



ADVANCED SUBSIDIARY (AS)  
General Certificate of Education  
January 2013

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## **Economics**

Assessment Unit AS 2

The National Economy

[AE121]

MONDAY 28 JANUARY, AFTERNOON

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# **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 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 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) A number of significant changes took place in the UK inflation rate during this period:
- inflation started in November 2009 at 1.9 per cent and ended the period in September 2011 at 5.2 per cent
  - this represents a rise of 3.3 percentage points or 173.7 per cent
  - there have been some fluctuations in the trend. For example, inflation between June 2010 and November 2010 was relatively subdued at around 3 per cent
  - for much of this period inflation was outside the government's target range. It was last within range in February 2010 (2 per cent  $\pm$  1 per cent).

**Level 1 ([1]–[2])**

Candidate provides little description of the changes in the UK rate of inflation over this period. There may be a few unconnected points or a narrative approach but no attempt at identifying a trend or manipulation of the data. Quality of written communication is limited.

**Level 2 ([3]–[4])**

Candidate provides some description of the features of the UK rate of inflation over this period. There is limited data manipulation and quality of written communication is satisfactory.

**Level 3 ([4]–[6])**

Candidate provides a clear and comprehensive description of the features of the UK rate of inflation over this period. There is extensive data manipulation and quality of written communication is of a high standard. [6]

- (b) The main reason why the UK has a much higher level of food price inflation than the Eurozone is the low value of the pound. This substantially increases the cost of imported food which is a very high proportion of UK food consumption. Furthermore, as the passage states, world food prices are being driven upwards for a variety of reasons. Some commentators allege that UK supermarkets are also responsible by maintaining high profit margins.

**Level 1 ([1]–[2])**

Candidate provides little explanation of why food price inflation is higher in the UK than in the Eurozone. There may be a few anecdotal points but no economic analysis. Quality of written communication is limited.

**Level 2 ([3]–[4])**

Candidate provides some explanation of why food price inflation is higher in the UK than in the Eurozone. There is a degree of economic analysis and quality of written communication is satisfactory.

**Level 3 ([5]–[6])**

Candidate provides a clear and comprehensive explanation of why food price inflation is higher in the UK than in the Eurozone. There is clear economic analysis and quality of written communication is of a high standard. [6]

- (c) A rise in food prices has a significant impact on the overall CPI. This is because food has a relatively high weighting of 12 per cent within the index which is designed to represent the pattern of expenditure of the typical household. The higher the percentage of total expenditure the greater the weighting which will be attached to any item. The 12 per cent weighting given to food means that roughly £12 out of every £100 spent goes on food. This means that it is relatively important and will have significant impact on the overall index. A 10 per cent rise in the price of food would have a 1.2 per cent impact on the CPI.

**Level 1 ([1]–[2])**

Candidate provides little explanation of how a rise in food prices would affect the overall CPI. There is no significant economic analysis and quality of written communication is limited.

**Level 2 ([3]–[4])**

Candidate provides some explanation of how a rise in food prices would affect the overall CPI. There is a degree of economic analysis and quality of written communication is satisfactory.

**Level 3 ([5]–[6])**

Candidate provides a clear and comprehensive explanation of how a rise in food prices would affect the overall CPI. There is significant economic analysis and quality of written communication is of a high standard. [6]

- (d) Negative real interest rates exist when the rate of inflation is greater than the nominal interest rate. In this case the real value of both savings and loans will be depreciating, making savers worse off and borrowers better off.

[1] for reference to nominal interest rate

[1] for reference to rate of inflation

[2] for explaining relationship between these variables

[1] for any other relevant point, e.g. impact on savers

Constrained maximum of [4] [4]

- (e) The standard of living is usually measured in terms of real disposable income. This is average disposable income adjusted for the rate of inflation. If inflation is 5 per cent then incomes must rise by at least 5 per cent in order to maintain existing living standards. Any rise in incomes of less than 5 per cent will lead to a fall in living standards. In this era of low economic growth incomes are rising slowly if at all. Inflation on the other hand is running at over twice the Bank of England's target level. Hence living standards are falling.

**Level 1 ([1]–[2])**

Candidate gives little explanation of how inflation is contributing to falling living standards in the UK. There may be vague references to the cost of living but little economic analysis. Quality of written communication is limited.

**Level 2 ([3]–[4])**

Candidate gives some explanation of how inflation is contributing to falling living standards in the UK. However, this will lack depth or contain errors. Quality of written communication is satisfactory.

**Level 3 ([5]–[6])**

Candidate gives a clear and comprehensive explanation of how inflation is contributing to falling living standards in the UK. Quality of written communication is of a high standard. [6]

- (f) The Monetary Policy Committee of the Bank of England has been faced with a very difficult dilemma when setting interest rates during this period.

On the one hand inflation has been consistently and significantly above target, a situation which would normally require a rise in interest rates. On the other hand the economy has been experiencing very low rates of economic growth which would normally require a monetary stimulus in the form of lower interest rates. However, these are already at a record low and there is no further scope for reduction, so the Bank of England has had to decide between raising rates to reduce inflation or keeping them at 0.5 per cent to stimulate growth. It appears as if the Bank of England has decided that growth is more important than inflation.

Issues for analysis and discussion include:

- explanation of an increase in interest rates on inflation
- explanation of possibility that increasing interest rates may be ineffective due to international nature of inflation
- explanation of economic costs of persistently high inflation
- explanation of impact of inflation on money markets and the ability of UK government to borrow
- explanation of exchange rate issues
- explanation of impact of higher interest rates on growth and employment
- explanation of economic costs of slow growth and increased unemployment
- evaluation of overall impact of increased interest rates.

**Level 1 ([1]–[4])**

Candidate provides little critical examination of the Bank of England's decision. There may be a vague anecdotal approach but no significant economic analysis. Quality of written communication is limited.

**Level 2 ([5]–[8])**

Candidate provides some critical examination of the Bank of England's decision. There is a degree of economic analysis though this may contain errors or be incomplete. Quality of written communication is satisfactory.

**Level 3 ([9]–[12])**

Candidate provides an in-depth critical examination and judgement of the Bank of England's decision. This is supported by relevant and accurate economic analysis and quality of written communication is of a high standard. [12]

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- 2 (a) Aggregate demand has four basic components:
- consumption (C): spending by households on goods and services
  - investment (I): spending by firms on investment goods
  - government spending (G): this includes current spending such as wages and office supplies. It also includes spending by the government on investment goods such as new schools and hospitals
  - exports minus imports (X–M): this is foreign spending on UK produced goods and services (X) less UK spending on foreign produced goods and services (M).

**Level 1 ([1]–[3])**

Candidate shows little understanding of the components of aggregate demand. There is no significant economic analysis and quality of written communication is limited.

**Level 2 ([4]–[7])**

Candidate shows some understanding of the components of aggregate demand. There is a degree of economic analysis and quality of written communication is satisfactory.

**Level 3 ([8]–[10])**

Candidate shows a clear and comprehensive understanding of the components of aggregate demand. There is significant economic analysis and quality of written communication is of a high standard. [10]

- (b) Candidates should briefly explain what is shown by the aggregate demand curve and then proceed to explain its shape.

There are three basic reasons why the aggregate demand curve slopes downwards from left to right:

- the wealth effect: rising prices reduce the real value of money balances and income held by consumers. There is a reduction in purchasing power
- the interest rate effect: rising prices increase the demand for money. This pushes up the rate of interest and reduces interest rate sensitive expenditure, especially investment. The rise in the rate of interest may have the further impact of increasing the value of the pound and reducing the net export component of aggregate demand
- international substitution: a rise in the price of UK goods will lead consumers at home and abroad to switch away from UK produced goods. There is likely to be a rise in imports and a fall in exports, causing a fall in net exports component of aggregate demand.

**Level 1 ([1]–[5])**

Candidate provides no meaningful analysis of the reasons why the aggregate demand curve slopes downwards from left to right. Key issues are missed or presented in a confused manner. Quality of written communication is limited.

**Level 2 ([6]–[10])**

Candidate provides some analysis of the reasons why the aggregate demand curve slopes downwards from left to right. The key issues are addressed though this may be incomplete or confused. Quality of written communication is satisfactory.

**Level 3 ([11]–[15])**

Candidate provides a clear and comprehensive analysis of the reasons why the aggregate demand curve slopes downwards from left to right. All the key issues are explained and quality of written communication is of a high standard. [15]

- (c) The idea of using government spending and taxation as a means of controlling aggregate demand has its origins in the writings of J M Keynes. He rejected the notion that spending and employment could be increased through market forces and changes in wages and prices. In the recent credit-crunch inspired recession many countries have used expansionary fiscal policies but with varying degrees of success.

Issues for analysis and evaluation include:

- explanation of fiscal policy and how it can be either expansionary or contractionary depending on the objective being pursued.
- explanation of the problems in fiscal policy, e.g. inflexible nature of government spending, possibility of crowding out especially through higher interest rates
- candidates should also refer to alternative policies and provide some comparison between them and fiscal policy
- explanation of monetary policy and its problems, e.g. impact on exchange rates, possibility of creation of asset price bubbles
- explanation of impact of exchange rate changes on aggregate demand
- explanation of problems in using the exchange rate as a policy instrument, e.g. the exchange rate is not totally under the control of domestic governments.

**Level 1 ([1]–[5])**

Candidate provides little critical examination of using fiscal policy to control aggregate demand. Any explanation will be vague and superficial and quality of written communication is limited.

**Level 2 ([6]–[10])**

Candidate provides some critical examination of using fiscal policy to control aggregate demand. However, economic analysis will be superficial or contain errors and evaluation will be one-sided or lacking in depth. Quality of written communication is satisfactory.

**Level 3 ([11]–[15])**

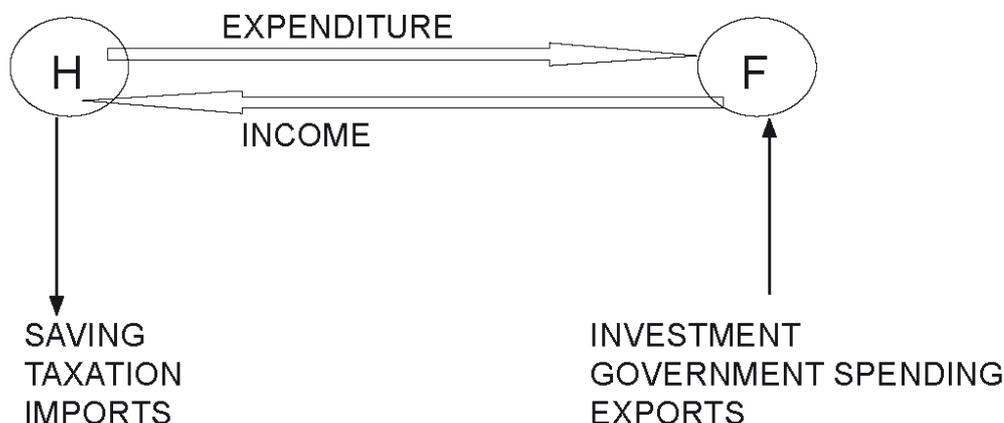
Candidate provides a comprehensive critical examination of using fiscal policy to control aggregate demand. There will be accurate economic analysis and in-depth evaluation and judgement. Quality of written communication is of a high standard.

[15]

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- 3 (a) This model of the economy is based on four economic agents:
1. Firstly, the households who are buyers in product markets and sellers in factor markets.
  2. Secondly, the firms who are sellers in product markets and buyers in factor markets.
  3. Thirdly, the government which is a purchaser of goods and services and finances this by collecting taxes from firms and households.
  4. Fourthly, the rest of the world which purchases our exports and sells us imports.

It is the interaction between these groups which gives us the circular flow of income and expenditure.



Leakages from the circular flow consist of saving, tax and imports. Injections are investment, government spending and exports.

**Level 1 ([1]–[3])**

Candidate shows little knowledge or understanding of the circular flow of income and expenditure. There is no significant economic analysis and quality of written communication is limited.

**Level 2 ([4]–[7])**

Candidate shows some knowledge and understanding of the circular flow of income and expenditure. There is a degree of economic analysis though this may contain minor errors or be incomplete. Quality of written communication is satisfactory.

**Level 3 ([8]–[10])**

Candidate shows clear and comprehensive knowledge and understanding of the circular flow of income and expenditure. There will be accurate and relevant economic analysis and quality of written communication is of a high standard. [10]

- (b) Both demand side and supply side policies may have an impact on an economy's rate of economic growth. However, the impact of the former is likely to be greater in the short run. Long run economic growth will require an increase in the quantity of resources or an increase in their productivity. However, demand side stimuli may be used in order to minimise any output gap.

Issues for analysis and discussion include:

- explanation of impact of expansionary demand-side policies on aggregate demand and supply
- explanation of inwards migration
- explanation of increased investment in education and training
- explanation of increased investment in physical capital
- explanation of impact of new technology
- explanation of impact of discovery of new supplies of natural resources
- explanation using production possibility curve
- explanation using LRAS.

**Level 1 ([1]–[5])**

Candidate provides little explanation of the causes of economic growth. There are likely to be vague references to issues like “more machinery” but no significant economic analysis. Quality of written communication is limited.

**Level 2 ([6]–[10])**

Candidate provides some explanation of the causes of economic growth. There will be a degree of economic analysis but 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 the causes of economic growth. There is accurate economic analysis and quality of written communication is of a high standard. [15]

- (c) The most widely used measure of economic welfare is real GDP per capita. However, this does have a number of significant defects most importantly the failure to account for negative externalities. For example, cigarette production is valued at the value of the cigarettes produced but makes no allowance for the costs to the smoker and to the NHS. A further example of this is the environmental costs of economic activity which are not deducted from the value of output. Similarly there are unpriced benefits which are not added to the value of output.

Issues for analysis and evaluation include:

- links between economic growth and environmental damage
- negative externalities associated with an increase in GDP
- problems in valuing environmental damage
- problems in valuation of other external costs and benefits
- difference between increases in GDP and increases in welfare
- explanation and evaluation of other measures of welfare such as HDI or ISEW.

**Level 1 ([1]–[5])**

Candidate provides little evaluation of the view that GDP should not be used as an indicator of economic welfare. There may be a superficial understanding of the flaws in GDP as measure of growth and quality of written communication is limited.

**Level 2 ([6]–[10])**

Candidate provides some evaluation of the view that GDP should not be used as an indicator of economic welfare. There will be a degree of understanding and some explanation of the flaws in GDP as measure of growth and quality of written communication is satisfactory.

**Level 3 ([11]–[15])**

Candidate provides a comprehensive evaluation and judgement of the view that GDP should not be used as an indicator of economic welfare. There will be a clear explanation of the flaws in GDP as a measure of growth and appropriate comparisons with alternative measures. Quality of written communication is of a high standard. [15]

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- 4 (a) Unemployment is when a respondent to the Labour Force Survey (LFS) classifies themselves as “Out of work but currently and actively seeking to work”.

The LFS further states that a person is unemployed if they:

- are without a job, have actively sought work in the last four weeks and are able to start work within the next two weeks; or
- are out of work, have found a job and are waiting to start it in the next two weeks.

Hence the key issue in being classified as unemployed is a person's level of job-seeking activity. Economic inactivity exists when a person is without any form of employment and is making no serious efforts at finding a job. Hence the economically inactive are not part of the work force, whereas the unemployed are.

The main causes of economic inactivity are:

- not available for work because of family responsibilities, usually care of young children
- not available for work because of long-term health problems
- not available for work because of early retirement
- not available for work because in full-time education.

### **Level 1 ([1]–[3])**

Candidate provides little explanation of the difference between economic inactivity and unemployment. There will typically be a vague anecdotal approach and quality of written communication is limited.

### **Level 2 ([4]–[7])**

Candidate provides some explanation of the difference between economic inactivity and unemployment. However, this will contain errors or be incomplete. Quality of written communication is satisfactory.

### **Level 3 ([8]–[10])**

Candidate provides a clear and comprehensive explanation of the difference between economic inactivity and unemployment. There is extensive development including appropriate examples and quality of written communication is of a high standard. [10]

- (b) It would be logical to expect supply side policies to lead to a fall in the rate of unemployment and though this is probable in the long run it is by no means certain. For example, increased productivity may enable the economy to grow but with little or no job creation.

Issues for analysis and discussion include:

- explanation of supply side policies
- use of AD and AS analysis
- distinction between long and short run impacts
- impact on output
- explanation of supply side policies, e.g. trade union reform which may be bad for employment in short run but beneficial in long run
- possibility that economic growth may yield relatively little in terms of job creation.

### **Level 1 ([1]–[5])**

Candidate provides little analysis of the impact of supply side policies on unemployment. There may be some understanding of such policies but no explanation of their impact. Quality of written communication is limited.

**Level 2 ([6]–[10])**

Candidate provides some analysis of the impact of supply side policies on unemployment. However, this analysis is likely to be incomplete or contain errors and quality of written communication is satisfactory.

**Level 3 ([11]–[15])**

Candidate provides a clear and comprehensive analysis of the impact of supply side policies on unemployment. Quality of written communication is of a high standard. [15]

- (c) Unemployment inflicts significant economic and social costs upon a community and its reduction has always been an important priority for government. However, it is questionable if it should be the main objective and achieved at the expense of other goals. Many economists today believe that macro-economic objectives can only be achieved together. They can be viewed as complements rather than substitutes.

Issues for analysis and evaluation include:

- the costs of unemployment and the benefits from its reduction
- the consequences of the policies needed to reduce unemployment
- possible conflicts between reducing unemployment and other objectives
- distinction between long and short run consequences
- evaluation and judgement of the view.

**Level 1 ([1]–[5])**

Candidate provides little evaluation of the view that “reducing unemployment should be the government’s main economic objective”. There may be a superficial explanation of the benefits of reducing unemployment but no comparison with other objectives. Quality of written communication is limited.

**Level 2 ([6]–[10])**

Candidate provides some evaluation of the view that “reducing unemployment should be the government’s main economic objective”. There is a degree of explanation of the benefits of reducing unemployment and some comparison with the benefits of achieving other objectives. Quality of written communication is satisfactory.

**Level 3 ([11]–[15])**

Candidate provides an in-depth evaluation and judgement of the view that “reducing unemployment should be the government’s main economic objective”. There is a significant explanation of the benefits of reducing unemployment and extensive comparisons with the benefits of achieving other objectives. Quality of written communication is of a high standard. [15]

<b>Total</b>	<b>40</b>
	<b>80</b>