits of membership, staying out of the EU's single currency was not a guarantee of economic success. The global financial and economic crises of 2007–08 had resulted in severe financial and balance of payments crises in, for example, Latvia.

Despite the uncertainty about the future of the euro, Estonia took the decision to join the eurozone on 1 January 2011. Estonia is widely regarded as one of the most successful economies of Central and Eastern Europe (CEE). It had consistently recorded high rates of economic growth and development until the crises of 2007–08. Whilst openness to international trade and high levels of Foreign Direct Investment (FDI) were important reasons for Estonia's economic success, they were not the only factors responsible for its impressive growth and development.

Despite the country's success in the past and renewed economic growth in 2010, the Estonian government was keen to ensure that future economic growth was consistent with greater sustainable development. The Estonian government had identified a number of areas in which high rates of economic growth had not delivered sustainable development in the past. On many sustainability indicators, Estonia was lagging behind the rest of the EU, including many of the economies which had joined the EU in 2004 and in 2007.

© OCR 2013

STEMUP.CO.UK

Pre-release stimulus material

Extract 1: **The birth and growth of the eurozone**

Extract 2: **New EU member states and the euro**

Extract 3: **Estonia's economic growth and development**

Extract 4: **The approach to sustainable development in the EU and Estonia**

Extract 5: **Estonia's progress towards sustainable development**

© OCR 2013

STEMUP.CO.UK

Extract 1

The birth and growth of the eurozone

On 1 January 1999, the eurozone came into existence. It comprised 11 EU countries which permanently fixed their exchange rates by adopting the euro as their currency. Three years later, on 1 January 2002, euro coins and banknotes were officially introduced as legal tender, and after a further six months national currencies were withdrawn.

The UK, Sweden and Denmark have all decided to stay out of the eurozone for the time being. Greece did not join at first because it failed to meet the Maastricht Convergence Criteria. However, on 1 January 2001, Greece became the 12th country to adopt the common currency after it was judged to have fulfilled all the requirements for eurozone entry.

On 1 May 2004, ten new countries joined the EU: Poland, Hungary, the Czech Republic, Slovakia, Slovenia, Estonia, Latvia, Lithuania, Cyprus and Malta. Three years later, on 1 January 2007, a further enlargement of the EU added two new members: Bulgaria and Romania. All of these new members of the EU have agreed to join the eurozone when the time is right for them to do so and when they have met the conditions of entry.

Of the 12 new member states of the EU, five fulfilled the Maastricht Convergence Criteria and became part of the eurozone by 2011.

© OCR 2013

STEMUP.CO.UK

Extract 2

New EU member states and the euro

When a new country joins the EU, it is expected to treat its exchange rate as a matter of common interest to all members of the EU. This means that it should not pursue competitive devaluations for fear of undermining the EU's single market. However, initially a country is free to decide whether its exchange rate is freely floating or fixed. Once a country has joined the Economic and Monetary Union (EMU), it must join the EU's fixed exchange rate mechanism known as ERM II. It is argued that this prepares them for eventual membership of the eurozone.

Any EU country joining the eurozone must have first met a number of strict conditions. These conditions ensure that the country will have reached a high degree of fiscal and monetary convergence before it finally adopts the euro.

Of the 12 countries which joined the EU between 2004 and 2007, five were members of the eurozone by 2011. Slovenia joined the eurozone on 1 January 2007. It was followed on 1 January 2008 by Cyprus and Malta, on 1 January 2009 by Slovakia and on 1 January 2011 by Estonia.

Of the remaining seven members, only Latvia and Lithuania had joined ERM II by 2011 with a view to adopting the euro. Since joining ERM II, Latvia's economic situation has worsened. As a result of the global financial and economic crises of 2007–08, Latvia needed loans totalling €7.5 billion from the International Monetary Fund (IMF), the World Bank and the EU in order to support its fixed exchange rate against the euro. In a statement issued at the time of the loan in 2008, the IMF said:

"*The current global financial crisis has brought Latvia's vulnerabilities to a head. Years of unsustainably high growth and large current account deficits have combined to create financial and balance of payments crises.*"

The financial and economic crises of 2007–08 substantially worsened the economic situation of many of the new EU members. Their currencies came under speculative attack and became dangerously volatile. Their budget deficits soared. Countries which had borrowed significant sums from Western Europe and were heavily dependent on FDI suffered most. As financial capital fled these economies, their currencies fell in value and the cost of repaying debt escalated dramatically.

Some economists were critical of the way in which CEE economies had sought to achieve economic development since joining the EU. The European Bank for Reconstruction and Development (EBRD), for example, issued a report in 2009 which criticised the CEE economies' reliance on financial integration to promote development. The report stated that "financial integration – in the form of large debt flows and FDI – has been an integral part of the 'development model' of transition countries". The EBRD urged CEE economies to be less dependent on international financial flows and FDI.

© OCR 2013

STEMUP.CO.UK

Extract 3

Estonia's economic growth and development

Since embarking on the transition to a market economy in 1991, Estonia's economic growth and development have been determined by a range of factors. Its transition to the market economy has been helped by membership of the EU. Its openness to international trade and FDI has also helped it to achieve high rates of economic growth. Estonia's international trade as a percentage of Gross Domestic Product (GDP) was 155% in 2009. In addition, it has one of the most favourable environments for FDI with a 0% tax rate on reinvested profits. However, other factors have also played a role in promoting economic development and growth in Estonia. These include the age structure of its population, the skills and education of its labour force, its geographical position, and its infrastructure. The Estonian currency, the kroon, has been stable thanks to prudent macroeconomic policy which has brought about price stability. Economic reforms have also created a well functioning market economy. As a result of the high rates of economic growth brought about by these economic conditions, the Estonian economy has been dubbed the 'Baltic Tiger'.

Figs 3.1 and 3.2 below show two measures of Estonia's economic performance from 2000 to 2010.

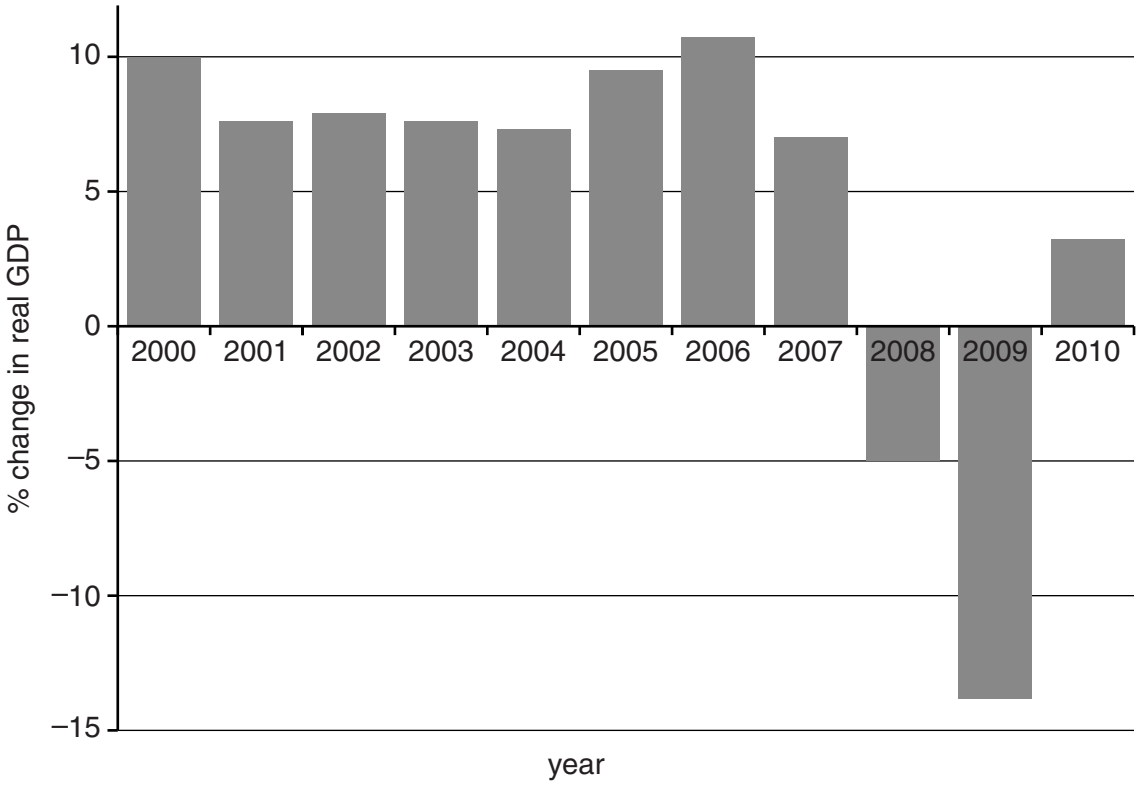


Fig. 3.1 – Estonia's annual economic growth rate (% change in real GDP), 2000–10

STEMUP.CO.UK

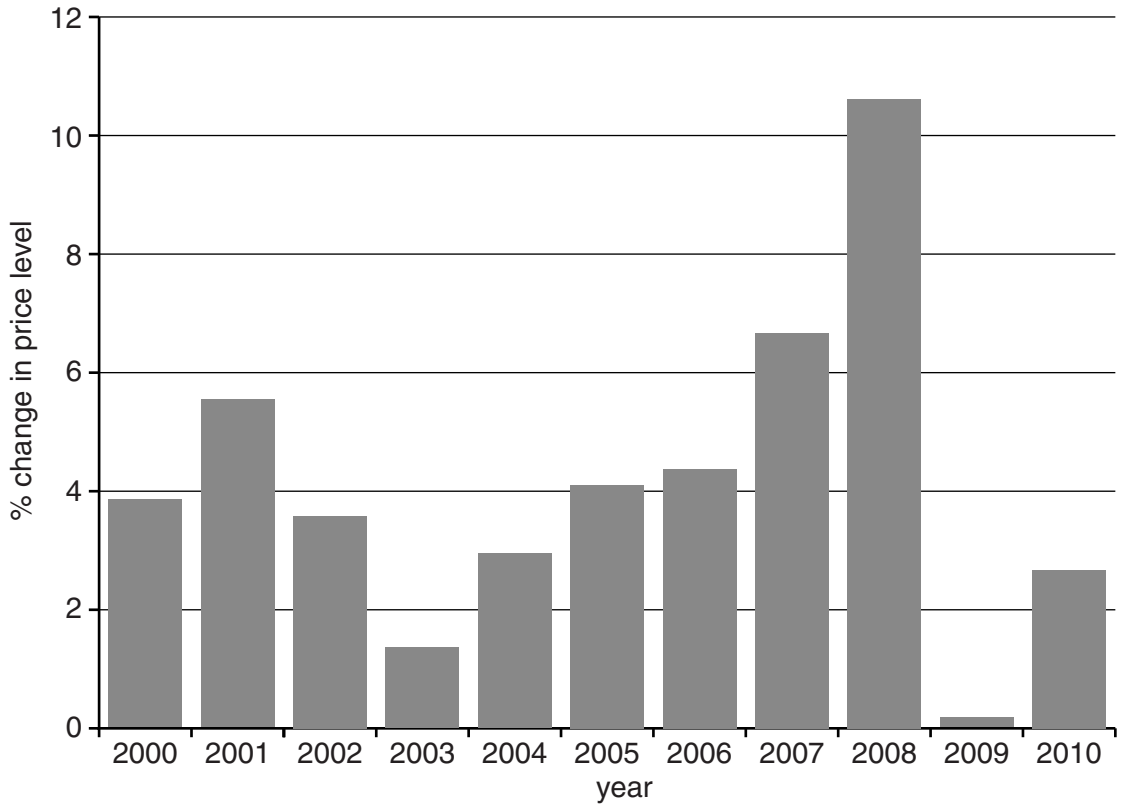


Fig. 3.2 – Estonia's annual inflation rate (% change in price level*), 2000–10

* *as measured by changes in the Harmonised Index of Consumer Prices (HICP).*

Despite all of these favourable conditions for growth, Estonia was not immune from the global economic recession of 2008 as its GDP fell by 5.1% in that year. The economic situation further worsened in 2009 as GDP fell by a massive 14% before a recovery in 2010 led by strong growth in its exports. Some forecasts of economic growth for 2011 were as high as 4.5%, suggesting a strong recovery from recession.

According to data published by Eurostat, living standards in Estonia remain below the average for the EU. Estonian GDP per capita at Purchasing Power Parity (PPP) was 67% of the EU average in 2008. Estonia's Prime Minister wants to raise living standards so that GDP per capita at PPP is in the top five in the EU by 2022. However, GDP per capita hides big differences between different areas of Estonia. It is estimated that over 50% of Estonia's GDP is generated in the capital, Tallinn. The GDP per capita in Tallinn was 172% of the Estonian average and 115% of the EU average.

Many indicators point to a healthy future for the Estonian economy. According to Eurostat, Estonia has the lowest ratio of government debt to GDP among EU countries. Estonia's balanced budget, almost non-existent public sector debt, flat-rate income tax, free trade regime, and its competitive commercial banking sector all bode well for its future economic growth and development. In addition, the government's willingness to significantly increase its spending to support innovation and research and development by businesses in Estonia could help to ensure that high rates of economic growth do not run up against capacity constraints.

© OCR 2013

STEMUP.CO.UK

Extract 4

The approach to sustainable development in the EU and Estonia

The EU's approach to sustainable development is set out in its Sustainable Development Strategy, adopted by the European Commission in 2001, and amended in 2006 and 2009. The strategy sets overall objectives and concrete actions for seven key priorities:

- climate change and clean energy
- sustainable transport
- sustainable consumption and production
- conservation and management of natural resources
- public health
- social inclusion, demography and migration
- global poverty and sustainable development challenges.

The member states of the EU each have different national strategies which take into account their different characteristics and needs. Estonia is the only EU member state to set out cultural objectives for sustainability. Nevertheless, there are some common features of the sustainability strategies of EU member states, including an agreed approach to environmental and climate issues. For example, the common energy policy of the EU sets the target of decreasing greenhouse gas emissions by 20% and increasing the share of renewable energy by 20% by 2020.

According to Estonia's sustainable development strategy, entitled 'Sustainable Estonia 21', the desired outcome for Estonia by 2030 is a socially coherent, culturally viable and ecologically balanced society with a high level of welfare. Estonia ranks its sustainability against other members of the EU using 78 indicators grouped into four main areas. It believes that this is useful for making policy decisions and choices.

The Estonian government believes that these indicators help to inform decision-making at national, business and individual levels. The government hopes that, instead of ranking among the last five EU member states in terms of most indicators, economic growth and development will become more sustainable. It aims to be amongst the EU leaders in terms of sustainable development in the near future.

The four areas of Estonia's sustainable development strategy are to achieve:

- a coherent society
- growth in welfare
- an ecological balance
- a viable cultural space.

© OCR 2013

STEMUP.CO.UK

Extract 5

Estonia's progress towards sustainable development

The Estonian government has made an assessment of the progress of the country in relation to the four areas of its sustainable development strategy (see Fig. 5.1).

1. Achieving a coherent society

Achieving a coherent society is one of the basic principles of sustainability. Estonia ranks 25th out of the 27 EU member states in terms of indicators such as relative poverty and income inequality. However, Estonia is in a better position than other member states on average in terms of long-term unemployment, early school-leavers and good broadband Internet connection.

2. Achieving growth in welfare

There is more to achieving growth in welfare than raising levels of GDP, though economic indicators such as GDP per capita are important. In addition to such economic indicators, health and education indicators need to be measured. In 2008, the value of education indicators was, on average, equal to or better than the average in the EU. However, in terms of productivity and health indicators, Estonia is among the last ten EU states. In terms of healthy life years at birth for males (50 years), Estonia is the last in Europe.

3. Achieving ecological balance

Moving towards ecological balance is also one of the basic principles of sustainability. In terms of all indicators of ecological balance, Estonia ranks 23rd among the EU states. The reason is the inefficient use of fossil fuels in electricity production which causes pollution. Estonia is in last place in the EU according to the share of electricity produced from renewable sources (1.5%). In terms of the generation of waste per capita, Estonia is among the last three EU states.

4. Achieving a viable cultural space

Setting the goal of achieving a viable cultural space and measuring progress towards achieving it is unique to Estonia. Traditional values in upbringing, ethics and morals are directly related to culture. In terms of cultural indicators, Estonia ranks eighth among the EU states which is the best result of all four areas of Estonia's development strategy.

Fig. 5.1 – An assessment by the Estonian government of its progress towards sustainable development in each of the four areas of its strategy

© OCR 2013

STEMUP.CO.UK

BLANK PAGE

© OCR 2013

STEMUP.CO.UK

BLANK PAGE

© OCR 2013

STEMUP.CO.UK

OCR
RECOGNISING ACHIEVEMENT

Copyright Information

OCR is committed to seeking permission to reproduce all third-party content that it uses in its assessment materials. OCR has attempted to identify and contact all copyright holders whose work is used in this paper. To avoid the issue of disclosure of answer-related information to candidates, all copyright acknowledgements are reproduced in the OCR Copyright Acknowledgements Booklet. This is produced for each series of examinations and is freely available to download from our public website (www.ocr.org.uk) after the live examination series.

If OCR has unwittingly failed to correctly acknowledge or clear any third-party content in this assessment material, OCR will be happy to correct its mistake at the earliest possible opportunity.

For queries or further information please contact the Copyright Team, First Floor, 9 Hills Road, Cambridge CB2 1GE.

OCR is part of the Cambridge Assessment Group; Cambridge Assessment is the brand name of University of Cambridge Local Examinations Syndicate (UCLES), which is itself a department of the University of Cambridge.

© OCR 2013

STEMUP.CO.UK

OCR
RECOGNISING ACHIEVEMENT

Tuesday 4 June 2013 – Afternoon

A2 GCE ECONOMICS

F585/01/SM The Global Economy

STIMULUS MATERIAL

F530601 13

Duration: 2 hours

INSTRUCTIONS TO CANDIDATES

- This is a clean copy of the Stimulus Material which you have already seen.
- You may **not** take your previous copy of the Stimulus Material into the examination.
- You may **not** take notes into the examination.

INFORMATION FOR CANDIDATES

- This document consists of **12** pages. Any blank pages are indicated.

INSTRUCTION TO EXAMS OFFICER / INVIGILATOR

- Do not send this Stimulus Material for marking; it should be retained in the centre or recycled. Please contact OCR Copyright should you wish to re-use this document.

© OCR 2013 [T/500/7921]
DC (CW/SW) 69043/1

OCR is an exempt Charity

STEMUP.CO.UK

Introduction

In 2011, there was much speculation about the death of the European Union's (EU) single currency, the euro. Some members of the eurozone, such as Greece and Ireland, had built up such high levels of public debt that there was increasing concern that they might have to default. The prospect of years of austerity needed to restore wage and price competitiveness had led to protests in Greece and political instability in Ireland. There was increasing reluctance in France and Germany to continue to bail out countries in debt and the future of the euro looked uncertain.

The history of the birth and growth of the euro dates back to 1999 when the eurozone came into existence. At that time, it was felt that setting criteria for the entry of member states into the eurozone would help create the conditions for the operation of a single currency in Europe. These criteria were designed to create fiscal and monetary convergence of the economies joining the eurozone and included a number of conditions necessary for entry. By 2011, there were 17 members of the eurozone, including five countries which had joined the EU in 2004.

Whilst some countries in the eurozone had clearly not enjoyed the expected benefits of membership, staying out of the EU's single currency was not a guarantee of economic success. The global financial and economic crises of 2007–08 had resulted in severe financial and balance of payments crises in, for example, Latvia.

Despite the uncertainty about the future of the euro, Estonia took the decision to join the eurozone on 1 January 2011. Estonia is widely regarded as one of the most successful economies of Central and Eastern Europe (CEE). It had consistently recorded high rates of economic growth and development until the crises of 2007–08. Whilst openness to international trade and high levels of Foreign Direct Investment (FDI) were important reasons for Estonia's economic success, they were not the only factors responsible for its impressive growth and development.

Despite the country's success in the past and renewed economic growth in 2010, the Estonian government was keen to ensure that future economic growth was consistent with greater sustainable development. The Estonian government had identified a number of areas in which high rates of economic growth had not delivered sustainable development in the past. On many sustainability indicators, Estonia was lagging behind the rest of the EU, including many of the economies which had joined the EU in 2004 and in 2007.

© OCR 2013

STEMUP.CO.UK

Pre-release stimulus material

Extract 1: **The birth and growth of the eurozone**

Extract 2: **New EU member states and the euro**

Extract 3: **Estonia's economic growth and development**

Extract 4: **The approach to sustainable development in the EU and Estonia**

Extract 5: **Estonia's progress towards sustainable development**

© OCR 2013

STEMUP.CO.UK

Extract 1

The birth and growth of the eurozone

On 1 January 1999, the eurozone came into existence. It comprised 11 EU countries which permanently fixed their exchange rates by adopting the euro as their currency. Three years later, on 1 January 2002, euro coins and banknotes were officially introduced as legal tender, and after a further six months national currencies were withdrawn.

The UK, Sweden and Denmark have all decided to stay out of the eurozone for the time being. Greece did not join at first because it failed to meet the Maastricht Convergence Criteria. However, on 1 January 2001, Greece became the 12th country to adopt the common currency after it was judged to have fulfilled all the requirements for eurozone entry.

On 1 May 2004, ten new countries joined the EU: Poland, Hungary, the Czech Republic, Slovakia, Slovenia, Estonia, Latvia, Lithuania, Cyprus and Malta. Three years later, on 1 January 2007, a further enlargement of the EU added two new members: Bulgaria and Romania. All of these new members of the EU have agreed to join the eurozone when the time is right for them to do so and when they have met the conditions of entry.

Of the 12 new member states of the EU, five fulfilled the Maastricht Convergence Criteria and became part of the eurozone by 2011.

© OCR 2013

STEMUP.CO.UK

Extract 2

New EU member states and the euro

When a new country joins the EU, it is expected to treat its exchange rate as a matter of common interest to all members of the EU. This means that it should not pursue competitive devaluations for fear of undermining the EU's single market. However, initially a country is free to decide whether its exchange rate is freely floating or fixed. Once a country has joined the Economic and Monetary Union (EMU), it must join the EU's fixed exchange rate mechanism known as ERM II. It is argued that this prepares them for eventual membership of the eurozone.

Any EU country joining the eurozone must have first met a number of strict conditions. These conditions ensure that the country will have reached a high degree of fiscal and monetary convergence before it finally adopts the euro.

Of the 12 countries which joined the EU between 2004 and 2007, five were members of the eurozone by 2011. Slovenia joined the eurozone on 1 January 2007. It was followed on 1 January 2008 by Cyprus and Malta, on 1 January 2009 by Slovakia and on 1 January 2011 by Estonia.

Of the remaining seven members, only Latvia and Lithuania had joined ERM II by 2011 with a view to adopting the euro. Since joining ERM II, Latvia's economic situation has worsened. As a result of the global financial and economic crises of 2007–08, Latvia needed loans totalling €7.5 billion from the International Monetary Fund (IMF), the World Bank and the EU in order to support its fixed exchange rate against the euro. In a statement issued at the time of the loan in 2008, the IMF said:

"*The current global financial crisis has brought Latvia's vulnerabilities to a head. Years of unsustainably high growth and large current account deficits have combined to create financial and balance of payments crises.*"

The financial and economic crises of 2007–08 substantially worsened the economic situation of many of the new EU members. Their currencies came under speculative attack and became dangerously volatile. Their budget deficits soared. Countries which had borrowed significant sums from Western Europe and were heavily dependent on FDI suffered most. As financial capital fled these economies, their currencies fell in value and the cost of repaying debt escalated dramatically.

Some economists were critical of the way in which CEE economies had sought to achieve economic development since joining the EU. The European Bank for Reconstruction and Development (EBRD), for example, issued a report in 2009 which criticised the CEE economies' reliance on financial integration to promote development. The report stated that "financial integration – in the form of large debt flows and FDI – has been an integral part of the 'development model' of transition countries". The EBRD urged CEE economies to be less dependent on international financial flows and FDI.

© OCR 2013

STEMUP.CO.UK

Extract 3

Estonia's economic growth and development

Since embarking on the transition to a market economy in 1991, Estonia's economic growth and development have been determined by a range of factors. Its transition to the market economy has been helped by membership of the EU. Its openness to international trade and FDI has also helped it to achieve high rates of economic growth. Estonia's international trade as a percentage of Gross Domestic Product (GDP) was 155% in 2009. In addition, it has one of the most favourable environments for FDI with a 0% tax rate on reinvested profits. However, other factors have also played a role in promoting economic development and growth in Estonia. These include the age structure of its population, the skills and education of its labour force, its geographical position, and its infrastructure. The Estonian currency, the kroon, has been stable thanks to prudent macroeconomic policy which has brought about price stability. Economic reforms have also created a well functioning market economy. As a result of the high rates of economic growth brought about by these economic conditions, the Estonian economy has been dubbed the 'Baltic Tiger'.

Figs 3.1 and 3.2 below show two measures of Estonia's economic performance from 2000 to 2010.

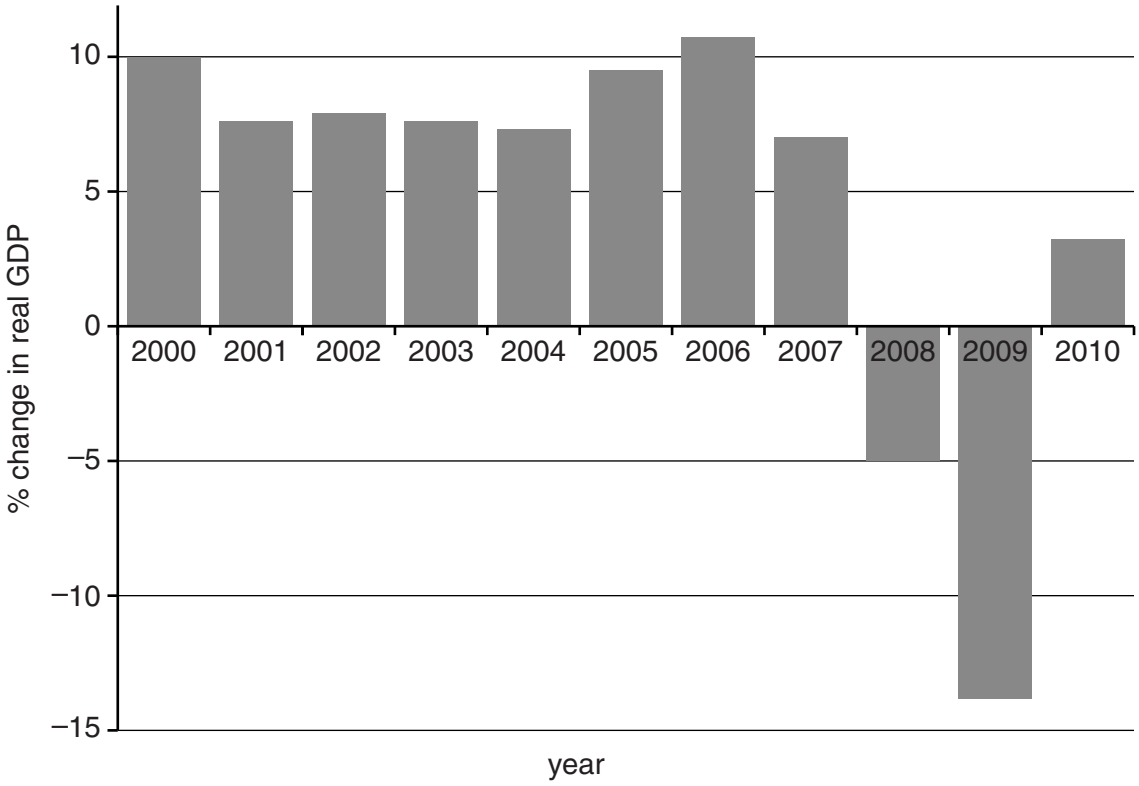


Fig. 3.1 – Estonia's annual economic growth rate (% change in real GDP), 2000–10

STEMUP.CO.UK

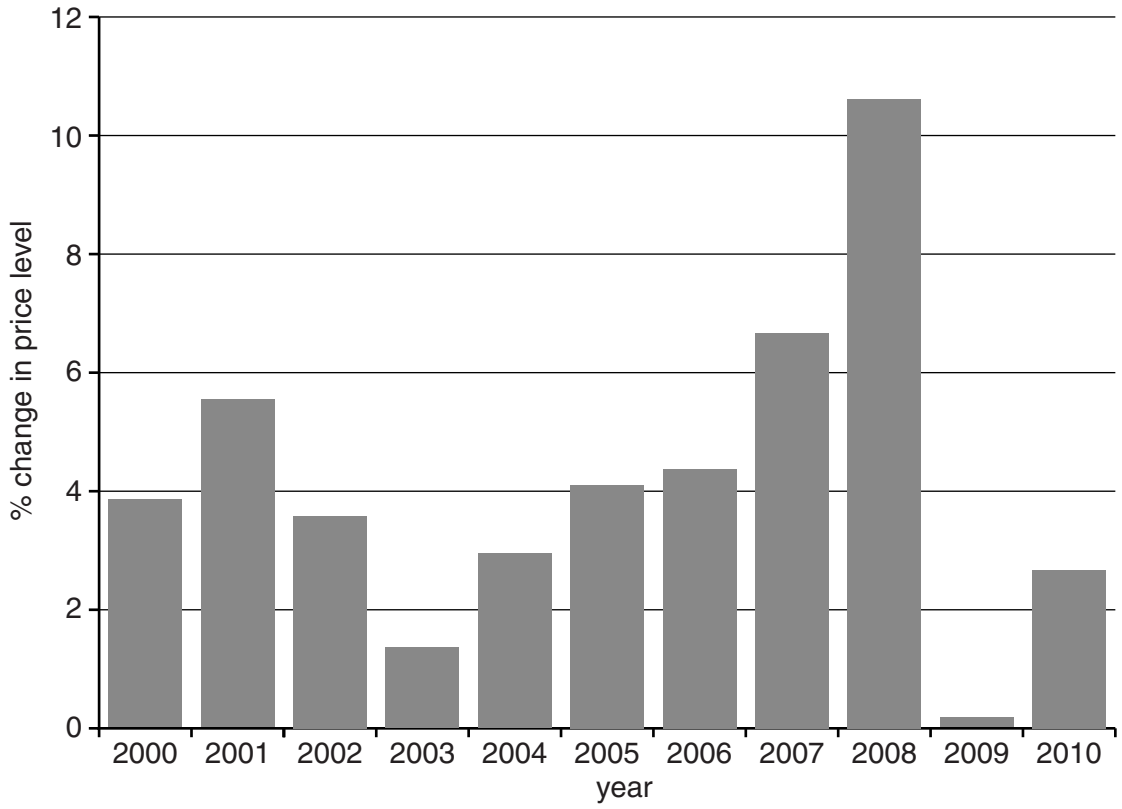


Fig. 3.2 – Estonia's annual inflation rate (% change in price level*), 2000–10

* *as measured by changes in the Harmonised Index of Consumer Prices (HICP).*

Despite all of these favourable conditions for growth, Estonia was not immune from the global economic recession of 2008 as its GDP fell by 5.1% in that year. The economic situation further worsened in 2009 as GDP fell by a massive 14% before a recovery in 2010 led by strong growth in its exports. Some forecasts of economic growth for 2011 were as high as 4.5%, suggesting a strong recovery from recession.

According to data published by Eurostat, living standards in Estonia remain below the average for the EU. Estonian GDP per capita at Purchasing Power Parity (PPP) was 67% of the EU average in 2008. Estonia's Prime Minister wants to raise living standards so that GDP per capita at PPP is in the top five in the EU by 2022. However, GDP per capita hides big differences between different areas of Estonia. It is estimated that over 50% of Estonia's GDP is generated in the capital, Tallinn. The GDP per capita in Tallinn was 172% of the Estonian average and 115% of the EU average.

Many indicators point to a healthy future for the Estonian economy. According to Eurostat, Estonia has the lowest ratio of government debt to GDP among EU countries. Estonia's balanced budget, almost non-existent public sector debt, flat-rate income tax, free trade regime, and its competitive commercial banking sector all bode well for its future economic growth and development. In addition, the government's willingness to significantly increase its spending to support innovation and research and development by businesses in Estonia could help to ensure that high rates of economic growth do not run up against capacity constraints.

© OCR 2013

STEMUP.CO.UK

Extract 4

The approach to sustainable development in the EU and Estonia

The EU's approach to sustainable development is set out in its Sustainable Development Strategy, adopted by the European Commission in 2001, and amended in 2006 and 2009. The strategy sets overall objectives and concrete actions for seven key priorities:

- climate change and clean energy
- sustainable transport
- sustainable consumption and production
- conservation and management of natural resources
- public health
- social inclusion, demography and migration
- global poverty and sustainable development challenges.

The member states of the EU each have different national strategies which take into account their different characteristics and needs. Estonia is the only EU member state to set out cultural objectives for sustainability. Nevertheless, there are some common features of the sustainability strategies of EU member states, including an agreed approach to environmental and climate issues. For example, the common energy policy of the EU sets the target of decreasing greenhouse gas emissions by 20% and increasing the share of renewable energy by 20% by 2020.

According to Estonia's sustainable development strategy, entitled 'Sustainable Estonia 21', the desired outcome for Estonia by 2030 is a socially coherent, culturally viable and ecologically balanced society with a high level of welfare. Estonia ranks its sustainability against other members of the EU using 78 indicators grouped into four main areas. It believes that this is useful for making policy decisions and choices.

The Estonian government believes that these indicators help to inform decision-making at national, business and individual levels. The government hopes that, instead of ranking among the last five EU member states in terms of most indicators, economic growth and development will become more sustainable. It aims to be amongst the EU leaders in terms of sustainable development in the near future.

The four areas of Estonia's sustainable development strategy are to achieve:

- a coherent society
- growth in welfare
- an ecological balance
- a viable cultural space.

© OCR 2013

STEMUP.CO.UK

Extract 5

Estonia's progress towards sustainable development

The Estonian government has made an assessment of the progress of the country in relation to the four areas of its sustainable development strategy (see Fig. 5.1).

1. Achieving a coherent society

Achieving a coherent society is one of the basic principles of sustainability. Estonia ranks 25th out of the 27 EU member states in terms of indicators such as relative poverty and income inequality. However, Estonia is in a better position than other member states on average in terms of long-term unemployment, early school-leavers and good broadband Internet connection.

2. Achieving growth in welfare

There is more to achieving growth in welfare than raising levels of GDP, though economic indicators such as GDP per capita are important. In addition to such economic indicators, health and education indicators need to be measured. In 2008, the value of education indicators was, on average, equal to or better than the average in the EU. However, in terms of productivity and health indicators, Estonia is among the last ten EU states. In terms of healthy life years at birth for males (50 years), Estonia is the last in Europe.

3. Achieving ecological balance

Moving towards ecological balance is also one of the basic principles of sustainability. In terms of all indicators of ecological balance, Estonia ranks 23rd among the EU states. The reason is the inefficient use of fossil fuels in electricity production which causes pollution. Estonia is in last place in the EU according to the share of electricity produced from renewable sources (1.5%). In terms of the generation of waste per capita, Estonia is among the last three EU states.

4. Achieving a viable cultural space

Setting the goal of achieving a viable cultural space and measuring progress towards achieving it is unique to Estonia. Traditional values in upbringing, ethics and morals are directly related to culture. In terms of cultural indicators, Estonia ranks eighth among the EU states which is the best result of all four areas of Estonia's development strategy.

Fig. 5.1 – An assessment by the Estonian government of its progress towards sustainable development in each of the four areas of its strategy

© OCR 2013

STEMUP.CO.UK

BLANK PAGE

© OCR 2013

STEMUP.CO.UK

BLANK PAGE

© OCR 2013

STEMUP.CO.UK

OCR
RECOGNISING ACHIEVEMENT

Copyright Information

OCR is committed to seeking permission to reproduce all third-party content that it uses in its assessment materials. OCR has attempted to identify and contact all copyright holders whose work is used in this paper. To avoid the issue of disclosure of answer-related information to candidates, all copyright acknowledgements are reproduced in the OCR Copyright Acknowledgements Booklet. This is produced for each series of examinations and is freely available to download from our public website (www.ocr.org.uk) after the live examination series.

If OCR has unwittingly failed to correctly acknowledge or clear any third-party content in this assessment material, OCR will be happy to correct its mistake at the earliest possible opportunity.

For queries or further information please contact the Copyright Team, First Floor, 9 Hills Road, Cambridge CB2 1GE.

OCR is part of the Cambridge Assessment Group; Cambridge Assessment is the brand name of University of Cambridge Local Examinations Syndicate (UCLES), which is itself a department of the University of Cambridge.

© OCR 2013

STEMUP.CO.UK

OCR
RECOGNISING ACHIEVEMENT

Tuesday 4 June 2013 – Afternoon

A2 GCE ECONOMICS

F585/01 The Global Economy

Candidates answer on the Question Paper.

OCR supplied materials:
- Clean copy Stimulus Material

Other materials required:
- Calculators may be used

Duration: 2 hours

F5300501 13

F 5 8 5 0 1

Candidate forename		Candidate surname	

Centre number						Candidate number				

INSTRUCTIONS TO CANDIDATES

- Refer to the Stimulus Material in a separate booklet. You must **not** bring your original copy into the examination.
- Write your name, centre number and candidate number in the boxes above. Please write clearly and in capital letters.
- Use black ink. HB pencil may be used for graphs and diagrams only.
- Answer **all** the questions.
- Read each question carefully. Make sure you know what you have to do before starting your answer.
- Write your answer to each question in the space provided. If additional space is required, you should use the lined pages at the end of this booklet. The question number(s) must be clearly shown.
- Do **not** write in the bar codes.

INFORMATION FOR CANDIDATES

- The number of marks is given in brackets **[ ]** at the end of each question or part question.
- The total number of marks for this paper is **60**.
- This document consists of **16** pages. Any blank pages are indicated.
- The quality of your written communication will be taken into account in the marking of your answer to question 3. All answers should be in continuous prose.

A calculator may be used for this paper

© OCR 2013 [T/500/7921]
DC (NF) 56831/6

OCR is an exempt Charity

STEMUP.CO.UK

Answer **all** questions.

1 **(a)** In order to gain membership of the eurozone, countries must achieve a high degree of fiscal and monetary convergence with existing members.

Describe what is meant by fiscal and monetary convergence.

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

..... **[4]**

© OCR 2013

STEMUP.CO.UK

(b) Analyse **two** economic benefits which Estonia might be expected to gain from membership of the eurozone.

1 .....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

2 .....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

..... **[6]**

© OCR 2013

STEMUP.CO.UK

(c) Comment on the likely economic benefits for Central and Eastern European (CEE) economies of high levels of Foreign Direct Investment (FDI).

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

© OCR 2013

STEMUP.CO.UK

[10]

© OCR 2013

STEMUP.CO.UK

2 **(a)** Distinguish between economic growth and economic development.

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

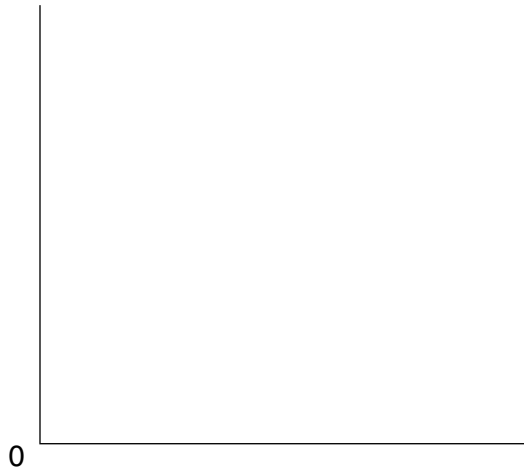
.....

..... **[4]**

© OCR 2013

STEMUP.CO.UK

(b) With the aid of a diagram, analyse **one** likely reason for the changes in Estonia's price level and real GDP in 2008.



.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

..... **[6]**

© OCR 2013

STEMUP.CO.UK

(c) Comment on the importance of international trade as a cause of Estonia's economic growth between 2000 and 2010.

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

© OCR 2013

STEMUP.CO.UK

[10]

© OCR 2013

STEMUP.CO.UK

3 Discuss the view that future high rates of economic growth alone may enable Estonia to achieve sustainable development. **[20]**

© OCR 2013

STEMUP.CO.UK

© OCR 2013

STEMUP.CO.UK

© OCR 2013

© OCR 2013

STEMUP.CO.UK

END OF QUESTION PAPER

© OCR 2013

ADDITIONAL ANSWER SPACE

If additional answer space is required, you should use the following lined page(s). The question number(s) must be clearly shown in the margins.

© OCR 2013

STEMUP.CO.UK

OCR
RECOGNISING ACHIEVEMENT

Copyright Information

OCR is committed to seeking permission to reproduce all third-party content that it uses in its assessment materials. OCR has attempted to identify and contact all copyright holders whose work is used in this paper. To avoid the issue of disclosure of answer-related information to candidates, all copyright acknowledgements are reproduced in the OCR Copyright Acknowledgements Booklet. This is produced for each series of examinations and is freely available to download from our public website (www.ocr.org.uk) after the live examination series.

If OCR has unwittingly failed to correctly acknowledge or clear any third-party content in this assessment material, OCR will be happy to correct its mistake at the earliest possible opportunity.

For queries or further information please contact the Copyright Team, First Floor, 9 Hills Road, Cambridge CB2 1GE.

OCR is part of the Cambridge Assessment Group; Cambridge Assessment is the brand name of University of Cambridge Local Examinations Syndicate (UCLES), which is itself a department of the University of Cambridge.

© OCR 2013

OCR
RECOGNISING ACHIEVEMENT

GCE

Economics

Advanced GCE

Unit **F585:** The Global Economy

Mark Scheme for June 2013

STEMUP.CO.UK

OCR (Oxford Cambridge and RSA) is a leading UK awarding body, providing a wide range of qualifications to meet the needs of candidates of all ages and abilities. OCR qualifications include AS/A Levels, Diplomas, GCSEs, Cambridge Nationals, Cambridge Technicals, Functional Skills, Key Skills, Entry Level qualifications, NVQs and vocational qualifications in areas such as IT, business, languages, teaching/training, administration and secretarial skills.

It is also responsible for developing new specifications to meet national requirements and the needs of students and teachers. OCR is a not-for-profit organisation; any surplus made is invested back into the establishment to help towards the development of qualifications and support, which keep pace with the changing needs of today's society.

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

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

Mark schemes should be read in conjunction with the published question papers and the report on the examination.

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

© OCR 2013

Annotations

Annotation	Meaning
	Unclear
BOD	Benefit of Doubt
EE	Effective evaluation
ND	No Development
L1	Level 1
L2	Level 2
L3	Level 3
L4	Level 4
NAQ	Not answered question
SEEN	Noted but no credit given
TV	Too vague
	Tick
	Development of point

STEMUP.CO.UK

Subject-specific Marking Instructions

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

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

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

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

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

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

STEMUP.CO.UK

Question	Answer	Marks	Guidance
1 (a)	**In order to gain membership of the eurozone, countries must achieve a high degree of fiscal and monetary convergence with existing members. Describe what is meant by fiscal and monetary convergence.** One mark for a definition of fiscal and monetary convergence: • The process by which economic conditions/indicators/ aspects in different economies become similar/ coincide/aligned/come together (one mark) Up to two marks for relevant examples of fiscal conditions: • annual government deficit/ratio of government deficit to GDP (one mark) • government debt/ratio of government debt to GDP (one mark) Up to two marks for relevant examples of monetary conditions: • rates of inflation (one mark) • (long term) interest rate (one mark) • exchange rate fluctuations/stability (one mark) Maximum four marks in total	4	Do **not** award definition mark for responses which say: • monetary and fiscal conditions must be **identical/same** • similarities in fiscal and monetary **polices** • countries adopt **common** fiscal and monetary policy • government spending and tax must be similar • economic cycle/employment/GDP must be similar In awarding marks for examples of monetary conditions accept details of the Maastricht Convergence Criteria: • inflation rate no higher than 1.5% of the average of the three existing members with lowest inflation/best performing economies • (long term) interest rate no higher than 2% of the average of the three existing members with lowest rates/best performing economies • membership of ERM II for two years and no devaluation over last two years Marks can be awarded for inflation rate and (long term) interest rates even if specific rates are incorrect In awarding marks for examples of fiscal conditions accept details of the Maastricht Convergence Criteria: • government debt to GDP ratio < 60% • budget deficit < 3% of GDP Use green ticks  for each mark awarded

STEMUP.CO.UK

Question	Answer	Marks	Guidance
(b)	**Analyse *two* economic benefits which Estonia might be expected to gain from membership of the eurozone.** Reduced **transactions costs** (one mark): • the cost of changing currencies is eliminated when trading with other members of the eurozone (one mark) **or** this reduces the cost of trading with other members of the eurozone (one mark) **or** exports are cheaper (one mark) • this leads to a rightward shift of AS/AD **and** increases real GDP/economic growth/employment/improved BoP current account/reduced inflation (one mark) Elimination of **exchange rate risk** (one mark): • there is no requirement to 'hedge' against the risk that exchange rates may change (one mark) **or** this reduces the cost of trading with other members of the eurozone (one mark) **or** profit margins increase leading to more investment (one mark) • this leads to a rightward shift of AS/AD **and** increases real GDP/economic growth/employment/improved BoP current account/reduced inflation (one mark) Increased **price transparency** (one mark): • prices in the eurozone are easier for consumers and producers to compare (one mark) **or** this raises competition between producers in the eurozone (one mark), **or** this reduces costs for producers (one mark) • this leads to a rightward shift of AS/AD **and** increases real GDP/economic growth/employment/improved BoP current account/reduced inflation (one mark)	6	One mark for each benefit identified One mark for each description of the nature of the benefit One mark for the link to aggregate demand (injections) **or** aggregate supply **or** economic efficiency **and** any key macroeconomic indicator Use green ticks ✔ for each mark awarded Award one mark for the following economic benefits with up to two additional marks **if** linked to reduced transaction costs/reduced exchange rate risk/increased price transparency **and** analysed in terms of AD/AS key macroeconomic indicators: • higher FDI • increased trade/exports • lower barriers to trade • access to larger market/economies of scale • greater factor mobility/migration Also accept: • **more stable currency/reduced ER uncertainty** (one mark) if the euro is less vulnerable to speculative attack (one mark) **or** resulting in higher levels of exports/FDI (one mark), this leads to a rightward shift of AS/AD **and** increasing real GDP/economic growth/employment/improved BoP current account/reduced inflation (one mark) Allow microeconomic benefits only eg: • reduced transaction costs/reduced ER risk/greater price transparency (one mark), reduces average costs/lowers prices/increases competition (one mark) which increases productive/allocative efficiency (one mark) **or** consumer surplus (one mark) Do not accept the following: • trade creation • removal of tariffs • advantages of a fixed exchange rate • low inflation • support from EU funding/IMF bailouts

STEMUP.CO.UK

Question			Answer	Marks	Guidance	
					Content	Levels of response
	(c)		**Comment on the likely economic benefits for Central and Eastern European (CEE) economies of high levels of Foreign Direct Investment (FDI).** **Commentary on benefits could include:** • **short term nature of the benefits** – FDI raises GDP per capita so wages rates rise so MNCs move to lower cost economies in the LR so FDI is 'footloose'/temporary/volatile • **depends on type of FDI** – mergers and acquisitions generate little or no increase in GDP in the SR and may generate unemployment compared to genuinely 'new' investment • **little impact on employment** - FDI may be capital intensive or MNCs bring own labour therefore limiting impact on tax revenue, income from employment, local multipliers, skills transfer • **profit may be repatriated** - impact on BoP current account may be negative, so short term increase in financial inflow has to be balanced with long term worsening of current account, possible impact on exchange rate • **depletion in natural resources** – any change in GDP, incomes etc is short lived and not sustainable so there is economic growth but not sustainable development • **pollution creates negative externalities** – causes MSC > MPC resulting in allocative inefficiency, impact on ISEW / HDI • **limited fiscal benefits** - due to small impact on employment/net tax benefits low because of inducements in the form of subsidy/low corporation tax receipts because of transfer pricing/tax avoidance etc • **specific context related to any CEE economy** - benefits likely to be more significant for smaller economies/economies with poor infrastructure/low capital stock/economies with legacy of a planned economy resulting in constrained growth due to low savings and investment	10	In Level 4 award marks as follows: • <u>one</u> **stated** point of evaluation = seven marks • <u>two</u> or more **stated** points of evaluation = eight marks • <u>one</u> **developed** comment = nine marks • <u>two</u> **developed** comments or <u>one</u> comment with <u>two</u> points of development = ten marks Do not accept: • depends on size of FDI (unless as a % of GDP) • FDI generates demand pull inflation (higher AD) Accept other comments: • impact on local firms • over-reliance on FDI • FDI may generate cost push inflation through increased wages	**Level 4 (7–10 marks)** For a commentary on the likely economic benefits for CEE economies of high levels of foreign direct investment (FDI) *Annotate each **stated** point of commentary using* L4 *in the LHS margin* *Annotate **developed** evaluation with* ✓+

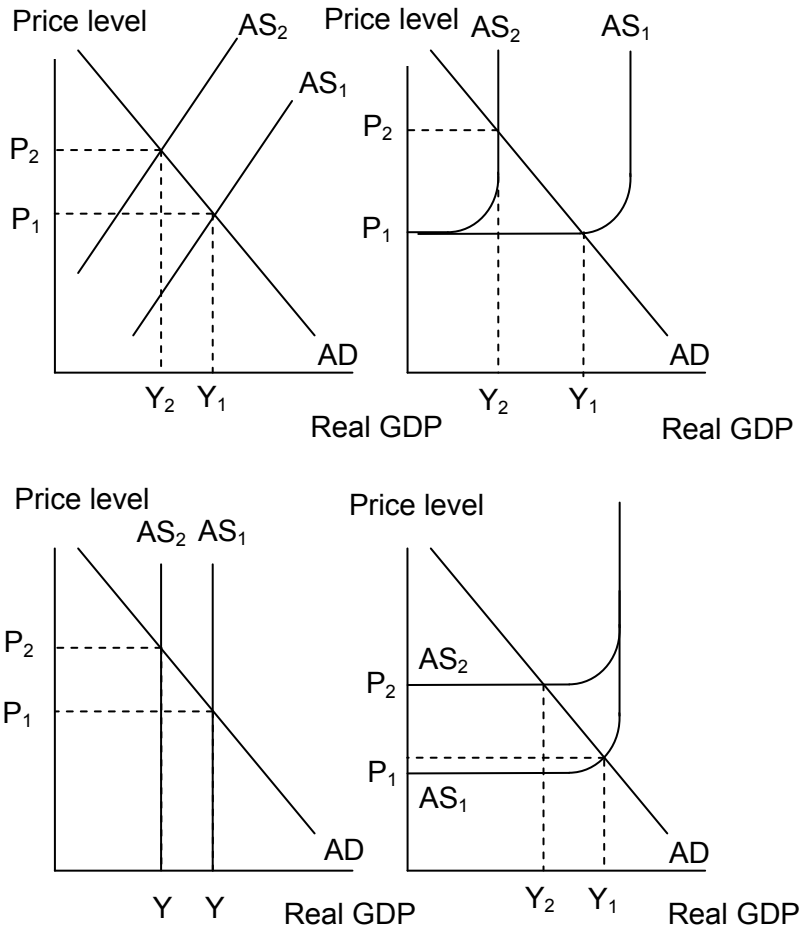
STEMUP.CO.UK

Question			Answer	Marks	Guidance	
					Content	Levels of response
			Analysis of benefits could include: • higher AD, raising real GDP/economic growth/employment/ improved BoP current account (exports) • increased injections into the circular flow, raising real GDP/ economic growth/employment/improved BoP current account (exports) • rightward shift in LRAS from increase in productive capacity (productivity), raising real GDP/economic growth/employment/ improved BoP current account (exports) • increase in development, resulting from higher employment/ incomes/living standards **or** increased tax revenue (income and corporation tax) allowing increased government spending on education and health **or** higher GDP per capita resulting in higher HDI • improvements in BoP financial account, resulting in ability to run current account deficit without experiencing currency depreciation **or** sustain higher rates of economic growth without BoP problems **Application of knowledge and understanding of benefits of high levels of FDI for CEE economies could include:** • higher employment/reduction in unemployment • transfer of skills and knowledge • higher government tax revenue • inflows on financial account of BoP • increase in GDP/GDP per capita **Knowledge and understanding of FDI could include:** • investment by MNCs in physical capital abroad or purchase of foreign firms		**Level 3** If only one benefit is referred to candidates should be capped to the bottom of the relevant Level as follows: • commentary on one benefit = seven marks • analysis of one benefit = four marks • application of one benefit = two marks. **Level 2** Mention of increase in AD, AS **without** the link to real GDP or employment remains in Level 2	**Level 3 (4–6 marks)** For a one-sided analysis of the likely economic benefits or drawbacks for CEE economies of high levels of foreign direct investment (FDI) *Annotate using* L3 *in the LHS margin* **Level 2 (2–3 marks)** For an application of knowledge and understanding of the likely economic benefits for CEE economies of high levels of foreign direct investment (FDI) *Annotate using* L2 *in the LHS margin* **Level 1 (1 mark)** For knowledge and understanding of foreign direct investment (FDI) *Annotate using* L1 *in the LHS margin*

STEMUP.CO.UK

Question			Answer	Marks	Guidance
2	(a)		**Distinguish between economic growth and economic development.** **Up to two marks for definitions of the terms:** • economic growth is an increase in an economy's output in the short run and an increase in its productive potential in the long run (one mark); • economic development is the process of improving people's economic well-being and quality of life (one mark). **Up to two marks for distinctions between the two.** A simple recognition that economic growth may not lead to economic development can be awarded one mark: • economic growth does not guarantee economic development/economic growth is a necessary but not sufficient condition for economic development (one mark) • economic growth can take place without an increase in living standards (one mark) There must some elaboration of **why** for two marks: • economic growth might take place with little impact on employment (one mark) because of the use of capital-intensive methods of production (one mark); • economic growth might be achieved by methods that result in high levels of pollution (one mark) so the quality of life is not improved (one mark); • economic development is a broader concept than economic growth (one mark) involving changes in more than one economic or social indicator (one mark); • economic growth might occur with no change in the structure of the economy (one mark), with the balance between primary, secondary and tertiary sectors largely unchanged (one mark) • economic growth is only one aspect of economic development (one mark) plus exemplification of other aspects (one mark). • economic growth will raise a nation's total income but be unequally distributed (one mark) so that a large number of people see little or no increase in their individual income – affluence and poverty co-exist (one mark)	4	Accept less precise definitions or incomplete definitions of economic growth: • economic growth is an increase in real GDP (one mark) Accept alternative definitions of economic development including: • a change in the structure of the economy. Accept differences in measurement as a distinction for one mark only. Use green ticks ✔ for each mark awarded Maximum of two marks for definitions of the two concepts

STEMUP.CO.UK

Question	Answer	Marks	Guidance
(b)	**With the aid of a diagram, analyse one likely reason for the changes in Estonia's price level and real GDP in 2008.** **Award diagram marks as follows:** • one mark for original AD and AS curves • one mark for original price level and real GDP • one mark for leftward shift of AS curve • one mark for new price level and real GDP. *Diagram marks can only be awarded if axes are correctly labelled (must be macroeconomic labels and **not** microeconomic)* **Award up to a further two marks for analysis of one likely reason for the shift of the AS curve which might include:** • higher commodity/raw material prices raise costs of production (one mark) shifting AS to the left resulting in an increase in the price level and a reduction in real GDP (one mark) • reductions in productivity raise production costs (one mark) shifting AS to the left resulting in an increase in the price level and a reduction in real GDP (one mark) • reduction in labour force participation rates reduce productive capacity of the economy (one mark) shifting AS to the left resulting in an increase in the price level and a reduction in real GDP (one mark) • reduction in FDI reduces economy's productive capacity (one mark) shifting AS to the left resulting in an increase in the price level and a reduction in real GDP (one mark) • rise in indirect taxes caused an increase in costs (one mark) shifting AS to the left resulting in an increase in the price level and a reduction in real GDP (one mark) *NB there is no need for candidates to distinguish between SRAS and LRAS* Use green ticks ✔ for each mark awarded	6	 **Acceptable labels:** • price level (PL), general price level (GPL), average price level (APL), CPI, RPI • real GDP (RGDP), real national output (RNO), real national income (RNI)

STEMUP.CO.UK

Question			Answer	Marks	Guidance	
					Content	Levels of response
	(c)		**Comment on the importance of international trade as a cause of Estonia's economic growth between 2000 and 2010.** **Commentary on importance of international trade could include:** • **depends on other components of AD** – economic growth may have been caused by higher consumption/investment/ government spending • **depends on PED of exports** – reduction in price of exports as a result of removal of tariffs on trade may not have led to a large increase in the volume of exports if PED is price inelastic • **depends on size of (X – M) in relation overall AD** – if income tax falls, the rise in disposable income would increase consumption which may be a larger percentage of GDP • **high levels of FDI attracted by low rates of corporation tax** – the favourable economic environment could have raised AD in the short run and increased productive capacity and productivity in the long run leading to a rightward shift in LRAS • **changes in the age structure of the population** – increase the labour force participation rate/economically active population this increased productive potential, resulting in a rightward shift of LRAS • **improvements in skills/human capital/productivity** – these increased productive potential, resulting in a rightward shift of LRAS • **increases in the capital stock** – this increased productive potential, resulting in a rightward shift of LRAS • **competitive commercial banking sector** – this would have helped channel funds for investment, increasing AD and LRAS	10	In Level 4 award marks as follows: • <u>one</u> **stated** point of evaluation = seven marks • <u>two</u> or more **stated** points of evaluation = eight marks • <u>one</u> **developed** comment = nine marks • <u>two</u> **developed** comments or <u>one</u> comment with <u>two</u> points of development = ten marks Do not accept as commentary: • higher imports/net trade (X – M) may reduce growth • global financial/economic crisis reduced demand for X reducing growth Accept other comments: • depends on having made the transition to a market economy, which raised competitiveness • the effect of the global financial/economic crisis on consumer and business confidence in Estonia, resulting in a reduction in consumption and investment reducing AD • geographic position	**Level 4 (7–10 marks)** For a commentary on the importance of international trade was as a cause of Estonia's economic growth 2000–10 *Annotate each **stated** point of commentary using* L4 *in the LHS margin* *Annotate **developed** evaluation with* ✓+

STEMUP.CO.UK

Question			Answer	Marks	Guidance	
					Content	Levels of response
			Analysis of importance of international trade could include: • joining the EU reduced tariffs on Estonia's exports, reducing price of exports raising exports demand and AD, raising real GDP/economic growth • trade may increase Estonia's exports raising AD, raising real GDP/economic growth • in the long run greater efficiency in resource allocation, technology transfers from greater openness, EoS from access to larger marker may lead to increases in LRAS, raising real GDP/economic growth • the global financial/economic crisis could have reduced Estonia's exports reducing AD, leading to lower GDP/economic growth • net trade (X – M) may explain Estonia's negative economic growth 2008–09 if there has been an increase in the mpm causing imports to rise reducing AD, leading to lower GDP/ economic growth • international trade exposes the Estonian economy to international competition, reducing costs and shifting AS right leading to an increase in GDP/economic growth **Application of knowledge and understanding of importance of international trade from Extract 3 could include:** • Estonia is an open economy and growth is based largely on trade and FDI • EU integration has boosted trade • recovery from recession based on strong growth in exports. **Knowledge of international trade and / or economic growth could include:** • economic growth is an increase in an economy's output in the short run and an increase in its productive potential in the long run • international trade is the exchange of goods and services across national boundaries		**Level 3** *NOTE: International trade might explain **both** positive **and** negative economic growth so credit analysis of **both** in L3 and **not** L4* Analytical responses are characterised by use of AD/AS analysis **explicitly linked** to a change in real GDP/economic growth – this need not be in the form of a diagram **Level 2** Mention of increase in AD, AS **without** the link to real GDP or employment remains in Level 2	**Level 3 (4–6 marks)** For a one-sided analysis of the importance of international trade or other factors as a cause of Estonia's economic growth 2000–10 *Annotate using* L3 *in the LHS margin* **Level 2 (2–3 marks)** For an application of knowledge and understanding of the importance of international trade was as a cause of Estonia's economic growth 2000–10 *Annotate using* L2 *in the LHS margin* **Level 1 (1 mark)** For knowledge and understanding of international trade and / or economic growth *Annotate using* L1 *in the LHS margin*

STEMUP.CO.UK

Question			Answer	Marks	Guidance	
					Content	Levels of response
3			**Discuss the view that future high rates of economic growth <u>alone</u> may enable Estonia to achieve sustainable development.** **Level 4, Band 3 responses** High rate of economic growth alone will not enable Estonia to achieve sustainable development unless accompanied by: • supply side policies to increase LRAS, including investment in infrastructure • progressive tax system • policies to internalise negative externalities • taxation of non-renewable resource to slow resource depletion **Level 4, Band 2 responses** High rates of economic growth may not enable Estonia to achieve sustainable development because: • growth may be inflationary if generated by increases in AD rather than LRAS • growth may be unevenly distributed due to the geographic concentration of economic activity/lack of infrastructure/lack of progressive tax system • there may be negative externalities resulting from MSC > MPC so there is over-production/consumption • there may be resource depletion which reduces ability of future generations to benefit from growth • improvements in education, health and social welfare will not be guaranteed because education, health and social welfare have significant positive externalities and will be under-provided is left to the market **Level 4, Band 1 responses** High rates of economic growth may not enable Estonia to achieve sustainable development because: • growth may be inflationary • growth may be unevenly distributed • there may be negative externalities and / or resource depletion • improvements in education, health and social welfare will not be guaranteed	20	**Level 4, Band 3** Responses in this Band must be supported by strong analysis of reasons why high rates of economic growth may **<u>and</u>** may **not** allow Estonia to achieve sustainable development **Level 4, Band 2** Responses in this Band will be characterised by strong supporting analysis of reasons why high rates of economic growth may **<u>and</u>** may **not** allow Estonia to achieve sustainable development **Level 4, Band 1** Responses characterised by weak supporting analysis but may include policies, if so – 11 marks: basic two sides 12 marks: policy named 13 marks: policy described 14 marks: policy analysed	**Level 4 Band 3 (18–20 marks)** For an explicit consideration of what else might be necessary to ensure that high rates of economic growth will enable Estonia to achieve sustainable development *Annotate using* EE *in the LHS margin* **Level 4 Band 2 (15–17 marks)** For a well-developed discussion of the view that future high rates of economic growth may enable Estonia to achieve sustainable development. *Annotate using* ✓+ *in the LHS margin* **Level 4 Band 1 (11–14 marks)** For a basic discussion of the view that future high rates of economic growth may enable Estonia to achieve sustainable development. *Annotate using* L4 *in the LHS margin*

STEMUP.CO.UK

Question			Answer	Marks	Guidance	
					Content	Levels of response
			Analysis must explicitly show how economic growth enables Estonia to achieve sustainable development **High rates of economic growth will increase real GDP** • this will increase GDP per capita, employment and disposable incomes and reduce unemployment • the result will be that higher incomes will make basic life-sustaining goods and services more affordable and lift people out of poverty • this helps to achieve sustainable development eg a 'coherent society' and 'growth in welfare' **High rates of economic growth raise profits** • firms are able to afford clean technology to reduce environmental pollution – this reduces the negative externalities of production – there is less divergence between MSC and MPC – this helps to achieve more sustainable development as the environmental capital left for future generations is not depleted/ degraded – this helps to achieve sustainable development eg 'ecological balance' • firms are able to increase investment in human and physical capital – this raises productive capacity, shifting LRAS to the right – higher productive capacity allows future growth in AD – this raises the ability of future generations to meet their own needs through consumption of goods and services (sustainable development) **Higher rates of economic growth produce a 'fiscal dividend'** • high growth rates generate higher output, income and expenditure • there will be an increase in receipts from income tax, expenditure taxes (VAT) and corporation tax • this will allow the government to increase expenditure on education, health and social welfare such as benefits and pensions • this will ensure that the benefits of growth are more widely shared, reducing poverty and inequality, increasing life expectancy and widening economic opportunities • this helps to achieve sustainable development eg a 'coherent society' and 'growth in welfare'		**Level 3** For 5–7 marks there should be analysis of how high rates of economic growth enables Estonia to achieve **one** aspect of sustainable development For 8–10 marks there should be analysis of how high rates of economic growth enables Estonia to achieve **two or more** aspects of sustainable development *Alternatively, responses in Level 3 may analyse why high rates of economic growth may **not** enable Estonia to achieve sustainable development.* *In this case:* • *For 5–7 marks there should be analysis of **one** reason why high rates of economic growth may not enable Estonia to achieve sustainable development* • *For 8–10 marks there should be analysis of **two or more** reasons*	**Level 3 (5–10 marks)** For a one-sided analysis of the view that future high rates of economic growth alone may enable Estonia to achieve sustainable development. *Annotate using* L3 *in the LHS margin*

STEMUP.CO.UK

Question			Answer	Marks	Guidance	
					Content	Levels of response
			Application of knowledge and understanding that high rates of economic growth could enable Estonia to achieve sustainable development might include: • higher GDP • investment in human and physical capital • investment in education, health and social welfare • investment in new technology to reduce environmental damage *Alternatively, responses in Level 2 may focus solely on the material in Extract 5 which suggests that despite high economic growth in the past Estonia lags behind other EU economies in terms of indicators of sustainable development, for example:* • *poverty and income inequality* • *healthy life years* • *share of electricity produced from renewable sources* **Knowledge and understanding of <u>sustainable development</u> might include:** • development that meets the needs of the current generation without compromising the ability of future generations to meet their own needs • development that improves living standards and the quality of people's lives, both now and in the future • development that balances the economic, social and environmental objectives of growth **Knowledge and understanding of <u>economic growth</u> might include:** • economic growth is an increase in an economy's output/increase in AD in the short run • economic growth is an increase in productive potential/increase in LRAS in the long run		**Level 2** For four marks candidates will make ***two or more*** of the points exemplified For three marks candidates will make ***one*** of the points exemplified **Level 1** For two marks candidates will show knowledge and understanding of sustainable development **and** economic growth For one mark candidates will show knowledge and understanding of sustainable development **or** economic growth	**Level 2 (3–4 marks)** For an application of knowledge and understanding of the view that future high rates of economic growth alone may enable Estonia to achieve sustainable development. *Responses in this Level will show a **TOTAL** lack of economic analysis of the relationship between economic growth and sustainability but will male some valid points.* Annotate using L2 in the LHS margin **Level 1 (1–2 marks)** For knowledge and understanding of sustainable development or economic growth Annotate using L1 in the LHS margin

STEMUP.CO.UK

OCR (Oxford Cambridge and RSA Examinations)
1 Hills Road
Cambridge
CB1 2EU

OCR Customer Contact Centre

Education and Learning
Telephone: 01223 553998
Facsimile: 01223 552627
Email: general.qualifications@ocr.org.uk

www.ocr.org.uk

For staff training purposes and as part of our quality assurance programme your call may be recorded or monitored

Oxford Cambridge and RSA Examinations
is a Company Limited by Guarantee
Registered in England
Registered Office; 1 Hills Road, Cambridge, CB1 2EU
Registered Company Number: 3484466
OCR is an exempt Charity

OCR (Oxford Cambridge and RSA Examinations)
Head office
Telephone: 01223 552552
Facsimile: 01223 552553

© OCR 2013

PART OF THE CAMBRIDGE ASSESSMENT GROUP

LLOYD'S REGISTER QUALITY ASSURANCE · ISO9001 · UKAS MANAGEMENT SYSTEMS 001

STEMUP.CO.UK

OCR
RECOGNISING ACHIEVEMENT

To be opened on receipt

A2 GCE ECONOMICS

F585/01/SM The Global Economy

STIMULUS MATERIAL

JANUARY 2013

F530140613

INSTRUCTIONS TO CANDIDATES

- This copy must **not** be taken into the examination room.
- You should make yourself familiar with the stimulus material before you take the question paper. A clean copy of the stimulus material will be given to you with the question paper.

INFORMATION FOR CANDIDATES

- The following stimulus material has been adapted from published sources. It was correct at the time of publication and all statistics have been taken directly from the published material.
- This document consists of **12** pages. Any blank pages are indicated.

© OCR 2013 [T/500/7921]
DC (KN/JG) 59814/3

OCR is an exempt Charity

STEMUP.CO.UK

Introduction

In November 2011, the former vice-president of the European Central Bank (ECB), Lucas Papademos, was named as Prime Minister of Greece. Unelected, he headed an interim government charged with reducing Greece's national debt in order that it could secure a critical rescue package from the European Commission, the ECB and the International Monetary Fund (IMF). Without this rescue package, there were fears that Greece would have to default on its debt and leave the eurozone.

Talk of the possibility of Greece defaulting on its national debt led many economists to compare the Greek debt crisis of 2011 with that in Argentina a decade earlier in 2001. A number of striking similarities between the two crises were identified. The first of these similarities concerned the policy decisions made by both countries a decade before their debt crises. Argentina had chosen to fix its exchange rate to the US dollar in 1991 and Greece had adopted the euro in 2001. These policy decisions had beneficial consequences for both economies at first, but in the long run the disadvantages became apparent.

The second similarity between the debt crisis in Argentina in 2001 and the Greek debt crisis of 2011 was the consequences of external shocks to the two economies. Both economies faced external shocks but lacked the monetary and fiscal policy flexibility to cope with the consequences of these shocks. Both countries had lacked fiscal discipline such that they had accumulated large levels of national debt prior to the emergence of an external shock. In the case of Greece, this was despite the existence of the eurozone's fiscal rules.

In order to restore fiscal credibility, both Argentina and Greece had sought to put in place austerity measures to reduce the fiscal deficit, bring national debt under control and restore economic stability. However, these austerity measures did much to damage economic growth. Joseph Stiglitz, Professor of Economics at Columbia University in New York and former World Bank Chief Economist, argued that the austerity measures were not the way to prevent default in Greece.

A decade earlier, Argentina had defaulted on its national debt. The consequences of its default were initially severe as Gross Domestic Product (GDP) collapsed, unemployment soared and poverty became widespread. However, Argentina soon recovered from this poor economic performance. Some economists have attributed the improvement in Argentina's economic growth since 2003 to the exchange rate, although other factors may have been at least as important.

Despite the increasing role of the state in the Argentinean economy since 2003, inflows of Foreign Direct Investment (FDI) have increased. FDI is just one form of international financial flow and its effect and relative importance in the promotion of economic development is debated amongst economists. Some see FDI as an important way of raising levels of investment in developing economies, whilst others argue that the impact of FDI is not always positive and that a policy of attracting FDI on its own is insufficient.

© OCR 2013

STEMUP.CO.UK

Pre-release stimulus material

Extract 1: **Policy decisions in Argentina and Greece**

Extract 2: **The impact of external shocks and internal indiscipline**

Extract 3: **The failure of austerity**

Extract 4: **The aftermath of default in Argentina**

Extract 5: **International financial flows and economic development**

© OCR 2013

STEMUP.CO.UK

Extract 1

Policy decisions in Argentina and Greece

The roots of the 2001 crisis in Argentina and the crisis in Greece in 2011 were very similar. Both countries had made policy decisions which reduced the flexibility of economic policy-makers to deal with external shocks to the economy.

In Argentina it was the radical decision to create a 'currency board' to try to reduce and then to stabilise its rate of inflation. The 'currency board' was an arrangement which guaranteed the convertibility of the Argentinean currency (the peso) to the US dollar at a fixed 1:1 ratio. This had a number of consequences for the Argentinean economy. Initially, there were major benefits of the fixed exchange rate for Argentina's rate of economic growth, as levels of FDI increased significantly, and for economic stability as the rate of inflation (see Fig. 1.1) was brought under control.

In Greece the root of the 2011 crisis was a decision to join the European Monetary Union (EMU) in 2001 and to adopt the euro. Greek inflation, much like that in Argentina a decade earlier, was kept at a low and stable rate (see Fig. 1.2). In addition, adopting the euro almost halved Greek interest rates by the end of 2001, allowing an increase in borrowing by both the public and private sectors.

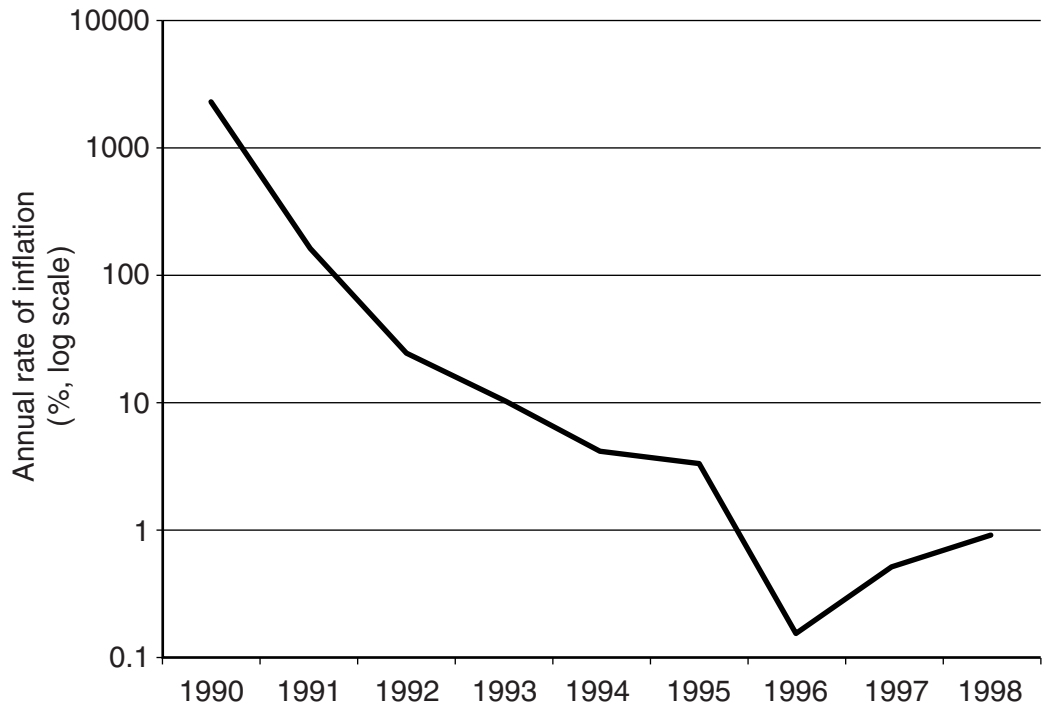


Fig. 1.1 – Rate of inflation (annual data) in Argentina, 1990–98

STEMUP.CO.UK

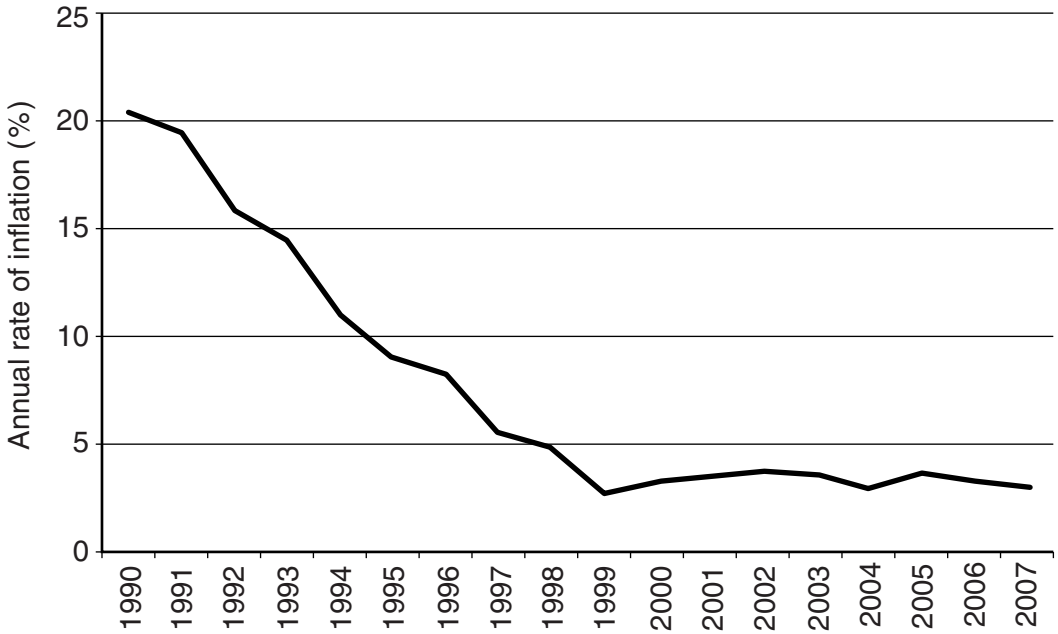


Fig. 1.2 – Rate of inflation (annual data) in Greece, 1990–2007

Whilst these two policy decisions had beneficial consequences at first, they also sowed the seeds of the crisis to emerge in each economy a decade or so later. The creation of a 'currency board' in Argentina meant that the country had effectively replaced its own currency with the US dollar and had lost control over domestic monetary policy. A 'currency board' is essentially a 'quasi' monetary union. Similarly, Greece had surrendered control of its interest rate to the ECB and lost the ability to alter its exchange rate.

The massive inflows of FDI and other financial inflows in both economies led not only to high rates of economic growth but also to high rates of inflation. These rates of inflation were much greater than their major trading partners. In Argentina, the fixed exchange rate regime of the 'currency board' began to resemble a 'straightjacket'. The peso's real exchange rate in terms of its purchasing power parity (PPP) rapidly increased. The problems of high inflation in Greece were compounded by more fundamental competitiveness issues signalled by rising unit labour costs.

© OCR 2013

STEMUP.CO.UK

Extract 2

The impact of external shocks and internal indiscipline

A number of external shocks hit the Argentinean economy in the 1990s after it had taken the decision to create a 'currency board'. These included a significant appreciation of the US dollar in 1995. These external shocks led to a slowdown in economic growth and a widening of the current account deficit which had begun to emerge after the fixing of the peso against the US dollar.

In Greece it was the global financial crisis which started in 2007 that created a large external shock to the economy. The financial crisis increased the perceived risk attached to global capital flows. Economies with weak external balances and high national debt began to be viewed with suspicion. Capital flows into Greece began to fall and, consequently, so did the rate of economic growth.

What made these external shocks more pronounced for both Argentina in the 1990s and Greece in 2011 was the lack of fiscal discipline characteristic of successive governments in both countries. International investors, concerned about budget deficits, national debt and current account deficits (see Fig. 2.1) demanded higher and higher interest rates on government debt (so called bond yields). This made it more costly for the governments of both countries to service their debt and raised fears that debt levels had become unsustainable.

	Argentina Annual Average 1996–2000	**Greece Annual Average 2006–10**	**Argentina 2001**	**Greece 2011**
Budget deficit (% of GDP)	2.9	9.5	6.1	7.5
National debt (% of GDP)	40.1	118.1	53.7	153.1
Current account deficit (% of GDP)	–3.7	–12.3	–1.4	–8.2

Fig. 2.1 – Budget deficit, national debt and current account deficit in Argentina and Greece

The lack of fiscal discipline in Argentina was characteristic of economic policy before the 'currency board' was formed. Governments would stimulate the economy by raising government expenditure, thus creating budget deficits. These deficits were 'financed' either by borrowing or by printing money. The result was high inflation and currency devaluations. When the 'currency board' was established, devaluation of the currency was no longer an option.

In many respects the same could be said of Greece which had entered the EMU not having met the Maastricht Convergence Criteria on budget deficits and national debt. The problem for Greece, however, was made worse by a failure of the eurozone's fiscal rules. The fiscal rules of the eurozone were laid down in the Stability and Growth Pact (SGP). These rules, however, failed to control budget deficits in some parts of the eurozone because they made an assumption that governments were in full control of their expenditure and tax receipts. As more eurozone economies broke the fiscal rules as a result of the global economic slowdown and ultimately domestic recessions, the SGP began to lose credibility and political support.

© OCR 2013

STEMUP.CO.UK

Extract 3

The failure of austerity

In order to avoid default both Argentina and Greece sought external help. Argentina secured the assistance of the IMF, but in return the IMF imposed strict conditions to avoid the government defaulting on its debt. Successive budgets sought to reduce government expenditure and raise tax receipts in order to reduce the budget deficit. In July 2001, the then Argentinean government introduced a 'zero deficit law', committing it to a balanced budget by the end of the year. Despite this, the budget deficit turned out to be 6.1% of GDP by the end of 2001 and economic growth, rather than the expected 3.5%, turned out to be –4.5%.

Something similar happened in Greece in 2010–11 as fiscal austerity measures failed to bring the budget deficit and national debt under control. The first attempt in early 2010 envisaged a reduction of the budget deficit from 12.9% of GDP to below 3% in 2012. Despite strong support for the deficit reduction strategy by the European Commission, the plan failed. In mid 2010, a second strategy, this time devised by the IMF, aimed to bring the budget deficit below 3%, but over a longer time period: by 2014. A month after the second strategy was announced, it was judged that Greece was still not on target to achieve the reduction in its budget deficit. As a result, the IMF provided more financial support in return for additional measures to reduce the budget deficit.

In both countries the IMF measures assumed that economic growth would return if budget deficits were reduced and structural reforms to the economy put in place. The austerity measures failed in both countries because they made budget deficits worse, not better. In addition, there was resistance to cuts in public sector wages in both economies.

In November 2011, the then Prime Minister of Greece, George Papandreou, announced a referendum on the latest bailout package offered by the eurozone economies and the further austerity measures required of Greece as a condition for financial assistance to the government to meet its expenditure commitments. The Prime Minister abandoned the referendum plans shortly afterwards, and was forced to resign. He was replaced, without an election, by Lucas Papademos, an economist, a former Governor of the Bank of Greece and Vice President of the ECB.

Social and political unrest in Argentina ultimately meant it was difficult to sustain the austerity measures required by the IMF. In October 2001, Argentina embarked on a 'debt restructuring process' trying to convince creditors to accept lower repayments over a longer period of time. The IMF insisted that Argentina impose capital controls to reduce the risk of capital flight. A run on the banking system followed, violence erupted on the streets and the IMF withdrew its financial assistance: so began a disorderly default.

Towards the end of 2011, it remained to be seen whether Greece would avoid the consequences of the disorderly default experienced by Argentina ten years earlier.

© OCR 2013

STEMUP.CO.UK

Extract 4

The aftermath of default in Argentina

The immediate aftermath of the disorderly default in Argentina was dramatic. The 'currency board' which had linked the peso to the US dollar was abandoned and the peso was allowed to float. Its value, which had previously been pegged at 1 peso = 1 US$, fell to 4 peso = 1 US$ within a few months. In 2002, a year after the default:

- economic growth had fallen to –10.9%
- unemployment had reached 21.5% of the workforce
- the percentage of the population living below the poverty line had reached 57.5%
- capital outflows had doubled to over US$11 billion
- FDI had fallen to US$1.6 billion from a peak of US$24 billion in 1999
- Argentina lost access to international capital markets, as it was considered to be too high a risk.

Since 2003, however, Argentina has recovered and has enjoyed high rates of economic growth (see Fig. 4.1). Argentina's recovery can be largely explained by a significant improvement in its balance of trade. From running trade deficits before 2001, Argentina began to experience surpluses in its trade from 2002. These surpluses owed much to the impact of the devaluation of the peso which occurred after it defaulted on its debt. In addition, Argentina has benefitted from an improvement in its terms of trade since 2003 (see Fig. 4.1). Rising demand for food from Asia increased the price of Argentina's exports of agricultural commodities, such as soybeans, increasing export revenue. The Argentinean government has taxed the increased profits of farmers in order to provide subsidies to multinational companies locating in the country.

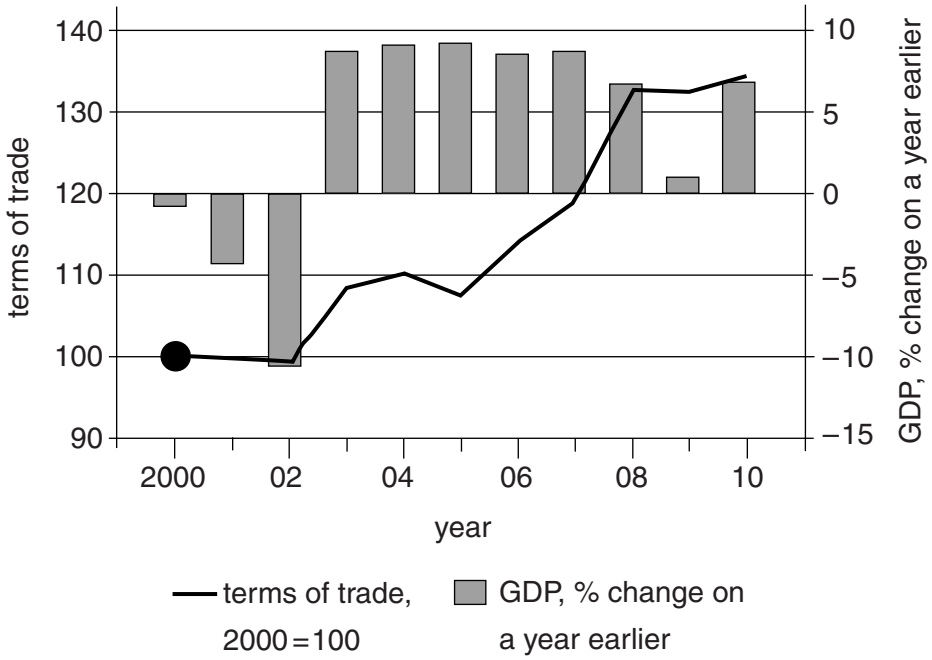


Fig. 4.1 – Argentina's rate of economic growth and terms of trade, 2000–10*

**2010 data based on Quarter 1*

STEMUP.CO.UK

Extract 5

International financial flows and economic development

Argentina has been successful in attracting high levels of FDI thus increasing the economy's productive capacity and growth potential. Over 500 US companies have located production in the country and they employ in excess of 155 000 workers. Annual real GDP growth rates in excess of 8.5% from 2003 – 07 have been an important reason for this FDI. However, there have been concerns about the increasing role of the state in the economy, including state control over prices and protectionist measures. As a member of Mercosur, a customs union in South America, Argentina has not been able to increase tariffs on imports. Instead, it has used non-tariff barriers, such as import licensing, to limit imports. Around 600 products require import licences, including toys, pharmaceutical ingredients, tyres, fabrics and farm machinery. In order to overcome such protectionism, some multinational companies have sought to locate production in Argentina. For example, Brightstar has set up a production facility in Argentina to assemble BlackBerrys, despite production costs being 15 times those in Asia. The government predicts imports of mobile phones will be reduced from 96% of the domestic market to under 20%.

The impact of FDI on economic development is debated by economists. According to some, FDI can allow developing economies to compensate for poor economic conditions which make it difficult to achieve the minimum growth rate necessary to meet the Millennium Development Goals set by the United Nations (UN). According to the Economic Commission for Africa, for example, an increase in investment is vital for sustained growth and development in Africa. However, this increase in investment is constrained by unpredictable flows of aid, Africa's low share in world trade, the high volatility of short-term capital flows and Africa's low savings rate. The importance of FDI to Africa has increased since 2000, as shown in Fig. 5.1, and is seen by some as more beneficial than Official Development Assistance (ODA). As well as increasing output, employment and incomes, FDI is thought to generate positive spill over effects on local businesses, add to the productive capacity of an economy and create important tax and export revenues. China's FDI in Africa, for example, has generated a rapid increase in trade (see Fig. 5.2) which some view as beneficial to Africa.

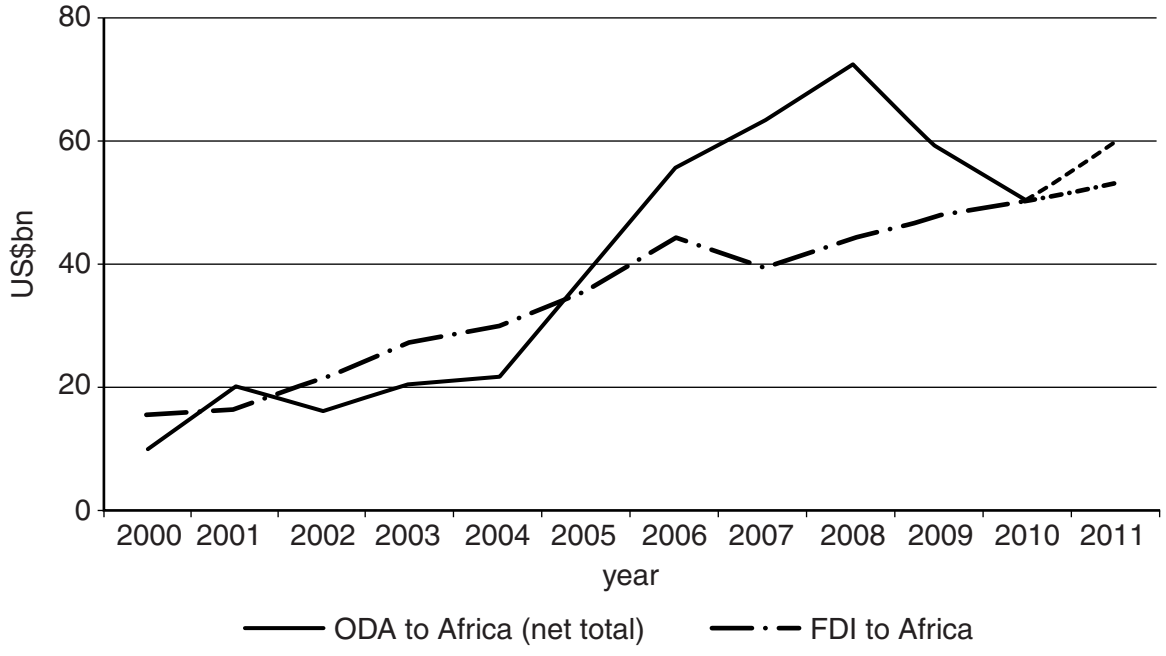


Fig. 5.1 – Flows of FDI and ODA to Africa, 2000 – 11*

**flows of FDI and ODA to Africa for 2011 are forecasts*

STEMUP.CO.UK

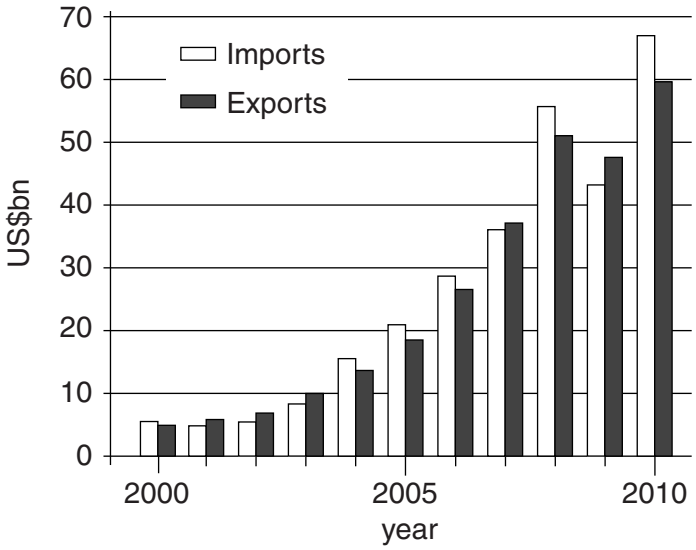


Fig. 5.2 – China's trade with Africa, 2000–10

Some economists, however, are more sceptical about the benefits of FDI for economic development. They point out that FDI, both in Latin America and Africa, is concentrated in only a few countries. In addition, they argue that whilst FDI has increased in Latin America and Africa, total investment as a percentage of GDP in these regions has decreased. The nature of FDI is also questioned. Andres Lopez, Professor of Economics at the University of Buenos Aires, says much FDI in Brazil and Argentina has taken the form of mergers and acquisitions. Chinese FDI to Africa has been concentrated in the natural resource sector and has raised fears about resource depletion and environmental degradation, although manufacturing's share of total Chinese FDI (22%) is beginning to catch up with mining (29%). Concerns are also raised about the impact of FDI on local product and labour markets. In addition to FDI, China has also increased loans to African governments and now lends more than the World Bank. However, most of these loans are 'tied'.

There is little doubt that investment promotes the development process. Whether FDI does so better than other ways, however, is still open to debate.

© OCR 2013

STEMUP.CO.UK

BLANK PAGE

© OCR 2013

STEMUP.CO.UK

RECOGNISING ACHIEVEMENT

Copyright Information

OCR is committed to seeking permission to reproduce all third-party content that it uses in its assessment materials. OCR has attempted to identify and contact all copyright holders whose work is used in this paper. To avoid the issue of disclosure of answer-related information to candidates, all copyright acknowledgements are reproduced in the OCR Copyright Acknowledgements Booklet. This is produced for each series of examinations and is freely available to download from our public website (www.ocr.org.uk) after the live examination series.

If OCR has unwittingly failed to correctly acknowledge or clear any third-party content in this assessment material, OCR will be happy to correct its mistake at the earliest possible opportunity.

For queries or further information please contact the Copyright Team, First Floor, 9 Hills Road, Cambridge CB2 1GE.

OCR is part of the Cambridge Assessment Group; Cambridge Assessment is the brand name of University of Cambridge Local Examinations Syndicate (UCLES), which is itself a department of the University of Cambridge.

© OCR 2013

STEMUP.CO.UK

OCR
RECOGNISING ACHIEVEMENT

Wednesday 30 January 2013 – Afternoon

A2 GCE ECONOMICS

F585/01/SM The Global Economy

STIMULUS MATERIAL

Duration: 2 hours

F530130613

INSTRUCTIONS TO CANDIDATES

- This is a clean copy of the Stimulus Material which you have already seen.
- You may **not** take your previous copy of the Stimulus Material into the examination.
- You may **not** take notes into the examination.

INFORMATION FOR CANDIDATES

- This document consists of **12** pages. Any blank pages are indicated.

INSTRUCTION TO EXAMS OFFICER / INVIGILATOR

- Do not send this Stimulus Material for marking; it should be retained in the centre or recycled. Please contact OCR Copyright should you wish to re-use this document.

© OCR 2013 [T/500/7921]
DC (LEG/JG) 69399

OCR is an exempt Charity

STEMUP.CO.UK

Introduction

In November 2011, the former vice-president of the European Central Bank (ECB), Lucas Papademos, was named as Prime Minister of Greece. Unelected, he headed an interim government charged with reducing Greece's national debt in order that it could secure a critical rescue package from the European Commission, the ECB and the International Monetary Fund (IMF). Without this rescue package, there were fears that Greece would have to default on its debt and leave the eurozone.

Talk of the possibility of Greece defaulting on its national debt led many economists to compare the Greek debt crisis of 2011 with that in Argentina a decade earlier in 2001. A number of striking similarities between the two crises were identified. The first of these similarities concerned the policy decisions made by both countries a decade before their debt crises. Argentina had chosen to fix its exchange rate to the US dollar in 1991 and Greece had adopted the euro in 2001. These policy decisions had beneficial consequences for both economies at first, but in the long run the disadvantages became apparent.

The second similarity between the debt crisis in Argentina in 2001 and the Greek debt crisis of 2011 was the consequences of external shocks to the two economies. Both economies faced external shocks but lacked the monetary and fiscal policy flexibility to cope with the consequences of these shocks. Both countries had lacked fiscal discipline such that they had accumulated large levels of national debt prior to the emergence of an external shock. In the case of Greece, this was despite the existence of the eurozone's fiscal rules.

In order to restore fiscal credibility, both Argentina and Greece had sought to put in place austerity measures to reduce the fiscal deficit, bring national debt under control and restore economic stability. However, these austerity measures did much to damage economic growth. Joseph Stiglitz, Professor of Economics at Columbia University in New York and former World Bank Chief Economist, argued that the austerity measures were not the way to prevent default in Greece.

A decade earlier, Argentina had defaulted on its national debt. The consequences of its default were initially severe as Gross Domestic Product (GDP) collapsed, unemployment soared and poverty became widespread. However, Argentina soon recovered from this poor economic performance. Some economists have attributed the improvement in Argentina's economic growth since 2003 to the exchange rate, although other factors may have been at least as important.

Despite the increasing role of the state in the Argentinean economy since 2003, inflows of Foreign Direct Investment (FDI) have increased. FDI is just one form of international financial flow and its effect and relative importance in the promotion of economic development is debated amongst economists. Some see FDI as an important way of raising levels of investment in developing economies, whilst others argue that the impact of FDI is not always positive and that a policy of attracting FDI on its own is insufficient.

© OCR 2013

STEMUP.CO.UK

Pre-release stimulus material

Extract 1: **Policy decisions in Argentina and Greece**

Extract 2: **The impact of external shocks and internal indiscipline**

Extract 3: **The failure of austerity**

Extract 4: **The aftermath of default in Argentina**

Extract 5: **International financial flows and economic development**

© OCR 2013

STEMUP.CO.UK

Extract 1

Policy decisions in Argentina and Greece

The roots of the 2001 crisis in Argentina and the crisis in Greece in 2011 were very similar. Both countries had made policy decisions which reduced the flexibility of economic policy-makers to deal with external shocks to the economy.

In Argentina it was the radical decision to create a 'currency board' to try to reduce and then to stabilise its rate of inflation. The 'currency board' was an arrangement which guaranteed the convertibility of the Argentinean currency (the peso) to the US dollar at a fixed 1:1 ratio. This had a number of consequences for the Argentinean economy. Initially, there were major benefits of the fixed exchange rate for Argentina's rate of economic growth, as levels of FDI increased significantly, and for economic stability as the rate of inflation (see Fig. 1.1) was brought under control.

In Greece the root of the 2011 crisis was a decision to join the European Monetary Union (EMU) in 2001 and to adopt the euro. Greek inflation, much like that in Argentina a decade earlier, was kept at a low and stable rate (see Fig. 1.2). In addition, adopting the euro almost halved Greek interest rates by the end of 2001, allowing an increase in borrowing by both the public and private sectors.

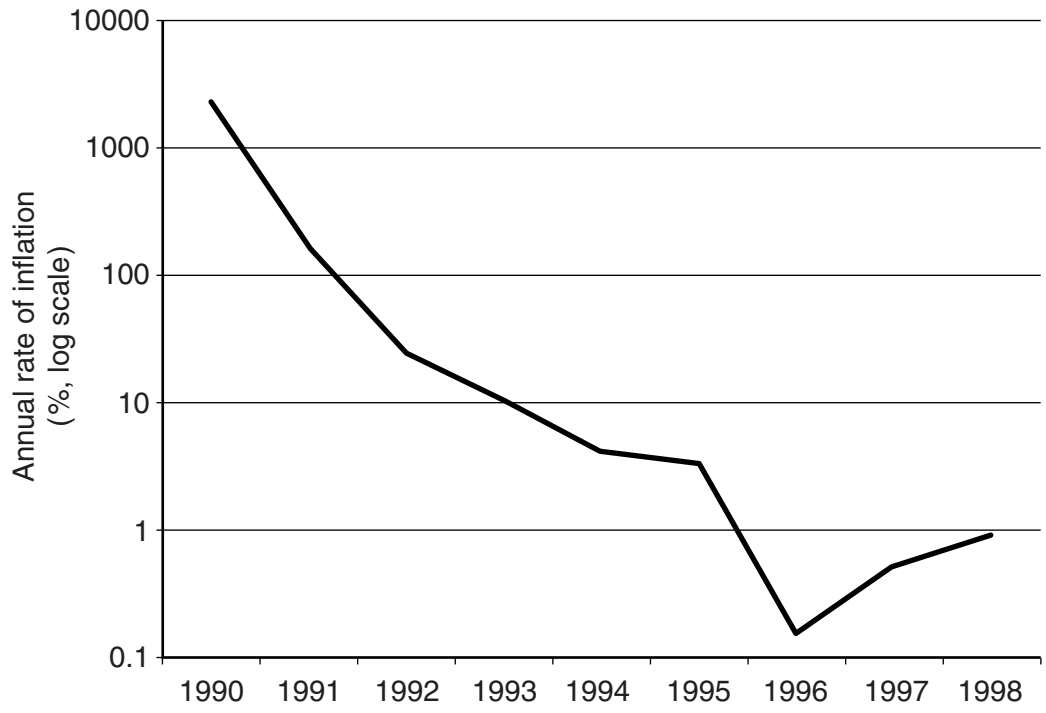


Fig. 1.1 – Rate of inflation (annual data) in Argentina, 1990–98

STEMUP.CO.UK

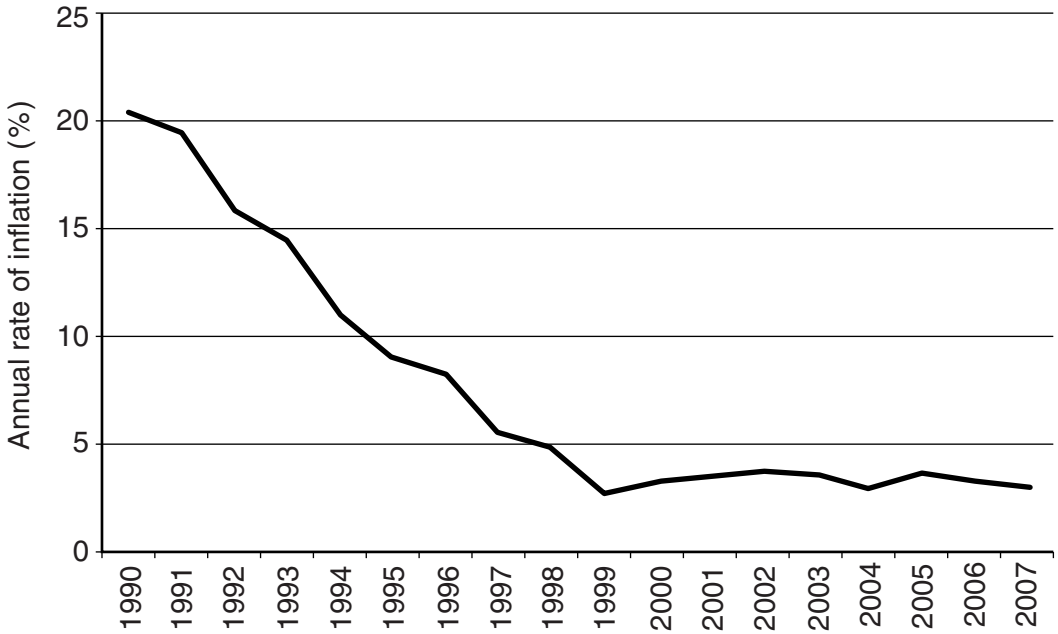


Fig. 1.2 – Rate of inflation (annual data) in Greece, 1990–2007

Whilst these two policy decisions had beneficial consequences at first, they also sowed the seeds of the crisis to emerge in each economy a decade or so later. The creation of a 'currency board' in Argentina meant that the country had effectively replaced its own currency with the US dollar and had lost control over domestic monetary policy. A 'currency board' is essentially a 'quasi' monetary union. Similarly, Greece had surrendered control of its interest rate to the ECB and lost the ability to alter its exchange rate.

The massive inflows of FDI and other financial inflows in both economies led not only to high rates of economic growth but also to high rates of inflation. These rates of inflation were much greater than their major trading partners. In Argentina, the fixed exchange rate regime of the 'currency board' began to resemble a 'straightjacket'. The peso's real exchange rate in terms of its purchasing power parity (PPP) rapidly increased. The problems of high inflation in Greece were compounded by more fundamental competitiveness issues signalled by rising unit labour costs.

© OCR 2013

STEMUP.CO.UK

Extract 2

The impact of external shocks and internal indiscipline

A number of external shocks hit the Argentinean economy in the 1990s after it had taken the decision to create a 'currency board'. These included a significant appreciation of the US dollar in 1995. These external shocks led to a slowdown in economic growth and a widening of the current account deficit which had begun to emerge after the fixing of the peso against the US dollar.

In Greece it was the global financial crisis which started in 2007 that created a large external shock to the economy. The financial crisis increased the perceived risk attached to global capital flows. Economies with weak external balances and high national debt began to be viewed with suspicion. Capital flows into Greece began to fall and, consequently, so did the rate of economic growth.

What made these external shocks more pronounced for both Argentina in the 1990s and Greece in 2011 was the lack of fiscal discipline characteristic of successive governments in both countries. International investors, concerned about budget deficits, national debt and current account deficits (see Fig. 2.1) demanded higher and higher interest rates on government debt (so called bond yields). This made it more costly for the governments of both countries to service their debt and raised fears that debt levels had become unsustainable.

	Argentina Annual Average 1996–2000	**Greece Annual Average 2006–10**	**Argentina 2001**	**Greece 2011**
Budget deficit (% of GDP)	2.9	9.5	6.1	7.5
National debt (% of GDP)	40.1	118.1	53.7	153.1
Current account deficit (% of GDP)	–3.7	–12.3	–1.4	–8.2

Fig. 2.1 – Budget deficit, national debt and current account deficit in Argentina and Greece

The lack of fiscal discipline in Argentina was characteristic of economic policy before the 'currency board' was formed. Governments would stimulate the economy by raising government expenditure, thus creating budget deficits. These deficits were 'financed' either by borrowing or by printing money. The result was high inflation and currency devaluations. When the 'currency board' was established, devaluation of the currency was no longer an option.

In many respects the same could be said of Greece which had entered the EMU not having met the Maastricht Convergence Criteria on budget deficits and national debt. The problem for Greece, however, was made worse by a failure of the eurozone's fiscal rules. The fiscal rules of the eurozone were laid down in the Stability and Growth Pact (SGP). These rules, however, failed to control budget deficits in some parts of the eurozone because they made an assumption that governments were in full control of their expenditure and tax receipts. As more eurozone economies broke the fiscal rules as a result of the global economic slowdown and ultimately domestic recessions, the SGP began to lose credibility and political support.

© OCR 2013

STEMUP.CO.UK

Extract 3

The failure of austerity

In order to avoid default both Argentina and Greece sought external help. Argentina secured the assistance of the IMF, but in return the IMF imposed strict conditions to avoid the government defaulting on its debt. Successive budgets sought to reduce government expenditure and raise tax receipts in order to reduce the budget deficit. In July 2001, the then Argentinean government introduced a 'zero deficit law', committing it to a balanced budget by the end of the year. Despite this, the budget deficit turned out to be 6.1% of GDP by the end of 2001 and economic growth, rather than the expected 3.5%, turned out to be –4.5%.

Something similar happened in Greece in 2010–11 as fiscal austerity measures failed to bring the budget deficit and national debt under control. The first attempt in early 2010 envisaged a reduction of the budget deficit from 12.9% of GDP to below 3% in 2012. Despite strong support for the deficit reduction strategy by the European Commission, the plan failed. In mid 2010, a second strategy, this time devised by the IMF, aimed to bring the budget deficit below 3%, but over a longer time period: by 2014. A month after the second strategy was announced, it was judged that Greece was still not on target to achieve the reduction in its budget deficit. As a result, the IMF provided more financial support in return for additional measures to reduce the budget deficit.

In both countries the IMF measures assumed that economic growth would return if budget deficits were reduced and structural reforms to the economy put in place. The austerity measures failed in both countries because they made budget deficits worse, not better. In addition, there was resistance to cuts in public sector wages in both economies.

In November 2011, the then Prime Minister of Greece, George Papandreou, announced a referendum on the latest bailout package offered by the eurozone economies and the further austerity measures required of Greece as a condition for financial assistance to the government to meet its expenditure commitments. The Prime Minister abandoned the referendum plans shortly afterwards, and was forced to resign. He was replaced, without an election, by Lucas Papademos, an economist, a former Governor of the Bank of Greece and Vice President of the ECB.

Social and political unrest in Argentina ultimately meant it was difficult to sustain the austerity measures required by the IMF. In October 2001, Argentina embarked on a 'debt restructuring process' trying to convince creditors to accept lower repayments over a longer period of time. The IMF insisted that Argentina impose capital controls to reduce the risk of capital flight. A run on the banking system followed, violence erupted on the streets and the IMF withdrew its financial assistance: so began a disorderly default.

Towards the end of 2011, it remained to be seen whether Greece would avoid the consequences of the disorderly default experienced by Argentina ten years earlier.

© OCR 2013

STEMUP.CO.UK

Extract 4

The aftermath of default in Argentina

The immediate aftermath of the disorderly default in Argentina was dramatic. The 'currency board' which had linked the peso to the US dollar was abandoned and the peso was allowed to float. Its value, which had previously been pegged at 1 peso = 1 US$, fell to 4 peso = 1 US$ within a few months. In 2002, a year after the default:

- economic growth had fallen to –10.9%
- unemployment had reached 21.5% of the workforce
- the percentage of the population living below the poverty line had reached 57.5%
- capital outflows had doubled to over US$11 billion
- FDI had fallen to US$1.6 billion from a peak of US$24 billion in 1999
- Argentina lost access to international capital markets, as it was considered to be too high a risk.

Since 2003, however, Argentina has recovered and has enjoyed high rates of economic growth (see Fig. 4.1). Argentina's recovery can be largely explained by a significant improvement in its balance of trade. From running trade deficits before 2001, Argentina began to experience surpluses in its trade from 2002. These surpluses owed much to the impact of the devaluation of the peso which occurred after it defaulted on its debt. In addition, Argentina has benefitted from an improvement in its terms of trade since 2003 (see Fig. 4.1). Rising demand for food from Asia increased the price of Argentina's exports of agricultural commodities, such as soybeans, increasing export revenue. The Argentinean government has taxed the increased profits of farmers in order to provide subsidies to multinational companies locating in the country.

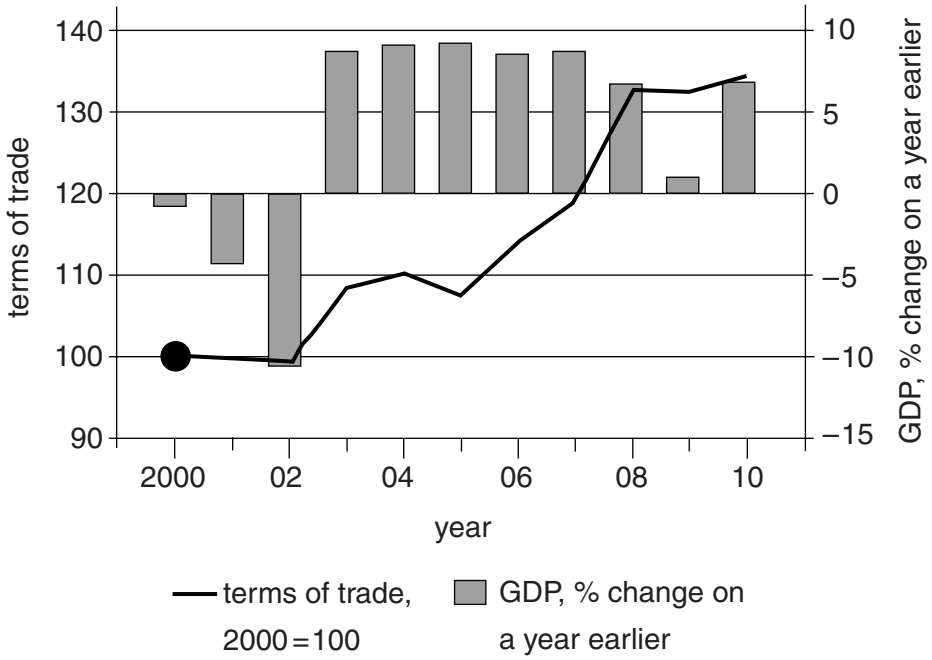


Fig. 4.1 – Argentina's rate of economic growth and terms of trade, 2000–10*

**2010 data based on Quarter 1*

STEMUP.CO.UK

Extract 5

International financial flows and economic development

Argentina has been successful in attracting high levels of FDI thus increasing the economy's productive capacity and growth potential. Over 500 US companies have located production in the country and they employ in excess of 155 000 workers. Annual real GDP growth rates in excess of 8.5% from 2003 – 07 have been an important reason for this FDI. However, there have been concerns about the increasing role of the state in the economy, including state control over prices and protectionist measures. As a member of Mercosur, a customs union in South America, Argentina has not been able to increase tariffs on imports. Instead, it has used non-tariff barriers, such as import licensing, to limit imports. Around 600 products require import licences, including toys, pharmaceutical ingredients, tyres, fabrics and farm machinery. In order to overcome such protectionism, some multinational companies have sought to locate production in Argentina. For example, Brightstar has set up a production facility in Argentina to assemble BlackBerrys, despite production costs being 15 times those in Asia. The government predicts imports of mobile phones will be reduced from 96% of the domestic market to under 20%.

The impact of FDI on economic development is debated by economists. According to some, FDI can allow developing economies to compensate for poor economic conditions which make it difficult to achieve the minimum growth rate necessary to meet the Millennium Development Goals set by the United Nations (UN). According to the Economic Commission for Africa, for example, an increase in investment is vital for sustained growth and development in Africa. However, this increase in investment is constrained by unpredictable flows of aid, Africa's low share in world trade, the high volatility of short-term capital flows and Africa's low savings rate. The importance of FDI to Africa has increased since 2000, as shown in Fig. 5.1, and is seen by some as more beneficial than Official Development Assistance (ODA). As well as increasing output, employment and incomes, FDI is thought to generate positive spill over effects on local businesses, add to the productive capacity of an economy and create important tax and export revenues. China's FDI in Africa, for example, has generated a rapid increase in trade (see Fig. 5.2) which some view as beneficial to Africa.

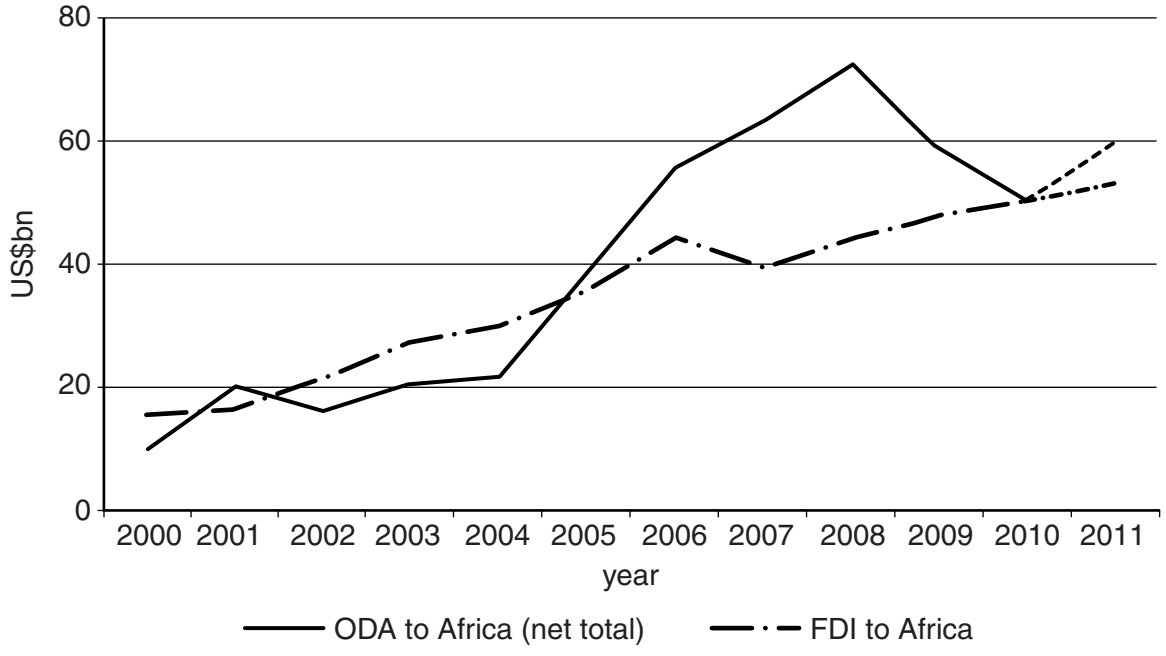


Fig. 5.1 – Flows of FDI and ODA to Africa, 2000 – 11*

**flows of FDI and ODA to Africa for 2011 are forecasts*

STEMUP.CO.UK

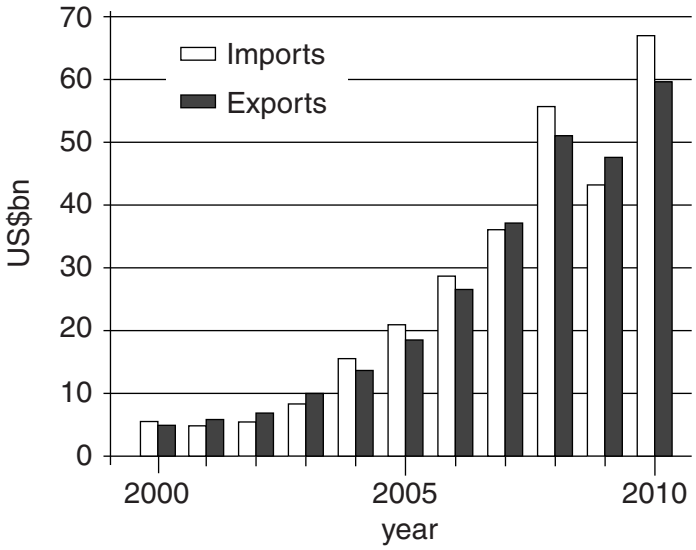


Fig. 5.2 – China's trade with Africa, 2000–10

Some economists, however, are more sceptical about the benefits of FDI for economic development. They point out that FDI, both in Latin America and Africa, is concentrated in only a few countries. In addition, they argue that whilst FDI has increased in Latin America and Africa, total investment as a percentage of GDP in these regions has decreased. The nature of FDI is also questioned. Andres Lopez, Professor of Economics at the University of Buenos Aires, says much FDI in Brazil and Argentina has taken the form of mergers and acquisitions. Chinese FDI to Africa has been concentrated in the natural resource sector and has raised fears about resource depletion and environmental degradation, although manufacturing's share of total Chinese FDI (22%) is beginning to catch up with mining (29%). Concerns are also raised about the impact of FDI on local product and labour markets. In addition to FDI, China has also increased loans to African governments and now lends more than the World Bank. However, most of these loans are 'tied'.

There is little doubt that investment promotes the development process. Whether FDI does so better than other ways, however, is still open to debate.

© OCR 2013

STEMUP.CO.UK

BLANK PAGE

© OCR 2013

STEMUP.CO.UK

RECOGNISING ACHIEVEMENT

Copyright Information

OCR is committed to seeking permission to reproduce all third-party content that it uses in its assessment materials. OCR has attempted to identify and contact all copyright holders whose work is used in this paper. To avoid the issue of disclosure of answer-related information to candidates, all copyright acknowledgements are reproduced in the OCR Copyright Acknowledgements Booklet. This is produced for each series of examinations and is freely available to download from our public website (www.ocr.org.uk) after the live examination series.

If OCR has unwittingly failed to correctly acknowledge or clear any third-party content in this assessment material, OCR will be happy to correct its mistake at the earliest possible opportunity.

For queries or further information please contact the Copyright Team, First Floor, 9 Hills Road, Cambridge CB2 1GE.

OCR is part of the Cambridge Assessment Group; Cambridge Assessment is the brand name of University of Cambridge Local Examinations Syndicate (UCLES), which is itself a department of the University of Cambridge.

© OCR 2013

STEMUP.CO.UK

OCR
RECOGNISING ACHIEVEMENT

Wednesday 30 January 2013 – Afternoon

A2 GCE ECONOMICS

F585/01 The Global Economy

Candidates answer on the Question Paper.

OCR supplied materials:
- Clean copy Stimulus Material

Other materials required:
- Calculators may be used

Duration: 2 hours

F5301206131

F 5 8 5 0 1

Candidate forename		Candidate surname	

Centre number						Candidate number				

INSTRUCTIONS TO CANDIDATES

- Refer to the Stimulus Material in a separate booklet. You must **not** bring your original copy into the examination.
- Write your name, centre number and candidate number in the boxes above. Please write clearly and in capital letters.
- Use black ink. HB pencil may be used for graphs and diagrams only.
- Answer **all** the questions.
- Read each question carefully. Make sure you know what you have to do before starting your answer.
- Write your answer to each question in the space provided. If additional space is required, you should use the lined pages at the end of this booklet. The question number(s) must be clearly shown.
- Do **not** write in the bar codes.

INFORMATION FOR CANDIDATES

- The number of marks is given in brackets **[ ]** at the end of each question or part question.
- The total number of marks for this paper is **60**.
- The quality of your written communication will be taken into account in the marking of your answer to question 3. All answers should be in continuous prose.
- This document consists of **16** pages. Any blank pages are indicated.

A calculator may be used for this paper

© OCR 2013 [T/500/7921]
DC (KN) 59816/2

OCR is an exempt Charity

Turn over

STEMUP.CO.UK

Answer **all** questions.

1 **(a)** What is meant by:

(i) a fixed exchange rate?

.....

.....

.....

.....

.....

.....

.....

..... **[2]**

(ii) purchasing power parity?

.....

.....

.....

.....

.....

.....

.....

..... **[2]**

© OCR 2013

STEMUP.CO.UK

(b) Argentina had used a fixed exchange rate system prior to its economic crisis in 2001.

Analyse **two** disadvantages of a fixed exchange rate system.

1 .....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

2 .....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

[6]

© OCR 2013

STEMUP.CO.UK

(c) Comment on the consequences of an external shock for an economy, such as Greece, which is a member of a monetary union. **[10]**

© OCR 2013

STEMUP.CO.UK

© OCR 2013

STEMUP.CO.UK

2 **(a)** Distinguish between a budget deficit and a national debt.

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

..... **[4]**

© OCR 2013

STEMUP.CO.UK

(b) Argentina's 'zero deficit law' and the European Union's (EU) Stability and Growth Pact are examples of fiscal rules.

Analyse **two** reasons why fiscal rules may be important in promoting economic stability.

1 .....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

2 .....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

[6]

© OCR 2013

STEMUP.CO.UK

(c) Other than the impact of Foreign Direct Investment (FDI), comment on the extent to which the exchange rate has been the most important influence on Argentina's economic growth since 2003. **[10]**

© OCR 2013

STEMUP.CO.UK

© OCR 2013

STEMUP.CO.UK

3 Discuss the extent to which Foreign Direct Investment, such as that to Latin America and Africa, is the most effective way of promoting development. **[20]**

© OCR 2013

STEMUP.CO.UK

© OCR 2013

STEMUP.CO.UK

© OCR 2013

© OCR 2013

STEMUP.CO.UK

END OF QUESTION PAPER

© OCR 2013

ADDITIONAL ANSWER SPACE

If additional answer space is required, you should use the following lined pages. The question number(s) must be clearly shown in the margins.

© OCR 2013

STEMUP.CO.UK

OCR
RECOGNISING ACHIEVEMENT

Copyright Information

OCR is committed to seeking permission to reproduce all third-party content that it uses in its assessment materials. OCR has attempted to identify and contact all copyright holders whose work is used in this paper. To avoid the issue of disclosure of answer-related information to candidates, all copyright acknowledgements are reproduced in the OCR Copyright Acknowledgements Booklet. This is produced for each series of examinations and is freely available to download from our public website (www.ocr.org.uk) after the live examination series.

If OCR has unwittingly failed to correctly acknowledge or clear any third-party content in this assessment material, OCR will be happy to correct its mistake at the earliest possible opportunity.

For queries or further information please contact the Copyright Team, First Floor, 9 Hills Road, Cambridge CB2 1GE.

OCR is part of the Cambridge Assessment Group; Cambridge Assessment is the brand name of University of Cambridge Local Examinations Syndicate (UCLES), which is itself a department of the University of Cambridge.

© OCR 2013

STEMUP.CO.UK

OCR
RECOGNISING ACHIEVEMENT

GCE

Economics

Advanced GCE

Unit **F585:** The Global Economy

Mark Scheme for January 2013

STEMUP.CO.UK

OCR (Oxford Cambridge and RSA) is a leading UK awarding body, providing a wide range of qualifications to meet the needs of candidates of all ages and abilities. OCR qualifications include AS/A Levels, Diplomas, GCSEs, Cambridge Nationals, Cambridge Technicals, Functional Skills, Key Skills, Entry Level qualifications, NVQs and vocational qualifications in areas such as IT, business, languages, teaching/training, administration and secretarial skills.

It is also responsible for developing new specifications to meet national requirements and the needs of students and teachers. OCR is a not-for-profit organisation; any surplus made is invested back into the establishment to help towards the development of qualifications and support, which keep pace with the changing needs of today's society.

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

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

Mark schemes should be read in conjunction with the published question papers and the report on the examination.

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

© OCR 2013

Annotations

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

STEMUP.CO.UK

Subject specific marking instructions

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

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

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

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

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

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

STEMUP.CO.UK

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

STEMUP.CO.UK

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

STEMUP.CO.UK

Question			Answer	Marks	Guidance	
					Content	Levels of response
1	(c)		Consequences depend on the nature of the external shock. An external shock can be a change in AD or SRAS resulting from a change in economic conditions outside the economy. Analysis of the shock should be in terms of AD/AS, though there is no requirement for this to be diagrammatic. Analysis should be developed to include impact on **two** of: • the change in AD/AS • GDP • employment/unemployment, inflation • balance of payments (current and/or capital account). Commentary could be in terms of: extent of consequences • need for a policy response in a monetary union • nature of the shock (different consequences for different shocks) • extent to which the shock is asymmetric • policy response of monetary authority.	10	If only **one** consequence is referred to candidates should be capped to the bottom of the relevant Level as follows: • commentary on one consequence = seven marks • analysis of one consequence = four marks • application of one consequence = two marks **In Level 4 award marks as follows:** • one stated point of evaluation = seven marks • two or more stated points of evaluation = eight marks • one developed comment = 9 marks • two developed comments or one comment with two points of development = 10 marks Annotate developed comment with  **Level 3** Analysis of the extent of the consequences **without** analysis of the consequences themselves should be awarded level 3 only.	**Level 4 (7–10 marks)** For a commentary on the consequences of an external shock for an economy, such as Greece, which is a member of a monetary union Annotate using L4 in the LHS margin **Level 3 (4–6 marks)** For an analysis of the consequences of an external shock for an economy, which makes clear the impact on AD or AS *Analytical responses are characterised by explicit use of the economists' toolkit of concepts and theories and through explanation of cause and consequence* Annotate using L3 in the LHS margin

STEMUP.CO.UK

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

STEMUP.CO.UK

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

STEMUP.CO.UK

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

STEMUP.CO.UK

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

STEMUP.CO.UK

Question			Answer	Marks	Guidance	
					Content	Levels of response
					Level 2 Responses in this level will show a TOTAL lack of economic analysis	**Level 2 (2–3 marks)** For an application of knowledge and understanding of influences on Argentina's economic growth since 2003 Annotate using L2 in the LHS margin **Level 1 (1 marks)** For knowledge and understanding of influences on Argentina's economic growth since 2003 Annotate using L1 in the LHS margin

STEMUP.CO.UK

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

STEMUP.CO.UK

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

STEMUP.CO.UK

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

STEMUP.CO.UK

Question			Answer	Marks	Guidance	
					Content	Levels of response
					Level 2 Responses in this Level will show a total lack of economic analysis **Examples of Level 2 responses** FDI creates jobs and so reduces unemployment (L2). This means that there are higher incomes (L2) FDI represents an increase in investment into the economy (L2), which raises the level of both AD and AS (L2).	**Level 2 (3–4 marks)** For an application of knowledge and understanding of whether or not FDI, such as that to Latin America and Africa, promotes development Annotate using L2 in the LHS margin **Level 1 (1–2 marks)** For knowledge and understanding of FDI or economic development Annotate using L1 in the LHS margin

STEMUP.CO.UK

OCR (Oxford Cambridge and RSA Examinations)
1 Hills Road
Cambridge
CB1 2EU

OCR Customer Contact Centre

Education and Learning
Telephone: 01223 553998
Facsimile: 01223 552627
Email: general.qualifications@ocr.org.uk

www.ocr.org.uk

For staff training purposes and as part of our quality assurance programme your call may be recorded or monitored

Oxford Cambridge and RSA Examinations
is a Company Limited by Guarantee
Registered in England
Registered Office; 1 Hills Road, Cambridge, CB1 2EU
Registered Company Number: 3484466
OCR is an exempt Charity

OCR (Oxford Cambridge and RSA Examinations)
Head office
Telephone: 01223 552552
Facsimile: 01223 552553

© OCR 2013

STEMUP.CO.UK

OCR
RECOGNISING ACHIEVEMENT

To be opened on receipt

A2 GCE ECONOMICS

F585/01/SM The Global Economy

STIMULUS MATERIAL

JUNE 2012

F530140612

INSTRUCTIONS TO CANDIDATES

- This copy must **not** be taken into the examination room.

INFORMATION FOR CANDIDATES

- The following stimulus material has been adapted from published sources. It was correct at the time of publication and all statistics have been taken directly from the published material.
- This document consists of **12** pages. Any blank pages are indicated.

© OCR 2012 [T/500/7921]
DC (NH/SW) 62898/3

OCR is an exempt Charity

STEMUP.CO.UK

Introduction

In 2011 global inflationary pressures had increased, largely due to increases in commodity prices and the threat of global resource scarcity. In the UK these external inflationary pressures occurred at a time of concern about the weakness of domestic demand following a significant fall in Gross Domestic Product (GDP) in the last quarter of 2010. This raised a dilemma for the Bank of England's Monetary Policy Committee (MPC). In order to ensure that inflationary expectations did not take hold in the labour market, some members of the MPC recommended that interest rates should rise. Others viewed the inflationary pressures as outside the control of the Bank of England and believed that inflation would return to its target rate in the medium term.

The UK was not the only economy struggling to cope with rising inflation. In China, for example, the authorities had indicated that economic growth needed to be curtailed in order to reduce its social and environmental consequences which were threatening the country's sustainable economic development. Indeed, some economists believed that higher inflation might bring more benefits than costs – not least in China itself.

The resource scarcity which had contributed to global inflationary pressures brought about different policy responses both nationally and regionally. The European Union (EU) looked to the correction of market failure through the creation of incentives to bring about resource-efficiency. China had introduced quotas on the export of so-called 'rare earths' and had given a clear indication that exports of certain key raw materials would be banned from 2015. The World Trade Organisation had already been called upon in 2009 to adjudicate in a dispute about China's export quotas on raw materials. China's announcement of a potential ban on the export of certain key raw materials from 2015 threatened to re-open a trade dispute between China and both the EU and the USA.

© OCR 2012

STEMUP.CO.UK

Pre-release stimulus material

Extract 1: Dilemma for the Bank of England's Monetary Policy Committee (MPC)

Extract 2: Inflation and the re-balancing of the Chinese economy

Extract 3: China's economic growth target cut

Extract 4: Emerging dispute over China's 'rare earths' export ban

© OCR 2012

STEMUP.CO.UK

Extract 1

Dilemma for the Bank of England's Monetary Policy Committee (MPC)

The conduct of monetary policy is not straightforward, but for many years the Bank of England's MPC had a relatively easy task. When inflation was set to accelerate, interest rates could be raised. When the UK's economic growth rate slowed, interest rates could be reduced.

In early 2011, the MPC faced tough decisions on interest rates which divided its nine members. The weakness of the economy, exemplified by a surprise fall of 0.6% in GDP in the fourth quarter of 2010, made an increase in interest rates likely to further weaken the economic recovery. Yet the rate of inflation had risen to over 4%, it had been above its target rate of 2% for too long and was expected to rise further. The three members of the MPC who voted for an increase in interest rates believed that it was better to reduce inflationary expectations sooner rather than later.

One of the members arguing for an increase in interest rates, Andrew Sentance, said shortly after the publication of the minutes of the February MPC meeting:

"In my view, the time [to raise rates] is overdue. We should increase them gradually and slowly if we can. But the risk of delaying interest rate rises too long is that this gradual approach may cease to be an option."

Another member of the MPC, Adam Posen, took a different view. He had voted in favour of further quantitative easing citing policy mistakes in Japan in the year 2000 and dismissing talk of a price-wage spiral:

"I am arguing that it would be a similar mistake for the MPC to try to prove its counter-inflationary toughness just for the sake of chatter about rising inflationary expectations that is not there in the data, nor likely to influence the actual inflation outcome."

The Bank of England's Inflation Report of February 2011 set out the prospects for inflation in the short and medium term (see Fig. 1.1).

© OCR 2012

STEMUP.CO.UK

Fig. 1.1 Extract from Bank of England's Inflation Report (February 2011)

Inflation is likely to pick up to between 4% and 5% in the near term, and to remain well above the 2% target throughout 2011, boosted by the increase in VAT, higher energy and import prices, and some rebuilding of companies' margins. Further ahead, inflation is likely to fall back as those effects wane and downward pressure on wages and prices from the margin of spare capacity persists. The extent of that fall is likely to be moderated by companies continuing to rebuild their margins and some upward drift in inflationary expectations.

The prospects for inflation in the medium term are highly uncertain. Continued strong global economic growth may lead to further upward pressure on commodity and other import prices. The degree of spare capacity and its impact on inflation will depend on: the strength of demand; the impact of the recession on potential productivity; the performance of the labour market; and the sensitivity of wages to labour market slack. The profile for domestically generated inflation will also depend on the extent and pace of any rebuilding of companies' margins. And inflation will be higher if expectations of inflation continue to rise and these feed through into wage and price-setting.

There remains a wider than usual range of views among Committee members over the outlook for inflation. On balance, the Committee judges that the most likely outcome is that inflation will fall a little below the target from the middle of 2012 but that the chances of inflation being either above or below the 2% target in the medium term are broadly equal.

The MPC faced a difficult time ahead. If it did not eventually raise interest rates its credibility for the control of inflation could be put at risk. Yet the Government's fiscal policy was also based around securing credibility by cutting public expenditure and raising taxation to bring down government borrowing. The fear amongst some economists was that pursuing both monetary policy and fiscal policy credibility at the same time might put at risk the economic recovery.

© OCR 2012

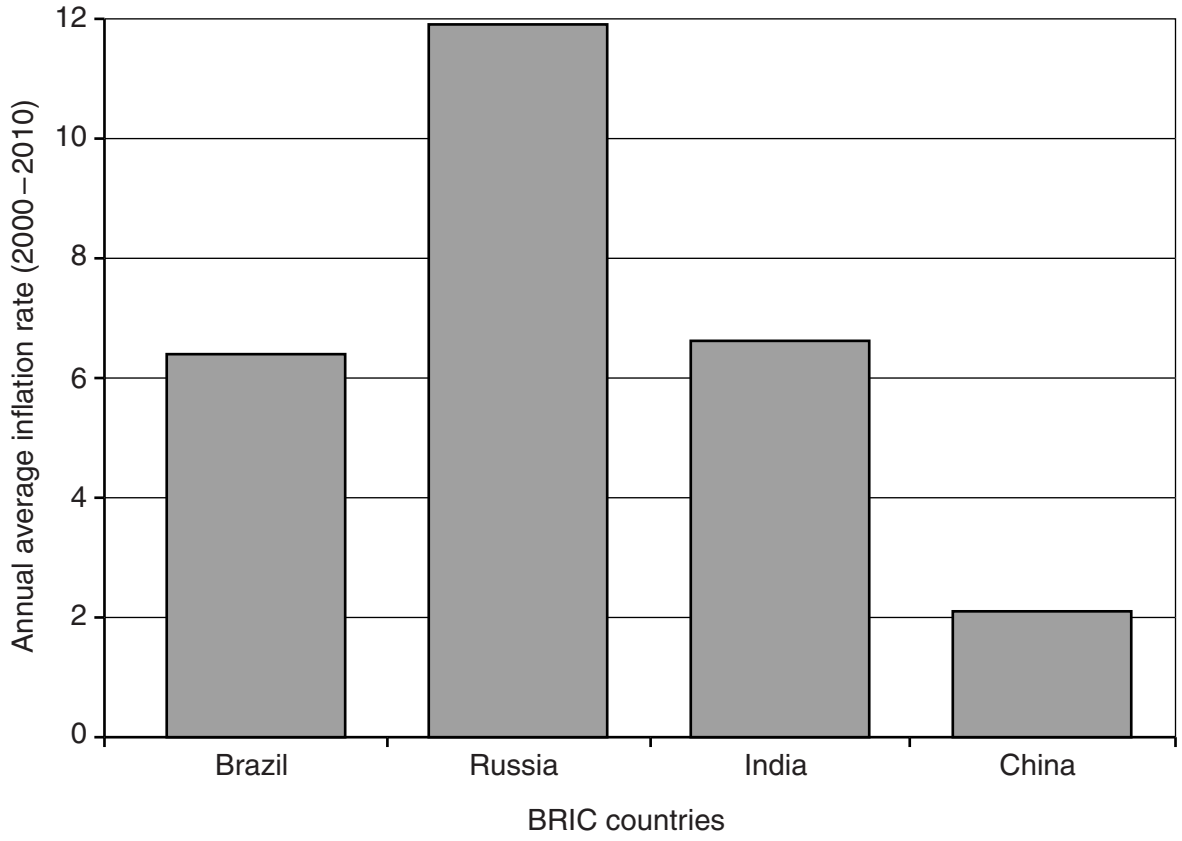
STEMUP.CO.UK

Extract 2

Inflation and the re-balancing of the Chinese economy

One of the common characteristics of developing economies is their tendency to have higher rates of inflation than developed economies. This can arise because of supply-side constraints and the impact of productivity growth in the traded goods sector on wages in the rest of the economy. Developing economies often face a trade-off between economic growth and inflation. Fig. 2.1 shows that this common characteristic is not a universal one, however. Notably, China has achieved a much lower annual average rate of inflation than the other BRIC economies over the period 2000 – 2010.

Fig. 2.1 Annual average inflation rates in the BRIC economies, 2000 – 2010



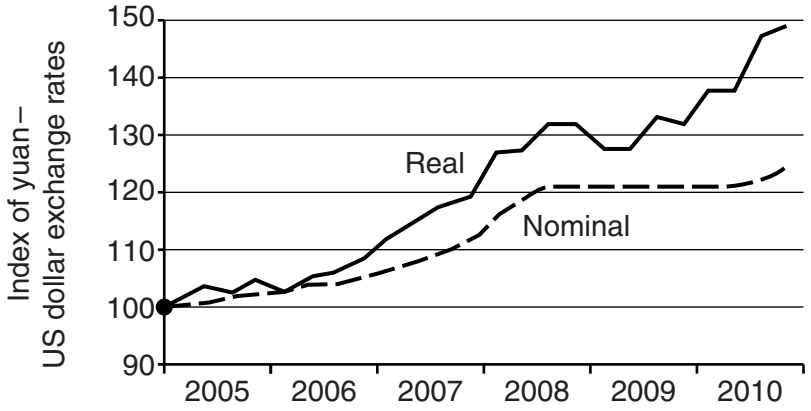
In the space of the twelve months to January 2011, China's rate of inflation more than trebled, however, to reach 4.9%. The cause of this increase in the rate of inflation was, in part, due to higher food prices. In addition, more of China's inflation was coming from rapid wage growth as the growth in its labour force slowed down due to the ageing of its population. Unlike the UK, the increase in China's rate of inflation is considered to be more structural than temporary. It is likely that wage growth in China will outstrip productivity growth for some time to come.

© OCR 2012

STEMUP.CO.UK

Some economists believe that higher inflation in China may not be such a bad thing, either for China or for the global economy. There are a number of costs normally associated with inflation. However, China's economy is unbalanced. Although investment is high, savings are higher still. The result is an economy driven by external rather than domestic demand, resulting in a large current account surplus. This has meant that China has amassed large foreign currency reserves for which it has little use. Some developed nations, notably the USA, have blamed China's large current account surplus on an undervaluation of its currency, the yuan/renminbi. However, as Fig. 2.2 below shows, there has been a 20% appreciation in the nominal exchange rate of the yuan against the US dollar since 2005. Most attention has focused on China's decision to operate a fixed exchange rate regime against the US dollar since 2008 and its failure to allow the yuan to appreciate significantly since this time. The real exchange rate of the yuan against the dollar tells a different story. Based on purchasing power parity (PPP), the yuan has appreciated by almost 50% against the dollar since 2005 which would suggest that the perceived undervaluation of the yuan is not the root cause of China's large current account surplus. Continued low levels of consumption and high savings have distorted economic growth in China. Higher inflation might be a way in which China can avoid some of the problems of persistent current account surpluses and rebalance its economy more towards domestic consumption.

Fig. 2.2 Nominal and real (PPP) yuan – US dollar exchange rates (2005 Q1 = 100)



Despite the desire to rebalance economic growth, policy makers in China are fearful of inflation getting out of control. Increasing interest rates to control inflation is difficult when an economy operates a fixed exchange rate. But without measures to control inflation there is a danger that inflationary expectations will increase, just as some members of the UK MPC argue. Whether China will try to reduce these expectations by adopting a formal inflation target, or whether it will allow a higher rate of inflation to help it rebalance its economy, remains to be seen.

© OCR 2012

STEMUP.CO.UK

Extract 3

China's economic growth target cut

In February 2011, the Chinese Prime Minister, Wen Jiabao, announced that China was to lower its annual economic growth target from 8% to 7% for the next five years. In each of the last six years, Chinese economic growth has exceeded the 8% target set by the government, with growth in 2010 reaching 10.3%. The announcement symbolises the government's concern with rising inflationary pressures and questions over the sustainability of China's rapid economic growth, as well as the extent to which rapid economic growth is capable of promoting development. These issues were raised in a question and answer session between the Chinese Prime Minister and Internet users in 2011.

Fig. 3.1 Statements made by Wen Jiabao in the Chinese Prime Minister's online question and answer session with Internet users

"We want to put the emphasis of our work on the quality and the benefits of economic growth. We want the fruits of economic growth to benefit the people. The purpose of economic development is to meet the people's growing material and cultural needs, and make the lives of our people better and better."

"Rapid price rises have affected the public and even social stability. The government has always made a priority of keeping prices at a generally stable level."

"We must no longer sacrifice the environment for the sake of rapid economic growth because such an approach would make our economic development unsustainable."

In order to promote sustainability the Chinese government will need to understand the social, environmental, resource and demographic impacts of growth. Traditional measures of economic growth, such as the change in real GDP, do not measure these impacts and can give a misleading indication of economic welfare. The Chinese government may need to turn its attention to adjusted (composite) measures of sustainability, such as the Index of Sustainable Economic Welfare (ISEW), and to adopt policies to make economic development more sustainable.

© OCR 2012

STEMUP.CO.UK

Extract 4

Emerging dispute over China's 'rare earths' export ban

Increased global competition for raw materials and the increased environmental 'footprint' of the world's population have been a direct consequence of economic growth, in particular the growth of emerging economies and growth in the global population. Concerned by the implications for the EU, the European Commission began to develop a strategy for raw materials in response to global resource scarcity. In its 'Roadmap to a Resource Efficient Europe' the European Commission laid out the causes, consequences and possible policy responses to a growing global resource crisis (see Fig. 4.1).

Fig. 4.1 Extracts from 'Roadmap to a Resource Efficient Europe' (European Commission, 2011)

The increasing wealth and population growth in a rapidly industrialising world has led to rising demand for resources. Greatly increasing demand for, and pressure on, natural and material resources are now among the key global challenges that we face today, and that is set to become even more acute in the future. These trends have significant consequences for competitiveness, climate change, the global environment and for the quality of life.

Pressure on resources is bound to be accelerated further as the global population heads toward nine billion by 2050. These developments lead to accelerating scarcity, and increasing difficulty of access to key resources, as well as price increases. These trends have major implications for the economic fundamentals of the global economy and, therefore, the relative competitiveness of industry sectors. To remain competitive, the EU economy will have to adjust faster than our competitors to these global trends. At the same time, scarcity increases the risk of disruption by increasing the EU's dependency on some supplier countries, including China.

There are various market failures which prevent the EU's adequately fast transition to a resource-efficient economy. A policy on resource-efficiency is needed to:

- *reduce the current overexploitation of limited natural resources, due to market prices not reflecting future scarcity;*
- *encourage more eco-innovation in the economy by providing better and clearer market incentives;*
- *accelerate the change in the infrastructure needed for greater resource-efficiency, without which the EU will lag behind our competitors.*

In summary, the EU needs to correct the market failures that prevent investment in resource-efficiency or fail to internalise externalities that damage the global resource base.

The EU has been particularly concerned about the impact of increased global demand for a number of raw materials. These raw materials are important components in high-tech industries, in technologies associated with renewable energy and in the reduction of greenhouse gases. Extraction of these raw materials is currently heavily geographically concentrated. For example, China produces 95% of all 'rare earths' (used in hand-held consumer electronics, LCD displays and high performance magnets); Brazil produces 90% of all niobium (needed for steel alloys in gas pipelines and super alloys in high-performance jet aircraft); and South Africa produces 79% of all rhodium (needed for car catalysts).

© OCR 2012

STEMUP.CO.UK

China, too, responded to the threat of a global resource crisis by announcing that it would ban the export of certain 'rare earths' from 2015. One of these raw materials, neodymium, is used to make high-power, lightweight magnets for the electric motors of hybrid cars, such as the Toyota Prius. With the demand for neodymium outstripping supply, prices have increased five-fold in recent years. China defends its move, which builds on previous export quotas on key raw materials, as part of its move towards sustainable development. These export quotas led to the EU and the USA making a complaint to the World Trade Organisation in 2009. The EU and the USA view such trade restraints as deliberate attempts by China to unfairly advantage its own industries. It is likely that any move by China to further restrict exports will lead to further trade disputes between China and both the EU and the USA.

© OCR 2012

STEMUP.CO.UK

BLANK PAGE

© OCR 2012

STEMUP.CO.UK

OCR
RECOGNISING ACHIEVEMENT

Copyright Information

OCR is committed to seeking permission to reproduce all third-party content that it uses in its assessment materials. OCR has attempted to identify and contact all copyright holders whose work is used in this paper. To avoid the issue of disclosure of answer-related information to candidates, all copyright acknowledgements are reproduced in the OCR Copyright Acknowledgements Booklet. This is produced for each series of examinations and is freely available to download from our public website (www.ocr.org.uk) after the live examination series.

If OCR has unwittingly failed to correctly acknowledge or clear any third-party content in this assessment material, OCR will be happy to correct its mistake at the earliest possible opportunity.

For queries or further information please contact the Copyright Team, First Floor, 9 Hills Road, Cambridge CB2 1GE.

OCR is part of the Cambridge Assessment Group; Cambridge Assessment is the brand name of University of Cambridge Local Examinations Syndicate (UCLES), which is itself a department of the University of Cambridge.

© OCR 2012

STEMUP.CO.UK

OCR
RECOGNISING ACHIEVEMENT

Wednesday 20 June 2012 – Morning

A2 GCE ECONOMICS

F585/01/SM The Global Economy

STIMULUS MATERIAL

Duration: 2 hours

F5301306121

INSTRUCTIONS TO CANDIDATES

- This is a clean copy of the Stimulus Material which you have already seen.
- You may **not** take your previous copy of the Stimulus Material into the examination.
- You may **not** take notes into the examination.

INFORMATION FOR CANDIDATES

- This document consists of **12** pages. Any blank pages are indicated.

INSTRUCTION TO EXAMS OFFICER / INVIGILATOR

- Do not send this Stimulus Material for marking; it should be retained in the centre or recycled. Please contact OCR Copyright should you wish to re-use this document.

© OCR 2012 [T/500/7921]
DC (CW/SW) 54878/1

OCR is an exempt Charity

STEMUP.CO.UK

Introduction

In 2011 global inflationary pressures had increased, largely due to increases in commodity prices and the threat of global resource scarcity. In the UK these external inflationary pressures occurred at a time of concern about the weakness of domestic demand following a significant fall in Gross Domestic Product (GDP) in the last quarter of 2010. This raised a dilemma for the Bank of England's Monetary Policy Committee (MPC). In order to ensure that inflationary expectations did not take hold in the labour market, some members of the MPC recommended that interest rates should rise. Others viewed the inflationary pressures as outside the control of the Bank of England and believed that inflation would return to its target rate in the medium term.

The UK was not the only economy struggling to cope with rising inflation. In China, for example, the authorities had indicated that economic growth needed to be curtailed in order to reduce its social and environmental consequences which were threatening the country's sustainable economic development. Indeed, some economists believed that higher inflation might bring more benefits than costs – not least in China itself.

The resource scarcity which had contributed to global inflationary pressures brought about different policy responses both nationally and regionally. The European Union (EU) looked to the correction of market failure through the creation of incentives to bring about resource-efficiency. China had introduced quotas on the export of so-called 'rare earths' and had given a clear indication that exports of certain key raw materials would be banned from 2015. The World Trade Organisation had already been called upon in 2009 to adjudicate in a dispute about China's export quotas on raw materials. China's announcement of a potential ban on the export of certain key raw materials from 2015 threatened to re-open a trade dispute between China and both the EU and the USA.

© OCR 2012

STEMUP.CO.UK

Pre-release stimulus material

Extract 1: Dilemma for the Bank of England's Monetary Policy Committee (MPC)

Extract 2: Inflation and the re-balancing of the Chinese economy

Extract 3: China's economic growth target cut

Extract 4: Emerging dispute over China's 'rare earths' export ban

© OCR 2012

STEMUP.CO.UK

Extract 1

Dilemma for the Bank of England's Monetary Policy Committee (MPC)

The conduct of monetary policy is not straightforward, but for many years the Bank of England's MPC had a relatively easy task. When inflation was set to accelerate, interest rates could be raised. When the UK's economic growth rate slowed, interest rates could be reduced.

In early 2011, the MPC faced tough decisions on interest rates which divided its nine members. The weakness of the economy, exemplified by a surprise fall of 0.6% in GDP in the fourth quarter of 2010, made an increase in interest rates likely to further weaken the economic recovery. Yet the rate of inflation had risen to over 4%, it had been above its target rate of 2% for too long and was expected to rise further. The three members of the MPC who voted for an increase in interest rates believed that it was better to reduce inflationary expectations sooner rather than later.

One of the members arguing for an increase in interest rates, Andrew Sentance, said shortly after the publication of the minutes of the February MPC meeting:

"In my view, the time [to raise rates] is overdue. We should increase them gradually and slowly if we can. But the risk of delaying interest rate rises too long is that this gradual approach may cease to be an option."

Another member of the MPC, Adam Posen, took a different view. He had voted in favour of further quantitative easing citing policy mistakes in Japan in the year 2000 and dismissing talk of a price-wage spiral:

"I am arguing that it would be a similar mistake for the MPC to try to prove its counter-inflationary toughness just for the sake of chatter about rising inflationary expectations that is not there in the data, nor likely to influence the actual inflation outcome."

The Bank of England's Inflation Report of February 2011 set out the prospects for inflation in the short and medium term (see Fig. 1.1).

© OCR 2012

STEMUP.CO.UK

Fig. 1.1 Extract from Bank of England's Inflation Report (February 2011)

Inflation is likely to pick up to between 4% and 5% in the near term, and to remain well above the 2% target throughout 2011, boosted by the increase in VAT, higher energy and import prices, and some rebuilding of companies' margins. Further ahead, inflation is likely to fall back as those effects wane and downward pressure on wages and prices from the margin of spare capacity persists. The extent of that fall is likely to be moderated by companies continuing to rebuild their margins and some upward drift in inflationary expectations.

The prospects for inflation in the medium term are highly uncertain. Continued strong global economic growth may lead to further upward pressure on commodity and other import prices. The degree of spare capacity and its impact on inflation will depend on: the strength of demand; the impact of the recession on potential productivity; the performance of the labour market; and the sensitivity of wages to labour market slack. The profile for domestically generated inflation will also depend on the extent and pace of any rebuilding of companies' margins. And inflation will be higher if expectations of inflation continue to rise and these feed through into wage and price-setting.

There remains a wider than usual range of views among Committee members over the outlook for inflation. On balance, the Committee judges that the most likely outcome is that inflation will fall a little below the target from the middle of 2012 but that the chances of inflation being either above or below the 2% target in the medium term are broadly equal.

The MPC faced a difficult time ahead. If it did not eventually raise interest rates its credibility for the control of inflation could be put at risk. Yet the Government's fiscal policy was also based around securing credibility by cutting public expenditure and raising taxation to bring down government borrowing. The fear amongst some economists was that pursuing both monetary policy and fiscal policy credibility at the same time might put at risk the economic recovery.

© OCR 2012

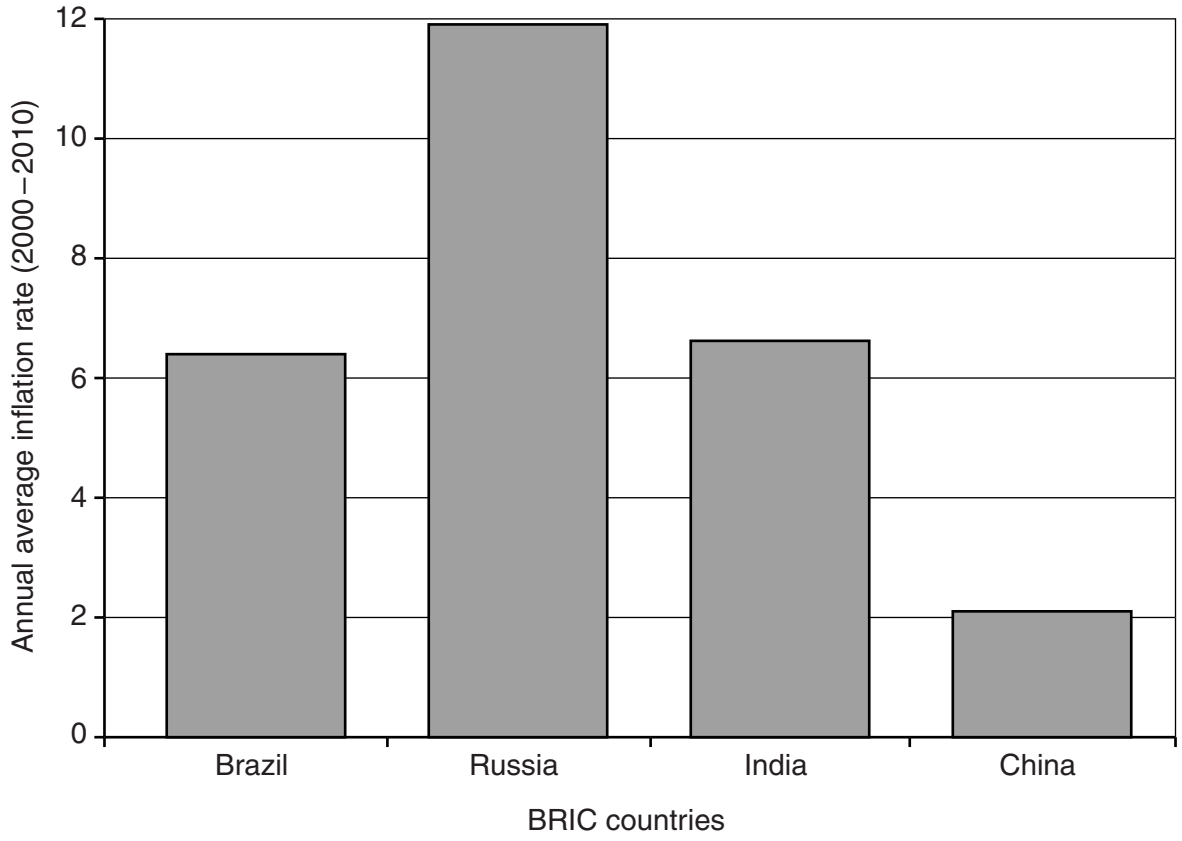
STEMUP.CO.UK

Extract 2

Inflation and the re-balancing of the Chinese economy

One of the common characteristics of developing economies is their tendency to have higher rates of inflation than developed economies. This can arise because of supply-side constraints and the impact of productivity growth in the traded goods sector on wages in the rest of the economy. Developing economies often face a trade-off between economic growth and inflation. Fig. 2.1 shows that this common characteristic is not a universal one, however. Notably, China has achieved a much lower annual average rate of inflation than the other BRIC economies over the period 2000 – 2010.

Fig. 2.1 Annual average inflation rates in the BRIC economies, 2000 – 2010



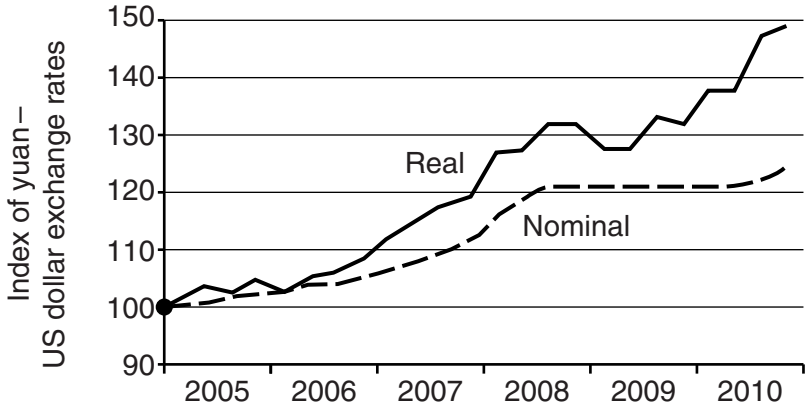
In the space of the twelve months to January 2011, China's rate of inflation more than trebled, however, to reach 4.9%. The cause of this increase in the rate of inflation was, in part, due to higher food prices. In addition, more of China's inflation was coming from rapid wage growth as the growth in its labour force slowed down due to the ageing of its population. Unlike the UK, the increase in China's rate of inflation is considered to be more structural than temporary. It is likely that wage growth in China will outstrip productivity growth for some time to come.

© OCR 2012

STEMUP.CO.UK

Some economists believe that higher inflation in China may not be such a bad thing, either for China or for the global economy. There are a number of costs normally associated with inflation. However, China's economy is unbalanced. Although investment is high, savings are higher still. The result is an economy driven by external rather than domestic demand, resulting in a large current account surplus. This has meant that China has amassed large foreign currency reserves for which it has little use. Some developed nations, notably the USA, have blamed China's large current account surplus on an undervaluation of its currency, the yuan/renminbi. However, as Fig. 2.2 below shows, there has been a 20% appreciation in the nominal exchange rate of the yuan against the US dollar since 2005. Most attention has focused on China's decision to operate a fixed exchange rate regime against the US dollar since 2008 and its failure to allow the yuan to appreciate significantly since this time. The real exchange rate of the yuan against the dollar tells a different story. Based on purchasing power parity (PPP), the yuan has appreciated by almost 50% against the dollar since 2005 which would suggest that the perceived undervaluation of the yuan is not the root cause of China's large current account surplus. Continued low levels of consumption and high savings have distorted economic growth in China. Higher inflation might be a way in which China can avoid some of the problems of persistent current account surpluses and rebalance its economy more towards domestic consumption.

Fig. 2.2 Nominal and real (PPP) yuan – US dollar exchange rates (2005 Q1 = 100)



Despite the desire to rebalance economic growth, policy makers in China are fearful of inflation getting out of control. Increasing interest rates to control inflation is difficult when an economy operates a fixed exchange rate. But without measures to control inflation there is a danger that inflationary expectations will increase, just as some members of the UK MPC argue. Whether China will try to reduce these expectations by adopting a formal inflation target, or whether it will allow a higher rate of inflation to help it rebalance its economy, remains to be seen.

© OCR 2012

STEMUP.CO.UK

Extract 3

China's economic growth target cut

In February 2011, the Chinese Prime Minister, Wen Jiabao, announced that China was to lower its annual economic growth target from 8% to 7% for the next five years. In each of the last six years, Chinese economic growth has exceeded the 8% target set by the government, with growth in 2010 reaching 10.3%. The announcement symbolises the government's concern with rising inflationary pressures and questions over the sustainability of China's rapid economic growth, as well as the extent to which rapid economic growth is capable of promoting development. These issues were raised in a question and answer session between the Chinese Prime Minister and Internet users in 2011.

Fig. 3.1 Statements made by Wen Jiabao in the Chinese Prime Minister's online question and answer session with Internet users

"We want to put the emphasis of our work on the quality and the benefits of economic growth. We want the fruits of economic growth to benefit the people. The purpose of economic development is to meet the people's growing material and cultural needs, and make the lives of our people better and better."

"Rapid price rises have affected the public and even social stability. The government has always made a priority of keeping prices at a generally stable level."

"We must no longer sacrifice the environment for the sake of rapid economic growth because such an approach would make our economic development unsustainable."

In order to promote sustainability the Chinese government will need to understand the social, environmental, resource and demographic impacts of growth. Traditional measures of economic growth, such as the change in real GDP, do not measure these impacts and can give a misleading indication of economic welfare. The Chinese government may need to turn its attention to adjusted (composite) measures of sustainability, such as the Index of Sustainable Economic Welfare (ISEW), and to adopt policies to make economic development more sustainable.

© OCR 2012

STEMUP.CO.UK

Extract 4

Emerging dispute over China's 'rare earths' export ban

Increased global competition for raw materials and the increased environmental 'footprint' of the world's population have been a direct consequence of economic growth, in particular the growth of emerging economies and growth in the global population. Concerned by the implications for the EU, the European Commission began to develop a strategy for raw materials in response to global resource scarcity. In its 'Roadmap to a Resource Efficient Europe' the European Commission laid out the causes, consequences and possible policy responses to a growing global resource crisis (see Fig. 4.1).

Fig. 4.1 Extracts from 'Roadmap to a Resource Efficient Europe' (European Commission, 2011)

The increasing wealth and population growth in a rapidly industrialising world has led to rising demand for resources. Greatly increasing demand for, and pressure on, natural and material resources are now among the key global challenges that we face today, and that is set to become even more acute in the future. These trends have significant consequences for competitiveness, climate change, the global environment and for the quality of life.

Pressure on resources is bound to be accelerated further as the global population heads toward nine billion by 2050. These developments lead to accelerating scarcity, and increasing difficulty of access to key resources, as well as price increases. These trends have major implications for the economic fundamentals of the global economy and, therefore, the relative competitiveness of industry sectors. To remain competitive, the EU economy will have to adjust faster than our competitors to these global trends. At the same time, scarcity increases the risk of disruption by increasing the EU's dependency on some supplier countries, including China.

There are various market failures which prevent the EU's adequately fast transition to a resource-efficient economy. A policy on resource-efficiency is needed to:

- *reduce the current overexploitation of limited natural resources, due to market prices not reflecting future scarcity;*
- *encourage more eco-innovation in the economy by providing better and clearer market incentives;*
- *accelerate the change in the infrastructure needed for greater resource-efficiency, without which the EU will lag behind our competitors.*

In summary, the EU needs to correct the market failures that prevent investment in resource-efficiency or fail to internalise externalities that damage the global resource base.

The EU has been particularly concerned about the impact of increased global demand for a number of raw materials. These raw materials are important components in high-tech industries, in technologies associated with renewable energy and in the reduction of greenhouse gases. Extraction of these raw materials is currently heavily geographically concentrated. For example, China produces 95% of all 'rare earths' (used in hand-held consumer electronics, LCD displays and high performance magnets); Brazil produces 90% of all niobium (needed for steel alloys in gas pipelines and super alloys in high-performance jet aircraft); and South Africa produces 79% of all rhodium (needed for car catalysts).

© OCR 2012

STEMUP.CO.UK

China, too, responded to the threat of a global resource crisis by announcing that it would ban the export of certain 'rare earths' from 2015. One of these raw materials, neodymium, is used to make high-power, lightweight magnets for the electric motors of hybrid cars, such as the Toyota Prius. With the demand for neodymium outstripping supply, prices have increased five-fold in recent years. China defends its move, which builds on previous export quotas on key raw materials, as part of its move towards sustainable development. These export quotas led to the EU and the USA making a complaint to the World Trade Organisation in 2009. The EU and the USA view such trade restraints as deliberate attempts by China to unfairly advantage its own industries. It is likely that any move by China to further restrict exports will lead to further trade disputes between China and both the EU and the USA.

© OCR 2012

STEMUP.CO.UK

BLANK PAGE

© OCR 2012

STEMUP.CO.UK

OCR
RECOGNISING ACHIEVEMENT

Copyright Information

OCR is committed to seeking permission to reproduce all third-party content that it uses in its assessment materials. OCR has attempted to identify and contact all copyright holders whose work is used in this paper. To avoid the issue of disclosure of answer-related information to candidates, all copyright acknowledgements are reproduced in the OCR Copyright Acknowledgements Booklet. This is produced for each series of examinations and is freely available to download from our public website (www.ocr.org.uk) after the live examination series.

If OCR has unwittingly failed to correctly acknowledge or clear any third-party content in this assessment material, OCR will be happy to correct its mistake at the earliest possible opportunity.

For queries or further information please contact the Copyright Team, First Floor, 9 Hills Road, Cambridge CB2 1GE.

OCR is part of the Cambridge Assessment Group; Cambridge Assessment is the brand name of University of Cambridge Local Examinations Syndicate (UCLES), which is itself a department of the University of Cambridge.

© OCR 2012

STEMUP.CO.UK

OCR
RECOGNISING ACHIEVEMENT

Wednesday 20 June 2012 – Morning

A2 GCE ECONOMICS

F585/01 The Global Economy

Candidates answer on the Question Paper.

OCR supplied materials:
- Clean copy Stimulus Material

Other materials required:
- Calculators may be used

Duration: 2 hours

F 5 8 5 0 1

F5301206121

Candidate forename		Candidate surname	

Centre number						Candidate number				

INSTRUCTIONS TO CANDIDATES

- Refer to the Stimulus Material in a separate booklet. You must **not** bring your original copy into the examination.
- Write your name, centre number and candidate number in the boxes above. Please write clearly and in capital letters.
- Use black ink. HB pencil may be used for graphs and diagrams only.
- Answer **all** the questions.
- Read each question carefully. Make sure you know what you have to do before starting your answer.
- Write your answer to each question in the space provided. If additional space is required, you should use the lined pages at the end of this booklet. The question number(s) must be clearly shown.
- Do **not** write in the bar codes.

INFORMATION FOR CANDIDATES

- The number of marks is given in brackets **[ ]** at the end of each question or part question.
- The total number of marks for this paper is **60**.
- You will be assessed on the quality of your written communication in question 3. All answers should be in continuous prose.
- This document consists of **16** pages. Any blank pages are indicated.

A calculator may be used for this paper

© OCR 2012 [T/500/7921]
DC (NH) 51944/2

OCR is an exempt Charity

STEMUP.CO.UK

Answer **all** questions.

1 **(a)** Describe **two** benefits of inflation targeting.

1. .....

.....

.....

.....

.....

.....

.....

.....

2. .....

.....

.....

.....

.....

.....

.....

..... **[4]**

© OCR 2012

STEMUP.CO.UK

(b) "Inflation is likely to pick up to between 4% and 5% in the near term, and to remain well above the 2% target throughout 2011." (Bank of England Inflation Report, February 2011)

With the aid of a diagram, analyse why the Bank of England expected inflation to rise at a time when there was significant spare capacity in the UK economy.

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

..... **[6]**

© OCR 2012

STEMUP.CO.UK

(c) Comment on the view that higher inflation in China might be advantageous.

© OCR 2012

STEMUP.CO.UK

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

..... **[10]**

© OCR 2012

STEMUP.CO.UK

2 **(a)** State and explain **two** reasons for the growing divergence between China's real (PPP) and nominal exchange rates since 2008 as shown in Fig. 2.2.

1. .....

.....

.....

.....

.....

.....

.....

.....

2. .....

.....

.....

.....

.....

.....

.....

..... **[4]**

© OCR 2012

STEMUP.CO.UK

(b) Analyse why it is difficult to increase interest rates in order to control inflation when an economy is operating a fixed exchange rate.

....

....

....

....

....

....

....

....

....

....

....

....

....

....

....

....

....

....

....

....

....

....

....

.... **[6]**

© OCR 2012

STEMUP.CO.UK

(c) Comment on the case for using an adjusted economic indicator, such as the Index of Sustainable Economic Welfare (ISEW), in assessing China's success in achieving sustainable economic development.

© OCR 2012

STEMUP.CO.UK

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

..... **[10]**

© OCR 2012

STEMUP.CO.UK

3 Discuss the case for China banning the export of certain key raw materials from 2015. **[20]**

© OCR 2012

© OCR 2012

STEMUP.CO.UK

© OCR 2012

© OCR 2012

Additional pages. When using this space please make sure your answers are numbered carefully.

© OCR 2012

© OCR 2012

PLEASE DO NOT WRITE ON THIS PAGE

OCR
RECOGNISING ACHIEVEMENT

Copyright Information

OCR is committed to seeking permission to reproduce all third-party content that it uses in its assessment materials. OCR has attempted to identify and contact all copyright holders whose work is used in this paper. To avoid the issue of disclosure of answer-related information to candidates, all copyright acknowledgements are reproduced in the OCR Copyright Acknowledgements Booklet. This is produced for each series of examinations and is freely available to download from our public website (www.ocr.org.uk) after the live examination series.

If OCR has unwittingly failed to correctly acknowledge or clear any third-party content in this assessment material, OCR will be happy to correct its mistake at the earliest possible opportunity.

For queries or further information please contact the Copyright Team, First Floor, 9 Hills Road, Cambridge CB2 1GE.

OCR is part of the Cambridge Assessment Group; Cambridge Assessment is the brand name of University of Cambridge Local Examinations Syndicate (UCLES), which is itself a department of the University of Cambridge.

© OCR 2012

OCR
RECOGNISING ACHIEVEMENT

GCE

Economics

Advanced GCE

Unit **F585:** The Global Economy

Mark Scheme for June 2012

Oxford Cambridge and RSA Examinations

STEMUP.CO.UK

OCR (Oxford Cambridge and RSA) is a leading UK awarding body, providing a wide range of qualifications to meet the needs of candidates of all ages and abilities. OCR qualifications include AS/A Levels, Diplomas, GCSEs, OCR Nationals, Functional Skills, Key Skills, Entry Level qualifications, NVQs and vocational qualifications in areas such as IT, business, languages, teaching/training, administration and secretarial skills.

It is also responsible for developing new specifications to meet national requirements and the needs of students and teachers. OCR is a not-for-profit organisation; any surplus made is invested back into the establishment to help towards the development of qualifications and support, which keep pace with the changing needs of today's society.

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

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

Mark schemes should be read in conjunction with the published question papers and the report on the examination.

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

© OCR 2012

Any enquiries about publications should be addressed to:

OCR Publications
PO Box 5050
Annesley
NOTTINGHAM
NG15 0DL

Telephone: 0870 770 6622
Facsimile: 01223 552610
E-mail: publications@ocr.org.uk

Annotations

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

STEMUP.CO.UK

Subject specific marking instructions

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

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

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

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

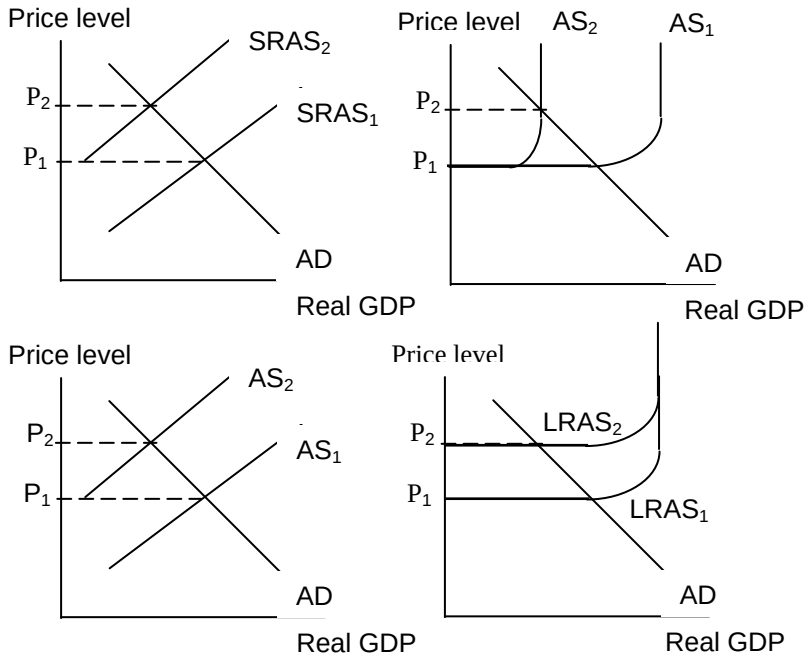
Level 2: Some simple ideas have been expressed in an appropriate context. There are likely to be some errors of spelling, punctuation and grammar of which some may be noticeable and intrusive.

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

STEMUP.CO.UK

Question			Answer	Marks	Guidance
1	(a)		Benefits of inflation targeting may include: • greater transparency and accountability • lower inflationary expectations • flexibility if a symmetric target • greater credibility/strictness of asymmetric target • greater confidence • greater economic stability/reduced volatility reduces uncertainty • leads to higher levels of investment • a guide to policy decisions • helps avoid the costs of inflation Examples of valid description: • inflation targets create transparency and accountability (1) by communicating a firm commitment to price stability to firms and households (1) • lower inflationary expectations (1) help to moderate wage demands and cost-push inflation (1) • inflation below the target is as important as inflation above the target (1) which avoids dangers of deflation as well as inflation (1) • greater confidence for firms (1) is likely to increase willingness to invest / raise LRAS / productive capacity (1)	4	One mark for each correct identification up to a maximum of two identifications, plus a further one mark for each of two descriptions. A valid description of each benefit requires a simple elaboration of what the benefit is, why it might arise or what the consequence might be. An analytical explanation is not required. Some candidates may give a second benefit in the description of the first; please credit. Use green ticks ✔ for each mark awarded. Maximum 4 marks

STEMUP.CO.UK

Question			Answer	Marks	Guidance
1	(b)		Diagram marks can only be awarded if axes are correctly labelled: • price level/general price level/average price level/CPI/PL • real GDP/real national output/real national income/RGDP Award diagram marks as follows: • 1 mark for original AD and AS curves • 1 mark for original price level • 1 mark for leftward shift of AS curve • 1 mark for new price level Award up to a further two marks for analysis of why inflation is expected to rise when there is spare capacity. For example: • higher commodity prices (1) raises costs of production (1) shifts AS left (1) so the price level rises whilst real GDP falls (1) • higher VAT (1) raises firm's costs (1) shifts AS left (1) so the price level rises whilst real GDP falls (1) Other valid reasons include higher energy/input/oil prices, rebuilding company's margins.	6	Acceptable variations of AD/AS diagrams shown below. Diagram showing **leftward shift of LRAS** can only be awarded 2 marks.  Use green ticks ✓ for each mark awarded. Maximum 6 marks

STEMUP.CO.UK

Question			Answer	Marks	Guidance	
					Content	Levels of response
1	(c)		**Level 4:** Commentary on the benefits of inflation might include: • costs of inflation eg shoe leather costs, menu costs, inflationary noise, fiscal drag, random redistribution of income, impact on investment • higher inflationary expectations • impact on other economies where PED is inelastic, ie inflation may be 'exported' • may not correct current account surplus if value of exports rise, ie PED for exports is inelastic **Level 3:** Higher inflation reduces the incentive to save and encourages greater domestic consumption. Greater domestic consumption reduces China's dependence on global demand for its exports and may lead to more sustained growth. Higher inflation reduces pressure on China to revalue its currency as it raises yuan's real exchange rate. **Level 2:** This could be a benefit to China because it will allow it to rebalance its economy. **Level 1:** Inflation is a sustained increase in the general price level. Higher inflation in China is characterised by an increase in the rate at which prices are rising.	10	**In Level 4:** • one stated point of evaluation = 7 marks • two or more stated points of evaluation = 8 marks • one developed point of evaluation = 9 marks • two or more developed points of evaluation = 10 marks **Routes into Level 4 include** • an analytical explanation of the benefits **and** problems of higher inflation for China or other economies • an analysis of the benefits of higher inflation in China and an explanation of what the benefits depend upon **Level 3 responses** will establish the beneficial consequences of higher inflation for China or other economies e.g. trading partners, using a reasoned chain of argument underpinned with economic concepts. **Level 2 responses** are characterised by valid but generalised statements without a reasoned chain of argument and are not underpinned by economic concepts.	**Level 4: (7 – 10 marks)** For a commentary on the view that higher inflation in China might be advantageous *Annotate using* L4 *in LHS margin* *Show development with* ✓+ *Annotate with* ^ *conclusions which repeat previous arguments* **Level 3: (4 – 6 marks)** For an analysis of either the advantages OR disadvantages of higher inflation in China but not both. *Annotate using* L3 *in LHS margin.* **Level 2: (2 – 3 marks)** For an application of knowledge and understanding of the advantages and / or disadvantages of higher inflation in China *Annotate using* L2 *in LHS margin.* **Level 1: (1 mark)** For knowledge and understanding of inflation only. *Annotate using* L1 *in LHS margin.*

STEMUP.CO.UK

Question			Answer	Marks	Guidance
2	(a)		The real exchange rate is the nominal exchange rate adjusted for the ratio of prices between two countries / taking into account purchasing power parity. Real exchange rate = nominal exchange rate x $\frac{\text{domestic price level}}{\text{world price level}}$ Valid explanations might include: • **higher inflation in China** than in the US / rest of the world (1) has raised the price of Chinese exports (1) and meant that more US$ are required to buy the same volume of Chinese goods (1) raising the real exchange rate of the yuan (1) • **lower growth in productivity in China** than in the US / rest of the world (1) means that Chinese goods are less competitive (1) meaning more US$ are required to buy the same volume of Chinese goods (1) raising the real exchange rate of the yuan (1) • **higher wage growth in China** than in the US / rest of the world (1) has increased costs of production in China (1) raising the price of Chinese exports (1) and meant that more US$ are required to buy the same volume of Chinese goods (1) raising the real exchange rate of the yuan (1) • **China operates a fixed exchange rate** so the nominal rate is unchanged (1) by raising / reducing demand / supply of Yuan / $US (1) or by raising / lowering interest rates (1).	4	Award marks as follows: 1 mark for each valid reason for the divergence in the real and nominal exchange rates up to a max of 2 marks 1 mark for each explanation of why this causes a divergence in the real and nominal exchange rates up to a max of 2 marks. Award 2 marks for an answer which identifies higher inflation as the cause of the divergence followed by an explanation which correctly states that the real exchange rate adjusts the nominal rate for changes in **relative** price levels Do not credit simple reference to undervaluation. Explanation of why the nominal rate is unchanged must be linked to Chinese government / central bank intervention in the FOREX markets to maintain the fixed exchange rate or changes in monetary policy Use green ticks for each mark awarded. Maximum 4 marks

STEMUP.CO.UK

Question			Answer	Marks	Guidance
2	(b)		Difficult to increase interest rates in order to control inflation when the economy is operating a fixed exchange rate because: • fixed exchange rate will be undermined / changes in interest rates will change the exchange rate / there will be a policy conflict (1). • impact of interest rates on the exchange rate makes it difficult to use interest rates to influence AD (1). Increase in interest rates will put pressure on the exchange rate to rise because there will be: • increased demand for currency (1), reduced supply of currency (1) creating excess demand for currency (1) which will raise the exchange rate (1). This is because of: • increased 'hot money' flows into domestic economy (1) as a result of higher returns from deposits in domestic banks as a result of the higher interest rate (1) • reduced 'hot money' flows out from domestic economy (1) as a result of higher returns from deposits in domestic banks as a result of the higher interest rate (1) The consequence will be that the central bank will have to: • intervene in the FOREX markets (1) by increasing the supply of the currency (1) by purchasing foreign currencies (1) in order to prevent an appreciation of the currency / maintain the currency at its fixed rate (1)	6	Use green ticks ✔ for each mark awarded. Maximum 6 marks Do **NOT** credit the idea that intervention in the foreign exchange markets to increase the supply of the currency raises the money supply and causes inflation **UNLESS** there is clear recognition that this only arises where such intervention is not "sterilised" by open market operations. Where candidates recognise this issue, marks can be awarded as follows: **IF** the central bank 'prints' money to buy foreign currency (1) this will increase the money supply (1) which could increase the rate of inflation (1) unless the effect on the money supply is offset by selling bonds in the domestic money markets (1).

STEMUP.CO.UK

Question			Answer	Marks	Guidance	
					Content	Levels of response
2	(c)		**Level 4:** problems might include • lack of agreement on the choice of adjustments to be made to GDP • no way of determining objectively the weightings to attach to each adjustment • difficulties of placing monetary values on eg costs of environmental degradation **Level 3:** Adjusted indicators are useful because they are (more) comprehensive measures (than e.g.GDP) (low L3). This helps governments to determine the best policies to pursue to achieve sustainability/allows economic, social and environmental outcomes of growth to be explicitly measured (mid L3). For example, higher GDP which results in pollution and a loss of biodiversity does not raise economic well-being even though it raises economic activity unless the government introduces a policy to internalise the negative externality (top L3).	10	**In Level 4** • one stated point of evaluation = 7 marks • two or more stated points of evaluation = 8 marks • one developed point of evaluation = 9 marks • two or more developed points of evaluation = 10 marks Do not reward commentary on why HDI or MDGs or HPI or MPI may be better measures as they are composite rather than adjusted indicators. **In Level 3** **L3 marks should not be awarded without understanding of adjusted indicators.** General explanation of why adjusted indicators are useful (low L3) Identification of outcomes of economic growth consistent with sustainable development or implications for government policy (mid L3) Exemplification of why adjustments are useful in assessing success (top L3)	**Level 4: (7 – 10 marks)** For a commentary on the case for using adjusted economic indicators to assess China's success in achieving sustainable economic development. *Annotate using*  *in LHS margin* *Show development with*  *Annotate with*  *conclusions which repeat previous arguments* **Level 3: (4 – 6 marks)** For an analysis of why adjusted economic indicators are useful or are not useful in assessing China's success in achieving sustainable economic development. *Annotate using*  *in LHS margin.*

STEMUP.CO.UK

Question			Answer	Marks	Guidance	
					Content	Levels of response
			Level 2: Adjusted economic indicators are useful in assessing success in achieving sustainable development because they measure things that raise the quality of life and deduct things that reduce the quality of life (low L2), such as environmental damage, defensive expenditures, income inequality, depreciation of natural capital, value of domestic labour (top L2) **Level 1:** Sustainable economic development is development that meets the needs of the current generation without compromising the ability of future generations to meet their own needs.		**In Level 2** Understanding that adjustments are made to GDP (low L2) Pros and cons of ISEW without knowledge and understanding of adjusted indicators or composition (top L2), one-sided (low L2) Identification of specific adjustments to GDP (top L2) **In Level 1** Definitions of economic development and/or sustainable economic development	**Level 2: (2 – 3 marks)** For an application of knowledge and understanding of why adjusted economic indicators are useful in assessing China's success in achieving sustainable economic development *Annotate using*  *in LHS margin.* **Level 1: (1 mark)** For knowledge and understanding of sustainable economic development only *Annotate using*  *in LHS margin.*

STEMUP.CO.UK

Question			Answer	Marks	Guidance	
					Content	Levels of response
3			**Examples of judgements in Level 4, Band 3** • in the short run a ban may be beneficial to China but in the long run it may be detrimental • the benefits of a ban to China may be reduced by the existence or emergence of substitutes • the negative impact of the ban may be confined to a narrow range of industries • case for depends on China's ability to attract FDI • Retaliatory action would have a negative effect on China and its poorest inhabitants in particular. • The role of the WTO in resolving such a dispute will determine the impact on the EU, US and Chinese people. • A quota may be more advantageous than a complete ban as it would still lead to a price that more fairly reflects the scarcity of raw materials but would limit the negative impacts on firms that rely on the imports of such materials.	20	**Level 4 Band 3 marks can only be awarded once there is evidence of developed discussion (Level 4 Band 2).** **Examples of Level 4 responses** • may lower export revenue and have an adverse impact on the balance of payments; • banning exports may not lead to optimal rate of depletion – may simply lead to foreign firms relocating to China to access raw materials so depletion rate is not affected' • may be deemed to be an unfair trade practice by WTO by giving unfair advantage to domestic firms • may lead to retaliation from US and EU, reducing demand for exports of other goods and services **Developed discussion is where evaluation is supported with economic concepts which establish cause or consequence.** **Top Level 4 band 1** is characterised by a wider range of basic discussion points. **Low level 4 band 1** is characterised by a narrow range of basic discussion points. Do not credit reduction in productive capacity of other economies.	**Level 4 Band 3: (18 – 20 marks)** For a discussion which includes a judgement on the case for China banning exports of certain raw materials *Annotate using*  *in LHS margin* *Annotate with*  *conclusions which repeat previous arguments* **Level 4 Band 2: (15 – 17 marks)** For a developed discussion of the pros and cons of China banning exports of certain raw materials, with context appropriate to the questions/stimulus *Annotate using*  *in LHS margin* **Level 4 Band 1: (11 – 14 marks)** For a basic discussion of the pros and cons of China banning exports of certain raw materials, with undeveloped analytical support and a lack of context. *Annotate using*  *in LHS margin*

STEMUP.CO.UK

Question			Answer	Marks	Guidance	
					Content	Levels of response
			Examples of Level 3 responses • a ban reduces the world supply **which leads to** higher world prices for rare earths consumption outside of China (need not be supported by a demand and supply diagram) • a ban on exports promotes sustainable development **because** it will raise the world price of rare earths **which leads to** reduced global consumption and slowing down the depletion of scarce / non-renewable resources • **the consequence of this** may be that there is a more optimal depletion path for raw materials as a result of the ban because resource use is not based on market rates of depletion • if there is increased FDI into China as a result of the ban **the consequence will be** an increase in China's AD and AS **which will lead** to higher real GDP and employment • **the consequences of this** will be higher levels of economic development in China and a diversification of the economic structure **because** China will be less dependent on exports		Low Level 3 responses will analyse the consequences of the ban e.g. lower world supply, higher prices. Or may analyse the market failure involved in the extraction or rare earths. Top Level 3 responses will then develop the consequences in the context of the question i.e. the case for or against. Analysis is likely to be supported by diagrams which will explain: • Increased world price and equilibrium quantity resulting from a reduction in world supply. • market failure in the absence of a ban (MSC > MPC) • benefits to the Chinese economy of a ban (increase in AD, AS, real GDP, employment)	**Level 3: (5 – 10 marks)** For an analysis of the case for China banning exports of certain raw materials **or** the case against but **not** both *Annotate using*  *in LHS margin.*

STEMUP.CO.UK

Question			Answer	Marks	Guidance	
					Content	Levels of response
			Examples of Level 2 responses • a ban leads to sustainable development • a ban results in greater FDI for China • a ban reduces negative externalities/pollution by reducing consumption • a ban will advantage Chinese industry • a ban will lead to trade disputes • a ban is damaging the other countries **Examples of Level 1 responses** • a ban on exports places a limit on the amount of raw materials which can be exported • the ban relates to commodities for which China has an effective global monopoly • the raw materials are key inputs into the production process		Responses which focus only on export quotas cannot achieve marks beyond Level 1.	**Level 2: (3 – 4 marks)** For an application of knowledge and understanding of the case for and/or against China banning exports certain raw materials *Annotate using*  *in LHS margin.* **Level 1: (1 – 2 marks)** For knowledge and understanding of what is meant by a ban on exports or the nature of key raw materials *Annotate using*  *in LHS margin.*

STEMUP.CO.UK

OCR (Oxford Cambridge and RSA Examinations)
1 Hills Road
Cambridge
CB1 2EU

OCR Customer Contact Centre

Education and Learning
Telephone: 01223 553998
Facsimile: 01223 552627
Email: general.qualifications@ocr.org.uk

www.ocr.org.uk

For staff training purposes and as part of our quality assurance programme your call may be recorded or monitored

Oxford Cambridge and RSA Examinations
is a Company Limited by Guarantee
Registered in England
Registered Office; 1 Hills Road, Cambridge, CB1 2EU
Registered Company Number: 3484466
OCR is an exempt Charity

OCR (Oxford Cambridge and RSA Examinations)
Head office
Telephone: 01223 552552
Facsimile: 01223 552553

© OCR 2012

OCR
RECOGNISING ACHIEVEMENT

To be opened on receipt

A2 GCE ECONOMICS

F585/01/SM The Global Economy

STIMULUS MATERIAL

JANUARY 2012

F536460112

INSTRUCTIONS TO CANDIDATES

- This copy must **not** be taken into the examination room.

INFORMATION FOR CANDIDATES

- The following stimulus material has been adapted from published sources. It was correct at the time of publication and all statistics have been taken directly from the published material.
- This document consists of **12** pages. Any blank pages are indicated.

© OCR 2012 [T/500/7921]
OCR is an exempt Charity

STEMUP.CO.UK

Introduction

The much anticipated UK Comprehensive Spending Review was finally revealed by the Chancellor of the Exchequer, George Osborne, on 20 October 2010. The UK recession of 2008–10 had been the deepest and most prolonged in recent memory and it had had a severe impact on consumer and business confidence, on the level of investment and on the public sector finances. The Coalition Government felt that a deficit reduction strategy involving immediate cuts to government expenditure and future tax rises was necessary in order to restore confidence and, ultimately, create an economic environment conducive to investment by and growth in the private sector. The package of cuts announced by the Chancellor amounted to reductions in government expenditure of £81 billion over four years.

One area of spending notably immune from the cuts was spending by the Department for International Development (DfID). This was to increase by 37% in order to allow the UK to meet its international commitment to raise its Official Development Assistance (ODA) as a percentage of GDP. DfID announced reforms to the way in which ODA would be granted to developing countries, in particular to better target aid so that it went to countries most in need. This had not always been the case.

One of the success stories of development, at least in terms of economic growth, has been India. The future prospects for India, particularly on the supply side, looked healthy in 2010. Some predicted that India's economic growth rate would soon exceed that of China. But there were a number of constraints which might limit not only economic growth but also development. Despite market-friendly reforms in the past, there was still much to do to reform the Indian economy in order to achieve future growth and development.

One of the greatest threats in late 2010 to both developed and developing economies alike was the growing global trade and balance of payments imbalances. The causes of these imbalances were disputed amongst the world's major economies and trading nations. The consequences, too, were not clear. The International Monetary Fund (IMF), however, was concerned that there were signs that one possible consequence, currency wars, was already raising a spectre over the global economy.

© OCR 2012

STEMUP.CO.UK

Pre-release stimulus material

Extract 1: UK investment and public finances

Extract 2: The UK budget deficit reduction plan

Extract 3: UK Official Development Assistance

Extract 4: The future of economic growth and development in India

Extract 5: Imbalances in the global economy

© OCR 2012

STEMUP.CO.UK

Extract 1

UK investment and public finances

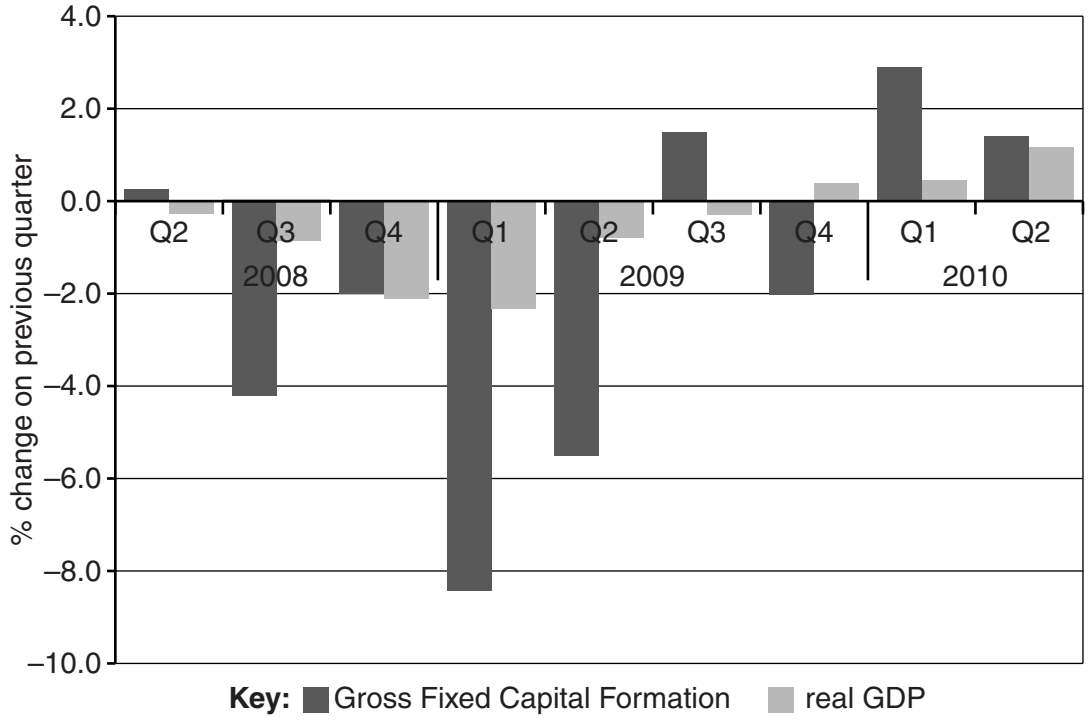
The financial crisis beginning in 2007 and the subsequent recession had a huge impact on both the level of UK investment and the UK's public finances.

Surveys of business confidence, such as that by the Confederation of British Industry (CBI), showed that business confidence collapsed at the start of the recession in the second quarter of 2008. The CBI Industrial Trends Survey asks manufacturing firms a number of questions about current trends and their expectations for the future, including whether their order books have increased, how optimistic they are and what their expectations are for future output.

Unsurprisingly, in this economic climate, investment fell dramatically in the UK. Total investment (Gross Fixed Capital Formation, GFCF) fell by 18.7% in 2009 Quarter 2 compared with a year earlier. Fig. 1.1 shows the relationship between changes in real GDP and GFCF on a **quarterly** basis.

The impact of the recession on the UK's public sector finances was no less severe, as automatic stabilisers raised government expenditure and reduced tax receipts (see Fig. 1.2). A return to growth would normally have been expected to reduce the cyclical budget deficit. It was, however, commonly believed in 2010 that the UK could not rely on economic growth to reduce the amount of public sector borrowing resulting from the government's budget deficit. The Treasury estimated that as much as two thirds of the UK's deficit was 'structural'. The UK's net public sector debt had breached the previous government's sustainable investment rule, with the result that the UK government was spending £44 billion on debt interest in 2010 (see Fig. 1.3). Hence, the view amongst many economists was that to tackle the deficit and reduce public sector borrowing required a combination of discretionary cuts in government expenditure and increases in taxation.

Fig. 1.1 UK Real GDP and Gross Fixed Capital Formation (GFCF) 2008 Q2–2010 Q2 (% change on previous quarter)



© OCR 2012

STEMUP.CO.UK

Fig. 1.2 UK public sector net borrowing 2002–03 to 2009–10 (£bn)

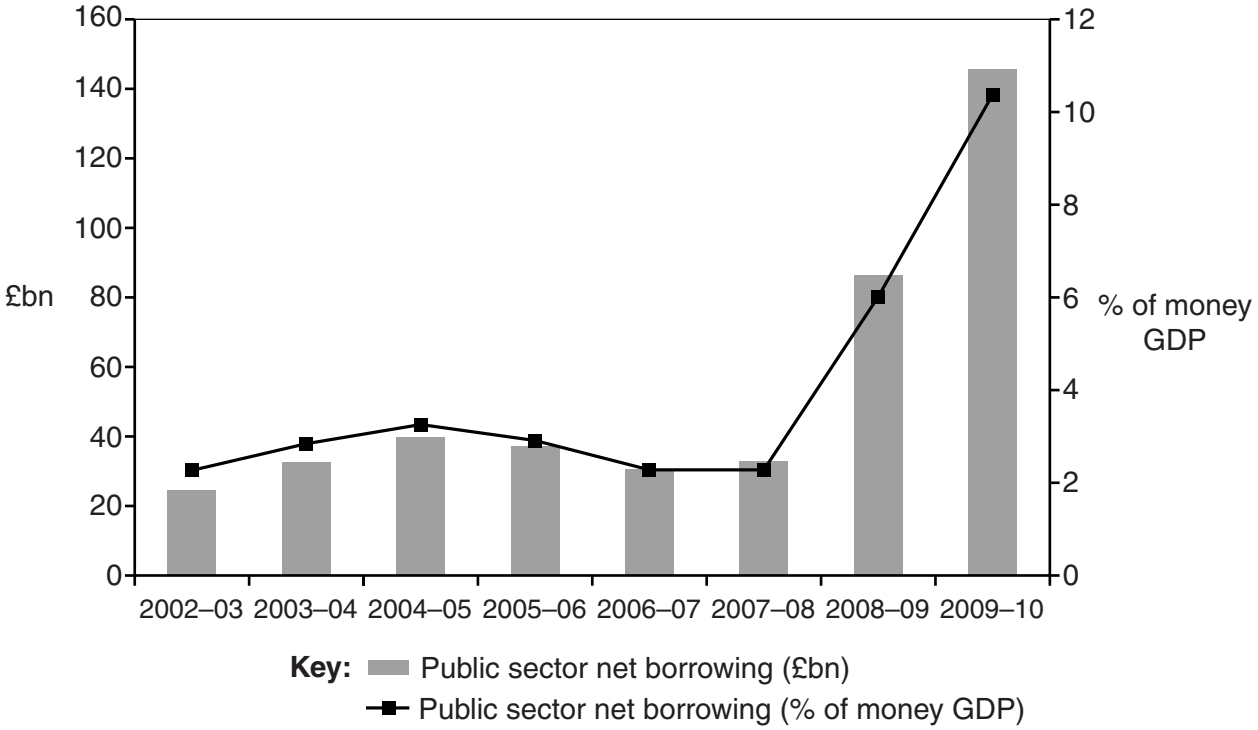
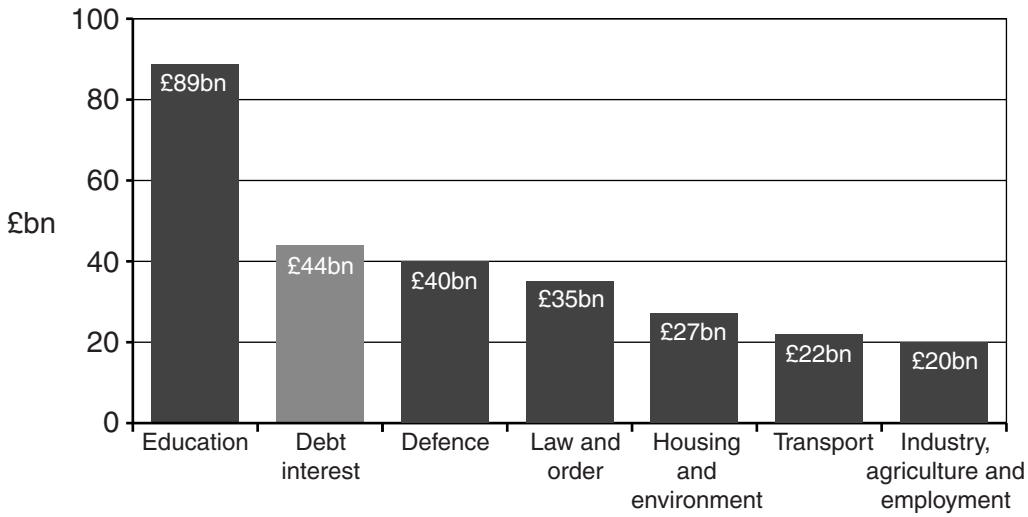


Fig. 1.3 UK government expenditure 2009–10 (£bn)



© OCR 2012

STEMUP.CO.UK

Extract 2

The UK budget deficit reduction plan

In response to the growing size of the UK budget deficit and rising public sector borrowing, the Coalition Government announced its intention to cut government spending. Its spending plans were announced by the Chancellor of the Exchequer, George Osborne, on 20 October 2010. In total, spending cuts of £81 billion were announced which would take effect over the period 2010–11 to 2014–15.

In his statement to the House of Commons, the Chancellor laid out the need to reduce the budget deficit (see Fig. 2.1). He claimed support from the IMF, the Governor of the Bank of England and business leaders for his deficit reduction plan.

Support for the deficit reduction plan, however, was not universal amongst economists and commentators. Some feared that the nature of the UK's economic recovery was too fragile and that reductions in government expenditure would risk a double-dip recession. Others questioned whether the emphasis on reductions in government expenditure was appropriate because of the national income multiplier. Some commentators suggested that cuts in government expenditure should be balanced by cuts in taxation financed by a higher budget deficit and they viewed the IMF's praise for austerity as 'foolish' (see Fig. 2.2).

There were grounds for optimism in the CBI's Quarterly Industrial Trends Survey of 19 October 2010 but the resilience of the economic recovery to the impact of the deficit reduction plan was not assured. The Office for National Statistics, however, announced that GDP growth in the third quarter of 2010 was provisionally 0.8%, rather than the anticipated 0.4%. This was a welcome sign of a stronger than expected recovery, despite growth being lower than the 1.2% recorded in the second quarter of 2010.

Fig. 2.1 Extracts from George Osborne's statement to the House of Commons, 20 October 2010

We have, at £109 billion, the largest structural budget deficit in Europe. This is at a time when the whole world is concerned about high deficits and our economic stability depends on allaying these concerns. We are paying, at a rate of £120 million a day, £44 billion a year in debt interest.

Last year the IMF warned this country to accelerate the reduction in the deficit and the Organisation for Economic Cooperation and Development (OECD), the Governor of the Bank of England and the CBI all agreed with them.

The emergency Budget in June was the moment when our fiscal credibility was restored. Our market interest rates fell to near record lows. Our country's credit rating was affirmed. The IMF went from issuing warnings to calling our Budget 'essential'.

I can confirm that the spending plans I set out today will achieve a balanced structural current budget and falling national debt by 2014–15.

To back down now and abandon our plans would be the road to economic ruin.

© OCR 2012

STEMUP.CO.UK

Fig. 2.2 The views of Martin Wolf, Financial Times columnist, 30 September 2010

Adam Posen, a member of the Bank of England's Monetary Policy Committee (MPC), argues: first, that the UK economy now has large excess capacity; second, the big danger is not a resurgence of inflation, but deflation, as happened in Japan; and, third, there is a substantial risk that prolonged weak demand will make temporary losses in output structural and permanent, via weak investment and long-term unemployment. He stated that: "The damage to our economy, our companies and our workforce can be made permanent through inaction by policymakers."

So what is to be done? Since Mr Posen is a member of the MPC he has to focus on monetary policy measures such as quantitative easing. The most effective policy, however, would be for the government to increase its deficit and have this rise funded by the Bank of England. If one accepts Mr Posen's argument that the economy is likely to suffer from deficient demand in the medium term, a simple option would be to proceed with the spending cuts, but slash taxes temporarily and fund the revenue shortfall by borrowing from the central bank. This would give a direct injection of purchasing power into the economy, promoting employment.

© OCR 2012

STEMUP.CO.UK

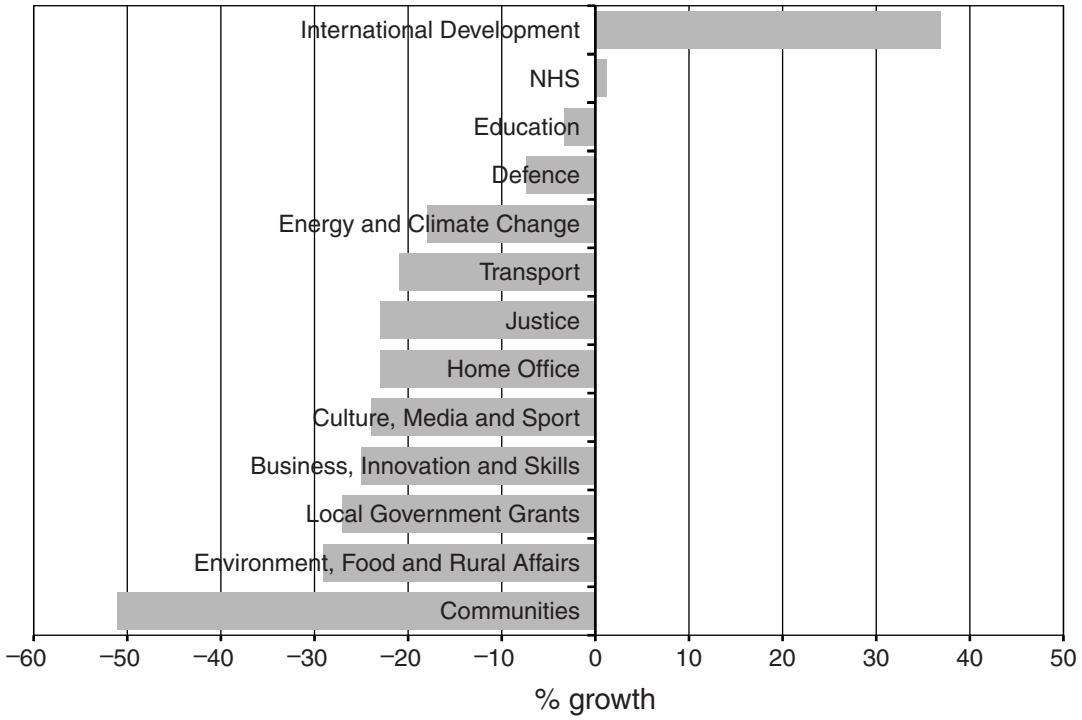
Extract 3

UK Official Development Assistance

Official Development Assistance (ODA) comes in many different forms and represents one of the many financial flows received by developing economies. It can help them overcome some of the constraints on their development.

The UK Comprehensive Spending Review did not involve cuts in spending for all government departments (see Fig. 3.1). Notably, expenditure on international development was planned to increase in real terms from 2010–11 to 2014–15. The Coalition Government sought to increase expenditure on international development in order to meet its commitment to increase UK ODA to 0.7% of GDP by 2013.

Fig. 3.1 Planned real growth in spending by government department 2010–11 to 2014–15



The Department for International Development (DfID) stated that it would use additional expenditure to change the way in which it delivers aid, redirecting funds to projects to combat poverty in developing economies and focus aid where it is needed most. It announced that aid to China and Russia would cease, focusing its efforts on:

- meeting UK commitments to the Millennium Development Goals
- making UK development policy more effective in promoting economic growth in developing economies
- supporting low carbon growth in developing economies
- helping fragile states and countries affected by conflict, particularly Afghanistan and Pakistan.

However, there were no plans to reduce aid to India, the recipient of the largest amount of UK ODA (see Fig. 3.2). UK aid to India has traditionally gone to health and education, climate change and to small industries in Madhya Pradesh, Orissa and Bihar.

© OCR 2012

STEMUP.CO.UK

Fig. 3.2 Top recipients of UK ODA (2007)

Country	UK ODA (US$m) 2007	GDP per capita (PPP US$) 2007	HDI 2007
India	700	2,753	0.612
Afghanistan	296	1,054	0.352
Nigeria	275	1,969	0.511
Ethiopia	273	779	0.414
Bangladesh	249	1,241	0.543
Tanzania	243	1,208	0.530
Pakistan	229	2,496	0.572
Sudan	203	2,086	0.531
China	201	5,383	0.772

© OCR 2012

STEMUP.CO.UK

Extract 4

The future of economic growth and development in India

India's GDP per capita may not be as high as China's but its growth rate (currently 8.5% per annum) is predicted to exceed China's by 2013. The reasons for this are to be found in India's supply side advantages. Unlike China, India's workforce is rapidly growing, with the result that it has one of the lowest dependency ratios in the world. By 2020 India's workforce is expected to have increased by 136 million, whereas that in China will have grown by only 23 million. In addition adult literacy rates in 2010, although lower (at 66%) than China's (93%), were rising fast.

The second reason why India's economic growth is likely to outstrip that of China is that there is less state direction of economic activity in India. Since 1991 India has adopted many of the policy prescriptions of the Washington Consensus, including fiscal discipline, wide-scale market liberalisation and privatisation, and trade liberalisation and the encouragement of foreign investment. India has dramatically reduced import tariffs and become more open to international trade. There has been a big surge in exports since India adopted these market-friendly reforms in 1991 with firms such as Arcelor Mittal (the world's largest manufacturer of steel), Tata Motors (owners of Jaguar and Land Rover), Bharti Airtel (a mobile telecommunications firm achieving rapid growth in Africa) and IT services companies such as Infosys, TCS and WIPRO challenging established western multinational companies. Firms supplying the domestic Indian market have responded to international competition by being more innovative. Soon to hit the Indian market is a US$35 laptop developed in partnership with the Indian Institute of Technology and the Indian Institute of Science. Multinational companies, such as Korea's LG, have been attracted by the growing domestic market and have located production in India.

Despite optimism for India's prospects for economic growth and development, there are a number of obstacles which may yet see growth falter and development fail to materialise. These include:

- poor infrastructure – transport infrastructure is notoriously bad; energy supplies are unreliable; and Indian cities are unable to cope with a growing population
- skill shortages – despite growing rates of literacy, a large percentage of the workforce (some estimate up to 40%) remain illiterate; unskilled surplus labour in agriculture coexists with significant shortages of engineers, other graduates and vocationally trained workers
- high rates of malnutrition amongst the under fives – some estimate this to be as high as 50%
- social and political instability – tensions with farmers and local residents created by the expansion of industry, the activities of multinational mining and logging companies and the building of transport infrastructure tend to erupt into violence; and there is little harmonisation between the policies of individual Indian states
- problems in making the best of India's comparative advantage – in particular, foreign companies are less inclined to outsource their activities to India at a time of recession; and other economies have rivalled India's comparative advantage in outsourcing.

China's state-directed economic growth may yet be challenged by the likes of India, but neither economic growth nor development is guaranteed in India.

© OCR 2012

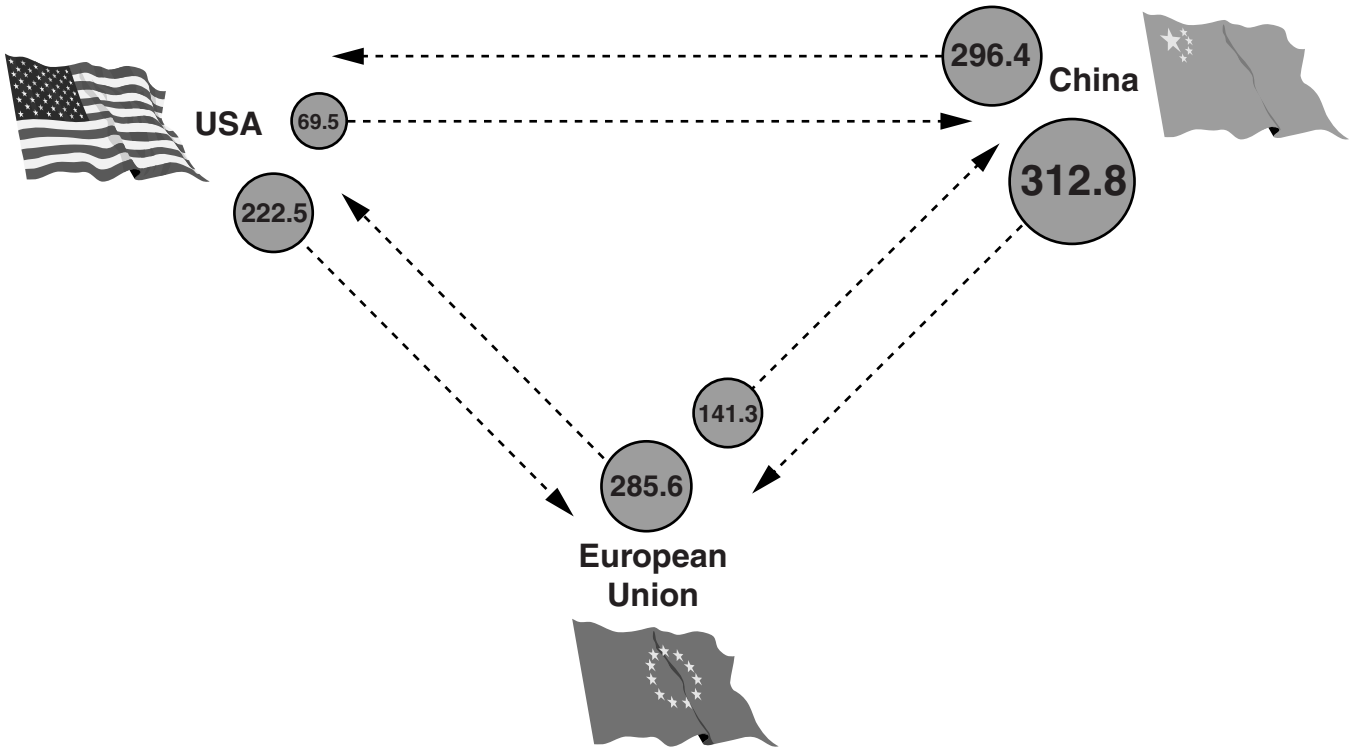
STEMUP.CO.UK

Extract 5

Imbalances in the global economy

In addition to high rates of economic growth, one of the features of the Chinese economy over recent years has been its current account surplus with the rest of the world. At the same time the US economy was running large current account deficits year on year. The extent of these imbalances in trade flows can be seen in Fig. 5.1 below. Despite these imbalances on the balance of payments, the exchange rate of the US dollar remained strong and there has not been as much appreciation of the Chinese renminbi (yuan) as might have been predicted by economic theory.

Fig. 5.1 Flows of international trade (US$ billion) 2009



The gross domestic products and the foreign currency reserves of the USA, China and the EU are shown in Fig. 5.2 and Fig. 5.3.

Fig. 5.2 Gross domestic product
in US$ billion (2009)

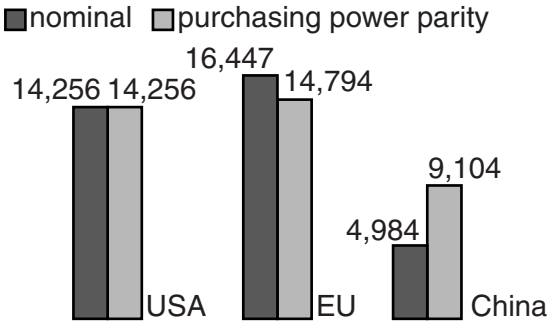
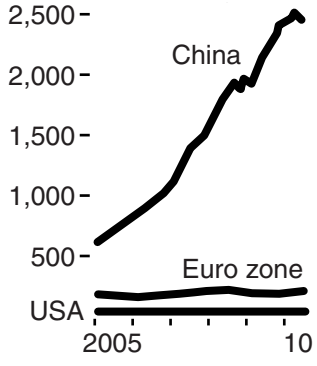


Fig. 5.3 Foreign currency reserves
in US$ billion



STEMUP.CO.UK

The trade imbalances between the US and China are only part of a bigger global picture of imbalances between rich, developed nations and the so-called emerging economies. The world has become divided into 'deficit countries' and 'surplus countries'. Such imbalances were at the heart of fears of a global 'currency war' in 2010. In advance of the annual meeting of the IMF and World Bank in October 2010, Brazil's Finance Minister announced that an 'international currency war' had broken out. Subsequently, there was much debate about which countries' economic policies were most responsible for endangering global economic growth and stability.

The US government accused the Chinese government of deliberately under-valuing its currency by buying foreign currencies, including the US dollar, on the foreign exchange markets. China intervened in the foreign exchange markets by as much as US$1 billion a day from 2005–2010, building up reserves of US$2.5 trillion. According to the US government, the renminbi was undervalued by as much as 20% relative to the economic fundamentals which should determine its exchange rate – China had effectively been subsidising its exports at the cost of US jobs. In 2010, the US House of Representatives passed into law a bill which paved the way for trade sanctions against countries which have 'a fundamentally undervalued currency', 'persistent global current account surpluses' and very large currency reserves. It was clear that this bill was targeted at China and escalated fears of a trade war between China and the USA.

Emerging economies, on the other hand, argued that in the past the US and other rich developed economies had run large current account deficits by effectively 'living beyond their means'. High domestic consumption and low savings had created a demand for imports from emerging markets and this was the root cause of global trade and balance of payments imbalances. To resolve these imbalances, emerging economies felt that the USA and other developed nations needed to increase their savings – in other words, reduce their dependence on consumption. Emerging economies feared that loose monetary policy, including quantitative easing in the USA in particular, would cause a depreciation of the US dollar damaging the international competitiveness of emerging economies.

Economists feared that, whatever the causes, these global trade and balance of payments imbalances might endanger the stability of the global economy.

OCR
RECOGNISING ACHIEVEMENT

Copyright Information

OCR is committed to seeking permission to reproduce all third-party content that it uses in its assessment materials. OCR has attempted to identify and contact all copyright holders whose work is used in this paper. To avoid the issue of disclosure of answer-related information to candidates, all copyright acknowledgements are reproduced in the OCR Copyright Acknowledgements Booklet. This is produced for each series of examinations and is freely available to download from our public website (www.ocr.org.uk) after the live examination series.

If OCR has unwittingly failed to correctly acknowledge or clear any third-party content in this assessment material, OCR will be happy to correct its mistake at the earliest possible opportunity.

For queries or further information please contact the Copyright Team, First Floor, 9 Hills Road, Cambridge CB2 1GE.

OCR is part of the Cambridge Assessment Group; Cambridge Assessment is the brand name of University of Cambridge Local Examinations Syndicate (UCLES), which is itself a department of the University of Cambridge.

© OCR 2012

STEMUP.CO.UK

OCR
RECOGNISING ACHIEVEMENT

Tuesday 31 January 2012 – Morning

A2 GCE ECONOMICS

F585/01/SM The Global Economy

STIMULUS MATERIAL

F530061112

Duration: 2 hours

INSTRUCTIONS TO CANDIDATES

- This is a clean copy of the Stimulus Material which you have already seen.
- You may **not** take your previous copy of the Stimulus Material into the examination.
- You may **not** take notes into the examination.

INFORMATION FOR CANDIDATES

- This document consists of **12** pages. Any blank pages are indicated.

INSTRUCTION TO EXAMS OFFICER / INVIGILATOR

- Do not send this Stimulus Material for marking; it should be retained in the centre or destroyed.

© OCR 2012 [T/500/7921]

OCR is an exempt Charity

STEMUP.CO.UK

Introduction

The much anticipated UK Comprehensive Spending Review was finally revealed by the Chancellor of the Exchequer, George Osborne, on 20 October 2010. The UK recession of 2008–10 had been the deepest and most prolonged in recent memory and it had had a severe impact on consumer and business confidence, on the level of investment and on the public sector finances. The Coalition Government felt that a deficit reduction strategy involving immediate cuts to government expenditure and future tax rises was necessary in order to restore confidence and, ultimately, create an economic environment conducive to investment by and growth in the private sector. The package of cuts announced by the Chancellor amounted to reductions in government expenditure of £81 billion over four years.

One area of spending notably immune from the cuts was spending by the Department for International Development (DfID). This was to increase by 37% in order to allow the UK to meet its international commitment to raise its Official Development Assistance (ODA) as a percentage of GDP. DfID announced reforms to the way in which ODA would be granted to developing countries, in particular to better target aid so that it went to countries most in need. This had not always been the case.

One of the success stories of development, at least in terms of economic growth, has been India. The future prospects for India, particularly on the supply side, looked healthy in 2010. Some predicted that India's economic growth rate would soon exceed that of China. But there were a number of constraints which might limit not only economic growth but also development. Despite market-friendly reforms in the past, there was still much to do to reform the Indian economy in order to achieve future growth and development.

One of the greatest threats in late 2010 to both developed and developing economies alike was the growing global trade and balance of payments imbalances. The causes of these imbalances were disputed amongst the world's major economies and trading nations. The consequences, too, were not clear. The International Monetary Fund (IMF), however, was concerned that there were signs that one possible consequence, currency wars, was already raising a spectre over the global economy.

© OCR 2012

STEMUP.CO.UK

Pre-release stimulus material

Extract 1: UK investment and public finances

Extract 2: The UK budget deficit reduction plan

Extract 3: UK Official Development Assistance

Extract 4: The future of economic growth and development in India

Extract 5: Imbalances in the global economy

© OCR 2012

STEMUP.CO.UK

Extract 1

UK investment and public finances

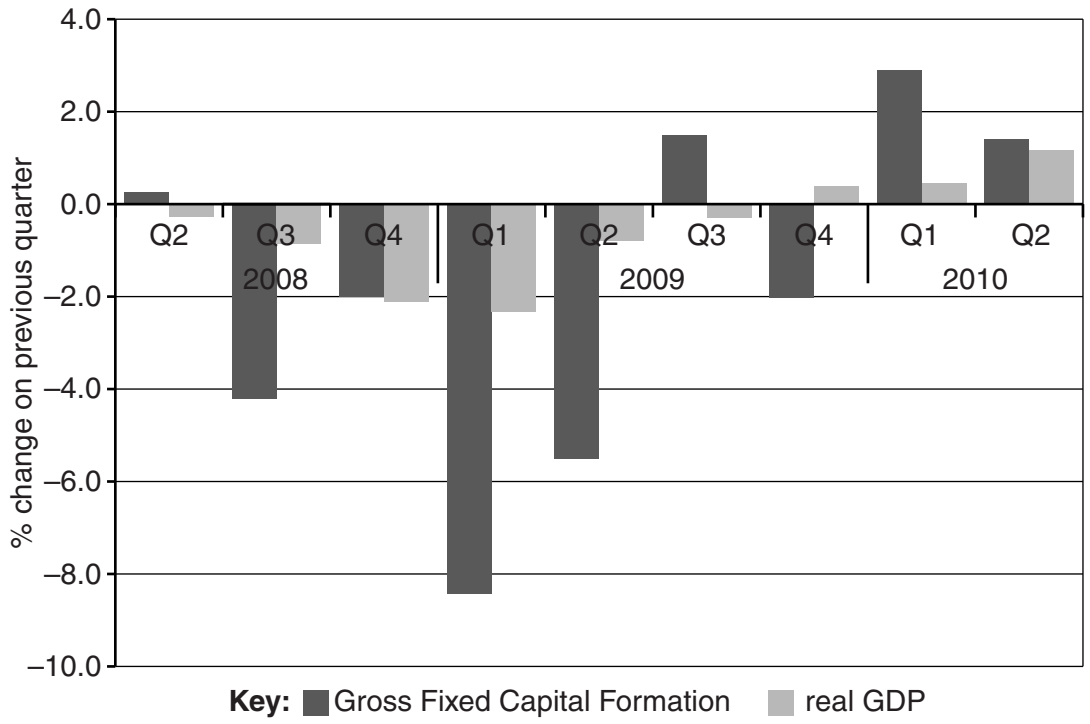
The financial crisis beginning in 2007 and the subsequent recession had a huge impact on both the level of UK investment and the UK's public finances.

Surveys of business confidence, such as that by the Confederation of British Industry (CBI), showed that business confidence collapsed at the start of the recession in the second quarter of 2008. The CBI Industrial Trends Survey asks manufacturing firms a number of questions about current trends and their expectations for the future, including whether their order books have increased, how optimistic they are and what their expectations are for future output.

Unsurprisingly, in this economic climate, investment fell dramatically in the UK. Total investment (Gross Fixed Capital Formation, GFCF) fell by 18.7% in 2009 Quarter 2 compared with a year earlier. Fig. 1.1 shows the relationship between changes in real GDP and GFCF on a **quarterly** basis.

The impact of the recession on the UK's public sector finances was no less severe, as automatic stabilisers raised government expenditure and reduced tax receipts (see Fig. 1.2). A return to growth would normally have been expected to reduce the cyclical budget deficit. It was, however, commonly believed in 2010 that the UK could not rely on economic growth to reduce the amount of public sector borrowing resulting from the government's budget deficit. The Treasury estimated that as much as two thirds of the UK's deficit was 'structural'. The UK's net public sector debt had breached the previous government's sustainable investment rule, with the result that the UK government was spending £44 billion on debt interest in 2010 (see Fig. 1.3). Hence, the view amongst many economists was that to tackle the deficit and reduce public sector borrowing required a combination of discretionary cuts in government expenditure and increases in taxation.

Fig. 1.1 UK Real GDP and Gross Fixed Capital Formation (GFCF) 2008 Q2–2010 Q2 (% change on previous quarter)



© OCR 2012

STEMUP.CO.UK

Fig. 1.2 UK public sector net borrowing 2002–03 to 2009–10 (£bn)

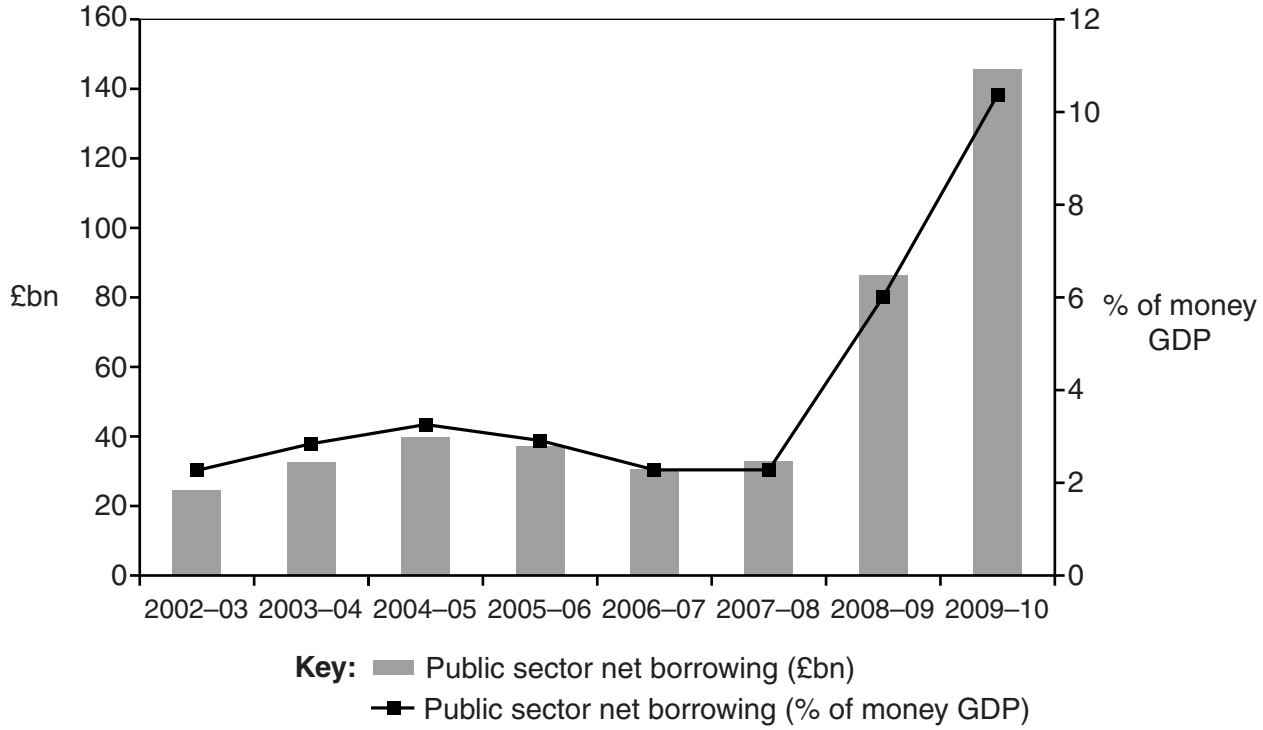
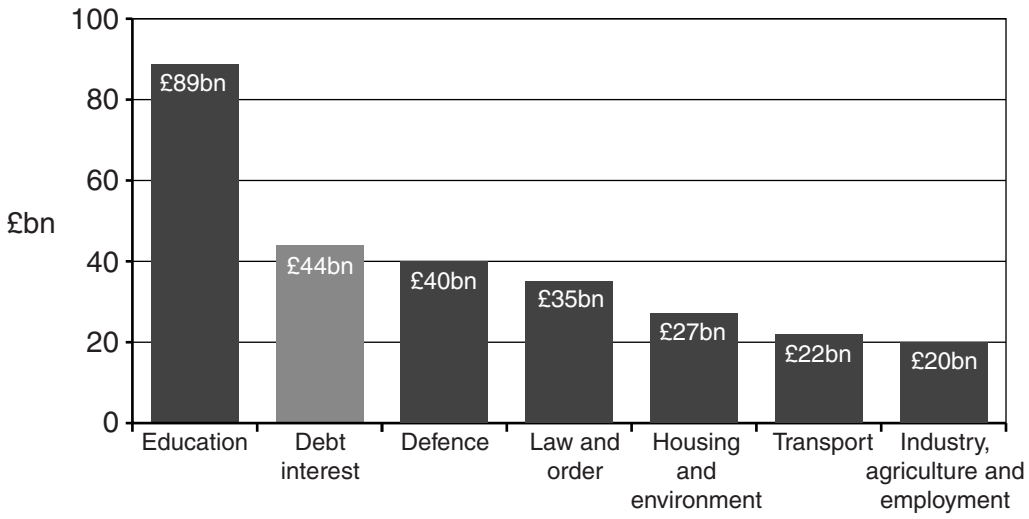


Fig. 1.3 UK government expenditure 2009–10 (£bn)



STEMUP.CO.UK

Extract 2

The UK budget deficit reduction plan

In response to the growing size of the UK budget deficit and rising public sector borrowing, the Coalition Government announced its intention to cut government spending. Its spending plans were announced by the Chancellor of the Exchequer, George Osborne, on 20 October 2010. In total, spending cuts of £81 billion were announced which would take effect over the period 2010–11 to 2014–15.

In his statement to the House of Commons, the Chancellor laid out the need to reduce the budget deficit (see Fig. 2.1). He claimed support from the IMF, the Governor of the Bank of England and business leaders for his deficit reduction plan.

Support for the deficit reduction plan, however, was not universal amongst economists and commentators. Some feared that the nature of the UK's economic recovery was too fragile and that reductions in government expenditure would risk a double-dip recession. Others questioned whether the emphasis on reductions in government expenditure was appropriate because of the national income multiplier. Some commentators suggested that cuts in government expenditure should be balanced by cuts in taxation financed by a higher budget deficit and they viewed the IMF's praise for austerity as 'foolish' (see Fig. 2.2).

There were grounds for optimism in the CBI's Quarterly Industrial Trends Survey of 19 October 2010 but the resilience of the economic recovery to the impact of the deficit reduction plan was not assured. The Office for National Statistics, however, announced that GDP growth in the third quarter of 2010 was provisionally 0.8%, rather than the anticipated 0.4%. This was a welcome sign of a stronger than expected recovery, despite growth being lower than the 1.2% recorded in the second quarter of 2010.

Fig. 2.1 Extracts from George Osborne's statement to the House of Commons, 20 October 2010

We have, at £109 billion, the largest structural budget deficit in Europe. This is at a time when the whole world is concerned about high deficits and our economic stability depends on allaying these concerns. We are paying, at a rate of £120 million a day, £44 billion a year in debt interest.

Last year the IMF warned this country to accelerate the reduction in the deficit and the Organisation for Economic Cooperation and Development (OECD), the Governor of the Bank of England and the CBI all agreed with them.

The emergency Budget in June was the moment when our fiscal credibility was restored. Our market interest rates fell to near record lows. Our country's credit rating was affirmed. The IMF went from issuing warnings to calling our Budget 'essential'.

I can confirm that the spending plans I set out today will achieve a balanced structural current budget and falling national debt by 2014–15.

To back down now and abandon our plans would be the road to economic ruin.

© OCR 2012

STEMUP.CO.UK

Fig. 2.2 The views of Martin Wolf, Financial Times columnist, 30 September 2010

Adam Posen, a member of the Bank of England's Monetary Policy Committee (MPC), argues: first, that the UK economy now has large excess capacity; second, the big danger is not a resurgence of inflation, but deflation, as happened in Japan; and, third, there is a substantial risk that prolonged weak demand will make temporary losses in output structural and permanent, via weak investment and long-term unemployment. He stated that: "The damage to our economy, our companies and our workforce can be made permanent through inaction by policymakers."

So what is to be done? Since Mr Posen is a member of the MPC he has to focus on monetary policy measures such as quantitative easing. The most effective policy, however, would be for the government to increase its deficit and have this rise funded by the Bank of England. If one accepts Mr Posen's argument that the economy is likely to suffer from deficient demand in the medium term, a simple option would be to proceed with the spending cuts, but slash taxes temporarily and fund the revenue shortfall by borrowing from the central bank. This would give a direct injection of purchasing power into the economy, promoting employment.

© OCR 2012

STEMUP.CO.UK

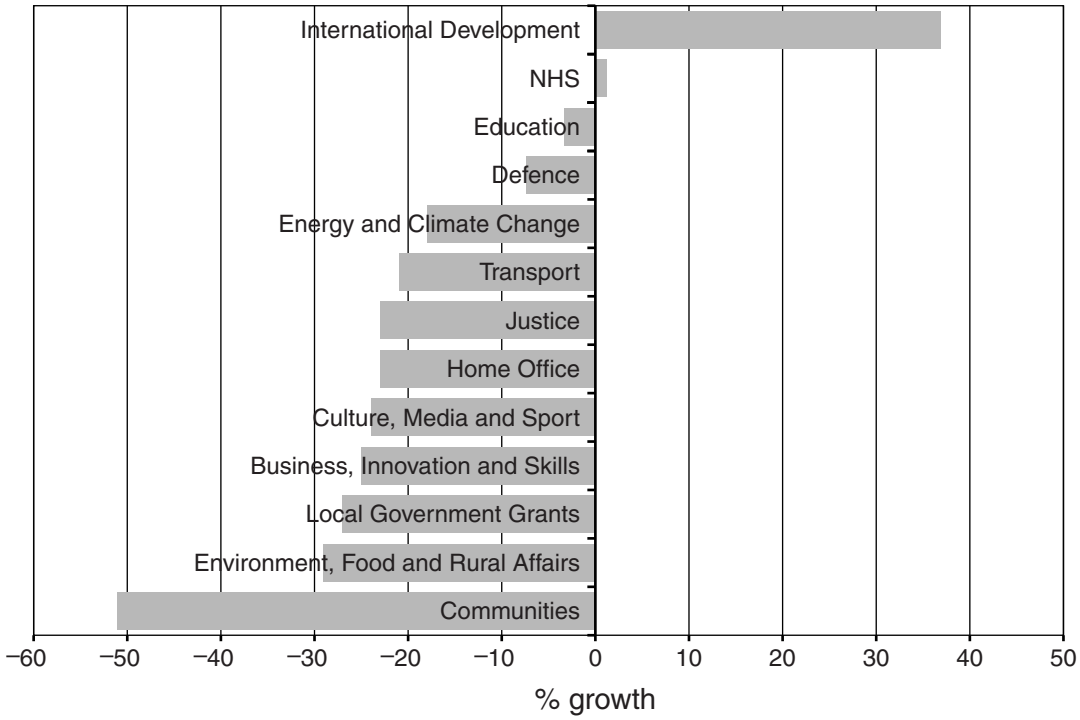
Extract 3

UK Official Development Assistance

Official Development Assistance (ODA) comes in many different forms and represents one of the many financial flows received by developing economies. It can help them overcome some of the constraints on their development.

The UK Comprehensive Spending Review did not involve cuts in spending for all government departments (see Fig. 3.1). Notably, expenditure on international development was planned to increase in real terms from 2010–11 to 2014–15. The Coalition Government sought to increase expenditure on international development in order to meet its commitment to increase UK ODA to 0.7% of GDP by 2013.

Fig. 3.1 Planned real growth in spending by government department 2010–11 to 2014–15



The Department for International Development (DfID) stated that it would use additional expenditure to change the way in which it delivers aid, redirecting funds to projects to combat poverty in developing economies and focus aid where it is needed most. It announced that aid to China and Russia would cease, focusing its efforts on:

- meeting UK commitments to the Millennium Development Goals
- making UK development policy more effective in promoting economic growth in developing economies
- supporting low carbon growth in developing economies
- helping fragile states and countries affected by conflict, particularly Afghanistan and Pakistan.

However, there were no plans to reduce aid to India, the recipient of the largest amount of UK ODA (see Fig. 3.2). UK aid to India has traditionally gone to health and education, climate change and to small industries in Madhya Pradesh, Orissa and Bihar.

© OCR 2012

STEMUP.CO.UK

Fig. 3.2 Top recipients of UK ODA (2007)

Country	UK ODA (US$m) 2007	GDP per capita (PPP US$) 2007	HDI 2007
India	700	2,753	0.612
Afghanistan	296	1,054	0.352
Nigeria	275	1,969	0.511
Ethiopia	273	779	0.414
Bangladesh	249	1,241	0.543
Tanzania	243	1,208	0.530
Pakistan	229	2,496	0.572
Sudan	203	2,086	0.531
China	201	5,383	0.772

© OCR 2012

STEMUP.CO.UK

Extract 4

The future of economic growth and development in India

India's GDP per capita may not be as high as China's but its growth rate (currently 8.5% per annum) is predicted to exceed China's by 2013. The reasons for this are to be found in India's supply side advantages. Unlike China, India's workforce is rapidly growing, with the result that it has one of the lowest dependency ratios in the world. By 2020 India's workforce is expected to have increased by 136 million, whereas that in China will have grown by only 23 million. In addition adult literacy rates in 2010, although lower (at 66%) than China's (93%), were rising fast.

The second reason why India's economic growth is likely to outstrip that of China is that there is less state direction of economic activity in India. Since 1991 India has adopted many of the policy prescriptions of the Washington Consensus, including fiscal discipline, wide-scale market liberalisation and privatisation, and trade liberalisation and the encouragement of foreign investment. India has dramatically reduced import tariffs and become more open to international trade. There has been a big surge in exports since India adopted these market-friendly reforms in 1991 with firms such as Arcelor Mittal (the world's largest manufacturer of steel), Tata Motors (owners of Jaguar and Land Rover), Bharti Airtel (a mobile telecommunications firm achieving rapid growth in Africa) and IT services companies such as Infosys, TCS and WIPRO challenging established western multinational companies. Firms supplying the domestic Indian market have responded to international competition by being more innovative. Soon to hit the Indian market is a US$35 laptop developed in partnership with the Indian Institute of Technology and the Indian Institute of Science. Multinational companies, such as Korea's LG, have been attracted by the growing domestic market and have located production in India.

Despite optimism for India's prospects for economic growth and development, there are a number of obstacles which may yet see growth falter and development fail to materialise. These include:

- poor infrastructure – transport infrastructure is notoriously bad; energy supplies are unreliable; and Indian cities are unable to cope with a growing population
- skill shortages – despite growing rates of literacy, a large percentage of the workforce (some estimate up to 40%) remain illiterate; unskilled surplus labour in agriculture coexists with significant shortages of engineers, other graduates and vocationally trained workers
- high rates of malnutrition amongst the under fives – some estimate this to be as high as 50%
- social and political instability – tensions with farmers and local residents created by the expansion of industry, the activities of multinational mining and logging companies and the building of transport infrastructure tend to erupt into violence; and there is little harmonisation between the policies of individual Indian states
- problems in making the best of India's comparative advantage – in particular, foreign companies are less inclined to outsource their activities to India at a time of recession; and other economies have rivalled India's comparative advantage in outsourcing.

China's state-directed economic growth may yet be challenged by the likes of India, but neither economic growth nor development is guaranteed in India.

© OCR 2012

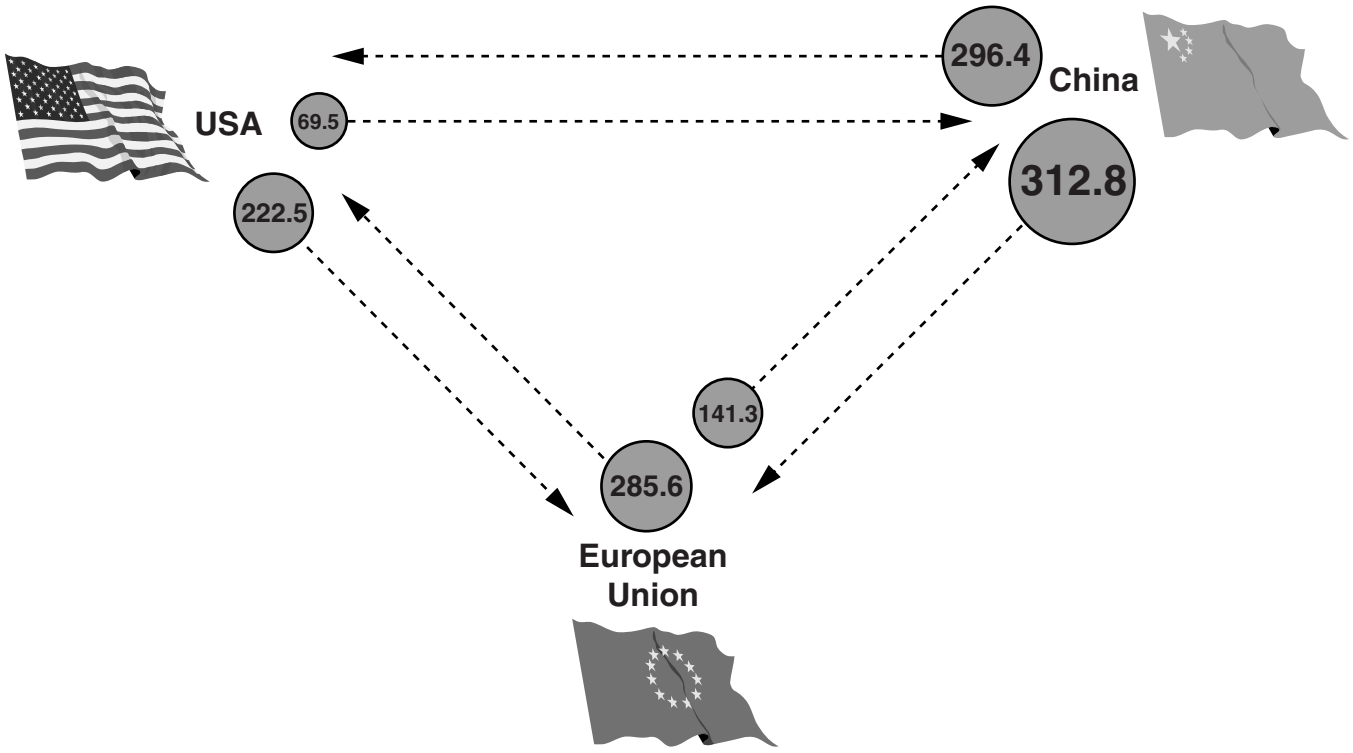
STEMUP.CO.UK

Extract 5

Imbalances in the global economy

In addition to high rates of economic growth, one of the features of the Chinese economy over recent years has been its current account surplus with the rest of the world. At the same time the US economy was running large current account deficits year on year. The extent of these imbalances in trade flows can be seen in Fig. 5.1 below. Despite these imbalances on the balance of payments, the exchange rate of the US dollar remained strong and there has not been as much appreciation of the Chinese renminbi (yuan) as might have been predicted by economic theory.

Fig. 5.1 Flows of international trade (US$ billion) 2009



The gross domestic products and the foreign currency reserves of the USA, China and the EU are shown in Fig. 5.2 and Fig. 5.3.

Fig. 5.2 Gross domestic product
in US$ billion (2009)

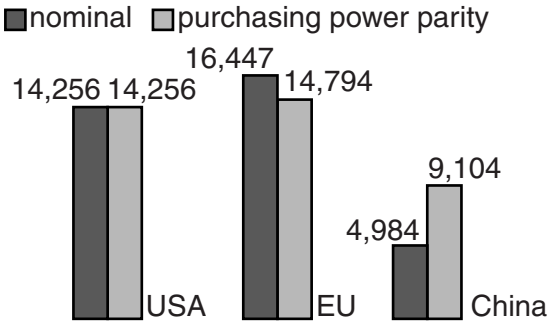
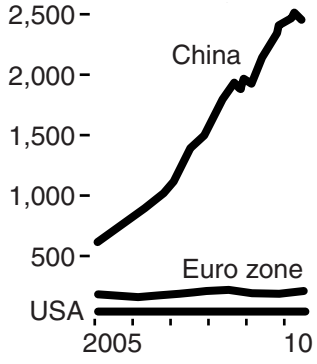


Fig. 5.3 Foreign currency reserves
in US$ billion



STEMUP.CO.UK

The trade imbalances between the US and China are only part of a bigger global picture of imbalances between rich, developed nations and the so-called emerging economies. The world has become divided into 'deficit countries' and 'surplus countries'. Such imbalances were at the heart of fears of a global 'currency war' in 2010. In advance of the annual meeting of the IMF and World Bank in October 2010, Brazil's Finance Minister announced that an 'international currency war' had broken out. Subsequently, there was much debate about which countries' economic policies were most responsible for endangering global economic growth and stability.

The US government accused the Chinese government of deliberately under-valuing its currency by buying foreign currencies, including the US dollar, on the foreign exchange markets. China intervened in the foreign exchange markets by as much as US$1 billion a day from 2005–2010, building up reserves of US$2.5 trillion. According to the US government, the renminbi was undervalued by as much as 20% relative to the economic fundamentals which should determine its exchange rate – China had effectively been subsidising its exports at the cost of US jobs. In 2010, the US House of Representatives passed into law a bill which paved the way for trade sanctions against countries which have 'a fundamentally undervalued currency', 'persistent global current account surpluses' and very large currency reserves. It was clear that this bill was targeted at China and escalated fears of a trade war between China and the USA.

Emerging economies, on the other hand, argued that in the past the US and other rich developed economies had run large current account deficits by effectively 'living beyond their means'. High domestic consumption and low savings had created a demand for imports from emerging markets and this was the root cause of global trade and balance of payments imbalances. To resolve these imbalances, emerging economies felt that the USA and other developed nations needed to increase their savings – in other words, reduce their dependence on consumption. Emerging economies feared that loose monetary policy, including quantitative easing in the USA in particular, would cause a depreciation of the US dollar damaging the international competitiveness of emerging economies.

Economists feared that, whatever the causes, these global trade and balance of payments imbalances might endanger the stability of the global economy.

OCR
RECOGNISING ACHIEVEMENT

Copyright Information

OCR is committed to seeking permission to reproduce all third-party content that it uses in its assessment materials. OCR has attempted to identify and contact all copyright holders whose work is used in this paper. To avoid the issue of disclosure of answer-related information to candidates, all copyright acknowledgements are reproduced in the OCR Copyright Acknowledgements Booklet. This is produced for each series of examinations and is freely available to download from our public website (www.ocr.org.uk) after the live examination series.

If OCR has unwittingly failed to correctly acknowledge or clear any third-party content in this assessment material, OCR will be happy to correct its mistake at the earliest possible opportunity.

For queries or further information please contact the Copyright Team, First Floor, 9 Hills Road, Cambridge CB2 1GE.

OCR is part of the Cambridge Assessment Group; Cambridge Assessment is the brand name of University of Cambridge Local Examinations Syndicate (UCLES), which is itself a department of the University of Cambridge.

© OCR 2012

STEMUP.CO.UK

OCR
RECOGNISING ACHIEVEMENT

Tuesday 31 January 2012 – Morning

A2 GCE ECONOMICS

F585/01 The Global Economy

Candidates answer on the Question Paper.

OCR supplied materials:
- Clean copy Stimulus Material

Other materials required:
- Calculators may be used

Duration: 2 hours

F5300501121

F 5 8 5 0 1

Candidate forename		Candidate surname	

Centre number						Candidate number				

INSTRUCTIONS TO CANDIDATES

- Refer to the Stimulus Material in a separate booklet. You must **not** bring your original copy into the examination.
- Write your name, centre number and candidate number in the boxes above. Please write clearly and in capital letters.
- Use black ink. HB pencil may be used for graphs and diagrams only.
- Read each question carefully. Make sure you know what you have to do before starting your answer.
- Write your answer to each question in the space provided. If additional space is required, you should use the lined pages at the end of this booklet. The question number(s) must be clearly shown.
- Answer **all** the questions.
- Do **not** write in the bar codes.

INFORMATION FOR CANDIDATES

- The number of marks is given in brackets **[ ]** at the end of each question or part question.
- The total number of marks for this paper is **60**.
- This document consists of **16** pages. Any blank pages are indicated.
- You will be assessed on the quality of your written communication in question 3. All answers should be in continuous prose.

A calculator may be used for this paper

© OCR 2012 [T/500/7921]
DC (SM) 46062/1

OCR is an exempt Charity

STEMUP.CO.UK

Answer **all** questions.

1 **(a)** Define what is meant by the:

(i) 'national income multiplier';

.....

.....

.....

..... **[2]**

(ii) 'accelerator'.

.....

.....

.....

..... **[2]**

© OCR 2012

STEMUP.CO.UK

(b) With reference to Fig. 1.1, analyse how the interaction of the national income multiplier and the accelerator might, in part, explain the severity and length of the UK recession 2008 Q2 to 2009 Q3.

.... **[6]**

© OCR 2012

STEMUP.CO.UK

(c) Comment on the possible consequences for UK economic growth of the Coalition Government's deficit reduction plan.

© OCR 2012

STEMUP.CO.UK

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

..... **[10]**

© OCR 2012

STEMUP.CO.UK

2 **(a)** "The Department for International Development (DfID) stated that it would use additional expenditure to … focus aid where it is needed most." (Extract 3)

With reference to Fig. 3.2, state and explain **two** ways in which UK ODA was **not** focused on where it was needed most in 2007.

1. .....

.....

.....

.....

.....

.....

.....

.....

2. .....

.....

.....

.....

.....

.....

.....

..... **[4]**

© OCR 2012

STEMUP.CO.UK

(b) Analyse **two** reasons why economic growth, such as that experienced by China and India, may not raise the level of development.

.... **[6]**

© OCR 2012

STEMUP.CO.UK

(c) Comment on the extent to which market-friendly reforms, such as those adopted by India in 1991, help to promote development.

© OCR 2012

STEMUP.CO.UK

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

..... **[10]**

© OCR 2012

STEMUP.CO.UK

3 Discuss the extent to which global trade and balance of payments imbalances, such as those mentioned in Extract 5, are a threat to global economic stability.

© OCR 2012

STEMUP.CO.UK

© OCR 2012

STEMUP.CO.UK

© OCR 2012

[20]

© OCR 2012

STEMUP.CO.UK

Additional pages. When using this space please make sure your answers are numbered carefully.

© OCR 2012

© OCR 2012

PLEASE DO NOT WRITE ON THIS PAGE

OCR
RECOGNISING ACHIEVEMENT

Copyright Information

OCR is committed to seeking permission to reproduce all third-party content that it uses in its assessment materials. OCR has attempted to identify and contact all copyright holders whose work is used in this paper. To avoid the issue of disclosure of answer-related information to candidates, all copyright acknowledgements are reproduced in the OCR Copyright Acknowledgements Booklet. This is produced for each series of examinations and is freely available to download from our public website (www.ocr.org.uk) after the live examination series.

If OCR has unwittingly failed to correctly acknowledge or clear any third-party content in this assessment material, OCR will be happy to correct its mistake at the earliest possible opportunity.

For queries or further information please contact the Copyright Team, First Floor, 9 Hills Road, Cambridge CB2 1GE.

OCR is part of the Cambridge Assessment Group; Cambridge Assessment is the brand name of University of Cambridge Local Examinations Syndicate (UCLES), which is itself a department of the University of Cambridge.

© OCR 2012

OCR
RECOGNISING ACHIEVEMENT

GCE

Economics

Advanced GCE

Unit **F585:** The Global Economy

Mark Scheme for January 2012

Oxford Cambridge and RSA Examinations

STEMUP.CO.UK

OCR (Oxford Cambridge and RSA) is a leading UK awarding body, providing a wide range of qualifications to meet the needs of candidates of all ages and abilities. OCR qualifications include AS/A Levels, Diplomas, GCSEs, OCR Nationals, Functional Skills, Key Skills, Entry Level qualifications, NVQs and vocational qualifications in areas such as IT, business, languages, teaching/training, administration and secretarial skills.

It is also responsible for developing new specifications to meet national requirements and the needs of students and teachers. OCR is a not-for-profit organisation; any surplus made is invested back into the establishment to help towards the development of qualifications and support, which keep pace with the changing needs of today's society.

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

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

Mark schemes should be read in conjunction with the published question papers and the report on the examination.

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

© OCR 2012

Any enquiries about publications should be addressed to:

OCR Publications
PO Box 5050
Annesley
NOTTINGHAM
NG15 0DL

Telephone: 0870 770 6622
Facsimile: 01223 552610
E-mail: publications@ocr.org.uk

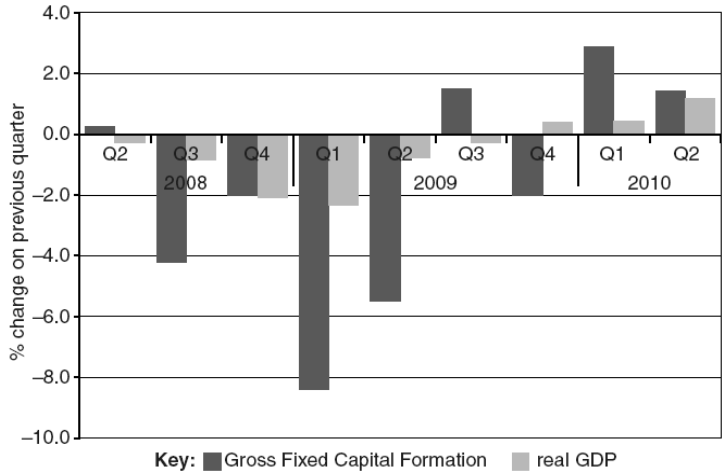
Annotations

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

STEMUP.CO.UK

Question			Answer	Mark	Guidance
1	(a)	(i)	The process by which any change (increase and/or decrease) in a component of aggregate demand / injections / withdrawals (1) results in a **greater** final change (increase and/or decrease) in real GDP / GDP / national income	2	Two marks for an acceptable definition (must include the idea of a greater final change in GDP) One mark for some vague understanding eg: • ΔY/ΔJ (1) • change in injections leads to change in national income (1) Acceptable formulae include: • 1/(mps + mpt + mpm), 1/(1 – mpc), 1/mps. 1/mpw (2) A rare but acceptable response for two marks is: • "a change in the level of GDP causes a greater final change in GDP" No marks for "it is the multiplier effect" without further elaboration of what this is. Annotate marks awarded with ✓
		(ii)	The accelerator theory that states that the level of investment (1) depends on the rate of change of national income (1).	2	Two marks for an acceptable definition of the term. One mark for a general vague understanding ie change in national income/AD/C but **not** RATE of change. Annotate marks awarded with ✓

STEMUP.CO.UK

Question	Answer	Mark	Guidance
(b)	**Explanation of recession** • investment falls **because** there is a slowdown in the rate of economic growth in 2007/08 (the accelerator effect) • the fall in investment reduces AD and **causes** a greater fall in GDP over time (the multiplier effect) • the fall in GDP leads to a further and larger fall in investment (accelerator effect) **Severity and length of recession** • the interaction of the multiplier and accelerator may be one part of the explanation for a severe recession **because of the large changes in investment** brought about • prolonged nature of the recession may reflect the fact that investment responds with a time lag to the recovery phase of rising GDP **because of** low levels of business confidence and that investment is a small component of AD so that large changes in investment alone would be needed to raise GDP The last two bullet points indicate the type of content which addresses the issues of severity and length of recession.	6	Marks should be awarded as follows: Up to two marks for valid application of the data in Fig. 1.1 Indicate application marks with ✓ Up to four marks for an analytical explanation of the interaction of the accelerator and multiplier Indicate explanation and analysis marks with ✓+ *Max of two marks where there is no reference to rate of change of GDP (accelerator) or greater fall in GDP (multiplier)* *Max of three marks where there is reference to multiplier or accelerator effects only* Up to two marks for an analytical explanation of the length and severity of the UK recession Max of four marks where there is no use of the data 

STEMUP.CO.UK

Question			Answer	Marks	Guidance	
					Content	Levels of response
	(c)		**Consequences for growth could be bad:** • reduction in G reduces AD and, therefore, SR economic growth • possibility of negative economic growth in the SR • increase in T may reduce disposable incomes and, therefore, C • continued slow growth / double dip due to reduction in AD **Consequences for growth could be good:** • reduced crowding out of the private sector leads to increase in business confidence increasing I • reduced risk of UK government defaulting on debt, reduces risk premium in capital markets therefore long term interest rates reduced/remain low stimulating business investment in the LR • private sector investment generates employment which compensates for job losses in the public sector • reduced debt interest allows public sector investment to increase in the LR • improves supply side of the economy and paves the way for return to economic growth in the long run	10	**Level 4** Responses should be underpinned by the use of AD/AS analysis. Valid commentary includes: • deficit reduction plan is designed to increase economic growth in the LR but may reduce it in the SR • consequences of deficit reduction plan depends on other factors (Plan A+, time period ...) • hysteresis effect may result in negative consequences in both SR and LR In Level 4 award marks as follows: • one <u>stated</u> point of evaluation = seven marks • two or more <u>stated</u> points of evaluation = eight marks • <u>developed</u> evaluation of one or more points MUST be awarded nine or ten marks Annotate developed commentary with  **Level 3** Responses should be underpinned by the use of AD/AS analysis. **Level 2** Likely to paraphrase Extract material and not make the link to AD/AS analysis.	**Level 4** **[7 – 10]** For a commentary on the possible consequences for UK economic growth of the deficit reduction plan Annotate using  in LHS margin **Level 3** **[4 – 6]** For a one-sided analysis of the possible consequences for UK economic growth of the deficit reduction plan. Annotate using  in LHS margin **Level 2** **[2 – 3]** For an application of knowledge and understanding of the possible consequences for UK economic growth of the deficit reduction plan Annotate using  in LHS margin **Level 1** **[1]** For knowledge and understanding of the deficit reduction plan only Annotate using  in LHS margin

STEMUP.CO.UK

<table>
<tr><th colspan="3">Question</th><th>Answer</th><th>Mark</th><th>Guidance</th></tr>
<tr><td>2</td><td>(a)</td><td></td><td>Some countries are allocated too much ODA (1) for example India which gets most aid yet has 2nd highest ranking in terms of GDP per capita and HDI (1)

Some countries are allocated too little ODA (1) such as Ethiopia, Tanzania and Sudan which are ranked lower in terms of ODA received than their need in terms of GDP per capita and/or HDI rankings (1)</td><td>4</td><td>One mark for the idea that some countries get more ODA than GDP per capita and/or HDI rankings would suggest they should.
One mark for use of Fig. 3.2 to support this idea.

One mark for the idea that some countries get less ODA than GDP per capita and/or HDI rankings would suggest they should.
One mark for use of Fig. 3.2 to support this idea.

<table>
<tr><th></th><th>ODA (US$m) 2007</th><th>GDP per capita (PPP US$) 2007</th><th>HDI 2007</th></tr>
<tr><td>India</td><td>700 [1]</td><td>2,753 [2]</td><td>0.612 [2]</td></tr>
<tr><td>Afghanistan</td><td>296 [2]</td><td>1,054 [8]</td><td>0.352 [9]</td></tr>
<tr><td>Nigeria</td><td>275 [3]</td><td>1,969 [5]</td><td>0.511 [7]</td></tr>
<tr><td>Ethiopia</td><td>273 [4]</td><td>779 [9]</td><td>0.414 [8]</td></tr>
<tr><td>Bangladesh</td><td>249 [5]</td><td>1,241 [6]</td><td>0.543 [4]</td></tr>
<tr><td>Tanzania</td><td>243 [6]</td><td>1,208 [7]</td><td>0.530 [6]</td></tr>
<tr><td>Pakistan</td><td>229 [7]</td><td>2,496 [3]</td><td>0.572 [3]</td></tr>
<tr><td>Sudan</td><td>203 [8]</td><td>2,086 [4]</td><td>0.531 [5]</td></tr>
<tr><td>China</td><td>201 [9]</td><td>5,383 [1]</td><td>0.772 [1]</td></tr>
</table>

<u>Do not credit responses which say that China does not need much aid because its GDP per capita and HDI are higher than others – this is true but IS reflected in the allocation of ODA – unless there is direct comparison with another country such as Sudan.</u>

Indicate marks awarded with ✓</td></tr>
</table>

STEMUP.CO.UK

Question			Answer	Mark	Guidance
	(b)		Possible reasons include: • unequal distribution of income (1): economic growth will raise total incomes but the additional income may be unequally distributed so that some people may see little or no increase in their individual incomes (1) with the result that affluence and poverty could coexist (1) • natural resource depletion (1): economic growth could lead to the depletion of natural resources reducing the stock of environmental capital available for future generations (1) making future generations worse off and making growth unsustainable (1) • capital intensive production (1); economic growth may be achieved through capital intensive production which provides few additional jobs (1) such that GDP rises with little impact on disposable income and, hence, well-being and quality of life (1)	6	The principle in marking this part of the question should be to award: One mark for each valid reason why economic growth may not raise the level of development Up to two marks for the reasoning offered (one mark if this is descriptive application of knowledge and understanding, two marks if this is analytical). Indicate each valid reason with  in LHS margin Indicate explanation marks with  in LHS margin Where a candidate gives no valid reasons or only identifies one valid reason with no development but shows knowledge and understanding of economic growth and/or development award up to two marks and annotate with 

STEMUP.CO.UK

Question			Answer	Marks	Guidance	
					Content	**Levels of response**
	(c)		**Commentary** on **the extent to which** market-friendly reforms may promote development might include: • impact of ending price controls and subsidies might be to increase food prices leading to higher malnutrition • declining terms of trade in primary products if trade liberalisation results in a dash for cash crops • fiscal discipline may involve cuts in health and education spending worsening human development • the real problem may be market failure which requires public sector investment in infrastructure • also a lack of domestic savings constrains investment • a lack of entrepreneurial culture and missing markets • may not be as effective as other ways of promoting development, such as international aid	10	**Level 4** Responses will normally analyse how market friendly reforms may promote development and why they might not. An alternative Level 4 response is one which considers what might determine the success of market friendly reforms in promoting development. In Level 4 award marks as follows: • one stated point of evaluation = seven marks • two or more stated points of evaluation = eight marks • developed evaluation of one or more points MUST be awarded nine or ten marks	**Level 4** **[7 – 10]** For a commentary on the role of market-friendly reforms, such as those adopted by India in 1991, in promoting development. Annotate using  in LHS margin In Level 4 award marks as follows: • one stated point of evaluation = seven marks • two or more stated points of evaluation = eight marks • developed evaluation of one or more points MUST be awarded nine or ten marks Annotate developed commentary with 

STEMUP.CO.UK

Question			Answer	Marks	Guidance	
					Content	Levels of response
			Analysis of how market friendly reforms may promote development might include: • creating macroeconomic stability and low inflation, through fiscal discipline, which may create conditions favourable to private sector investment raising the long rate of economic growth • market liberalisation and privatisation would reduce government failure, improve productivity and allocative efficiencies and allow the profit motive to act as an incentive for private sector investment, including FDI, with the result that the long term rate of economic growth is increased • trade liberalisation exposes domestic firms to international competition and allows developing economies to earn export revenue, creating further allocative and dynamic efficiencies and higher investment • by increasing economic growth, market friendly reform should raise the level of GDP which should raise living standards for all through 'trickle down'		**Level 3** Responses are characterised by an analytical explanation of HOW market friendly reforms promote development Award six marks for developed analysis of one or more reform measures. Award five marks for weak analysis of two or more reform measures OR for reasonable analysis of one reform measure. Award four marks for weak analysis of any one reform measure. **Level 2** Responses are characterised by valid but generalised statements which are not underpinned by economic terms, concepts or theories (ie there is no attempt to establish CAUSE and EFFECT), eg market friendly reforms will raise the rate of economic growth but might cause poverty. **Level 1** Nothing of relevance other than knowledge of reform measures or of economic development, eg one market friendly reform would be to liberalise markets and privatise state-owned industries.	**Level 3** **[4 – 6]** For an analysis of the role of market-friendly reforms, such as those adopted by India in 1991, in promoting development. Annotate using L3 in LHS margin **Level 2** **[2 – 3]** For an application of knowledge and understanding of market-friendly reforms but lacking economic analysis of how they might promote development. Annotate using L2 in LHS margin **Level 1** **[1]** For knowledge and understanding of examples of market-friendly reforms or development only. Annotate using L1 in LHS margin

STEMUP.CO.UK

Question			Answer	Marks	Guidance	
					Content	Levels of response
3			Valid **judgement** might include: • threat to global stability is intensified by current global economic problems, including slowdown in world growth, eurozone crisis etc • threat to global economic stability is long term since there are other short term threats such as eurozone crisis • global imbalances are not the most important threat to global economic stability • extent of the threat depends on international policy co-ordination Valid **discussion** includes ways in which threat to global economic stability can be reduced / minimised: • WTO may act to restrict protectionism • economic growth in countries with current account surpluses may cause appreciation of their real exchange rate • exchange rates could be realigned either by government intervention or by greater reliance on freely floating exchange rates • threat to global stability can be reduced by rebalancing savings and investment globally	20	**Level 4 Band 3** *Judgements should be based on well developed analytical discussion*. Stated judgements = 18 marks One or more developed judgements MUST be awarded 19 or 20 marks Responses which discuss whether global trade threatens global stability and whether BoP imbalances threaten global stability can access ALL marks in the mark scheme. **Level 4 Band 2** *The discussion should be based on strong supporting analysis.* **Level 4 Band 1** *Responses in this Band will give reason(s) why trade and BoP imbalances might threaten global economic stability and reason(s) why they might not. There will be weak supporting analysis and little context beyond naming of countries (eg China and US)*	**Level 4 Band 3** **[18 – 20]** For a judgement on the extent to which global trade and balance of payments imbalances are a threat to global economic stability with appropriate analysis and context. Annotate using EE in LHS margin **Level 4 Band 2** **[15 – 17]** For a balanced discussion of the consequences of global trade and balance of payments imbalances and the threats posed to global economic stability, with appropriate context. Annotate using ✓+ in LHS margin **Level 4 Band 1** **[11 – 14]** For a unbalanced discussion of the threat to global economic stability created by a global trade and balance of payments imbalances, with undeveloped analytical support and context. Annotate using 14 in LHS margin

STEMUP.CO.UK

Question			Answer	Marks	Guidance	
					Content	Levels of response
			Analysis of the threat to global stability: • trade wars – countries with trade and current account deficits are likely to engage in protectionism. This may lead to trade wars, lowering volume of world trade. Global 'consumption' is reduced, reducing global AD, growth and GDP • currency wars – countries with trade and current account deficits may devalue their currencies in order to raise X and lower M. If this leads to competitive devaluations world trade would be reduced which would reduce global AD and threaten stability of world growth. Exchange rate instability would itself reduce world trade and cross border investment • capital controls – there is likely to be an increase in global capital flows as a result of some countries running significant trade and current account surpluses. Some countries may impose capital controls to prevent their exchange rates rising, thereby limiting or reducing FDI • destabilising capital flows – capital outflows from countries with trade and current account surpluses runs the risk of creating unsustainable asset price bubbles / boom-bust		**Level 3** Responses which analyse the consequences for INDIVIDUAL ECONOMIES of trade and BoP imbalances should be awarded a maximum of eight marks. **Level 2** Responses in this Level will recognise that trade and currency wars are likely to result from global trade and BoP imbalances. However, there will be a **TOTAL** lack of economic analysis of the CONSEQUENCES for global economic stability but will. They are likely to simply paraphrase Extract 5. **Level 1** Economic stability at the global level is characterised by an avoidance of fluctuations in world economic growth, inflation, employment/unemployment and exchange rates. It is underpinned by consistent growth in world trade.	**Level 3** **[5 – 10]** For a one-sided analysis of the consequences of global trade and balance of payments imbalances for global economic stability. Annotate using  in LHS margin **Level 2** **[3 – 4]** For an application of knowledge and understanding of the consequences of global trade and balance of payments imbalances for global economic stability. Annotate using  in LHS margin **Level 1** **[1 – 2]** For knowledge and understanding of global trade and balance of payments imbalances and/or their CAUSES and/or global economic stability only. Annotate using  in LHS margin

STEMUP.CO.UK

APPENDIX 1

In question 3, the following applies for quality of written communication:

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

Level 3 responses
Responses characterised by explicit use of the **economists' toolkit of concepts and theories** and through **explanation of cause and consequence**
Relatively straightforward ideas have been expressed with some clarity and fluency. Arguments are generally relevant, though may stray from the point of the question. There will be some errors of spelling, punctuation and grammar, but these are unlikely to be intrusive or obscure meaning.

Level 2 responses
Responses in this level will show a TOTAL lack of economic analysis and are characterised by generalised statements.
There are likely to be some errors of spelling, punctuation and grammar of which some may be noticeable and intrusive.

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

STEMUP.CO.UK

OCR (Oxford Cambridge and RSA Examinations)
1 Hills Road
Cambridge
CB1 2EU

OCR Customer Contact Centre

Education and Learning
Telephone: 01223 553998
Facsimile: 01223 552627
Email: general.qualifications@ocr.org.uk

www.ocr.org.uk

For staff training purposes and as part of our quality assurance programme your call may be recorded or monitored

Oxford Cambridge and RSA Examinations
is a Company Limited by Guarantee
Registered in England
Registered Office; 1 Hills Road, Cambridge, CB1 2EU
Registered Company Number: 3484466
OCR is an exempt Charity

OCR (Oxford Cambridge and RSA Examinations)
Head office
Telephone: 01223 552552
Facsimile: 01223 552553

© OCR 2012

STEMUP.CO.UK

OCR
RECOGNISING ACHIEVEMENT

ADVANCED GCE

ECONOMICS

The Global Economy

F585/SM

STIMULUS MATERIAL

Thursday 23 June 2011
Afternoon

Duration: 2 hours

F530570611

INSTRUCTIONS TO CANDIDATES

- This is a clean copy of the Stimulus Material which you have already seen.
- You may **not** take your previous copy of the Stimulus Material into the examination.
- You may **not** take notes into the examination.

INFORMATION FOR CANDIDATES

- This document consists of **12** pages. Any blank pages are indicated.

INSTRUCTION TO EXAMS OFFICER / INVIGILATOR

- Do not send this Stimulus Material for marking; it should be retained in the centre or destroyed.

© OCR 2011 [T/500/7921]
DC (NF/DJ) 41953/1

OCR is an exempt Charity

STEMUP.CO.UK

Introduction

The euro area economies all experienced negative economic growth during 2008 – 2009 as the global economic crisis spread. However, the reduction in GDP was not uniform. Some euro area economies entered recession earlier than others, some experienced more severe recessions than others and not all economies had emerged from recession by the end of 2009. The lack of convergence of the economic cycles in the euro area raised questions about the viability of the monetary union which was just over 10 years old.

It was not just the lack of convergence of the economic cycles which raised concerns about the future of monetary union in the European Union (EU). A number of economies appeared to suffer from a lack of competitiveness both inside and outside the euro area. Portugal, Ireland, Italy, Greece and Spain (dubbed the PIIGS) had grown increasingly uncompetitive during their membership of the EU's monetary union. Without implementing measures to tackle this lack of competitiveness many thought that their continued membership of the euro area was unsustainable.

Of the PIIGS, Ireland, Spain and Greece had experienced rates of economic growth above the average of the euro area as a whole up to 2007. In part this was because their economies had attracted high levels of foreign direct investment (FDI). But it was increasingly apparent that much of this growth was short-term in nature, fuelled by negative real interest rates resulting from high inflation and a nominal interest rate set by the European Central Bank and not by their own central banks. In the absence of a freely floating exchange rate against their euro area partners, these economies faced tough decisions in order to improve their long run economic performance. In addition, the PIIGS were constrained in putting in place further fiscal stimulus packages as they faced the problem of high and rising budget deficits.

Whilst fiscal stimulus measures had had an impact on economic growth in the short term, the World Trade Organisation (WTO) called upon developed and developing economies to renew their efforts to further liberalise world trade. Pascal Lamy, the Director-General of the WTO, stated his belief that, in the long term, trade liberalisation was the key to promoting economic growth for developed and developing economies alike. Such a view is strongly supported by economic theory, yet trade liberalisation on its own is not a guarantee of human development and poverty reduction.

© OCR 2011

STEMUP.CO.UK

Pre-release stimulus material

Extract 1: **Recession in the euro area economies 2008 – 2009**

Extract 2: **Portugal, Italy, Ireland, Greece and Spain – the PIIGS**

Extract 3: **The future of the Spanish economy**

Extract 4: **International trade, international trade negotiations and developing economies**

STEMUP.CO.UK

Extract 1

Recession in the euro area economies 2008 – 2009

Since its launch in 1999, and the issue of notes and coins in 2002, the euro has established itself as a major international currency. Fears that the euro would be a 'soft' currency have not been realised. In fact, the euro is now the world's second largest reserve currency and the second most popular currency for international transactions. The euro area economy is the second largest in the world, based on comparisons of GDP at purchasing power parity.

The economies of the euro area were not immune from the effects of the global economic crisis of 2008 – 2009. Setting interest rates for the euro area as a whole is difficult when there is a lack of convergence in economic cycles. The European Central Bank (ECB) must make a judgement based on the performance of the euro area economy as a whole.

Fig. 1.1 shows the quarterly growth in real GDP for the euro area as a whole and for its individual economies, except Malta. Despite euro area GDP falling in the second quarter of 2008, only five of the 16 members had experienced negative economic growth. This number rose to nine by the third quarter of 2008 and to 13 by the fourth quarter of the same year. It was not until the first quarter of 2009 that all euro area economies were experiencing falling GDP. Similarly, the end of recession for the euro area economy as a whole came in the third quarter of 2009, yet three economies (Greece, Spain and Cyprus) remained in recession. They were joined by Italy in the fourth quarter as the country looked set to enter a double-dip recession. Not only was the timing and length of the recession different in the various national economies of the euro area, so too was the severity of the recession. Ireland, Luxembourg, Slovenia, Slovakia and Finland all experienced a reduction in GDP from peak to trough significantly above that of the average for the euro area economy as a whole. The fall in GDP in Greece, France and Cyprus was significantly below this average.

Some economists expressed concerns that the national economies of the euro area had not converged. Differences in their economic performance could be only partly explained by differences in the fiscal response to the downturn. Much more important was that economic performance appeared to be affected by differences in their openness to international trade, the structure of their economies and in their competitiveness. As it emerged from recession there were concerns that a 'two-speed' euro area was developing, seriously affecting the viability of the monetary union.

© OCR 2011

STEMUP.CO.UK

Fig. 1.1 Quarterly real GDP growth in the euro area 2008 – 2009

	2008				2009				
	Q1	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**% fall in GDP from peak to trough**
Ireland	–1.0	–2.0	0.2	–5.4	–2.1	–0.6	0.3	na	10.5
Slovenia	1.9	0.8	0.5	–4.0	–6.2	0.6	1.0	na	10.0
Finland	0.2	0.9	0.2	–4.1	–4.9	–0.3	0.3	na	9.1
Luxembourg	0.8	–1.6	–0.8	–3.1	–0.9	–2.7	4.2	na	8.8
Slovakia	–2.0	1.6	1.2	0.6	–8.1	1.2	1.6	2.0	8.1
Germany	1.6	–0.6	–0.3	–2.4	–3.5	0.4	0.7	0.0	6.7
Italy	0.5	–0.6	–0.8	–2.1	–2.7	–0.5	0.6	–0.2	6.5
Netherlands	1.0	0.0	–0.7	–1.2	–2.3	–1.1	0.5	0.3	5.2
Euro area	**0.8**	**–0.3**	**–0.4**	**–1.9**	**–2.5**	**–0.1**	**0.4**	**0.1**	**5.1**
Spain	0.4	0.0	–0.6	–1.1	–1.7	–1.0	–0.3	–0.1	4.7
Austria	1.2	0.2	–0.6	–1.3	–2.2	–0.5	0.5	0.4	4.5
Portugal	0.2	0.1	–0.5	–1.7	–2.0	0.5	0.7	na	4.1
Belgium	0.5	0.4	–0.2	–2.1	–1.7	–0.1	0.7	na	4.1
France	0.5	–0.4	–0.2	–1.5	–1.4	0.3	0.2	0.6	3.5
Cyprus	1.2	0.7	0.2	0.1	–0.7	–1.0	–0.8	–0.3	2.8
Greece	0.7	0.6	0.1	–0.7	–0.5	–0.1	–0.4	na	1.7

© OCR 2011

STEMUP.CO.UK

Extract 2

Portugal, Italy, Ireland, Greece and Spain – the PIIGS

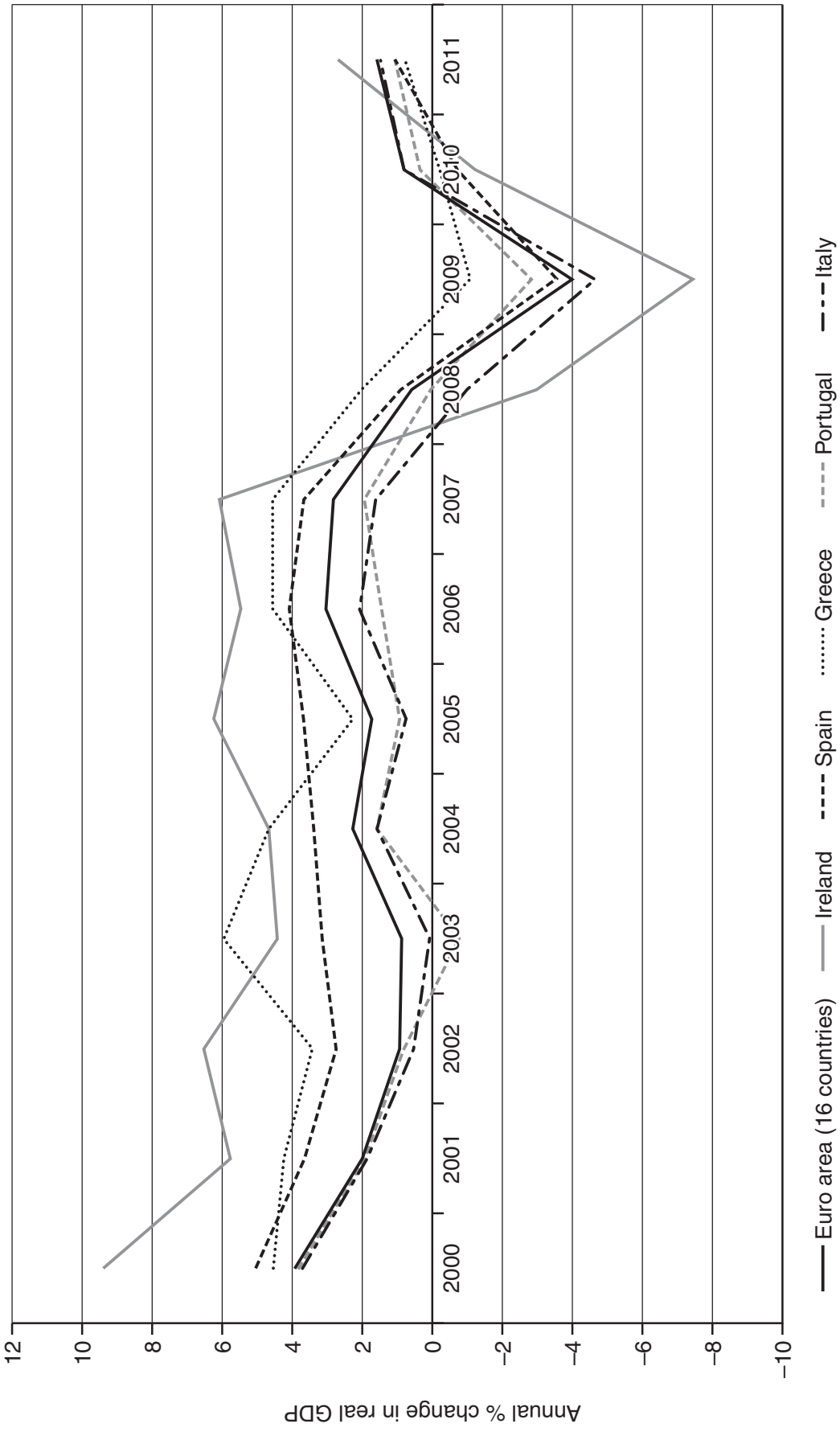
Five countries in the euro area are now singled out as countries sharing common characteristics likely to make their continued membership of the euro area challenging. These economies – Portugal, Italy, Ireland, Greece and Spain (the PIIGS) – on the surface look an unlikely grouping (see Fig. 2.1). Economic performance in Ireland, Greece and Spain was strong before the recent recession. All three economies had experienced above average rates of economic growth in the period 2000 to 2007. Over the whole period Greece and Spain had grown twice as much as the average for the euro area as a whole, where real GDP had increased by 18.5%. In Ireland, real GDP had grown by almost 56% over the same period. In comparison, economic growth in Portugal and Italy over the period was about two thirds of the average for the euro area economy.

What unites these five economies is a loss in competitiveness compared to the rest of the euro area and to economies outside the euro area. The ECB produces two measures of competitiveness. One is based on increases in output prices (see Fig. 2.2) and the other on increases in relative unit labour costs (see Fig. 2.3). Both measure changes in the competitiveness of individual economies relative to their main trading partners over time. Both indices show a decline in the competitiveness of the PIIGS since 1999, the year of the launch of monetary union in the EU. Part of this lost competitiveness is due to the failure of ECB monetary policy to control inflation in all parts of the euro area. Effectively, monetary policy has been too 'loose' for Portugal, Italy, Ireland, Greece and Spain. Short term economic growth has come at the cost of high inflation. Part of their decline in competitiveness stems from these economies having a 'fixed' exchange rate against other members of the euro area. High inflation cannot result in a reduction in the 'exchange rate' with other members of the euro area. With the risk of depreciation eliminated, FDI has poured into these fast-growing economies. But these are short term influences on economic growth. The real problem for these economies are the longer term influences on economic growth which come from a poor supply side performance.

© OCR 2011

STEMUP.CO.UK

Fig. 2.1 Annual GDP growth rates for the PIIGS and for the euro area[1]

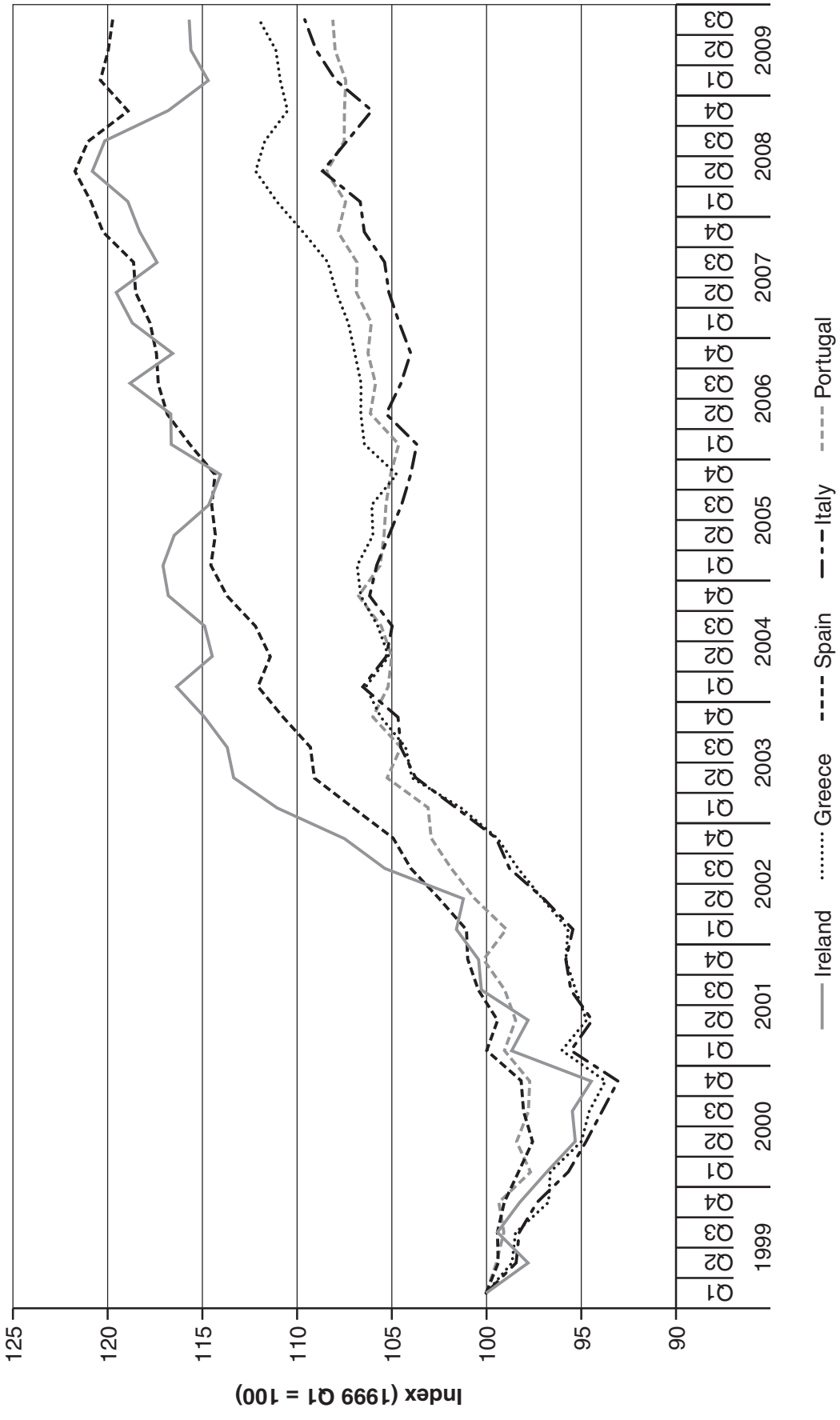


[1] Annual data shown at the mid-point of each year

© OCR 2011

STEMUP.CO.UK

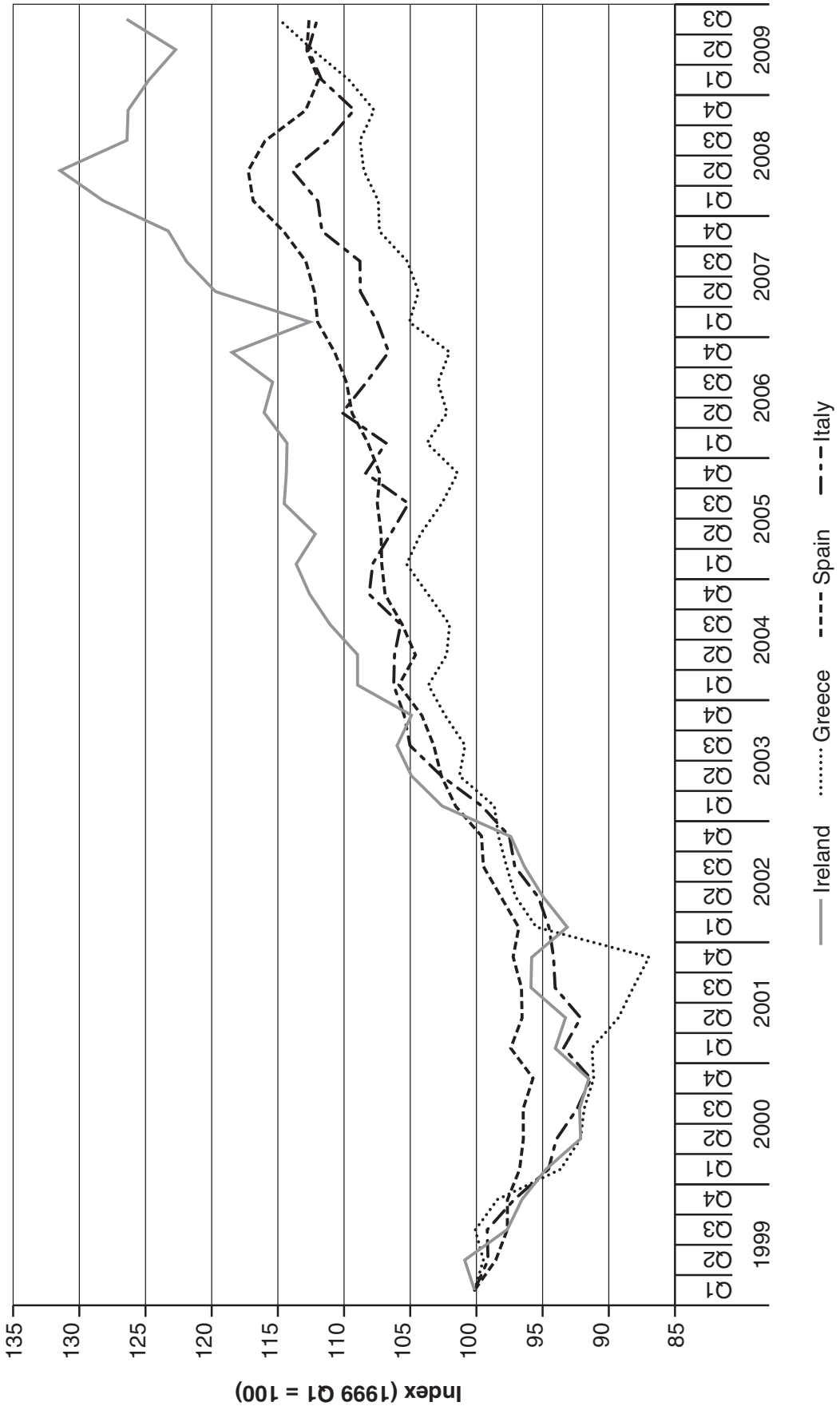
Fig. 2.2 ECB index of competitiveness based on output prices for Portugal, Ireland, Italy, Greece and Spain 1999 – 2009 (1999 Q1 = 100)



© OCR 2011

STEMUP.CO.UK

Fig. 2.3 ECB index of competitiveness based on relative unit labour costs for Ireland, Italy, Greece and Spain 1999 – 2009 (1999 Q1 = 100)[2]



[2] Data not available for Portugal

© OCR 2011

STEMUP.CO.UK

Extract 3

The future of the Spanish economy

Up until the end of 2009, the decline in Spain's GDP (4.71% from peak to trough) was less than the average of that in the euro area as a whole (see Fig. 1.1). Yet RR de Acuña & Asociados, a research group in Madrid, predicted that Spain's dependence on the construction industry might mean that it would not recover from recession with the rest of the euro area economies and that, peak to trough, the decline in GDP might be as much as 11%. They suggested that an economic recovery might not begin until 2012 and that, as a result, Spain's unemployment rate could rise to 25%.

Spain has one of the most generous welfare systems in the euro area. Typically, a worker made unemployed in Spain will receive up to 60% of their previous wage for 18 months after losing their job. Fearing the social consequences of rising unemployment, the Spanish government introduced guaranteed benefits of €420 per month for the long-term unemployed. This alone added 3% of GDP to the government's budget deficit. Combined with a reduction in tax receipts, the budget deficit in Spain has required big cuts in discretionary spending and has limited the ability of the Spanish government to continue to use fiscal policy to prevent aggregate demand falling further. Unlike the first decade of its membership of the euro area, Spain cannot expect the ECB interest rate to boost economic growth. With high inflation for much of the last decade, real interest rates in Spain were negative. Spain's GDP growth rarely fell below 3% per annum as a result.

In the next ten years, Spain must turn its attention to improving its long-run growth potential as emphasised not only by research groups such as RR de Acuña & Asociados but also by the IMF. As part of its role, the IMF holds discussions with members every year. A team from the IMF visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies before preparing a report. Fig. 3.1 summarises key aspects of the report published by the IMF on the Spanish economy in March 2009.

Fig. 3.1 Key aspects of a report published by the IMF on the Spanish economy in March 2009

Despite the economic slowdown, wage and unit-labour costs are outpacing those in other euro area countries and inflation remains structurally above the euro area average. This reflects a lack of competition and contestability in output markets, inefficient labour markets, and relatively low productivity.

Spain must introduce policies to improve its international competitiveness. Plans for product market reforms also need to be implemented.

© OCR 2011

STEMUP.CO.UK

Extract 4

International trade, international trade negotiations and developing economies

Concerns about the impact of the global economic recession are not confined to members of the euro area. Pascal Lamy, Director-General of the WTO, emphasised the importance of international trade in his speech to the European Policy Centre in Brussels on 24 February 2010. The role of the WTO is to promote international trade and ensure that trade flows smoothly, freely, fairly and predictably. Pascal Lamy concluded his speech by stating that there was an "economic imperative" to conclude the Doha Round of international trade negotiations. Fig. 4.1 below reproduces excerpts from his speech.

Fig. 4.1 Excerpts from a speech by Pascal Lamy to the European Policy Centre in Brussels on 24 February 2010

These are not easy times. We know that in 2009, growth of real world GDP was negative, estimated at –2.2%. Furthermore, the global unemployment rate reached its highest level ever. The adverse impact of the recent financial crisis on the world economy in terms of output and employment is undeniable.

World trade has also been a casualty of this crisis, contracting in volume terms by around 12% in 2009 — the sharpest decline since the end of the Second World War. The main explanation for this freefall in trade has been the simultaneous reduction in aggregate demand across all major world economies. To a lesser degree, trade has been adversely affected by some instances of increased tariffs and domestic subsidies, new non-tariff measures and more anti-dumping actions.

In most developed economies, including the EU, stimulus packages have been instrumental in preventing further deterioration in output, while preparing the path to recovery. But the positive impact of national stimulus packages is at best temporary and worries are mounting over the huge budget deficits created by many governments. Economies urgently need other sources of growth. This is where trade can be an important part of the story, both in the short to medium-term and in the long run.

We must, therefore, ensure that trade remains open. But we must also work to keep opening trade through the conclusion of the Doha Round. A Doha deal would provide new market opportunities for developing economies, in particular, through the reduction of tariff barriers and domestic subsidies.

The Doha Round of international trade negotiations was started in 2001. The last talks in Geneva in 2008 collapsed as China, India, the USA and the EU could not agree on import rules. The main issue surrounded agricultural trade and rules which allow countries to protect poor farmers through tariffs in the event of falling prices. The Doha Round of trade talks has tried to ensure that developing countries benefit more from freer trade. But talks have repeatedly collapsed because of a failure of developed and developing countries to agree on the key issues surrounding access to each others' markets. On the one hand, developed economies such as the USA and the EU want their producers to be able to gain greater access to fast-growing markets such as China and India. On the other hand, developing countries want to be able to gain greater access to markets for agricultural products in the USA and the EU. So far, agreement between the developed and developing countries has been illusive.

© OCR 2011

STEMUP.CO.UK

OCR
RECOGNISING ACHIEVEMENT

Copyright Information

OCR is committed to seeking permission to reproduce all third-party content that it uses in its assessment materials. OCR has attempted to identify and contact all copyright holders whose work is used in this paper. To avoid the issue of disclosure of answer-related information to candidates, all copyright acknowledgements are reproduced in the OCR Copyright Acknowledgements Booklet. This is produced for each series of examinations and is freely available to download from our public website (www.ocr.org.uk) after the live examination series.

If OCR has unwittingly failed to correctly acknowledge or clear any third-party content in this assessment material, OCR will be happy to correct its mistake at the earliest possible opportunity.

For queries or further information please contact the Copyright Team, First Floor, 9 Hills Road, Cambridge CB2 1GE.

OCR is part of the Cambridge Assessment Group; Cambridge Assessment is the brand name of University of Cambridge Local Examinations Syndicate (UCLES), which is itself a department of the University of Cambridge.

© OCR 2011

STEMUP.CO.UK

OCR
RECOGNISING ACHIEVEMENT

ADVANCED GCE

ECONOMICS

The Global Economy

F585

Candidates answer on the question paper.

OCR supplied materials:
- Clean copy of Stimulus Material

Other materials required:
- Calculators may be used

Thursday 23 June 2011
Afternoon

Duration: 2 hours

Candidate forename		Candidate surname	

Centre number						Candidate number				

INSTRUCTIONS TO CANDIDATES

- Refer to the Stimulus Material in a separate booklet. You must **not** bring your original copy into the examination.
- Write your name, centre number and candidate number in the boxes above. Please write clearly and in capital letters.
- Use black ink. Pencil may be used for graphs and diagrams only.
- Read each question carefully. Make sure you know what you have to do before starting your answer.
- Write your answer to each question in the space provided. If additional space is required, you should use the lined pages at the end of this booklet. The question number(s) must be clearly shown.
- Answer **all** the questions.
- Do **not** write in the bar codes.

INFORMATION FOR CANDIDATES

- The number of marks is given in brackets **[ ]** at the end of each question or part question.
- The total number of marks for this paper is **60**.
- This document consists of **16** pages. Any blank pages are indicated.
- You will be assessed on the quality of your written communication in question 3. All answers should be in continuous prose.

A calculator may be used for this paper

© OCR 2011 [T/500/7921]
DC (KN) 33331/2

OCR is an exempt Charity

STEMUP.CO.UK

Answer **all** questions

1 **(a)** Describe what is meant by the economic cycle.

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

..... **[4]**

© OCR 2011

STEMUP.CO.UK

(b) Analyse why the convergence of economic cycles is important in a monetary union.

.... **[6]**

© OCR 2011

STEMUP.CO.UK

(c) Comment on the likely consequences for Ireland's economy of its high rate of economic growth in the period 2000 – 2007.

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

© OCR 2011

STEMUP.CO.UK

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

..... **[10]**

© OCR 2011

STEMUP.CO.UK

2 **(a)** Distinguish between short and long run economic growth.

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

..... **[4]**

© OCR 2011

STEMUP.CO.UK

(b) Analyse the implications for Spain of the trend in its competitiveness shown in Figs. 2.2 and 2.3.

....

....

....

....

....

....

....

....

....

....

....

....

....

....

....

....

....

....

....

....

....

....

....

....

.... **[6]**

© OCR 2011

STEMUP.CO.UK

(c) Comment on **one** policy Spain might introduce to improve its international competitiveness.

© OCR 2011

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

..... **[10]**

© OCR 2011

STEMUP.CO.UK

3 Discuss the view that greater openness to international trade is the key to promoting economic and human development. **[20]**

© OCR 2011

STEMUP.CO.UK

© OCR 2011

STEMUP.CO.UK

© OCR 2011

© OCR 2011

Additional pages. When using this space please make sure your answers are numbered carefully.

© OCR 2011

© OCR 2011

PLEASE DO NOT WRITE ON THIS PAGE

OCR
RECOGNISING ACHIEVEMENT

Copyright Information

OCR is committed to seeking permission to reproduce all third-party content that it uses in its assessment materials. OCR has attempted to identify and contact all copyright holders whose work is used in this paper. To avoid the issue of disclosure of answer-related information to candidates, all copyright acknowledgements are reproduced in the OCR Copyright Acknowledgements Booklet. This is produced for each series of examinations and is freely available to download from our public website (www.ocr.org.uk) after the live examination series.

If OCR has unwittingly failed to correctly acknowledge or clear any third-party content in this assessment material, OCR will be happy to correct its mistake at the earliest possible opportunity.

For queries or further information please contact the Copyright Team, First Floor, 9 Hills Road, Cambridge CB2 1GE.

OCR is part of the Cambridge Assessment Group; Cambridge Assessment is the brand name of University of Cambridge Local Examinations Syndicate (UCLES), which is itself a department of the University of Cambridge.

© OCR 2011

OCR
RECOGNISING ACHIEVEMENT

GCE

Economics

Advanced GCE

Unit **F585:** The Global Economy

Mark Scheme for June 2011

STEMUP.CO.UK

OCR (Oxford Cambridge and RSA) is a leading UK awarding body, providing a wide range of qualifications to meet the needs of pupils of all ages and abilities. OCR qualifications include AS/A Levels, Diplomas, GCSEs, OCR Nationals, Functional Skills, Key Skills, Entry Level qualifications, NVQs and vocational qualifications in areas such as IT, business, languages, teaching/training, administration and secretarial skills.

It is also responsible for developing new specifications to meet national requirements and the needs of students and teachers. OCR is a not-for-profit organisation; any surplus made is invested back into the establishment to help towards the development of qualifications and support which keep pace with the changing needs of today's society.

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

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

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

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

© OCR 2011

Any enquiries about publications should be addressed to:

OCR Publications
PO Box 5050
Annesley
NOTTINGHAM
NG15 0DL

Telephone: 0870 770 6622
Facsimile: 01223 552610
E-mail: publications@ocr.org.uk

<table>
<tr><th>Question</th><th>Answer</th><th>Marks</th><th>Guidance</th></tr>
<tr>
<td>1 (a)</td>
<td>The economic cycle is the regular fluctuations in economic activity / GDP, characterised by four distinct stages:

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

One mark for a definition of the economic cycle – regular fluctuations in economic activity / GDP or variation of actual GDP around trend
Two marks for a list of <u>all four</u> stages of the economic cycle OR a correctly labelled diagram of the economic cycle (maximum of one mark for 2 or 3 stages only in list or diagram)
One mark for a each description of the four stages of the economic cycle

Maximum four marks</td>
<td>4</td>
<td>Any of the following terms is acceptable:
• upturn
• downturn
• slump
• bust

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

Use green ticks  for each mark awarded</td>
</tr>
</table>

STEMUP.CO.UK

Question	Answer	Marks	Guidance
1 (b)	Up to two marks for **identifying reasons** why convergence of economic cycles is important: • single interest rate won't suit all economies; • interest rate will be too high for some / too low for others; • ECB monetary policy will be ineffective / too loose / too tight; • it will be difficult for ECB to set the 'right' interest rate; • a requirement for an optimal currency area; • loss of exchange rates *within* the euro area. Up to two marks for **basic elaboration** of any of the above points • economies in the boom phase of the economic cycle will need higher interest rates, economies in recession phase will need lower interest rates; • consequence may be reduction in competitiveness for some economies; • single interest rate may not control eurozone inflation; • unable to respond to lack of competitiveness by exchange rate depreciation. Up to four marks for **analysis** of the consequences of any of the above points • impact of interest rates changes on propensities to consume and save; • consequences for C and I; • impact of changes on AD; • impact of changes in AD on the economic performance / competitiveness of economies at different stages of the economic cycle.	6	**1 reason, with basic elaboration and well developed analysis can score full marks (e.g. 1+1+4)** No credit for distinction between cyclical and structural (nominal and real) convergence or definition of monetary union No credit for reasons, elaboration or analysis which is expressed in terms of EU rather than eurozone Use green ticks  for reasons (two max) Use green tick plus  for elaboration and analysis In going beyond elaboration marks to award analysis marks look for chains of reasoning • e.g. the impact of a single interest rate / changes in ECB interest rate on components of AD and consequently on economic performance of economies at different stages in the economic cycle

STEMUP.CO.UK

Question	Answer	Marks	Guidance	
			Content	**Levels of Response**
1 (c)	Candidates should analyse and comment on the implication of high rates of economic growth for at least two of the following: • employment/unemployment – higher employment, higher standard of living; • inflation – increases; • competitiveness – worsens due to inflation; • current a/c of BoP – worsens; • government's fiscal position – improves; • impact on FDI – high growth attracts FDI, inflows on financial a/c of BoP; • reduction in negative output gap, emergence of positive output gap; • increase in negative externalities – lack of environmental sustainability. Commentary could mention any of the following: • some consequences are positive, some are negative – max bottom L4 where this is the only point of commentary; • consequences depend on the stage of the economic cycle; • consequences depend on increases in productivity/productive capacity; • consequences depend on size of the output gap; • consequences depend on nature of growth – SR growth due to increased AD without adequate expansion of AS is likely to result in significant inflation and BoP problems	**10**	In Level 4 award marks as follows: 1 <u>stated</u> point of evaluation = seven marks 2 or more <u>stated</u> points of evaluation = eight marks <u>Developed</u> evaluation of 1 or more points MUST be awarded nine or ten marks Show development with  For Level 3 marks to be awarded it is important that these consequences are explained rather than just stated. If only one consequence is referred to candidates should be capped to the bottom of the relevant level, ie seven marks in L4, 4 marks in L3 and 2 marks in L2 Watch out for answers that focus on Irish economy 2008 onwards.	**Level 4 [7 – 10]** Comment on the likely consequences of Ireland's high rate of economic growth. Annotate using  in LHS margin **Level 3 [4 – 6]** For an analysis of the likely consequences with no attempt to say what determines the consequences. Annotate using  in LHS margin **Level 2 [2 – 3]** For an application of knowledge and understanding of the consequences with **NO** use of economic concepts/theory or reasoning. Annotate using  in LHS margin **Level 1 [1]** For knowledge and understanding of high rates of economic growth only Annotate using  in LHS margin

STEMUP.CO.UK

Question	Answer	Marks	Guidance
2 (a)	Up to two marks for definitions of the terms • short run economic growth relates to increases in GDP (one mark) or is the rate of actual economic growth (one mark) • long run economic growth relates to increases in an economy's productive capacity (one mark) or is the rate of potential economic growth (one mark) Up to two marks for distinctions between the two • short run growth is generated by increases in AD or SRAS (one mark), long run economic growth is determined by increases in the quantity or quality of the factors of production / LRAS (one mark) • short run growth refers to a movement towards the PPC (one mark), long run growth involves a shift of the PPC (one mark)	4	Use green ticks for definitions Use green tick plus for distinctions Distinctions should relate to the causes or consequences of short and long run economic growth

STEMUP.CO.UK

Question	Answer	Marks	Guidance	
			Content	Levels of Response
2 (b)	Spain suffered a reduction in competitiveness as shown by the indicators in Figs 2.2 and 2.3. This is because output prices and unit labour costs have risen more than other economies in the euro area and elsewhere. The consequences (Implications) of this reduction in competitiveness include: • reduction the demand for their exports; • increase in the demand for imports; • worsening of the current account of the balance of payments; • reduction in net trade and AD (although not consistent with rates of economic growth in stimulus material); • multiplier consequences and impact on employment; • cost-push inflation/shift of SRAS; • capital flight / loss of FDI. **NOTES:** • trends in output prices impact on SRAS but many candidates will analyse impact on AD, ie (X-M) – this is OK • do not credit falling import prices (import prices become RELATIVELY cheaper not ABSOLUTELY) • do not credit BoP without reference to the current account • analysis can focus on explaining why BoP on current account deteriorates rather than impact on AD	6	**Examples of analysis**: • Higher priced exports will reduce export demand leading to a reduction in AD / deterioration in BoP on current account • Rising unit labour costs shift SRAS to the left causing rise in price level, reduction in real GDP, reduction in employment **Examples of application**: • Rising unit labour costs means that the price of Spanish goods has increased • This will lead to a fall in exports and a rise in imports • Unexplained AD / AS diagrams **Examples of knowledge and understanding**: • Competitiveness is an economy's ability to sell their goods / services at a relatively low price and / or relatively high quality • Spain's unit labour costs have risen by 13% and its output prices by 20% since 1999 causing a reduction in its competitiveness	**Level 3 [5 – 6]** For an analysis of the implications of a loss of competitiveness. Analysis begins when candidates explain the impact on current account or AD or employment / unemployment or other macroeconomic issues Annotate using L3 in LHS margin **Level 2 [3 – 4]** For application of knowledge and understanding of the implications of the trends in Figs 2.2 and 2.3. Responses in this level will state impacts rather than explain them or simply recognise that exports are likely to fall and imports rise Annotate using L2 in LHS margin **Level 1 [1 – 2]** For knowledge of competitiveness and understanding that Spain's competitiveness has worsened. Annotate using L1 in LHS margin

STEMUP.CO.UK

Question	Answer	Marks	Guidance	
			Content	**Levels of Response**
2 (c)	Accept any valid policy, including: • measures to increase productivity; • reduction in labour costs; • investment in education and training; • subsidy of training or new technology; • measures to improve labour market flexibility; • measures to improve contestability of / improve competition in product markets; • reduction in rate of inflation through contractionary fiscal policy; • measures to improve non-price competitiveness; • withdrawal from the euro area. Accept any valid comment, including: • time taken to have an impact; • need for higher government expenditure; • trade union resistance; • possible unemployment in the short term; • why the chosen policy may be better than alternatives; • until labour costs may not fall if there is an increase in wage rates as well as an increase in productivity **NOTES** Do not accept policies which would not be possible for Spain to implement as a member of the EU such as: • export subsidies; • tariffs on imports;	**10**	In Level 4 award marks as follows: 1 <u>stated</u> point of evaluation = seven marks 2 or more <u>stated</u> points of evaluation = eight marks <u>Developed</u> evaluation of 1 or more points MUST be awarded nine or ten marks Show development with  There should be explicit explanation of how the policy will improve competitiveness for Level 3 marks to be awarded. The policy should be clearly identified. If there is reference to “supply side policies” only responses should be capped to the bottom of the relevant level, ie 4 marks in L3 and 7 marks in L4. If more than one policy is identified, consider all and credit the best.	**Level 4 [7 – 10]** For a commentary on a policy to improve competitiveness. Annotate using  in LHS margin **Level 3 [4 – 6]** For an analysis of HOW the policy might improve competitiveness. Alternatively, an analysis of why the policy might NOT improve competitiveness ONLY Annotate using  in LHS margin **Level 2 [2 – 3]** For an application of knowledge and understanding of a policy to improve competitiveness but lacking explicit economic analysis of how it would work. Annotate using  in LHS margin **Level 1 [1]** For knowledge and understanding of a policy to improve competitiveness only – ie simple statement of what the policy might be. Annotate using  in LHS margin

STEMUP.CO.UK

Question	Answer	Marks	Guidance	
			Content	Levels of Response
3	Discussion might include: • short term consequences of greater openness in terms of reduced employment; • declining terms of trade for agricultural commodity exporters; • greater dependence on other economies in terms of net external demand; • lack of access to developed economy markets; • primary commodity dependence and volatile export prices; • other 'keys' to economic development – domestic savings; • inequality in the distribution of gains	20	**Example of Level 4 Band 3 response** *"The extent to which greater openness to international trade is the key to economic and human development depends on governments putting measures in place to tackle income inequalities that might arise from the resulting economic growth."* Stated judgements = max 19 marks One or more developed judgements MUST be awarded 19 or 20 marks Annotate judgement using  **Example of Level 4 Band 2 response** *"The Prebisch-Singer hypothesis states that developing economies, due to their dependence on primary sector production, will face declining terms of trade in the long run as primary products are income inelastic. As they have to export more primary goods to pay for imports of capital they are trapped in a low level of development."* **Example of Level 4 Band 1 response** *"Whilst a greater openness to international trade might be an advantage to an economy because the price of imports will fall raising consumer surplus, domestic suppliers may suffer because of increased competition so that there is a reduction in producer surplus."*	**Level 4 Band 3 [18-20]** For a judgement on the factors that determine whether greater openness to international trade is the **KEY** to promoting economic and human development. *In this Band, candidates can consider other ''KEYS' to economic and human development or identify why greater openness ON ITS OWN is not the key to economic and human development* **Level 4 Band 2 [15-17]** For a discussion of the advantages and disadvantages of greater openness to international trade with EXPLICIT reference to the context of development *Undeveloped discussion should be awarded marks at the bottom of Band 2* Annotate using  in LHS margin **Level 4 Band 1 [11-14]** For a discussion of the advantages and disadvantages of greater openness to international trade WITHOUT reference to the context of development. *Undeveloped discussion should be awarded marks at the bottom of Band 1*

STEMUP.CO.UK

Question	Answer	Marks	Guidance	
			Content	**Levels of Response**
	Analysis of the impact of greater openness will need to make use of some, but not all, of the following concepts: • demand and supply diagram showing impact of removal of a tariff and / or quota; • theory of comparative advantage and efficiency gains from specialisation; • greater competition and impact on technological progress through increasing the incentives to innovate; • transfer of technology; • access to a larger variety of intermediate inputs; • economies of scale; • AD / AS diagram to show impact of greater openness to international trade.		**Level 3** Candidates are expected to show the impact of openness on economic and human development by making reference to some, but not all, of the following: • higher level of GDP; • increased GDP per capita; • higher levels of employment; • greater tax revenues and ability to increase expenditure on health, education and infrastructure; • reduction in poverty; • change in the economic structure. **Level 2** Responses in this level will show a **TOTAL** lack of economic analysis of the impacts but will make some valid general points. **Examples of Level 2 response** *"The advantage of removing tariffs is that consumer choice will increase"* *"However, USA firms are now undercutting domestically produced Chinese chicken causing a negative impact of greater openness to international trade."* **Example of Level 1 response** *"Greater openness to international trade involves reductions in the barriers to trade, e.g. reduction in tariffs and quotas."*	Annotate using  in LHS margin **Level 3 [5-10]** For a one-sided analysis of the impact of greater openness to international trade on economic and/or human development.. Annotate using  in LHS margin **Level 2 [3-4]** For an application of knowledge and understanding of the impact of greater openness to international trade on economic and/or human development. Annotate using  in LHS margin **Level 1 [1-2]** For knowledge and understanding of economic or human development **and** openness to international trade Annotate using  in LHS margin

STEMUP.CO.UK

OCR (Oxford Cambridge and RSA Examinations)
1 Hills Road
Cambridge
CB1 2EU

OCR Customer Contact Centre

14 – 19 Qualifications (General)
Telephone: 01223 553998
Facsimile: 01223 552627
Email: general.qualifications@ocr.org.uk

www.ocr.org.uk

For staff training purposes and as part of our quality assurance programme your call may be recorded or monitored

Oxford Cambridge and RSA Examinations
is a Company Limited by Guarantee
Registered in England
Registered Office; 1 Hills Road, Cambridge, CB1 2EU
Registered Company Number: 3484466
OCR is an exempt Charity

OCR (Oxford Cambridge and RSA Examinations)
Head office
Telephone: 01223 552552
Facsimile: 01223 552553

© OCR 2011

STEMUP.CO.UK

OCR
RECOGNISING ACHIEVEMENT

ADVANCED GCE

ECONOMICS

The Global Economy

STIMULUS MATERIAL

F585/SM

Tuesday 1 February 2011
Afternoon

Duration: 2 hours

OCE/38338

INSTRUCTIONS TO CANDIDATES

- This is a clean copy of the Stimulus Material which you have already seen.
- You may **not** take your previous copy of the Stimulus Material into the examination.
- You may **not** take notes into the examination.

INFORMATION FOR CANDIDATES

- This document consists of **12** pages. Any blank pages are indicated.

© OCR 2011 [T/500/7921]
DC (NH) 38338/1

OCR is an exempt Charity

STEMUP.CO.UK

Introduction

International trade disputes tend to come and go. However, the dispute about trade in bananas between the USA (home to many of the multinational corporations owning banana plantations in Latin America), some Latin American countries and the European Union (EU) had lasted for 16 years. In 2009 the so-called 'banana wars' came to an end when the EU finally agreed to reduce tariffs on bananas from Latin America. Caribbean countries, which had previously enjoyed tariff-free preferential access to the EU market (along with African and Pacific producers), claimed that the deal would hit their small family-owned banana farms hard and damage their economies. The world market for bananas, like other global markets for primary products, exhibits price volatility. This has significant implications for the export revenues of countries dependent on trade in bananas.

Production of bananas is concentrated in developing economies. Whilst these economies share many common characteristics they are also a diverse group of nations, both in the structure of their economies and in their levels and rates of development. Measuring economic development is not easy. However, the United Nations' Human Development Index (HDI) allows useful insights and comparisons to be made between countries.

The ending of the 'banana wars' in 2009 coincided with the second year of a global economic downturn. Caribbean economies were not immune from the consequences of this downturn because of their integration into the global economy. Globalisation had, in the past, brought many benefits to Caribbean economies, especially as a result of the growing levels of foreign direct investment (FDI) in the region. Much of this had gone into tourism, allowing some Caribbean economies to gain from their comparative advantage in this sector. For some Caribbean economies, tourism is a major source of export revenue. The global downturn reduced the demand for tourism, as well as for exports of primary commodities such as bauxite. Negative economic growth in the Caribbean had severe consequences for unemployment in the region and for the fiscal position of many countries.

Some Caribbean nations, as a result, looked to deepening regional economic integration through the creation of a single market and economic union. The hope was that this would, alongside the existing monetary union, provide for the small economies of the Caribbean, the economic benefits enjoyed by the EU and provide insulation from the immediate downsides to globalisation experienced in 2008 – 2009.

© OCR 2011

STEMUP.CO.UK

Pre-release stimulus material

Extract 1: The world market for bananas

Extract 2: Banana exporting countries

Extract 3: Impact of the global downturn on economies in the Caribbean

Extract 4: The move to deepen regional economic integration in the Caribbean

© OCR 2011

STEMUP.CO.UK

Extract 1

The world market for bananas

Bananas are grown in all tropical regions of the world and are especially important for the economies of many developing countries. Banana production takes place in over 85 countries. In terms of volume and value, they top the list of the world's most exported fresh fruit. However, the world's largest producers, India and Brazil, mainly produce bananas for domestic consumption.

The world's biggest exporters of bananas include Ecuador, Costa Rica, the Philippines and Colombia. Together these four countries accounted for around 64% of total world banana exports in 2006. Production in these countries takes place on large mechanised plantations owned and operated by US multinational companies such as Dole, Del Monte and Chiquita. Ecuador is the world's largest exporter of bananas, and the industry is the second biggest source of Ecuadorian export revenue after oil. In the Caribbean, bananas are equally important for developing economies. In the Windward Islands (the source of over 30% of EU banana imports), for example, banana production is the biggest sector of the economy, employs the most people and accounts for 80% of export earnings. Yet the Caribbean's share of world trade in bananas amounts to a little over 8%. Banana production in the Caribbean is characterised by a large number of small, labour-intensive, family-run farms. These farms are high cost because the steep slopes on which bananas are cultivated are unsuitable for irrigation or large-scale production. The result is that yields are less than 50% of those in Ecuador and the farms are also subject to drought and hurricanes.

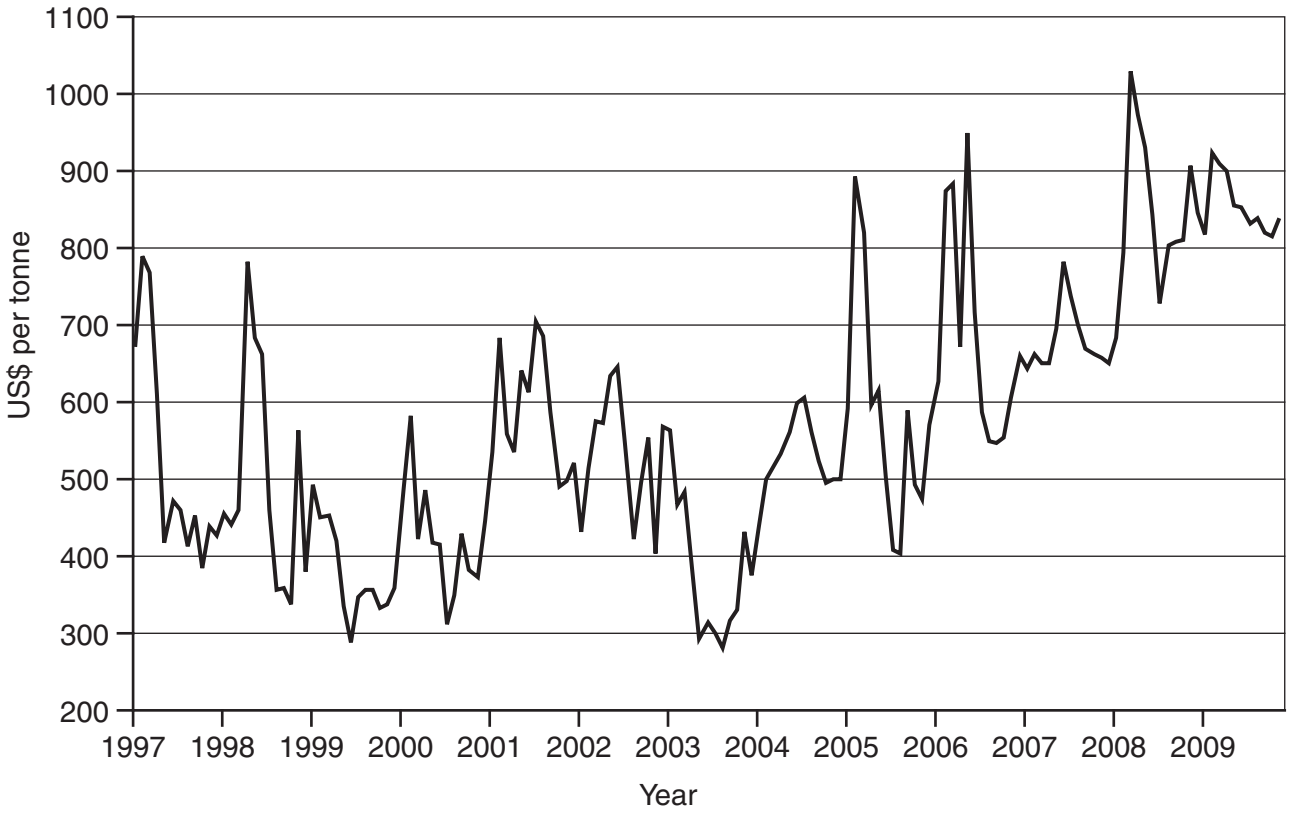
The world's largest importers of bananas are the EU and the USA. Together they account for over 60% of world imports of bananas. The banana trade could not be more different in these two areas. Access to the USA banana market is unlimited for developing economies and the trade in bananas is not subject to any tariffs. In comparison, in the EU there is a complex system of tariffs and quotas. The EU has operated a common trade policy for bananas in all member states since 1993. Under this trade policy, African, Caribbean and Pacific (ACP) states were allowed to export bananas to the EU tariff free, up to a maximum of 857 000 tonnes. Bananas from Central and South America were given a quota of two million tonnes on which the EU imposed a tariff of €100 per tonne. Imports in excess of either of these quotas faced punitive tariffs to prevent the EU market being over-supplied and to maintain high prices for banana producers in the Canary Islands and Martinique (territories of Spain and France). The combined result of this trade policy was that EU consumers in the 1990s were paying up to twice the world price for bananas.

The volume of world trade in bananas has grown over a number of decades and, until 1997, so too did the value of banana exports. The value of banana exports for developing countries depends critically on the world price of bananas. This price is volatile in the short term, yet there are distinct trends in price over the medium term. From 1997 to 2003 the world price of bananas fell (see Fig. 1.1) and with it the value of banana exports. Since 2003 the world price has increased. As the volume of banana exports increased too, there has been a significant increase in the value of banana exports. These trends have important implications for developing countries dependent on banana exports and for their terms of trade.

© OCR 2011

STEMUP.CO.UK

Fig. 1.1 World price of bananas January 1997 – November 2009



© OCR 2011

STEMUP.CO.UK

Extract 2

Banana exporting countries

Banana exporting countries are largely developing economies. As such they share a number of common characteristics which help to define and explain their lack of development. For example, the banana exporting countries listed in Fig. 2.1 are heavily dependent on primary commodities as a source of export revenue, with the exception of the Dominican Republic. Four of these six countries are also lower middle-income economies according to their GDP per capita in 2007 (see Fig. 2.2). As such they are likely to have low living standards. Despite these common characteristics, there is a degree of diversity between banana exporting countries. This can be seen in their economic structures, the extent to which their economies are dependent on exports of bananas and in their level and rate of development.

Guatemala and St Lucia, for example, share common characteristics, yet in important respects are different. The economic structure of Guatemala and St Lucia is different in that agriculture contributes a larger percentage to GDP in Guatemala and employs a larger percentage of the workforce. Whilst both economies are dependent on the export of primary commodities, Guatemala is less dependent on trade in bananas. St Lucia has attracted large amounts of FDI, especially in offshore banking and tourism which are important export sectors, whereas Guatemala's lack of a skilled workforce and poor infrastructure has been a constraint on FDI. With a GDP per capita less than half that of St Lucia, living standards are significantly lower in Guatemala.

Fig. 2.1 Export structure of selected banana exporting countries (average 2004 – 2009)

Country	Region	Revenue from banana exports as % of total export earnings	Primary commodities as a % of total volume of exports	Exports of food as a % of total volume of exports
Ecuador	South America	9.3	91.8	32.4
Guatemala	Central America	5.9	51.2	40.0
Dominican Republic	Caribbean	6.8	16.4	15.1
St Lucia	Caribbean	19.7	64.9	41.9
Côte d'Ivoire	Africa	na	74.9	45.6
Cameroon	Africa	na	91.0	18.7

© OCR 2011

STEMUP.CO.UK

Fig. 2.2 Measures of development for selected banana exporting countries

Country	GDP per capita (US$) 2007	GDP per capita (PPP US$) 2007	Average annual % growth rate of GDP per capita 1990 – 2007	HDI 2007	Average annual % growth rate in HDI 1990 – 2007	Average % of population living below US$2 a day 2000 – 2007
Ecuador	3335	7449	1.2	0.806	0.47	12.8
Guatemala	2536	4562	1.4	0.704	1.40	24.3
Dominican Republic	3772	6706	3.8	0.777	0.90	15.1
St Lucia	5834	9786	1.3	0.821	n/a*	40.6
Côte d'Ivoire	1027	1690	–0.7	0.484	0.26	46.8
Cameroon	1116	2128	0.6	0.523	0.44	57.7

*No HDI growth rate is available since HDI was not calculated for St. Lucia in 1990.

© OCR 2011

STEMUP.CO.UK

Extract 3

Impact of the global downturn on economies in the Caribbean

Speaking at a World Bank conference in 2007, Takatoshi Kato, Deputy Managing Director of the International Monetary Fund (IMF), said that:

"The Caribbean region is particularly well placed to benefit from globalisation. Its rich democratic history, generally strong institutions, and impressive social indicators (notably on education and health) provide a solid foundation for competing effectively in the global economy. The region has already proven adept at seizing on its comparative advantage by developing a thriving tourism sector, and it is now broadening the market to new visitors such as those from Asia and Eastern Europe."

A year later, the global economic crisis of 2008 – 2009 had exposed the negative aspects of greater integration into the global economy for the economies of the Caribbean. In 2009 the IMF forecast a reduction in GDP in Caribbean economies of 2.5%. Even stronger economies rich in gas and oil reserves, such as Trinidad and Tobago, were not expected to be immune from this downturn.

The economies of the Caribbean had been hit hard by a 30% decline in revenue from tourism, a fall in remittances[1], the cancellation of many large scale construction projects and the collapse of commodity prices. Production of bauxite in Guyana, Jamaica and Suriname had been heavily hit (production, for example, fell by 61% in Guyana) and Jamaica had temporarily ceased production of alumina (which is made from bauxite and 90% of which is used in the manufacture of aluminium metal). The international aluminium industry is directly dependent on global economic growth. Growth in aluminium consumption tends to rise more rapidly than GDP during periods of economic growth, but also falls at a much faster rate than GDP during a recession. The global demand for aluminium fell by over 7% in 2009, more than twice the decline in world GDP. In the Caribbean's main markets for exports of bauxite and alumina, North America and Europe, demand fell by around 15% in 2009.

The result of this decline in economic activity in Caribbean economies has been a sharp rise in unemployment and an increase in levels of poverty. In addition, government debt in many economies has risen to over 100% of GDP (see Fig. 3.1). Such high and rising debt levels pose a threat to fiscal stability and to future economic development in the region.

Fig. 3.1 Government debt (% of GDP) in selected Caribbean economies, 2009

Country	Government debt (% of GDP)
St Kitts	182%
Jamaica	122%
Grenada	109%
Guyana	109%
Barbados	96%
Trinidad and Tobago	27%

[1] remittances are transfers of money to friends and relatives from workers employed abroad

© OCR 2011

STEMUP.CO.UK

Many Caribbean economies experienced large current account and fiscal deficits as a direct consequence of the global economic crisis and found it difficult to attract private external finance. As a result, they were not able to put in place policies which might have made the impact on output and employment less severe. During 2009, Jamaica was in the process of negotiating borrowing arrangements with the IMF. Other countries, such as Guyana and Trinidad and Tobago, however, had built up substantial international reserves in the decade before the global economic crisis. In addition, as food and fuel prices dropped in 2009, most Caribbean economies were able to relax monetary policy as inflationary pressure had eased. Nevertheless, it was expected that many Caribbean economies would still be in recession even after recovery had started in the USA and Europe.

© OCR 2011

STEMUP.CO.UK

Extract 4

The move to deepen regional economic integration in the Caribbean

St Lucia is an island nation in the Caribbean and is one of the Windward Islands. It achieved full independence from the United Kingdom in 1979. Its economy is heavily dependent on offshore banking, tourism and the banana trade. Its well educated labour force and well developed infrastructure have increased FDI in recent years, mainly in offshore banking and tourism. This has been helped by economic reforms ending price controls and privatisation of the state banana company.

St Lucia has pursued regional economic integration through membership of the Caribbean Community (CARICOM), the Organisation of Eastern Caribbean States (OECS) and the Eastern Caribbean Currency Union (ECCU).

Including St Lucia there are 15 members of CARICOM. Membership of CARICOM had not brought about the expected benefits of trade creation which might have been anticipated from economic integration as Fig. 4.1 shows. As a result, St Lucia and 11 other CARICOM members sought to deepen economic integration in the Caribbean by establishing the CARICOM Single Market and Economy (CSME) in 2006. The CSME has brought about:

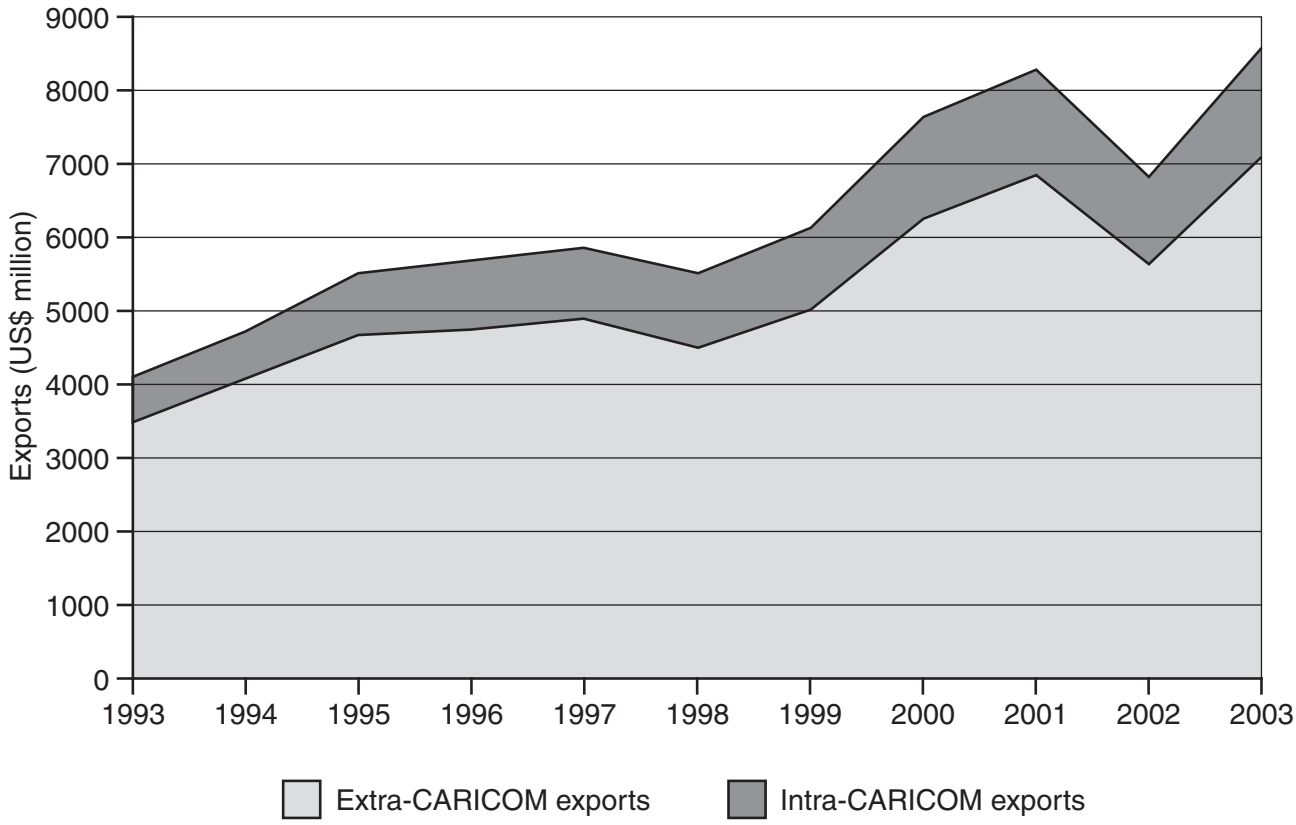
- the free movement of goods and services by abolishing trade barriers between the members and harmonising product standards;
- the free movement of capital through the elimination of exchange controls;
- the free movement of labour by establishing common standards for qualifications, harmonising social services and allowing the transfer of social security benefits for workers working in different member states;
- a common trade policy including a common external tariff applied by all members to products imported from countries outside the single market;
- the harmonisation of laws relating to business;
- the harmonisation of monetary and fiscal policy, including the coordination of national indirect taxes and budget deficits.

St Lucia is one of nine members of the OECS, all but one of which share the same currency, the Eastern Caribbean dollar. As part of this monetary union, St Lucia's monetary policy is set by the Eastern Caribbean Central Bank, which has been responsible for the common currency since 1983.

© OCR 2011

STEMUP.CO.UK

Fig 4.1 Exports of CARICOM members 1993 – 2003 (US$ million)



© OCR 2011

STEMUP.CO.UK

OCR
RECOGNISING ACHIEVEMENT

Copyright Information

OCR is committed to seeking permission to reproduce all third-party content that it uses in its assessment materials. OCR has attempted to identify and contact all copyright holders whose work is used in this paper. To avoid the issue of disclosure of answer-related information to candidates, all copyright acknowledgements are reproduced in the OCR Copyright Acknowledgements Booklet. This is produced for each series of examinations and is freely available to download from our public website (www.ocr.org.uk) after the live examination series.

If OCR has unwittingly failed to correctly acknowledge or clear any third-party content in this assessment material, OCR will be happy to correct its mistake at the earliest possible opportunity.

For queries or further information please contact the Copyright Team, First Floor, 9 Hills Road, Cambridge CB2 1GE.

OCR is part of the Cambridge Assessment Group; Cambridge Assessment is the brand name of University of Cambridge Local Examinations Syndicate (UCLES), which is itself a department of the University of Cambridge.

© OCR 2011

STEMUP.CO.UK

OCR
RECOGNISING ACHIEVEMENT

ADVANCED GCE

ECONOMICS

The Global Economy

F585

Candidates answer on the question paper.

OCR supplied materials:
- Clean copy of Stimulus Material

Other materials required:
- Calculators may be used

Tuesday 1 February 2011
Afternoon

Duration: 2 hours

OCE/33334

Candidate forename		Candidate surname	

Centre number						Candidate number				

INSTRUCTIONS TO CANDIDATES

- Refer to the Stimulus Material in a separate booklet. You must **not** bring your original copy into the examination.
- Write your name, centre number and candidate number in the boxes above. Please write clearly and in capital letters.
- Use black ink. Pencil may be used for graphs and diagrams only.
- Read each question carefully. Make sure you know what you have to do before starting your answer.
- Write your answer to each question in the space provided. If additional space is required, you should use the lined pages at the end of this booklet. The question number(s) must be clearly shown.
- Answer **all** the questions.
- Do **not** write in the bar codes.

INFORMATION FOR CANDIDATES

- The number of marks is given in brackets **[ ]** at the end of each question or part question.
- The total number of marks for this paper is **60**.
- This document consists of **16** pages. Any blank pages are indicated.
- You will be assessed on the quality of your written communication in question 3. All answers should be in continuous prose.

A calculator may be used for this paper

© OCR 2011 [T/500/7921]
OCR is an exempt Charity

STEMUP.CO.UK

Answer **all** questions

1 (a) (i) Define what is meant by the 'terms of trade'.

.....

.....

.....

.....

.....

.....

.....

..... **[2]**

(ii) With reference to Figs. 1.1 and 2.1, state and explain what is likely to have happened to St Lucia's terms of trade from 2004 onwards.

.....

.....

.....

.....

.....

.....

.....

..... **[2]**

© OCR 2011

STEMUP.CO.UK

(b) Using a diagram, analyse why the prices of primary commodities, such as bananas, are volatile in the short term.

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

..... **[6]**

© OCR 2011

STEMUP.CO.UK

(c) Comment on the case for granting preferential access to EU markets for bananas from African, Caribbean and Pacific (ACP) states.

© OCR 2011

STEMUP.CO.UK

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

..... **[10]**

© OCR 2011

STEMUP.CO.UK

2. **(a)** Fig. 2.2 shows that the Dominican Republic has a lower rate of growth in its HDI than Guatemala.
Explain **two** possible reasons for this difference in the HDI growth rates.

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

..... **[4]**

© OCR 2011

STEMUP.CO.UK

(b) Analyse the impact of the global economic crisis on Caribbean countries.

.... **[6]**

© OCR 2011

STEMUP.CO.UK

(c) Comment on the extent to which high levels of government debt, such as those experienced by St Kitts and Jamaica, act as a constraint on economic development.

© OCR 2011

STEMUP.CO.UK

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

..... **[10]**

© OCR 2011

STEMUP.CO.UK

3 Discuss the benefits of regional economic integration for a small economy such as St Lucia.

© OCR 2011

STEMUP.CO.UK

© OCR 2011

STEMUP.CO.UK

© OCR 2011

[20]

© OCR 2011

STEMUP.CO.UK

Additional pages. When using this space please make sure your answers are numbered carefully.

© OCR 2011

© OCR 2011

PLEASE DO NOT WRITE ON THIS PAGE

OCR
RECOGNISING ACHIEVEMENT

Copyright Information

OCR is committed to seeking permission to reproduce all third-party content that it uses in its assessment materials. OCR has attempted to identify and contact all copyright holders whose work is used in this paper. To avoid the issue of disclosure of answer-related information to candidates, all copyright acknowledgements are reproduced in the OCR Copyright Acknowledgements Booklet. This is produced for each series of examinations and is freely available to download from our public website (www.ocr.org.uk) after the live examination series.

If OCR has unwittingly failed to correctly acknowledge or clear any third-party content in this assessment material, OCR will be happy to correct its mistake at the earliest possible opportunity.

For queries or further information please contact the Copyright Team, First Floor, 9 Hills Road, Cambridge CB2 1GE.

OCR is part of the Cambridge Assessment Group; Cambridge Assessment is the brand name of University of Cambridge Local Examinations Syndicate (UCLES), which is itself a department of the University of Cambridge.

© OCR 2011

OCR
RECOGNISING ACHIEVEMENT

GCE

Economics

Advanced GCE

Unit **F585:** The Global Economy

Mark Scheme for January 2011

STEMUP.CO.UK

OCR (Oxford Cambridge and RSA) is a leading UK awarding body, providing a wide range of qualifications to meet the needs of pupils of all ages and abilities. OCR qualifications include AS/A Levels, Diplomas, GCSEs, OCR Nationals, Functional Skills, Key Skills, Entry Level qualifications, NVQs and vocational qualifications in areas such as IT, business, languages, teaching/training, administration and secretarial skills.

It is also responsible for developing new specifications to meet national requirements and the needs of students and teachers. OCR is a not-for-profit organisation; any surplus made is invested back into the establishment to help towards the development of qualifications and support which keep pace with the changing needs of today's society.

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

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

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

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

© OCR 2011

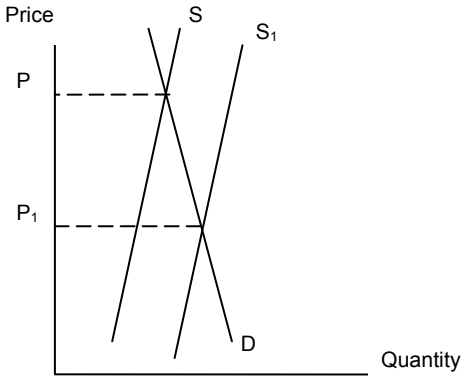
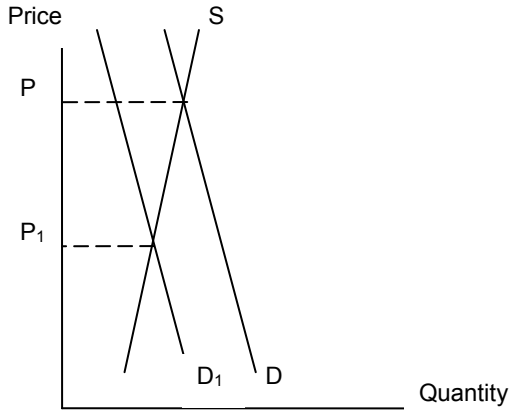
Any enquiries about publications should be addressed to:

OCR Publications
PO Box 5050
Annesley
NOTTINGHAM
NG15 0DL

Telephone: 0870 770 6622
Facsimile: 01223 552610
E-mail: publications@ocr.org.uk

Question	Answer	Marks	Guidance
1 (a) (i)	The average price of a country's exports relative to the average price of its imports 2 marks for an accurate definition	**2**	Annotate using ✓ (1 tick for each mark) Also accept for 2 marks the terms of trade formula: = (**index** of **average** price of exports/**index** of **average** price of imports) **x 100** Award 1 mark for: • missing out 'average' or n 'index' from the formula • formula is correct but wrong way around • X 100 is missing from formula • amount of imports a country can buy for a set amount of exports or the rate of exchange between two countries. • the price at which goods and services can be exchanged • understanding of the basic idea of the price of exports relative to the price of imports Award 0 marks for: • price of exports or price of imports ONLY • no reference at all to price
1 (a) (ii)	Award 1 mark for what is likely to have happened to the terms and trade and 1 mark for the reason • Terms of trade are likely to have improved/strengthened/increased/ better (1) • This is because banana exports are a significant % of St Lucia's total export earnings **AND** world banana prices have risen (1)	**2**	For the second mark to be awarded there must be reference (this can be a simple statement) to banana exports as a % of total export earnings as the question explicitly requires candidates to make use of Fig. 2.1 **Award only 1 mark where a candidate says terms of trade have improved because banana prices have risen.** **0 marks for 'value' (P x Q) rather than 'price' (P)**

STEMUP.CO.UK

Question	Answer	Marks	Guidance
1 (b)	Primary commodities tend to have both price inelastic demand and supply and are subject to demand and/or supply shocks. The result is that price changes tend to be large. The causes of these shifts depends on the commodity but may include reference to derived demand for commodities (such as bauxite, alumina), rising/falling global income/GDP, good/poor harvests (crop disease, weather), new suppliers. • 1 mark for correctly drawn and labelled demand and supply curves (must be D and S and not AD and AS) • 1 mark for a shift in demand/shift in supply (shift can be either leftward or rightward) • 1 mark for **old** equilibrium price (must be labelled) • 1 mark for **new** equilibrium price (must be labelled) • 1 mark for explicit recognition that demand or supply of primary commodities are price inelastic. • 1 mark for the cause of the shift in demand/supply or the reason why PED or PES is inelastic.	6	To access the four diagram marks the axes must be correctly labelled. Wrongly labelled axes no marks for diagram (must be price and quantity or quantity traded or quantity demanded and supplied) No marks for labelling equilibrium POINTS not PRICES. **NOTE: there should only be 4 diagram marks (check the number of ticks awarded)** Two acceptable diagrams are shown below.  

STEMUP.CO.UK

Question	Answer	Marks	Guidance	
			Content	Levels of Response
1 (c)	Case for preferential access to EU markets for bananas from ACP states • without preferential access ACP bananas would struggle to compete because producers lack economies of scale and/or yields are low; • low yields may be the result of a lack of capital for investment or inappropriate resource endowment; • access to EU markets generates higher export revenue, higher employment and incomes contributing to higher levels of development. Case against is limited and there is a strong case against preferential access • it raises prices for EU consumers, reducing consumer surplus; • ACP states' gain is Latin America's loss eg income, employment and GDP; • preferential access promotes inefficient production and runs contrary to free trade/comparative advantage; • it may trap ACP states in a low level of development by creating a dependency on the EU market and on primary production so it is difficult to diversify the economic structure.	10	Answers in Level 4 should be underpinned by relevant economic analysis and marks should be awarded as follows: • one stated comment 7 marks maximum • several stated comments 8 marks • one comment with brief elaboration 8 marks • one comment with brief elaboration + one stated comment 9 marks • one comment well developed or two comments with brief elaboration 10 marks **RESPONSES WHICH USE A TRADE CREATION/DIVERSION DIAGRAM TO ANALYSE AND COMMENT ARE CAPPED TO BOTTOM OF L4** Level 3 responses are characterised by the use of the economist's toolkit of concepts, theories and models. This could include: a tariff diagram; AD/AS analysis Level 2 responses will be descriptive and lack analytical reasoning.	**Level 4 [7 – 10 marks]** For a commentary on the case for preferential access to EU market. This is most likely to be an analysis of the arguments for and against. **Level 3 [4 – 6 marks]** For analysis of the case for or case against but not both. Candidates in this level will make use of some economic concepts show an ability to explain cause and consequence. **Level 2 [3 marks]** For an application of knowledge and understanding of arguments for and against preferential access. Answers in this level will contain NO economic analysis/concepts eg they will make NO use of the economic concepts and not make clear cause and consequence. **Level 1 [1 – 2 marks]** For knowledge and understanding of preferential access only.

STEMUP.CO.UK

Question	Answer	Marks	Guidance
2 (a)	Up to 2 marks for knowledge of the composition of the HDI: • GDP per capita (PPP US$) (1) or GNI per capita (PPP US$) (1); • life expectancy at birth (1); • adult literacy (1); • primary, secondary or tertiary education enrolment (1); • mean years of schooling (1); • expected years of schooling (1). Up to 2 application marks for explanation of why Dominican Republic has a lower rate of growth in its HDI than Guatemala. Since Dominican Republic has a higher growth rate in GDP per capita than Guatemala, relevant explanations include: • lower growth/fall in life expectancy (1); • lower growth/fall in adult literacy rates (1); • lower growth/fall in primary, secondary or tertiary education enrolment (1); • lower growth in government expenditure on health care (1) **or** lower priority given to government expenditure on health care (1); • lower growth in government expenditure on education (1) **or** lower priority given to government expenditure on education (1) ; • greater priority given to government expenditure on area not related to components of HDI eg defence (1); • lower growth in foreign aid directed to these areas (1).	**4**	Composition of HDI was changed in 2010 – some candidates may be aware of this. New components of HDI are referred to in acceptable answers opposite. Watch out for explanations, therefore, that refer to differences in mean years of schooling, expected years of schooling or net property income from abroad (given that reference is made to GDP per capita in the question). Reference to 'other components increasing less rapidly' is only worth 1 mark for application Do not accept 'lower level of HDI therefore easier to achieve higher growth rate in HDI' for application marks 1 mark only for reference to spending on 'measures which improve HDI' without specific mention of education or health care Use  to indicate knowledge marks (max 2) Use  to indicate application marks (max 2)

STEMUP.CO.UK

Question	Answer	Marks	Guidance
2 (b)	**Application marks** Up to 2 marks for an application of knowledge and understanding of the structure of Caribbean economies: • heavy dependence on exports (1) • dependence on exports of primary commodities (1) OR specific mention of one commodity (1) eg bananas, bauxite, gas, oil, food; • dependence on tourism (1), offshore banking (1), remittances (1). **Analysis marks** Up to 2 marks **only** for a **basic** analysis of the impact on Caribbean economies such as: • fall in demand for tourism because it is income elastic (1); • fall in exports earnings (1); • worsening of current account position (1); • lower employment/higher unemployment (1); • fiscal deficit (1); • increased debt (1); • fall in remittances (1); • reduction in FDI/construction projects (1); • capital outflows (1). Up to 4 marks where the impact is analysed using the AD/AS framework or multiplier or multiplier/accelerator relationship	6	Use the following annotations in Scoris to distinguish between application and analysis marks  for application marks (max 2 marks)  for analysis marks (max 4 marks) Analysis may be shown through the use of an AD/AS diagram. Only reward as analysis if the diagram is incorporated into the textual explanation ie no marks for unexplained diagrams

STEMUP.CO.UK

Question	Answer	Marks	Guidance	
			Content	Levels of Response
2 (c)	Government debt is the total amount of money owed by central and local government. Such debt can be internal (owed to lenders within the country) or external (owed to lenders from abroad). High levels of government debt may act as a constraint on economic development because: • it limits government expenditure on health and education or capital investment reducing life expectancy literacy causing fall in HDI ; • it limits government expenditure on capital investment which may impact negatively on AS and on economic growth in the long run; • results in high levels of debt interest payments = opportunity cost; The extent to which depends on: • scale of the debt in relation to GDP; • interest rate on the debt; • what debt has been used for; • how the debt is managed; • whether debt is internal or external; • whether there are other more significant constraints on development.	10	The most common route into Level 4 is going to be via an analysis of the ways in which government debt constrains economic development followed by an explanation of why it might not. In Level 4 award marks as follows: • one stated comment 7 marks maximum • several stated comments 8 marks • one comment with brief elaboration 8 marks • one comment with brief elaboration + one stated comment 9 marks • one comment well developed or two comments with brief elaboration 10 marks	**Level 4 [7 – 10 marks]** For a commentary on the extent to which high levels of government debt, such as those experienced by St. Kitts and Jamaica, act as a constraint on economic development. Must be supported by economic analysis **Level 3 [4 – 6 marks]** For an analysis of how economic development is constrained by high levels of government debt. Candidates in this level will make use of economic concepts and explain cause and consequence. **Level 2 [3 marks]** For an application of knowledge and understanding of how high levels of government debt may impact on economic development. Answers in this level will contain NO economic analysis/concepts and not make clear cause and consequence. **Level 1 [1 – 2 marks]** For knowledge and understanding of government debt and/or economic development

STEMUP.CO.UK

Question	Answer	Marks	Guidance	
			Content	Levels of Response
3	Economic integration brings benefits in terms of: • trade creation; • greater competition; • more innovation and R&D; • a larger market and economies of scale. In addition, there are benefits from a monetary union which include: • reduced transaction costs; • elimination of exchange rate risk; • increased price transparency; Discussion is likely to include a consideration of the costs of economic integration, which might include issues such as: • trade diversion; • core-periphery in the region; • regional and structural unemployment; • the need for common regional policy to ensure the benefits are spread equally; • the need for competition policy to prevent the abuse of monopoly power; • the loss of monetary policy sovereignty; • constraints on fiscal policy; • the degree of economic convergence and optimal currency area issues.	20	Candidates are expected to introduce some analysis of the benefits opposite (Level 3) in their responses rather than just list the benefits (Level 2). Watch out for candidates who confuse a single market with a single currency. Give **BOD** for a single error but not where there is consistent confusion. Candidates who recognise any of the discussion points opposite are likely to be awarded marks in Level 4 of the mark scheme assuming this builds upon analysis of the benefits of integration. Where the issues have not been expressed clearly and fluently and where sentences and paragraphs have not been well structured marks at the bottom of Level 4 Band 1 should be awarded. Candidates need to base their discussion on the context of a small economy (this can be a European economy such as Ireland or Belgium) **OR** a typical Caribbean economy (such as St Lucia) in order to access marks in Band 2 and above. Please highlight relevant context.	**Level 4, Band 3 [18 – 20 marks]** For a discussion that includes a judgement on the benefits of regional economic integration for a small economy, such as St. Lucia. At least one judgement must be developed for 20 marks to be awarded. **Level 4, Band 2 [15 – 17 marks]** For a discussion of the benefits of regional economic integration for a small economy, such as St. Lucia. There will be some development of the benefits and costs and a recognition that the question focuses specifically on a small/Caribbean economy. **Level 4, Band 1 [11 – 14 marks]** For a basic discussion of the benefits of regional economic integration without reference to a small economy. This is likely to be an analysis of the benefits of integration plus a list of some of the costs of integration without reference to a small **OR** a Caribbean economy.

STEMUP.CO.UK

Question	Answer	Marks	Guidance	
			Content	Levels of Response
	Judgement is likely to include a consideration of: • the significance of the benefits and/or costs to a small economy such as St. Lucia; • the degree to which the benefits of economic integration shield a small economy from the negative aspects of globalisation; • the extent to which regional integration allows a small economy to maximise the gains from globalisation; • the factors that determine the extent of the benefits and/or costs.		Candidates offering judgements such as those opposite will be awarded marks in Level 4, Band 3 of the mark scheme. Annotate judgements using 	**Level 3 [5 – 10 marks]** For an analysis of the benefits of regional economic integration for a small economy, such as St. Lucia. **Level 2 [3 – 4 marks]** For an application of knowledge and understanding of the **benefits** and/or **costs** of regional economic integration for a small economy, such as St. Lucia. Responses must NOT be placed in this Level where candidates have included relevant, if limited, economic analysis of either benefits or costs of economic integration **Level 1 [1 – 2 marks]** For knowledge and understanding of regional economic integration only.

STEMUP.CO.UK

APPENDIX 1: QUALITY OF WRITTEN COMMUNICATION

Quality of written communication is embedded into Levels of Response mark schemes as follows:

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

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

Level 2
Some simple ideas have been expressed. There will be some errors of spelling, punctuation and grammar.

Level 1
There are likely to be some errors of spelling, punctuation and grammar of which some may be noticeable and intrusive.

STEMUP.CO.UK

OCR (Oxford Cambridge and RSA Examinations)
1 Hills Road
Cambridge
CB1 2EU

OCR Customer Contact Centre

14 – 19 Qualifications (General)
Telephone: 01223 553998
Facsimile: 01223 552627
Email: general.qualifications@ocr.org.uk

www.ocr.org.uk

For staff training purposes and as part of our quality assurance programme your call may be recorded or monitored

Oxford Cambridge and RSA Examinations
is a Company Limited by Guarantee
Registered in England
Registered Office; 1 Hills Road, Cambridge, CB1 2EU
Registered Company Number: 3484466
OCR is an exempt Charity

OCR (Oxford Cambridge and RSA Examinations)
Head office
Telephone: 01223 552552
Facsimile: 01223 552553

© OCR 2011

STEMUP.CO.UK

THIS IS A NEW SPECIFICATION

OCR
RECOGNISING ACHIEVEMENT

ADVANCED GCE

ECONOMICS

The Global Economy

F585/SM

STIMULUS MATERIAL

Friday 25 June 2010
Morning

Duration: 2 hours

OCE/31109

INSTRUCTIONS TO CANDIDATES

- This is a clean copy of the Stimulus Material which you have already seen.
- You may **not** take your previous copy of the Stimulus Material into the examination.
- You may **not** take notes into the examination.

INFORMATION FOR CANDIDATES

- This document consists of **12** pages. Any blank pages are indicated.

© OCR 2010 [T/500/7921]
DC (SLM) 31109

OCR is an exempt Charity

STEMUP.CO.UK

Introduction

Towards the end of 2009 many developed economies began to emerge from recession, as the 'green shoots' of recovery appeared. Most commentators expected the same would be true for the UK economy, but official data showed a continued reduction in total output. The UK economy had experienced its longest and possibly its deepest recession since the 1930s.

Policy rules, in both the UK and the European Union (EU), came under pressure as a result of the impact of the recession on public expenditure and tax revenues. Though different in their nature, both the UK fiscal rules and those of the EU's Stability and Growth Pact were broken. What had been seen as guarantees of 'fiscal prudence' came to be seen by some as a 'fiscal straightjacket'.

Unsurprisingly in the recession, some countries' exchange rates came under pressure too. In Central and Eastern European economies, the choice of exchange rate regime appeared to have implications for the key macroeconomic indicators – the 'floaters' recording generally better macroeconomic performance than the 'fixers'.

The recovery in global economic growth in 2009 was fragile for a number of reasons. One of these was the dramatic rise in protectionism. It was not just the increase in tariffs that threatened a recovery in world trade, but the much more serious impact of domestic subsidies. Anti-dumping cases lodged with the World Trade Organisation (WTO) increased by 31.5% from 2008 to 2009.

The end of the recession for some economies coincided with an ambitious global summit in Copenhagen in December 2009 to seek agreement on limiting carbon emissions. The aim of this agreement was to make future growth and development more sustainable. Inevitably, there was disagreement between developed and developing countries about what targets should be set and, in particular, what assistance should be made available to the developing world to help it to meet these targets.

© OCR 2010

STEMUP.CO.UK

Pre-release stimulus material

Extract 1: Longest and deepest UK recession since 1930s?

Extract 2: Fiscal rules broken

Extract 3: Fixers and floaters

Extract 4: The return of protectionism

Extract 5: Making economic growth and development sustainable

© OCR 2010

STEMUP.CO.UK

Extract 1

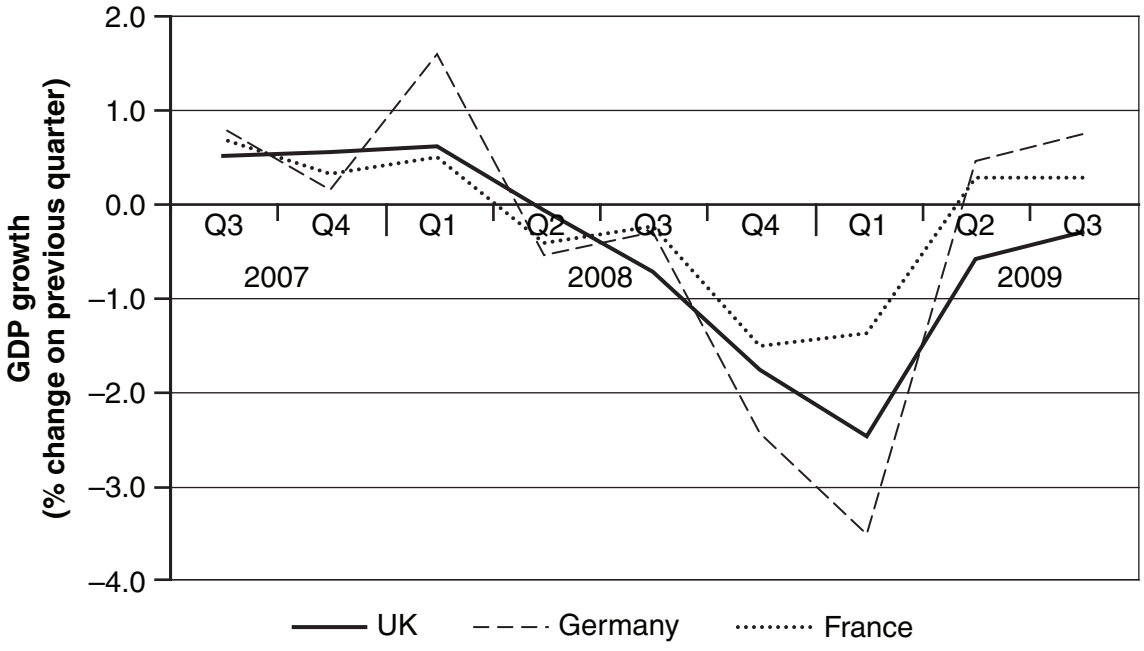
Longest and deepest UK recession since 1930s?

Exactly 12 months after the release of GDP figures which confirmed that the UK economy had entered recession, there were high hopes that data for the third quarter of 2009 would confirm the end of a period of falling GDP. These hopes were dashed when, in October 2009, it was announced by the Office of National Statistics (ONS) that UK GDP in the third quarter of 2009 had fallen by 0.4% over the previous three months. The 'green shoots' of recovery had not yet emerged. Instead, UK GDP had declined for six consecutive quarters making it the longest recession in the post-war period and, possibly, the deepest if recovery did not begin by early 2010.

Inevitably, commentators drew comparisons between macroeconomic performance in the UK and other economies in the period 2008–2009. By November 2009, the UK was the only major global economy not to have emerged from recession. The USA joined France, Germany and Japan in recording positive economic growth in the third quarter of 2009. The euro area as a whole also emerged from recession in the same period, ahead of the UK.

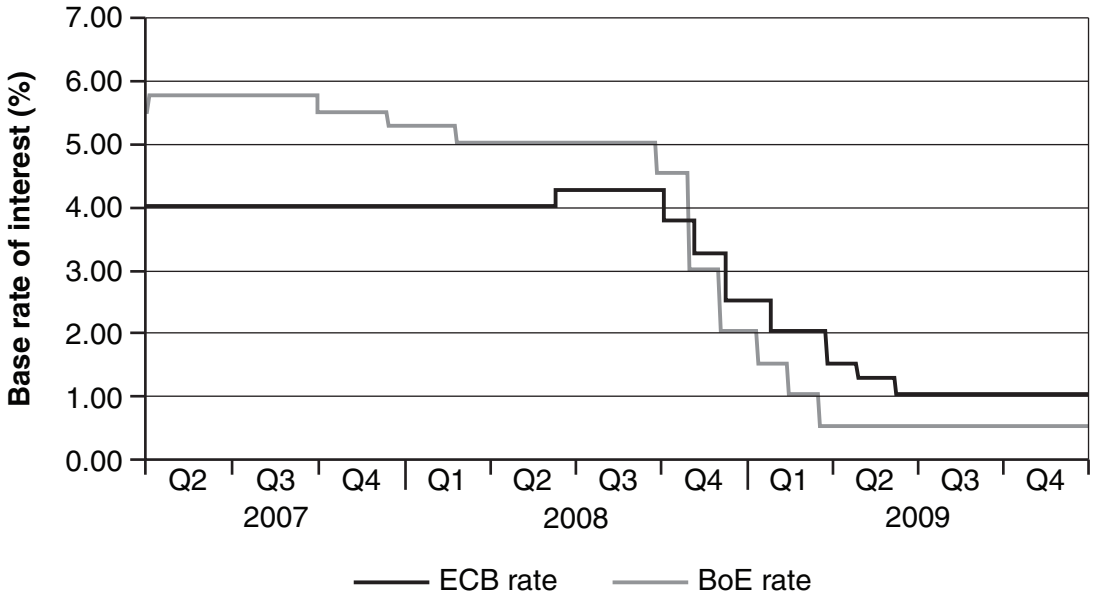
Figs 1.1 and 1.2 below show that the UK economy was still in recession, despite the Bank of England cutting interest rates earlier and more aggressively than the European Central Bank. Economists believed this was due to the different impact that the financial crisis, which had preceded the recession, had had on the UK economy. Consequently, UK policies to stimulate growth had been less effective than the policies in other developed countries. In addition, the behaviour of UK firms in the recession had made the recession more prolonged, as evidenced by the massive reduction in stocks (inventories). This was most obvious in the car industry where assembly lines were simply closed down.

Fig. 1.1 A comparison of quarterly GDP growth



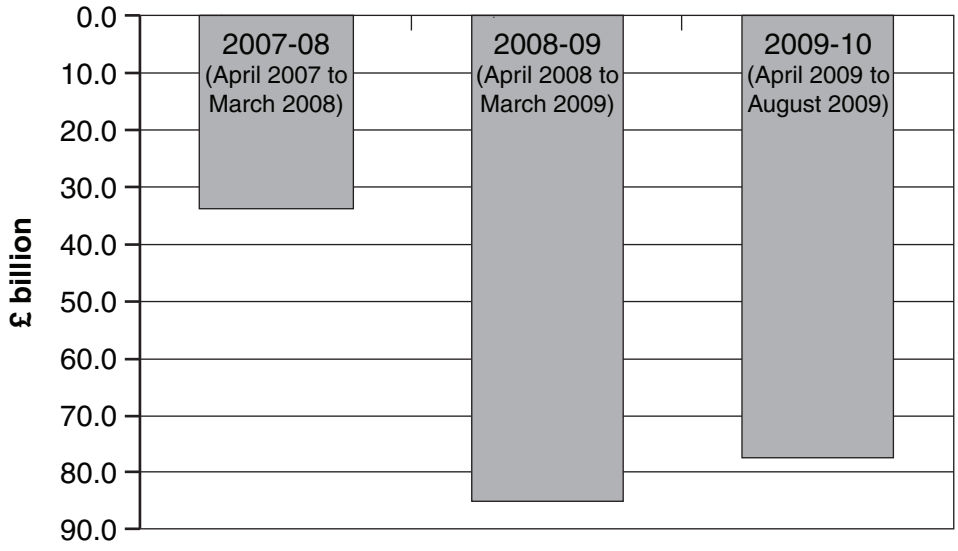
STEMUP.CO.UK

Fig. 1.2 European Central Bank (ECB) and Bank of England (BoE) base rates of interest (%)



Both monetary and fiscal policy in the UK should have helped promote economic growth or, at least, reduced the impact of the recession. The Bank of England base rate was held at an historic low of 0.5% from March 2009. In addition, the Bank effectively created money by buying £125 billion of government bonds back from the private sector: a policy known as quantitative easing. Monetary policy was also eased by the fall in the value of sterling: sterling's effective exchange rate index had fallen by 15% since the start of recession and it had fallen almost 19% against the US$. Fiscal policy was also loosened. The rise in the UK budget deficit (Fig. 1.3) was not just a cyclical rise, as might be expected in a recession. There were discretionary increases in public expenditure and a cut in VAT, adding to the structural (rather than cyclical) nature of the deficit.

Fig. 1.3 UK public sector net borrowing (£bn)



© OCR 2010

STEMUP.CO.UK

Extract 2

Fiscal rules broken

The state of the UK public finances aroused much debate at the end of 2009. The Chancellor of the Exchequer, Alistair Darling, said that it made economic sense for government borrowing to increase as it had done during the recession. Other politicians accused the Government of being 'irresponsible' in its use of fiscal policy. The fiscal rules, which had governed fiscal policy since 1997, had been breached. Alistair Darling argued that it would be 'perverse' to apply the fiscal rules strictly given the severity of the recession and argued that the 'rules' needed to be flexible. Whilst he conceded that the 'golden rule' and the 'sustainable investment rule' would be broken, he stated that the principles underlying the conduct of fiscal policy (credibility, flexibility and transparency) would remain in place.

Members of the euro area had also struggled to meet the fiscal rules set under the European Union's Stability and Growth Pact (SGP). The European Commission produced macroeconomic forecasts for each member state of the European Union in November 2009 (Fig. 2.1). France's budget deficit was forecast by the European Commission to be 8.3% of GDP by the end of 2009, over two and a half times the limit set by the SGP. The budget deficits for Spain and Greece were forecast to be even greater at 11.2% and 12.7% of GDP respectively.

The European Commission said that:

"*the average budgetary position in the EU had gone from –0.8% of GDP in 2007, the best position in 30 years, to –2.3% in 2008, the year when the financial crisis turned into a full-blown economic crisis. That figure is expected to treble to –6.9% in 2009 and to increase further to –7.5% in 2010. Public debt is set to increase by more than 20 percentage points of GDP in the same period, and to continue rising even after the deficits start coming down.*"

On the basis of the budget deficits experienced by some member states, the European Commission put some countries under its Excessive Deficit Procedure (EDP), setting targets for the reduction in deficits over a number of years.

Fig. 2.1 European Commission macroeconomic forecasts for selected EU member states, 2009

	GDP growth (%)	Inflation Rate (%)	Unemployment Rate (%)	Budget deficit (% of GDP)	Current account deficit (% of GDP)
UK	–4.6	2.0	7.8	–12.1	–2.4
France	–2.2	0.1	9.5	–8.3	–2.3
Spain	–3.7	–0.4	17.9	–11.2	–5.4
Greece	–1.1	1.2	9.0	–12.7	–8.8

© OCR 2010

STEMUP.CO.UK

Extract 3

Fixers and floaters

The news that the UK remained in recession in the third quarter of 2009 caused the sharpest depreciation in the value of sterling on the foreign exchange markets in six months. On one day of trading in October, sterling fell 1.5% against the euro.

The downturn in economic activity has also tested the exchange rate regimes of a number of Central and Eastern European economies. Two of these, Slovakia and Slovenia, had joined the euro. The other six Central and Eastern European economies which joined the EU in 2004 had adopted either freely floating or fixed exchange rate regimes:

- Poland, the Czech Republic and Hungary operated freely floating exchange rates;
- Estonia, Lithuania and Latvia had a fixed exchange rate against the euro.

Those which adopted a fixed exchange rate regime appeared to have had most problems. Estonia, Lithuania and Latvia had all enjoyed a decade of high growth prior to the recession, in part promoted by significant levels of foreign direct investment. However, the recession experienced by these economies was deep and prolonged. In addition, since the onset of recession, Estonia, Lithuania and Latvia experienced severe balance of payments problems, despite maintaining positive balances on their current accounts. Potential investors feared that these economies might abandon their fixed exchange rate against the euro, consequently capital inflows dried up and capital outflows increased. There were several speculative attacks on the Estonian, Lithuanian and Latvian currencies which made the problems of these economies worse.

Macroeconomic performance for those member states with floating exchange rates was mixed. Poland's GDP was forecast by the European Commission to grow over the whole of 2009, helped by a 30% fall in the value of the zloty on the foreign exchange markets. On the other hand, Hungary had to be bailed out by the International Monetary Fund (IMF) and the 10% fall in the value of the forint did not prevent the recession from being severe. The experience of the Czech Republic was better than Hungary, but weaker than Poland (see Fig. 3.1).

Fig. 3.1 European Commission macroeconomic forecasts for selected Central and Eastern European EU member states, 2009

	GDP growth (%)	Inflation Rate (%)	Unemployment Rate (%)
Estonia	–13.7	0.2	13.6
Lithuania	–18.1	3.9	14.5
Latvia	–18.0	3.5	16.9
Poland	1.2	3.9	8.4
Czech Republic	–4.8	0.6	6.9
Hungary	–6.5	4.3	10.5

© OCR 2010

STEMUP.CO.UK

Extract 4

The return of protectionism

Whilst it was good news that major developed nations were recovering from recession at the end of 2009, some of the policy reaction to the global downturn was worrying. It had become increasingly apparent that there had been a return to economic nationalism during the recession. Tariffs and quotas had been imposed by some countries on imports and restrictions had been placed on takeovers of national firms by foreign capital. The return of protectionism was also evidenced by the number of anti-dumping cases brought to the World Trade Organisation (WTO), up by one third. Of the 85 cases launched in the first half of 2009, half were against China. More worrying still was the fact that 88 of the 104 anti-dumping cases in the second half of the year were brought by developing countries against subsidised imports.

Barak Obama's presidential campaign at the beginning of the global slowdown raised fears that the USA would turn to protectionism as the spectre of job losses loomed. Obama was quoted as saying:

"*China must change its currency practices. Because it pegs its currency at an artificially low rate, China is running massive current account surpluses. This is not good for US firms and workers, and not good for the world.*"

The US government's fiscal stimulus package contained strong 'Buy American' provisions that limited public sector spending to firms in the USA. In September 2009 the US government imposed 35% tariffs on tyres imported from China – US$1.3 billion of tyres had been imported in the first six months of 2009. China complained to the WTO and announced retaliatory tariffs on imports of US car parts and chicken meat. Such measures were not confined to the USA, however. French President, Nicolas Sarkozy, proposed a 'strategic investment fund' to fight off foreign takeovers; Indonesia introduced licences to limit imports; India and Vietnam introduced tariffs on steel; and Russia imposed tariffs of 30% on cars and 15% on farm machinery.

Just as the global economy emerged from recession, the dramatic rise in protectionism reduced the volume of world trade seriously threatening the global recovery. Both the United Nations (UN) and the Organisation for Economic Co-operation and Development (OECD), forecast that world trade would fall by 15% during 2009 – the first decline for over 20 years.

© OCR 2010

STEMUP.CO.UK

Extract 5

Making economic growth and development sustainable

As the global economic slowdown and recession neared its end, governments of developed and developing nations met in Copenhagen in December 2009 to seek an agreement to further limit carbon emissions. The Copenhagen summit took place under the United Nations Framework Convention on climate change. The major achievement under the UN Framework was the signing of the Kyoto Protocol in 1997. This protocol set binding targets for the carbon dioxide emissions of the major developed economies and established an important principle with respect to developing economies. This principle was that developing economies would face a lower burden in reducing emissions than developed countries.

The Copenhagen summit was the first step in agreeing a successor to the Kyoto Protocol, which expires in 2012. The task ahead of the participants was monumental. According to the International Panel on Climate Change (IPCC), to ensure that global temperatures were no more than 2% above their pre-industrial levels would require a cut in global carbon emissions of 50% of 1990 levels by 2050. For rich developed nations it was estimated that this would require an 80% reduction in emissions. According to the International Energy Agency, such cuts in emissions would require US$1 trillion a year in investment in cleaner technology. The World Bank estimated that, of this global total, US$475 billion a year in investment was needed in developing countries.

Getting an agreement to reduce emissions was only one problem. How to ensure that countries met their agreements was an even bigger issue. Breaking an international commitment to reduce carbon emissions simply involves having to make bigger cuts in emissions in the next round of negotiations. Economists have suggested that the issues surrounding reaching international agreements to bring about a reduction in emissions can be explained in terms of a range of different market failures.

Some countries, such as France, proposed that a failure to meet agreed targets should result in trade sanctions and tariffs to provide countries with incentives to honour their commitments. Developing countries, in particular, were opposed to such measures at a time of slow growth in global trade. They argued that they lacked the capital to make the investments necessary to reduce carbon emissions. Low levels of development made it difficult for them to reduce emissions. They proposed that developing countries should receive increased capital flows from developed nations. China called for the developed countries to contribute 1% of their GDP per year, about US$400 billion. The African Union asked for US$67 billion a year for Africa alone.

If targets had been agreed at Copenhagen, individual governments would need to make policy decisions on how best to achieve these targets. There are three options:

- regulation;
- carbon-pricing;
- subsidies.

Regulation has a role to play, particularly where markets do not work well. But regulation on its own, however, is unlikely to be able to deliver the reductions in carbon emissions the IPCC estimates require. Economists generally argue that carbon pricing is a much more effective and efficient method of reducing carbon emissions. The only large-scale attempt to use carbon pricing is the EU's Emissions Trading Scheme (ETS), set up in 2005. A study by the Massachusetts Institute of Technology concluded that, in its first three years, the ETS had reduced carbon emissions by between 120 million and 300 million tonnes.

© OCR 2010

STEMUP.CO.UK

This meant that emissions were 2–5% a year lower than they would have been without the ETS. In comparison, regulation and subsidies are either ineffective or subject to government failure. Most notable has been the policy to subsidise the production of crops for bio-fuels in the USA which has raised global food prices, yet had little impact on carbon emissions.

China, the world's largest emitter of greenhouse gases, is central to the achievement of any global agreement on cutting carbon emissions. Previously, China has resisted cuts in its emissions, arguing that it unfairly limited its economic development. It would seem that China is now more committed to taking action to ensure sustainable development. It has moved away from the single-minded pursuit of economic growth. Part of the reason for this change in approach to economic development has been the undeniable economic and social impacts from increasing air and water pollution in China. Another is the financial capital it has received under the Kyoto Protocol to enable it to produce clean energy and introduce cleaner technologies in general.

In addition, China can see benefits in a shift to more sustainable development. According to Hu Angang, an economist at Tsinghua University, sustainable development provides:

"*a huge opportunity for China. The country will become the largest renewable-energy market, bio-energy market, clean-coal market, nuclear-power market, carbon-exchange market, environmental-technology market, low-carbon economy, exporter of low-carbon products and low-carbon-technology innovator.*"

Because of its level of development, China may lack the capital and technology to take advantage of these opportunities for sustainability. However, it has an abundance of cheap labour and a political system which allows it to take into account the long term benefits and costs of sustainable growth.

© OCR 2010

STEMUP.CO.UK

BLANK PAGE

© OCR 2010

STEMUP.CO.UK

OCR
RECOGNISING ACHIEVEMENT

Copyright Information

OCR is committed to seeking permission to reproduce all third-party content that it uses in its assessment materials. OCR has attempted to identify and contact all copyright holders whose work is used in this paper. To avoid the issue of disclosure of answer-related information to candidates, all copyright acknowledgements are reproduced in the OCR Copyright Acknowledgements Booklet. This is produced for each series of examinations, is given to all schools that receive assessment material and is freely available to download from our public website (www.ocr.org.uk) after the live examination series.

If OCR has unwittingly failed to correctly acknowledge or clear any third-party content in this assessment material, OCR will be happy to correct its mistake at the earliest possible opportunity.

For queries or further information please contact the Copyright Team, First Floor, 9 Hills Road, Cambridge CB2 1GE.

OCR is part of the Cambridge Assessment Group; Cambridge Assessment is the brand name of University of Cambridge Local Examinations Syndicate (UCLES), which is itself a department of the University of Cambridge.

© OCR 2010

STEMUP.CO.UK

THIS IS A NEW SPECIFICATION

OCR
RECOGNISING ACHIEVEMENT

ADVANCED GCE
ECONOMICS
The Global Economy

F585

Candidates answer on the Question Paper

OCR Supplied Materials:
- Clean copy of Stimulus Material

Other Materials Required:
- Calculators may be used

Friday 25 June 2010
Morning

Duration: 2 hours

OCE/27303

Candidate Forename		Candidate Surname	

Centre Number						Candidate Number				

INSTRUCTIONS TO CANDIDATES

- Refer to the Stimulus Material given in a separate booklet. You must **not** bring your original copy into the examination.
- Write your name clearly in capital letters, your Centre Number and Candidate Number in the boxes above.
- Use black ink. Pencil may be used for graphs and diagrams only.
- Read each question carefully and make sure that you know what you have to do before starting your answer.
- Answer **all** the questions.
- Do **not** write in the bar codes.
- Write your answer to each question in the space provided. If additional space is required, you should use the lined pages at the end of this booklet. The question number(s) must be clearly shown.

INFORMATION FOR CANDIDATES

- The number of marks is given in brackets **[ ]** at the end of each question or part question.
- You will be assessed on the quality of your written communication in question 3. All answers should be in continuous prose.
- The total number of marks for this paper is **60**.
- This document consists of **16** pages. Any blank pages are indicated.

A calculator may be used for this paper

© OCR 2010 [T/500/7921]

OCR is an exempt Charity

STEMUP.CO.UK

Answer **all** questions

1 **(a)** For **two** of the key macro-economic variables, describe the consequences of a period of negative economic growth such as that experienced by the UK economy in 2008–2009.

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

..... **[4]**

© OCR 2010

STEMUP.CO.UK

(b) Despite the Bank of England cutting interest rates earlier and more aggressively than the European Central Bank, the UK economy had not emerged from recession by the third quarter of 2009.

Analyse the reasons why this was the case.

.... **[6]**

© OCR 2010

STEMUP.CO.UK

(c) Comment on the extent to which an economy's macroeconomic performance, such as that of Estonia, Lithuania and Latvia, is affected by its decision to operate a fixed exchange rate regime.

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

© OCR 2010

STEMUP.CO.UK

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

..... **[10]**

© OCR 2010

STEMUP.CO.UK

2 **(a)** Distinguish between the fiscal rules of the UK and those of the European Union's Stability and Growth Pact.

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

..... **[4]**

© OCR 2010

STEMUP.CO.UK

(b) Analyse the impact on economies such as France, Spain and Greece, of adhering to the fiscal rules of the European Union's Growth and Stability Pact in a time of recession.

.... [6]

© OCR 2010

STEMUP.CO.UK

(c) Comment on the case for restricting imports, such as the US tariffs on imported tyres from China, in a time of recession.

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

© OCR 2010

STEMUP.CO.UK

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

..... **[10]**

© OCR 2010

STEMUP.CO.UK

3 The discussions which took place in Copenhagen in December 2009 as part of the United Nations Framework Convention on climate change, together with the Kyoto Protocol are examples of international agreements aimed at promoting sustainability.

Discuss the extent to which international agreements are useful in promoting sustainability. **[20]**

© OCR 2010

STEMUP.CO.UK

© OCR 2010

STEMUP.CO.UK

© OCR 2010

[20]

© OCR 2010

Additional pages. When using this space please make sure your answers are numbered carefully.

© OCR 2010

© OCR 2010

PLEASE DO NOT WRITE ON THIS PAGE

OCR
RECOGNISING ACHIEVEMENT

Copyright Information

OCR is committed to seeking permission to reproduce all third-party content that it uses in its assessment materials. OCR has attempted to identify and contact all copyright holders whose work is used in this paper. To avoid the issue of disclosure of answer-related information to candidates, all copyright acknowledgements are reproduced in the OCR Copyright Acknowledgements Booklet. This is produced for each series of examinations, is given to all schools that receive assessment material and is freely available to download from our public website (www.ocr.org.uk) after the live examination series.

If OCR has unwittingly failed to correctly acknowledge or clear any third-party content in this assessment material, OCR will be happy to correct its mistake at the earliest possible opportunity.

For queries or further information please contact the Copyright Team, First Floor, 9 Hills Road, Cambridge CB2 1GE.

OCR is part of the Cambridge Assessment Group; Cambridge Assessment is the brand name of University of Cambridge Local Examinations Syndicate (UCLES), which is itself a department of the University of Cambridge.

© OCR 2010

RECOGNISING ACHIEVEMENT

GCE

Economics

Advanced GCE **F585**

The Global Economy

Mark Scheme for June 2010

STEMUP.CO.UK

OCR (Oxford Cambridge and RSA) is a leading UK awarding body, providing a wide range of qualifications to meet the needs of pupils of all ages and abilities. OCR qualifications include AS/A Levels, Diplomas, GCSEs, OCR Nationals, Functional Skills, Key Skills, Entry Level qualifications, NVQs and vocational qualifications in areas such as IT, business, languages, teaching/training, administration and secretarial skills.

It is also responsible for developing new specifications to meet national requirements and the needs of students and teachers. OCR is a not-for-profit organisation; any surplus made is invested back into the establishment to help towards the development of qualifications and support which keep pace with the changing needs of today's society.

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

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

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

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

© OCR 2010

Any enquiries about publications should be addressed to:

OCR Publications
PO Box 5050
Annesley
NOTTINGHAM
NG15 0DL

Telephone: 0870 770 6622
Facsimile: 01223 552610
E-mail: publications@ocr.org.uk

Question Number	Answer	Max Mark	Additional Guidance
1 (a)	**For <u>two</u> of the key macro-economic variables, describe the consequences of a period of negative economic growth such as that experienced by the UK economy in 2008–2009** *Synoptic knowledge: AS Unit F582, The national economy* *Government economic policy objectives and indicators of national economic performance* Up to 4 marks: 1 mark for identification of a relevant macroeconomic performance indicator (x2) Accept employment, unemployment, rate of inflation, balance of payments on current account, exports, imports, savings, taxation receipts, government expenditure, budget deficit (PSNCR), investment, consumption, exchange rate, national debt (x2) 1 mark for a description of how a relevant macroeconomic performance indicator is likely to be affected by negative economic growth (x2) Accept employment falls, unemployment rises, rate of inflation falls, balance of payments on current account improves **or** worsens, exports fall if negative growth is global, imports fall, savings rise **or** fall, taxation (receipts) fall, government expenditure rises, budget deficit (PSNCR) increases, investment falls, consumption falls, exchange rate rises **or** falls, national debt rises. (x2) Maximum 4 marks	[4]	Do not accept balance of payments unless specified to be current account. Accept trade balance instead of current account balance. Accept price level (1) falls (1) or deflation (1) BUT do not also credit **<u>fall</u>** in rate of inflation. NOTE: Some variables can change in different ways depending on other factors – candidates are not expected to identify or explain these other factors. So, for example, accept exchange rate rises OR falls. Do not credit interest rates as this is a policy response rather than a variable. **ONE TICK PER MARK AWARDED TO A MAXIMUM OF 4 TICKS**

STEMUP.CO.UK

Question Number	Answer	Max Mark	Additional Guidance
1 (b)	**Despite the Bank of England cutting interest rates earlier and more aggressively than the European Central Bank, the UK economy had not emerged from recession by the third quarter of 2009.** **Analyse the reasons why this was the case.** *Synoptic knowledge: AS Unit F582, The national economy* *Aggregate demand and aggregate supply and their interaction* *The application of macroeconomic policy instruments.* 1 mark for a valid/plausible reason (x2) Up to 4 marks for an analysis of the reasons why the UK economy had not emerged from recession in the third quarter of 2009. Analysis marks should be awarded where candidates make a clear attempt to identify cause and consequence (i.e. **linkages**) in their responses as opposed to listing reasons or making assertions. Example responses: • UK economy may have larger multiplier (1) so that there was a greater reduction in consumer and business confidence than in euro area (1), this resulted a greater reduction in AD in the UK (1) • Interest rate reductions in the UK may have been less effective in raising consumption and investment (1), because of high levels of household and corporate debt (1) which meant that the interest elasticity of consumption and investment was lower (1) • UK firms responded to the recession by de-stocking (1), this caused a bigger reduction in output in the UK (1) and meant that when consumption began to increase there was not corresponding increase in output/GDP (1) *(No marks for a statement such as 'behaviour of firms' only)*	[6]	It is not possible to list all possible approaches candidates might take to this question. The key point is to award 1 mark for the reason (indicate with green tick) and up to 3 additional marks for analysis of each of the reasons given (use green tick plus) Valid reasons might also include: • role of the housing market in the UK; • consumer confidence; • households paying back debt at low interest rates rather than raising consumption; • ability of economies such as Germany to benefit from upturn in global economy, because of its economic structure (increase in manufactured exports); • monetary stimulus could not be sustained once interest rates had reached 0.5% No marks for how expansionary monetary policy SHOULD work. In awarding analysis marks ensure that the candidate is explicitly explaining why UK had not emerged from recession despite the cut in interest rates.

STEMUP.CO.UK

Question Number	Answer	Max Mark	Additional Guidance
	• Fiscal expansion in the UK wasn't as big (1) or automatic stabilisers in the UK less effective (1), so impact of lower interest rates was not supported by fiscal policy to same extent (1) and continued reductions in consumption and investment not compensated by increases in G or increases in disposable income through tax cuts (1) • UK retail banks did not pass on lower base rates to customers (1), so no incentives to increase borrowing or reduce saving (1), so UK AD continued to fall (1), because the monetary policy transmission mechanism was weakened (1) Max 6 marks in total for this question Max 2 marks for reasons only		Additional analysis marks can be awarded where candidate offers more than 2 reasons, but no more than 2 marks can be awarded for the reasons themselves i.e. there are only 2 x AO2 marks for this question

STEMUP.CO.UK

Question Number	Answer	Max Mark	Additional Guidance
1 (c)	**Comment on the extent to which an economy's macroeconomic performance, such as that of Estonia, Lithuania and Latvia, is affected by its decision to operate a fixed exchange rate regime.** *Synoptic knowledge: AS Unit F582, The national and international economy* *Aggregate demand and aggregate supply and their interaction* *Government economic policy objectives and indicators of national economic performance* Level 4 **[7 – 10 marks]** For a commentary on the extent to which an economy's macroeconomic performance, such as that of Estonia, Lithuania and Latvia, is affected by its decision to operate a fixed exchange rate regime. Examples of responses in this level: • The extent to which macroeconomic performance is improved by a fixed exchange rate regime depends on the rate which the currency is fixed. The beneficial impacts of a fixed exchange rate regime are likely to be greater the more the exchange rate is undervalued. • Macroeconomic performance in the long run is determined by real economic factors not monetary ones. The exchange rate does little to affect capital investment and productivity and impacts more on the demand side of the economy than the supply side. • Long run economic growth is more influenced by policies to improve the supply side performance of the economy than it is by exchange rate policies which impact largely on AD. In the short run, macroeconomic performance may be more influenced by other factors as the experience of the UK economy might suggest.	[10]	To gain 10 marks candidates must refer to **other** determinants of macroeconomic performance Where 2 sides are well analysed but there is no reference to other determinants of macroeconomic performance maximum of 9 marks.

STEMUP.CO.UK

Question Number	Answer	Max Mark	Additional Guidance
	Level 3 **[4 – 6 marks]** For a one-sided analysis of the extent to which an economy's macroeconomic performance, such as that of Estonia, Lithuania and Latvia, is affected by its decision to operate a fixed exchange rate regime. Examples of responses in this level which explain the **benefits only** of a fixed exchange rate regime for macroeconomic performance • Fixed exchange rates may improve macroeconomic performance by reducing exchange rate uncertainty and reducing the risks from trade. This is likely to boost export led growth. This has a beneficial impact on AD which, in turn, is likely to raise GDP and employment and reduce unemployment. Fixed exchange rates also reduce the costs of trade, further boosting AD, growth and employment. • Deliberate over-valuation of the exchange rate in a fixed regime may improve macroeconomic performance by reducing inflation – domestic firms have to reduce costs or increase efficiency in order to gain or retain international competitiveness and, for a major importer of production inputs, the impact may be significantly beneficial. Examples of responses in this level which explain the **costs only** of a fixed exchange rate regime for macroeconomic performance • With a fixed exchange rate governments must sacrifice the ability to set domestic interest rates to manage performance in order to achieve an exchange rate target. A fall in the value of the currency will require higher interest rates to maintain the fixed rate of the currency. This might damage macroeconomic performance by reducing AD, especially at a time of recession. This may mean that interest rates cannot be cut during an economic recession to stimulate AD and boost GDP/GDP growth and employment		Level 3 **[4 – 6 marks]** Responses in this level will show an ability to EXPLAIN how macroeconomic performance is affected by choosing to operate a fixed exchange rate regime. Candidates will explain why performance might be improved or might be worsened but will not consider both perspectives. 1 benefit / problem for macroeconomic performance explained well can achieve up to 5 marks 2 benefits / problems for macroeconomic performance with supporting explanation should be awarded 6 marks

STEMUP.CO.UK

Question Number	Answer	Max Mark	Additional Guidance
	• A fixed exchange rate regime does not allow for the correction of imbalances on the balance of payments or for the adjustment to external economic shocks, such as the global recession in 2008-09. The fact that the exchange rate cannot depreciate does not allow the economy to restore price competitiveness or lower the price of exports to boost external demand. Level 2 **[2 – 3 marks]** For an application knowledge and understanding, and critical understanding, of the extent to which an economy's macroeconomic performance, such as that of Estonia, Lithuania and Latvia, is affected by its decision to operate a fixed exchange rate regime. Examples of responses in this level: • The decision to operate a fixed exchange rate regime will benefit macroeconomic performance because it will reduce uncertainty in trade and raise exports. • The Baltic States had negative economic growth whereas countries with floating exchange rates had better rates of economic growth Level 1 **[1 mark]** For knowledge and understanding of exchange rate regimes or macroeconomic performance only, with no attempt to link the two.		Level 2 **[2 – 3 marks]** Responses in this level will only make STATEMENTS about how macroeconomic performance might be affected either positively or negatively by a decision to operate a fixed exchange rate regime. Alternatively, they will focus only on the stimulus material paraphrasing it or using examples descriptively. Level 1 **[1 mark]** Responses in this level will only show knowledge of a fixed exchange rate regime (either explicit or implicit) and/or what is meant by macroeconomic performance (economic growth, inflation, employment/unemployment, balance of payments on current account)

STEMUP.CO.UK

Question Number	Answer	Max Mark	Additional Guidance
2 (a)	**Distinguish between the fiscal rules of the UK and those of the European Union's Stability and Growth Pact.** Up to 2 marks for knowledge: • 1 mark for UK's 'golden rule' states that, over the course of the economic cycle, governments should not borrow to finance current expenditure • 1 mark for UK's 'sustainable investment rule' states that, over the course of the economic cycle, national debt as a percentage of GDP should be set at a 'stable and prudent' level (<40% of GDP) • 1 mark for EU's Stability and Growth Pact limits borrowing to 3% of GDP • 1 mark for EU's Stability and Growth Pact limits national debt to a maximum of 60% of GDP Up to 2 marks for application of the distinction / difference (either 1 mark for two of the following points or 2 marks for one of the points done well) • UK rules take account of the economic cycle, whereas EU rules are annual (1) • UK rules relate to different types of public expenditure, whereas EU rules relate solely to the budget deficit (1) • UK rules place a tighter restriction on national debt (1), though over the course of the economic cycle rather than in any one year (1). • UK rules are more relaxed / flexible (1) as they do not relate to any one year (1) • One of the UK rules does not specify a figure (1) • UK rule sets no limit on size of borrowing / PSNCR (1) • EU rule, by setting a limit, should be more effective in controlling budget deficits (1) • EU rules carry penalties if broken, UK rules do not (1)	[4]	**USE GREEN TICKS FOR KNOWLEDGE MARKS (MAX 2)** Candidates MUST state 'over the course of the economic cycle'. Accept: business cycle, over 10 years, in a boom current surplus should be enough to pay off deficit from recession Candidates MUST state < 40% of GDP' **or** 'stable'/'prudent' level Candidates MUST state 'as a % of GDP' Candidates MUST state 'as a % of GDP' **USE GREEN TICK PLUS FOR DISTINCTIONS (MAX 2)** No marks for EU rules apply to more countries!

STEMUP.CO.UK

Question Number	Answer	Max Mark	Additional Guidance
2 (b)	**Analyse the impact on economies such as France, Spain and Greece, of adhering to the fiscal rules of the European Union's Growth and Stability Pact in a time of recession.** *Synoptic knowledge: AS Unit F582, The national and international economy* *Aggregate demand and aggregate supply and their interaction* Level 3 (**5 – 6 marks**) For an analysis of the impact on economies such as France, Spain and Greece of adhering to the SGP's fiscal rules in a time of recession Responses in this level will make explicit use of economic concepts such as: • AD, components of AD, AD / AS diagram (though not required for highest mark), and develop the impact on GDP, unemployment, rate of inflation, current account of the balance of payments Level 2 (**3 – 4 marks**) For an application of knowledge and understanding of economies such as France, Spain and Greece will be affected by adhering to the fiscal rules in a time of recession Responses in this level will be descriptive and include no economic concepts. Example responses • To adhere to the fiscal rule governments may need to reduce government expenditure / raise revenue from taxation • Sticking to the fiscal rules will make the recession worse • Expansionary fiscal policy will be limited • The economy will be more stable	[6]	Level 3 Credit in Level 3 alternative analysis of the impact of sticking to fiscal rules. This is likely to be a non-Keynesian approach which argues that limiting public sector borrowing / debt will increase business confidence / reduce crowding out and raise levels of private sector investment Watch out for answers which analyse the problems stemming from BREAKING the rules

STEMUP.CO.UK

Question Number	Answer	Max Mark	Additional Guidance
	• They will avoid fines from the EU Level 1 (**1 – 2 marks**) For knowledge and understanding of a recession and / or the need to reduce government expenditure / raise taxation receipts in a recession to meet the rules Example responses: • Recession is two consecutive quarters of negative economic growth • In a recession government spending will rise and tax receipts fall so budget deficit may exceed the limit (automatic stabilisers) • France, Spain and Greece have all broken one of SGP's fiscal rules (deficits > 3% of GDP) • In a recession expansionary fiscal policy may be needed		

STEMUP.CO.UK

Question Number	Answer	Max Mark	Additional Guidance
2 (c)	**Comment on the case for restricting imports, such as the US tariffs on imported tyres from China, in a time of recession.** *Synoptic knowledge: AS Unit F582, The national and international economy* *The international economy – free trade vs protectionism* Level 4 **[7 – 10 marks]** For a commentary on the case for restricting imports, such as the US tariffs on imported tyres from China, **in a time of recession.** Responses in this level will consider the case for **and** the case against restricting imports <u>in a time of recession</u> **OR** simply comment on the case for restricting <u>imports in a time of recession</u> Examples of comments on the case for might include: • The case for protection of domestic jobs depends on how many jobs are likely to be at risk from foreign competition. • The case for restricting imports might be stronger where the industry concerned has suffered large reductions in demand and employment as a result of the recession itself. • The case for restricting imports might be greater where there are large multiplier effects, particularly in supply industries. Level 3 **[4 – 6 marks]** For one-sided analysis of the case for **OR** against restricting imports, such as the US tariffs on imported tyres from China. Examples of responses in this level which explain the **case for** restricting imports: • Tariffs raise the price of imported goods, encouraging domestic consumers to buy more domestically produced goods.	**[10]**	To gain 10 marks candidates must relate their arguments to the recession Where 2 sides are well analysed but there is no developed reference to the recession then maximum of 9 marks Level 3 **[4 – 6 marks]** This might be the case for analysis of the arguments for or the arguments against, but not both. Diagrammatic analysis would be helpful to candidates but is not required for the award of marks at the top of Level 3.

STEMUP.CO.UK

Question Number	Answer	Max Mark	Additional Guidance
	• Without tariffs there are likely to be multiplier effects of reductions in employment. • Reductions in employment will reduce government receipts from taxation and raise government expenditure on welfare benefits causing an increase in the government's budget deficit. • Restricting imports may be justified if there is unfair subsidisation of foreign firms or industries as it can be viewed as an anti-dumping measure which would have added validity in times of recession. • By raising consumption of domestically produced goods, AD is higher than it would otherwise be and so too is GDP and employment. Examples of responses in this level which explain the **case against** restricting imports: • Import restrictions raise domestic prices which reduce domestic consumption causing a reduction in consumer surplus which is not offset by the increased producer surplus in protected industries. Overall economic efficiency (allocative) is reduced. • Protectionism may allow inefficient domestic production to continue, with resource allocation implications. • Restrictions on imports by any one economy are likely to result in retaliation in times of recession. • There is a danger that retaliatory measures reduces the overall level of global trade which will cause a reduction in global AD and GDP		

STEMUP.CO.UK

Question Number	Answer	Max Mark	Additional Guidance
	Level 2 **[2 – 3 marks]** For an application of knowledge and understanding of, the case for and / or against restricting imports, such as the US tariffs on imported tyres from China. Examples of responses in this level: • Countries might restrict imports in order to protect domestic jobs. • Countries might restrict imports to encourage consumers to buy domestically produced goods. • Imports might be restricted because they are unfairly subsidised by foreign governments Level 1 **[1 mark]** For knowledge and understanding of methods of restricting imports only Examples of responses in this level: • Imports can be restricted with the use of tariffs, quotas, voluntary export restraints and / or non-tariff barriers to trade		Level 2 **[2 – 3 marks]** Responses in this level will only make STATEMENTS about why countries such as the US might restrict imports in a time of recession and will lack ANY economic analysis. Responses with unexplained diagrams are also likely to be in this level unless there is textual analysis elsewhere.

STEMUP.CO.UK

Question Number	Answer	Max Mark	Additional Guidance
3	**The discussions which took place in Copenhagen in December 2009 as part of the United Nations Framework Convention on climate change, together with the Kyoto Protocol are examples of international agreements aimed at promoting sustainability. Discuss the extent to which international agreements are useful in promoting sustainability.** *Synoptic knowledge: AS Unit F581, Markets in Action* *Market failure and government intervention* Level 4 (a) **[16 – 20 marks]** For a discussion which includes a judgement on the extent to which international agreements are useful in promoting sustainability. Examples of the types of judgements which candidates might make in this level include: • The extent to which international agreements are useful in promoting sustainability depends on the ability of all governments to monitor the implementation of the agreement and the outcomes of the policies introduced by each country • A determinant of whether international agreements promote sustainability concerns who agrees to what – for examples, whether targets are based current levels of emissions, on per capita emissions rather than the total level of emissions or whether developing economies receive aid/capital to make the necessary adjustments to internalise the external costs of production • The problems of international agreements can be overcome by putting in place measures to ensure that all parties stick to the agreement reached – for example through trade sanctions against non-compliance. • Trade sanctions against non-compliance would internalise the external costs of failing to implement international agreements and end the possibility of free riding which undermines	**[20]**	Candidates are likely to focus on agreements such as Kyoto and focus their responses on environmental sustainability. Credit must be given to other approaches which consider economic and social sustainability and, therefore, candidates who make links to the usefulness of the WTO for example should be able to access all levels of the mark scheme. Level 4 (a) **[16 – 20 marks]** Annotate where candidates state, explain, or develop judgements using EE To gain 20 marks, two or more judgements must be explained / developed To gain 19 marks, candidates explain / develop one judgement and state others To gain 18 marks, candidates must explain / develop one judgement To gain 17 marks, candidates must state two or more brief judgements To gain 16 marks, candidates need only state one brief judgement

STEMUP.CO.UK

Question Number	Answer	Max Mark	Additional Guidance
	international agreements. • Use of the market mechanism might help to overcome the problems of international agreements by establishing a global price for carbon which would allow some countries to gain from exceeding their emissions 'quota' by selling the rights to those economies not meeting their quotas. • The equity issues between developed and developing nations depend very much on how quotas/targets for emissions are arrived at. • Depends on which methods/policies are used to meet the targets set • Usefulness depends on how 'international' the agreement is ie how many countries are involved Level 4 (b) **[11 – 15 marks]** For a balanced discussion of the usefulness of international agreements to promote sustainability. This is most likely to take the form of an analysis of why and how international agreements are useful and the recognition of a range of problems in reaching agreements, meeting agreements or of the aspects of sustainability which might not be met (i.e. a recognition that sustainability involves more than just achieving the environmental objectives of economic growth). Candidates will explain the two sides outlined in Level 3 below. They may also make additional points such as: • Measures to promote environmental sustainability do not necessarily promote the social objectives of economic growth or ensure that the benefits from such growth increase standards of living The discussion will be underpinned by the use of appropriate economic concepts and theories at the top of this band.		Level 4 (b) **[11 – 15 marks]** To gain 15 marks, candidates must explain one side of the argument and explain / develop two or more points on the other side To gain 14 marks, candidates must explain one side of the argument, explain / develop one point on the other side and state others To gain 13 marks, candidates must explain one side of the argument and explain / develop one point on the other side To gain 12 marks, candidates must explain one side of the argument and make two or more brief statements on the other side To gain 11 marks, candidates must explain one side of the argument and make one brief statement on the other side

STEMUP.CO.UK

Question Number	Answer	Max Mark	Additional Guidance
	Discussion which is simply descriptive should be awarded a mark at the bottom of this level. Analysis of the usefulness of international agreements in promoting sustainability with descriptive discussion should be awarded a mark at the bottom of this level. Level 3 **[5 – 10 marks]** For a one-sided analysis of the usefulness of international agreements to promote sustainability. **There are two approaches which can gain L3 marks:** • **Approach 1 – analysis of why international agreements ARE useful** • **Approach 2 - analysis of why international agreements are NOT useful** Analytical responses will make use of at least one of the following terms and concepts: • opportunity cost, use of PPCs, diagrams explaining policy measures, internalisation of external costs, MPC, MSC, AD, AS etc Candidates are most likely to focus on the way in which international agreements can help to internalise the external costs of production. Diagrammatic analysis is likely to characterise responses at the top of this level, but is not necessary to achieve the highest marks. The key to recognising analysis is that candidates move beyond description and assertion, employ relevant theoretical concepts and clearly establish cause and consequence through reasoned explanation of how international agreements promote sustainability. This is unlikely to be possible without a clear understanding of the nature of sustainability. Approach 1: Examples of responses which explain why international agreements **ARE** useful in promoting sustainability: • Individual governments are unlikely to put in place the		Level 3 **[5 – 10 marks]** Treat as one-sided analysis, explanation of pros and cons of different methods of achieving sustainability where these just focus on the policies and are not set in the context of international agreements For example: Candidates who explain two of the measures/policies made under international agreements, how they correct market failure and explain two problems of such measures should be awarded 10 marks Candidates who explain two of the measures/policies made under international agreements, how they correct market failure and explain one problem of such measures should be awarded 9 marks Candidates who explain one of the measures/policies made under international agreements, how they correct market failure and explain one problem of such measures should be awarded 8 marks Candidates who explain one of the measures/policies made under international agreements and how they correct market failure should be awarded 7 marks.

STEMUP.CO.UK

Question Number	Answer	Max Mark	Additional Guidance
	measures to promote sustainability without them • Measures to promote sustainability include raising the marginal private costs of production towards the marginal social costs • If one country introduces measures to increase the private costs of production, through environmental taxation or pollution permits for example, whilst others do not the cost of such action could be detrimental to economic performance and living standards • There are few incentives for individual countries to take the steps necessary to promote sustainability on their own • The benefit of international agreements is that it should ensure that the maximum global economic benefit is attained by all. Approach 2: Examples of responses which explain why international agreements are **NOT** useful in promoting sustainability: • Countries can effectively free ride off the actions of others to meet their targets – they, therefore, gain from lower levels of global emissions without taking the action themselves • Countries may agree to cut carbon emissions but not carry out the action necessary to bring about such reductions. • Countries may gain from increased international competitiveness by cheating on the agreement • International agreement is difficult to reach • Developing economies argue that damage to the environment and to sustainable economic growth has been created by the development of rich nations such as the USA and that they should not be burdened with the additional costs of reducing emissions simply because they lack the capital to make the investments needed • The interests of future generations are unlikely to feature in the short term calculations of any one individual government and agreements are likely to be very hard to reach.		Candidates who explain one or more of the measures/policies made under international agreements and the problems/limitations should be awarded 6 marks Candidates who explain one or more of the measures/policies made under international agreements should be awarded 5 marks

STEMUP.CO.UK

Question Number	Answer	Max Mark	Additional Guidance
	Level 2 **[3 – 4 marks]** For an application of knowledge and understanding of the nature of measures/policies to promote sustainability or general reasons why they are useful Responses in this level will show a total lack of economic analysis of the impacts but will make some valid general points. Theoretical terms and concepts will not be employed, the response will be descriptive and candidates will not move beyond assertion to reasoned explanation of cause and consequence. Examples of responses in this level: • Measures / policies to promote sustainability include emissions trading schemes, environmental taxation and emissions targets • Raises awareness of sustainability issues Level 1 **[1 – 2 marks]** For knowledge and understanding of sustainability and/or international agreements only. Responses in this level will not consider what the usefulness and problems of international agreements in promoting sustainability are. Examples of responses in this level: • Sustainability is economic growth which meets the needs of the current generation without compromising the ability of future generations to meet their own needs • Sustainability is concerned with ensuring that economic growth improves the living standards and the quality of people's lives both now and in the future • Sustainability requires a balance between the economic objectives of increasing output in an economy and the social, environmental and resource consequences of growth.		

STEMUP.CO.UK

Assessment Objectives Grid (includes QWC)

Question	AO1	AO2	AO3	AO4	Total
1 (a)	4	0	0	0	**4**
1 (b)	0	2	4	0	**6**
1 (c)	1	2	3	4	**10**
2 (a)	2	2	0	0	**4**
2 (b)	2	2	2	0	**6**
2 (c)	1	2	3	4	**10**
3	2	2	6	10	**20**
Totals	**12**	**12**	**18**	**18**	**60**

STEMUP.CO.UK

OCR (Oxford Cambridge and RSA Examinations)
1 Hills Road
Cambridge
CB1 2EU

OCR Customer Contact Centre

14 – 19 Qualifications (General)
Telephone: 01223 553998
Facsimile: 01223 552627
Email: general.qualifications@ocr.org.uk

www.ocr.org.uk

For staff training purposes and as part of our quality assurance programme your call may be recorded or monitored

Oxford Cambridge and RSA Examinations
is a Company Limited by Guarantee
Registered in England
Registered Office; 1 Hills Road, Cambridge, CB1 2EU
Registered Company Number: 3484466
OCR is an exempt Charity

OCR (Oxford Cambridge and RSA Examinations)
Head office
Telephone: 01223 552552
Facsimile: 01223 552553

© OCR 2010

STEMUP.CO.UK

THIS IS A NEW SPECIFICATION

OCR
RECOGNISING ACHIEVEMENT

ADVANCED GCE

ECONOMICS

The Global Economy

F585/SM

STIMULUS MATERIAL

Tuesday 2 February 2010

OCE/25154

INSTRUCTIONS TO CANDIDATES

- This is a clean copy of the Stimulus Material which you have already seen.
- You may **not** take your previous copy of the Stimulus Material into the examination.
- You may **not** take notes into the examination.

INFORMATION FOR CANDIDATES

- This document consists of **12** pages. Any blank pages are indicated.

© OCR 2010 [T/500/7921]
DC (KN) 25154

OCR is an exempt Charity

STEMUP.CO.UK

Introduction

During the ten years up to 2008, the pursuit of economic stability appeared to rise to the top of the macroeconomic policy objectives of many countries, including the UK. It was felt that it was not enough simply to achieve high growth, low inflation, high rates of employment and low rates of unemployment and to avoid balance of payments problems. Economic stability was seen as a pre-condition for all of the other policy objectives. Various measures, including widespread adoption of inflation targeting by central banks, were put in place to bring about economic stability. Events during 2008, however, brought to an end this era of economic stability.

One of the symptoms of the end of the era of stability was the sharp downturn in economic activity in countries including the UK and the USA. Fears of recession led policy makers to take dramatic action to counter the downturn in the economic cycle. Monetary expansion, through interest rate reductions, was the most immediate and dramatic of the policy reactions to the downturn. Yet there was much comment as to whether this monetary expansion, on its own, would be sufficient to counter the downturn. Many commentators feared monetary policy would be ineffective in the circumstances of late 2008.

Domestic instabilities soon spread to the global economy and the International Monetary Fund (IMF) was called upon to fulfil its role in the world's financial systems. The IMF put in place packages to support a number of countries, including Hungary, whose economic weaknesses had become apparent. These weaknesses were most obvious in their balance of payments positions. Such weaknesses had been responsible for the collapse of currencies, such as the Hungarian forint, in the turmoil of late 2008.

The events of 2008 brought into sharp focus the consequences of the process of globalisation. Globalisation has long been the subject of debate amongst economists, who see both advantages and disadvantages to the process, particularly for developing economies. The extent to which the net impact of globalisation on any one developing economy is positive or negative remains an issue which is still unresolved.

© OCR 2010

STEMUP.CO.UK

Pre-release stimulus material

Extract 1: UK economic stability threatened

Extract 2: Instability creates macroeconomic policy debate in the UK

Extract 3: Countries call on the International Monetary Fund (IMF)

Extract 4: Globalisation raises fears for developing countries

STEMUP.CO.UK

Extract 1

UK economic stability threatened

During October 2008 the 'R' word (recession) featured heavily in commentary on the performance of the UK economy. The National Institute of Economic and Social Research predicted recession. The British Chambers of Commerce said that its members (small and medium sized businesses) were experiencing the effects of recession. Even the Governor of the Bank of England and the Prime Minister acknowledged recession was likely.

Following zero economic growth in the second quarter of 2008, official statistics for the third quarter showed a decline in UK national output. Many economists believed that official statistics for the fourth quarter would show further negative economic growth. This would be enough to confirm the UK's first recession since 1992.

Sixteen years of continuous economic growth in the UK had convinced many people that economic policy makers had delivered an unprecedented period of economic stability. The Labour Government had boasted of its record on economic stability since coming to office in 1997. In his first Budget as Chancellor, Gordon Brown had said:

> *"to avoid a lurch backwards towards the kind of boom-bust instability that brought interest rates as high as 15 per cent in the late 1980s, the Government and the Bank of England took action to ensure economic stability."*

This action included:

- granting operational independence to the Bank of England in the conduct of monetary policy and setting the Bank an inflation target;
- creating a Code of Fiscal Stability in which there were clearly defined rules for the conduct of fiscal policy;
- raising interest rates five times during 1997 to reduce inflationary pressures in the economy.

The downturn in economic activity, the uncertainty in financial markets and the depreciation of the UK exchange rate brought to an end the period of economic stability.

Some economists argued that the breakdown of economic stability had begun in 2007 when UK inflation exceeded the Bank of England's target rate. The downturn in economic activity in 2008, the volatility in financial markets and the depreciation of the UK's exchange rate certainly confirmed the end of an era of stability.

© OCR 2010

STEMUP.CO.UK

Extract 2

Instability creates macroeconomic policy debate in the UK

The financial and economic crises of 2008 were not confined to the UK. They were global crises. The financial crisis had its roots in over-inflated asset prices, particularly house prices in the USA, and bank lending against these assets to households with poor credit ratings. As interest rates in the USA rose, these households were unable to repay their borrowing, house prices fell and the bank loans made to those with poor credit ratings (so-called sub-prime lending) came to be viewed as too risky. Banks most exposed to these risks began to collapse. The globalisation of financial markets meant that the crisis spread outside the USA. Depositors panicked. In the UK, savers in the Northern Rock bank withdrew £1 billion from their accounts in one day. Globally, banks stopped lending to each other and more banks and financial institutions ran into trouble. Banks merged to avoid bankruptcy, some were part-nationalised and governments world-wide injected cash into the banking system to try to ease the growing credit crunch.

The financial crisis was not the only problem which policy makers had to confront in 2008. As economic growth slowed down many people feared that the global economy would enter recession. Central banks began to reduce interest rates aggressively in response to the economic slowdown. Interest rate reductions were co-ordinated by the world's biggest central banks in October 2008 – the US Federal Reserve, European Central Bank (ECB), Bank of England, and the central banks of Canada, Sweden and Switzerland all made emergency interest rate cuts of half a percentage point. Interest rates in the US fell to just 1%. Shortly afterwards, the Bank of England slashed its interest rate by a further 1.5 percentage points.

However, questions were raised about the effectiveness of monetary policy. It was clear that cuts in central bank base rates were initially having little impact on the rates at which banks lent to each other (inter-bank rates) and so to households and firms. It was not unknown for these rates, such as the three month London Inter-Bank Offer Rate (LIBOR), to remain stubbornly high, if not increase, as central bank rates came down (see Fig. 2.1). As a result, the monetary policy transmission mechanism was weakened.

Fiscal policy measures were advocated as an alternative to monetary expansion. Tax cuts were proposed to encourage a growth in spending. Some governments proposed increased public expenditure. In the UK, the Chancellor of the Exchequer announced that public expenditure plans would be brought forward to help bolster demand in the economy. There was a recognition that public borrowing would have to increase to fund this expenditure and that fiscal rules, such as the 'golden rule', might have to be broken. In addition, negative economic growth would further increase public sector borrowing through its impact on tax revenues and welfare spending. Even before the economic crisis deepened in October 2008, public sector borrowing in the UK had reached record levels. Some forecasters expected UK public sector borrowing to reach £60 billion in the financial year 2008–09.

Economists in the UK were divided on the appropriate response to an economic downturn and negative economic growth. A group of 16 economists wrote a letter to The Sunday Telegraph declaring the UK Government's plans to be "misguided and discredited". Their letter is reproduced below in Fig. 2.2.

© OCR 2010

STEMUP.CO.UK

Fig. 2.1 The Bank of England base rate and the three month inter-bank offer rate (LIBOR), 1 January 2008 to 20 October 2008

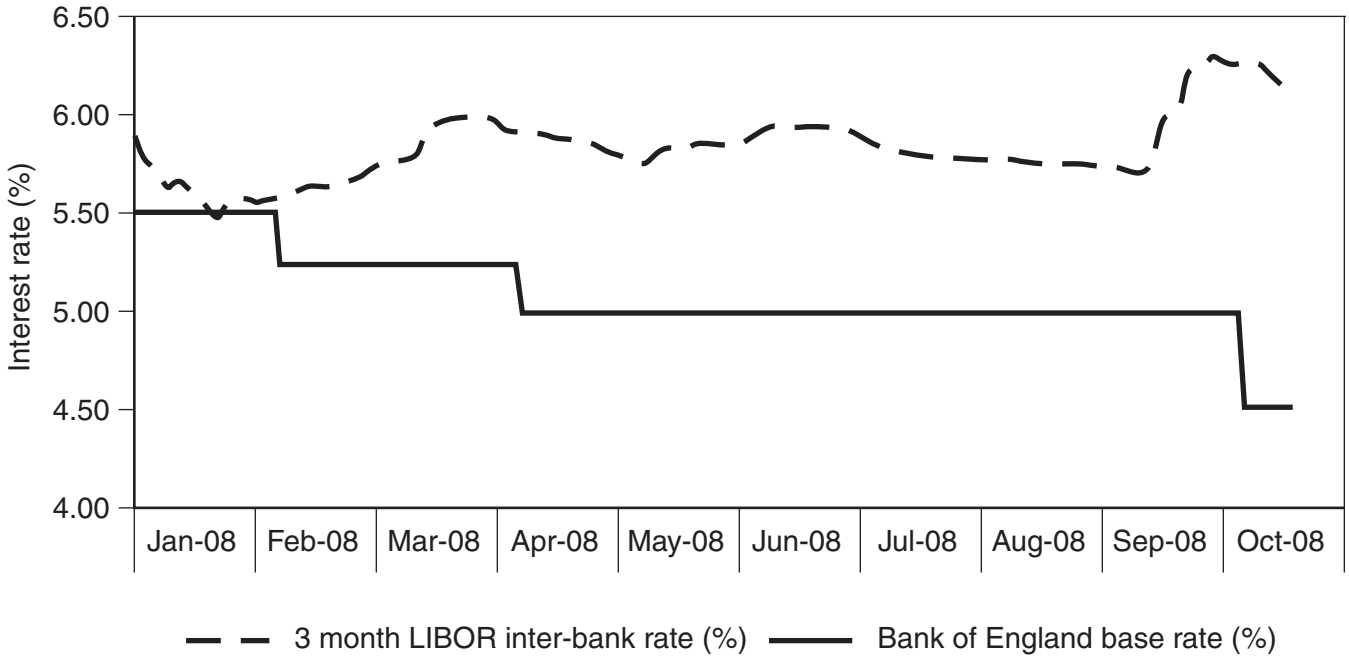


Fig. 2.2 Letter to The Sunday Telegraph by 16 UK economists

Keynesian over-spending won't rescue the economy

Further to your interview with Alistair Darling, we would like to dissent from the attempt to use a public works programme to spend the country's way out of recession.
It is misguided for the Government to believe that it knows how much specific sectors of the economy need to shrink and which will shrink "too rapidly" in a recession.
Thus the Government cannot know how to use an expansion in expenditure that would not risk seriously misallocating resources.
Furthermore, public expenditure has already risen very rapidly in recent years, and a further large rise would take the role of the state in many parts of the economy to such a dominant position that it would stunt the private sector's recovery once recession is past.
Occasional slowdowns are natural and necessary features of a market economy.
Insofar as they are to be managed at all, the best tools are monetary and not fiscal ones. It is inevitable that government expenditure and debt naturally rise in a recession but planned rises in government spending are misguided and discredited as a tool of economic management.
If this recession has features that demand more active fiscal policy, which is highly disputable, taxes should be cut. This would allow the market to determine which parts of the economy shrink and which flourish to replace them.

© OCR 2010

STEMUP.CO.UK

Extract 3

Countries call on the International Monetary Fund (IMF)

One of the consequences of the global financial crisis was a loss in confidence in the banking system. Just as this causes individuals to withdraw their cash (a 'run on the bank'), a loss of confidence in a country's ability to repay its 'debts' causes a run on the currency. Capital flight, as it is called, can send a currency into free fall and send countries cap in hand to the International Monetary Fund (IMF).

In early October 2008, the exchange rates of a number of countries collapsed as capital flight took hold. These countries approached the IMF for assistance. According to the BBC's Business Editor, Robert Peston:

"Queuing up for the intensive care ward are Iceland, Hungary, Pakistan, Ukraine and Belarus, all of which are in discussions about accessing special loans from the International Monetary Fund, the emergency medical service for the global economy. But there has also been a substantial withdrawal of capital from South Africa, Argentina and - most worrying of all - South Korea."

These countries have, in the past, attracted large amounts of foreign capital as their economies have undergone economic development. This means that they have large external debts. The level of this debt ranged from around US$40 billion for Pakistan to US$100 billion in Hungary, to almost US$200 billion in the case of South Korea. Some countries, though not all, had experienced large and growing current account deficits on their balance of payments. They had financed these deficits by attracting flows of money from abroad. This was all very well as long as those providing the financial capital carried on doing so or did not want it back in a hurry. Not so good when this source of long-term financial capital dries up or the investors want their money back. And that is what happened in 2008 – financial capital was withdrawn from these economies, causing their currencies to depreciate dramatically. For example, Hungary's currency (the forint) fell against the euro by 15% in October 2008, forcing Hungary's central bank to raise interest rates by three percentage points in an attempt to halt the depreciation of the forint. Only when the country received loans from the IMF, the World Bank and the EU totalling US$25 billion did the forint recover. These loans were conditional upon Hungary taking steps to reduce its large and significant current account deficit.

South Korea's situation, however, was different. As one of the world's major exporters, its current account balance was healthy. Much more so than that of the UK, where there had been a persistent and growing current account deficit for a number of years. It was not surprising, then, that the UK also experienced a fall in its exchange rate during 2008. From August to October, sterling fell 22% against the US$; it depreciated by 14% in October alone. As the UK operates a freely floating exchange rate, the value of sterling is likely to fall as exports are reduced by global economic downturns. But sterling's exchange rate is also affected by short term financial capital flows. The anticipation of lower interest rates, as part of a monetary expansion, was likely to have been a major factor in sterling's depreciation in 2008.

The depreciation of sterling was viewed by some economists as a good thing for the UK economy. For others it raised a dilemma for economic policy. These economists argued that a fall in the value of sterling made it more difficult for the Bank of England to reduce interest rates, because of the possible inflationary consequences of higher import prices. Some commentators argued that it was time to abandon inflation targets – at least temporarily – since, perversely, they were undermining the return to economic stability. Others pointed out that the dilemma for economic policy made the case for the UK's membership of the euro area stronger than it had ever been before.

© OCR 2010

STEMUP.CO.UK

Extract 4

Globalisation raises fears for developing countries

The financial crisis of 2008 had its roots very firmly in the developed world. However, the nature of globalisation meant that there were concerns that the developing world would suffer consequences too. For example, Shanta Devarajan, Chief Economist of the World Bank's Africa Region, identified three ways in which Africa might suffer:

- a decline in private financial capital flows, which Africa has become dependent on for its infrastructure investment;
- a decline in commodity prices, as the global economic slowdown reduces the demand for commodities such as oil and copper;
- a reduction in flows of aid, as developed economies reallocate public expenditure during the economic slowdown.

In addition, fears were expressed that developed countries could demand debt repayments from African countries. This would inevitably lead to cutbacks in expenditure on health and education in African countries, with severe consequences for economic development.

However, Louis Kasekende, Chief Economist at the African Development Bank (AfDB), considered that African economies would continue to record annual economic growth averaging 6% until 2010. He felt that the impact on Africa of the global financial and economic crisis would be limited in the short term because of its weak integration into the global economy. The signing of an African Free Trade Area agreement would also limit the initial impact of the global economic slowdown.

In contrast, goods and services produced in Asia tend to be traded much more internationally. Asian nations would be worried that a slowdown in the growth of demand in Western developed nations would reduce the demand for their exports and risk the loss of jobs in Asia. China's economic growth, for example, fell throughout 2008, and it was reported that half of China's toy manufacturers had gone out of business. There were calls from China for the USA to reduce its trade barriers in order to open up its market to products from China and other developing countries.

Some economists took the opportunity to express their doubts about the benefits of globalisation for developing countries. Jayati Ghosh, Professor of Economics at Jawaharlal Nehru University, in Delhi, India, said that:

"India is seen as a big success story of globalisation, but only a minority of Indians have benefited materially from the high economic growth. Formal sector employment stagnated; real wages for most workers actually fell; nearly 200,000 farmers committed suicide in the period of 1995-2006 alone; and there was an increase in the number of malnourished children.
So the recent economic growth was not inclusive. But, unfortunately, the coming slump will be only too inclusive, forcing those who did not gain earlier to pay for the sins of irresponsible and unregulated finance, through their own loss of livelihood and reduced living standards."

Others, such as Jagdish Bhagwati (Professor at Columbia University, USA), warned that the benefits globalisation had brought, in terms of greater openness of economies and the gains from international trade, should not be sacrificed by a return to protectionism.

© OCR 2010

STEMUP.CO.UK

BLANK PAGE

© OCR 2010

STEMUP.CO.UK

BLANK PAGE

© OCR 2010

STEMUP.CO.UK

BLANK PAGE

© OCR 2010

STEMUP.CO.UK

OCR
RECOGNISING ACHIEVEMENT

Copyright Information

OCR is committed to seeking permission to reproduce all third-party content that it uses in its assessment materials. OCR has attempted to identify and contact all copyright holders whose work is used in this paper. To avoid the issue of disclosure of answer-related information to candidates, all copyright acknowledgements are reproduced in the OCR Copyright Acknowledgements Booklet. This is produced for each series of examinations, is given to all schools that receive assessment material and is freely available to download from our public website (www.ocr.org.uk) after the live examination series.

If OCR has unwittingly failed to correctly acknowledge or clear any third-party content in this assessment material, OCR will be happy to correct its mistake at the earliest possible opportunity.

For queries or further information please contact the Copyright Team, First Floor, 9 Hills Road, Cambridge CB2 1GE.

OCR is part of the Cambridge Assessment Group; Cambridge Assessment is the brand name of University of Cambridge Local Examinations Syndicate (UCLES), which is itself a department of the University of Cambridge.

© OCR 2010

STEMUP.CO.UK

THIS IS A NEW SPECIFICATION

OCR
RECOGNISING ACHIEVEMENT

ADVANCED GCE
ECONOMICS
The Global Economy

F585

OCE/12646

Candidates answer on the Question Paper

OCR Supplied Materials:
- Clean copy of Stimulus Material

Other Materials Required:
- Calculators may be used

Tuesday 2 February 2010
Afternoon

Duration: 2 hours

Candidate Forename		Candidate Surname	

Centre Number						Candidate Number				

INSTRUCTIONS TO CANDIDATES

- Refer to the Stimulus Material given in a separate booklet. You must not bring your original copy into the examination.
- Write your name clearly in capital letters, your Centre Number and Candidate Number in the boxes above.
- Use black ink. Pencil may be used for graphs and diagrams only.
- Read each question carefully and make sure that you know what you have to do before starting your answer.
- Answer **all** the questions.
- Do **not** write in the bar codes.
- Write your answer to each question in the space provided. If additional space is required, you should use the lined pages at the end of this booklet. The question number(s) must be clearly shown.

INFORMATION FOR CANDIDATES

- The number of marks is given in brackets **[ ]** at the end of each question or part question.
- You will be assessed on the quality of your written communication in question 3. All answers should be in continuous prose.
- The total number of marks for this paper is **60**.
- This document consists of **12** pages. Any blank pages are indicated.

A calculator may be used for this paper

© OCR 2010 [T/500/7921]
DC (KN) 12646/7

OCR is an exempt Charity

Turn over

STEMUP.CO.UK

Answer **all** questions

1 **(a)** Describe what is meant by economic stability.

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

..... **[4]**

(b) Analyse how inflation targeting, such as that used in the UK, can help promote economic stability.

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

© OCR 2010

STEMUP.CO.UK

.....

.....

.....

.....

.....

..... **[6]**

(c) Comment on the effectiveness of using expansionary monetary policy during a downturn in the economic cycle, such as that experienced in the UK in 2008.

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

© OCR 2010

STEMUP.CO.UK

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

..... **[10]**

© OCR 2010

2 **(a)** Explain the role of the International Monetary Fund (IMF).

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

.....

..... **[4]**

© OCR 2010

STEMUP.CO.UK

(b) Using a diagram, analyse the causes of the depreciation of the Hungarian forint which occurred during 2008.

.....

.....

.....

.....

.....

.....

.....

.....

..... **[6]**

(c) Comment on the extent to which a deficit on the current account of the balance of payments, such as that in Hungary and the UK, is a sign of economic weakness.

.....

.....

.....

.....

.....

.....

© OCR 2010

STEMUP.CO.UK

[10]

© OCR 2010

STEMUP.CO.UK

3 Discuss the impact of globalisation on developing economies.

© OCR 2010

STEMUP.CO.UK

[20]

© OCR 2010

STEMUP.CO.UK

Additional pages. When using this space please make sure your answers are numbered carefully.

© OCR 2010

© OCR 2010

PLEASE DO NOT WRITE ON THIS PAGE

OCR
RECOGNISING ACHIEVEMENT

Copyright Information

OCR is committed to seeking permission to reproduce all third-party content that it uses in its assessment materials. OCR has attempted to identify and contact all copyright holders whose work is used in this paper. To avoid the issue of disclosure of answer-related information to candidates, all copyright acknowledgements are reproduced in the OCR Copyright Acknowledgements Booklet. This is produced for each series of examinations, is given to all schools that receive assessment material and is freely available to download from our public website (www.ocr.org.uk) after the live examination series.

If OCR has unwittingly failed to correctly acknowledge or clear any third-party content in this assessment material, OCR will be happy to correct its mistake at the earliest possible opportunity.

For queries or further information please contact the Copyright Team, First Floor, 9 Hills Road, Cambridge CB2 1GE.

OCR is part of the Cambridge Assessment Group; Cambridge Assessment is the brand name of University of Cambridge Local Examinations Syndicate (UCLES), which is itself a department of the University of Cambridge.

© OCR 2010

OCR
RECOGNISING ACHIEVEMENT

GCE

Economics

Advanced GCE **A2 H461**

Advanced Subsidiary GCE **AS H061**

Mark Schemes for the Units

January 2010

HX61/MS/R/10J

STEMUP.CO.UK

OCR (Oxford Cambridge and RSA) is a leading UK awarding body, providing a wide range of qualifications to meet the needs of pupils of all ages and abilities. OCR qualifications include AS/A Levels, Diplomas, GCSEs, OCR Nationals, Functional Skills, Key Skills, Entry Level qualifications, NVQs and vocational qualifications in areas such as IT, business, languages, teaching/training, administration and secretarial skills.

It is also responsible for developing new specifications to meet national requirements and the needs of students and teachers. OCR is a not-for-profit organisation; any surplus made is invested back into the establishment to help towards the development of qualifications and support which keep pace with the changing needs of today's society.

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

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

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

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

© OCR 2010

Any enquiries about publications should be addressed to:

OCR Publications
PO Box 5050
Annesley
NOTTINGHAM
NG15 0DL

Telephone: 0870 770 6622
Facsimile: 01223 552610
E-mail: publications@ocr.org.uk

F585 The Global Economy

Question Number			Answer	Max Mark	Rationale/Additional Guidance
1	(a)		**Describe what is meant by economic stability.** Economic stability refers to a environment which enhances long term macroeconomic performance by reducing uncertainty and promoting business and consumer confidence and investment. The result is a higher rate of long term economic growth. In particular economic stability relates to the avoidance of volatility in: • economic growth rates; • inflation; • employment and unemployment; • exchange rates. *Synoptic knowledge: AS Unit F582, The national economy Government economic policy objectives and indicators of national economic performance* 1 mark for a definition of economic stability or the outcome of economic stability in terms of macroeconomic performance 3 marks for any of the aspects of economic stability in the bullets above	**[4]**	**There must be a definition along these lines which describes the link between economic stability and the performance of the economy in the long run. No marks for reduced uncertainty, promoting confidence and investment on their own.** **Answers which simply list these characteristics should be awarded a maximum of 3 marks (1 mark for each indicator). Accept 'avoidance of volatility', 'little fluctuation', little variation', 'steady', 'target BAND for inflation (eg 1 – 3%)' BUT NOT 'stable' or 'low'** **Answers which talk of 'stable' inflation, growth etc can be awarded a maximum of 2 marks on the basis that candidates are being asked to describe what stability is!** **No marks to be awarded for 'low inflation', low unemployment' etc as these do not get to the heart of stability**

Question Number			Answer	Max Mark	Rationale/Additional Guidance
1	(b)		**Analyse how inflation targeting, such as that used in the UK, can help promote economic stability.** The UK inflation target is symmetrical – the central target is 2%, with an 'upper ceiling' of 3% and a 'floor' of 1%. As a result, built into the target is a belief that low inflation is as much a concern as high inflation. The costs of high inflation include: the impact on long-term planning; increased risks and borrowing costs; the misallocation of resources; and the impact on the distribution of income. Given the difficulties of measuring the rate of inflation, a low rate of inflation risks a low rate of economic growth. The advantage of a symmetrical inflation target, then, is that interest rate changes are likely to be less frequent and of a lower amount. In this way, a symmetrical inflation target is likely to promote economic stability. In addition, the objectives of this aspect of macroeconomic policy are clear and transparent. This has an impact on inflationary expectations, considered to be a key determinant of inflation in modern macroeconomics. Furthermore, the UK inflation target acts as a constraint on fiscal policy – policy makers are aware that any fiscal expansion which is likely to compromise the inflation target is likely to be met by monetary policy tightening. In short, inflation targeting reduces macroeconomic instability created by manipulation of monetary and fiscal policy for short term political objectives and ensures that monetary policy decisions are not unduly influenced by current macroeconomic conditions. Implicitly, inflation targets recognise the time-lags inherent in monetary policy. *Synoptic knowledge: AS Unit F582, The national economy The application of macroeconomic policy instruments.*		**Award application marks as follows:** **1 mark for setting a specific target, such as 2% in the UK** **1 mark for setting a target band such as 1 – 3% in the UK** **1 mark for inflation targets can be symmetrical or asymmetrical** **Max 2 marks for application** **In awarding analysis marks it is important to distinguish between responses which simply give reasons WHY inflation targets promote stability and those that explain HOW inflation targets promote stability.** **So, statements of reasons only are to be awarded 2 marks (annotate with green ticks)** **Relevant reasons which can be credited include:** • **reduced inflationary expectations** • **constraint on fiscal expansion** • **clear and transparent objectives of monetary policy** • **avoidance of deflationary bias – low inflation matters as much as high inflation, monetary policy is 'flexible', maintains economic growth at stable rate** • **keeps inflation within a band / keeps inflation stable** • **businesses and consumers can confidently plan for the future** • **can help achieve stable inflation**

STEMUP.CO.UK

Question Number			Answer	Max Mark	Rationale/Additional Guidance
			Up to 2 marks for an understanding of the nature of inflation targets such as those in the UK. Up to 4 marks for an analysis of how inflation targets may promote economic stability by reducing the costs of inflation, promoting certainty and reducing inflationary expectations.	[6]	**Explanation of HOW should be awarded an additional 2 marks (annotate with green tick +) Analysis is likely to include use of 'connectives' eg 'this is because', 'this will result in', 'the consequence will be' (it may be useful to highlight these phrases). Link to stability is needed for 2 marks, can get 1 if explains how confidence promotes investment etc** **Max of 4 marks for green ticks only**

STEMUP.CO.UK

Question Number			Answer	Max Mark	Rationale/Additional Guidance
1	(c)		**Comment on the effectiveness of using expansionary monetary policy during a downturn in the economic cycle, such as that experienced in the UK in 2008.** Monetary policy involves central bank and / or government decisions on interest rates, the money supply and the exchange rate. An expansionary monetary policy would involve reductions in the rate of interest, increases in the money supply and measures designed to bring about a fall in a country's exchange rate. Extract 2 clearly focuses on the effectiveness of reductions in the interest rate and this is how the vast majority of candidates are likely to approach the question. However, credit must be given in an identical way to those candidates who choose to comment on the effectiveness of increases in the money supply and / or reductions in the exchange rate. Candidates are expected to show an ability to analyse the monetary policy transmission mechanism and how reductions in interest rates might be effective in a downturn in the economic cycle. For example, a reduction in the central bank's official (base) rate of interest will lead to market rates of interest being reduced. This will have an effect on domestic and net external demand. A lower interest rate reduces the incentive to save, raises consumption and investment (by reducing the cost of borrowing) and raises export demand and lowers import demand by leading to a fall in the exchange rate. The overall effect is to increase aggregate demand, thereby cushioning the impact of the economic slowdown or reversing it.		**Responses to this question should be annotated using the L1, L2, L3, L4 tools in Scoris consistent with the level descriptors below** **Analysis and commentary should relate EXPLICITLY to the effectiveness of monetary policy in promoting GROWTH of AD and / or GDP** **Level 4 answers MUST show how monetary policy should work to raise AD and / or GDP AND reasons why it might not be effective in this respect** **Where reasons why monetary policy might not be effective are simply stated and not explained a maximum mark of 8 should be awarded** **Accept as L4 response the argument that cuts in interest rates were not effective as BoE had to supplement this kind of expansionary monetary policy with quantitative easing** **Accept recognition of the time lag in monetary policy as a point of evaluation** **Accept explanation of why fiscal policy may be more effective as a point of evaluation for L4 marks** **Do not accept inflationary consequences of lower interest rates as commentary on effectiveness as it is not in context**

STEMUP.CO.UK

Question Number			Answer	Max Mark	Rationale/Additional Guidance
1	(c)		Commentary on the effectiveness can take different forms, but is most likely to focus on the extent to which the monetary policy transmission mechanism operates as expected. Extract 2 provides context on the behaviour of LIBOR, which candidates could usefully comment upon. Reductions in base rates may not lead to reductions in market rates of interest and therefore expansionary monetary policy may not be effective. Candidates should recognise that this is a special case limiting the effectiveness of expansionary monetary policy as it relates to the circumstances of 2008 where the banking crisis had made banks wary of lending to each other without a significant 'risk premium'. Expansionary monetary policy is more effective at other times. Candidates could also make judgements about the benefits of expansionary monetary policy in terms of the ability to make a rapid response to the downturn because of the absence of time lags in monetary policy decisions. Developed commentary should seek to examine other weaknesses in the monetary policy transmission mechanism. For example, reductions in interest rates may not stimulate spending and investment during an economic downturn – the interest elasticity of demand for loans may be inelastic. Firms are unlikely to increase investment expenditure in an economic downturn just because borrowed funds are cheaper. They are much more likely to delay investment plans whilst they expect the downturn to continue. Similarly, consumers are unlikely to borrow money to fund consumption if they have been made unemployed or fear that they will be. During an economic downturn, expectations may be a more important determinant of the overall level of aggregate demand than the interest rate. The impact of lower interest rates on net		**Level 4 [7 – 10 marks]** For a commentary on the effectiveness of expansionary monetary policy during a downturn in the economic cycle, such as that experienced in the UK in 2008. Commentary should be supported by explicit economic analysis of the monetary policy transmission mechanism and the circumstances in which it may not operate effectively. **Level 3 [4 – 6 marks]** For an analysis of expansionary monetary policy during a downturn in the economic cycle, such as that experienced in the UK in 2008. Responses at the top of this level should make explicit use of more than one component of AD to analyse cause and effect of expansionary monetary policy / a reduction in interest rates. **Level 2 [2 – 3 marks]** For an application of knowledge and understanding of the causal links between expansionary monetary policy and the level of economic activity. Responses in this level, however, will lack any clear economic analysis of the impact of expansionary monetary policy on the components of AD. **Level 1 [1 mark]** For knowledge and understanding of expansionary monetary policy and / or an economic downturn only, but which shows no understanding of the causal link between the two.

STEMUP.CO.UK

Question Number			Answer	Max Mark	Rationale/Additional Guidance
			external demand depends on the extent of any fall in the exchange rate and the price elasticities of demand for exports and imports. In a time of global slowdown, foreign income may be a more important determinant of the demand for exports than the price of exports. The timing and size of interest rate reductions would also have an impact on their effectiveness. *Synoptic knowledge: AS Unit F582, The national and international economy* *Aggregate demand and aggregate supply and their interaction.* *Government economic policy objectives and indicators of national economic performance* *The application of macroeconomic policy instruments.* **Level 4 [7 – 10 marks]** For a commentary on the effectiveness of expansionary monetary policy during a downturn in the economic cycle, such as that experienced in the UK in 2008. Commentary should be supported by explicit economic analysis of the monetary policy transmission mechanism and the circumstances in which it may not operate effectively. At the top end, candidates should comment on more than one factor limiting the effectiveness of expansionary monetary policy and reach a reasoned conclusion. **Level 3 [4 – 6 marks]** For an analysis of expansionary monetary policy during a downturn in the economic cycle, such as that experienced in the UK in 2008.		

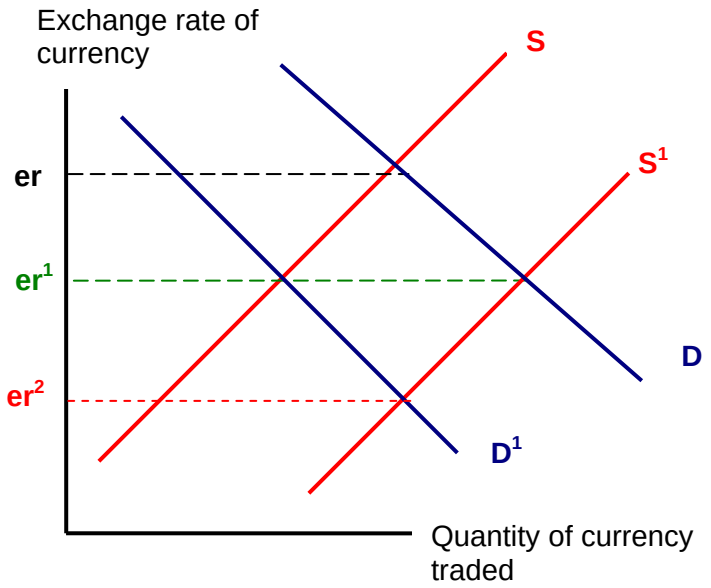
STEMUP.CO.UK

Question Number			Answer	Max Mark	Rationale/Additional Guidance
1	(c)		Responses at the top of this level should make explicit use of more than one component of AD to analyse cause and effect of expansionary monetary policy / a reduction in interest rates. **Level 2 [2 – 3 marks]** For an application of knowledge and understanding of the causal links between expansionary monetary policy and the level of economic activity. Responses in this level, however, will lack any clear economic analysis of the impact of expansionary monetary policy on the components of AD. **Level 1 [1 mark]** For knowledge and understanding of expansionary monetary policy and / or an economic downturn only, but which shows no understanding of the causal link between the two.	**[10]**	

STEMUP.CO.UK

Question Number			Answer	Max Mark	Rationale/Additional Guidance
2	(a)		**Explain the role of the International Monetary Fund (IMF).** The IMF aims to create international financial stability and, in doing so, promote global economic growth and international trade. Global economic growth and economic stability is compromised when countries run into balance of payments problems, particularly when this leads to massive short term selling of a currency (a run on the currency) and capital flight. To avoid these problems, the IMF will lend money to countries which face severe balance of payments problems in return for agreements to put in place economic policies which the IMF believes will return economic stability to a country. The IMF also regularly monitors the economic performance and policy of its members and advises them on policies which, in its view, are necessary to achieve stability in exchange rate and economic growth. By helping to achieve more stable economic conditions globally, the IMF believes that is creating greater certainty which encourages investment (thereby raising long term rates of economic growth) and trade between nations. Up to 2 marks for a description of the role of the IMF, which may include an example. Up to 2 marks for an explanation of the role of the IMF in terms of how its activities are believed to contribute to global economic growth, economic stability of international trade.	**[4]**	**Use green ticks to indicate where a candidate is describing <u>WHAT</u> the IMF does (2 max)** **Descriptive points include:** • **creates international financial stability / global monetary co-operation** • **promotes global economic growth and international trade** • **lends money to countries with BoP problems** • **places conditions, such as greater reliance on market forces, on loans to prevent reoccurrence of problems** • **advises on macroeconomic policies to promote growth** • **annual surveillance / reports** **Use green tick with + to indicate where a candidate is explaining <u>WHY</u> the IMF does what it does (2 max)** **Explanation may include:** • **impact of BoP problems** • **impact of capital flight** • **impact of protectionism** • **how IMF policies promote international and domestic stability** • **consequences of global stability** **Reward candidates who give examples of things such as conditions / advice etc where these are linked to the aims of the IMF.** **Be on the look out for responses which confuse the role of the IMF with the role of the World Bank**

STEMUP.CO.UK

Question Number			Answer	Max Mark	Rationale/Additional Guidance
2	(b)		**Using a diagram, analyse the causes of the depreciation of the Hungarian forint which occurred during 2008.**  Freely floating exchange rates a interaction of the demand for and supply of the currency on the foreign exchange markets. A currency can depreciate if the demand for the currency falls and / or the supply of the currency increases. In the case of Hungary, Extract 3 suggests that the forint depreciated because of the emergence of a growing and unsustainable current account deficit. This led to the withdrawal of capital from the country. An increase in capital outflows shifts the supply of the currency from S to S^1, causing the exchange rate to depreciate from er to er^1.		**Indicate all marks awarded by use of the green tick tool** **Place ticks alongside parts of the diagram to indicate AO1 and AO2 marks** **At this level it is expected that candidates will label axes correctly – so do not award axes mark if vertical axis labelled price only (price of forint is OK, but price of $ or any other currency is NOT). It is OK for horizontal axis just to be labelled quantity.** **Demand and Supply curves must also be labelled accurately (eg D / S not AD / AS) to access application marks eg shift and equilibrium.** **For analysis marks it must be explicit that shifts in D and S relate to the demand and supply of the CURRENCY** **Acceptable reasons for depreciation include (1 mark to be awarded for identification of the reason):** • **Current account deficit (not lack of demand for exports) = either reduction in demand or increase in supply depending on cause of deficit** • **Withdrawal of capital / capital flight = increase in supply** • **Reduction in capital inflows / FDI = fall in demand** • **Reduction in Hungarian interest rate (either relative or absolute) = reduction in demand and / or increase in supply**

STEMUP.CO.UK

Question Number			Answer	Max Mark	Rationale/Additional Guidance
2	(b)		Candidates may argue that the growing current account deficit would increase the supply of the currency (a higher value of imports) or reduce the demand for the currency (lower value of exports). Some candidates may analyse the depreciation in terms of **both** a reduction in demand and an increase in supply of the currency. *Synoptic knowledge: AS Unit F581, Markets in action* *Competitive markets and how they work – the impact of changes in demand and supply on equilibrium* *Synoptic knowledge: AS Unit F582, The national and international economy* *Government economic policy objectives and indicators of national economic performance – an understanding of how exchange rates are determined* **Analysis marks [1 – 2 marks]** Up to 2 marks for an analysis of the cause of the shift in supply and/or demand. For marks to be awarded for analysis there must be an explicit explanation of the shift(s) of demand and/or supply in terms of the growing current account deficit and/or capital flight. **Application marks [1 – 2 marks]** 1 mark for a rightward shift in supply of Hungarian forint. 1 mark for leftward shift in the demand for Hungarian forint. 1 mark for new exchange rate equilibrium. Max 2 marks **Knowledge marks [1 – 2 marks]** 1 mark for correctly labelled axes. 1 mark for correctly drawn and labelled demand and supply curves.	**[6]**	**Award an additional analysis mark where this reason is correctly linked to D or S** **Do not award analysis marks for simple description of the shifts in the curves – there must be explanation in terms of the determinants of D and S of the currency**

STEMUP.CO.UK

Question Number			Answer	Max Mark	Rationale/Additional Guidance
2	(c)		**Comment on the extent to which a deficit on the current account of the balance of payments, such as that in Hungary and the UK, is a sign of economic weakness.** The current account of the balance of payments measures flows of money in and out of a country arising from: • trade in goods; • trade in services; • net flows of profit, interest and dividends; • transfers. It follows that a deficit on the balance of payments can occur because of a deficit in any one or more of these which is not compensated for by surpluses elsewhere. A current account deficit on the balance of payments can be a sign of economic weakness where high levels of domestic consumption result in excessive spending on foreign-produced goods and services. This might indicate that domestic firms have lost competitiveness in global markets due to a lack of investment, high labour costs or low productivity. Such a deficit would be structural and would be a sign of economic weakness. However, the extent to which a deficit on the current account of the balance of payments is a sign of economic weakness depends on the cause of the deficit. In the case of a deficit on trade in goods and services, there are other reasons apart from a lack of international competitiveness which might explain the deficit. For example, high growth in domestic demand could be considered to be a sign of economic strength rather than of weakness. In this case, the deficit would be considered cyclical rather than structural. Alternatively, there may be high levels of investment taking place in the economy, resulting in imports		**The rationale of the question is to get candidates to explore which of the possible causes of a current account deficit are related to fundamental weaknesses in the macroeconomy and which are not.** **The key to a successful response, then, is an explicit consideration of what is meant by economic weakness as well as the different causes of a current account deficit.** **Responses to this question should be annotated using the L1, L2, L3, L4 tools in Scoris consistent with the level descriptors below** **Analysis and commentary should relate EXPLICITLY to both the causes of a current account deficit and to why this may or may not indicate economic weakness** **Answers that lack this explicit focus are likely to consider the CONSEQUENCES of a current account deficit and / or whether it is a problem. Such responses are unlikely to get a mark beyond L2 of the mark scheme.** **There will be the inevitable responses which confuse a current account deficit with a budget deficit. Such responses should be awarded 0 marks at this level and in the light of the pre-release of the stimulus material.**

STEMUP.CO.UK

Question Number			Answer	Max Mark	Rationale/Additional Guidance
2	(c)		of capital goods. This would not be a sign of economic weakness since such investment would generate greater efficiency and competitiveness in the future. The deficit would be viewed as temporary. A current account deficit in either case may not be a sign of weakness so long as the country attracts sufficient long term capital flows to finance the deficit. A country that attracts large capital flows will find that there will be a net outflow of profit, interest and dividends which might cause a current account deficit. Despite the deficit, the economy may be considered successful, depending on whether the capital flows were in the form of foreign direct investment, what attracted the FDI and its duration. Without knowledge of the causes of the current account deficit, it is not possible to conclude whether the deficit is a sign of economic weakness or strength. There may be better indicators of the weakness or strength of an economy, such as unit labour costs. *Synoptic knowledge: AS Unit F582, The national and international economy* *Government economic policy objectives and indicators of national economic performance – the causes and consequences of a deficit on the current account of the balance of payments* **Level 4 [7 – 10 marks]** For a commentary on the extent to which a deficit on the current account of the balance of payments is a sign of economic weakness. At the top end of this level, candidates' commentaries will clearly identify the factors that determine whether or not a current account deficit is a sign of economic weakness.		**Analytical answers will include relevant economic concepts – expect to see reference to REASONS for a lack of competitiveness which might include:** • **low productivity** • **high wages (wage growth)** • **poor quality** • **high unit labour costs** **Level 4 [7 – 10 marks]** For a commentary on the extent to which a deficit on the current account of the balance of payments is a sign of economic weakness. At the top end of this level, candidates' commentaries will clearly identify the factors that determine whether or not a current account deficit is a sign of economic weakness. **Level 3 [4 – 6 marks]** For a one-sided analysis of the extent to which a deficit on the current account of the balance of payments is a sign of economic weakness. Candidates in this level will analyse why a deficit on the current account could be considered a sign of weakness **or** why it might not but not both perspectives. There will be no commentary on the extent. **Level 2 [2 – 3 marks]** For an application of knowledge and understanding of the likely causes of current account deficits. **Level 1 [1 mark]** For knowledge and understanding of the meaning of a current account deficit or of what economic weakness might involve, but there will be no attempt to link the two.

STEMUP.CO.UK

Question Number			Answer	Max Mark	Rationale/Additional Guidance
			Level 3 [4 – 6 marks] For a one-sided analysis of the extent to which a deficit on the current account of the balance of payments is a sign of economic weakness. Candidates in this level will analyse why a deficit on the current account could be considered a sign of weakness **or** why it might not but not both perspectives. There will be no commentary on the extent. **Level 2 [2 – 3 marks]** For an application of knowledge and understanding of the likely causes of current account deficits or of the structure of the BoP (eg current account deficit offset by financial account surplus) or of deficit as % of GDP **Level 1 [1 mark]** For knowledge and understanding of the meaning of a current account deficit or of what economic weakness might involve, but there will be no attempt to link the two.	**[10]**	

STEMUP.CO.UK

Question Number			Answer	Max Mark	Rationale/Additional Guidance
3			**Discuss the impact of globalisation on developing economies.** Globalisation refers to the increasing economic integration of national economies into the global economy through: • international trade; • foreign direct investment; • increased capital flows; • the spread of technology; • migration of people. The result is that national economies are much more interdependent through a global system of production and exchange. The question is, therefore, a wide ranging one. Candidates need not address all aspects of globalisation in their responses, but should focus on at least two, developing breadth in their analysis and evaluation.		**The rationale of this question is to get candidates to set the pros and cons of globalisation in the context of developing economies. As such it links two parts of the specification.** **L4 responses should show a clear ability to balance benefits and costs of globalisation and show how these might impact on economic development.** **Within L4 it is useful to distinguish 'bands' of responses:** **Band 3 (16 – 20)** **The discussion is well developed, has depth of reasoning, is clearly set in the context of developing economies and reaches a REASONED judgement on the impact. The judgement should seek to establish what the impact depends upon. Use of country case studies will be effective rather than simply descriptive of points.** **It is important to use the WHOLE mark range within this band and in particular to award FULL marks for responses which clearly meet the criteria above.** **USE EE ANNOTATION IN SCORIS TO INDICATE WHERE CANDIDATE IS SHOWING THIS SKILL**

STEMUP.CO.UK

Question Number			Answer	Max Mark	Rationale/Additional Guidance
3			The benefits of globalisation for a developing economy should be analysed rather than just stated. Analysis requires an explanation of cause and effect and should be under-pinned by economic theory. So, for example, the benefits of free trade might be analysed using the concept of comparative advantage. Candidates could show how a developing economy, by specialising according to its comparative advantage, would be able to improve resource allocation, consume outside its PPF and enjoy the benefits of lower prices, higher employment and higher rates of economic growth. The benefits of FDI could be analysed using aggregate demand and supply analysis, showing an increase both AD and AS and consequent improvement in real GDP, living standards, employment and the balance of payments. Better responses will be able to illustrate these benefits using examples. In order to provide real focus on the question, candidates should be able to explain why these benefits are particularly important for developing economies perhaps by reference to indicators of development. For example, higher real GDP and living standards associated with globalisation may be responsible for reductions in rates of poverty in countries such as China and India which have embraced globalisation. Developing economies which have not embraced free trade and FDI, such as those in sub-Saharan Africa, have seen little change in poverty over the last 20 years. Other references to the developing economy context might include reduced income inequalities, higher life expectancy, reduced infant mortality … . Other benefits might include higher tax revenue to fund investment in infrastructure, improved productivity of labour, technology transfer etc.		**Band 2 (14 – 15)** **A developed discussion, with some developing economy context but not reaching that bit further. Expect to see some ref to nature of developing economies and / or explicit use of HDI** **Responses in this level should consider at least two aspects of globalisation** **Band 1 (11 – 13)** **A basic discussion with relatively undeveloped points, limited developing economy context and no judgement.** **Responses in this level are likely to cover just pros and cons of globalisation without setting this explicitly in the context of developing economies** **Level 3 [5-10 marks]** For a one-sided analysis of the impact of globalisation on a developing economy. **Level 2 [3-4 marks]** For an application of knowledge and understanding of the impact of globalisation on a developing economy. Marks in this Level will show a total lack of economic analysis of the impacts but will make some valid general points. **Level 1 [1-2 marks]** For knowledge and understanding of developing economies and / or globalisation only. Responses in this level will not consider what the benefits or costs of globalisation might be.

STEMUP.CO.UK

Question Number			Answer	Max Mark	Rationale/Additional Guidance
3			There is a wide range of evaluations of globalisation which candidates might make which would result in the award of Level 4 marks. These include: • primary product dependency and declining terms of trade trapping developing countries in a low level of economic development and giving rise to balance of payments problems; • globalisation does not bring significant benefits to developing economies because of the lack of access to developed economy markets as a result of continued existence of tariffs and subsidies of domestic producers – this is most often argued in the context of agricultural trade; • competition between developing economies to attract FDI results in a lack of social protection, such as minimum wage laws and keeps wages low; • the benefits accrue mainly to consumers in the developed world and multinationals companies originating from such economies; • temporary gains in employment only, especially where foreign forms are footloose; • inappropriate technology introduced to developing countries; • environmental costs arising from poor regulation of the activities of foreign investors; • limits to the benefits of trade created by the continued dominance of intra-regional and intra-industry trade rather than inter-regional and inter-industry trade; • the extent to which economic growth generated by increased trade and FDI results in greater human development; • increased exposure to external economic shock created by a greater dependence on developed economy markets.		

STEMUP.CO.UK

Question Number			Answer	Max Mark	Rationale/Additional Guidance
3			There should be an attempt to make a judgement on the extent of the impact, either positive or negative. This judgement may include a consideration of the determinants of the impact, for example, or may arise from the candidates' choice of developing economy. *Synoptic knowledge: AS Unit F582, The national and international economy* *The application of macroeconomic policy instruments and the international economy - awareness of the general nature and benefits of international trade.* **Level 4 (a) [16-20 marks]** For a discussion that includes a judgement on the extent of the impact of globalisation on a developing economy of the candidate's own choice. **Level 4 (b) [11-15 marks]** For a balanced discussion of the impact of globalisation on a developing economy. This discussion will provide an analytical explanation of benefits **and** costs of globalisation for a developing economy or consider the determinants of either the benefits **or** the costs. In this Level candidates will make no attempt to exemplify the impact of globalisation through considering a developing economy of their own choice. A discussion that lacks balance should be awarded a maximum of 13 marks. Complex issues have been expressed clearly and fluently using a style of writing appropriate to the complex subject matter. Sentences and paragraphs, consistently relevant, have been well structured, using appropriate technical terminology. There may be few, if any, errors of spelling, punctuation and grammar.		

STEMUP.CO.UK

Question Number			Answer	Max Mark	Rationale/Additional Guidance
3			**Level 3 [5-10 marks]** For a one-sided analysis of the impact of globalisation on a developing economy. Relatively straightforward ideas have been expressed with some clarity and fluency. Arguments are generally relevant, though may stray from the point of the question. There will be some errors of spelling, punctuation and grammar, but these are unlikely to be intrusive or obscure meaning. **Level 2 [3-4 marks]** For an application of knowledge and understanding of the impact of globalisation on a developing economy. Marks in this Level will show a total lack of economic analysis of the impacts but will make some valid general points. There are likely to be some errors of spelling, punctuation and grammar of which some may be noticeable and intrusive. **Level 1 [1-2 marks]** For knowledge and understanding of developing economies and / or globalisation only. Responses in this level will not consider what the benefits or costs of globalisation might be. Some simple ideas have been expressed. There will be some errors of spelling, punctuation and grammar.	**[20]**	

STEMUP.CO.UK