GCE A LEVEL MARKING SCHEME

SUMMER 2017

A LEVEL (NEW)
ECONOMICS - UNIT 3
1520U30-1

INTRODUCTION

This marking scheme was used by WJEC for the 2017 examination. It was finalised after detailed discussion at the examiners' conference by all the examiners involved in the assessment. The conference was held shortly after the paper was taken so that reference could be made to the full range of candidates' responses, with photocopied scripts forming the basis of discussion. The aim of the conference was to ensure that the marking scheme was interpreted and applied in the same way by all examiners.

It is hoped that this information will be of assistance to centres but it is recognised at the same time that, without the benefit of participation in the examiners' conference, teachers may have different views on certain matters of detail or interpretation.

WJEC regrets that it cannot enter into any discussion or correspondence about this marking scheme.

Positive Marking

It should be remembered that learners are writing under examination conditions and credit should be given for what the learner writes, rather than adopting the approach of penalising him/her for any omissions. It should be possible for a very good learner to achieve full marks and a very poor one to achieve zero marks. Marks should not be deducted for a less than perfect answer if it satisfies the criteria of the mark scheme, nor should marks be added as a consolation where they are not merited.

Below are the assessment objectives for this specification. Learners must demonstrate their ability to:

AO1 Demonstrate knowledge of terms/concepts and theories/models to show an understanding of the behaviour of economic agents and how they are affected by and respond to economic issues

AO2 Apply knowledge and understanding to various economic contexts to show how economic agents are affected by and respond to economic issues

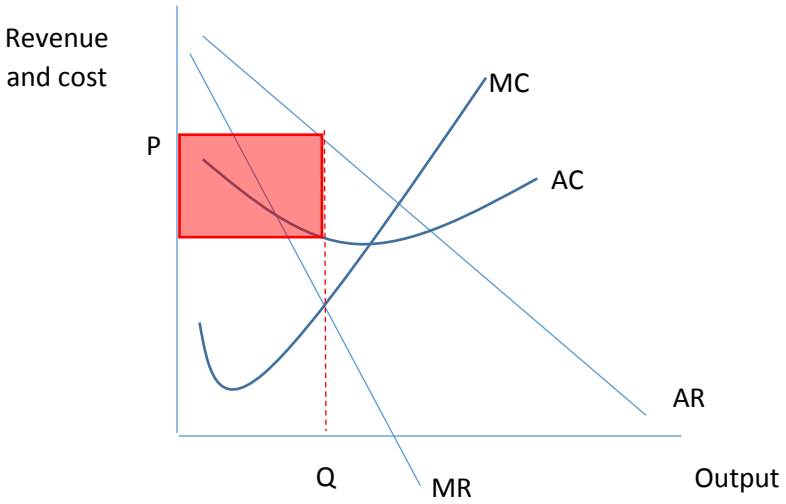
AO3 Analyse issues within economics, showing an understanding of their impact on economic agents

AO4 Evaluate economic arguments and use qualitative and quantitative evidence to support informed judgements relating to economic issues.

WJEC GCE A LEVEL ECONOMICS - UNIT 3 (NEW)

SUMMER 2017 MARK SCHEME

SECTION A

Question	Mark Scheme	Total
1 (a)	**Describe the difference between normal and abnormal profit.** **AO1: 2 marks** Normal profit is the minimum profit required to keep a firm operating in a particular industry (*or* the opportunity cost of the factors of production in use in a particular firm). 1 mark Normal profit is the profit earned when AR = AC and abnormal profit is the profit earned when AR > AC (**or** normal profit is earned when TR= TC and abnormal profit is earned when TR > TC). *N.b. do not accept that normal profit is the same as 'break even'* 1 mark Abnormal profit is any profit earned over and above the level of normal profit. 1 mark	**2**
1 (b)	**Adapt the diagram above to show the area representing the level of abnormal profit being made by the monopoly firm.** **AO2: 2 marks** 2 marks for correct area shaded. 1 mark if the profit maximising point (P and Q) at MR = MC is correctly indicated  	**2**
1 (c)	**Using the diagram, explain why this firm is not productively efficient.**	

Question	Mark Scheme	Total
1 (c)	**AO1: 1 mark** Understanding of productive efficiency (producing at lowest average cost; maximum output from minimum input etc.) **AO2: 2 marks** Correct identification of productively efficient point (lowest AC) on the [1] N.b. also accept that productive efficiency is achieved at the point where AC = MC. Recognition that the profit maximising level of output is less than the productively efficient point. [1] For AO2 marks there must be an explicit use of / reference to the diagram – the diagram could be annotated. **AO3: 1 mark** Further development e.g. stating that the firm therefore is technically not productively efficient at the profit maximising point because the AC of the monopoly firm is above the cost minimising point of production. The monopoly firm has an alternative objective i.e. profit maximisation and not productive efficiency. The monopoly firm does not need to be productively efficient in order to survive, especially because of the lack of competition.	**4**

<table>
<tr><th>Question</th><th>Mark Scheme</th><th>Total</th></tr>
<tr><td>2 (a)</td><td>Calculate the 2-firm concentration ratio for the selected UK coffee shop companies.

AO2: 2 marks

1 mark for both Total revenue of Costa and Starbucks = 1132
And Total coffee shop revenue = 1366
but then no correct answer.

2 marks for the concentration ratio = (1132 / 1366) * 100 = 82.86% (accept answers between 82.8% and 83%; own figure rule applies; for both marks, there must be a % sign).</td><td>2</td></tr>
<tr><td>2 (b)</td><td>Using an example, describe how coffee shop companies could compete using non-price competition.

AO2: 2 marks

1 mark for specific example of how coffee shops could compete using non-price competition e.g. variety of coffee available, counter service vs at-table service, availability of complements such as cake and biscuit, queue length, loyalty cards – and 1 mark for understanding of how that example is non-price competition i.e. these aren’t price factors.</td><td>2</td></tr>
<tr><td>2 (c)</td><td>The following payoff matrix illustrates possible profits (in £m) if Costa and Starbucks decide to compete in terms of price.

<table>
<tr><td colspan="2"></td><td colspan="2">Starbucks</td></tr>
<tr><td colspan="2"></td><td>High Price</td><td>Low Price</td></tr>
<tr><td rowspan="2">Costa</td><td>High Price</td><td>95 45</td><td>65 50</td></tr>
<tr><td>Low Price</td><td>120 30</td><td>75 40</td></tr>
</table>

Indicate the Nash equilibrium in this scenario, and justify your answer.

AO1: 1 mark

Understanding of the concept of a Nash equilibrium i.e. the optimal outcome from a game in which no player has an incentive to change from his/her chosen strategy, in response to the other player’s choice. Or understanding of the interdependence of firms in a duopoly/oligopoly. This could be implicit.

AO2: 2 marks

Correct identification of the Nash equilibrium (the Low Price: Low Price) option [1]
or
Correct identification of each firm’s dominant strategies [1]
Some use of data which could be via annotation of the payoff matrix or outline of how to interpret boxes within the matrix [1]

AO3: 1 mark

Explanation of why (Low Price: Low Price) is the Nash equilibrium – no incentive to deviate, likely that candidates will use the numbers from the table to illustrate what happens if either firm deviates from the Nash equilibrium.</td><td>4</td></tr>
</table>

Question	Mark Scheme	Total
3 (a)	**State and outline one possible factor that could cause the downwards shift in the short run aggregate supply curve from SRAS1 to SRAS2.** **AO1: 1 mark** Identification of one factor that could cause SRAS to shift downwards e.g. fall in commodity prices, reduction in factor prices e.g. wages, rents, energy prices, oil/raw materials, due to unemployment/underemployment of resources. **AO2: 1 mark** Application to the diagram i.e. the factor identified as a result of the decrease in AD. N.b. do not accept factors that shift LRAS.	**2**
3 (b)	**Explain possible reasons why a Keynesian economist might disagree that a new equilibrium at P3Y1 would be reached.** **AO1: 2 marks** 1 mark for each factor identified, up to a maximum of 2 marks (1 + 1). Factors are likely to cover reasons such as inflexible labour markets (existence of a NMW, sticky wages, long-term employment contracts, and trade union activity) or inflexible factor markets (inelastic demand for raw materials in the short-run) or inflexible product markets due to, for example, monopoly power or different understanding of the shape of the AS curve for Keynesians. **AO3: 2 marks** 1 mark for each factor developed, up to a maximum of 2 marks (1 + 1). **Or** 2 marks for one factor developed very well. For example, the existence of a NMW means that there is a floor below which wages cannot fall and so according to a Keynesian economist if AD falls from AD1 to AD2 causing unemployment/a negative output gap, then wages cannot fall despite the larger pool of available labour, and so SRAS will not shift downwards from SRAS 1 to SRAS2, or the view that a fall in AD taking the economy away from full employment will not be self-correcting according to Keynesians and will instead require an increase of AD to restore full employment.	**4**

Question	Mark Scheme	Total
4	**With reference to the data, discuss the likely reasons for the patterns shown.**	6

Band	AO2	AO3	AO4
	2	2	2
2	**2 marks** The use of data is fully integrated into the answer. 2 data references are made. An excellent understanding of the trends in the data is shown.	**2 marks** Good analysis of the reasons for the trends in the data.	**2 marks** Good evaluation of the reasons for the trends shown.
1	**1 mark** The candidate has minimal data reference and/or data is not fully integrated into the answer.	**1 mark** Limited analysis of one or more reasons for the trends shown, but brief and underdeveloped.	**1 mark** Some valid evaluation of the reasons for the trends shown.
0	**0 marks** No reference to data.	**0 marks** No valid analysis of the causes of the unemployment trends shown.	**0 marks** No valid evaluation of the causes of unemployment trends shown.

Indicative content

Data: unemployment was highest in all regions in 2010, South Wales has the highest rate of unemployment, and Mid Wales the lowest; there is no need for candidates to explicitly quote the statistics from the table in order to be awarded AO2 marks.

Analysis: possibly demand-deficit unemployment in 2010 in all areas due to recession; possibly more self-employed workers in Mid Wales resulting in lower unemployment figures; structural unemployment/long term unemployment in South Wales, the NMW may have different effects in different Welsh regions due to different elasticities of labour supply/demand and different local equilibrium wages.

Evaluation: need for more data i.e. size of labour force, economic inactivity etc; combination of factors explaining the trend so we can't easily isolate one cause; different causes may be more or less important in different Welsh regions; direct evaluation of analytical points e.g. the extent to which the NMW may affect South Wales more than other Welsh regions depends on the wage elasticities of labour demand and supply/the extent to which the NMW or NLW is above the equilibrium wage rate etc.

<table>
<tr><th>Question</th><th>Mark Scheme</th><th>Total</th></tr>
<tr><td>5 (a)</td><td>Calculate the index number for house prices in Wales in 2015. Show your workings.

AO2: 2 marks

Correct answer = 287.4 (accept a range of 287 to 288 owing to rounding) [award 2 marks for correct answer even if no working is shown].

Candidates may use a number of methods:

Method 1: work out the base year house price (1993 value) and then calculate the % change from 2015 to 1993. 1993 house price = £48415. Therefore the index figure for 2015 is 287.4

Method 2: (139 171 ÷ 139 911) x 288.9 = 287.4

For correct workings but no correct answer award 1 mark.</td><td>2</td></tr>
<tr><td>5 (b)</td><td>With reference to the data, discuss the consequences of house-price bubbles for the Welsh economy.

<table>
<tr><th>Band</th><th>AO2</th><th>AO4</th></tr>
<tr><td></td><td>2</td><td>2</td></tr>
<tr><td>2</td><td>2 marks

The use of data is fully integrated into the answer.

A wide range of understanding of the data is shown.</td><td>2 marks

Consequence(s) for the Welsh economy of house-price bubbles are clearly evaluated with a consideration of either pros/cons or a consideration of the impact of the bubble and then subsequent crash.</td></tr>
<tr><td>1</td><td>1 mark

The candidate has made reference to the data but the data is not fully integrated into the answer.

There is some understanding of what the data shows without specific reference to the data.</td><td>1 mark

Some valid judgement of the consequences of changing house prices.</td></tr>
<tr><td>0</td><td>0 marks

No reference to data.</td><td>0 marks

No valid evaluation.</td></tr>
</table>

Indicative content:

Data: identification of 2007 and 2008 as being the height of the bubble, followed by the crash in house prices in 2009; recognition that house prices still have not reached the level in 2015 that they had reached in 2008 – candidates must expressly connect the data to the concept of an asset-price bubble.

Evaluation could include:
- Increased uncertainty for some house owners
- Not as badly hit as other parts of the country with bigger bubbles
- Impact on consumer spending (wealth effect/negative wealth effect)
- Link to boom and recession / inflation / instability
- Impact on tax revenue from changing revenue from Stamp Duty</td><td>4</td></tr>
</table>

<table>
<tr><th>Question</th><th>Mark Scheme</th><th>Total</th></tr>
<tr><td>6</td><td>To what extent is the Eurozone an example of an Optimal Currency Area? Refer to the data provided in your answer.
<table>
<tr><th>Band</th><th>AO2</th><th>AO4</th></tr>
<tr><td></td><td>2</td><td>4</td></tr>
<tr><td>2</td><td>2 marks

The use of data is fully integrated into the answer.

A wide range of understanding of the data is shown, with at least 2 references to the data.</td><td>3-4 marks

Well-reasoned judgement of at least one side of the argument i.e. the eurozone either is or is not an OCA, with at least 1 well-developed evaluative point as to whether the EU is or is not an OCA.

For the top of this band, candidates will consider more than one country and/or more than one macro indicator.</td></tr>
<tr><td>1</td><td>1 mark

The candidate has made reference to the data but the data is not fully integrated into the answer.

There is some understanding of what is meant by an Optimal Currency Area.</td><td>1 -2 marks

A limited evaluation, with generic points e.g. countries are different.</td></tr>
<tr><td>0</td><td>0 marks

No valid reference to data.</td><td>0 marks

No valid evaluation.</td></tr>
</table></td><td>6</td></tr>
</table>

Indicative content:
An Optimal Currency Area is a geographical area over which it makes economic sense to use the same currency.

Data:
- some countries such as France are very close to the EU average figures for all macro indicators shown, whereas others such as Greece have very different data and therefore economic cycles are dissimilar;
- inflation rates are similar other than for Greece;
- large disparities in government debt figures.

Evaluation / discussion:
Judgements may include:
- The degree of price transparency;
- Extent to which there is labour/capital mobility in Europe;
- Loss of independent monetary policy implies that harmonisation is likely to occur;
- Much of the eurozone is harmonised, but there are odd exceptions e.g. Greece.

More data might be needed to reach an informed judgement, such as information on fiscal transfers / harmonisation, or use of Regional Funds.
Some candidates may specifically identify Mundell's key characteristics of an OCA – labour mobility, capital mobility with price/wage flexibility, automatic fiscal transfers, similar business cycles – and assess the data against these characteristics in order to reach a judgement.

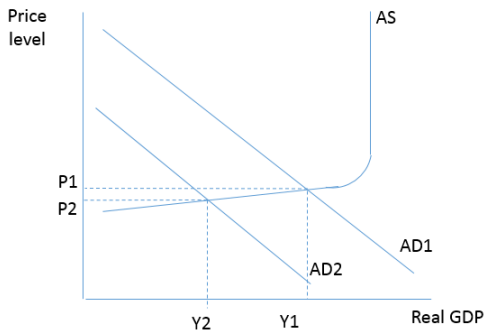
SECTION B

Data Response

7	**Outline, using an AD/AS diagram, how a stronger yen could have contributed to falling economic growth rates in Japan.** **[4]**	
Band	AO1	AO2
	2	2
2	**2 marks** A good, complete, fully-labelled and accurate AD/AS diagram.	**2 marks** Good application of exchange rate theory to the Japanese economy with consideration of the impact on both exports and imports.
1	**1 mark** Limited or partially correct diagram.	**1 mark** Limited application of exchange rate theory to the Japanese economy, with consideration of either the impact on exports or the impact on imports.
0	**0 marks** No valid attempt at an appropriate diagram.	**0 marks** No application of exchange rate theory.

Indicative content:

Anticipated diagram: a left shift/decrease in AD resulting in a fall in the general price level and a fall in real GDP



Anticipated use of data:

- A stronger yen (appreciation) makes Japanese exports more expensive in terms of other currencies therefore reducing the number of exports sold, **and** that imports become relatively cheaper for the Japanese so demand for them rises. Therefore, AD is likely to fall.

Alternatively, award correct diagrams and analysis that consider the impact on (short run) AS of falling import costs and therefore falling production costs.

8 (a)	**With reference to Figure 1 and lines 6 to 14, explain two likely reasons why there are differences in the GDP growth rates of low-income and high-income countries. [4]**	
Band	AO2	AO3
	2	2
2	**2 marks** Data from Figure 1 fully integrated in the answer with a clear understanding that growth rates in high-income countries are less than those in low-income countries, over the period shown. Two reasons identified.	**2 marks** Good analysis of two reasons why there are differences in GDP growth rates.
1	**1 mark** Some data from Figure 1 included in the answer. One reason identified.	**1 mark** Limited analysis of the reason identified.
0	**0 marks** No use of data.	**0 marks** No reasons given and no explanation.

Indicative content

Possible reasons for differences in growth rates include:
- LEDCs may have younger, more active populations whereas MEDCs may have ageing populations who are economically inactive
- LEDCs have larger negative output gaps than MEDCs so are more likely to be operating on the elastic section of the AS curve, therefore easier to expand the level of output
- Rapid urbanisation in LEDCs can lead to faster growth
- Productivity gains in LEDCs are high as education levels increase
- Diminishing returns or diseconomies of scale may not yet have kicked in in LEDCs
- There may be different marginal propensities to import (MPM) in LEDCs and MEDCs, and so a higher proportion of imports in MEDCs may slow growth rates
- LEDCs may attract more FDI / MNCs because of the low production costs and this can result in higher growth rates

N.b. candidates may construct their answer in such a way that focuses on why growth rates in high-income countries are lower than those in low-income countries, rather than why low-income country growth rates are higher – this is entirely acceptable.

8 (b)	**Assess how powerful the multiplier effect of the 2012 fiscal stimulus appears to be.** **[4]**		
Band	AO1	AO2	AO4
	1	1	2
2			**2 marks** Very good judgement on the strength of the multiplier. For 2 marks, candidates should reach a clear judgment about the strength of the multiplier.
1	**1 mark** Understanding of the multiplier effect (may be implicit).	**1 mark** Correct identification of the key data – initial injection of $116bn and final change in spending $212bn. **Or** Fully credit the correct calculation of the multiplier (n.b. multiplier formula not needed): 212/116 = 1.83 (2dp). **Or** Using the data to provide a quantitative assessment of the increase in the GDP as a result of the injection of $116bn i.e. roughly twice as much.	**1 mark** Some valid judgement of the strength of the multiplier.
0	**0 marks** No valid understanding of the multiplier effect.	**0 marks** No valid interpretation of the strength of the multiplier.	**0 marks** No valid evaluation.

Indicative evaluative content:

- Multiplier of nearly 2 not that powerful
- Savings are high i.e. high leakages
- High savings offset by minimal imports, but this may change due to the TPP
- Difficult to isolate the effect of rising government spending without knowing about the other injections or leakages
- Difficult to know whether the full multiplier effect has kicked in – the final change in income could be much larger than $212bn
- Spending on infrastructure implies large-scale projects, which may take considerable time for the full spending and multiplier effect to take place

8 (c)	**Explain how the fiscal expansion in Japan in 2012 led to an increase in the GDP growth rate in 2012 and 2013.** **[4]**	
Band	AO2	AO3
	2	2
2	**2 marks** Fully integrated data throughout the answer, referring to *both* the fiscal stimulus measures *and* the growth rate data.	**2 marks** Good analysis of how the fiscal measures taken in Japan could lead to an increase in GDP. Candidates may also use a well-labelled AD/AS diagram within their analysis.
1	**1 mark** Some reference to data on the nature of the fiscal stimulus and/or the GDP growth rate in 2012 and 2013.	**1 mark** Some analysis of how the Japanese fiscal measures may lead to growth.
0	**0 marks** No valid use of data.	**0 marks** No valid analysis.

Indicative content

Reference to data:

- Fiscal stimulus measures: $116bn of direct goverment spending, spending on capital infrastructure projects such as tunnels, provision of fuel subsidies / shopping vouchers, the $29.1bn “top up” injection
- GDP growth rate data for 2012 (1.7%) and 2013 (1.6%)
- The implied multiplier effect, as the initial injection of $116bn would result in a total change in GDP of $212bn.

Analysis issues:

- Rising direct government spending causes AD to increase i.e. shift right, because G is a component of AD, therefore leading to short run growth although not necessarily long-run growth
    - An AD/AS diagram to illustrate a right shift in AD due to increases in current spending, *and possibly* a right shift in AS because of the increase in capital spending. Diagrams may also illustrate the multiplier effect i.e. several right shifts in AD.
- Spending on capital projects causes LRAS/inelastic section of the AS curve to shift to the right, therefore leading to long run growth
- Reference to the multiplier effect, so that the initial injection in government spending would lead to a further increase in AD and a more than proportionate effect on real GDP; candidates may show a number of AD curves moving further to the right as the multiplier effect works
- Rising government spending causes rising employment which in turn causes incomes to rise, and in turn consumer spending and AD to rise

9	**Discuss the extent to which Japan's high government debt is a problem for the Japanese economy.** **[8]**		
Band	AO2	AO3	AO4
	2	2	4
2	**2 marks** Data is fully integrated throughout the answer, and the answer is focused on the Japanese economy. Candidates use a wide range of data in their answer.	**2 marks** Sound explanation of why high government debt can be a problem for an economy such as Japan.	**3-4 marks** Detailed evaluation of the reasons why government debt is a problem for Japan with both sides of the argument discussed throughout. A clear judgement is reached on whether high government debt is or is not a problem. The discriminator word here is "high" government debt – the best candidates should distinguish between "some" debt and "high" debt.
1	**1 mark** The candidate makes some reference to the data but does not integrate it within their answer.	**1 mark** Some attempt at explanation of why high government debt can be a problem for an economy such as Japan.	**1-2 marks** Brief or one-sided evaluation and/or evaluation points are underdeveloped. No clear judgement is reached.
0	**0 marks** No use of data.	**0 marks** No valid attempt at analysis.	**0 marks** No valid attempt at evaluation.

Indicative content

Possible data that candidates might include:
- Debt-to-GDP ratio in 2015 is 240% and set to rise to 258% by 2020
- Budget balance is currently a deficit of -7.68% of GDP
- Japan's government debt is the highest in the world when expressed as a % of GDP
- Japan's government debt would appear smaller, at around 80% of GDP, if there had been moderate inflation of 2% for the past couple of decades
- Reference to other macroeconomic indicators as means of assessing the performance of the Japanese economy, e.g. GDP, unemployment rate, productivity, trade balance and inflation data
- The Japanese government has had to raise VAT in order to "plug the gap"

Possible analytical points:
- High government debt must be paid for eventually, so it simply delays tax-hikes leading to intergenerational inequity
- High government debt can lead to a rapid increase in AD, leading to inflation, fuel asset-bubbles etc; candidates might outline the problems that inflation or bubbles cause
- There may be an incentive to monetise the debt through further QE, which could be highly inflationary (possible reference to Quantity Theory)
- High government debt can cause a fall in confidence for bond buyers, especially if ratings agencies downgrade the debt (which has happened in Japan); this causes an increase in the rate of interest that must be paid on debt worsening the debt and potentially leading to default (e.g. Argentina)
- The increases in sales tax to plug the gap, and the unwillingness of the government to reduce the high rates of corporation tax – because of the high debt – is reducing business profitability and therefore reducing their incentives to take on more workers, to invest, to expand
- Possible crowding out of private investment as government borrowing increases

Possible evaluative points:
- There is little evidence of inflationary pressure in Japan, suggesting that the government debt has not been overly monetised; in fact, there is more evidence of deflation. Candidates may refer to the possibility of raising the inflation target because of the deflationary concerns. It could be that the fiscal stimulus, which led to the debt rising, was so supply-side focused that in fact the size of the output gap rose.
- The budget deficit is not set to increase between 2015 and 2020, suggesting that the government is managing to exercise some constraint
- The debt simply appears large compared to other countries because of the lack of inflation since the early 1990s, and therefore isn't really a concern
- The Japanese government has had little option other than to spend large amounts of money to protect its economy against major supply-side shocks such as earthquakes; therefore its spending now could help to protect the economy in the future i.e. it has been using a sustainable approach to macroeconomic management, and taken a short-term hit to protect the long-term prospects of the economy
- The TPP free trade deal could be an alternative way to boost economic growth in Japan – once the economy is growing again then automatic stabilisers will work, causing the budget deficit and in turn, the government debt, to fall
- There is still room in Japan's fiscal strategy to raise taxes to reduce the debt - VAT is comparatively low.
- Cost of servicing debt is relatively low
- Japan is a nation of savers and so funding the deficit/debt is relatively straightforward

N.b. this is a reversible answer

10	**Discuss the view that the Bank of Japan should raise its inflation target from 2% to 4%. [8]**		
Band	AO2	AO3	AO4
	2	2	4
2	**2 marks** A sound application of what is meant by an inflation target of 2% and a target of 4%, and its purpose. A sound application of the nature of "core CPI" used by the BOJ. A sound application to the Japanese economy e.g. slow growth, ageing population etc.	**2 marks** A sound analysis of the reasons for raising the inflation target.	**3-4 marks** A clear judgement is reached on whether the inflation target should be increased. Economic theory and evidence is used to justify the conclusion. The argument is balanced, and evaluation points are well-developed.
1	**1 mark** Some understanding of what is meant by inflation target and its purpose, or the role of a central bank.	**1 mark** Some analysis of the reasons why the inflation target should be raised.	**1-2 marks** Brief or one-sided evaluation and/or evaluation points are underdeveloped. No clear judgement is reached.
0	**0 marks** No valid understanding of inflation targets or their role, or the role of a central bank.	**0 marks** No valid attempt at analysis of why the inflation target should be raised.	**0 marks** No valid attempt at evaluation.

Indicative content

Possible AO2 points:
- Reference to the use of the "core CPI" which ignores energy and food costs, since these drag down the inflation rate
- Reference to the monetary "arrow" of Abenomics, and the initial introduction of the 2% inflation target in 2012 in the first wave of Abenomics
- Reference to the role of central banks such as the Bank of Japan in controlling inflation, managing inflationary expectations, and controlling the money supply
- General reference to the nature of the Japanese economy based on evidence in the case study e.g. slow/stagnant growth, high savings rates etc.

Reasons for raising the inflation target:
- A higher inflation target can lead to higher inflationary expectations, so Japanese workers may demand higher wages, which in turn cause higher consumer spending and economic growth; higher wages might also in turn boost productivity as a result of motivation and higher morale (the data suggests that productivity in Japan is set to fall by 2020)
- A higher inflation target might require looser monetary policy e.g. more QE/bond purchases, and the monetary transmission mechanism would therefore lead to higher rates of inflation – this in turn would reduce the value of household and government debt automatically, and boost the confidence of investors
- It is essential to move the economy away from the risk of deflation; candidates may refer to some of the consequences of malign deflation (delayed spending leading to lower growth, rising value of debt)
- Higher inflation redistributes income from savers to borrowers, thus encouraging people to stop building up savings and start to borrow/spend, again leading to growth
- The usual SR Phillips curve relationship is not evident in Japan – the low rates of inflation are coupled with low unemployment rates. Any increase in the rate of inflation might, therefore, encourage some of the many economically inactive people in Japan (the elderly, housewives etc) to join the labour force if they anticipate higher wages. This would in turn reduce the burden on government finances.
- A higher target may lead to higher growth following fiscal and monetary stimulation, and this could in turn result in fiscal drag which could boost the government's tax revenue and help to tackle the large government debt

Reasons for not raising the inflation target
- It is hard to adjust inflationary expectations – people need to believe that the BOJ is credible (which they may not believe given the lack of success of QE so far), and need to adjust their wage demands upwards which they may not do in Japanese culture
- Inflation may overshoot – 4% is quite high anyway for a MEDC – if inflationary expectations over-adjust
- Increasing globalisation, and especially Japan's signing of the TPP agreement, may mean that inflation is affected more by factors external to Japan than internally, so a new inflation target may make no difference at all
- Alternatively, maybe the target needs to be higher than 4%, say 8%, to have any effect
- The demand-side boost may be offset by fiscal tightening e.g. the rising rate of VAT, the unwillingness of the government to reduce the rate of corporation tax
- Maybe the BOJ should target the exchange rate rather than the inflation rate, and attempt to intervene in the Forex market to bring down the value of the Yen.
- Raising the inflation target is not the same as raising the rate of inflation – changing the target does not necessarily have an effect
- Increased uncertainty due to higher inflation may cause falling confidence, which would have the opposite effect to that intended
- Higher inflation could result in less price-competitive Japanese exports, which could be detrimental to the economy given the TPP

N.b. this is a reversible answer

11	**With reference to the data, discuss the extent to which Japan's economy is likely to benefit from increased free-trade and reduced protectionism. [8]**		
Band	AO2	AO3	AO4
	2	2	4
2	**2 marks** Data is fully integrated throughout the answer, and the answer is focused on the Japanese economy. Candidates use a wide range of data in their answer.	**2 marks** Sound explanation of why increased free-trade and reduced protectionism is beneficial for Japan.	**3-4 marks** Detailed evaluation of the reasons why increased free-trade and reduced protectionism is beneficial for Japan. A clear judgement is reached on whether increased trade and reduced protectionism is or is not good for Japan. The discriminator words here are "increased" free-trade and "reduced" protectionism – the best candidates should respond appropriately to these words.
1	**1 mark** The candidate makes some reference to the data but does not integrate it within their answer.	**1 mark** Some attempt at explanation of why increased free trade and/or reduced protectionism is beneficial for Japan.	**1-2 marks** Brief or one-sided evaluation and/or evaluation points are underdeveloped. No clear judgement is reached.
0	**0 marks** No use of data.	**0 marks** No valid attempt at analysis.	**0 marks** No valid attempt at evaluation.

Indicative content:

Possible data references:
- Reference to the recent signing of the TPP with 11 other countries
- Reference to the continued protection of the rice and car industries in Japan
- Reference to Japan's trade balance data of 0.7% of GDP in 2015 rising to 0.92% by 2020

Arguments in favour of increased free trade and reduced protectionism:
- Theory of comparative advantage showing the theoretical gains from trade – potentially very useful for Japan with their falling productivity, since specialisation may boost productivity
- Other gains from trade for Japan – greater variety of products for consumers, potentially more able to sell exports to countries with which they have not traded much before; the US in particular is a huge market in which to sell Japanese cars
- Cheaper products e.g. food, for the Japanese
- Cheaper fuel for the Japanese – particularly useful given that the government currently has to provide subsidies to make fuel affordable
- Less "tit for tat" protectionism

Arguments against increased free trade and reduced protectionism:
- As Japan's population ages they may not be able to produce manufactured goods; services for the elderly, for example, cannot easily be exported, and so exports may decline
- Japan's strong currency may be a major factor in preventing the sale of exports, so maybe intervention by the BOJ in the currency market is needed
- Unemployment is very low in Japan so it may be difficult to meet any additional demand for exports
- Japanese businesses may struggle to adapt to overseas requirements – the case study implies that executive boards are very inwards-looking, although external business advisors are now mandated
- Japan's firms may be undercut by cheap manufacturing nations around the Pacific rim, and have little competitive advantage
- TPP may not be effective – non tariff barriers are hard to prove / counteract, transport costs around the Pacific Rim may be high etc.
- Japan's government may lose important tax revenue from tariffs, which has been essential given their large fiscal stimulus and rising debt

N.b. this is a reversible answer