

**Published Mark Schemes for
GCE AS Economics**

Summer 2010

Issued: October 2010

MARK SCHEMES (2010)

Foreword

Introduction

Mark Schemes are published to assist teachers and students in their preparation for examinations. Through the mark schemes teachers and students will be able to see what examiners are looking for in response to questions and exactly where the marks have been awarded. The publishing of the mark schemes may help to show that examiners are not concerned about finding out what a student does not know but rather with rewarding students for what they do know.

The Purpose of Mark Schemes

Examination papers are set and revised by teams of examiners and revisers appointed by the Council. The teams of examiners and revisers include experienced teachers who are familiar with the level and standards expected of 16- and 18-year-old students in schools and colleges. The job of the examiners is to set the questions and the mark schemes; and the job of the revisers is to review the questions and mark schemes commenting on a large range of issues about which they must be satisfied before the question papers and mark schemes are finalised.

The questions and the mark schemes are developed in association with each other so that the issues of differentiation and positive achievement can be addressed right from the start. Mark schemes therefore are regarded as a part of an integral process which begins with the setting of questions and ends with the marking of the examination.

The main purpose of the mark scheme is to provide a uniform basis for the marking process so that all the markers are following exactly the same instructions and making the same judgements in so far as this is possible. Before marking begins a standardising meeting is held where all the markers are briefed using the mark scheme and samples of the students' work in the form of scripts. Consideration is also given at this stage to any comments on the operational papers received from teachers and their organisations. During this meeting, and up to and including the end of the marking, there is provision for amendments to be made to the mark scheme. What is published represents this final form of the mark scheme.

It is important to recognise that in some cases there may well be other correct responses which are equally acceptable to those published: the mark scheme can only cover those responses which emerged in the examination. There may also be instances where certain judgements may have to be left to the experience of the examiner, for example, where there is no absolute correct response – all teachers will be familiar with making such judgements.

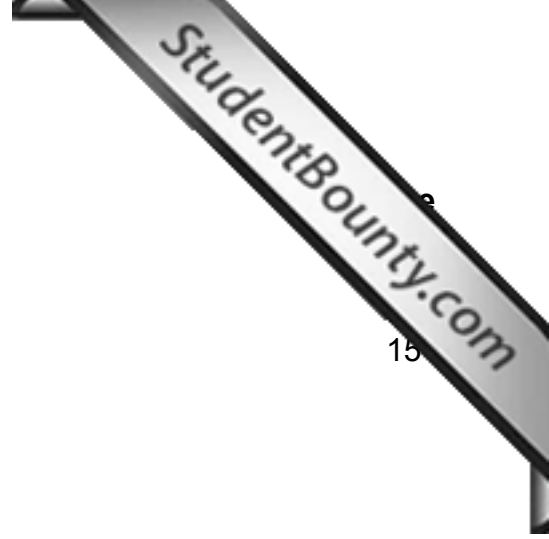
The Council hopes that the mark schemes will be viewed and used in a constructive way as a further support to the teaching and learning processes.

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**ADVANCED SUBSIDIARY (AS)
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Economics

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assessing

Markets and Prices

[AE111]

THURSDAY 3 JUNE, AFTERNOON

MARK SCHEME

- 1 (a) The share of income earned by the top quintile group has increased from 36% in 1977 to 44% in 1990 it then fell back to 41% in 95/96 and has stayed between 41% and 43% since.

The share of income earned by the bottom quintile group has fallen from 10% in 1977 to approximately 7% in 06/07. The biggest fall occurred between 1984 and 1990 when it fell from 10% to 6%. It has remained around 6%-7% since 1990.

Overall the gap between the top and bottom quintile group has widened since 1977. In 1977 the top quintile earned approximately 3.6 times that of the bottom quintile group whereas by 2007 the income of the top quintile group was about 6 times that of the bottom.

Level 1 ([1]-[2])

Candidate provides little comparison of the changes in the share of household disposable income of the top quintile group with that of the bottom quintile. Quality of written communication is limited.

Level 2 ([3]-[4])

Candidate provides some comparison of the changes in the share of household disposable income of the top quintile group with that of the bottom quintile. Quality of written communication is satisfactory.

Level 3 ([5]-[6])

Candidate provides a clear and comprehensive comparison of the changes in the share of household disposable income of the top quintile group with that of the bottom quintile. Quality of written communication is of a high standard. [6]

- (b) Possible reasons include:

- The earnings of the top quintile group have grown at a much higher rate than those in the bottom quintile group
- Fall in the real value of benefits has reduced the incomes of those who are unemployed
- Reduction in the higher rate of income tax which means that higher earners keep more of their income.

2 for each point explained up to a maximum of 4 [4]

- (c) Absolute poverty refers to a set standard which is the same in all countries and which does not change over time. An income-related example would be living on less than \$2 per day. Normally someone would be considered to be living in absolute poverty if they could not afford the basic necessities of life; food, clothing and shelter.

Relative poverty refers to a standard which is defined in terms of the society in which an individual lives and which therefore differs between countries and over time. An income-related example would be living on less than 50% of median income.

Absolute poverty and relative poverty are both valid concepts. The concept of absolute poverty is that there are minimum standards below which no one anywhere in the world should ever fall. The concept of relative poverty is that, in a rich country such as the UK, there are higher minimum standards below

which no one should fall, and that these standards should rise if, and as, the country becomes richer.

Level 1 ([1]-[2])

Candidate shows little understanding the difference between absolute and relative poverty. Quality of written communication is limited.

Level 2 ([3]-[4])

Candidate shows some understanding of the difference between absolute and relative poverty. Quality of written communication is satisfactory.

Level 3 ([5]-[6])

Candidate shows clear and comprehensive understanding the difference absolute and relative poverty. Quality of written communication is of a high standard. [6]

- (d) Some people consider measures of relative poverty to be ineffective in comparing poverty rates between countries since they tell us very little about actual material deprivation. As the text states someone in the bottom quintile group in the UK could have a higher real income than someone in the top quintile group in a country such as Rwanda. Measures of absolute poverty may give a much more accurate indicator of poverty rates.

2 for explanation that relative poverty tells us very little about material deprivation

2 for explanation that someone in the bottom quintile group in the UK could have a higher real income than someone in the top quintile group in a country such as Rwanda. [4]

- (e) Universal benefits are given to whole categories of a population, like children or old people without other tests, for example child allowance. Whereas means tested benefits are based mainly on a test of income, though some also include tests of assets or savings. Examples include the child tax credit and the pension credit.

The advantages of means tested benefits are:

- they concentrate resources on those most in need
- they are usually cheaper to provide than universal benefits
- they are progressive, and redistribute resources vertically from rich to poor.

The disadvantages are:

- they are complex and difficult to administer which can add significant admin costs
- they often fail to reach those in need. The reasons commonly given for low take up are ignorance, complexity, the effect of changing circumstances, fear, and the stigma attached to claiming.
- they can create a 'poverty trap', creating disincentives to work. People who have an increase in earnings suffer from the withdrawal of benefits as their earnings increase. However this may also apply to universal benefits.

Level 1 ([1]-[2])

Candidate shows little understanding the difference between means tested and universal benefits or of the case for and against means testing. Quality of written communication is limited.

Level 2 ([3]-[5])

Candidate shows some understanding of the difference between means tested and universal benefits and of the case for and against means testing. Quality of written communication is satisfactory.

Level 3 ([6]-[8])

Candidate shows clear and comprehensive understanding of the difference between means tested and universal benefits and of the case for and against means testing. Quality of written communication is of a high standard. [8]

- (f) Classical economists are opposed to the government taking action to redistribute household income. They argue that if the government take no action the money will filter down to the poor naturally, through the working of the market economy. They argue that government action to redistribute income actually reduces the incentive to work for both the rich and the poor and is therefore counterproductive. They point to the very high tax rates imposed by the UK government in the 1960's and 70's, which created huge disincentives to work and led to a large number of tax exiles in the UK.

However, most economists would argue that some form of redistribution is necessary.

They argue that if society is too unequal it will lead to great social problems. Figure 2 shows clearly that there is a strong correlation between relative poverty rates and social problems such as obesity and prison population (a rough indicator of crime levels).

They also argue that redistribution actually benefits the whole of society and the economy, since the poor will spend all of their additional income, which will benefit the economy and create further jobs.

Obviously some balance is needed between a tax and benefit system, which is both fair and protects the poorest in society, and one which does not punish those who have worked hard to earn a good income, and rewards those who are reluctant to seek employment.

Issues for analysis and discussion include:

- Causes of relative poverty
- Alternative policy responses
- Reasons for intervention
- Link between relative poverty and social problems
- Disincentive effects of government intervention
- Comparison of the efficiency of market redistribution compared to government redistribution
- Laffer curve effects
- International comparisons

Level 1 ([1]-[4])

Candidate shows little understanding of the arguments for and against government intervention to reduce relative poverty. There is no significant evaluation of the issues and quality of written communication is limited.

Level 2 ([5]-[8])

Candidate provides some understanding of the arguments for and against government intervention to reduce relative poverty. There is a degree of evaluation though this may lack depth or be one-sided and quality of written communication is satisfactory.

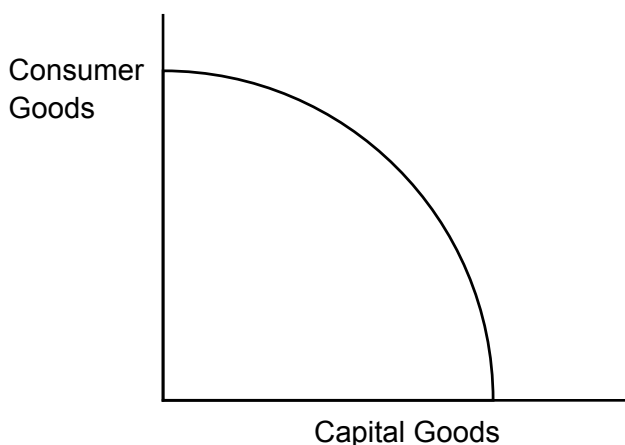
Level 3 ([9]-[12])

Candidate provides a clear and comprehensive understanding of the arguments for and against government intervention to reduce relative poverty. There is significant evaluation and judgement and quality of written communication is of a high standard. [12]

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- 2 (a) The production possibility frontier (PPF) shows the alternative maximum combinations of two items which can be produced from a fixed quantity of resources.

It reflects scarcity in that it is only possible to obtain more consumer goods by having fewer capital goods. However the nature of this trade off is not fixed. If it were then the production possibility curve (PPF) would be a straight line. Any point on the PPF represents an efficient allocation of resources whereas points inside the PPF represent an inefficient allocation of resources since it would be possible to produce more of one good without sacrificing any of the other.



Level 1 ([1]-[3])

Candidate shows little knowledge or understanding of production possibility curves. There is at best seriously flawed definition and little development through relevant examples, diagrams or technical language. Quality of written communication is limited.

Level 2 ([4]-[7])

Candidate shows some knowledge or understanding of production possibility curves. There is a credible definition though this may contain minor errors and some development through relevant examples, diagrams or technical language. Quality of written communication is satisfactory.

Level 3 ([8]-[10])

Candidate shows clear and comprehensive knowledge or understanding of production possibility curves. There is an accurate definition and extensive development through relevant examples, diagrams or technical language. Quality of written communication is of a high standard. [10]

- (b) Although economic resources are fixed in the short term, in the long run it becomes possible to obtain more resources or to make better use of those which we have. Therefore the PPF will shift to the right if a country can increase the quantity or quality of resources available to it. There are a number of ways in which this can be achieved.

Issues, analysis and areas for discussion include the following:

- Investment in human capital through education and training
- Investment in physical capital
- Immigration of labour
- Development of new technology
- Government investment in the economy's infrastructure
- Development of social capital
- Discovery of natural resources such as oil
- Appropriate diagrams
- Historical and international examples

Level 1 ([1]-[5])

Candidate provides little analysis of the factors which might cause an outward shift in an economy's production possibility curve. There are few if any relevant examples and diagrams will be non-existent or seriously flawed. Quality of written communication is limited.

Level 2 ([6]-[10])

Candidate provides some analysis of the factors which might cause an outward shift in an economy's production possibility curve. There are some relevant examples, perhaps supported by a relevant, if slightly flawed diagram. Quality of written communication is satisfactory.

Level 3 ([11]-[15])

Candidate provides clear and comprehensive analysis of the factors which might cause an outward shift in an economy's production possibility curve. There is significant development through examples and/or flawless diagrams. Quality of written communication is of a high standard. [15]

- (c) The concept of scarcity lies at the heart of economic theory and portrays the human condition as a constant struggle between limited resources and unlimited wants. The founding fathers of modern economics such as Smith and Ricardo wrote mainly in the 18th and 19th centuries when absolute poverty and deprivation were the norm for most of the population of the British Isles. Life expectancy was much shorter, malnutrition common and general living standards bore no resemblance to those which we currently enjoy. The same is true of less developed countries today. In 2003 people living in "poor" countries had an average annual income of £285. So in one way the statement is correct. The extremes of scarcity and poverty which once existed are no longer a problem in developed economies.

However this does not mean that scarcity has totally disappeared in the developed world. It may take a different form but it still exists. If it did not we would live in a world of super abundance where we could enjoy as much of everything as we wanted.

Sadly this is not the case. There is scarcity of health care. We want better cars, bigger houses, more holidays and more advanced consumer durables.

There is also a degree of emotional scarcity and a shortage of "happiness".

In short our aspirations still outstrip the economy's capacity to produce.

So scarcity is alive and well and likely to remain so.

Areas for analysis and evaluation include:

- Explanation of scarcity
- Difference between needs and wants
- Difference between poverty and scarcity
- Contextual nature of scarcity and poverty
- Historical examples
- International examples
- Timeless and universal nature of scarcity
- Unfulfilled emotional needs in developed economies
- Time as a scarce resource

Level 1 ([1]-[5])

Candidate displays little understanding of the nature of scarcity.

There is little attempt at comparing the scarcity of less developed countries with that of the developed world. Quality of written communication is limited.

Level 2 ([6]-[10])

Candidate displays some understanding of the nature of scarcity. There is a serious attempt at comparing the scarcity of less developed countries with that of the developed world. Quality of written communication is satisfactory.

Level 3 ([11]-[15])

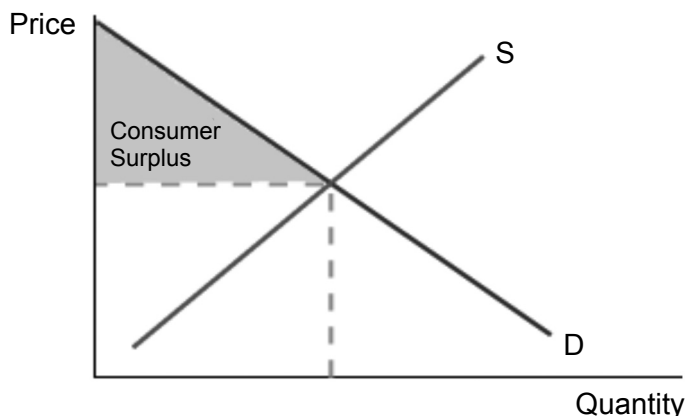
Candidate displays a clear and comprehensive understanding of the nature of scarcity. Extensive comparisons are made between the scarcity of less developed countries and that of the developed world. Quality of written communication is of a high standard.

[15]

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- 3 (a) Consumer surplus is defined as the difference between what a consumer is willing to pay for a good and the price they actually pay. If a consumer is willing to pay £30 for a good but the market price of the good is £20 then the consumer earns a welfare bonus of £10. This welfare bonus is known as consumer surplus.

Consumer surplus can be shown on a diagram. It is equal to the area under the demand curve above the price line.



In general when prices rise consumer surplus falls therefore consumers face a reduction in welfare. When price falls consumer surplus generally increases therefore consumers receive an increase in welfare. However this will ultimately depend on what has caused the change in price.

Level 1 ([1]-[3])

Candidate shows little knowledge or understanding of consumer surplus. There is at best a seriously flawed definition and little development through relevant examples, diagrams or technical language. Quality of written communication is limited.

Level 2 ([4]-[7])

Candidate shows some knowledge or understanding of consumer surplus. There is a credible definition though this may contain minor errors and some development through relevant examples, diagrams or technical language. Quality of written communication is satisfactory.

Level 3 ([8]-[10])

Candidate shows clear and comprehensive knowledge or understanding of consumer surplus. There is an accurate definition and extensive development through relevant examples, diagrams or technical language. Quality of written communication is of a high standard. [10]

- (b) Producer surplus is defined as the difference between what a producer is willing to supply a good for and the price they actually receive.

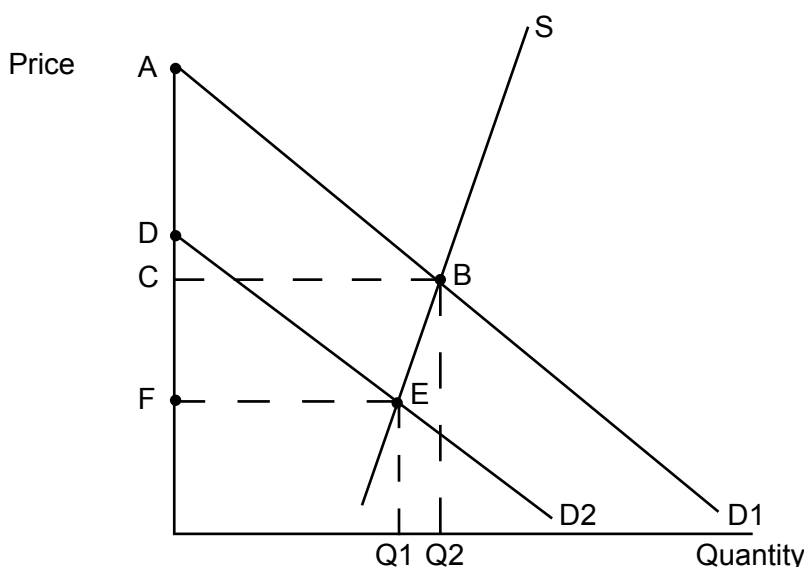
If a producer is willing to supply a good onto the market for £10 but the market price is £20 then this producer will earn a welfare bonus of £10. This welfare bonus is known as producer surplus.

Producer surplus can be shown on a diagram. It is equal to the area above the supply curve below the price line.

The recent fall in house prices has been caused by dramatic reduction in demand for housing. This reduction in demand has in turn been caused by the economic recession and the credit crunch which makes it difficult for potential house purchasers to get the mortgage required to purchase a house.

If we assume that the price elasticity of demand and supply are unchanged then it is clear that the reduction in house prices will lead to only a small reduction in consumer surplus since both the market price and the price that consumers are willing to pay have fallen.

Producer surplus on the other hand will have fallen significantly (by area CBEF) as shown in the diagram below.



Issues for analysis and discussion include:

- Impact on consumer and producer surplus
- Impact on first time buyers
- Impact on estate agents, house builders and those selling houses
- Relevant diagrams

Level 1 ([1]-[5])

Candidate provides little analysis of the impact of falling house prices on economic welfare. There are few if any relevant examples and diagrams will be non-existent or seriously flawed. Quality of written communication is limited.

Level 2 ([6]-[10])

Candidate provides some analysis of the impact of falling house prices on economic welfare. There are some relevant examples, perhaps supported by a relevant, if slightly flawed diagram. Quality of written communication is satisfactory.

Level 3 ([11]-[15])

Candidate provides clear and comprehensive analysis of the impact of falling house prices on economic welfare. There is significant development through examples and or flawless diagrams. Quality of written communication is of a high standard.

[15]

- (c) The UK government intervenes in the housing market in a number of different ways. For example planning permission is required to build a house, green belt restrictions place limits on where houses can be built and what type/style of house can be built. At the same the government provide social housing, and assistance to help individuals purchase a house through the shared equity scheme. Stamp duty is levied on house purchases and sellers are now required to provide an information pack to all potential buyers.

For some economists this intervention (particularly with regard to planning restrictions) has made the UK housing market much more volatile, since it reduces the price elasticity of supply.

They argue that if the market was free from government intervention it would lead to a much more efficient allocation of resources.

Others however would argue that housing is too important to be left to market forces and the government need to intervene to ensure that the various market failures are dealt with.

Issues for analysis and evaluation include:

- Market failure in the housing market and the need for government intervention
- Good quality housing as a merit good
- External costs associated with unregulated house building
- Various form of government intervention
- Government failure- inefficiency/ problems associated with government intervention
- Efficiency of market mechanism
- Price elasticity of housing supply
- Homelessness and poor quality housing

Level 1 ([1]-[5])

Candidate displays little understanding of the view that housing is too important to be left solely to market forces. There is no significant evaluation of the issues and quality of written communication is limited.

Level 2 ([6]-[10])

Candidate provides some understanding of the view that housing is too important to be left solely to market forces. There is a degree of evaluation though this may be one-sided or lack depth and quality of written communication is satisfactory.

Level 3 ([11]-[15])

Candidate provides a clear and comprehensive understanding of the view that housing is too important to be left solely to market forces. There is significant evaluation and judgement and quality of written communication is of a high standard.

[15]

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- 4 (a) An externality occurs when the activity of one economic agent has an impact on a third party.

A positive externality occurs when the activity has a positive impact on the well being of a third party. Whereas a negative externality occurs when the activity of one economic agent has a negative impact on a third party.

Externalities can result from both the production of goods and services and from their consumption.

Appropriate development

- Discussion of examples
- Description of nature of external costs and benefits and how they are received.
- Reference to merit and demerit goods
- Relevant diagrams

Level 1 ([1]-[3])

Candidate shows little knowledge or understanding of the term externality. There is at best seriously flawed definition and little development through relevant examples, diagrams or technical language. Quality of written communication is limited.

Level 2 ([4]-[7])

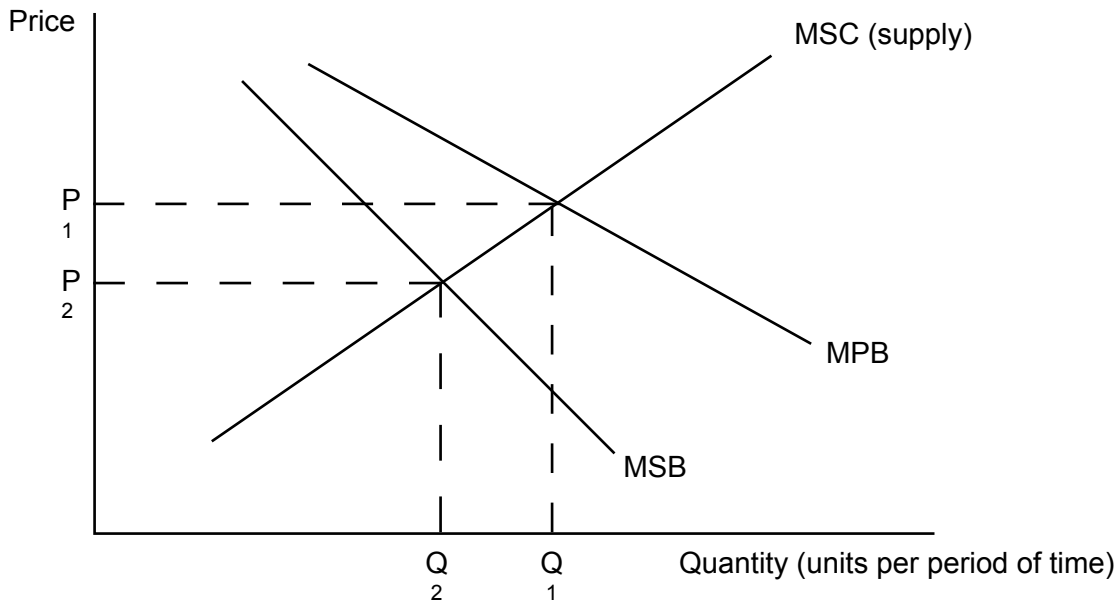
Candidate shows some knowledge or understanding of the term externality. There is a credible definition though this may contain minor errors and some development through relevant examples, diagrams or technical language. Quality of written communication is satisfactory.

Level 3 ([8]-[10])

Candidate shows clear and comprehensive knowledge or understanding of the term externality. There is an accurate definition and extensive development through relevant examples, diagrams or technical language. Quality of written communication is of a high standard. [10]

- (b) Demerit goods are good which in a paternalistic sense the government believe we should not consume.

Demerit goods are often over consumed because the benefit received by the consumer exceeds the social benefit. For example in the case of drugs the demand curve based solely on the marginal private benefit (MPB) is higher than that which encompasses the disutility suffered by others as a consequence of drug use (MSB). Hence drugs are overvalued and over-consumed in a free market.



The free market price is P_1 and consumption is Q_1 . When allowance is made for the disutility suffered by others then the socially optimum level of consumption is Q_2 . Alternatively demerits goods may be over consumed due to a lack of information on the part of the person consuming the good. Some people may not be fully aware of the dangers involved in consuming a good or may simply discount the dangers since they are likely to occur some time in the future.

Note: Alternative analyses such as that presented by tutor2u are equally valid.

Level 1 ([1]-[5])

Candidate shows little understanding of why free markets often lead to the over consumption of demerit goods. No attempt is made to represent this in a diagram or if an attempt is made it will contain significant errors. Quality of written communication is limited.

Level 2 ([6]-[10])

Candidate shows some understanding of why free markets often lead to the over consumption of demerit goods. A diagram may support the analysis but could contain minor errors. Quality of written communication is satisfactory.

Level 3 ([11]-[15])

Candidate shows clear and comprehensive understanding of why free markets often lead to the over consumption of demerit goods. This analysis may be supported by a clear and accurate diagram. Quality of written communication is of a high standard. [15]

(c) Those who support the increases in alcohol duty argue that it will reduce consumption and therefore reduce the numerous external costs associated with excessive alcohol consumption. In addition the extra tax revenue could be ring-fenced to deal with alcohol related issues. However those opposed to the increases may argue that increases in duty are likely to be ineffective since it could be argued that the PED for alcohol is less than one. They may also point out that UK duty on alcohol is already quite high when compared to the EU average and that other methods may be more effective in reducing alcohol abuse.

Issues, analysis and areas for discussion include:

- Other forms of intervention e.g. restriction on use, sensible drinking campaigns etc
- PED of alcohol – some studies indicate that it may actually have a value of 1 and for heavy drinker demand may be more elastic since it is likely to comprise a greater proportion of their income
- Comparison of UK and EU duty rates
- The fact that the vast majority of UK citizens drink sensibly
- Impact on cheaper imported alcohol
- Recent fall in the real cost of alcohol as incomes have increased
- Impact of higher tax rates on tax revenue – Laffer curve.

Level 1 ([1]-[5])

Candidate displays little understanding of the case for and against the view that increases in alcohol duty are the most effective method of dealing with binge drinking. There is no significant evaluation of the issues and quality of written communication is limited.

Level 2 ([6]-[10])

Candidate provides some understanding of the case for and against the view that increases in alcohol duty are the most effective method of dealing with binge drinking. There is a degree of evaluation though this may be one-sided or lack depth and quality of written communication is satisfactory.

Level 3 ([11]-[15])

Candidate provides a clear and comprehensive understanding of the case for and against the view that increases in alcohol duty are the most effective method of dealing with binge drinking. There is significant evaluation and judgement and quality of written communication is of a high standard. [15]

Total

40

80

New
Specification



Rewarding Learning

**ADVANCED SUBSIDIARY (AS)
General Certificate of Education
2010**

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Economics

Assessment Unit AS 2

assessing

The National Economy

[AE121]

MONDAY 7 JUNE, AFTERNOON

MARK SCHEME

- 1 (a) Economic theory defines the unemployed as those who are without a job but who are actively seeking work at the current wage rate.

Until 1997 the main measure of UK unemployment was the claimant count which was simply the total of all those who were claiming what was then called unemployment benefit. The claimant count was abandoned as the main measure of unemployment for two reasons:

- It was subject to political manipulation as many of the unemployed were transferred to other benefits.
- It was not internationally recognised so it was difficult to compare UK unemployment levels with those in other countries.

The main differences between the Claimant Count and the Labour Force survey measures are:

- Many workers, mostly female, are unemployed and actively seeking work but cannot claim benefit for various reasons, the most common one being that their partner earns so much that they do not qualify for means-tested benefits.
- Older workers may have a pension from previous employment and for this reason are also excluded from benefits even though they may have no job and are actively seeking employment.
- There is a time lag between becoming unemployed and being eligible for benefit. During this period these unemployed would not appear on the Claimant Count but would be counted in the Labour Force Survey.
- Part-time workers are likely to be employed under LFS but unemployed in Claimant Count.

For these reasons the LFS usually gives a higher figure than the Claimant Count.

Level 1 ([1]-[2])

Candidate provides little explanation of the main differences between the two measures of unemployment and quality of written communication is limited.

Level 2 ([3]-[4])

Candidate provides some explanation of the main differences between the two measures of unemployment. However this will be incomplete or contain minor errors and quality of written communication is satisfactory.

Level 3 ([5]-[6])

Candidate provides a clear and comprehensive explanation of the main differences between the two measures of unemployment and quality of written communication is of a high standard.

[6]

(b) There are number of reasons why the UK may be in recession for longer than other countries:

- Other countries may have more flexible factor and product markets. High levels of regulation tend to prevent markets from adjusting to changed circumstances.
- The UK may have greater exposure to housing and financial services, the two sectors most affected by the recession.
- The UK has higher levels of personal debt. Hence it will be more difficult to persuade consumers to start spending again.
- The UK has higher levels of government debt, making it more difficult for the government to pursue an expansionary fiscal policy.
- The UK is a relatively open economy and export demand is limited by the recession in other counties.

Level 1 ([1]-[2])

Candidate provides little explanation of why the recession is predicted to be longer and deeper in the UK than in other major developed countries. There may be vague references to relevant factors but these are not developed and quality of written communication is limited.

Level 2 ([3]-[5])

Candidate provides some explanation of why the recession is predicted to be longer and deeper in the UK than in other major developed countries. However this will be incomplete or contain minor errors and quality of written communication is satisfactory.

Level 3 ([6]-[8])

Candidate provides a clear and comprehensive explanation of why the recession is predicted to be longer and deeper in the UK than in other major developed countries. Quality of written communication is of a high standard. [8]

(c) The fall in the value of the pound will affect the UK economy in a variety of ways and although there is some disagreement amongst economists as to the net impact, there appears to be an emerging consensus that it will provide a boost to aggregate demand. This will primarily be through the effect on the net exports component of aggregate demand.

Issues for discussion include:

- Impact on importers.
- Impact on exporters
- Impact on tourism.
- Impact on inflation.
- Importance of "openness" of UK economy.
- Possibility of export led growth and job creation.

Level 1 ([1]-[2])

Candidate provides little analysis of the effect of the fall in the value of the pound upon aggregate demand and employment in the UK. There may be references to some relevant issues but these are not explained or developed and quality of written communication is limited.

Level 2 ([3]-[5])

Candidate provides some analysis of the effect of the fall in the value of the pound upon aggregate demand and employment in the UK. Key issues will be explained though not always in great depth or there may be minor errors. Quality of written communication is satisfactory.

Level 3 ([6]-[8])

Candidate provides a clear and comprehensive analysis of the effect of the fall in the value of the pound upon aggregate demand and employment in the UK. Key issues are explained accurately and in depth. Quality of written communication is of a high standard. [8]

- (d) High levels of unemployment may cause social unrest in a variety of ways. There is likely to be an increase in crime as poverty creates a mood of desperation leading some people to contemplate criminal acts which they would not previously have considered. There is also likely to be a greater level of drug and alcohol dependency with a corresponding increase in the external costs associated with these demerit goods.

Finally, extremist political movements often thrive in periods of high unemployment and this may lead to violent demonstrations and clashes with authority.

Level 1 ([1]-[2])

Candidate provides little explanation of how high levels of unemployment might create social disorder. There may be vague references to issues like crime but no significant development. Quality of written communication is limited.

Level 2 ([3]-[5])

Candidate provides some explanation of how high levels of unemployment might create social disorder. However this will tend to be brief and miss key issues. Quality of written communication is satisfactory.

Level 3 ([6]-[8])

Candidate provides a clear and comprehensive explanation of how high levels of unemployment might create social disorder. Quality of written communication is of a high standard. [8]

- (e) Two years ago views such as this would have been treated with derision. Now they are being seriously considered by policy makers throughout the world. If the various fiscal and monetary stimulus packages being implemented by most major countries do not succeed then many may start to examine proposals such as these. Desperate times require desperate measures and if, as has happened in Japan, tools, like monetary policy, fail to stimulate the economy then direct state intervention may be the last policy option available.

Issues for analysis and discussion include:

- Disincentive impact of high taxes on the rich and on large firms.
- Crowding out.
- The Laffer curve.
- Political and libertarian issues surrounding this massive increase in the role of the state.
- Assessment of impact of expansionary fiscal and monetary policies.
- Possibility of insufficient revenues to finance these programmes.
- Problems of gilt issuance.

Level 1 ([1]-[3])

Candidate provides little critical evaluation of the trade unionist's proposals. Key issues are missed and quality of written communication is limited.

Level 2 ([4]-[7])

Candidate provides some critical evaluation of the trade unionist's proposals. Some key issues are explored though this may lack depth or be one-sided. Quality of written communication is satisfactory.

Level 3 ([8]-[10])

Candidate provides a clear and comprehensive critical evaluation and judgement of the trade unionist's proposals. Quality of written communication is of a high standard. [10]

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Essays

- 2 (a) Nominal GDP is GDP valued at the prices of the year in which it is measured ie not adjusted for inflation.

Real GDP is GDP which has been adjusted for inflation usually by valuing output at the prices of some previous year.

Appropriate Development.

- Explanation of GDP.
- Explanation of impact of inflation on GDP.
- Explanation of adjusting for inflation
- Numerical example

Level 1 ([1]-[3])

Candidate shows little knowledge or understanding of real and nominal GDP. There may be a reference to inflation but its significance is not explained. Quality of written communication is limited.

Level 2 ([4]-[7])

Candidate shows some knowledge and understanding of real and nominal GDP. There is some explanation of the significance of inflation though may be incomplete or contain minor errors. Quality of written communication is satisfactory.

Level 3 ([8]-[10])

Candidate shows a clear and comprehensive knowledge and understanding of real and nominal GDP. The significance of inflation is fully and accurately explained and quality of written communication is of a high standard. [10]

- (b) GDP data can be used for a variety of purposes:

- (i) Measuring economic growth

Economic growth exists when an economy experiences a year on year increase in output. In order to calculate the rate of economic growth it is necessary to remove the impact of inflation from nominal GDP in order to obtain real GDP.

Having calculated real GDP it is necessary to calculate the annual percentage change on the previous year and this gives us the rate of economic growth.

- (ii) Formulating economic policies

Government can assess, using the GDP and growth figures, if the economy is experiencing a recessionary or an inflationary gap and hence decide on the appropriate economic policies.

- (iii) To measure and compare living standards.

Real per capita GDP is often used as a guide to a nation's standard of living.

(iv) To decide upon contributions to international bodies such as the UN and NATO.

(v) To construct economic models and theories.

Level 1 ([1]-[5])

Candidate shows little or no understanding of the reasons why such data is collected. Quality of written communication is limited and there is little use of technical terms.

Level 2 ([6]-[10])

Candidate shows some understanding of the reasons why such data is collected. Quality of written communication is satisfactory and there is some use of technical terms.

Level 3 ([11]-[15])

Candidate shows a clear understanding of the reasons why such data is collected. Quality of written communication is of a high standard and there is extensive use of technical terms. [15]

(c) Standard of living refers to the material welfare of a nation's inhabitants. One measure of this is real GDP per capita which is the value of a nation's output after adjustment for inflation and the size of the population. It includes all output even those items such as defence which do not contribute directly to living standards. It excludes imports which do contribute directly to our living standards.

For this and many other reasons it is a flawed measure of welfare but so also are the alternatives such as the Human Development Index and it does have the advantage of ease of calculation and objectivity.

Areas of analysis and evaluation include:

- Definition of real GDP per head.
- Definition of standard of living.
- Weaknesses of real GDP per head as guide to standard of living e.g. pollution, working conditions, inequality etc.
- Other relevant issues eg political freedom, literacy etc.
- Other indicators of the standard of living eg Human Development Index
- Problems with these other indicators eg measuring the extent of political freedom etc.

Level 1 ([1]-[5])

Candidate shows little exploration of the issues relating to the use of real GDP per capita as a measure of welfare. There is little serious evaluation and quality of written communication is limited.

Level 2 ([6]-[10])

Candidate shows some exploration of the issues relating to the use of real GDP per capita as a measure of welfare. There is a degree of evaluation though this may lack depth or be one-sided and quality of written communication is satisfactory.

Level 3 ([11]-[15])

Candidate shows clear and comprehensive exploration of the issues relating to the use of real GDP per capita as a measure of welfare. There is in-depth evaluation and judgement including a comparison with other measures of welfare. Quality of written communication is of a high standard. [15]

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- 3 (a) Aggregate demand curve shows the relationship between the price level (usually measured by the consumer price index) and real expenditure in the economy.

Appropriate Development:

- Explanation of the components of aggregate demand, (C+I+G+X-M)
- Explanation of the inverse relationship.
- Diagram.

Level 1 ([1]-[3])

Candidate provides little explanation of what is shown by an aggregate demand curve. There may be vague references to some of its components but these are not explained and quality of written communication is limited.

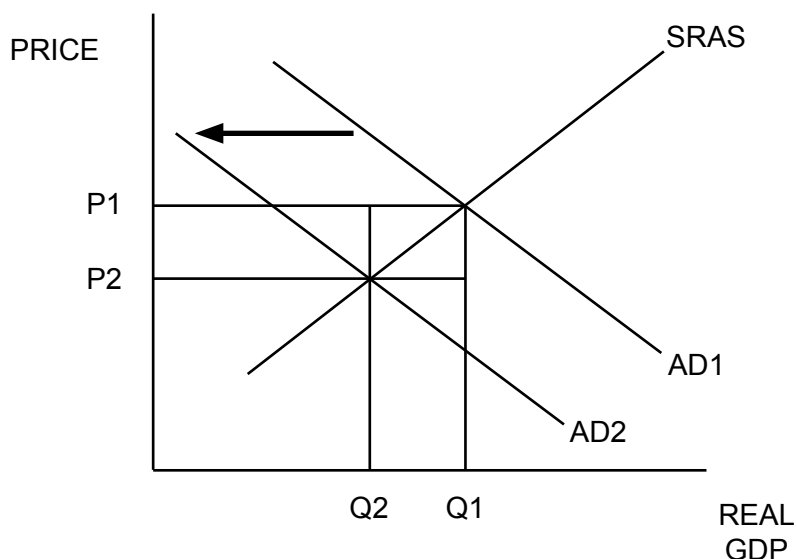
Level 2 ([4]-[7])

Candidate provides some explanation of what is shown by an aggregate demand curve. However this will be incomplete or contain minor errors and quality of written communication is satisfactory.

Level 3 ([8]-[10])

Candidate provides a clear and comprehensive explanation of what is shown by an aggregate demand curve. Quality of written communication is of a high standard. [10]

- (b) Consumer confidence is a measure of how optimistic or pessimistic consumers feel about the economy in general and also their own personal financial circumstances. Negative readings indicate that consumers lack confidence and are therefore unlikely to make major purchases. Hence the consumer spending component of aggregate demand is reduced and the aggregate demand curve shifts leftwards.



The fall in consumer confidence shifts the aggregate demand curve from AD1 to AD2. The economy now enters a period of recession with prices falling from P1 to P2 and real GDP falling from Q1 to Q2. There is likely to be significant involuntary unemployment.

Neo-classical economists assert that the economy will emerge from this recession in the long run because the rise in unemployment will reduce wages and shift the SRAS to the right until full employment is restored.

Issues for analysis and discussion include:

- Explanation of consumer confidence.
- Explanation of impact on aggregate demand curve.
- Explanation of impact on price level and real GDP.
- Explanation of possible government response.
- Possibility of long run return to full employment through wage and price flexibility.

Level 1 ([1]-[5])

Candidate provides little aggregate demand and supply analysis to explain the likely impact on the economy of a fall in consumer confidence. There may be vague references to relevant issues but these are not explained or developed. Quality of written communication is limited.

Level 2 ([6]-[10])

Candidate provides some aggregate demand and supply analysis to explain the likely impact on the economy of a fall in consumer confidence. However, this will be incomplete or contain minor errors. Quality of written communication is satisfactory.

Level 3 ([11]-[15])

Candidate provides clear and comprehensive aggregate demand and supply analysis to explain the likely impact on the economy of a fall in consumer confidence. Quality of written communication is of a high standard. [15]

- (c) Controlling aggregate demand in order to achieve macroeconomic objectives such as full employment is a policy usually associated with the economic ideas of John Maynard Keynes and was extensively used by UK governments for three decades after the Second World War.

However it was abandoned in the late 1970s when it was held to be responsible for the massive levels of government spending and borrowing which led the UK government to a state of virtual bankruptcy. It was replaced by a reliance on improving the overall productivity of the economy through supply side policies and by keeping tight control on government borrowing.

However the credit crunch and the ensuing recession has caused governments throughout the world to use both monetary and fiscal stimuli, bringing Keynesian ideas back into the policy agenda. There is considerable debate as to what the long term impact of this will be. Neo-Classical critics argue that it will create inflation and leave the economy with a debt burden for future generations.

Issues, analysis and areas for discussion include the following:

- Explanation of monetary and fiscal stimuli.
- Explanation of crowding out.
- Explanation of the Laffer curve.
- Explanation of the natural rate of unemployment.
- The inflexibility of many areas of government spending.
- The disincentive effects of high rates of direct taxation.
- Explanation of the credit crunch.
- The “open” nature of the UK economy and the limited knock on impacts of fiscal stimuli.
- Impact of monetary expansion on asset prices.
- Explanation of need for global response to credit crunch.

Level 1 ([1]-[5])

Candidate provides little critical examination of the view that attempts by governments to control aggregate demand cause long term damage to the economy. There may be vague references to key issues but these are not explained. Quality of written communication is limited.

Level 2 ([6]-[10])

Candidate provides some critical examination of the view that attempts by governments to control aggregate demand cause long term damage to the economy. However this may lack depth or be one-sided. Quality of written communication is satisfactory.

Level 3 ([11]-[15])

Candidate provides a clear and comprehensive critical examination and judgement of the view that attempts by governments to control aggregate demand cause long term damage to the economy. Quality of written communication is of a high standard.

[15]

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- 4 (a) The inflation rate is the change in the average price level of an economy over a period of time, usually one year. An economy's average price level is measured in the form of an index such as the consumer price index (CPI) in the UK. So if the CPI were 95 in year one and rose to 106 in year 2 then the rate of inflation is 11.6%.

Candidates should explain how a price index is constructed including the use of weightings and then show how the index is used to calculate the rate of inflation.

Level 1 ([1]-[3])

Candidate shows little understanding of how the UK's rate of inflation is measured. Quality of written communication is limited.

Level 2 ([4]-[7])

Candidate shows some understanding of how the UK's rate of inflation is measured. However this will be incomplete or contain minor errors. Quality of written communication is satisfactory.

Level 3 ([8]-[10])

Candidate shows a clear and comprehensive understanding of how the UK's rate of inflation is measured. Quality of written communication is of a high standard. [10]

- (b) Inflation may have a number of adverse impacts on the economy:

- (i) Once established inflation may create expectations of further inflation and hence lead to hyper inflation where prices rise at a phenomenal rate. When this happens people may lose confidence in money as it loses its value very quickly and resort to the use of other commodities such as cigarettes as a medium of exchange. This happened in 1923 in the Weimar republic in Germany and by the end of that year prices were a million times higher than their pre first world war level.

Inflation of this type creates great social and political instability.

- (ii) Inflation may lead to an arbitrary redistribution of real income. Not all prices will rise at the same rate and different income groups are affected in different ways with some gainers and some losers.

Those on fixed incomes such as holders of fixed interest bonds will experience a fall in real income whilst those whose incomes are derived from profits will probably gain. Workers whose wages are index linked will see their real incomes remain unchanged.

- (iii) When inflation is unanticipated the rate of inflation is greater than the rate of interest. This penalises savers and rewards borrowers and may cause further instability in the economy.

- (iv) Rising domestic prices makes imports more attractive and makes exports less so, leading to a balance of payments deficit. It may also lead to a massive depreciation of the currency and ultimately to a refusal by foreign sellers to accept it as a means of payment

- (v) More and more taxpayers may be dragged into higher tax brackets, hence creating a transfer of income from taxpayers to government.
- (vi) Menu costs of changing prices, and shoe-leather costs of seeking best value

Level 1 ([1]-[5])

Candidate shows little understanding of the impact of inflation upon the economy. Quality of written communication is limited.

Level 2 ([6]-[10])

Candidate shows some understanding of the impact of inflation upon the economy. However this will be incomplete or contain minor errors. Quality of written communication is satisfactory.

Level 3 ([11]-[15])

Candidate shows a clear and comprehensive understanding of the impact of inflation upon the economy. Key issues are explored in depth and quality of written communication is of a high standard. [15]

- (c) There are a number of ways in which a government can attempt to reduce the rate of inflation. However since 1997 in the UK the main method has been monetary policy which is administered by the Bank of England in order to meet a 2 per cent inflation target.

Until 2008 it could be argued that this had been reasonably successful, However the housing market bubble has been blamed by some economists on lax monetary policy which took no account of house price inflation. So one disadvantage of monetary policy is that it has a disproportionate impact on asset prices which are not reflected in the official measure of inflation.

A contractionary fiscal policy could also be used to reduce aggregate demand and hence the rate of inflation. However higher tax may create disincentives and reduced government spending will hit hardest at low income earners.

Supply-side policies will shift SRAS and LRAS curves to the right

Issues for analysis and evaluation include:

- Explanation of contractionary monetary policy.
- Explanation of contractionary fiscal policy.
- Explanation of supply-side policy
- Problems of monetary policy eg impact on asset prices, impact on investment.
- Problems of fiscal policy eg inflexible nature of much government spending, disincentive effect of higher tax.
- Exchange rate policy.
- Explanation of possible link between money supply and the general price level.
- Problems of measuring inflation.

Level 1 ([1]-[5])

Candidate provides little critical examination of the policies which a government might use in order to reduce a country's rate of inflation. There may be vague references to some relevant policies but these are not developed. Quality of written communication is limited.

Level 2 ([6]-[10])

Candidate provides some significant critical examination of the policies which a government might use in order to reduce a country's rate of inflation. However this may lack depth or be one-sided. Quality of written communication is satisfactory.

Level 3 ([11]-[15])

Candidate provides an in-depth critical examination and judgement of the policies which a government might use in order to reduce a country's rate of inflation. Quality of written communication is of a high standard. [15]

Total

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