



Rewarding Learning

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

Economics

Assessment Unit AS 2

The National Economy

[AE121]

WEDNESDAY 20 JUNE, 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.

Marking calculations

In marking answers involving calculations, examiners should apply the “own figure” rule. 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) Gross Domestic Product (GDP) is the total output of all the resources located within a particular country. No allowance is made for the ownership of these resources nor for depreciation. Real GDP is the value of this output after allowance has been made for inflation. This is normally done by the use of a GDP deflator.

Level 1 ([1]–[2])

- candidate provides little explanation of real GDP
- there is no significant economic analysis
- quality of written communication is limited.

Level 2 ([3]–[4])

- candidate provides some explanation of real GDP
- there is a degree of economic analysis though this will be incomplete or contain errors
- quality of written communication is satisfactory.

Level 3 ([5]–[6])

- candidate provides a clear and comprehensive explanation of real GDP
- there is significant and accurate economic analysis
- quality of written communication is of a high standard. [6]

- (b) A number of trends are evident in UK economic growth and the rate of increase of UK house prices over this period. There is some evidence of a correlation between the two variables:

- throughout 2007 and early 2008 UK growth was fairly constant at around 2.5 per cent per annum
- throughout most of 2007 UK house prices were rising at around 10 per cent per annum
- the UK growth rate declined rapidly throughout 2008 and most of 2009
- the rate of increase of UK house prices started to decline in September 2007 and continued to fall until early 2009
- the UK entered a period of negative growth in mid 2008
- UK house prices started to fall in February 2008 and continued to fall until September 2009
- the UK housing market performed worst in early 2009 when prices were falling at around 19.4 per cent
- the worst period for growth was in the middle of 2009 when growth was around -6 per cent
- growth became positive in spring 2010
- UK house prices started to rise again in September 2009 and continued to rise until October 2010, though the rate of increase has fallen from around 10 per cent (March) to 1.4 per cent (November)
- changes in house prices tended to occur before changes in GDP growth rates.

Level ([1]–[2])

- candidate gives little description or analysis of the main trends in GDP growth and the rate of increase of house prices in this period
- there may be a narrative approach but no identification of trends nor manipulation of data
- quality of written communication is limited.

Level 2 ([3]–[5])

- candidate gives some description or analysis of the main trends in GDP growth and the rate of increase of house prices in this period
- this is likely to be incomplete or contain errors
- quality of written communication is satisfactory.

Level 3 ([6]–[8])

- candidate gives a clear and comprehensive description and analysis of the main trends in GDP growth and the rate of increase of house prices in this period
- quality of written communication is of a high standard. [8]

(c) Adverse weather conditions can affect an economy’s rate of growth in a number of ways:

- transport links are likely to be disrupted. This can affect the ability of manufacturers to get supplies of materials, the ability of shops to acquire stock and the ability of some employees to get to work
- industries such as agriculture and construction may be unable to function
- there may be a decline in travel and tourism revenue
- there may be an increase in consumption of oil which is generally imported and a negative component in GDP
- consumers may be unable to get to shops and restaurants.

Level 1 ([1]–[2])

- candidate provides little explanation of how adverse weather affects economic growth
- there may be some vague anecdotal points but these are not fully explained or related to growth
- quality of written communication is limited.

Level 2 ([3]–[4])

- candidate provides some explanation of how adverse weather affects economic growth
- this may be narrow in focus or not fully developed
- quality of written communication is satisfactory.

Level 3 ([5]–[6])

- candidate provides a clear and comprehensive explanation of how adverse weather affects economic growth
- this is fully developed and clearly related to economic growth
- quality of written communication is of a high standard. [6]

- (d) A double dip recession is a period of at least two consecutive quarters of negative growth followed by a recovery and then by another two successive quarters of negative growth. So the economy is in recession, makes a recovery but then slips back into recession.

There are a number of factors that could drive the UK into a double dip recession.

These include:

- persistently above target inflation could force the Bank of England to increase interest rates
- these could cause a rise in the value of the pound and a fall in net exports
- proposed increases in VAT could cause consumers to cut spending
- cuts in government spending could increase unemployment and cause consumers to cut spending
- a sovereign debt crisis in some eurozone nations could affect our exports
- households are already heavily indebted and may be reluctant to increase spending
- the fall in house price inflation may be an indicator of lower growth
- continuing reluctance of banks to lend.

Level 1 ([1]–[2])

- candidate shows little understanding of the factors which might cause a double dip recession in the UK
- there is no significant economic analysis
- quality of written communication is limited.

Level 2 ([3]–[5])

- candidate shows some understanding of the factors which might cause a double dip recession in the UK
- there is a degree of economic analysis, though this is likely to be incomplete or contain errors
- quality of written communication is satisfactory. [8]

Level 3 ([6]–[8])

- candidate shows a clear and comprehensive understanding of the factors which might cause a double dip recession in the UK
- there is accurate and relevant economic analysis
- quality of written communication is of a high standard.

- (e) The cuts in welfare spending are part of the government's overall programme of expenditure cuts aimed at reducing the UK's enormous fiscal deficit. They are however, more controversial than cuts in other areas as the burden will tend to fall on lower income groups. However, the cost of doing nothing would be higher interest rates and an enormous burden of debt interest which would force cuts in other areas of government spending.

Issues for analysis and evaluation include:

- explanation of cuts in welfare benefits, including removing child benefit from higher rate tax payers
- explanation of the fiscal deficit and the consequences of doing nothing to correct it, e.g. higher interest rates, reaction of bond market, level of debt interest repayments, etc.
- explanation and evaluation of other policies such as increasing taxation
- explanation of effect of welfare cuts on work incentives and the level of economic inactivity
- evaluation of “fairness” of compelling welfare recipients to carry out some form of work
- evaluation of general theme of “fairness”, focusing on issues like cuts in housing benefit, bankers bonuses, etc.

Level 1 ([1]–[4])

- candidate provides little explanation of the effect of cuts in welfare benefits
- there is no evaluation of the policy of cutting benefits
- quality of written communication is limited.

Level 2 ([5]–[8])

- candidate provides some explanation of the effect of cuts in welfare benefits
- there is a degree of evaluation though this is likely to be superficial or one-sided
- quality of written communication is satisfactory.

Level 3 ([9]–[12])

- candidate provides a clear and comprehensive explanation of the effect of cuts in welfare benefits
- there is in-depth evaluation and judgement of the policy of cutting benefits
- quality of written communication is of a high standard. [12]

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- 2 (a) The aggregate supply curve shows the quantity of goods and services that firms are willing to supply at each price level. In the short run it is assumed that the prices of factors of production remain unchanged so that an increase in the price of the finished product should increase profitability and cause firms to increase output.

The short run aggregate supply curve (SRAS) will be relatively elastic as increased output will only lead to slight increases in costs, perhaps due to lower productivity or the payment of overtime rates. Wage rates and other factor costs are unchanged. Should these factor prices change then the SRAS will shift either to the right if they fall or to the left if they rise.

Level 1 ([1]–[3])

- candidate provides little explanation of what is shown by the short run aggregate supply curve
- any definition is flawed or incomplete and there is no significant exposition
- quality of written communication is limited.

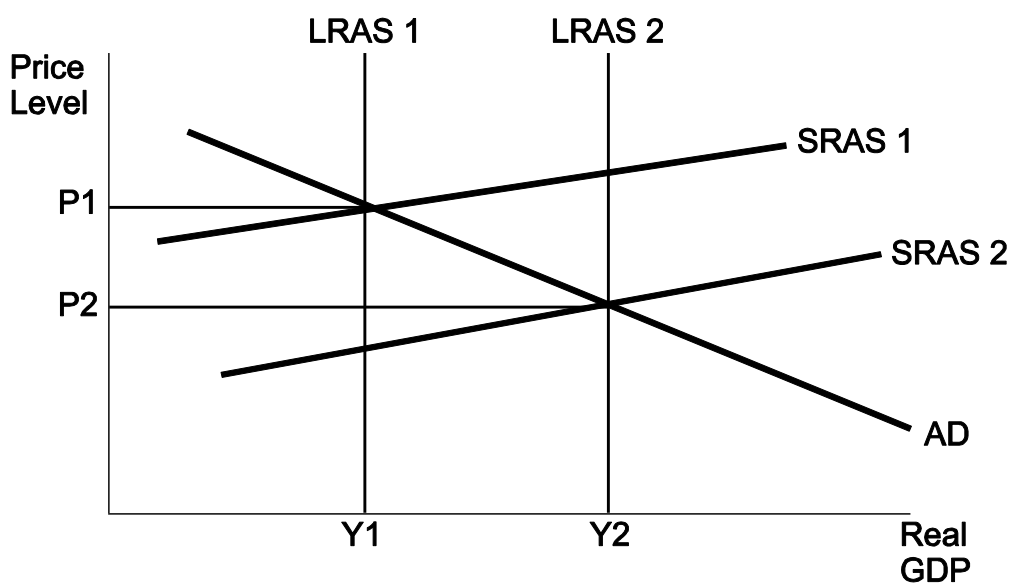
Level 2 ([4]–[7])

- candidate provides some explanation of what is shown by the short run aggregate supply curve
- there is a reasonable definition though this may contain minor errors and a degree of exposition
- quality of written communication is satisfactory.

Level 3 ([8]–[10])

- candidate provides a clear and comprehensive explanation of what is shown by the short run aggregate supply curve
- there is an accurate and complete definition with significant exposition
- quality of written communication is of a high standard. [10]

(b) An increase in immigration of skilled labour will increase the supply of labour and drive down the market wage rate. There will also be an increase in the productive potential of the economy. Hence both the SRAS and the LRAS will shift to the right. As a consequence of these changes the economy grows from Y1 to Y2 and the price level falls from P1 to P2.



Issues for analysis and discussion include:

- explanation of impact of immigration on labour market
- explanation of impact of lower wages on SRAS
- explanation of impact of increased supply of skilled labour upon LRAS
- overall impact on the economy
- analysis based on neo-Keynesian LRAS
- explanation of possibility that this process may be blocked by minimum wage legislation or by discrimination against immigrant labour.

Level 1 ([1]–[5])

- candidate provides little explanation of the probable impact on the UK economy of increased availability of skilled labour from abroad
- there may be some vague anecdotal observations based on the issue of immigration but no significant economic analysis
- quality of written communication is limited.

Level 2 ([6]–[10])

- candidate provides some explanation of the probable impact on the UK economy of increased availability of skilled labour from abroad
- there is a degree of economic analysis though this is likely to be superficial or contain errors
- quality of written communication is satisfactory.

Level 3 ([11]–[15])

- candidate provides a clear and comprehensive explanation of the probable impact on an economy of increased availability of skilled labour from abroad
- there is relevant and accurate economic analysis
- quality of written communication is of a high standard. [15]

- (c) The idea that aggregate demand can be self-correcting is based very much in the neo-classical school of economics. When aggregate demand is too low and the economy faces an output gap then this will be automatically corrected by falling wages in the labour market and falling prices in the goods market. This process will continue until the output gap is closed. Hence all that government need do is to increase the full employment potential of the economy and leave flexible labour and goods markets to close any output gap.

Of course many economists do not accept this view. Keynes argued that the labour market was too inflexible to allow falling wages to correct unemployment. In the recent recession Nobel Laureate Paul Krugman argued that in an era of private sector deleveraging it was up to governments and central banks to stimulate demand or the economy could be trapped in deflation for decades.

Issues for analysis and evaluation include:

- explanation of theory of self-correcting aggregate demand
- evaluation of this theory
- explanation and evaluation of policies to increase aggregate demand
- explanation of impact of supply-side policies
- evaluation of impact of supply-side policies.

Level 1 ([1]–[5])

- candidate provides little explanation of the view that governments should focus solely on increasing aggregate supply and leave aggregate demand alone
- there is no significant evaluation
- quality of written communication is limited.

Level 2 ([6]–[10])

- candidate provides some explanation of the view that governments focus solely on increasing aggregate supply and leave aggregate demand alone
- there is a degree of evaluation, though this may lack depth or be one-sided
- quality of written communication is satisfactory.

Level 3 ([11]–[15])

- candidate provides a clear and comprehensive explanation of the view that governments should focus solely on increasing aggregate supply and leave aggregate demand alone
- there is in-depth evaluation and judgement
- quality of written communication is of a high standard. [15]

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- 3 (a) Inflation is a sustained increase in the general level of prices. The rate of inflation is the annual percentage rise in the general level of prices, usually measured by the CPI or the RPI. So if the CPI in year one is 100 and in year two is 105 then the rate of inflation is five per cent.

Issues for analysis and explanation include:

- numerical example
- historical examples of high rate of inflation
- explanation of CPI or RPI.

Level 1 ([1]–[3])

- candidate provides little explanation of the rate of inflation
- there may be vague references to price increases but no significant exposition
- quality of written communication is limited.

Level 2 ([4]–[7])

- candidate provides some explanation of the rate of inflation
- there will be some reference to the CPI or RPI but this will lack detail or contain errors
- quality of written communication is satisfactory.

Level 3 ([8]–[10])

- candidate provides a clear and comprehensive explanation of the rate of inflation
- there will be a detailed analysis of either CPI or RPI
- quality of written communication is of a high standard. [10]

(b) There are three basic explanations of the inflationary process:

- 1 Demand–pull
- 2 Cost–push
- 3 Excessive monetary expansion.

Issues for analysis and discussion include:

- why aggregate demand might increase to cause demand–pull inflation
- why production costs might rise to create cost–push inflation
- AD and AS analysis
- monetarist explanation
- Phillips curve
- historical examples of different types of inflationary spiral
- UK inflation at present (Feb 2011) is probably of the cost–push variety in that its origins lie in the increase in the price of imported raw materials.

Level 1 ([1]–[5])

- candidate provides little explanation of the causes of inflation in the UK
- there may be a superficial awareness of some of the causes but no meaningful economic analysis
- quality of written communication is limited.

Level 2 ([6]–[10])

- candidate provides some explanation of the causes of inflation
- this may involve a detailed analysis of one cause or a more limited analysis of two
- quality of written communication is satisfactory.

Level 3 ([11]–[15])

- candidate provides a clear and comprehensive explanation of at least two causes of inflation
- there is accurate and relevant economic analysis and application to the UK economy
- quality of written communication is of a high standard. [15]

- (c) There are a number of ways in which the UK government and the Bank of England 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 (CPI).

Presently (February 2011) the UK rate of inflation is just over 4 per cent, meaning that the Bank of England has missed its inflation target for over a year.

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 could be used to increase productivity, shifting the LRAS curve to the right and reducing the price level. However, these policies can be socially divisive and may take a long time to work through to affect the price level.

Issues for analysis and evaluation include:

- explanation of contractionary monetary policy
- explanation of contractionary fiscal policy
- problems of monetary policy, e.g. impact on asset prices, impact on investment
- problems of fiscal policy, e.g. 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
- explanation and evaluation of price and income controls
- problems of measuring inflation
- explanation and evaluation of supply-side policies
- problems in dealing with imported inflation.

Level 1 ([1]–[5])

- candidate provides little critical examination of the policies which governments and central banks might use in order to reduce an economy'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 critical examination of the policies which governments and central banks might use in order to reduce an economy's rate of inflation
- 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 governments and central banks might use in order to reduce an economy's rate of inflation
- quality of written communication is of a high standard. [15]

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- 4 (a) Equilibrium means that an economic variable, in this case the macro-economy, is static and showing no tendency to change. Usually this is because the forces driving it in one direction are balanced by forces driving it in the other.

This can be illustrated by using the aggregate demand and supply model. Equilibrium will exist where AD is equal to long and short run AS.

It can also be illustrated through the circular flow of income and expenditure model. Equilibrium here will exist where planned injections equal withdrawals.

Issues for analysis and explanation include:

- explanation of concept of equilibrium national income
- explanation of equilibrium using AD and AS model
- explanation of equilibrium using circular flow of income and expenditure model.

Level 1 ([1]–[3])

- candidate provides little explanation of the equilibrium level of national income
- there is no significant economic analysis
- quality of written communication is limited.

Level 2 ([4]–[7])

- candidate provides some explanation of the equilibrium level of national income
- there is a degree of economic analysis though this may be incomplete or contain errors
- quality of written communication is satisfactory.

Level 3 ([8]–[10])

- candidate provides a clear and comprehensive explanation of the equilibrium level of national income
- there is accurate economic analysis
- quality of written communication is of a high standard. [10]

- (b) There are a number of policies which a government could pursue in order to increase an economy's equilibrium level of national income. Some of these will focus on increasing expenditure through aggregate demand management. Others will focus on increasing the economy's productive potential through supply-side policies.

Issues for analysis and discussion include:

- explanation of impact of expansionary fiscal policy
- explanation of impact of authorising the central bank to initiate an expansionary monetary policy
- explanation of impact of currency depreciation
- explanation of impact of supply-side policies
- explanation of distinction between long and short economic growth.

Level 1 ([1]–[5])

- candidate provides little explanation of how a government could increase the economy's equilibrium level of national income
- there is no economic analysis
- quality of written communication is limited.

Level 2 ([6]–[10])

- candidate provides some explanation of how a government could increase the economy's equilibrium level of national income
- there is a degree of economic analysis though this is likely to be incomplete or contain errors
- quality of written communication is satisfactory.

Level 3 ([11]–[15])

- candidate provides a clear and comprehensive explanation of how a government could increase the economy's equilibrium level of national income
- there is accurate and relevant economic analysis
- quality of written communication is of a high standard. [15]

- (c) Achieving a fairer distribution of income is an objective of left-leaning government throughout the world. However, this has proved very difficult to achieve. Indeed 13 years of Labour government in the UK actually saw an increase in inequality. Policies to reduce inequality include high rates of progressive taxation and high levels of welfare benefits to low income earners. Benefits can be in kind or in cash. In order to ensure that the right people receive benefits there would have to be a system of means testing. This can be a costly process and may create disincentives for both low and high earners.

Issues for analysis and evaluation include:

- explanation of how a fairer distribution of income could be achieved
- explanation of means testing
- explanation of Laffer curve
- explanation of disincentive effect of policies to achieve a fairer distribution of income
- social benefits of greater fairness, e.g. reduced crime.

Level 1 ([1]–[5])

- candidate shows little understanding of how a fairer distribution of income could be achieved
- there is no significant evaluation of the view that this should be a government’s top economic priority
- quality of written communication is limited.

Level 2 ([6]–[10])

- candidate shows some understanding of how a fairer distribution of income could be achieved
- there is a degree of evaluation of the view that this should be a government’s top economic priority. However, this is likely to lack depth or be one-sided
- quality of written communication is satisfactory.

Level 3 ([11]–[15])

- candidate shows a clear and comprehensive understanding of how a fairer distribution of income could be achieved
- there is in-depth evaluation and judgement of the view that this should be a government’s top economic priority
- quality of written communication is of a high standard. [15]

Total

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80