



Sample Papers – Set 2

Edexcel A Level – Paper 3 (Microeconomics and Macroeconomics)

Answer Guide

This document is intended to support paper 3 of the second set of the EzyEconomics sample exam papers.

The answer guide provides a commentary on possible effective approaches to answer the sample exam

Note from the Editors

This answer guide has been created by EzyEducation Ltd. It has not been ratified by the exam board. The main purpose of this material is to provide schools with an additional source of material to help teachers prepare students for their examinations. The guide aims to indicate to students what EzyEducation Ltd consider to be good exam technique. It also indicates the content that students might use to answer specific questions.

Although it has been influenced by the specification and sample mark schemes published by examination boards, it is not possible to guarantee that this document will accurately reflect the way examinations are actually marked. This is subject to uncertainty due to the subjective nature of the marking process.

Contents

Section A

- Question 1a – Pg 4 – 5
- Question 1b – Pg 6 – 8
- Question 1c – Pg 9 – 15
- Question 1d – Pg 16 – 26
- Question 1e – Pg 27 – 36

Section B

- Question 2a – Pg 37 - 38
- Question 2b – Pg 39 - 44
- Question 2c – Pg 45 - 48
- Question 2d – Pg 49 - 59
- Question 2e – Pg 60 - 72

Question 1a

With reference to Figure 1, explain one possible reason for the changes to US interest rates during 2008.

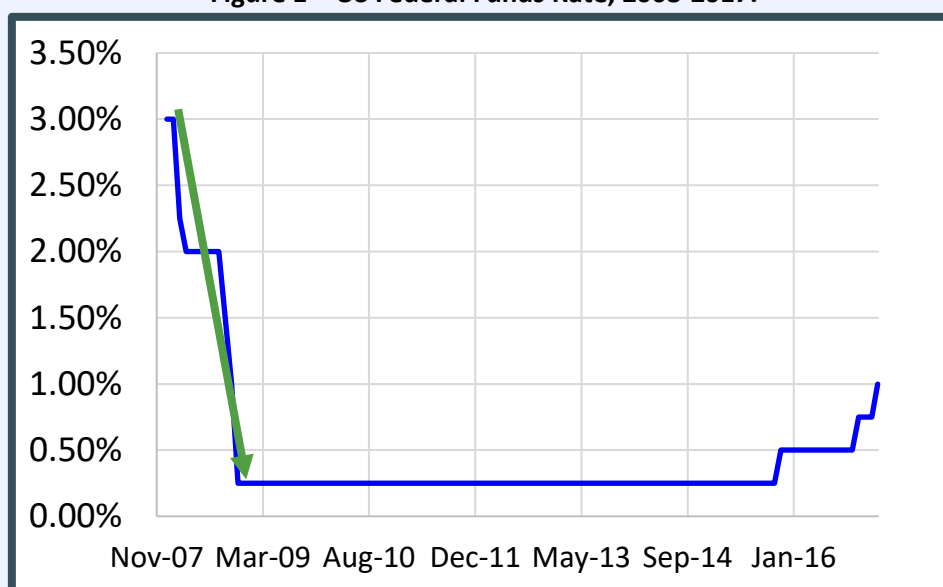
[5 marks]

There are two key elements required in this answer:



Figure 1 shows the US Federal Funds rate (the US base rate of interest).

Figure 1 – US Federal Funds Rate, 2008-2017.



It is clear that during 2008 (the green arrow) the US Federal Funds Rate fell significantly. In order to effectively highlight this change, you need to make specific mentions of the data. For example:

“At the start of 2008, the US Federal Funds rate stood at 3%. It soon fell down to 2% before falling again towards the end of 2008 down to 0.25%.”

Now that you have identified the change you need to provide a reason for this. Some of the possible reasons you could provide can be extracted from the other extracts. For example:

Financial Crisis - Recession

Extract B highlights that 2008 was the year of the financial crisis. This meant it was a time of recession for the US. A fall in interest rates is an example of expansionary monetary policy, usually implemented during times of recession to stimulate aggregate demand. This ensures that the effects of the recession on growth and unemployment is somewhat neutralised.

Financial Crisis - Lending

A financial crisis leads to banks failing and acting in a conservative manner regarding lending can have disastrous effects upon an economy. Businesses and consumers can no longer access credit, reducing their economic activity. Reducing interest rates encourages banks to increase their lending as the opportunity cost of doing so (the interest paid if they keep their funds as deposits with the central bank) is lower.

2008 Sub-prime Mortgages

Extract B touches upon the fact that it was the US housing market which “fired the starting-gun” on the US financial crisis. Home owners were finding it difficult to make their mortgage repayments and were therefore defaulting on their debt on an alarming scale. One of the reasons why the central bank reduced interest rates may have been to try and reduce the mortgage costs for home owners in order to help alleviate this crisis.

There are other possible reasons which you could introduce.

The important thing, no matter which reason you use, is that you clearly link it back to the change shown by the data.

There are likely to be up to **2 marks** available for identifying and explaining a reason, up to **2 marks** for clearly identifying the change in the data with references to specific data points, and finally **1 mark** available for making a link between the reason and the change in the data.

Question 1b

With reference to Figure 2, examine the likely impact of the trend in consumer confidence between September 2016 and January 2017 on US economic growth.

[8 marks]

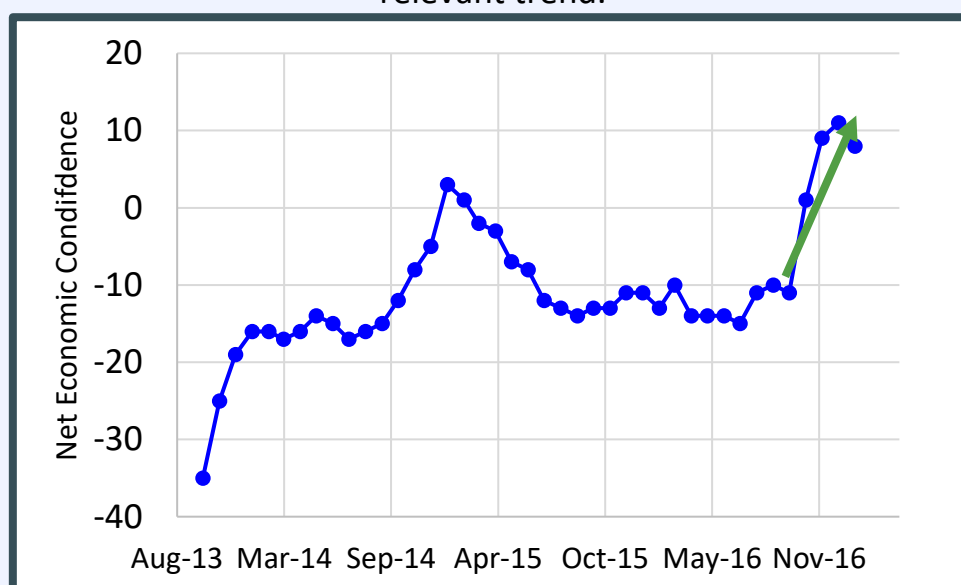
To gain the full **8 marks** in this question you need to demonstrate your ability to hit all of the assessment objectives required for this specific question. You need to be able to explain what the trend in consumer confidence is and then how that is likely to impact economic growth. You are not required to include a diagram in this question, although if you have time (which may be unlikely) it might be useful.

Consumer Confidence

You may want to begin by defining consumer confidence. For example:

“Consumer confidence refers to how upbeat the consumers, on average, in an economy feel about the economy’s and their own prospects. Data about consumer confidence is usually collected through polling which asks consumers how confident they feel about the economy.”

The next thing is to establish what the change in consumer confidence has been over the time period specified (September 2016 – January 2017). Figure 2 provides a time range that stretches back too far. The green arrow shows the relevant trend.



It is clear that consumer confidence has increased. It is best if you highlight this by quoting specific data from the chart:

“In September 2016, US net consumer confidence was negative, hovering just below a rating of -10. However, over the following months it proceeded to increase sharply, reaching a net positive rating around +10 by January 2017.”

Impact on Growth

Increasing consumer confidence has important implications for aggregate demand. Consumers who are more confident about the state of the economy are likely to engage in more consumption. Businesses who witness this may increase their levels of investment to take advantage of the more buoyant economy.

Both consumption (C) and investment (I) are components of aggregate demand. As a result, increasing consumer confidence is likely to cause an increase in aggregate demand.

An increase in aggregate demand leads to an increase in the real output of the economy in the short-run. You could show this (if you have time) with an AD/AS diagram but this is not essential. An increase in real output represents economic growth, so we can interpret this as an increase in growth.

This explains the standard economic result of an increase in consumer confidence causing an increase in growth in the short-run.

There are also 2 marks available in this question for evaluation comments. Some examples of these are:

Spare Capacity?

The impact that increasing consumer confidence has upon growth is likely to depend upon the initial state of the capacity. Keynesian analysis argues that if the economy is already close to full employment then an increase in aggregate demand is likely to have a mostly inflationary effect with negligible impact on economic growth. However, if the economy initially has spare capacity, the impact upon growth might be high.

Sustainability

An increase in consumer confidence over a few months is likely to have less of an effect compared to a sustained level of high confidence over several years.

If confidence is sustained it is much more likely to lead to the theoretical increases in consumption and investment which cause higher short-run economic growth.

Causality

It may be that rather than higher confidence causing economic growth, that the correct direction of causality is that higher growth causes higher confidence.

You are not expected to include all of these evaluative comments in your response. Including one evaluative comment in your answer would be appropriate.

The mark allocation of this question is split up and based on the four main exam skills:

Knowledge – 2 marks

Application – 2 marks

Analysis – 2 marks

Evaluation – 2 marks

Question 1c

With reference to the information provided, discuss the likely impact of an increase in US interest rates on the US housing market and consumer confidence. **[12 marks]**

Step 1: Knowledge and Understanding

You need to demonstrate that you have sound knowledge of the question topic. You can signal this by including key definitions. For example, in this question you might want to weave a definition of ‘demand for housing’ in to your introduction:

“The increase in interest rates witnessed in the US has significant implications all over the US economy. One sector that will, perhaps most prominently, be affected is the housing market. The demand for housing is defined as the number of houses that consumers are willing and able to buy at a given price. Housing is predominantly financed through mortgages in developed economies like the US. An increase in interest rates means that mortgages become more expensive and therefore a house at a given price becomes less appealing to consumers.”

Step 2: Impact on Housing Market

The analysis most logically should start with what is meant by rising interest rates.

“Rising interest rates most notably refers to the US Federal Reserve’s base rate (the Federal Funds rate). This is a very specific interest rate which governs funds deposited at the central bank by large financial institutions. However, increases to this interest rate do tend to filter through the economy and affect other interest rates.

This is because the opportunity cost a bank suffers when it lends out money, for example in the form of a mortgage, is now higher as it is forgoing the opportunity to enjoy a higher interest rate itself by depositing with the central

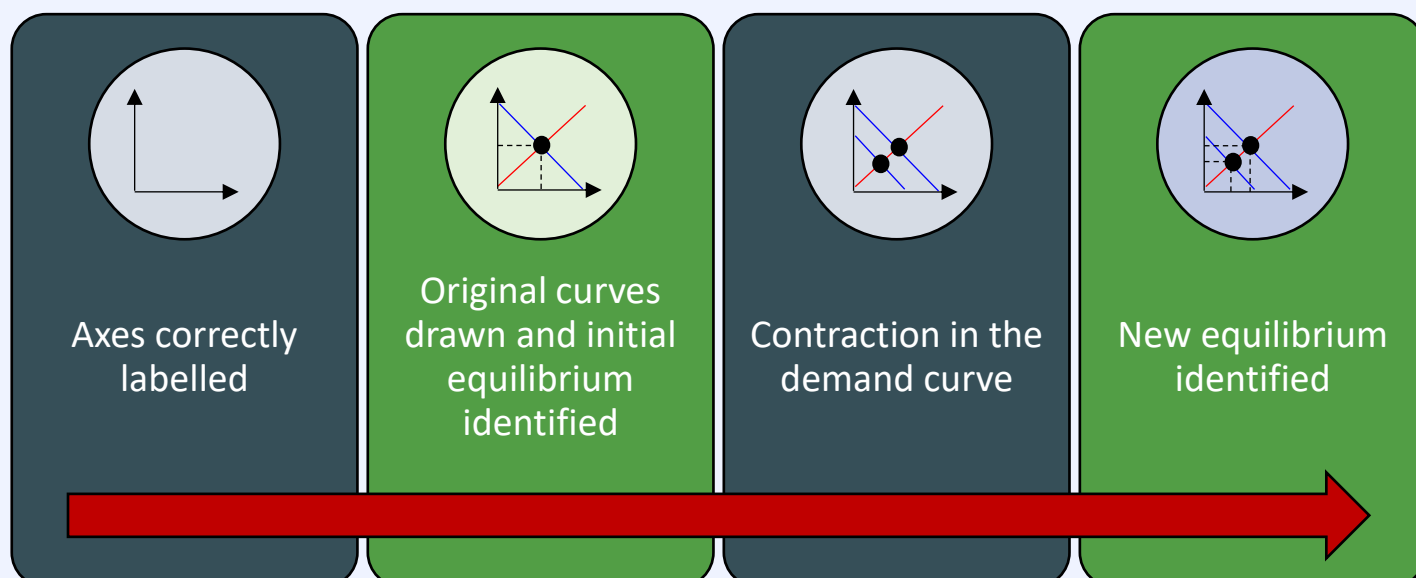
bank. To overcome this, the banks need to charge higher interest rates on the funds they themselves lend out.”

This leads itself into a thorough explanation of how this impacts the housing market.

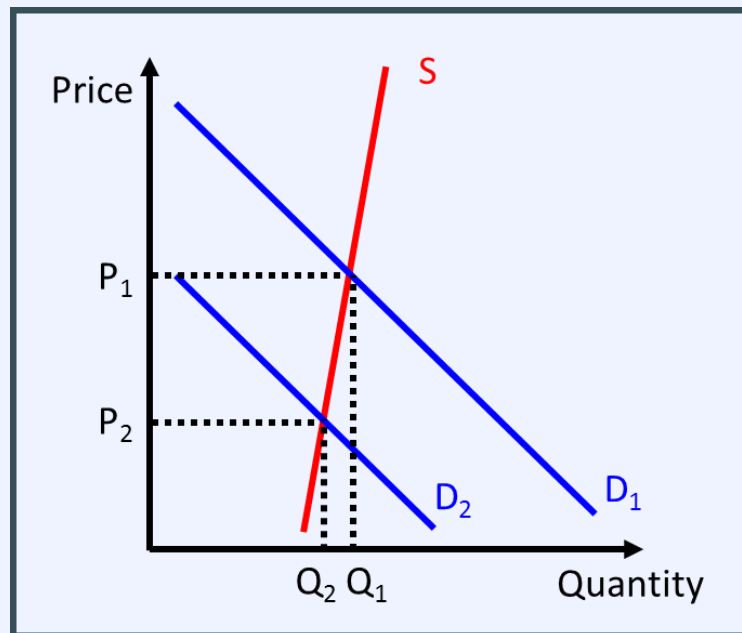
“If consumers are faced with higher interest rates when applying for a mortgage, this will reduce the demand for housing. It makes the process of buying a house more expensive for the large proportion of the population who do so via mortgage finance. At any given house price, with the cost of mortgage finance increased, there will be less demand for housing.

To showcase the effects of this reduction in demand effectively, a demand/supply diagram is required.

To be accurate, the diagram need to include the following features:



Use a ruler and ensure the diagrams are neat and tidy.



Notice that the supply curve has been drawn as a price inelastic supply curve (with a steep gradient). That is because, in the short-run, it is very difficult to alter the supply of housing as there are significant time lags involved the creation or destruction of housing. The significance of that is that the demand curve shift primarily impacts the equilibrium price within the market rather than the quantity.

You will need an accompanying explanation for your diagram:

“Reduced demand for housing is represented in the supply and demand diagram by an inwards shift in the demand curve from D_1 to D_2 . This causes the market equilibrium to change. The most significant effect is a large reduction in the market price from P_1 to P_2 . The size of this price fall is large because, in the short-run at least, the supply of housing is price inelastic. This is due to the significant time lags and capital required to build new houses. This is also the reason why the market quantity of housing is affected little.

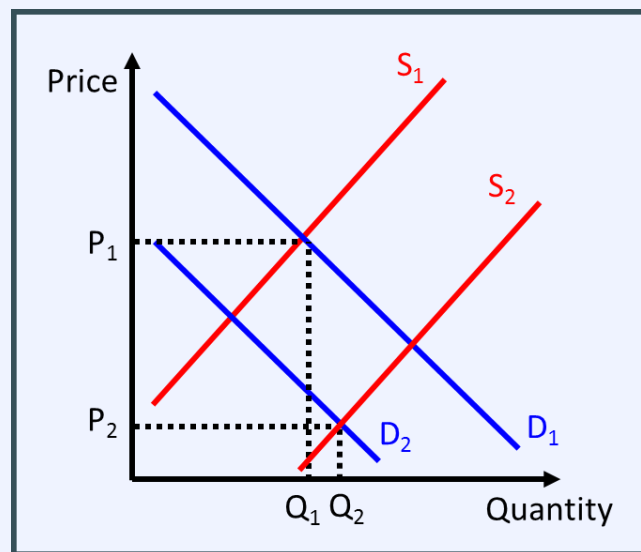
You may want to expand on this accurate, but standard analysis. There are many avenues you could take. Be careful not to try and include too much. A couple of examples are:

Defaults

The sub-prime mortgage crisis which stimulated the 2008 financial crisis arose because house owners could not afford the repayments for their mortgage and

the housing market crashed. An increase in interest rates does not only impact potential home buyers, it also affects home owners who are currently making mortgage repayments.

If the increase in interest rates causes these repayments to increase, some home owners may no longer be able to afford them and may either default on their mortgage or decide to sell their house to move to somewhere more affordable. If you use a supply and demand diagram to represent house available for sale rather than the entire housing stock, this could be represented by an outwards shift in the supply curve.



This analytical route suggest that house prices are likely to fall even more severely. To avoid such a scenario, however, in the wake of the 2008 crisis, governments including the US have tightened regulations to ensure that mortgage lenders assess the affordability of mortgages even in the event of significant interest rate rises.

Long-run Impact

In the long-run, changes to interest rates may affect the supply of housing significantly. If rising interest rates do indeed cause demand to fall and prices to drop, housebuilders may be reluctant to proceed with housebuilding projects. The lower house prices indicate that the potential profit available for such building project is lower.

Step 3: Impact on Consumer Confidence

Having concluded that rising interest rates are likely to cause house prices to fall, this provides a natural link in the chain of reasoning towards the impact on consumer confidence.

The housing market is one of the most important markets in the economy. A fall in the price of houses means that home owners all across the economy feel poorer. This is primarily through two avenues.

If they own their house outright, the fall in the value of one of their largest assets makes them less wealthy. With less wealth, their confidence is likely to be shaken and they are likely to be more frugal with the consumption decisions.

If they have a mortgage, then rising interest rates mean that their mortgage repayments each month are likely to be higher. This, in turn, means that they have less disposable income to engage in other consumption. This is likely to affect their confidence.

Rising interest rates are also likely to reduce consumer confidence through other channels. For example:

“Higher interest rates mean that consumer borrowing is likely to become more expensive. This includes personal finance deals for the purchase of a new, all the way down to any debt accumulated on a credit card. With knowledge that any debt they accumulate is likely to be more expensive, consumers may have less confidence about the prospects of the economy.”

Step 4: Evaluation

There are **4 marks** available for providing relevant evaluative comments Some examples of these are:

Time Frame/Lags

Discussing the fact that the outcomes may differ in the long-run compared to the short-run, like we have done in the analysis sections above, is a good way to evaluate the impact of rising interest rates.

You may also want to touch upon the fact that monetary policy usually has a significant time lag between implementation and it having an impact upon the economy. This may mean that in the months following the change in interest rates (the very short-run) there is little to no effect.

Price Elasticity of Supply

We have discussed that the PES for the housing market in the short-run is likely to be highly inelastic due to the time lags involved in housebuilding. Demonstrating an awareness of the impact upon prices of the extent to which this is the case is a good way to weave some evaluation in to your response.

Railway infrastructure projects are unlikely to rely upon using pure crude steel. Instead, they are likely to require specialised products made out of steel. The impact, then, that a reduction in the steel price has, will depend upon whether the intermediary firms which produce the specialised final products pass on the lower price or not.

Ceteris Paribus

Much of the analysis is dependent upon all other things remaining equal. The impact of rising interest rates on the housing market and consumer confidence may be diluted or exacerbated by fiscal policy decisions or other significant markets throughout the economy.

Transmission Mechanism

The extent to which changes made to interest rates by the central bank affect the housing market and consumer confidence depends upon how effective the transmission mechanism is. That is, how sensitive commercial banks are with regards to changing their interest rates (particularly for mortgages) in response to a change in the base rate.

These provide just a flavour of the potential evaluative avenues you could go down.

The mark allocation of this question is split up and based on the four main exam skills:

Knowledge – 2 marks

Application – 2 marks

Analysis – 4 marks

Evaluation – 4 marks

Question 1d

With reference to the information provided and your own knowledge, evaluate the possible microeconomic and macroeconomic effects on the UK economy of an increase in US interest rates.

[25 marks]

To access top marks in any economics essay, it is important to focus on two key elements:



As essay structure is a more general skill, we will focus on showcasing how to hit the different assessment objectives required for this specific question. However, hopefully, the following discourse will provide some assistance with regards to essay structure.

In this question, you need to assess the impact that an increase in US interest rates will have on the **UK economy**. This will most likely be centered around the impact on exchange rates and the subsequent macroeconomic consequences for the UK.

AO1: Knowledge

Being able to display accurate knowledge is judged to be the most basic requirement. It is still important to demonstrate good knowledge throughout your essay. You can signpost this by including accurate definitions. For example, in your introduction, you might want to introduce the concept of interest rates in the context of the rates of return enjoyed by investors.

“Interest rates refer to the price paid by borrowers to lenders for the benefit of borrowing money. Manipulation of interest rates throughout the economy is one of the primary monetary policy tools available to central banks. An increase in interest rates has consequences throughout the economy. For

example, potential investors can now expect to enjoy larger returns on their money.”

AO2: Application

Being able to apply your knowledge to the relevant context is particularly important when writing an essay. In this case, you are looking at applying theory to a specific context: the US interest rates and the UK economy. The data extracts provide a number of avenues into application. Some of these include:

Extract A (Lines 1 – 5)

This explains the importance of the US as the world’s largest economy. It suggests that decisions taken about US monetary policy affects other countries as well as its own.

Extract B (Lines 1 – 5)

This provides context in the form of the recent history of US interest rates. It describes how during the financial crisis of 2008, US interest rates was dragged down from over 5% to a record low of 0.25%. It also explains how they have been slowly increasing recently, up to 1% by March 2017.

This could be used as a useful evaluative point to explain that whilst interest rates are rising, they are rising quite slowly and are nowhere near the levels they have been previously.

Extract B (Lines 6 – 9)

Explains some of the reasons why the US Federal Reserve have taken the decision to increase interest rates. It details that inflation has been increasing up to 2.7% and unemployment in the US is down to 4.7%.

This can be used to as an avenue in to a discussion about the stage of the business cycle the US finds itself in. High-end responses may also consider that these effects may also be afflicting the UK economy and it itself may also raise interest rates.

Extract B (Lines 18 – 22)

This explains the US Dollar's role as the world's reserve currency. It explains that changes to US interest rates have a particularly large impact upon developing economies who often denominate their government debt in US dollars.

Extract B (Lines 23 – 24)

This provides the largest hint that one of the main effects, from the UK's perspective, of rising US interest rates is via the foreign exchange markets. This analytical strand is likely to be a significant part of most responses.

Extract B (Lines 27 – 30)

This explains that the US is a large trading partner for the UK and that the UK has many significant businesses which operate in the US and bring profits made back to the UK.

AO3: Analysis

The core of top-level essays consists of well-constructed, relevant analysis of the topic. This should be presented using logical chains of reasoning, and where appropriate, clear diagrams.

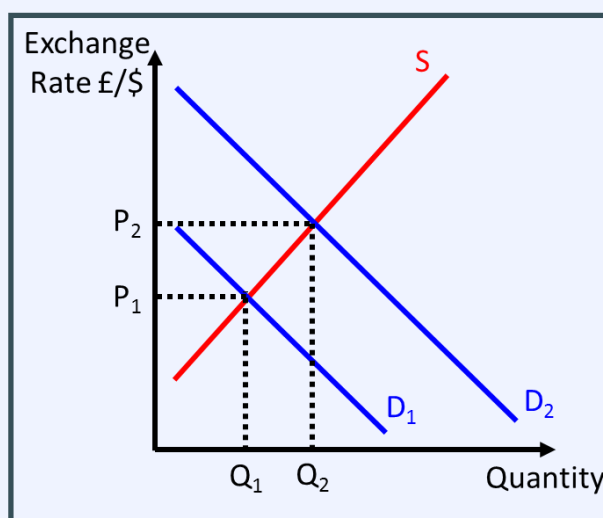
The heart of the analysis is likely to involve discussing the impact of an increase in US interest rates on the US-UK exchange rate and the subsequent impact on net trade for the UK. Once that has been outlined, it provides a platform to discuss the precise impact upon the UK's macroeconomic objectives. It will also be possible to weave in plenty of evaluation as the topics under consideration lend themselves well towards critique.

Impact on Exchange Rates

A logical chain of reasoning which explains how higher US interest rates will affect the US Dollar – UK Sterling exchange rate might look like:

“An increase in US interest rates has a significant impact upon the rates of return that investors can expect upon all assets in the US. This ranges from the purchase of government bonds, through to investments in corporate debt. This increased rate of return means that US investments are more enticing for global investors. In turn, this means that investors are likely to demand more US dollars on the foreign exchange markets.”

The best way to demonstrate the effects this will have on the exchange rate is to draw a supply and demand diagram for the foreign exchange market. You could alternatively just explain the result via a written chain of reasoning.

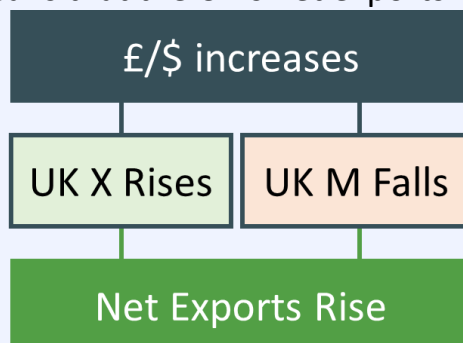


The increased demand for dollars is represented by an outwards shift in the demand curve from D_1 to D_2 . This causes the value of dollars to appreciate. This means that one dollar now is able to purchase more of other currencies, including UK Sterling.

Impact on Trade

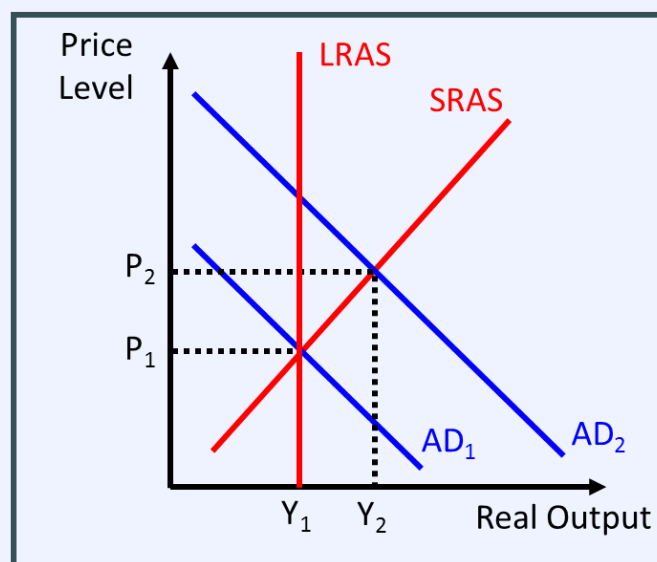
Looking at this from the UK's perspective, this means the Pound has depreciated against the US dollar. This has important implications for UK-US

trade. US consumers are now able to buy UK goods at a lower cost in dollar terms. This is likely to stimulate increased US demand for UK exports. Conversely, UK consumers will now find that US goods and services cost more in Pounds. UK consumers will demand fewer US imports. Taken together it means that the UK's net exports rise.



AD/AS Analysis

Net exports (X-M) are a component of aggregate demand. A rise in net exports causes aggregate demand to rise. The effects on the UK economy can therefore be analysed with the assistance of a AD/AS diagram.



The diagram requires an accompanying explanation:

"In the AD/AS diagram above, the economy is initially stationed at a macroeconomic equilibrium characterised by a price level of P_1 and a real output level of Y_1 . The increase in aggregate demand is modelled by an outwards shift in the aggregate demand curve. This forces the economy to

reach a new macroeconomic equilibrium. This occurs at a higher level of real output (Y_2) and a higher price level (P_2)."

Note: The diagram has been drawn with the economy initially at a long-run macroeconomic equilibrium as we will analyse the impact of spare capacity later using a Keynesian AS curve. However, you could alter this or indeed draw the diagram without the LRAS curve present.

Macroeconomic Objectives

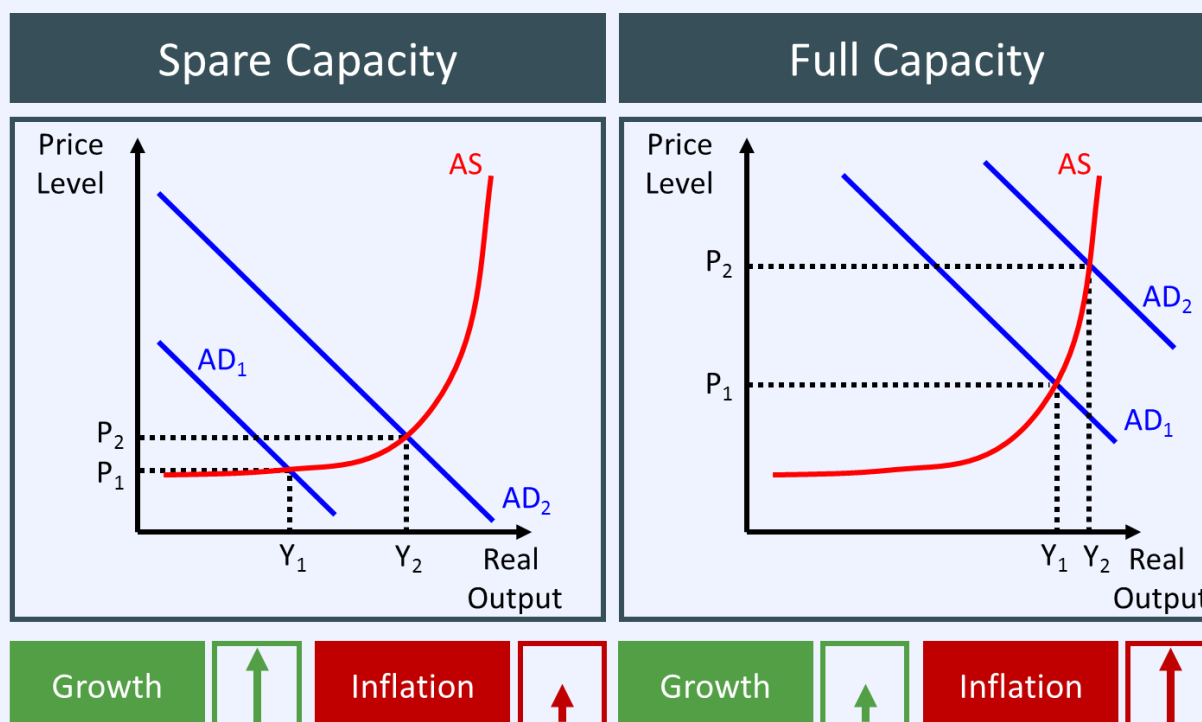
The AD/AS analysis prompts discussion about the impact on the main macroeconomic objectives. These are to achieve strong economic growth, low and stable inflation, low unemployment, a good position on the balance of payments and some economists include limiting inequality.

In this case, the first consideration is that the increase in real output means that the economy is growing. It also implies, in turn, that unemployment is likely to fall. On the other hand, the price level has risen and this can be interpreted as an increase in inflation. Finally, an increase in net exports means that there will be an improvement to the current account of the balance of payments. As the UK currently runs a substantial deficit on the current account of balance of payments, this will be welcome news. Overall, therefore, the outlook is that in the short-run, increased net trade is positive for the main macroeconomic objective, with the exception of inflation.

Spare Capacity

Of course, above we have discussed just the direction of travel for the main macroeconomic objectives. One way to introduce some advanced analysis is to consider the magnitude of these impact using Keynesian AS analysis.

That is to say that the extent to which an increase in aggregate demand is good for the UK economy depends upon what state the UK economy is in initially. If there is sufficient spare capacity available, then it will predominantly increase growth and therefore unemployment with limited impact upon inflation. However, if the economy is close to full capacity, the opposite will be the case.



Long-run / Supply-side Impact

Thus far the AD/AS analysis has focused mostly upon aggregate demand in the short-run. This implies that there is expected to be limited long-run impact. This is primarily due to there being no obvious supply-side impact. It is possible that one could make the case that increasing exports to the US, a similar developed economy, may cultivate high-tech, high-skilled industry in the UK which might provide the successful conditions for supply-side improvements. In which case there are likely to be positive long-run effects for the UK economy.

Failing this, however, it is worthwhile acknowledging the timeframe being considered is primarily the short-run and making a nod towards the negligible long-run effects predicted.

UK Companies operating in US

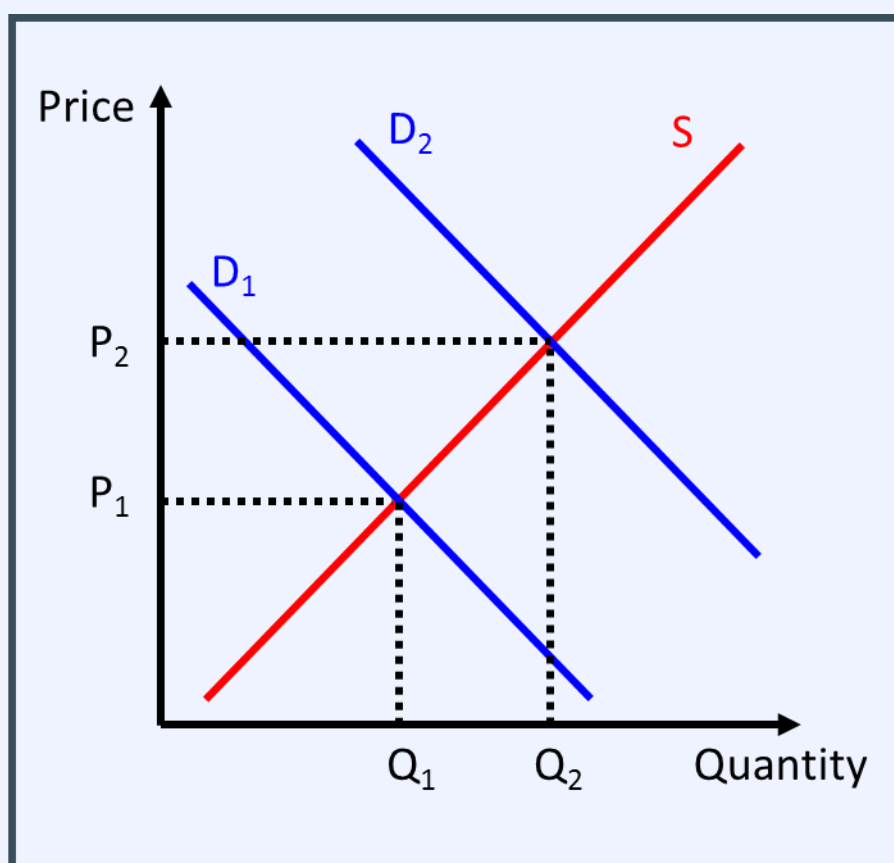
A slightly different angle, albeit one which reaches similar conclusions, is to discuss the impact the changing exchange rate would have on UK companies who have significant operations in the US. Such companies, like BP, often bring 'home' their profits from other markets. The stronger dollar would mean that such occurrences would result in higher profits being logged in Pounds,

increasing incomes (of shareholders and potentially employees) and confidence in the UK economy.

Micro: Impact on UK Exporting Firms

The question asks you to consider the microeconomic effects as well as the macroeconomic effect. Despite the question lending itself more towards a macro approach, there are avenues you can take to include some micro analysis. One would be to hone in on markets or firms who are involved significantly in exporting their goods or services to the US. Their market enjoys an increase in demand from the US, increasing the market price and output.

This could be shown on a supply-demand diagram.



Individual firms are likely to enjoy higher profits as a result of the increase in demand. The extent to which these last for will depend upon the structure of the market: if it is competitive then more firms will enter, reducing profits in the long-run.

Firms, with the large US market in their targets, may be able to exploit economies of scale, thereby becoming more productively efficient.

AO4: Evaluation

Including accurate and relevant evaluation in your essay is the most important thing to ensure you achieve top marks. Evaluation is the art of making supported judgements, of deciding which factors are most important and highlighting in which circumstances particular factors assume greater or lesser importance.

There are a huge number of evaluative angles you could take within this essay. Here we will showcase some useful points. You would not be expected to include all of these examples – there simply is not enough time!

UK Interest Rates

Interest rates in the US are being increased by its central bank because the economic indicators are suggesting that the economy is in a strong state. It may be that the UK's central bank makes a similar conclusion soon about the UK economy and decides to increase interest rates there. If this occurs then the logic surrounding higher interest rates in the US incentivising investors to increase their demand for dollars no longer holds, as similar great incentives will also be encouraging investors to purchase Pounds Sterling. This will cause the UK's currency to appreciate, meaning that the US-UK exchange rate may remain steady.

Size of the rise in US Interest Rates

The magnitude of the effects discussed will depend upon exactly how large the increase in US interest rates are. By March 2017, US interest rates had risen only to 1%, not exactly a massive rise. Whilst it is likely they will rise further, the Federal Reserve has indicated that rises are likely to be slow and measured.

Marshall-Lerner Condition

The logical chain of reasoning assumes that a depreciation in the value of the Pound Sterling relative to the US Dollar will increase the value of UK net exports. This is only true if the Marshall-Lerner condition; that is that the sum of the absolute values of the import and export elasticities is greater than 1. If this is not the case then the depreciation will actually cause the value of net exports to fall!

US Consumption

Interest rate rises by a central bank are often implemented in order to try and deflate an economy. If this is successful it may mean that the US economy's growth rate, and therefore its appetite for the UK's exports, declines. This might provide a headwind against the impact of the exchange rate change on net exports.

Relative Importance of Macro Objectives

You could argue that, given the UK's current significant balance of payments deficit, it would be valid to prioritise this over the other macroeconomic objectives.

Overall, it is important to provide in your essay, a reasoned judgement; an argument deciding whether or not increasing US interest rates are good for the UK economy. It doesn't matter which side of the argument you make the case for – you will be examined on how effectively you structure that argument and how well you support it with economic theory.

The concluding paragraph of your essay is often a very good place to make clear what your overall reasoned judgement of the question is. Some people also like to include a similar judgement in their introduction, to signpost clearly to the examiner that they will be making an evaluative judgement in their essay.

Here is a good example of an attempt to, in one paragraph, argue that increasing US interest rates are a positive development for the UK economy:

“Overall, it is clear that the America’s current monetary policy has the potential to have positive effects on the UK, mostly by improving the UK’s balance of payments position which is urgently in need of repair. Whilst the potential inflationary impact should not be ignored, the boost to the UK’s exporting industries should take precedence and the UK government should welcome this development”

Alternatively, it would be just as valid to argue that tightening US monetary policy is negative for the UK:

“On balance, the prospect of increasing US interest rates is a worrying one from a UK perspective, if indeed it has much of an impact at all. The UK is approaching full employment, as indicated by its recent low unemployment figures and what it desperately needs is supply-side improvement, not further boosts to the demand-side of the economy. Indeed, it may be wise for UK policymakers to anticipate the impact via trade channels and protect the macroeconomy by instigating their own increases in interest rates.”

Essays are marked on a levels basis. The overall quality of your essay will be considered when deciding upon which level the answer is. There are up to 16 marks available for knowledge, application and analysis:

Level 1 [1 – 4 Marks] – Weak knowledge and understanding which included generic or irrelevant information.

Level 2 [5 – 8 Marks] – A narrow response which contains some knowledge and understanding but under-developed chains of reasoning.

Level 3 [9 – 12 Marks] – Accurate knowledge and understanding with clear analysis but the answer may lack balance.

Level 4 [13 – 16 Marks] – Precise knowledge and understanding with relevant and coherent analysis.

There are up to 9 marks available for evaluation:

Level 1 [1 – 3 Marks] – Generic evaluative comments without relevant evidence.

Level 2 [4 – 6 Marks] – Reasonable evaluation which may be sometimes unbalanced or not fully supported.

Level 3 [7 – 9 Marks] – Strong levels of well-supported evaluation.

Question 1e

With reference to the information provided and your own knowledge, evaluate the possible microeconomic and macroeconomic effects of increasing US consumer confidence on the global economy.

[25 marks]

To access top marks in any economics essay, it is important to focus on two key elements:



As essay structure is a more general skill, we will focus on showcasing how to hit the different assessment objectives required for this specific question. However, hopefully, the following discourse will provide some assistance with regards to essay structure.

In this question, you need to evaluate the **effects** of increasing US consumer confidence. An easy mistake to make would be to focus on the **causes** of increasing US consumer confidence. Whilst not completely irrelevant, this would not be effectively answering the question.

AO1: Knowledge

Being able to display accurate knowledge is judged to be the most basic requirement. It is still important to demonstrate good knowledge throughout your essay. You can signpost this by including accurate definitions.

Your introduction is a good opportunity to signal that you have understood the question that has been posed, and to provide a way in to the main body of your answer. For example, the following part of an introduction defines consumer confidence and highlights the possible routes into analysis.

“The US remains the largest economy in the world. As a result, the state of the US economy has a large impact on the overall global economy. Consumer confidence refers to the sentiment that consumers have about the state of the economy and their own personal economic experiences. If consumer confidence is increasing, it is a sign that the economy is in a buoyant state, possibly moving towards the ‘boom’ stage of the business cycle. This is likely to cause US growth and therefore global economic growth to increase, as well as having important implications for exchange rates, trade and investment.”

AO2: Application

Being able to apply your knowledge to the relevant context is particularly important when writing an essay. In this case, you are looking at applying theory to a specific context: lower steel prices. The data extracts provide some avenues into application. Some of these include:

Extract A (Lines 1 – 5)

This explains that the US is the largest economy in the world and describes how this means that its performance has large implications for overall global economic performance. This may stimulate emphasis in your response about how the size of the American economy affects the importance of rising US consumer confidence from a global perspective.

Extract A (Lines 6 – 14)

This discusses the structural change that has taken place within the American economy since globalisation started. It describes how labour-intensive manufacturing businesses struggled against competition from countries with low labour costs. It also, however, discusses the high-tech industries that the US has taken a lead in and that the fracking has encouraged a resurgence in American oil production. This could be used to integrate some microeconomic analysis about the potential impact of higher consumer confidence on these types of industries.

Extract A (Lines 15 – 20)

This details how the US runs a persistent trade deficit and how the election of Trump has thrown light on trade deals. This might be used as a challenge to the ‘ceteris paribus’ assumption used. The theoretical effects that increasing confidence might have may be diluted by America retreating from global free trade.

Extract A (Lines 21 – 25)

This explains how the election of President Trump and his ‘pro-growth’ agenda, including increases to spending on defence, seems to have inspired greater consumer confidence. This could be used to evaluate whether or not this confidence will be sustained or whether it is just a post-election polling bump.

Extract B (Lines 7 – 13)

This discusses the current state of the US economy. It highlights that inflation is increasing and unemployment is low, but that growth is still sluggish. This could be used as an evaluative tool as evidence of whether the US economy has any spare capacity or not.

As ever, you only need to include some of these application examples and you can introduce freely application which you retrieve from your own knowledge.

AO3: Analysis

The core of top-level essays consists of well-constructed, relevant analysis of the topic. This should be presented using logical chains of reasoning, and where appropriate, clear diagrams.

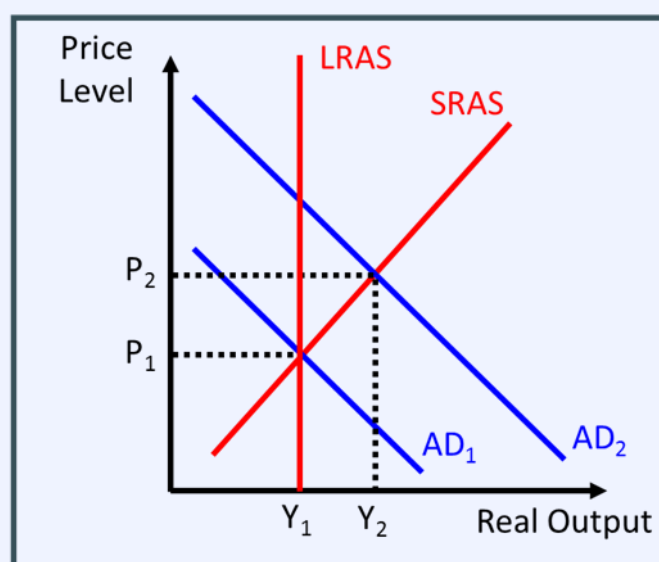
There are lots of analytical routes you could go down with a question like this. The question asks about the effects on the **global economy**. It might be useful to break this down in to the effects on the US economy (which forms a large part of the global economy) and the effects on the rest of the global economy (all other countries). This will provide the platform for discussing the overall impact and provides lots of space to introduce evaluation.

Impact on the US

When consumers have more confidence about the state of the economy and its future prospects, they tend to make more active consumption decisions. They will make purchases now that they might otherwise have delayed. They become more willing to fund such purchases by borrowing. The net result is that consumption increases.

Witnessing increased consumption and feeling the increased confidence throughout the economy, firms become more likely to want to take advantage of this by investing more. As a result, investment increases.

Consumption and investment are two important components of aggregate demand. Therefore, higher consumer confidence causes an increase in aggregate demand. We can analyse the impact of this using a AD/AS diagram.



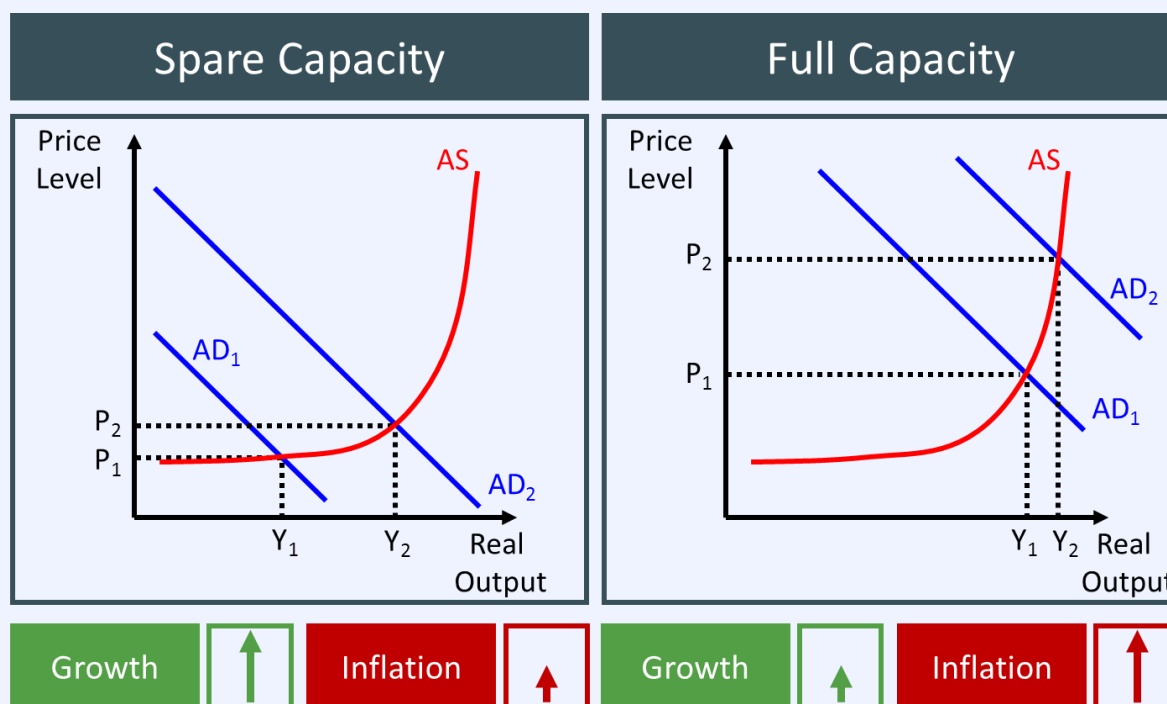
The diagram requires an accompanying explanation:

“The increase in aggregate demand has been modelled by an outwards shift in the AD curve. Initially the economy is depicted at a long-run macroeconomic equilibrium with a price level of P_1 and a real output level of Y_1 . The shift in the AD curve from AD_1 to AD_2 causes the economy to move up the SRAS curve until it reaches a new macroeconomic equilibrium. Here the economy now has a higher price level (P_2) and a higher real output (Y_2).

This has implications for the main macroeconomic objectives. Higher real output suggests increased economic growth and therefore, lower unemployment. The downside is that inflation increases. The effect on the current account of the balance of payments is likely to be negative. This will be

covered in more detail when we consider the impact on the rest of the global economy.

In the diagram above, the economy is initially depicted at a long-run macroeconomic equilibrium. One useful tool available is to introduce some Keynesian AS analysis to describe how the impact of increased consumer confidence is likely to depend on whether the economy has any spare capacity.

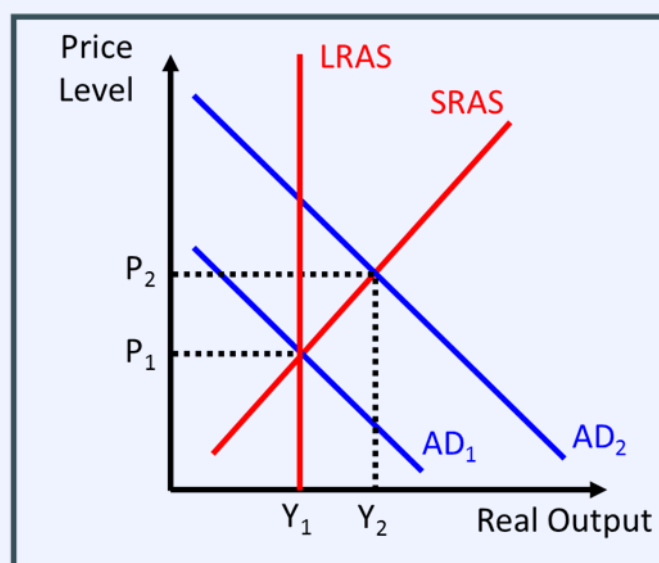


You could argue this either way! The American economy currently has low unemployment and an increasing inflation rate which suggests that it is close to full employment. However, growth remains slow, hovering around 2% which might imply that there is some spare capacity available.

Impact on the rest of the world

Increased US consumer confidence leads to US consumers purchasing more goods. This includes imported goods. For economies who are significant exporters to the US, this will result in an increase in their exports. Countries which fall in to this category include developed economies, like the UK, geographical neighbours, like Mexico, and the low-cost manufacturing economies like China and India. This may indeed be exacerbated if higher US inflation makes US goods less competitive compared to the rest of the world.

An increase in exports leads to an increase in aggregate demand as net exports are a component of aggregate demand. This can be shown on a similar AD/AS graph as previously introduced.



Other countries therefore enjoy similar outcomes compared to those discussed about the US economy: higher growth, lower unemployment and higher inflation. The same discussion about spare capacity and Keynesian AS analysis can be introduced.

The difference between the benefits enjoyed by the US and the rest of the economy is undoubtedly with regards to the balance of payments. The US suffers a deterioration in its current account of the balance of payments, whilst exporting countries enjoy an improvement.

Other Effects

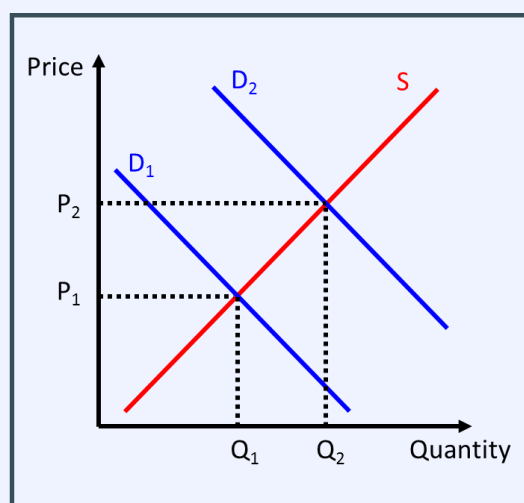
In today's globalised world, the impact of the world's largest economy enjoying higher consumer confidence is not necessarily confined to the traditional analytical channel of trade. The most obvious impact is that good news from America tends to lift economic confidence in economies across the world. International investors enjoy a wealth effect from holding American assets which are appreciating in value and this increases their economic activity in their own economies. Multinational companies are spurred on to increase investment across the globe. Most of this can be modelled as a general increase in aggregate demand.

Indeed, very sophisticated answers might wish to comment on the fact that globalisation has made aggregate demand for economies around the globe to move more consistently with each other. This was evident when the financial crisis which originated in the US caused a slowdown in economic growth all across the world.

Another avenue of analysis could be the long-run impact. We have touched upon the idea that increasing consumer confidence may lead to increased business investment. Higher investment spurs on supply-side improvements. Coming within the US, a pioneer for high-tech advancements, this may cause the global LRAS curve to shift outwards, improving the long-run prospects for the global economy.

Micro: Impact on Export Firms

The question asks you to consider the microeconomic effects as well as the macroeconomic effect. Despite the question lending itself more towards a macro approach, there are avenues you can take to include some micro analysis. One would be to hone in on markets or firms who are involved significantly in exporting their goods or services to the US. Their market enjoys an increase in demand from the US, increasing the market price and output. This could be shown on a supply-demand diagram.



Individual firms are likely to enjoy higher profits as a result of the increase in demand. The extent to which these last for will depend upon the structure of the market: if it is competitive then more firms will enter, reducing profits in the long-run.

Firms, with the large US market in their targets, may be able to exploit economies of scale, thereby becoming more productively efficient.

There are, of course, a wide range of other analytical avenues you could go down in your essay.

AO4: Evaluation

Including accurate and relevant evaluation in your essay is the most important thing to ensure you achieve top marks. Evaluation is the art of making supported judgements, of deciding which factors are most important and highlighting in which circumstances particular factors assume greater or lesser importance.

There are a huge number of evaluative angles you could take within this essay. Here we will showcase just some possible avenues:

Sustainability of Confidence Levels

Whether US consumer confidence is high for a couple of months or several years will affect the magnitude of economic effects felt in the US and around the world.

US Interest Rates

Further increases to US interest rates may dampen down the effects of any rise in consumer confidence, and may, in fact, reduce consumer confidence itself. This is a classic effect of contractionary monetary policy. Indeed, the fact that the US central bank is acting to increase interest rates could be used to suggest that the economy is close to full capacity and increasing confidence needs to be watered down to avoid highly inflationary effects.

Size of Trade with the US

The impact on economies around the world of rising US consumer confidence will depend, partly, upon how important the US is as a trading partner. If a country trades little with the US, then they may derive little to no benefit at all

How confident?

The premise of the question is that consumer confidence is increasing. It can be argued, however, that the increase in confidence is rather small. A poll rating of +10 indicates that only 10% more people have high confidence in the economy than have low confidence. This is hardly a unanimous vote of confidence in the prospects for the US economy.

Overall, it is important to provide in your essay a reasoned judgement. It doesn't matter exactly what you argue – you will be examined on how effectively you structure that argument and how well you support it with economic theory.

The concluding paragraph of your essay is often a very good place to make clear what your overall reasoned judgement of the question is. Some people also like to include a similar judgement in their introduction, to signpost clearly to the examiner that they will be making an evaluative judgement in their essay.

Here is a good example of an attempt to, in one paragraph, argue that rising US consumer confidence will have a large positive impact on the global economy:

“For a global economy, which has been sleep-walking its way through recovery from the 2008 financial crisis, increasing consumer confidence has the potential to provide just the stimulus it needs. The impact it will have on economic growth in the US will promote confidence throughout the globalised economy. This will be made tangible by economies throughout the rest of the world enjoying higher exports. It is perhaps more important than ever that the US provides a lead in strong economic performance to help the global economy return to ‘normal’ levels of trend growth.”

This is just one possible conclusion!

Essays are marked on a levels basis. The overall quality of your essay will be considered when deciding upon which level the answer is. There are up to 16 marks available for knowledge, application and analysis:

Level 1 [1 – 4 Marks] – Weak knowledge and understanding which included generic or irrelevant information.

Level 2 [5 – 8 Marks] – A narrow response which contains some knowledge and understanding but under-developed chains of reasoning.

Level 3 [9 – 12 Marks] – Accurate knowledge and understanding with clear analysis but the answer may lack balance.

Level 4 [13 – 16 Marks] – Precise knowledge and understanding with relevant and coherent analysis.

There are up to 9 marks available for evaluation:

Level 1 [1 – 3 Marks] – Generic evaluative comments without relevant evidence.

Level 2 [4 – 6 Marks] – Reasonable evaluation which may be sometimes unbalanced or not fully supported.

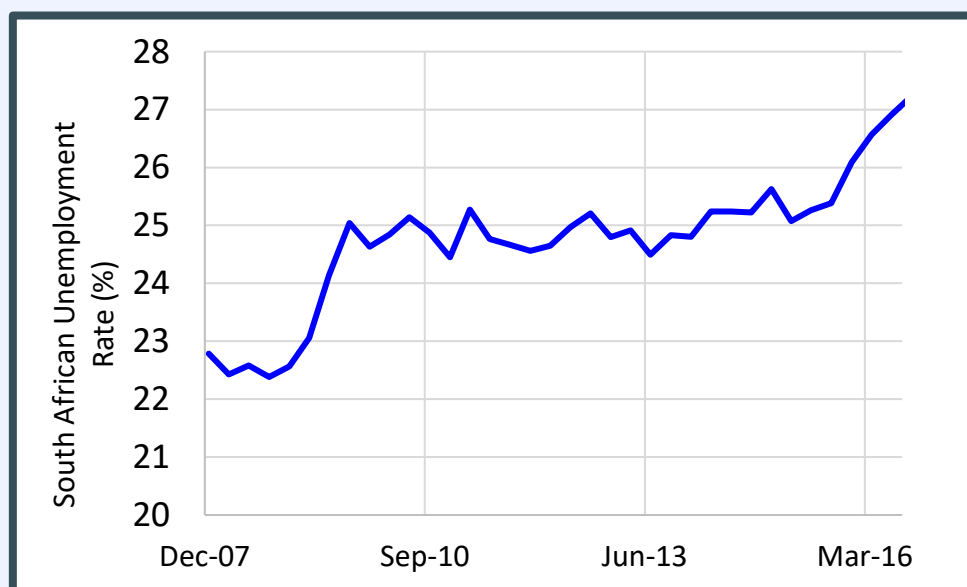
Level 3 [7 – 9 Marks] – Strong levels of well-supported evaluation.

Question 2a

There are two key elements required within this answer:



In this question, you need to provide just **one** reason for the increase in the unemployment rate in South Africa. You can see by looking at Figure 6 that the unemployment rate sharply increased in 2009 from just under 23% to 25%. The unemployment rate has gradually increased over the remaining period, before another sharp rise at the start of 2016. Overall this increase in the unemployment rate is graphically represented via an upward trend in the line chart in Figure 6:



Some of the explanatory reasons behind the rise in the South African unemployment rate can be found by referring to Extract D. A summary of the reasons given are:

Corruption

Corruption can be defined as an action which is divisive and immoral and often involves bribery payments or the use of public funds for private purposes.

South Africa is a country that suffers severely from corruption, particularly at a government level. This has resulted in major contracts for government spending commitments to be flawed and unproductive. The lack of law enforcement means that any adequate and stringent anti-corruption policies put in place are ineffective.

Corruption is a cause of unemployment because if governments use public funds for their own private use this results in a loss of spending towards productive and job-creating sectors of the economy such as the manufacturing or construction sectors. As these sectors often rely upon public money to finance projects, the demand for labour will decrease. This results in higher unemployment as the number of jobs available in the economy falls.

Labour Force Participation

The labour force of a country consists of all the people who are willing and able to work (working-age) in a country. The unemployment rate is a measure of the percentage of people in the labour force who have been actively searching for work in the last month but have been unsuccessful. Therefore, workers who are not actively seeking work are not included in the unemployment rate.

However, if there is an increase in the number of people seeking job opportunities that traditionally would not do so, this will cause the unemployment rate to increase rapidly. In countries like South Africa, proactive movements have been made to increase the role and empowerment of women in labour markets. If there is an increase in the number of women searching for jobs in South Africa it will correspond to an increase in the unemployment rate.

Low Labour Demand

The demand for labour is derived from the demand for firms' products in the economy. This is because firms need to employ labour to produce the products that they sell. If firms have a reduced incentive to demand labour, it will result in less employment and therefore a higher unemployment rate.

The important element to this question is identifying a reason why the unemployment rate in South Africa has increased and including specific references to figure 6 in your answer.

Question 2b

With reference to the information provided, discuss the likely impact on the South African economy of an increase in government spending in the education sector.

[12 marks]

There are two suggested elements for this answer:



A good (but not the only) approach to this question is:

Step 1: Knowledge and Application

Beginning by introducing the context and setting the scene for the diagram to follow allows you to display important knowledge and application skills.

The example below makes a clear reference to the context (South African economy), provides an appropriate and applied definition (Supply Side Policy) and sets up the answer for the diagram by describing what we are trying to analyse (Productivity Impact).

“The central remit of any government is to achieve macroeconomic stability, so that the four main macroeconomic objectives can be achieved. These objectives are: sustainable economic growth, stable inflation, low unemployment and a sustainable balance of payments position. The quality and quantity of factors of production in an economy are a key determinant of the long-term performance of an economy. The government can influence this by implementing a range of supply side policies. These are policies designed with one main goal in mind - to raise the productive capacity of the economy over time.

This is important for a country like South Africa where poor and underdeveloped infrastructure has created huge social and economic problems. One of those problems is a chronic skills shortage created by a lack of

investment into education. Education is a good which emits positive externalities and therefore policies to improve the quality and quantity of education across South Africa will not only benefit individuals passing through the education system, but society in general from an increase in real output over time. This will help South Africa avoid some of the nationwide problems of poor education such as inequality and a loss of competitiveness.”

This introductory paragraph sets up the analysis of the impact of greater spending into the education sector.

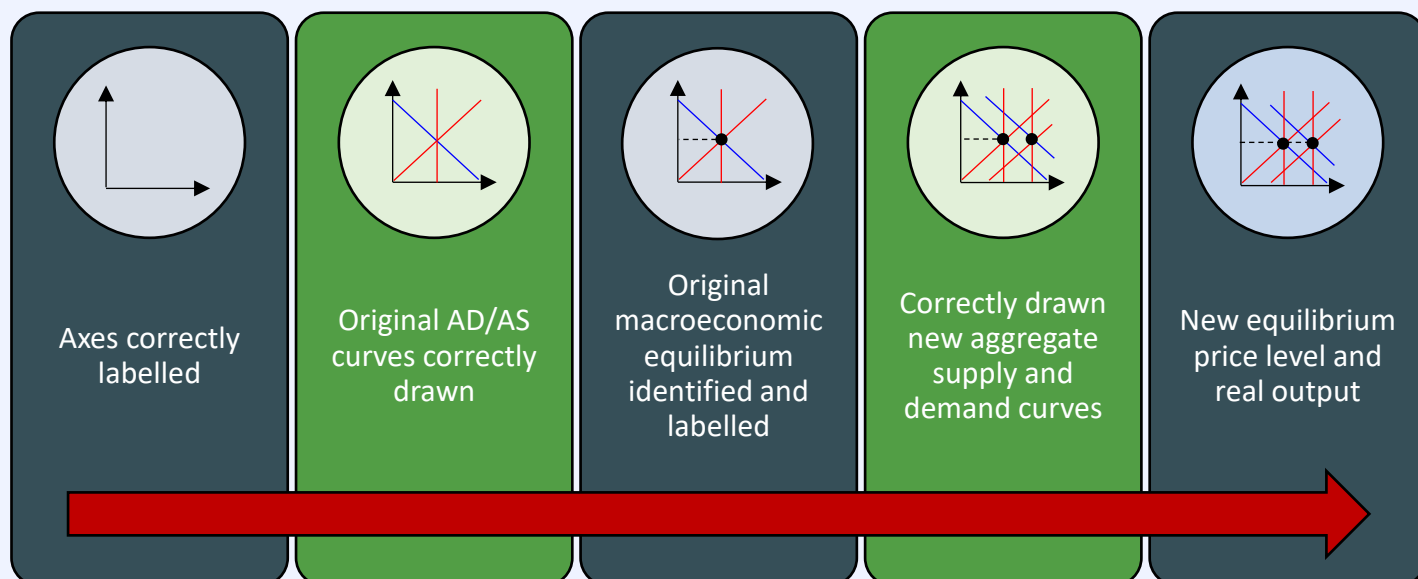
However, you may also want to include an application point regarding this policy. In Extract C, you are told that one of the long-term measures in South Africa to reduce inequality and unemployment is to increase spending in education. There have been significant increases in government expenditure towards this channel of the economy. The extract states that “Total expenditure on education increased from 169 billion Rand in 2009 to 249 billion Rand in 2014, an increase of 47%.” This is significant evidence of the government using a supply side policy to remove some of the long-term hysteresis effects that exist from high unemployment.

Step 2: Analysis

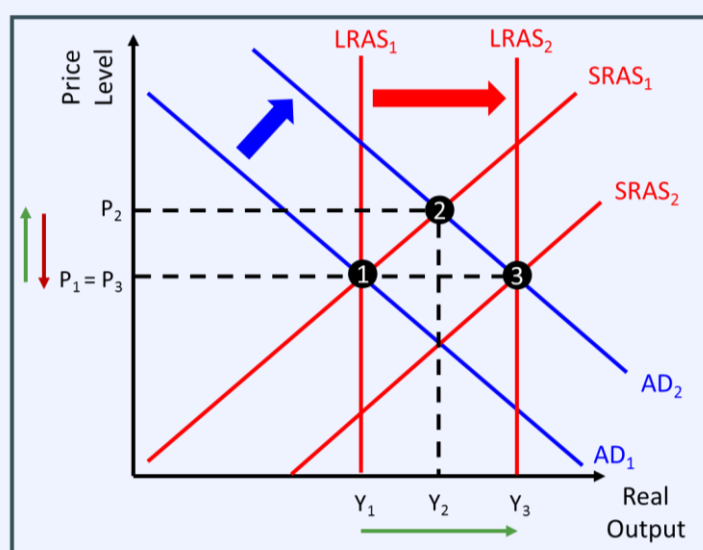
Here the question revolves around higher government spending on the education sector. Therefore, the appropriate diagram here is an AD/AS diagram. The focus should be on the impact on the LRAS curve, as an increase in spending in education should raise the domestic productivity of a country.

You may also wish to depict the aggregate demand curve shifting outwards, as we will do here. This is because government spending has a direct influence on the position of the aggregate demand curve in the short-run.

For the diagram to be completed accurately, the following features should be present:



Use a ruler and ensure the diagram is neat and tidy.



AD and LRAS Curve Expansion

Full Employment Level of Output increases in LR

Sustainable Growth

Step 3: Written Explanation

The first thing your written explanation needs to do is to clearly explain what your diagram shows. To assist clarity, it helps to refer to the labels you have given on your diagram. Where possible, the results of the diagram should be applied to the context you are discussing. For example:

“In the AD/AS diagram, the original macroeconomic equilibrium is represented at point 1, the point where the original aggregate demand curve (AD_1) and the short-run aggregate supply curve ($SRAS_1$) intersect the long-run aggregate supply curve ($LRAS_1$). The price level across the economy is equal to P_1 with the output at the full employment level of Y_1 .

Higher government spending on the education sector through the form of subsidies to educational institutions or financial provisions to firms to support training and apprenticeship programmes would have the short-run effect of increasing aggregate demand. This is because government spending is a direct component of aggregate demand and therefore, this is depicted by an outwards shift in the AD curve from AD_1 to AD_2 .

In the short-run, this leads to a new macroeconomic equilibrium at point 2. However, in the long-run the increased investment either directly from government or indirectly from firms will increase the productivity and productive capacity of the economy. This is depicted by way of an outwards shift in the aggregate supply curves of the economy. The SRAS curve shifts outwards from $SRAS_1$ to $SRAS_2$ and, more importantly, the LRAS curve shifts out from $LRAS_1$ to $LRAS_2$.

This results in a new long-term macroeconomic equilibrium at point 3. The supply-side improvement in the economy stimulated by the supply side policy leads to an improvement in the macroeconomic performance of the economy. Real output has increased from Y_1 to Y_3 . This is likely to also have knock-on effects on the level of unemployment as firms demand more labour when workers' skills set are enhanced.”

This describes the economic theory behind how greater government spending on education can improve the economic prospects of an economy. However, you also need to finish your analysis off with a paragraph relating this analysis to the South African economy:

“Based on the economic theory, increased government spending by the South African government on improving education standards across the economy is likely to provide a welcomed stimulus boost to the economy via productivity improvements. However, given corruption is such a prevalent issue in South Africa, there are always question marks surrounding the certainty and effectiveness of these policies.”

Step 4: Evaluation

However, as this question uses the word ‘evaluate’ in the phrasing of the question, it is important to be able to identify a couple of reasons why a policy of this design may not always contribute to higher productivity:

Size of Curve Shifts

The diagram shows the impact that the two curve shifts have on the price level and real output of an economy, but the exact impact will depend on how large the curve shifts are.

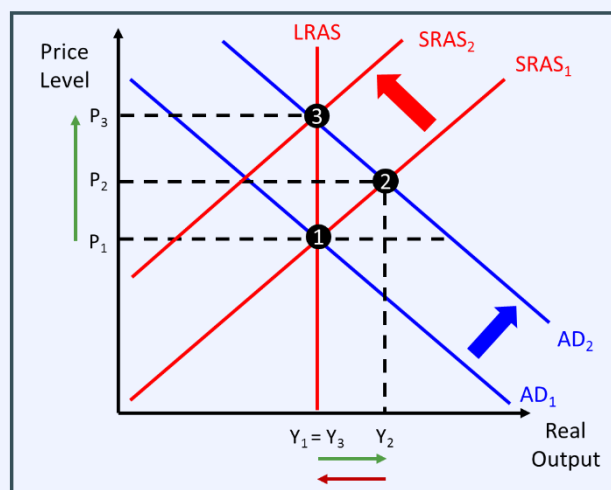
Ceteris Paribus

This logical chain of reasoning all runs on the assumption that we are only considering this form of supply-side policy but there may be other factors that we could consider which could affect the outcome of this e.g. the current monetary policy stance by the central bank.

Ineffective Policies

There is no guarantee that the government will effectively direct its investment into the right areas of education. It may be that it is primary schools where the most productive investment opportunities lie, but instead the government prefers to invest in flashy universities which have a far lower impact on the overall economy.

If this is the case, as shown on the AD/AS diagram below, there will be little impact upon the LRAS curve.



Time Lags

If the government increases spending on education, even if it is effective this will take a long time to materialise into productivity benefits for the economy. Therefore, the government must be willing to sacrifice money to generate long-term gains in the future.

Opportunity Costs

Increased government spending into education will result in a fall in spending from other areas of the economy or an increase in taxes or borrowing. Therefore, the likelihood is that these effects will neutralise some of the impact of an increase in government spending on education across the economy.

As always you only need to raise a couple of these evaluation points or some of your own to secure the evaluation marks available in this essay.

The mark allocation of this question is split up and based on the four main exam skills:

Knowledge – 2 marks

Application – 2 marks

Analysis – 4 marks

Evaluation – 4 marks

Question 2c

With reference to Figure 8, examine the likely impact of the trend in R&D spending on the South African economy.

[8 marks]

To gain the full **8 marks** you need to be able to showcase your ability to hit all four of the different assessment objectives.

Step 1: Knowledge

There are **2 marks** in total available for the knowledge section of your answer.

The cleanest way to capture these marks is to provide a definition and explanation of what R&D is and the importance it has for an economy:

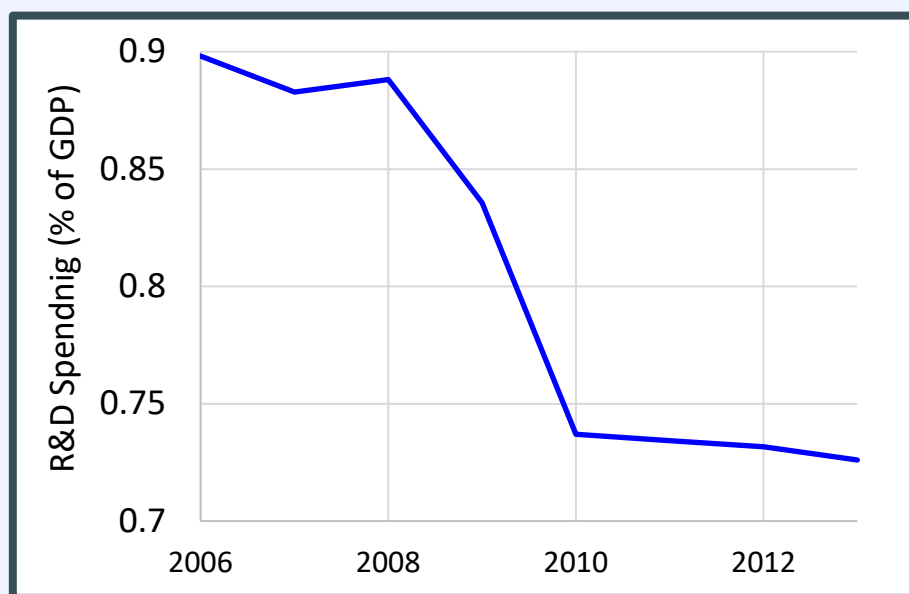
“Research and development (R&D) refers to the process of firms maintaining a fixed commitment to an investment project, in anticipation of the future gains that are expected to materialise. Firms have the incentive to undertake these projects to ensure the pace and progress of both innovation and invention is maintained. Innovation and invention improves both products and production processes providing firms with more demand or lower costs.

However, governments also have a vested interest to ensure that firms undertake investment projects. This is because they contribute to the improvement in the quantity and/or quality of factors of production and therefore can help increase real GDP over time. Therefore, these projects are key to the overall performance and strength of an economy.”

Step 2: Application

In this question, there are **2 marks** available for relevant application made in your response.

Figure 8 shows the change in research and development spending levels as a percentage of GDP for the South African economy between 2006 and 2013.



“The South African economy has experienced high levels of research and development spending as a percentage of GDP over time compared to other developing economies. This is because it is a net recipient of FDI from the rest of the world. This provides South African firms with the finance required to undertake R&D projects. This is reflected in 2006, when the South African economy was strong, as R&D spending as a percentage of GDP was at approximately 0.9%.

However, on the back of the 2008 Financial Crisis, capital flight and economic instability meant that international investors moved to ‘safe havens’ and domestic South African firms did not have the required confidence and patience to wait for the long-term gains these projects bring. This is reflected in R&D spending dropping down to under 0.75% of GDP by 2010.

Since 2010, R&D spending has been crawling even lower reflecting further weaknesses in the confidence and strength of the South African economy.”

Step 3: Analysis

There are **2 marks** in total available for the analysis section of your answer. You need to explain the economic consequences of South Africa’s falling levels of R&D spending. Potential effects include:

Reduces Growth Potential

If there is less research and development undertaken by firms in South Africa it will result in a reduction in the growth potential of the country in the long-term. Research and development promotes innovation and invention which provides supply-side improvements to an economy. This leads to sustainable economic growth in the long-run. Lower R&D spending, therefore, is likely to result in lower growth in the long-run.

Competitiveness

R&D spending levels are likely to affect the competitiveness levels of a country. This is because the current state of capital and technology affects the overall quality of goods produced. If the quality of goods being produced does not increase it is likely to cause a deterioration in the competitiveness and trade performance of a country as other economies do improve their goods.

Unemployment

Less investment by firms into research and development projects is likely to result in lower profitability for those firms. If firms' profitability is hit it means they will come under intense competitive pressure from both domestic and international rivals. This may result in job losses in certain domestic industries.

Human Capital/Productivity

If the pace of invention and innovation slows in an economy, it means the technology that workers have to complete their jobs is of lower quality than it would be otherwise. This means that the output of each worker will fall and this will represent a decline in productivity across the South African economy.

Step 4: Evaluation

There are **2 marks** available for evaluation. Some examples of these are:

Effectiveness of R&D

There is no guarantee that even if firms spend excessive amounts on R&D projects that it will yield productivity improvements. This is because often firms can invest in the wrong areas of the production process, or in poor product innovation. The end result is wasted spending. Indeed, a lot of R&D spending does not result in improvements – but the R&D projects which do deliver, tend to have large impacts.

Time Frame

Even though South Africa experienced a large decline in R&D spending levels over the period shown in figure 8, it does not guarantee that the competitiveness of the South African economy fell as dramatically. This is because the benefits of R&D spending tend to be enjoyed only in the long-run as projects deliver benefits and the supply-side of the economy improves.

Other Investment Channels

R&D projects are not the only investment projects which can lead to innovation of the production process increasing. Innovation may come from knowledge spill-over effects from industries or the influence of entrepreneurs in the production process. The damage of lower R&D on the overall performance on the South African economy may not be as damaging as expected if the government manages to foster an entrepreneurial spirit.

This is just an example of some of the evaluation points which can be made. Be careful that you do not spend longer than **10 minutes** on this question – be selective about the points you include.

The mark allocation of this question is split up and based on the four main exam skills:

Knowledge – 2 marks

Application – 2 marks

Analysis – 2 marks

Evaluation – 2 marks

Question 2d

With reference to the information provided and your own knowledge, evaluate the possible microeconomic and macroeconomic effects of South Africa's high level of inequality.

[25 marks]

To access top marks in any economics essay, it is important to focus on two key elements:



As essay structure is a more general skill, we will focus on showcasing how to hit the different assessment objectives required for this specific question. However, hopefully, the following discourse will provide some assistance with regards to essay structure.

In this question, you need to briefly explain the economic consequences of high levels of inequality in South Africa. You must consider the consequences at both a Micro and Macro level before arriving at a final judgement on the overall impact.

AO1: Knowledge

Being able to display accurate knowledge is judged to be the most basic requirement. It is still important to be able to demonstrate accurate knowledge throughout your essay. You can signpost this by including accurate definitions. For example, in your introduction, you might want to define inequality. For example:

“Equity relates to how fairly and evenly distributed economic resources and opportunities are between different groups in society. The income distribution of a country defines how equally shared the income of a country is between different groups in society. The greater the level of inequality in a country, the more unequally shared the distribution of income between the richest and

poorest parts of the population. Inequality is important for countries to consider as high levels of inequality often breeds political and social problems. Therefore, achieving an equitable distribution of income is considered to be an important economic objective for governments.”

AO2: Application

Being able to apply your knowledge is particularly important for essays within data response questions. In this case, the question asks about the economic consequences (both micro and macro) of high levels of inequality. Utilising the data extracts can provide some helpful angles to use to demonstrate that you are applying economic theory to this particular context. Some examples are:

Data: Figure 5

Provides a chart that shows the the Gini coefficients of a collection of different countries in 2015. In the data, the country with the highest Gini coefficient in 2015 was South Africa with a gini coefficient above 0.6. As the closer the Gini coefficient is to 1 the more unequal the distribution of income is perceived to be. Therefore, this indicates that the distribution of income is more unequal in South Africa relative to countries like France and Bazil.

Data: Figure 6

This figure shows the rising level of unemployment in South Africa since 2008. This can be used to provide a possible explanation behind some of the causes of high income inequality in South Africa.

Data: Figure 7

This figure shows the annual GDP groth rate for the South African economy between 2008 and 2016. It shows that despite a recovery in economic growth in 2010, the performance of the South African economy has deteriorated and weakened in the last 6 years.

This potentially highlights the hysteresis effects of rising inequality on the growth rate of the South African economy.

Extract C - Lines 7-12

This section of the extract explains some of the short-term and long-term policy solutions put in place to fix rising inequality in South Africa. This can be used to show the commitment of the South African government towards reducing inequality across the country.

Extract C - Lines 13-22

This section of the extract highlights one of the main costs of rising levels of inequality in South Africa.

Extract D – Lines 5-7

Provides an indication of the economic turmoils that South Africa faced in 2016. This is particularly important to bear in mind given the demographic makeup of South Africa.

Extract D – Lines 15-25

This section of the extract indicates the long-term problems of high unemployment across the South African economy.

You are only expected to use some of these application examples in your essay.

AO3: Analysis

The core of top-level essays consists of well-constructed, relevant analysis of the topic. This should be presented using logical chains of reasoning, and where appropriate, clear diagrams.

As you need to assess both the macroeconomic and microeconomic consequences of high inequality, it might help you to focus on the individual effects of inequality on society and then aggregate these effects to consider the macroeconomic effects. A good (but not only) way to start your essay is to outline what inequality means in the context of the South African economy. You can then discuss the economic consequences of high levels of inequality.

Inequality

“Inequality means there is a gap between the highest income earners and the lowest income earners. This is because of an uneven distribution of the rewards which are paid to the factors of production across an economy’s population. The distribution of income is a key economic indicator of equality as it represents the extent to which workers receive different wage rates and salaries throughout an economy.”

Where an economy is subject to inequalities in the distribution of income and wealth, there are two main arguments why society might view this as a negative phenomenon and want the government to intervene.

The first is a consideration of the fairness of pay differentials. This relates the concept of inequality to the concept of inequity (unfairness). Whilst a contentious view, there are many who believe that severe pay differentials are inherently unfair and for honest labour, the divergences in wages should be reduced. Much economic thinking assumes that the government is interested in the overall welfare of society as a whole (the sum of all individuals), in which case there is an argument to be made that if the government can intervene to reduce income inequality and inequity then they will have a positive effect upon society’s overall welfare.

The second is to consider income differentials as a source of market failure. This is especially the case if those at the bottom end of the distribution of income are pushed into poverty. The argument is that the market is failing to provide a sufficient labour income for workers to be fully functioning members of society. Low incomes may prevent them from being able to afford an effective education or from being able to search for jobs effectively. Consider being unable to apply for a job because you couldn’t afford a suit for the interview. You might articulate this like:

“Pay differentials and the unequal distribution of income that results are arguably very damaging to the overall welfare of society. The concept of the equity of different wage rates has been a long-discussed topic in economies around the world. Socialists have often argued that wide pay differentials are simply unfair and that governments should implement policies to increase the fairness of labour markets. Furthermore, many argue that an unequal distribution of income is an example of market failure, as it can impose costs

upon society. The inability of those subject to poverty to engage in essential consumption decisions may restrict their ability to effectively participate and progress in the workforce.”

Inequality is usually seen as a source of market failure because of some of the social costs it imposes upon an economy. These include:

Poverty

Rising inequality within a society are likely to contribute to higher poverty rates over time. An individual is classed as living in poverty if they are unable to afford their basic human life-sustaining needs and wants such as access to shelter, clothing and food. Rising inequality and poverty contributes towards a lower standard of living of individuals.

However, it is important to ensure that you talk about the right type of poverty when analysing this cost. Absolute poverty is when individuals are on an income that is below the income threshold required to meet the basic minimum standard of living. Relative poverty refers to individuals whose income falls below the median income level of a country. The most likely effect is that with rising inequality, relative poverty is likely to rise significantly as more individual's incomes are dragged below the median income line.

In Extract C, the impact that rising inequality has had on the poverty rate of South Africa is outlined. For instance, you are told that 35% of the population live on less than \$3.10 day contributing to a decline in health outcomes, educational attainment and living standards of that section of the population.

You could argue that when individuals get locked into poverty, it can contribute to a viscous cycle of declining living standards for not just the individual itself, but also the extended family of that individuals for generations.

Social Conflicts

Inequality may create a society where tensions exist within communities between the very rich and the very poor. This can be damaging for an economy because social unrest and conflict can contribute to an increase in the number

of workers who become disengaged with the rewards of working. It can also contribute to other social problems such as higher crime rates.

The government of the country may have to increase spending on not only social security benefits, but also on improving law enforcement services across the country.

Decline in Productivity

If there is a growing gap between the rich and poor, it increases the number of people who may be unable to afford the right level of health care and education in society. The exclusion of a large percentage of the population from the consumption of these merit goods, contributes to a lower marginal revenue product of the average South African worker, as well as a lower level of productivity across the economy. This is because if the skill level and health of a worker falls they are likely to be less efficient and productive.

You might also want to discuss the impact on low-paid worker incentives if the pay of the highest earners is increasing. This is because if low-paid workers see an increase in pay of chief executives, they might perceive the pay they receive as being unfair and therefore this might encourage them to be less motivated by the rewards of their pay.

If the productivity of the workforce is adversely affected, then it may cause a decline the rate of increase in the productive capacity of the economy over time.

Higher levels of Indebtedness

If the income gap between the rich and poor contributes to lower living standards of the poorest individuals in society, this may encourage those individuals to boost consumption by borrowing more and building up higher levels of debt in the process.

This is because the only way individuals can ensure that their living standards do not fall is to increase consumption. However, their ability to do this is limited during periods of high inequality. Therefore, individuals must increase their disposable income by borrowing from financial institutions. If the poorest

households are building up large debt levels, it increases consumption in the short-run which boosts the profits of firms and the growth potential of the economy.

However, it also reduces the level of financial stability in the economy. This is because a persistent rise in debt, means that individuals are saving less. Also, high debt levels are often a pre-cursor for an economic and financial slowdown, as it increases the likelihood of financial crises. The looming threat of large defaults from the lowest income earners can create significant problems for the financial sector of the country.

Greater borrowing (higher consumer leverage) increases consumption, growth and inflation in the short-run. However, it may damage the long-term growth prospects of the economy if it precipitates a problem in the financial sector. This was what seen in the 2008 financial crisis for a host of different countries including South Africa. Figure 7, shows the impact of this period on the growth potential of the South African economy.

Hysteresis Effects

If low-paid workers become less productive and less motivated from working, it may increase the number of workers that are not only unemployed in the short-run, but also in the long-run as well. This is because there are quite often 'traps' that individuals living in poverty and on the wrong end of the income scale get locked into. If a child is brought up in poverty, the educational and workplace opportunities available to them will be restricted and this prevents individuals from acquiring the skills and income required to escape the cycle of poverty in the future. Families living in poverty have an inability to pass down stocks of wealth such as a house down to their offspring and therefore the lack of wealth accumulation contributes to the restrained living standards of these members of the population.

Efficiency v Equity Argument

Despite some of the economic costs of greater inequality being significant, you might suggest that maintaining perfect equality may not always lead to an improved outcome over time. This is because inequality provides individuals with the incentives to work harder and be more productive as they are rewarded more richly for their actions. Therefore, you can argue inequality is

necessary for providing incentives in a free market economy; without some level of inequality there may well be economic problems for a country, as entrepreneurs lack the incentives to proactively engage and invest in an economy.

On the other hand, you could argue that inequality has many disadvantages and is evidence of fundamental problems in society. When markets are free from imperfections, resources will be allocated in such a way that efficiency will be achieved. In attempting to achieve equity, governments may intervene and distort the workings of the market so that while equity is gained, efficiency is lost. This is known as the equity-efficiency trade-off.

Therefore, some degree of inequality is required to ensure that an economy can meet some of its main macroeconomic objectives. However, the main issue when discussing inequality is that it is a normative concept. This is because there is no optimal level of inequality that can exist in an economy. Everyone holds a different view over the acceptable level of inequality in a society.

AO4: Evaluation

Including accurate and relevant evaluation in your essay is the most important thing to ensure you achieve top marks. Evaluation is the art of making supported judgements, of deciding which factors are most important and examining the scenarios in which factors assume greater or lesser importance.

There a huge number of evaluative angles you could take within this essay. Here we will showcase some useful evaluative points you could make in an essay of this subject. You would not be expected to include all of these examples – there simply is not enough time!

The Extent of Inequality

Just how unequal a society is will affect the size of the societal costs imposed on the economy. South Africa is one of the moest unequal economies in the

world and, therefore, it can be argued that the costs of inequality in South Africa are very severe.

Equity

Any discussion about equality can quickly lead to a debate about how closely equality represents equity (fairness). Some argue that actually some degree of inequality represents fairness as it reflects different levels of talent and effort within the workplace.

Trickle Down Economics

If rising inequality persists, the income of the highest earners increases. However, this may lead to some of that income trickling down to the lowest income earners. This is because the increase in income for the rich is likely to increase consumption, which may feed into not only higher incomes for the lowest paid, but also may help create more jobs in society. Therefore, inequality at face value may seem damaging, but the impact of income that trickles down to the rest of society may improve the economic outcome for all.

Greater Enterprise

Inequality provides the entrepreneurs in an economy with the incentive to invest and improve the long-run potential of the economy. This is because inequality is a by-product of private individuals following their incentives to improve their own private outcome. If there is greater enterprise in the economy it is likely to improve the prospects of an economy in terms of growth and jobs, as well as raising the international competitiveness of a country.

Adjustment of Declining and Emerging Industries

If inequality is a by-product of the dominant role of market forces in an economy, then you can argue that it will lead to an economy specialising in the production of goods and services which provide agents with the greatest benefits. Therefore, it is likely to see producers move away from inefficient, unproductive declining industries, towards more efficient emerging industries. This may create some job losses in the declining industries, but the growth of emerging industries can contribute to net benefits for society.

Overall, it is important to provide in your essay, a reasoned judgement; an argument which decides upon the net impact of high levels of inequality in South Africa. It doesn't matter which side of the argument you make the case for – you will be examined on how effectively you structure that argument and how well you support it with economic theory.

The concluding paragraph of your essay is often a very good place to make clear what your overall reasoned judgement of the question is. Some people also like to include a similar judgement in their introduction, to signpost clearly to the examiner that they will be making an evaluative judgement in their essay.

Here is a good example of an attempt to, in one paragraph, argue that high levels of inequality can be detrimental to the prospects of an economy:

“Overall, rising levels of inequality in a society is likely to be a barometer of an economy that continually rewards only a select few. The powerful incentives that inequality provides to the main wealth creators in society deserve consideration. However, the vast economic costs of growing income gaps between the rich and the poor are likely to be more significant. This is because, rising inequality can cause large social costs to be imposed on society, which in turn can damage the long-term performance of an economy. Therefore, countries like South Africa with rising levels of inequality, should be concerned about the restrictions that rising levels of inequality have on the living standards of a growing contingent of households.”

Alternatively, it would be just as valid to argue that high levels of inequality can provide some desirable consequences for society:

“On balance, rising inequality may potentially be an inevitable side-effect of a strong and buoyant economy. This is because when an economy grows, the profitability of producers is enhanced. The greatest proportion of those profits will go towards fuelling the incomes of the highest income earners in society, widening the gap between the rich and the poor. However, such is the inclusive nature of an economy, the likelihood is that the income gap will not reflect the benefits that the rest of the economy gets from wealth creators having more income at their disposal i.e. the creation of jobs and greater investment. Therefore, it might be the case that an economy has to devise a way of managing inequality levels in a country, whilst at the same time maintaining

the incentives that individual decision makers have to improve their living standards.”

Essays are marked on a levels basis. The overall quality of your essay will be considered when deciding upon which level the answer is. There are up to 16 marks available for knowledge, application and analysis:

Level 1 [1 – 4 Marks] – Weak knowledge and understanding which included generic or irrelevant information.

Level 2 [5 – 8 Marks] – A narrow response which contains some knowledge and understanding but under-developed chains of reasoning.

Level 3 [9 – 12 Marks] – Accurate knowledge and understanding with clear analysis but the answer may lack balance.

Level 4 [13 – 16 Marks] – Precise knowledge and understanding with relevant and coherent analysis.

There are up to 9 marks available for evaluation:

Level 1 [1 – 3 Marks] – Generic evaluative comments without relevant evidence.

Level 2 [4 – 6 Marks] – Reasonable evaluation which may be sometimes unbalanced or not fully supported.

Level 3 [7 – 9 Marks] – Strong levels of well-supported evaluation.

Question 2e

With reference to the information provided and your own knowledge, evaluate the possible microeconomic and macroeconomic effects of South Africa's low levels of unemployment benefits.

[25 marks]

To access top marks in any economics essay, it is important to focus on two key elements:



As essay structure is a more general skill, we will focus on showcasing how to hit the different assessment objectives required for this specific question. However, hopefully, the following discourse will provide some assistance with regards to essay structure.

In this question, you need to briefly explain what is meant by unemployment benefits in the context of an economy. Then you need to consider the positive and negative effects of lower unemployment benefits at a Micro and Macro level before arriving at a final judgement on the overall impact.

AO1: Knowledge

Being able to display accurate knowledge is judged to be the most basic requirement. It is still important to be able to demonstrate accurate knowledge throughout your essay. You can signpost this by including accurate definitions. For example, in your introduction, you might want to describe the role of unemployment benefits in the economy. For example:

“Unemployment benefits represent payments from the government of a country towards the unemployed portion of the labour force. The benefits are there to provide individuals with an injection of income during a period of personal uncertainty where they are no longer receiving a fixed income from an employer.”

The government tries to set the benefits paid out at a level that stabilises people's incomes during periods of unemployment, whilst also ensuring that they are not set too high to deter people's incentives towards getting back into employment."

AO2: Application

Being able to apply your knowledge is particularly important for essays within data response questions. In this case, the question particularly asks about the economic consequences (both micro and macro) of lower unemployment benefits in South Africa. Utilising the data extracts can provide some helpful angles to use to demonstrate that you are applying economic theory to this particular context. Some examples are:

Data: Figure 5

Provides a chart that shows the the Gini coefficients of a collection of different countries in 2015. In the data, the country with the highest Gini coefficient in 2015 was South Africa with a gini coefficient above 0.6. As the closer the Gini coefficient is to 1 the more unequal the distribution of income is perceived to be. Therefore, this indicates that the distribution of income is unequal in South Africa relative to countries like France and Brazil.

Data: Figure 6

This figure shows the rising level of unemployment in South Africa since 2008. This can be used to evaluate the importance to government finances of paying only a low level of unemployment benefits.

Data: Figure 7

This figure shows the annual GDP growth rate for the South African economy between 2008 and 2016. It shows that despite a recovery in economic growth in 2010, the performance of the South African economy has deteriorated and weakened in the last 6 years.

This potentially highlights the reason why people are finding it difficult to obtain employment. It is down to the state of the economy rather than anything to do with unemployment benefits.

Extract C - Lines 7-12

This section of the extract explains some of the short-term and long-term policy solutions put in place to fix rising inequality in South Africa. This can be used to show the commitment of the South African government towards reducing inequality across the country. In this context, you can critique the approach towards unemployment benefits.

Extract C - Lines 13-22

This section of the extract highlights one of the main costs of rising levels of inequality in South Africa.

Extract D – Lines 5-7

Provides an indication of the economic turmoils that South Africa faced in 2016. This is particularly important to bear in mind given the demographic makeup of South Africa.

Extract D – Lines 22-25

This section of the extract indicates one of the main issues that low unemployment benefits have on an economy with a high unemployment rate. This can be used as a counter-argument against the theoretical employment boost that low unemployment benefits can present a country.

As ever, you only need to include some of these issues. Indeed, some of these application examples are quite specific and would only be expected of sophisticated answers.

A03: Analysis

The core of top-level essays consists of well-constructed, relevant analysis of the topic. This should be presented using logical chains of reasoning, and where appropriate, clear diagrams.

Unemployment Benefits

There are lots of analytical routes you could go down with a question like this. The core analysis will involve an explanation of the economic consequences of lower unemployment benefits for the South African economy. A good way to start might be to outline the impact that unemployment benefits has on the incentive of individuals to work:

“Unemployment benefits provide individuals out of work with income payments to support and facilitate their ability to maintain their current living standards. The level of unemployment benefits paid out to society affects the incentives of rational individuals to work. This is because if the unemployed receive benefits that are of higher value, then this it will cause the difference between in-work and out-of-work income to fall.

As for most individuals, the incentive to work is affected by the income they receive. If the extra income that individuals can earn upon working is reduced compared to not working it will contribute to fewer people searching for employment opportunities.”

Therefore, governments face a trade-off over the level of unemployment benefits they decide to set. This is a poignant issue for the South African government to consider because with an unemployment rate of over 30%, enough benefits need to be paid out to protect the incomes of the unemployed workers and prevent them from slipping into poverty. However, given unemployment is at such a level, the government needs to continue to encourage workers to seek work by ensuring that these benefits are not too generous.”

Unemployment Trap

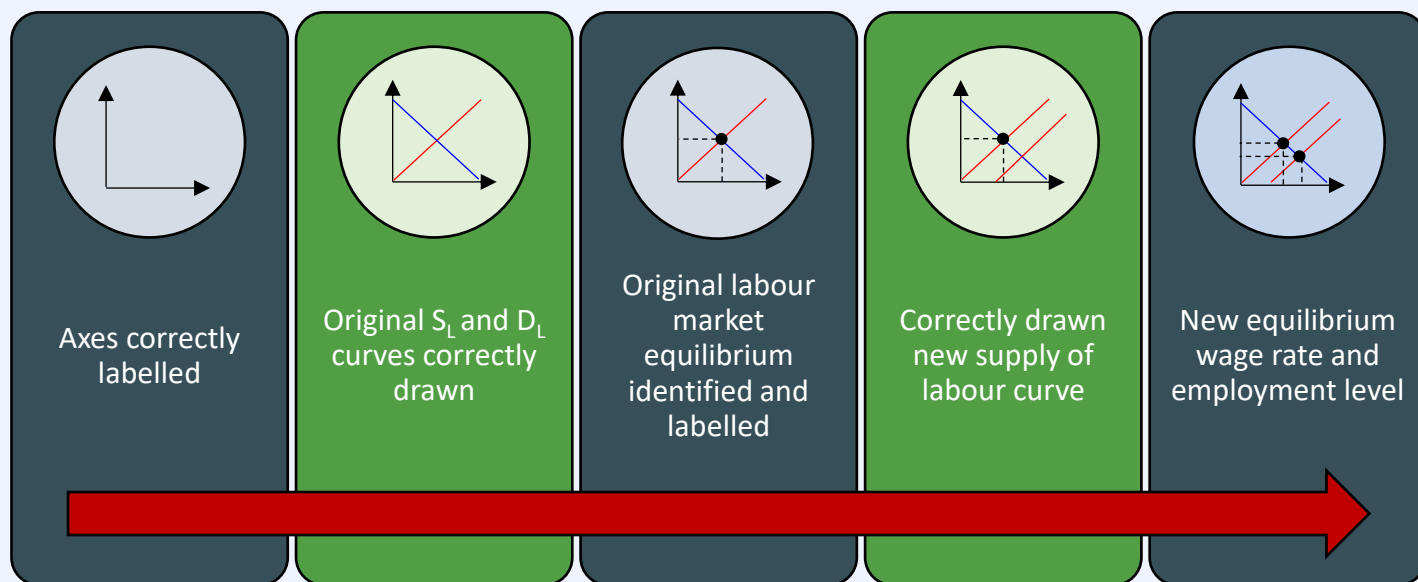
One effective way of linking workers’ incentives to work with the level of unemployment benefits paid out by the government, is to make reference to the unemployment trap. This explains the theory behind the level of unemployment benefits and the level of unemployment in an economy.

It states that unemployment benefits can reach a point where there is no incentive for someone who is unemployed to start working because the combined loss of benefits and need to pay income tax would result in them being made worse off. Therefore, unemployment benefits fuel higher unemployment in the economy and these benefits represent a drain on the public finances of a country. This provides the economic rationale for a country to reduce unemployment benefits to a point where prospective workers do have an active incentive to work in the economy.

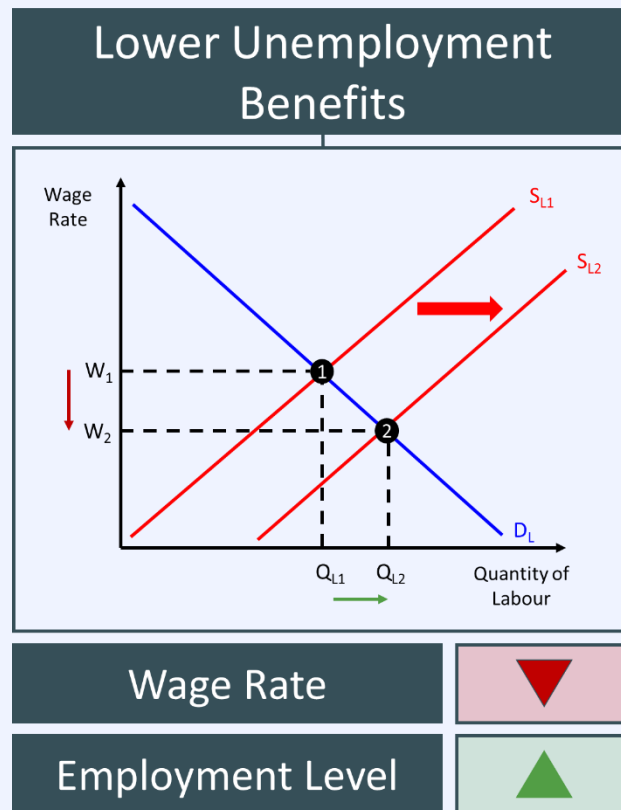
Lower Unemployment Benefits

The logical chain of reasoning above sets up the use of a labour market diagram to assess the impact of lower unemployment benefits given by the South African government to the unemployed. The diagram will be a labour market diagram as you want to show the impact of lower unemployment benefits on the amount of labour supplied in the South African economy.

For the diagram to be completed accurately, the following features should be present:



Use a ruler and ensure the diagram is neat and tidy.



The accompanying explanation could be:

“The diagram showcases the effect of the South African government intervening in labour markets by reducing the current level of unemployment benefits paid out to the unemployed. Assuming ceteris paribus, if the unemployed now receive a lower safety net of payments from the government upon being made unemployed, it will incentivise workers who previously did not have the incentive to work under the existing wage rate being offered.

If more people are incentivised to work at every given wage rate, this is reflected by an expansion in the supply of labour curve.

The diagram shows the effect of this policy is to shift the supply of labour curve outwards from S_{L1} to S_{L2} . If South African firms have a greater pool of available labour to choose from to fill any job vacancies, it results in the firms being able to hire workers at a lower wage rate as firms take advantage of their relative power in the labour that is presented via an excess of supply of labour. This lower wage rate results in a movement down the demand for labour curve, with a new equilibrium wage rate being paid of W_2 .

The end result of this policy is movement from the original labour market equilibrium at point 1 (W_1, Q_{L1}) to a new labour market equilibrium at point 2 (W_2, Q_{L2})."

Therefore, a reduction in the unemployment benefits has encouraged more people to work. However, it comes at a cost of reducing the wage rate of all workers in South Africa as there is now a surplus of labour for South African firms to choose from.

High Unemployment, Low Unemployment Benefits

The theory of the impact of lower unemployment benefits on South African labour markets has been outlined in the diagram above. However, it may be the case that lower unemployment benefits could contribute to the problem of long-term unemployment in the economy given the travails of the South African economy.

Low unemployment benefits traditionally increase the incentive individuals have to work and therefore is said to contribute to higher employment levels. However, if we consider the economic struggles of the South African economy, in terms of growth performance and job creation, it may be the case that lower benefits paid out may amplify the problem of individuals failing to find a job. This is because South Africa has a very high unemployment rate, which means there are lots of workers already searching for a job. The fact this unemployment rate has remained high since the financial crisis already suggests that individuals have problems finding a job that best suits their preferences. Therefore, low unemployment benefits are only going to increase the number of people looking for a job. If the South African economy is struggling and the pace of jobs creation is low, then there will be an increasing number of frustrated South African workers waiting to get on the jobs ladder. Therefore, it might be the case that the South African government also need to implement policies which increase the pace of jobs being created in the economy to facilitate the greater number of people searching for work. Alternatively, this could reflect a skills shortage across the economy and explains why individuals cannot obtain a job in the labour market.

Low benefits may mean that those searching for a job are unable to afford to improve their education or skills in order to become more appealing to employers and more productive for the economy.

Economic Consequences

Apart, from the impact on wages and employment you now need to assess the economic consequences of lower unemployment benefits at both a micro and macro level. The best place to start here is to focus on the impact of the level of inequality in the economy.

Inequality

Inequality refers to an uneven distribution of income and wealth across different sectors of the population. This means a growing income and wealth divide between the richest and poorest parts of society.

Low unemployment benefits can have an uncertain impact on the level of inequality across the economy. Firstly, if low unemployment benefits encourage people to search for work, and workers can secure the security of a job it will reduce the level of income inequality. The extent of this reduction in inequality depends on whether there are jobs available. The current high unemployment in South Africa suggests that this may not be the case.

However, a more feasible explanation is that low unemployment benefits cause high inequality. This is because the unemployed are usually the poorest in society. Providing them with a low income means that the bottom of the distribution is further away from the top.

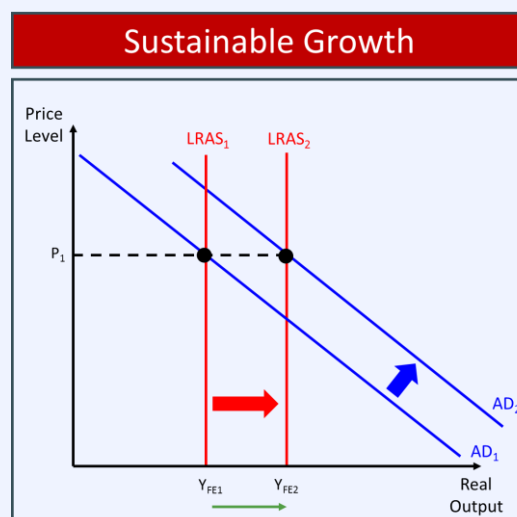
This is important to consider as income inequality can create significant social and economic costs within a society as divides and conflicts emerge between the rich and poor parts of society.

South African Growth Prospects

If lower unemployment benefits contribute to a higher employment level, this is likely to have positive implications for consumption in the economy. This is because job security is one of the driving forces behind the confidence levels of consumers. If consumers feel more secure about their job prospects, the stable income will cause consumers to be more ambitious and adventurous in their

spending plans. If consumption increases, it will provide the economy with a significant consumption boost. As consumption is one of the main components of aggregate demand, this will create a positive AD curve shift in the short-run.

However, we also need to consider the effects in the long-run. If the lower unemployment benefits follow the theorised prediction of increased employment across South Africa, then the full employment output level of the South African economy will expand. This is because if there is more labour being employed, more goods and services can be produced. An increase in the full employment output level is reflected by an increase in the productive capacity of the economy. This can be shown via an AD/AS diagram i.e. an expansion in the LRAS curve. This is because the LRAS curve for an economy is determined by the quantity and quality of factors of production in the economy at any point in time. If more people are employed, the productive potential of the economy expands and it can help provide long-term benefits for society.



NOTE: we have not included the SRAS curves as we are looking at the long-run implications of greater employment across South Africa.

The other perspective to think about is the direct impact of low government spending on unemployment benefits. This has a direct impact on aggregate demand and means that it is lower than it would be if benefits were higher.

Government Finances

If the government are paying out low unemployment benefits to the unemployed it is likely to free up funds for investment into other areas of the economy. When you consider that South Africa suffers from poor educational infrastructure, these funds can be used to improve the educational attainment of individuals. This may be a good policy to introduce as it will increase the skills of the labour force which may increase. This will improve inequality in the long-run compared to higher unemployment benefits which would most likely have only a short-run impact.

However, you might raise the point that South Africa has historically had problems regarding government corruption. Therefore, there is no guarantee that the savings through low unemployment benefits will in fact find its way back into productive areas of the economy.

AO4: Evaluation

Including accurate and relevant evaluation in your essay is the most important thing to ensure you achieve top marks. Evaluation is the art of making supported judgements, of deciding which factors are most important and examining the scenarios in which factors assume greater or lesser importance.

There a huge number of evaluative angles you could take within this essay. Here we will showcase some useful evaluative points you could make in an essay of this subject. You would not be expected to include all of these examples – there simply is not enough time!

High Initial Unemployment

The fact that unemployment in South Africa is currently high has several important implications. It means that any increase to unemployment benefits would be very costly for the government as such a large proportion of the population would be claiming them. The significant opportunity cost of increasing unemployment benefits needs to be considered carefully before any recommendation to do so is issued.

Impact on National Statistics

One of main focuses of economists studying the South African economy is on its high unemployment rate. This, however, may be evidence that the low level of unemployment benefits are doing their job. They are encouraging people to attempt to find employment, which increases the official unemployment figures. However, is the fact that they are searching for jobs a positive compared to being content surviving on benefit payments?

Sensitivity

The precise effect of low unemployment benefits depends upon how sensitive (elastic) the supply of labour is to unemployment benefits. It may be that South African workers are particular sensitive to the incentives offered by benefits and therefore the low level of benefits has a large effect.

Differential Benefits

The benefits on offer to different people is likely to differ across South Africa. For example, the disabled are likely to be able to claim more generous benefits compared to the able-bodied unemployed. There may also be differences according to region. This means that the effects of the level of unemployment benefits has on the economy will likely be different across it.

Who Pays?

Some commentators argue that unemployment benefits should be set low as it is net taxpayers who provide the government with the funds to afford them. They argue that it is unfair for those who do work to pay for those who don't.

Equity

One of the main arguments against the low level of benefits offered is that it increases inequality. Any discussion about equality can quickly lead to a debate about how closely equality represents equity (fairness). Some argue that actually some degree of inequality represents fairness as it reflects different levels of talent and effort within the workplace.

Overall, it is important to provide in your essay, a reasoned judgement; an argument which decides upon the net impact of high levels of inequality in South Africa. It doesn't matter which side of the argument you make the case

for – you will be examined on how effectively you structure that argument and how well you support it with economic theory.

The concluding paragraph of your essay is often a very good place to make clear what your overall reasoned judgement of the question is. Some people also like to include a similar judgement in their introduction, to signpost clearly to the examiner that they will be making an evaluative judgement in their essay.

Here is a good example of an attempt to, in one paragraph, argue that low unemployment benefits are detrimental to the South African economy.

“Overall, it is clear that the unemployment benefits available in South Africa are set too low. Whilst the impact on government finances of a higher level of unemployment benefit should be taken into consideration, the chief challenge currently facing South Africa is inequality. Low unemployment benefits exacerbate inequality by ensuring that those at the very bottom of the income distribution stay there. Furthermore, increasing unemployment benefits has a real possibility of driving long-term economic growth by pushing households out of poverty and allowing them to access to basic goods they need to push on and improve their life chances.”

Alternatively, it would be just as valid to argue that low unemployment benefits are positive for South Africa:

“It can be tempting to link the high levels of inequality currently found in South Africa with the low levels of unemployment benefits on offer. However, it would be simply infeasible for the government to offer higher benefits due to the vast cost this would impose upon the government’s budget. In fact, low unemployment benefits has long-term benefits for the economy by ensuring that more of the potential labour force are actively searching for employment and will contribute to the productive capacity of the economy.”

Essays are marked on a levels basis. The overall quality of your essay will be considered when deciding upon which level the answer is. There are up to 16 marks available for knowledge, application and analysis:

Level 1 [1 – 4 Marks] – Weak knowledge and understanding which included generic or irrelevant information.

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