Candidate Marks Report

Series : 6 2018

This candidate's script has been assessed using On-Screen Marking. The marks are therefore not shown on the script itself, but are summarised in the table below.

Centre No :		Assessment Code :	H460
Candidate No :		Component Code :	02
Candidate Name :			

Total Marks : **44 / 80**

In the table below 'Total Mark' records the mark scored by this candidate.
'Max Mark' records the Maximum Mark available for the question.

Paper:	**H460/02**		
Paper Total:	**44 / 80**		
Question	Total Mark	/ Max Mark	Used In Total
1a	3	/ 3	✔
1b	2	/ 2	✔
1c	2	/ 2	✔
1d	3	/ 3	✔
1e	5	/ 8	✔
1f	3	/ 12	✔
2	10	/ 25	✔
3	NR	/ 25	
4	NR	/ 25	
5	16	/ 25	✔

SECTION A

Read the following stimulus material and answer **all** parts of question 1 which follow in this section.

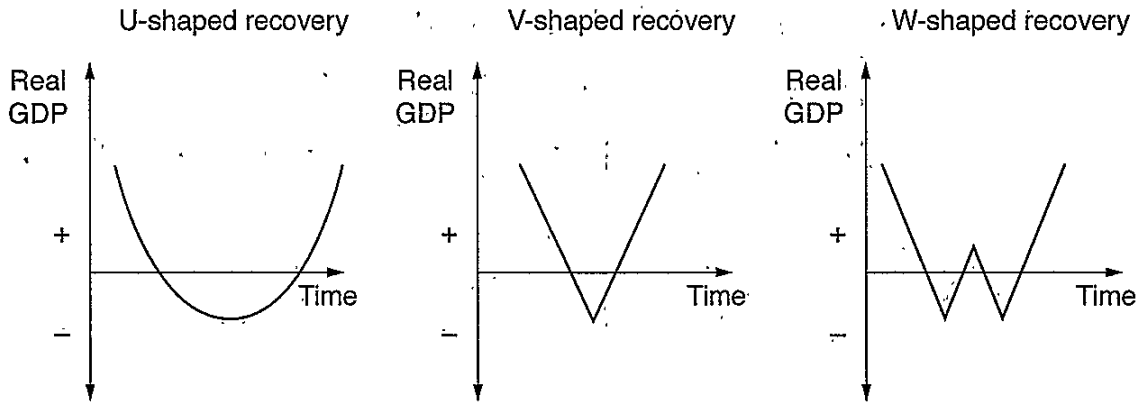
The recovery of the Icelandic economy

In the last two decades the Icelandic economy has experienced some significant changes in economic activity. One influencing factor has been changes in the standard rate of income tax. The rate was cut in a number of stages from 46% to 36% in 2006. Despite the lower income tax rate, government income tax revenue rose, allowing the government to spend more on the country's infrastructure. In 2009 and 2010 the income tax rate was increased.

In the period 2008 to 2011, the economy experienced a serious recession. The country's three largest banks were allowed to fail. It was the third largest bankruptcy in history and, according to the size of the economy, the biggest banking failure in history. The value of the country's stock market fell by 95%, the currency declined in value by 60%, unemployment increased by 8% and inflation rose to 12%.

From 2011 the economy has made a remarkable recovery. In 2014 its real GDP was US$14.85bn and it grew by 4% in 2015, one of the fastest rates in Europe. Economists have developed an 'alphabet' of recoveries with the three most common types shown in Fig. 1.

Fig. 1 Different types of economic recovery



In 2015 the Icelandic government was paying back its loans to the International Monetary Fund early. It had removed capital controls and had reformed the country's financial sector. A number of the country's industries were expanding, most noticeably its tourist industry. Income from tourism can fluctuate significantly. In 2015 the total contribution of Iceland's tourist industry to the country's GDP was 23%. The impressive growth of Iceland's tourist industry was contributing to a fall in unemployment due to a rise in hotel construction, and an increase in infrastructure, although this was also putting pressure on house prices as people were buying them to rent out to tourists. In 2015 the unemployment rate was 5.3%, which was lower than in many European countries, but it was predicted to rise in 2016.

For a small country with a population of only 0.33 million in 2014, Iceland has a relatively high HDI value. Fig. 2 shows some details of the HDI values of six countries.

Fig. 2 The Human Development Index of six selected countries

Country	HDI ranking 2014	HDI value 2014	GNI per capita (US$) 2014
Norway	1	0.944	64,992
Australia	2	0.935	42,261
Germany	6	0.916	43,918
USA	8	0.915	52,947
UK	14	0.907	39,267
Iceland	16	0.898	35,182

25 As Iceland's economy has grown, so has the country's aid for developing countries. In 2013, for instance, its foreign aid budget increased by 27.8%.

1 **(a)** Using Fig. 1, explain which type of economic recovery is likely to be most beneficial for an economy.

The U-shaped recovery is likely to be most beneficial as there are no sudden shocks to real GDP which increases economic stability and reduces volatility. The gradual change in GDP gives time the economic agents to react to the change so that they are not shocked.

[3]

(b) Using information from the stimulus material, including Fig. 2, calculate the difference between Iceland's real GDP per head and its GNI per capita in 2014.

$\frac{14.85\text{ bn}}{0.33\text{ mn}}$ = $45 000 GNI = $35 182

45000 − 35182 = $9818

[2]

(c) Using Fig. 2, explain why Australia had a higher HDI value than the USA in 2014.

Aus - 0.935
USA - 0.915

The HDI value is made up of 3 components: life span, literacy rate and access to resources. If any or all of these components increase, the HDI value increases. Australias HDI value in 2014 was 0.935 where as USA's was 0.915. Although USA has a higher access to resources than Australia; Australia may have a higher life span & literacy rate than the USA thus, the HDI for Australia is higher. [2]

(d) Identify one piece of evidence in the stimulus material of the relationship suggested by the Laffer curve and explain why it is an example of such a relationship.

The laffer curve helps identify the optimal tax rate to maximise tax revenue for the government. Although Iceland cut the tax stage from 46% to 36%, their income tax revenue rose. This shows that as there may be more workers incentivised by the tax cut so they took a higher paid position.

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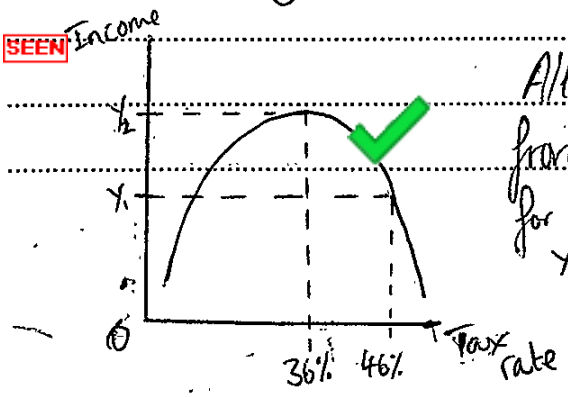

Although the tax rate fell from 46% to 36%, income for the government rose from Y_1 to Y_2. [3]

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(e) Using information in the stimulus material, evaluate whether Iceland would be likely to experience a recession after 2015.

It could be likely that Iceland would experience a recession after 2015. The unemployment rate in 2015 was 5.3% but it is forecasted to rise in 2016 which means AN there is a higher unemployment of resources which causes aggregate demand (AD) to shift to the left. This means that consumption would also fall as people now have less to spend. As demand has fallen, it may cause investment to fall as firms are uncertain if there will be enough demand for their products. This again shifts AD to the left. If this continues for two AN KU consecutive quarters, Iceland would be in a recession. However, this depends on if the tourist industry continues to grow. 23% of Iceland's GDP was from this industry so, if it continues to rise - there may be more job creation in this EVAL industry which means there would only be a small increase in unemployment. EVAL

KU

[8]

NB - Aid means money going out
- leads to C.F.I
- less for economy to spend
not beneficial

(f)* Evaluate whether an increase in the aid Iceland provides to developing countries would benefit the Icelandic economy. [12]

Aid is where a country, i.e. Iceland sends
KU money to a foreign country in order to increase the amount of money they have. This acts as an injection into the circular flow
KU of income for the foreign country.

By the Icelandic economy increasing aid, means that
AN more money is leaving the economy which shows a leakage in the circular flow of income. This means that GDP per capita is lower leading to a fall in consumption and a fall in the households material standard of living. Due to this, the increase in aid may not be beneficial to the Icelandic economy. However, the countries industries are expanding so, although there is a higher leakage, the firms are producing more
TV output and households are earning more factor incomes which shows the economy may not be in a worse or better state.

BP

SECTION B

Answer **EITHER** question **2 OR** question **3**.

EITHER

2* The fall in the value of the South African rand between 2012 and 2016 had an impact on the current account of the country's balance of payments.

Evaluate, with the use of an appropriate diagram(s), whether a fall in the value of a country's currency will always reduce a deficit on the current account of its balance of payments. **[25]**

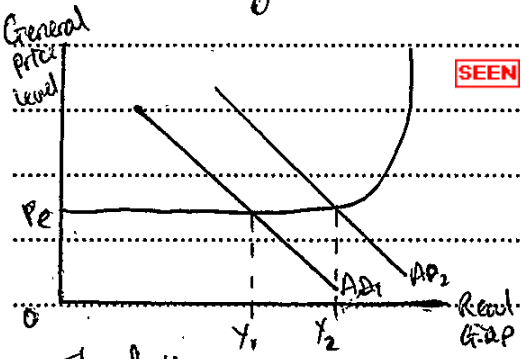
OR

3* Japan's macroeconomic performance in recent years has been influenced by its experience of deflation.

Evaluate, with the use of an appropriate diagram(s), whether deflation always harms a country's macroeconomic performance. **[25]**

Question No 2

Currency shows us one countries exchange rate in terms of another.



The fall in the currency of Africa South Africa means that it is cheaper for other countries to buy South African goods. This means that exports are more attractive and not exports could increase. This could lead to a shift to the right of the AD curve from AD_1 to AD_2 as net exports is a component of the Aggregate Demand formula. This could lead to trade in goods and services to increase

which could reduce the deficit on the current account for South Africa. However, South Africa is a Less Developed Economic Country (LEDC) which means that could their market structure could be dominated by the primary sector. This could mean that although their currency has fallen, they may not see any change in their balance of payments as they are producing commodity goods which are generally price inelastic.

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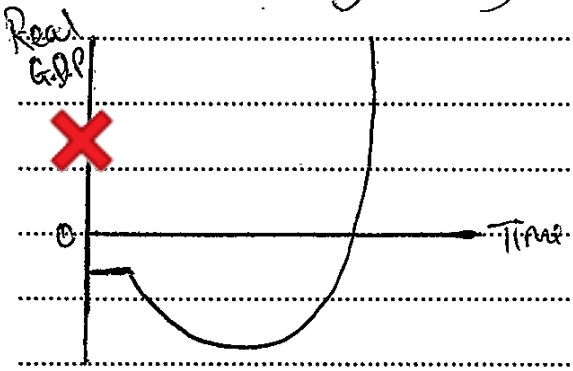
EVAL



According to the J-curve and the Marshall Lerner condition, the balance of payments deficit would get worse before it gets better, if the currency was to fall. This could be due to other countries being tied into contracts which could take time to get out of before trade can start which is where the balance of payments would begin to improve.

EVAL

KU KU

SEEN

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Plan

Para 1: - currency down
- cheaper for others by exports
net exports ↑, AD ↑ shift to right
- increase in ~~GDP~~ or economic growth
- in trade in goods and services
- B.O.P improves

SEEN

SECTION C

Answer **EITHER** question **4** **OR** question **5**.

EITHER

4* Some economists argue that attempts by the Greek Government to reduce its budget deficit have contributed to the rise in the country's unemployment rate.

Evaluate the extent to which government policy measures to reduce a budget deficit will increase unemployment. **[25]**

OR

5* Investment has fluctuated significantly in Poland in recent years. For example, it increased by 8.3% in 2008, fell by 1.5% in 2012 and grew by 5.9% in 2015.

Evaluate the extent to which the accelerator theory explains the level of investment in an economy. **[25]**

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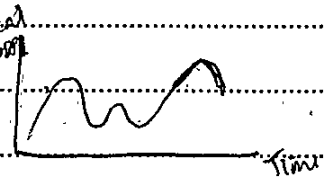
Question No 5

Plan

Def: Accelerator: a theory which shows the level of investment depends on the change in real output

Para 1: 

Eval: other factors affect investment

Para 2: Credit multiplier, more savings
- more credit for firms
- firms borrow then invest, inv. increase
Eval: savers don't demand money back

Para 3: - government policy
- Exp: monetary → low interest rates, credit cheaper for firms borrow

Eval: confidence

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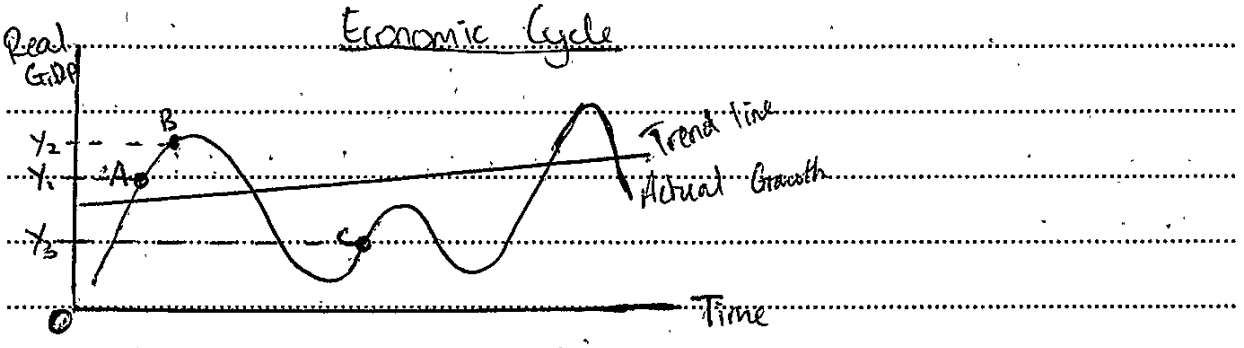
Answer

The accelerator is a theory which shows the level of investment in an economy depends on the change in real output.



At the point A, firms feel confident about the future as growth is increasing so investment levels are high. At the point B, the growth is slowing down in the economy so certainty and confidence falls which causes investment to fall. Although there is still growth, the accelerator shows us that the slow-down in growth has caused investments to decrease. At the point C, investment will still be low as the country still has spare capacity as, before it was operating at B which is higher than C. Any investment will be to replace old or broken machines. However, this theory assumes that nothing else affects the level of investment but in reality - there are other factors such as: whether a busine firm has the ability to invest or if they actually want to invest even if the economy is growing. This means that the accelerator may not be a good explanation for the level of investment.

Another explanation for the level of investment within a economy could be the credit multiplier. This is a theory where banks hold a reserve ratio of what savers deposit and lend out the rest. This gives the banks more money to lend out for firms so that they can increase investment by borrowing. This increases investment in the economy which could explain the level of investment. However, this only works if the savers do not make a bank run. This is where savers go back to the bank and request all of their savings in which case the credit multiplier would crash.

Moreover, another explanation for the level of investment in a economy could be the government policy being implemented. If there is a expansionary monetary policy, this would mean that interest rates are low and there is an ease off credit supply which means loans are cheaper and easier to obtain. If a firm wants to borrow money, and they are in a good financial position to do so, the extra money could be used for investment thus, increasing the level of investment in an economy. However, this depends on whether firms are confident about the future and are willing to invest. If the economy is in a recession, then firms may be reluctant to invest.

Overall, I think that the accelerator cannot explains to a small extent, the level of investment in the economy. For Poland, investment has fluctuated from 8.3% to 6.8% then to 12.7%. There could be other reasons for this other than the change in output for example: loans are easier to obtain so firms can borrow more thus, increasing investment.

SEEN KU KU KU

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END OF QUESTION PAPER

ADDITIONAL ANSWER SPACE

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

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