



**Education**

## **2018 Edexcel Economics Paper 2 Macroeconomics Paper**

### **Model Answers**

This document is helpful for longer essay questions/responses. Please reference the Mark Scheme for answers to Multiple Choice questions.

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# Examiners' Report

## June 2018

GCE Economics A 9EC0 02

## Question 1 (b)

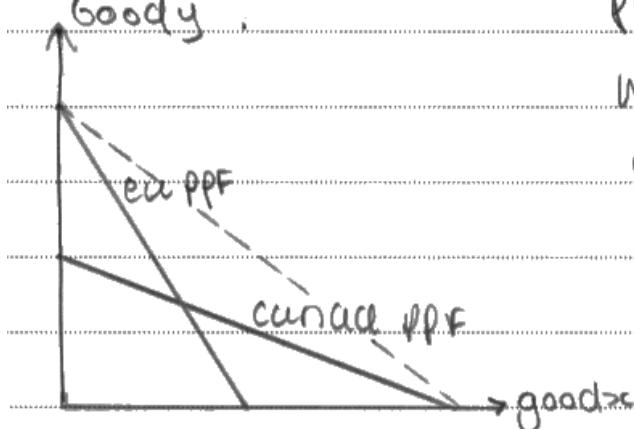
- (b) With reference to the theory of comparative advantage, explain how CETA may increase the GDP of both the EU and Canada.

(4)

Based on the theory of comparative advantage states that if countries have a lower opportunity cost than another at producing one good "x" they should specialise in producing good "x" and trade. By trading their goods,

PPF can increase to

where the dotted line is showing a clear increase in the size of the PPF



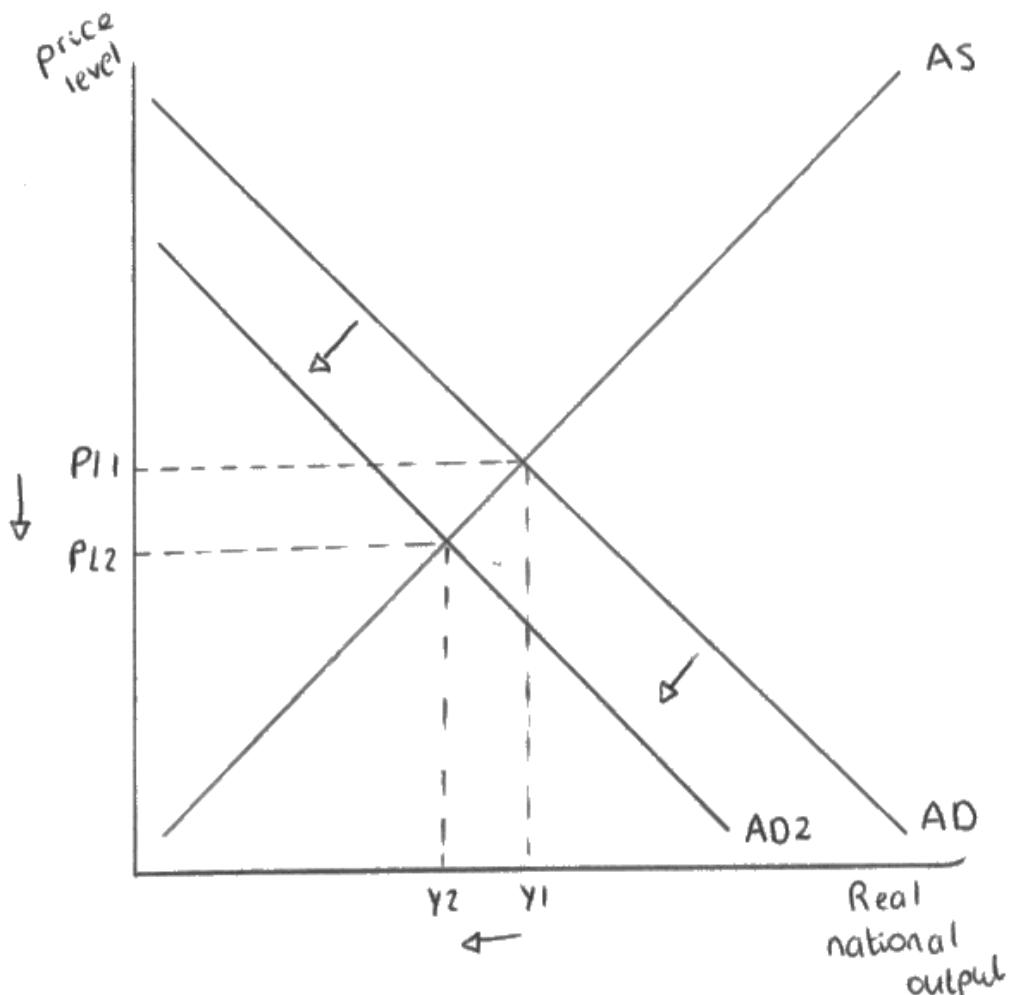
This answer achieves 3/4. In terms of knowledge there is one mark for lower opportunity cost and one for a reference to specialisation. There is then one further mark for the diagram.

## Question 2 (b)

This question specifically asks candidates to draw a diagram. There is **no need** for candidates to write any explanation to go along with their diagram. When drawing diagrams candidates should always double-check that the lines and axes are correctly labelled. In this question half of the marks are awarded for this.

- (b) Draw an aggregate demand and aggregate supply diagram illustrating the likely impact of a rise in interest rates on the price level and real output.

(4)

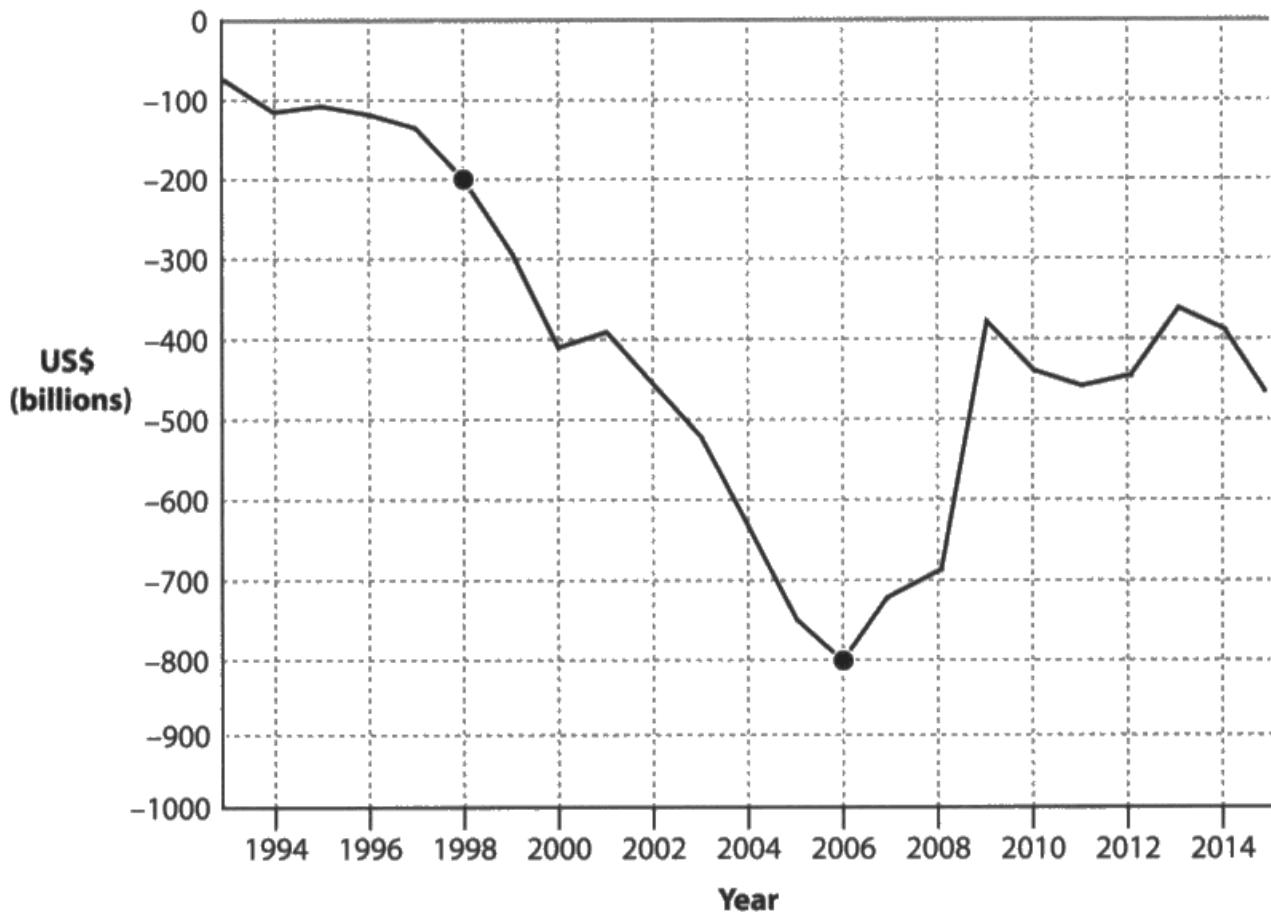


This diagram is correctly labelled. It also shows the shift in the correct direction and illustrates the impact on the price level and real output. Therefore this answer achieves full marks.

### Question 3 (a)

This question should be a standard calculation task. Candidates simply need to calculate the percentage change using the data provided. The main mistake candidates made was not correctly working out that the change in the current account from -200 to -800 is 600.

#### 3 United States current account of the balance of payments, 1993–2015



(Source: <http://data.worldbank.org/indicator/BN.CAB.XOKA.CD?end=2015&locations=US&start=1993>)

- (a) Calculate the percentage change in the United States current account deficit on the balance of payments between 1998 and 2006.

(2)

Initial deficit = -\$200 billion

Change = \$600 billion

Change in current account deficit as a percentage = 300%



This candidate has the correct answer of 300% and hence achieves full marks.

### **Question 3 (b)**

(b) Explain the term 'current account of the balance of payments'.

(2)

It includes net trade of imports, net trade of exports, primary income flows (money coming in ~~and~~ out of the economy and secondary income flows such as government transfers.



This answer correctly explains the term in terms of the four parts of the current account and therefore achieves full marks.

## Question 4 (a)

- 4 The UK has experienced a budget deficit since 2001. The government aimed to reach a budget surplus by 2019, but in 2016 this target was abandoned.

(Source: adapted from <https://www.gov.uk/government/news/autumn-statement-2016-some-of-the-things-weve-announced>)

- (a) Explain **one** likely reason why the 2019 budget surplus target was abandoned. (2)

Economic growth was revised down due to lower than expected growth rates, currently being only 0.1% in Q1 of 2018. As a result ~~of~~ of low confidence as a result of BREXIT the economy must be further stimulated through expansionary policies pushing back the 2019 budget Surplus target.



This answer includes a relevant reason – Brexit and the resultant fall in confidence. The candidate has also explained their reason, discussing the resultant expansionary policies that would be needed as a result.

## Question 4 (b)

In this question the marks are split into one mark for knowledge and one for application. The knowledge mark is for explaining that the national debt would increase and the analysis mark is for explaining **why** it would increase.

- (b) Explain the likely impact of abandoning the budget surplus target on the UK national debt.

(2)

Due to the UK abandoning the budget surplus their national debt will get bigger as they will still be in a budget deficit, so they'll have to finance their spending through government borrowing which will increase the ~~debt~~ national debt



This answer achieves full marks. One mark for saying that the national debt will 'get bigger'. The second mark for explaining that the government will have to 'finance their spending' etc.



Ensure you read the question carefully. Here the question is specifically asking what the impact will be **on the UK national debt**, not the economy in general.

## Question 5 (a)

There are two marks for this question, one for knowledge and one for identifying a likely reason. The second analysis mark is for linked development – justifying the reason.

### 5 UK total bank lending to individuals, percentage change on previous year

2014	2.5%
2015	3.2%
2016	4.0%

(Source: Bank of England 2017)

- (a) Explain **one** likely reason why consumer demand for bank loans has increased.

(2)

If interest rates decrease, the cost of borrowing reduces so consumers are more likely going to demand bank loans to spend. This explains why total bank lending increased from 2.5% to 4% in 2014 to 2016.



This answer achieves full marks – one knowledge mark for interest rates decrease. Then the analysis mark for the rest of this sentence in the candidate's answer.

## Question 5 (c)

This answer is actually very straightforward but it seems that many candidates did not correctly understand the data they had been presented with before starting to answer the question. The data is already presented as percentage change, as it says clearly in the title. Therefore candidates simply needed to add 4 to 100 to get the answer of 104.

- (c) Calculate the index number for the total value of bank lending in 2016 using 2015 as a base year.

(2)

$$100 \times 1.04$$

$$= 104$$



This candidate has the correct answer of 104 and as such achieves the full two marks.



Ensure you understand what index numbers are and that you can calculate them.

## Question 6 (a)

In this answer there are two marks for knowledge, two for application, and one for analysis. Candidates were generally better at explaining absolute poverty than relative poverty. Many candidates achieved 4/5 as they did not offer anything that earnt the analysis mark.

- (a) With reference to the information provided, explain the distinction between absolute poverty and relative poverty.

(5)

Absolute poverty is defined as individuals who do not have enough money/income for the basic needs e.g. food, water and shelter. It is said that people living on less than \$1.90-a-day 2011 PPP -as stated in Figure 1 are in absolute poverty. This figure has since risen to > \$2 per day.

Relative poverty occurs when individuals have very low incomes in comparison to other people. It is said that people who earn 20% (or more) less than the average wage rate are in relative poverty. Extract A states that "A billion people have been taken out of absolute poverty, but relative poverty remains a problem."

The distinction is that in absolute poverty an individual does not have the required funds to live and afford basic needs but in relative poverty you do, you simply have less than average but enough to survive.



This answer achieves a total of 4/5. In the first paragraph the candidate gains one knowledge mark for defining absolute poverty and two application marks for \$1.90 a day at PPP. In the second paragraph they explain the idea of relative poverty.

## Question 6 (b)

- (b) With reference to the information provided and your own knowledge, examine **two** factors that might explain the differing rates of decline in absolute poverty in East Asia and Sub-Saharan Africa.

(8)

- One factor may be the opening of economies in East Asia and the cutting of bariffs.
- Closed economies are ones who are self-reliant and choose to depend solely on themselves, with the absence of trading.
- However, increasing the amount of trade in East Asia allows the country to access a larger variety of goods and services which increases the level of utility in the economy and increases the standard of living. This leads to an increase in consumption which increases aggregate demand and accelerates economic growth.
- However, there may be a time lag involved as trade protectionism is a lengthy process if it involves changing laws and it may be difficult to build up relationships and negotiate with other countries.
- Another factor may be its climate. Sub-Saharan Africa has a much hotter climate, making the conditions for growing crops very narrowed and restricted. If it decides to import or export these goods, it will have difficulty due to it being a very LANDLOCKED AREA. This results in high

transportation costs which leads to a decrease in the level of trade which lowers the country's level of globalisation.

This leads to a decrease in Sub-Saharan Africa's investment levels which prohibits economic growth.

However, developing technology has increased the efficiency of transportation and managed to lower its costs.



This is an excellent answer to this question. Two distinct policies are discussed – opening up to trade and the landlocked state of many Sub-Saharan African countries. Both policies are also evaluated effectively.



Remember the allocation of marks for these 8-mark 'examine' questions will be consistent – 2 marks for each of knowledge, application, analysis, and evaluation.

## Question 6 (c)

- (c) With reference to Extract A, discuss two macroeconomic policies, apart from protectionism, that a government could use to reduce the negative effects of globalisation.

(12)

As Extract A mentions, creating an efficient welfare system may be one way of reducing negative effects of globalisation.

By creating a welfare system negative effects such as low wages and insecure employment are offset. This is because people on low wages will be able to receive welfare payments to increase their overall income which they can use to buy more ~~goods~~ essential goods such as food or towards housing. Also, insecure employment will be helped as people who lose their job will be able to claim welfare payments to spend on essentials which will segregate them from extreme poverty.

The welfare payments may be beneficial as they will be spent in the economy contributing to growth.

However, higher levels of welfare payments <sup>budget</sup> may lead to a high government deficit as tax revenue may not be enough. Also, poor efficiency and corruption in developing nations will lead to failure of the system.

Also, to reduce the negative effects, governments could introduce minimum wages ~~for~~ to combat low wages.

By doing this companies that are investing will have

to pay workers are at a wage rate that is enough to give to workers decent grocery power and a to buy essential; as living wage. This will combat chronic poverty and stop exploitation of cheap labour and contribute also towards the economy and higher wages lead to more disposable income, leading to more consumer spending, an increase in aggregate demand and GDP growth.

However, this could risk capital flight and investors may move to a neighbouring country where labour costs are lower and there are no minimum wage laws. This could lead to no wage instead of low wages.



This is a good answer to this question that suggests two relevant policies – welfare payments and minimum wages. The candidate is a bit confused between income and wealth and it is not a perfect answer, but it does achieve a mark of 9/12 in total.

### Question 6 (d)

- (d) Assess the view that 'some level of inequality is desirable to maintain an appropriate incentive structure in the economy' (Extract B, lines 19 and 20).

(10)

I agree to some extent with this statement. An incentive to better yourself is one reason why people work hard at their education and go after jobs which may be harder and more demanding but pay better wages.

If all jobs paid the same for example or everyone received a basic income as some people propose and has been tried in Sweden then this could cause a disincentive to strive for better paying jobs which are of greater value to society.

For example if teachers and doctors were paid the same as people who stack shelves at super markets some may decide to chose the easier job at the super market. This could be bad for the economy as there would be an even greater shortage of people entering teaching and medical professions.

A shortage of supply of these professions would reduce the quality of

labour in the economy which is an important factor of production so there would be a reduced long run aggregate supply in general. This would mean lower economic growth and lower GDP capita meaning worse standard of living for all residents.

However it may be argued that it is unfair to allow people to be poor just because they chose not to or cannot get a better paying job. Particularly people who due to illness or health disabilities cannot access better paying jobs should be given benefits even though this reduces inequality and potentially the incentive structure as was ~~said~~ quoted clear by the governor of the Bank of England. There is a balance that must be kept between fairness and maintaining the incentive for economic growth.



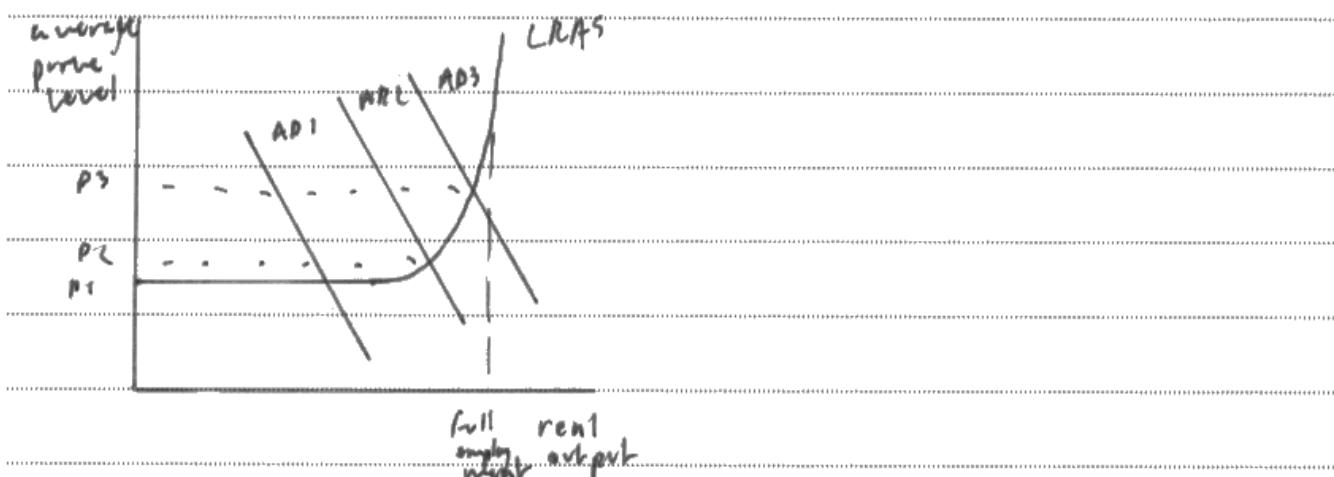
This is a clear and well-written answer to the question which addresses the key elements of it, especially on the KAA side, for example looking at different jobs and their differing pay rates. The evaluation is, unfortunately, a little bit on the brief side. Overall this is a very good answer and it achieves 8/10 in total.

## Question 6 (e)

- (e) Discuss the role of the financial sector in the growth and development of developing countries.

(15)

Firstly, the financial sector provides developing economies with a platform for people to save their money and therefore for firms to be able to draw from people's savings and increase their investment levels. Indeed, without banks, we would not be a loanable funds market for firms to borrow and increase investment levels. As firms borrow and invest into new capital, they can reduce their unit production costs, become more productive and increased profit margins. The increase in investment will shift the AD to the right as it is a part of the AD equation and an injection in the circular flow of income, and depending on the size of the accelerator and multiplier, it will lead to subsequent rounds of growth.



However, depending on the size of the negative export gap, this could lead to inflationary pressures. For instance, the UK has a low 4.5% unemployment rate, so this would create AD demand pull inflation as the economy already operates on the relatively flat part of the LRAS. But this is a developed country, and Zimbabwe has a 80% unemployment rate, so this means it has a large reservation wage gap and will not cause inflation.

Secondly, financial sector can help firms to develop. Indeed, financial services mean that a country can enter the foreign exchange market and import goods from other countries through either buying some foreign currency. This will lead to development as developing countries will <sup>import</sup> capital goods necessary for development.



This is a well-written answer to this question, particularly in terms of the KAA where there are two good points. The first one focuses on the role of banks in terms of savings and investment and the second on foreign exchange. These are also evaluated, although this isn't quite as good as the KAA points. Therefore, overall this answer achieves Level 3 KAA and Level 2 evaluation.

## Question 7

### SECTION C

multiple

$\uparrow G$   $\uparrow AD$

$\uparrow I$

$\uparrow LM$

$\uparrow LRPS$

infrastructure

increases

PL

Very due to  
mechanism's  
 $\downarrow C + AD$   
infrastructure  
increases

Answer ONE question from this section.

Write your answer in the spaces provided.

You are advised to spend 30 minutes on this section.

EITHER

- 7 In 2016 the UK Chancellor of the Exchequer announced that the government would spend an extra £23 billion on innovation and infrastructure over the following five years.

Evaluate the likely economic effects of this planned increase in government expenditure.

(Total for Question 7 = 25 marks)

OR

- 8 The British pound fell by over 10% to a 30-year low against the US dollar after the UK voted to leave the European Union.

To what extent will this depreciation impact on future economic growth in the UK?

(Total for Question 8 = 25 marks)

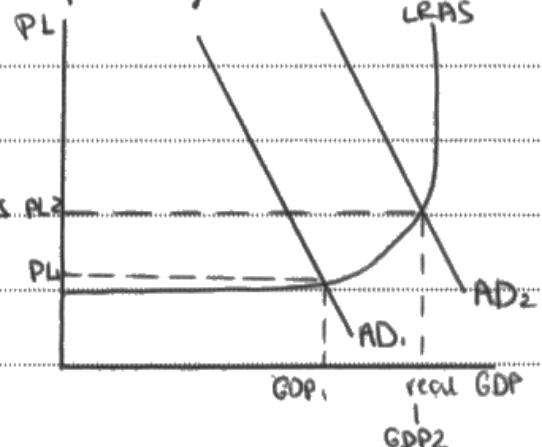
Indicate which question you are answering by marking a cross in the box  If you change your mind, put a line through the box  and then indicate your new question with a cross .

Chosen question number:  Question 7   Question 8

Write your answer here:

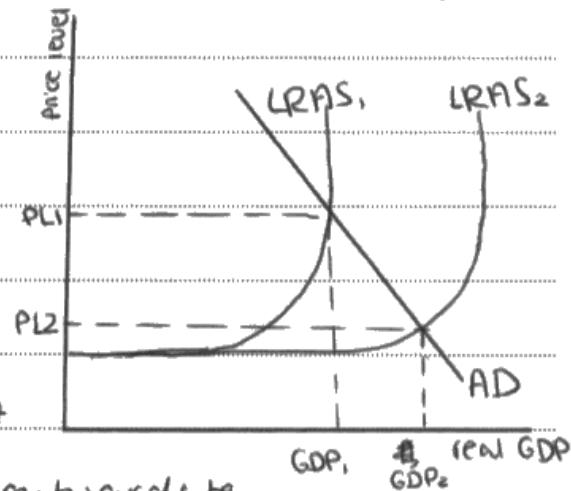
An injection into the economy, such as the planned increase in government spending of £23 billion, may have numerous positive and negative impacts on the UK economy.

One likely economic effect of the spending is an increase in aggregate demand. As government spending is a component of AD, an increase would cause a shift outwards  $\oplus 2$  on the AD curve from  $AD_1$  to  $AD_2$ . Thus, real GDP would also



increase, from  $GDP_1$  to  $GDP_2$ , as shown on the diagram. Therefore, an impact of the planned increase in government spending is an increase in output and aggregate demand. However, as AD shifts outwards, the price level in the economy increases from  $PL_1$  to  $PL_2$ , showing an increase in inflation. This could negatively impact the economy, particularly for people on fixed incomes such as pensioners. Furthermore, if wages do not increase at the same rate, real wages will fall, causing an increase in the cost of living.

Another economic effect of the planned increase in government expenditure is an increase in long run aggregate supply. An increase in spending on innovation and infrastructure in the economy would likely reduce the cost of production for all firms at different price levels. Thus LRAS shifts outwards to  $LRAS_2$ , causing an increase in GDP from  $GDP_1$  to  $GDP_2$ .



Furthermore, a shift in LRAS causes a fall in the price level, which could benefit workers on fixed wages as the cost of living reduces, as long as disinflation is controlled.

However, a negative economic impact due to investment in innovation is ~~too~~ unemployment. For example, if the £23 billion, or part of it, was spent on producing capital machinery that is more ~~less~~ productive than

human labour at certain jobs, production costs would reduce for firms if they were to use <sup>the</sup> machinery, and thus cause structural unemployment in these industries. This would also have the knock-on effect of reduced consumption in the economy due to lower incomes, and the need ~~is~~ for the government to spend further money on retraining workers who are consequently occupationally inactive. Thus, due to the nature of the spending, unemployment may occur, carrying secondary negative impacts on the economy with it.

Another economic effect of this government spending is an improvement in the current account on the balance of payments. Improved infrastructure would reduce production costs for firms in a variety of industries, thus ~~not~~ allowing them to reduce their prices and become more internationally competitive. This would likely increase exports relative to imports, which, in addition to increasing aggregate demand, would improve the current account deficit that the UK has had for over 20 years.

However, the extent to which this is beneficial may be dependent on other factors influencing competitiveness, such as the exchange rate. If the country was particularly uncompetitive in producing a certain good to begin with, improved infrastructure may not be enough to reduce prices ~~an~~ enough

to increase foreign demand.

To conclude, there are ~~too~~ many positive economic ~~effects~~ effects to be reaped from this injection into the circular flow of income, as the impact of which would be ~~too~~ enhanced by the multiplier.

However, there are also ~~too~~ unintended consequences associated with these impacts, which may do more damage than good.



This is a good, solid answer to the question which presents clear effects on the economy of the increase in government expenditure and does an equally good job of evaluating them. Overall this answer achieves top Level 3 for KAA and top Level 2 for evaluation. It is just slightly lacking the depth and context to reach the very top levels but nonetheless is a good answer.

## Question 8

EITHER

- 7 In 2016 the UK Chancellor of the Exchequer announced that the government would spend an extra £23 billion on innovation and infrastructure over the following five years.

Evaluate the likely economic effects of this planned increase in government expenditure.

(Total for Question 7 = 25 marks)

OR

- 8 The British pound fell by over 10% to a 30-year low against the US dollar after the UK voted to leave the European Union.  ~~1~~ → AD RS But SR → 1.2% low spare capacity → trade off job loss decline

To what extent will this depreciation impact on future economic growth in the UK?

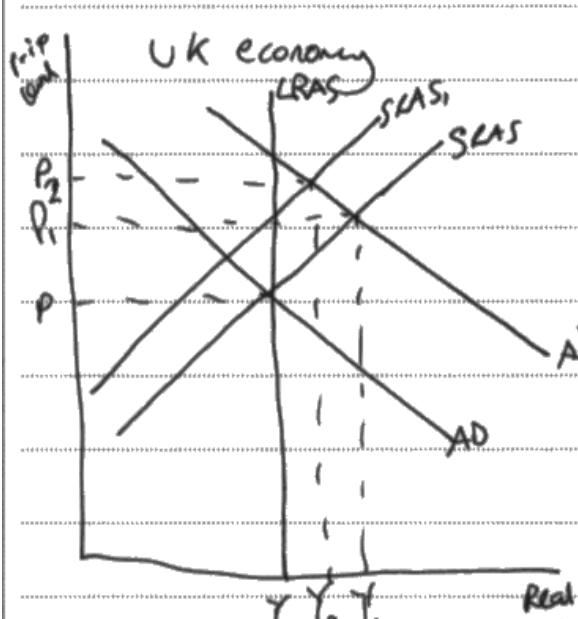
1.7 → 2.5%  $\rightarrow$  multiplier  $\rightarrow$  size of multiplier  $\rightarrow$  low confidence  
devaluation  $\rightarrow$  interest rate  $\rightarrow$  investment  $\rightarrow$  growth  
length of firms  $\rightarrow$  depends on business cycle  
Only LR but limited business confidence so limited.

(Total for Question 8 = 25 marks)

Indicate which question you are answering by marking a cross in the box . If you change your mind, put a line through the box ~~1~~ and then indicate your new question with a cross .

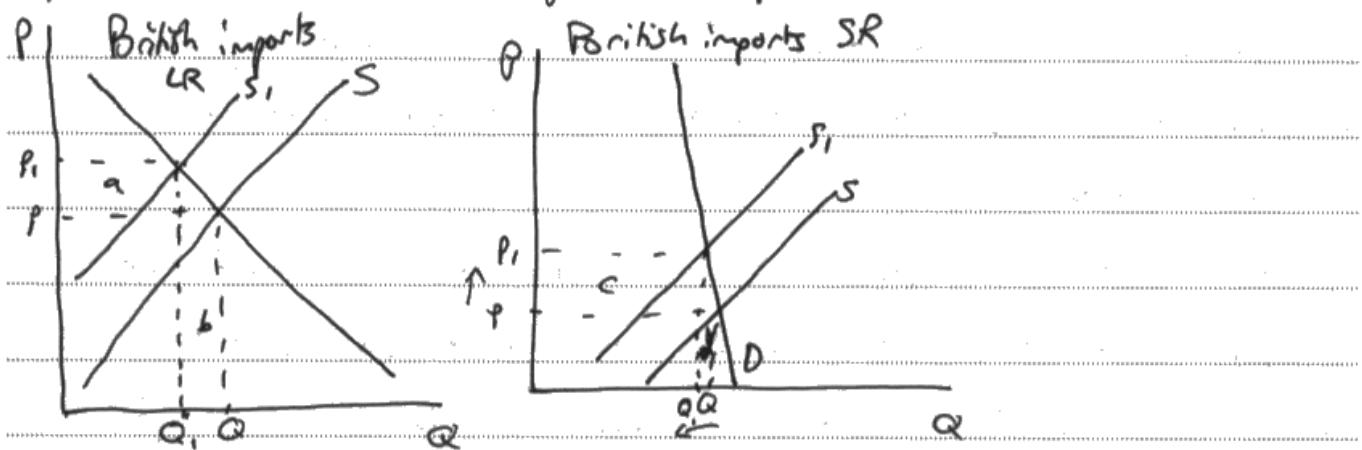
Chosen question number: Question 7  Question 8

Write your answer here:



A depreciation of the British pound against numerous exchange rates around the world will make imports to the UK more expensive, since if a pound buys fewer dollars the US imports for instance will require more pounds. Here, it is possible that British import value M will fall. Conversely, foreign

currency now buys more pounds, so each British export is cheaper to foreigners. Therefore arguably foreign sales of British exports and export values rises ( $X_P$ ). Since  $AD = C + G + I + X - M$  and  $X_P$  and  $M_b$ ,  $AD$  shifts right, leading to a new and higher real GDP of  $Y_1$ , hence economic growth has occurred. However, this analysis assumes that price of exports and imports is constant, which is not the case. Therefore it is important to consider PED of exports and imports.



In the short run, UK importers are likely to be bound by fixed contracts and therefore are unable to substitute to British produce as prices rise to  $P_1$ . Therefore PED is inelastic which causes an increase in import value of  $(c-d)$ . Only in the long run, where contracts can be broken can UK importers of for example beef decide to buy UK beef instead. So in the long run import value  $c'$  falls by  $(b-a)$ . If  $M_P$  in the SR then  $AD$  will shift left rather than right, moving growth rate down from the 1.7% current value.

Additionally, since the UK GDP is now 80% in the tertiary sector, it is clearly very much dependent on foreign imports for production. Therefore the rise in the price of imports from  $P$  to  $P_1$  is likely to raise costs of production for British firms, causing SRAS to shift left from SRAS<sub>1</sub> to SRAS<sub>2</sub>.

reducing the increase in GDP to  $Y_2 - Y_1$ . But equality

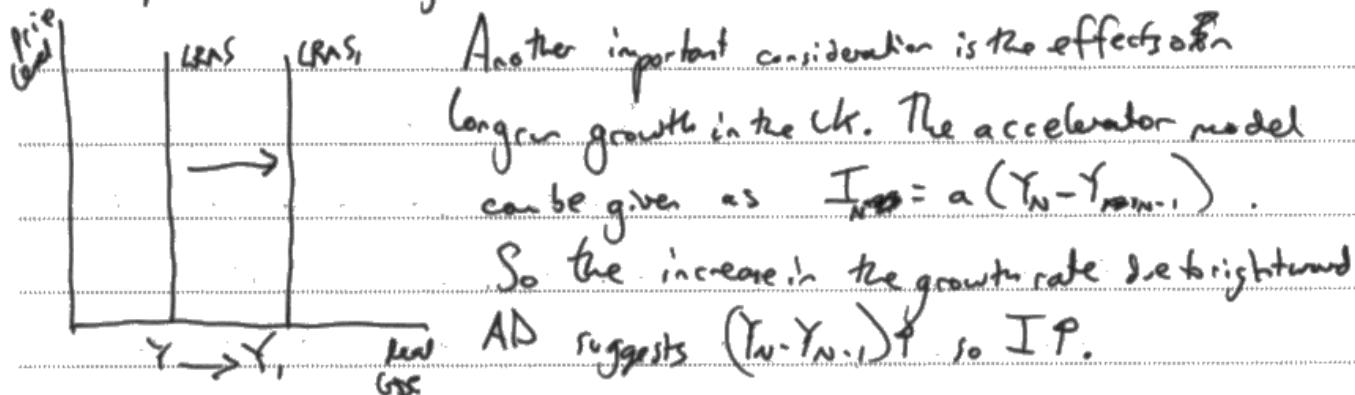
But there are also implications on the labour market for growth.

Inflation of  $P_2 - P_1$  will erode the real value of workers' incomes so trade unions may push for wage rises in order to preserve the purchasing power of members. Therefore, the costs of production faced by British firms rise even further which could shift SRAS left, further restricting growth increase.

However this is likely to be relatively insignificant rise. Trade union density in the UK has fallen from 52% in 1970 to 25% today, so

bargaining power may be restricted due to the lower impact strikes would have on British firms.

But on the other hand, the rightward shift in AD is likely to contribute towards a positive multiplier effect. A rise in national income from  $Y_1$  to  $Y_2$  may indicate increased demand for labour, since labour is a derived demand from demand for products. Therefore unemployment falls and wages rise, increasing purchasing power of consumers and also higher incomes mean higher income tax revenue for governments. Therefore  $G^P$  and  $C^P$ , pushing AD further right and causing a recurring growth pattern. However, following uncertainty of Brexit deal, workers are likely to have low confidence on their future employment prospects, so MPC is likely to be low, causing the multiplier,  $\frac{1}{1-MPC}$  to reduce. Therefore the gains to economic growth in the UK arising from multiplier effect are likely to be limited.



This can be explained by the fact that businesses anticipate the higher growth rate to continue, so rising incomes and demand requires them to increase their capital stock to meet the extra demand. With more capital, the UK productive capacity will rise, pushing CRAS out to CRAS<sub>1</sub>, hence causing long-run growth of  $Y_1 - Y_0$ .

The extent to which growth is sustained in the UK following the depreciation really depends on the quality of the Brexit deal gained. A good deal will restore confidence in the pound, raising its value and halting the gains the UK receives to its competitiveness and growth. However in the SR, increases in the productive capacity are likely to be weakened <sup>long</sup> by business confidence. Businesses are unsure what tariffs may arise following Brexit etc so this uncertainty reduces animal spirits in the British economy. So investment gains are likely to be limited and most of the growth is likely to only be short-run.



This is a high-quality answer to this question that achieves top levels on both KAA and evaluation. The candidate starts with an explanation of the impact on AD, via imports and exports. This is clearly explained both in words and a diagram. It is also convincingly evaluated regarding the elasticity of demand for imports and exports. The answer continues well, discussing in detail other impacts. What is also good here is the candidate has included some context in their answer, for example declining power of trade unions and the ongoing uncertainty in the UK's Brexit negotiations. This was used to particularly good effect at the end of the candidates' answer in their judgement.