



# GCE

## Economics

Advanced GCE

Unit **F585**: The Global Economy

# Mark Scheme for June 2012

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All examiners are instructed that alternative correct answers and unexpected approaches in candidates' scripts must be given marks that fairly reflect the relevant knowledge and skills demonstrated.

Mark schemes should be read in conjunction with the published question papers and the report on the examination.

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F585

Mark Scheme

June 2012

## Annotations

Annotation	Meaning
	Unclear
	Benefit of Doubt
	Cross
	Effective evaluation
	No development
	Level 1
	Level 2
	Level 3
	Level 4
	Not answered question
	Noted but no credit given
	Too vague
	Tick
	Development of point

F585

Mark Scheme

June 2012

**Subject specific marking instructions**

Some questions may have a 'Level of Response' mark scheme.

The following guidelines on the **quality of written communication** are embedded into the Levels of Response mark scheme used for question 3:

- Level 4:** Complex ideas have been expressed clearly and fluently using a style of writing which is appropriate to the complex subject matter. Sentences and paragraphs, consistently relevant, have been well structured, using appropriate technical terminology. There may be few, if any, errors of spelling, punctuation and grammar.
- Level 3:** Relatively straightforward ideas have been expressed with some clarity and fluency. Arguments are generally relevant, though may stray from the point of the question. There will be some errors of spelling, punctuation and grammar, but these are unlikely to be intrusive or obscure meaning.
- Level 2:** Some simple ideas have been expressed in an appropriate context. There are likely to be some errors of spelling, punctuation and grammar of which some may be noticeable and intrusive.
- Level 1:** Some simple ideas have been expressed. There will be some errors of spelling, punctuation and grammar

F585

Mark Scheme

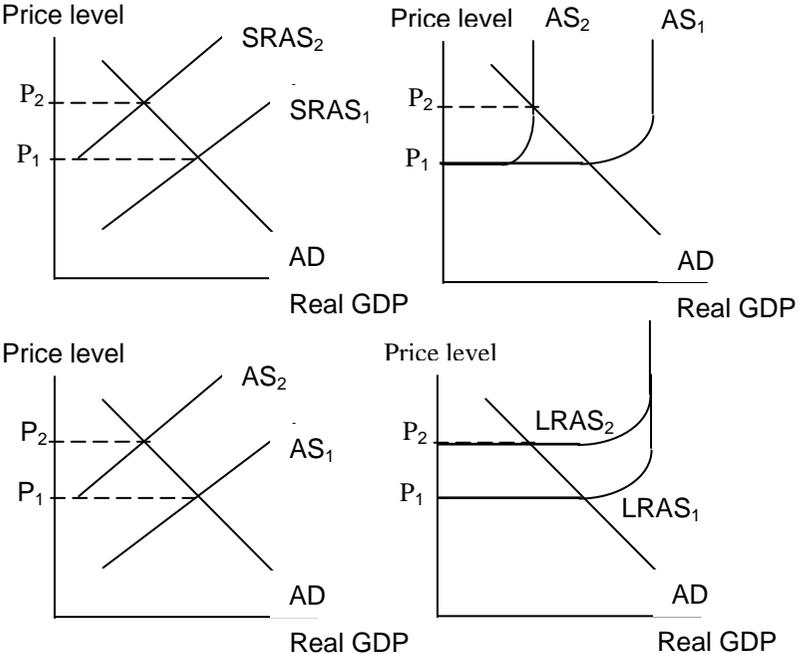
June 2012

Question		Answer	Marks	Guidance
1	(a)	<p>Benefits of inflation targeting may include:</p> <ul style="list-style-type: none"> <li>• greater transparency and accountability</li> <li>• lower inflationary expectations</li> <li>• flexibility if a symmetric target</li> <li>• greater credibility/strictness of asymmetric target</li> <li>• greater confidence</li> <li>• greater economic stability/reduced volatility reduces uncertainty</li> <li>• leads to higher levels of investment</li> <li>• a guide to policy decisions</li> <li>• helps avoid the costs of inflation</li> </ul> <p>Examples of valid description:</p> <ul style="list-style-type: none"> <li>• inflation targets create transparency and accountability (1) by communicating a firm commitment to price stability to firms and households (1)</li> <li>• lower inflationary expectations (1) help to moderate wage demands and cost-push inflation (1)</li> <li>• inflation below the target is as important as inflation above the target (1) which avoids dangers of deflation as well as inflation (1)</li> <li>• greater confidence for firms (1) is likely to increase willingness to invest / raise LRAS / productive capacity (1)</li> </ul>	4	<p>One mark for each correct identification up to a maximum of two identifications, plus a further one mark for each of two descriptions.</p> <p>A valid description of each benefit requires a simple elaboration of what the benefit is, why it might arise or what the consequence might be. An analytical explanation is not required.</p> <p>Some candidates may give a second benefit in the description of the first; please credit.</p> <p>Use green ticks  for each mark awarded.</p> <p>Maximum 4 marks</p>

F585

Mark Scheme

June 2012

Question	Answer	Marks	Guidance
<p>1 (b)</p>	<p>Diagram marks can only be awarded if axes are correctly labelled:</p> <ul style="list-style-type: none"> <li>price level/general price level/average price level/CPI/PL</li> <li>real GDP/real national output/real national income/RGDP</li> </ul> <p>Award diagram marks as follows:</p> <ul style="list-style-type: none"> <li>1 mark for original AD and AS curves</li> <li>1 mark for original price level</li> <li>1 mark for leftward shift of AS curve</li> <li>1 mark for new price level</li> </ul> <p>Award up to a further two marks for analysis of why inflation is expected to rise when there is spare capacity. For example:</p> <ul style="list-style-type: none"> <li>higher commodity prices (1) raises costs of production (1) shifts AS left (1) so the price level rises whilst real GDP falls (1)</li> <li>higher VAT (1) raises firm's costs (1) shifts AS left (1) so the price level rises whilst real GDP falls (1)</li> </ul> <p>Other valid reasons include higher energy/input/oil prices, rebuilding company's margins.</p>	<p>6</p>	<p>Acceptable variations of AD/AS diagrams shown below. Diagram showing <b>leftward shift of LRAS</b> can only be awarded 2 marks.</p>  <p>Use green ticks  for each mark awarded.</p> <p>Maximum 6 marks</p>

F585

Mark Scheme

June 2012

Question		Answer	Marks	Guidance	
				Content	Levels of response
1	(c)	<p><b>Level 4:</b> Commentary on the benefits of inflation might include:</p> <ul style="list-style-type: none"> <li>costs of inflation eg shoe leather costs, menu costs, inflationary noise, fiscal drag, random redistribution of income, impact on investment</li> <li>higher inflationary expectations</li> <li>impact on other economies where PED is inelastic, ie inflation may be 'exported'</li> <li>may not correct current account surplus if value of exports rise, ie PED for exports is inelastic</li> </ul> <p><b>Level 3:</b> Higher inflation reduces the incentive to save and encourages greater domestic consumption. Greater domestic consumption reduces China's dependence on global demand for its exports and may lead to more sustained growth. Higher inflation reduces pressure on China to revalue its currency as it raises yuan's real exchange rate.</p> <p><b>Level 2:</b> This could be a benefit to China because it will allow it to rebalance its economy.</p> <p><b>Level 1:</b> Inflation is a sustained increase in the general price level. Higher inflation in China is characterised by an increase in the rate at which prices are rising.</p>	10	<p><b>In Level 4:</b></p> <ul style="list-style-type: none"> <li>one stated point of evaluation = 7 marks</li> <li>two or more stated points of evaluation = 8 marks</li> <li>one developed point of evaluation = 9 marks</li> <li>two or more developed points of evaluation = 10 marks</li> </ul> <p><b>Routes into Level 4 include</b></p> <ul style="list-style-type: none"> <li>an analytical explanation of the benefits <u>and</u> problems of higher inflation for China or other economies</li> <li>an analysis of the benefits of higher inflation in China and an explanation of what the benefits depend upon</li> </ul> <p><b>Level 3 responses</b> will establish the beneficial consequences of higher inflation for China or other economies e.g. trading partners, using a reasoned chain of argument underpinned with economic concepts.</p> <p><b>Level 2 responses</b> are characterised by valid but generalised statements without a reasoned chain of argument and are not underpinned by economic concepts.</p>	<p><b>Level 4: (7 – 10 marks)</b> For a commentary on the view that higher inflation in China might be advantageous</p> <p>Annotate using  in LHS margin</p> <p>Show development with </p> <p>Annotate with  conclusions which repeat previous arguments</p> <p><b>Level 3: (4 – 6 marks)</b> For an analysis of either the advantages OR disadvantages of higher inflation in China but not both.</p> <p>Annotate using  in LHS margin.</p> <p><b>Level 2: (2 – 3 marks)</b> For an application of knowledge and understanding of the advantages and / or disadvantages of higher inflation in China</p> <p>Annotate using  in LHS margin.</p> <p><b>Level 1: (1 mark)</b> For knowledge and understanding of inflation only.</p> <p>Annotate using  in LHS margin.</p>

F585

Mark Scheme

June 2012

Question	Answer	Marks	Guidance
2 (a)	<p>The real exchange rate is the nominal exchange rate adjusted for the ratio of prices between two countries / taking into account purchasing power parity.</p> $\text{Real exchange rate} = \text{nominal exchange rate} \times \frac{\text{domestic price level}}{\text{world price level}}$ <p>Valid explanations might include:</p> <ul style="list-style-type: none"> <li>• <b>higher inflation in China</b> than in the US / rest of the world (1) has raised the price of Chinese exports (1) and meant that more US\$ are required to buy the same volume of Chinese goods (1) raising the real exchange rate of the yuan (1)</li> <li>• <b>lower growth in productivity in China</b> than in the US / rest of the world (1) means that Chinese goods are less competitive (1) meaning more US\$ are required to buy the same volume of Chinese goods (1) raising the real exchange rate of the yuan (1)</li> <li>• <b>higher wage growth in China</b> than in the US / rest of the world (1) has increased costs of production in China (1) raising the price of Chinese exports (1) and meant that more US\$ are required to buy the same volume of Chinese goods (1) raising the real exchange rate of the yuan (1)</li> <li>• <b>China operates a fixed exchange rate</b> so the nominal rate is unchanged (1) by raising / reducing demand / supply of Yuan / \$US (1) or by raising / lowering interest rates (1).</li> </ul>	4	<p>Award marks as follows:                      1 mark for each valid reason for the divergence in the real and nominal exchange rates up to a max of 2 marks                      1 mark for each explanation of why this causes a divergence in the real and nominal exchange rates up to a max of 2 marks.</p> <p>Award 2 marks for an answer which identifies higher inflation as the cause of the divergence followed by an explanation which correctly states that the real exchange rate adjusts the nominal rate for changes in <b>relative</b> price levels</p> <p>Do not credit simple reference to undervaluation.</p> <p>Explanation of why the nominal rate is unchanged must be linked to Chinese government / central bank intervention in the FOREX markets to maintain the fixed exchange rate or changes in monetary policy</p> <p>Use green ticks  for each mark awarded.</p> <p>Maximum 4 marks</p>

F585

Mark Scheme

June 2012

Question	Answer	Marks	Guidance
2 (b)	<p>Difficult to increase interest rates in order to control inflation when the economy is operating a fixed exchange rate because:</p> <ul style="list-style-type: none"> <li>fixed exchange rate will be undermined / changes in interest rates will change the exchange rate / there will be a policy conflict (1).</li> <li>impact of interest rates on the exchange rate makes it difficult to use interest rates to influence AD (1).</li> </ul> <p>Increase in interest rates will put pressure on the exchange rate to rise because there will be:</p> <ul style="list-style-type: none"> <li>increased demand for currency (1), reduced supply of currency (1) creating excess demand for currency (1) which will raise the exchange rate (1).</li> </ul> <p>This is because of:</p> <ul style="list-style-type: none"> <li>increased 'hot money' flows into domestic economy (1) as a result of higher returns from deposits in domestic banks as a result of the higher interest rate (1)</li> <li>reduced 'hot money' flows out from domestic economy (1) as a result of higher returns from deposits in domestic banks as a result of the higher interest rate (1)</li> </ul> <p>The consequence will be that the central bank will have to:</p> <ul style="list-style-type: none"> <li>intervene in the FOREX markets (1) by increasing the supply of the currency (1) by purchasing foreign currencies (1) in order to prevent an appreciation of the currency / maintain the currency at its fixed rate (1)</li> </ul>	6	<p>Use green ticks  for each mark awarded.</p> <p>Maximum 6 marks</p> <p>Do <b>NOT</b> credit the idea that intervention in the foreign exchange markets to increase the supply of the currency raises the money supply and causes inflation <b>UNLESS</b> there is clear recognition that this only arises where such intervention is not "sterilised" by open market operations.</p> <p>Where candidates recognise this issue, marks can be awarded as follows:  <b>IF</b> the central bank 'prints' money to buy foreign currency (1) this will increase the money supply (1) which could increase the rate of inflation (1) unless the effect on the money supply is offset by selling bonds in the domestic money markets (1).</p>

F585

Mark Scheme

June 2012

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				Content	Levels of response
2	(c)	<p><b>Level 4:</b> problems might include</p> <ul style="list-style-type: none"> <li>• lack of agreement on the choice of adjustments to be made to GDP</li> <li>• no way of determining objectively the weightings to attach to each adjustment</li> <li>• difficulties of placing monetary values on eg costs of environmental degradation</li> </ul> <p><b>Level 3:</b> Adjusted indicators are useful because they are (more) comprehensive measures (than e.g.GDP) (low L3). This helps governments to determine the best policies to pursue to achieve sustainability/allows economic, social and environmental outcomes of growth to be explicitly measured (mid L3). For example, higher GDP which results in pollution and a loss of biodiversity does not raise economic well-being even though it raises economic activity unless the government introduces a policy to internalise the negative externality (top L3).</p>	10	<p><b>In Level 4</b></p> <ul style="list-style-type: none"> <li>• one stated point of evaluation = 7 marks</li> <li>• two or more stated points of evaluation = 8 marks</li> <li>• one developed point of evaluation = 9 marks</li> <li>• two or more developed points of evaluation = 10 marks</li> </ul> <p>Do not reward commentary on why HDI or MDGs or HPI or MPI may be better measures as they are composite rather than adjusted indicators.</p> <p><b>In Level 3</b>  <b>L3 marks should not be awarded without understanding of adjusted indicators.</b>                      General explanation of why adjusted indicators are useful (low L3)                      Identification of outcomes of economic growth consistent with sustainable development or implications for government policy (mid L3)                      Exemplification of why adjustments are useful in assessing success (top L3)</p>	<p><b>Level 4: (7 – 10 marks)</b>                      For a commentary on the case for using adjusted economic indicators to assess China’s success in achieving sustainable economic development.</p> <p>Annotate using  in LHS margin</p> <p>Show development with </p> <p>Annotate with  conclusions which repeat previous arguments</p> <p><b>Level 3: (4 – 6 marks)</b>                      For an analysis of why adjusted economic indicators are useful or are not useful in assessing China’s success in achieving sustainable economic development.</p> <p>Annotate using  in LHS margin.</p>

F585

Mark Scheme

June 2012

Question			Answer	Marks	Guidance	
					Content	Levels of response
			<p><b>Level 2:</b> Adjusted economic indicators are useful in assessing success in achieving sustainable development because they measure things that raise the quality of life and deduct things that reduce the quality of life (low L2), such as environmental damage, defensive expenditures, income inequality, depreciation of natural capital, value of domestic labour (top L2)</p> <p><b>Level 1:</b> Sustainable economic development is development that meets the needs of the current generation without compromising the ability of future generations to meet their own needs.</p>		<p><b>In Level 2</b> Understanding that adjustments are made to GDP (low L2) Pros and cons of ISEW without knowledge and understanding of adjusted indicators or composition (top L2), one-sided (low L2) Identification of specific adjustments to GDP (top L2)</p> <p><b>In Level 1</b> Definitions of economic development and/or sustainable economic development</p>	<p><b>Level 2: (2 – 3 marks)</b> For an application of knowledge and understanding of why adjusted economic indicators are useful in assessing China’s success in achieving sustainable economic development</p> <p>Annotate using  in LHS margin.</p> <p><b>Level 1: (1 mark)</b> For knowledge and understanding of sustainable economic development only</p> <p>Annotate using  in LHS margin.</p>

F585

Mark Scheme

June 2012

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3		<p><b>Examples of judgements in Level 4, Band 3</b></p> <ul style="list-style-type: none"> <li>in the short run a ban may be beneficial to China but in the long run it may be detrimental</li> <li>the benefits of a ban to China may be reduced by the existence or emergence of substitutes</li> <li>the negative impact of the ban may be confined to a narrow range of industries</li> <li>case for depends on China's ability to attract FDI</li> <li>Retaliatory action would have a negative effect on China and its poorest inhabitants in particular.</li> <li>The role of the WTO in resolving such a dispute will determine the impact on the EU, US and Chinese people.</li> <li>A quota may be more advantageous than a complete ban as it would still lead to a price that more fairly reflects the scarcity of raw materials but would limit the negative impacts on firms that rely on the imports of such materials.</li> </ul>	20	<p><b>Level 4 Band 3 marks can only be awarded once there is evidence of developed discussion (Level 4 Band 2).</b></p> <p><b>Examples of Level 4 responses</b></p> <ul style="list-style-type: none"> <li>may lower export revenue and have an adverse impact on the balance of payments;</li> <li>banning exports may not lead to optimal rate of depletion – may simply lead to foreign firms relocating to China to access raw materials so depletion rate is not affected'</li> <li>may be deemed to be an unfair trade practice by WTO by giving unfair advantage to domestic firms</li> <li>may lead to retaliation from US and EU, reducing demand for exports of other goods and services</li> </ul> <p><b>Developed discussion is where evaluation is supported with economic concepts which establish cause or consequence.</b></p> <p><b>Top Level 4 band 1</b> is characterised by a wider range of basic discussion points.</p> <p><b>Low level 4 band 1</b> is characterised by a narrow range of basic discussion points.</p> <p>Do not credit reduction in productive capacity of other economies.</p>	<p><b>Level 4 Band 3: (18 – 20 marks)</b> For a discussion which includes a judgement on the case for China banning exports of certain raw materials</p> <p>Annotate using  in LHS margin</p> <p>Annotate with  conclusions which repeat previous arguments</p> <p><b>Level 4 Band 2: (15 – 17 marks)</b> For a developed discussion of the pros and cons of China banning exports of certain raw materials, with context appropriate to the questions/stimulus</p> <p>Annotate using  in LHS margin</p> <p><b>Level 4 Band 1: (11 – 14 marks)</b> For a basic discussion of the pros and cons of China banning exports of certain raw materials, with undeveloped analytical support and a lack of context.</p> <p>Annotate using  in LHS margin</p>

F585

Mark Scheme

June 2012

Question			Answer	Marks	Guidance	
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			<p><b>Examples of Level 3 responses</b></p> <ul style="list-style-type: none"> <li>a ban reduces the world supply <b>which leads to</b> higher world prices for rare earths consumption outside of China (need not be supported by a demand and supply diagram)</li> <li>a ban on exports promotes sustainable development <b>because</b> it will raise the world price of rare earths <b>which leads to</b> reduced global consumption and slowing down the depletion of scarce / non-renewable resources</li> <li><b>the consequence of this</b> may be that there is a more optimal depletion path for raw materials as a result of the ban because resource use is not based on market rates of depletion</li> <li>if there is increased FDI into China as a result of the ban <b>the consequence will be</b> an increase in China's AD and AS <b>which will lead</b> to higher real GDP and employment</li> <li><b>the consequences of this</b> will be higher levels of economic development in China and a diversification of the economic structure <b>because</b> China will be less dependent on exports</li> </ul>		<p>Low Level 3 responses will analyse the consequences of the ban e.g. lower world supply, higher prices. Or may analyse the market failure involved in the extraction or rare earths.</p> <p>Top Level 3 responses will then develop the consequences in the context of the question i.e. the case for or against.</p> <p>Analysis is likely to be supported by diagrams which will explain:</p> <ul style="list-style-type: none"> <li>Increased world price and equilibrium quantity resulting from a reduction in world supply.</li> <li>market failure in the absence of a ban (<math>MSC &gt; MPC</math>)</li> <li>benefits to the Chinese economy of a ban (increase in AD, AS, real GDP, employment)</li> </ul>	<p><b>Level 3: (5 – 10 marks)</b> For an analysis of the case for China banning exports of certain raw materials <b>or</b> the case against but <b>not</b> both</p> <p>Annotate using  in LHS margin.</p>

F585

Mark Scheme

June 2012

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			<p><b>Examples of Level 2 responses</b></p> <ul style="list-style-type: none"> <li>• a ban leads to sustainable development</li> <li>• a ban results in greater FDI for China</li> <li>• a ban reduces negative externalities/pollution by reducing consumption</li> <li>• a ban will advantage Chinese industry</li> <li>• a ban will lead to trade disputes</li> <li>• a ban is damaging the other countries</li> </ul> <p><b>Examples of Level 1 responses</b></p> <ul style="list-style-type: none"> <li>• a ban on exports places a limit on the amount of raw materials which can be exported</li> <li>• the ban relates to commodities for which China has an effective global monopoly</li> <li>• the raw materials are key inputs into the production process</li> </ul>			<p>Responses which focus only on export quotas cannot achieve marks beyond Level 1.</p>	<p><b>Level 2: (3 – 4 marks)</b> For an application of knowledge and understanding of the case for and/or against China banning exports certain raw materials</p> <p>Annotate using  in LHS margin.</p> <p><b>Level 1: (1 – 2 marks)</b> For knowledge and understanding of what is meant by a ban on exports or the nature of key raw materials</p> <p>Annotate using  in LHS margin.</p>

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