Oxford Cambridge and RSA

GCE

Economics

Unit **F585:** The Global Economy

Advanced GCE

Mark Scheme for June 2014

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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.

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

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

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

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.

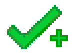
Question			Answer	Marks	Guidance	
					Content	**Levels of response**
Comment on the extent to which fiscal expansion necessarily conflicts with the UK Government's Deficit Reduction Plan.						
1	c		**Level 4:** Fiscal expansion may not conflict with the UK Government's Deficit Reduction Plan: • fiscal 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 <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 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*

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**.

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.

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.	10	**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 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 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 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		**Level 3 responses** will use a reasoned chain of argument underpinned by economic concepts	**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*

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).		*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: 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 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: • 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.			**Level 1: (1 mark)** For knowledge and understanding of external imbalances / exchange rate devaluation / internal devaluation *Annotate using* L1 *in LHS margin*

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*

Question			Answer	Mark	Guidance: Content	Guidance: 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.		**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 4 Band 1: (11 – 14 marks)** For a *<u>basic and undeveloped</u>* 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* $\boxed{L4}$ *in LHS margin*
			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		**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 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* $\boxed{L3}$ *in LHS margin*

Question			Answer	Mark	Guidance: Content	Guidance: 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.		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: 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 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: 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.			**Level 1: (1-2 marks)** For knowledge and understanding of economy development or international trade. *Annotate using* L1 *in LHS margin*

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