

GCE

Edexcel GCE

Economics (6353)

Summer 2005

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Mark Scheme (Results)

6353/01 MARK SCHEME
June 2005

Question 1

Section

Mark

- (a)(i) **Define *annual real GDP growth*.**
Year on year (1) adjusted for inflation, or volume/constant prices, (1) percentage change/increase (1) in the output of goods and services produced (1) 4
- (a)(ii) **Explain two limitations of using GDP data as an indicator of changes in living standards over time.**
Inaccuracies in the data (as exemplified by the figure) or other factors influencing standard of living e.g. environment, pace of life, black economy, subsistence farming, non-marketed services, income distribution, population changes and therefore GDP per capita, reference to inflation, numbers of hours worked, provision of public services, changes in quality of goods.
1 for identification + 1 for explanation x 2
A list - max 2 marks
2 separate points must be evident 4
- (b)(i) **Explain what is meant by the 'inflation target' (Extract 1, line 14)?**
Inflation target in terms of RPIX or HICP/CPI (1), 2.5%, or 2% target for the HICP (1) \pm 1% (1)
Discussion of purpose of inflation target up to 2 marks.
Answers without reference to RPIX/HICP max 2 marks 3
- (b)(ii) **Briefly assess the importance of accurate GDP growth figures for the Monetary Policy Committee in seeking to achieve its inflation target.**

Must identify evaluation (x2 marks) in separate annotations within body of text.

If growth is above sustainable levels then there may be a threat of inflation as factor markets tighten/excessive demand. Candidates may use a diagram to support answer. Accept answers based on below trend growth. Reward accurate reference to the significance of output gap. (2)

Reserve 2 marks for evaluation e.g.: if growth is reported as being lower than it actually is interest rates may be reduced inappropriately; or if GDP is higher than reported, then interest rates may not be raised enough. Accept significance of GDP and alternative issues(2) 4

(c)(i) Outline three main components of the *current account* of the balance of payments.
Accept any three from: trade in goods/visibles (2), trade in services/invisibles (2), investment income (IPD) (2), and transfers (2). In each case 1 mark for identification and 1 mark for brief explanation/use of example. 6

(c)(ii) With reference to Figure 1, explain whether the current account balance represents a *withdrawal* or an *injection*.
Accept explanation based on injections

- Identification of withdrawal (1)
- Definition of withdrawal - money leaving circular flow or money leaving the country (1)
- Reference to deficit or - £9.6bn or - £19bn (1)
- Statement that Imports > Exports (1)

Reward use of a diagram (up to 2) or if correct definition of injection given (1 mark) 4

(d) Using aggregate demand and supply analysis and making reference to the role of the multiplier, evaluate the effectiveness of fiscal policy to achieve a higher rate of economic growth.

Must identify evaluation (x6 marks) in separate annotation within body of text.

Allow nine marks for analysis, reserving six marks for evaluation.

Definition of fiscal policy - government spending and taxation (1)
Use of fiscal policy - identification and explanation of fall in taxes and increase in government spending including transmission mechanisms.
Identification (1 mark) + Explanation (1 mark)

- Increase in Gov't Spending
- Decrease in Taxation

Both required for full marks. (2 x 2 marks)

AD/AS diagram to illustrate above and showing changes in Price + output (2)

Explanation of multiplier process (2)

Any two evaluation points up to 3 marks each (or 3 evaluation points x 2 marks each):

- Understanding that other things are not equal, e.g. the monetary position, world prices.
- What is happening on the supply side?
- Any consideration of elasticities
- Reference back to the uncertainties in the data
- Time Lags
- The relative inflexibility of fiscal policy
- Crowding out issues
- Impact on AS
- Impact on Government revenue and spending
- Monetary Policy or Supply Side Policies
- Impact on Inflation Target
- Whether G or T is more effective

Total Mark for Question 1: 40

15

Question 2

Section	Marks
<p>(a)(i) Explain what is meant by <i>inflation</i>. An increase in the cost of living (2) or fall in the purchasing power of £1 (2) or an increase in the average/general price level (2). Accept rising prices (1 mark) Do not reward reference to Demand Pull / Cost Push unless supported by explanation of rising prices. No reward for explanation of measurements.</p>	2
<p>(a)(ii) Define <i>investment</i>. Change in the capital stock (2), or purchases of plant and machinery by firms (2). Accept Gov't Spending on infrastructure (1 mark) Investment in Human Capital (1 mark) and explanation of Human Capital (1 mark)</p>	2
<p>(a)(iii) Use aggregate demand and supply analysis to explain the likely effects of a fall in company investment on UK prices and real output. Effect on AD through C+I+G+X-M (1) illustrated on diagram, showing shift in AD left (2) consequent fall in the price level and level of real output (1) effect on AS curve or multiplier (1) Maximum of 3 marks if answer is focussed solely on shifts in AS</p>	5
<p>(a)(iv) Assess the significance of two items of information, other than those mentioned in the extract, which the Monetary Policy Committee may have considered before reaching its decision to cut interest rates. Must identify evaluation (x2 marks) in separate annotation within body of text. Accept any sensible suggestion from the wide basket of indicators used by the MPC. For each point: identification (1) explanation of likely effect on inflation (1). For example, oil prices, other commodity prices, level of government spending, house prices, factory gate prices, unemployment, exchange rates and trade position. Reserve 2 marks for evaluation e.g.: significance of a measure, relative importance. Do not accept earnings growth, consumer demand, economic growth, investment and global eco performance.</p>	6
<p>(b) Explain the likely effect on inflation of the fall in the value of the pound (Extract 1, line 3). Effect of a fall in the pound on the level of AD. As exports rise and imports fall so AD rises (1 mark each). Up to 2 marks for appropriate diagram or written explanation. Rise in the price level (or inflationary pressure). Effect on inflation of higher import prices through higher costs or Elasticities (2)</p>	6

(c) Outline the likely effects on income distribution of the fall in interest rates.

For any two points: identification (1) explanation of effect on income distribution (1). For example, a cut in interest rates will reduce the return on savings for the better off (who tend to be net creditors). Debtors will pay less interest e.g. on mortgages and borrowing is cheaper, therefore improving income distribution.

1 mark for identification of effected group

1 mark for explanation of effects i.e. 2 x 2 marks

- Long-term debts spiral
- Creditors : Return on savings
- Debtors : Fall in cost of borrowing
- Growth increases therefore employment and incomes rise
- Growth causes increase in government revenues and therefore benefits / public services improve
- Inflationary impact of higher spending worsens Income distribution for those on fixed incomes

4

(d) Evaluate the effectiveness of monetary policy as a means of achieving price stability in the UK economy.

Must identify evaluation (x6 marks) in separate annotations within body of text.

Allow nine marks for analysis, reserving six marks for evaluation.

A clear understanding of monetary policy (1).

Reference to low and stable prices or target range (1) and reference to inflation target in the UK (1).

Use of interest rates: 2 explanations and transmission mechanism (2 x 2 marks) or (3 + 1 mark)

Written or diagrammatic application to AD/AS (2).

Award any two evaluative points up to (3 marks) each (or 3 evaluation points x 2 marks each).

Evaluation marks should be reserved for candidates who are able to critically examine the use of such policies.

- Lagged effect of changing interest rates.
- Difficulty in achieving accurate information
- MPC tends to undershoot its target?
- Over-sensitivity of the exchange rate
- Reasons for effectiveness of Monetary Policy
- Wider macroeconomic impacts of Monetary Policy
- Regularity of change of Monetary Policy
- Elasticity of AD/AS
- Size of change in Interest rates
- Banks may not adjust rates with same regularity

15

Total Mark for Question 2: 40

Assessment Objectives Grid

Question	Knowledge	Application	Analysis	Evaluation	TOTAL
Qu. 1(a)(i)	4				4
Qu. 1(a)(ii)		4			4
Qu. 1(b)(i)	1	2			3
Qu. 1(b)(ii)		2		2	4
Qu. 1(c)(i)	4	2			6
Qu. 1(c)(ii)		2	2		4
Qu. 1(d)	3		6	6	15
Total	12	12	8	8	40
Qu. 2(a)(i)	2				2
Qu. 2(a)(ii)	2				2
Qu. 2(a)(iii)	1	3	1		5
Qu. 2(a)(iv)	2	1	1	2	6
Qu. 2(b)	1	4	1		6
Qu. 2(c)		2	2		4
Qu. 2(d)	4	2	3	6	15
Total	12	12	8	8	40