



**ADVANCED SUBSIDIARY (AS)
General Certificate of Education
January 2012**

Economics

Assessment Unit AS 2

The National Economy

[AE121]

WEDNESDAY 18 JANUARY, MORNING

MARK SCHEME

General Marking Instructions

This mark scheme is intended to ensure that the AS examinations are marked consistently and fairly. The mark scheme provides examiners with an indication of the nature and range of candidate responses likely to be worthy of credit. It also sets out the criteria which they should apply in allocating marks to candidates' responses. The mark scheme should be read in conjunction with these general marking instructions which apply to all papers.

Quality of candidates' responses

In marking the examination papers, examiners will be looking for a quality of response reflecting the level of maturity which may reasonably be expected of 17-year-olds, which is the age at which the majority of candidates sit their AS examinations.

Flexibility in marking

The mark scheme is not intended to be totally prescriptive. For many questions, there may be a number of equally legitimate responses and different methods by which the candidates may achieve good marks. No mark scheme can cover all the answers which candidates may produce. In the event of unanticipated answers, examiners are expected to use their professional judgement to assess the validity of answers. If an answer is particularly problematic, then examiners should seek the guidance of the Supervising Examiner for the paper concerned.

Positive marking

Examiners are encouraged to be positive in their marking, giving appropriate credit for valid responses rather than penalising candidates for errors or omissions. Examiners should make use of the whole of the available mark range for any particular question and be prepared to award full marks for a response which is as good as might reasonably be expected for 17-year-old candidates. Conversely, marks should only be awarded for valid responses and not given for an attempt which is completely incorrect or inappropriate.

Types of mark schemes

Mark schemes for questions which require candidates to respond in extended written form are marked on the basis of levels of response which take account of the quality of written communication. These questions are indicated on the cover of the examination paper. Other questions which require only short answers are marked on a point for point basis with marks awarded for each valid piece of information provided.

Levels of response

Questions requiring candidates to respond in extended writing are marked in terms of levels of response. In deciding which level of response to award, examiners should look for the "best fit" bearing in mind that weakness in one area may be compensated for by strength in another. In deciding which mark within a particular level to award to any response, examiners are expected to use their professional judgement. The following guidance is provided to assist examiners.

Threshold performance: Response which just merits inclusion in the level and should be awarded a mark at or near the bottom of the range.

Intermediate performance: Response which clearly merits inclusion in the level and should be awarded a mark at or near the middle of the range.

High performance: Response which fully satisfies the level description and should be awarded a mark at or near the top of the range.

Making calculations

In marking answers involving calculations, examiners should apply the “own figure” rule so that candidates are not penalised more than once for a computational error.

Quality of written communication

Quality of written communication is taken into account in assessing candidates’ responses to questions that require them to respond in extended written form. These questions are marked on the basis of levels of response. The description for each level of response includes reference to the quality of written communication. Where the quality of candidates’ economics is not matched by the quality of written communication, marks awarded will not exceed the maximum for Level 2 in questions which have three levels of response or the maximum for Level 3 in those which have four levels of response.

For conciseness, quality of written communication is distinguished within levels of response as follows:

Level 1: Quality of written communication is limited.

Level 2: Quality of written communication is satisfactory.

Level 3: Quality of written communication is of a high standard.

In interpreting these level descriptions, examiners should refer to the more detailed guidance provided below:

Level 1 (Limited): The candidate makes only a limited attempt to select and use an appropriate form and style of writing. The organisation of material may lack clarity and coherence. There is little use of specialist vocabulary. Presentation, spelling, punctuation and grammar may be such that intended meaning is not clear.

Level 2 (Satisfactory): The candidate makes a reasonable attempt to select and use an appropriate form and style of writing, supported with appropriate use of diagrams as required. Relevant material is organised with some clarity and coherence. There is some use of appropriate specialist vocabulary. Presentation, spelling, punctuation and grammar are sufficiently competent to make meaning evident.

Level 3 (High Standard): The candidate successfully reflects and uses an appropriate form and style of writing, supported with the effective use of diagrams where appropriate. Relevant material is organised with a high degree of clarity and coherence. There is widespread use of appropriate specialist vocabulary. Presentation, spelling, punctuation and grammar are of a sufficiently high standard to make meaning clear.

- 1 (a) The most important features are:
- CPI inflation was at 4.4 per cent at the start of the period and at 3.1 per cent at the end
 - CPI inflation fell significantly from just over 5 per cent in October 2008 to its lowest level of around 1 per cent in September 2009
 - from September 2009 until July 2010 CPI inflation rose from 1 per cent to 3.1 per cent
 - RPI inflation started the period at around 5 per cent and ended the period at roughly the same level
 - RPI inflation fell from 5 per cent in July 2008 to its low point of – 1.6 per cent in June 2009
 - RPI inflation was negative from February 2009 until November 2009
 - for most of the period CPI inflation was higher than RPI inflation.

Level 1 ([1]–[2])

Candidate provides little comparison of the trends in RPI and CPI inflation over the period. There may be vague assertions but little use of the data and quality of written communication is limited.

Level 2 ([3]–[4])

Candidate provides some comparison of the trends in RPI and CPI inflation over the period. There is a degree of use of the data but manipulation is limited and quality of written communication is satisfactory.

Level 3 ([5]–[6])

Candidate provides a clear and comprehensive comparison of the trends in RPI and CPI inflation over the period. There is extensive use and manipulation of the data. Quality of written communication is of a high standard. [6]

- (b) There are four basic differences between the RPI and the CPI:

1. RPI and CPI measure the change in the cost of a slightly different basket of goods.

Items which are included in the RPI basket but not in the CPI basket include:

- mortgage interest payments
- council tax (rates)
- house depreciation
- buildings insurance
- TV licence
- road fund licence (car tax).

Items which are included in the CPI basket but not in the RPI basket include:

- stockbroker fees
- university accommodation fees
- foreign student tuition fees.

2. The range of households surveyed to calculate weights is slightly different.
The CPI includes all UK private households whilst the RPI excludes the highest earners and pensioner households which are dependent mainly on state benefits.
3. The weights attached to items in the basket differs between the CPI and the RPI.
4. The RPI is calculated using an arithmetic mean whilst the CPI uses a geometric mean.

Level 1 ([1]–[2])

Candidate provides little explanation of why the RPI measure of inflation differs from the CPI. There may be a verbatim repetition of sections of the passage but this will not be developed or explained. Quality of written communication is limited.

Level 2 ([3]–[5])

Candidate provides some explanation of why the RPI measure of inflation differs from the CPI. A number of key issues are explained, and quality of written communication is satisfactory.

Level 3 ([6]–[8])

Candidate provides a clear and comprehensive explanation of why the RPI measure of inflation differs from the CPI. Most key issues are explained, and quality of written communication is of a high standard.

[8]

- (c) A rise in the value of the pound tends to reduce the rate of inflation because of lower import prices and their knock-on effect on the wider economy.

Issues for analysis and discussion include:

- imports of manufactured goods such as clothing and electrical goods are cheaper
- imports of commodities such as oil and copper become cheaper and this reduces costs for UK manufacturers
- lower shop prices may have a knock-on effect on wage demands and prevent the development of a wage price spiral
- (X–M) component of all demand is reduced.

Level 1 ([1]–[2])

Candidate provides little explanation of the impact of a rise in the value of the pound upon the UK rate of inflation. There is no significant economic analysis and quality of written communication is limited.

Level 2 ([3]–[5])

Candidate provides some explanation of the impact of a rise in the value of the pound upon the UK rate of inflation. There is a degree of economic analysis though is likely to be superficial or contain errors. Quality of written communication is satisfactory.

Level 3 ([6]–[8])

Candidate provides a clear and comprehensive explanation of the impact of a rise in the value of the pound upon the UK rate of inflation. There is accurate and relevant economic analysis and quality of written communication is of a high standard. [8]

- (d) There are a number of factors other than the exchange rate which can contribute to the UK having a higher inflation rate than the EU as a whole.

These include:

- The UK's economic cycle may be at a different stage from that of most members of the EU
- UK households may have significantly different consumption patterns from many EU nations
- some newer member states may have less accurate methods of measuring inflation
- the Bank of England and the European Central Bank may be pursuing different monetary policies.

Level 1 ([1]–[2])

Candidate provides little explanation of why the UK's rate of inflation is significantly higher than that of the EU as a whole. There is no significant economic analysis and quality of written communication is limited.

Level 2 ([3]–[5])

Candidate provides some explanation of why the UK's rate of inflation is significantly higher than that of the EU as a whole. There is a degree of economic analysis, though this may contain errors or be incomplete. Quality of written communication is satisfactory.

Level 3 ([6]–[8])

Candidate provides a clear and comprehensive explanation of why the UK's rate of inflation is significantly higher than that of the EU as a whole. There is accurate economic analysis, and quality of written communication is of a high standard. [8]

- (e) The UK government has set the Bank of England an inflation target of 1 percentage point either side of 2 per cent. Adherence to this target is a means of promoting confidence in the UK government and allowing it to borrow large sums of money to finance its deficit. Failure to control inflation could make it difficult for the UK government to borrow on world markets. However, achieving the target could have a negative impact on other economic objectives such as full employment and sustainable economic growth.

Issues for analysis and evaluation include:

- explanation of impact of high inflation upon UK's financial status
- explanation of impact of high inflation upon UK economy

- explanation of how reducing inflation might affect aggregate demand and unemployment
- explanation of how reducing inflation might affect aggregate demand and economic growth
- explanation of the distinction between long and short run effects of low inflation
- explanation of Phillips Curve relationship in long and short run
- historical and international examples.

Level 1 ([1]–[3])

Candidate shows little understanding of the links between low inflation and other macroeconomic variables. There is no significant economic analysis nor any evaluation of the view that the inflation target should be achieved no matter what the cost. Quality of written communication is limited.

Level 2 ([4]–[7])

Candidate shows some understanding of the links between low inflation and other macroeconomic variables. There is a degree of economic analysis, though this will be superficial or incomplete. There will also be some evaluation of the view that the inflation target should be achieved no matter what the cost, but this will be one-sided or lacking in depth. Quality of written communication is satisfactory.

Level 3 ([8]–[10])

Candidate shows a clear and comprehensive understanding of the links between low inflation and other macroeconomic variables. There is accurate economic analysis and in-depth evaluation and judgement of the view that the inflation target should be achieved no matter what the cost. Quality of written communication is of a high standard. [10]

40

- 2 (a) GDP measures the output of all resources which are located within the UK, irrespective of ownership. Hence, it will, for example, include the output of Corus Steel which is now Indian owned. It will exclude the output of UK-owned resources which are located abroad. So to convert from GDP to GNP allowance must be made for inflows of interest dividends, profits and rents from UK-owned assets in other countries and for similar outflows to foreign owners of assets in the UK.

In short, GDP measures all economic activity which takes place within the UK. Whilst GNP measures the output of UK-owned resources no matter where they are located.

Issues for analysis and explanation include:

- explanation of GDP
- explanation of GNP
- explanation of net income from abroad
- explanation of problems of definition, e.g. a UK registered company may have many overseas shareholders.

Level 1 ([1]–[3])

Candidate provides little explanation of the differences between GDP and GNP. Key issues are not addressed and quality of written communication is limited.

Level 2 ([4]–[7])

Candidate provides some explanation of the differences between GDP and GNP. Most key issues are addressed, though this may lack detail, and quality of written communication is satisfactory.

Level 3 ([8]–[10])

Candidate provides a clear and comprehensive explanation of the differences between GDP and GNP. The key issues are addressed in detail, and quality of written communication is of a high standard. [10]

- (b) The expenditure method measures total spending on UK produced goods and services. It consists of consumption, investment, government spending and net exports.

The income method measures the rewards earned by the providers of the factors of production used in delivering GDP. So labour earns wages, land earns rent, capital earns interest and enterprise earns profit.

Issues, analysis and areas for discussion include:

- market prices and basic prices
- stock appreciation
- imputed rent
- circular flow of income and expenditure
- problems in compilation of the statistics
- sources of information.

Level 1 ([1]–[5])

Candidate provides little explanation of how GDP can be measured using the income and expenditure approaches. There is no significant economic analysis, and quality of written communication is limited.

Level 2 ([6]–[10])

Candidate provides some explanation of how GDP can be measured using the income and expenditure approaches. There is a degree of economic analysis though this may contain errors or be incomplete. Quality of written communication is satisfactory.

Level 3 ([11]–[15])

Candidate provides a clear and comprehensive explanation of how GDP can be measured using the income and expenditure approaches. There is accurate and relevant economic analysis, and quality of written communication is of a high standard. [15]

- (c) The most commonly used measure of economic growth is the annual percentage increase in real GDP. However, this is not necessarily a good indicator of the welfare of individual citizens. For example, growth may have been associated with high levels of immigration so that GDP may have risen, but GDP per capita could well have fallen or at least risen much more slowly than the rate of economic growth. Even if GDP per capita has risen many citizens could still remain in poverty because income is divided very unequally amongst its citizens.

There are a number of other factors which make economic growth a poor indicator of the welfare of individual citizens. Furthermore, happiness and welfare are not just the result of the material items reflected in a country's growth rate. Non-material items such as living in a stable family environment are also important. Recently a number of economists have been analysing the concept of happiness and examining ways in which governments could promote it.

Issues for analysis and evaluation include:

- explanation of why growth may not increase the welfare of many of a nation's citizens
- explanation of the contribution of non-material items to a sense of well-being. These include a sense of community, access to arts and music and stable family relationships
- explanation and evaluation of ways in which a government could promote a sense of well-being. These include funding of community workers and subsidising access to the creative arts. It may also involve reducing inequality by redistributing income and wealth
- evaluation of concept of "nanny state".

Level 1 ([1]–[5])

Candidate shows little understanding of the distinction between growth and welfare. There is no serious examination of the view that government should promote welfare rather than growth. Policies are not evaluated, and quality of written communication is limited.

Level 2 ([6]–[10])

Candidate shows some understanding of the distinction between growth and welfare. There is a degree of examination of the view that government should promote welfare rather than growth. Some policies are evaluated but not in depth, and quality of written communication is satisfactory.

Level 3 ([11]–[15])

Candidate shows a clear and comprehensive understanding of the distinction between growth and welfare. There is an in-depth evaluation and judgement of the view that government should promote welfare rather than growth and also of the policies which might achieve this. Quality of written communication is of a high standard.

[15]

40

- 3 (a) A standard textbook definition of fiscal policy is “Policy to affect aggregate demand by altering the balance between government expenditure and taxation”. (J Sloman)

Issues for analysis and explanation include:

- explanation of aggregate demand
- explanation of budget deficits, surpluses and balanced budgets
- explanation of expansionary, contractionary and neutral fiscal policy
- appropriate examples.

Level 1 ([1]–[3])

Candidate shows little knowledge or understanding of what is meant by fiscal policy. There is no significant explanation either through technical language, appropriate examples or diagrams. Quality of written communication is limited.

Level 2 ([4]–[7])

Candidate shows some knowledge and understanding of what is meant by fiscal policy. There is a degree of explanation through technical language, appropriate examples or diagrams. However, this is likely to be incomplete or contain errors. Quality of written communication is satisfactory.

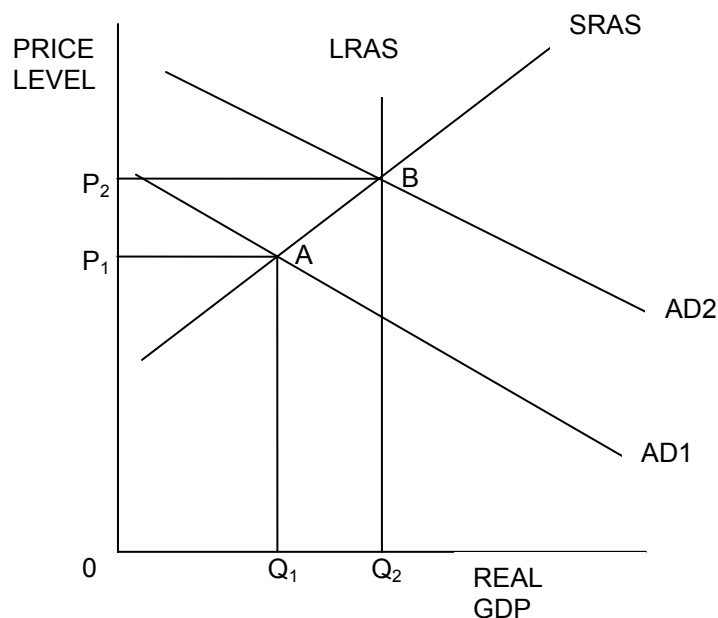
Level 3 ([8]–[10])

Candidate shows clear and comprehensive knowledge and understanding of what is meant by fiscal policy. There is accurate explanation through technical language, appropriate examples or diagrams. Quality of written communication is of a high standard. [10]

- (b) An expansionary fiscal policy is one where the government deliberately spends more than it collects in taxation in order to stimulate aggregate demand. The effect of this will in part depend upon the state of the economy when the policy is implemented. If there exists a high level of involuntary unemployment then the effects will be less inflationary than if the economy is at or near its full employment potential.

The diagram below shows the impact of an expansionary fiscal policy on an economy with a significant output gap. The economy is initially in equilibrium at point A with a price level of P_1 and real GDP of Q_1 .

Aggregate demand rises from AD_1 to AD_2 . The economy moves to a new equilibrium at point B and there is an increase in both real GDP (to Q_2) and the price level (to P_2).



Issues for analysis and discussion include:

- explanation of expansionary fiscal policy
- explanation of impact on aggregate demand
- explanation of impact on equilibrium price level and real GDP
- explanation of possible longer term effects.

Level 1 ([1]–[5])

Candidate provides little explanation of the effect of an expansionary fiscal policy upon an economy. There is no significant use of aggregate demand and supply analysis, and quality of written communication is limited.

Level 2 ([6]–[10])

Candidate provides some explanation of the effect of an expansionary fiscal policy upon an economy. There is a degree of use of aggregate demand and supply analysis, though this may contain errors. Quality of written communication is satisfactory.

Level 3 ([11]–[15])

Candidate provides a clear and comprehensive explanation of the effect of an expansionary fiscal policy upon an economy. There is widespread and accurate use of aggregate demand and supply analysis, and quality of written communication is of a high standard. [15]

- (c) A basic definition of a balanced budget is a situation where there is equality between government revenue, mostly from taxation, and government expenditure. However, it would be unrealistic, and probably undesirable, for the government to attempt to achieve this on a permanent basis. This is for two reasons:
- it is normal for the government's budget to vary throughout the economic cycle
 - a distinction should be drawn between current and capital spending.

Issues for analysis and discussion include:

- explanation of balanced budget
- distinction between current and capital spending
- analysis of link between economic cycle and government finances
- consequences of failure by government to correct inflation and recession
- historical and international examples. [15]

40

Level 1 ([1]–[5])

Candidate provides little evaluation of the desirability of a permanently balanced budget. Key issues are not addressed, and quality of written communication is limited.

Level 2 ([6]–[10])

Candidate provides some evaluation of the desirability of a permanently balanced budget. Key issues are addressed though this will be incomplete or contain minor errors, and quality of written communication is satisfactory.

Level 3 ([11]–[15])

Candidate provides an in-depth evaluation and judgement of the desirability of a permanently balanced budget. Key issues are addressed in detail and quality of written communication is of a high standard.

- 4 (a) Unemployment in the UK is measured by the ILO Labour Force Survey and by the Claimant Count. As its name would indicate the Claimant Count method only includes unemployed persons who qualify for benefits such as Job Seekers Allowance.

The ILO method includes persons such as those with working partners who may be unemployed but not able to claim benefit. According to the ILO definition unemployment means that an individual has no job, not even a part-time one, is available to start work within two weeks and has actively sought work during the previous four weeks.

This usually produces a higher figure than the Claimant Count measure, although it should be noted that some workers with only part-time jobs would be included in the Claimant Count as unemployed, but not classified as unemployed by the ILO definition.

The ILO figures are supported by the EU and by the OECD and hence are a better basis for international comparisons.

Candidates may extend their development by describing how the unemployment rate is calculated.

Level 1 ([1]–[3])

Candidate shows little understanding of the main features of either the Claimant Count or Labour Force Survey methods. Quality of written communication is limited.

Level 2 ([4]–[7])

Candidate shows some understanding of the main features of both the Claimant Count and Labour Force Survey methods. Quality of written communication is satisfactory.

Level 3 ([8]–[10])

Candidate shows a clear and comprehensive understanding of the main features of both the Claimant Count and Labour Force Survey methods. Quality of written communication is of a high standard. [10]

- (b) The causes of unemployment are reflected in the different types of unemployment:
- there may be an output gap when aggregate demand is too low to generate full employment. This is often referred to as cyclical or demand deficient unemployment
 - classical or real wage unemployment occurs when for some reason the real wage rate is set above the level needed to clear the labour market. This could happen if the National Minimum Wage were set at too high a level
 - labour may be immobile and the period between jobs may be prolonged. This is referred to as frictional unemployment
 - seasonal unemployment caused by the demand for certain types of labour varying throughout the year
 - structural unemployment exists when the demand for labour is less than its supply in individual labour markets. Regional, sectoral and technological unemployment are all examples of structural unemployment
 - natural rate unemployment exists even when the economy is at full employment. It is the sum of frictional and structural unemployment
 - unemployment in the UK appears to be a combination of demand deficient unemployment as a result of the recession and long term structural unemployment.

Level 1 ([1]–[5])

Candidate provides little explanation of the causes of unemployment. There is no significant economic analysis, and quality of written communication is limited.

Level 2 ([6]–[10])

Candidate provides some explanation of the causes of unemployment. There is a degree of economic analysis, though this may contain errors or be incomplete. Quality of written communication is satisfactory.

Level 3 ([11]–[15])

Candidate provides a clear and comprehensive explanation of the causes of unemployment coupled with some application to the UK economy. There is accurate and relevant economic analysis, and quality of written communication is of a high standard. [15]

- (c) This view is generally associated with the neo-classical school of economic thought. It is based on the belief that lower wages and prices will increase demand in both the goods and the labour markets and so eliminate unemployment. Of course, in our society, benefits would have to fall in line with wages or there would be no incentive to work at all.

Issues for analysis and evaluation include:

- explanation of impact of lower wages on international competitiveness and upon demand for exports and import substitutes
- explanation of possibility of substitution of labour for capital
- explanation of need to reduce benefits in line with wages
- explanation of possibility of wage stickiness
- explanation of social impact of lower wages
- explanation of problems in getting long-term unemployed back to work
- explanation of how the unemployed may be reclassified as too ill for work
- explanation and evaluation of other policies which might be used for reducing unemployment.

Level 1 ([1]–[5])

Candidate shows little understanding of how lower wages and benefits might help to reduce long-term unemployment. There is no significant evaluation, and quality of written communication is limited.

Level 2 ([6]–[10])

Candidate shows some understanding of how lower wages and benefits might help to reduce long-term unemployment. There is a degree of evaluation, though this is likely to be one-sided or lack depth, and quality of written communication is satisfactory.

Level 3 ([11]–[15])

Candidate shows a clear and comprehensive understanding of how lower wages and benefits might help to reduce long-term unemployment. There is in-depth evaluation and judgement, and quality of written communication is of a high standard. [15]

| | |
|--------------|-----------|
| Total | 40 |
| | 80 |