



Rewarding Learning

**ADVANCED SUBSIDIARY (AS)
General Certificate of Education
2011**

Economics

Assessment Unit AS 2

assessing

The National Economy

[AE121]

FRIDAY 3 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.

Making 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 Weak Recovery

- (a) (i) A recession is a period of two consecutive quarters of negative economic growth. Hence real GDP falls over a six month period.

For an accurate definition [4]

If definition contains minor errors or is incomplete [3]

For vague references to economic slowdown or falling output maximum [2]

[4]

- (ii) Many of the world's economies slipped into recession in 2008 as a result of the world financial crisis known as the credit crunch. Banks both in the UK and in the USA made large numbers of injudicious loans to high risk borrowers. When these high risk or sub-prime borrowers defaulted the banks were forced to cut back on new lending and to attach very strict conditions to such loans. Indeed a number of banks lost so much money on these loans that they became virtually insolvent and were only saved from bankruptcy by massive government bail outs.

This led to great difficulty in obtaining mortgage finance and there was a collapse in the housing market on both sides of the Atlantic. A major fall in aggregate demand and a recession inevitably followed this financial crisis.

Issues for analysis and discussion include:

- explanation of the credit crunch
- impact on housing market
- impact on construction industry
- knock-on effects from falling house prices and decline in house building
- impact on consumer confidence
- impact on investment
- overall impact on aggregate demand
- globalisation and spread of financial contagion
- high levels of debt
- high oil and commodity prices.

Level 1 ([1]–[2])

Candidate provides little analysis of the causes of recession. There may be vague anecdotal references to banking but no significant economic analysis, and quality of written communication is limited.

Level 2 ([3]–[4])

Candidate provides some analysis of the causes of recession but this will be incomplete or contain minor errors. Quality of written communication is satisfactory.

Level 3 ([5]–[6])

Candidate provides a clear and comprehensive analysis of the causes of recession, and quality of written communication is of a high standard. [6]

(b) GDP estimates may be revised for a variety of reasons:

- changes in definitions of some of the components
- changes in the methods of computation
- discovery of errors or omissions
- inflation is notoriously difficult to estimate.

[3] for each point explained

Constrained maximum of [4]

[4]

(c) There are a number of reasons why economic growth may not lead to a fall in unemployment:

- the economic growth may be based on increased productivity which enables more output to be achieved without any rise in employment
- the working population may be increasing at a faster rate than job creation. This may be due to immigration or an increase in the economic activity rate
- firms may be reluctant to hire labour until they are certain that any economic recovery is likely to continue. They may be content to use more overtime working
- excessive regulation in the labour market may deter firms from hiring
- during the recession firms may have introduced short-time working and will be able to increase output without hiring new workers
- people may remain voluntarily unemployed
- GDP growth may be concentrated in high productivity centres
- very low growth rates make little difference
- firms may have high stock levels and be able to increase sales without increasing employment.

Level 1 ([1]–[2])

Candidate provides little explanation as to why economic growth might not lead to a fall in unemployment. There is no significant economic analysis and quality of written communication is limited.

Level 2 ([3]–[5])

Candidate provides some explanation as to why economic growth might not lead to a fall in unemployment. There is a degree of economic analysis, though this may be superficial or contain errors. Quality of written communication is satisfactory.

Level 3 ([6]–[8])

Candidate provides a clear and comprehensive explanation as to why economic growth might not lead to a fall in unemployment and this is supported by relevant and accurate economic analysis. Quality of written communication is of a high standard. [8]

- (d) A number of factors have contributed to Chinese and Indian rates of economic growth being higher than that of the other countries in Fig. 1. Most are common to both countries but some are peculiar to one or the other.

The most important factors are:

- both countries have highly skilled, motivated and low-cost workforces
- both countries have embraced free market reforms; this has led to more flexibility in the labour market
- both countries have been effective in attracting foreign investment
- China has kept its exchange rate artificially low and this has facilitated export-led growth
- both countries have invested heavily in education
- both countries have enormous domestic markets which enables producers to achieve economies of scale
- China in particular has been successful in changing the pattern of its comparative advantage. Twenty years ago it specialised in textiles and clothing. Today it specialises in technologically advanced products
- both countries have been able to avoid the worst of the recent recession by switching production from European and American markets to domestic and other Asian markets
- countries such as the UK and Italy have much higher fiscal deficits than China and India and cannot give their economies a fiscal stimulus
- mature economies are experiencing diminishing returns from capital investment and may be highly regulated.

Level 1 ([1]–[2])

Candidates provide little explanation for higher growth rates in India and China. There will be vague anecdotal points but no significant relevant economic analysis, and quality of written communication is limited.

Level 2 ([3]–[5])

Candidates provide some explanation for higher growth rates in India and China. There will be relevant economic analysis to support this explanation, though this may be incomplete or contain errors. Quality of written communication is satisfactory.

Level 3 ([6]–[8])

Candidates provide a clear and comprehensive explanation for higher growth rates in India and China and this will contain relevant and accurate economic analysis. Quality of written communication is of a high standard.

[8]

- (e) The dangers of excessive public sector debt has been highlighted by the experience of Greece which shows that any country which loses the confidence of financial markets will have to pay a premium interest rate when trying to borrow. This can undermine its currency and prevent economic recovery.

Issues for analysis and evaluation include:

- impact of contractionary fiscal policy upon aggregate demand and the UK's economic recovery
- disincentive effect of tax increases
- impact on public services of cuts in government expenditure
- explanation of high government borrowing upon interest rates
- explanation of impact of high interest rates upon the economy
- impact of large deficits upon value of pound.

Level 1 ([1]–[3])

Candidate shows little understanding of the issues involved in attempting to correct the UK's budget deficit. There is no significant evaluation and quality of written communication is limited.

Level 2 ([4]–[7])

Candidate shows some understanding of the issues involved in attempting to correct the UK's budget deficit and there is a degree of evaluation. However this is likely to be one-sided or lack depth. Quality of written communication is satisfactory.

Level 3 ([8]–[10])

Candidate shows a clear and comprehensive understanding of the issues involved in attempting to correct the UK's budget deficit. This will be accompanied by in-depth evaluation and judgement. Quality of written communication is of a high standard.

[10]

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2 Government cannot achieve all of its economic objectives

- (a) The main economic objectives of government are:
- high levels of employment and low levels of unemployment
 - a reduction in the rate of economic inactivity
 - high but sustainable rates of economic growth
 - low levels of inflation. The official target is around two per cent annual growth in CPI
 - a satisfactory balance of payments position. This is one which does not undermine confidence in either the pound or in the competence of the UK government.

Level 1 ([1]–[3])

Candidate shows little understanding of the government's main economic objectives. There may be vague references to one or two objectives but no significant explanation. Quality of written communication is limited.

Level 2 ([4]–[7])

Candidate shows some understanding of the government's main economic objectives. There will be a detailed explanation of at least two objectives or a more generalised explanation of at least three. Quality of written communication is satisfactory.

Level 3 ([8]–[10])

Candidate shows a clear and comprehensive understanding of the government's main economic objectives. There will be a detailed explanation of a range of objectives and quality of written communication is of a high standard.

[10]

(b) There are a number of problems faced by the UK government in attempting to achieve its economic objectives:

- the UK is a relatively open economy and as such is extremely sensitive to international events over which the UK government has little control
- the appropriate economic policies may be politically unpopular and hence difficult to implement
- there may be significant time lags between implementing a policy and its impact
- there may be conflicts between policy objectives, making it difficult to achieve all objectives simultaneously
- the economic data on which policies are based may be unreliable.

Level 1 ([1]–[5])

Candidate provides little explanation of the problems faced by the UK government in attempting to achieve its economic objectives. There may be vague references to issues such as international events but little economic analysis. Quality of written communication is limited.

Level 2 ([6]–[10])

Candidate provides some explanation of the problems faced by the UK government in attempting to achieve its economic objectives. There may be references to issues such as international events and a degree of economic analysis though this will tend to be superficial. Quality of written communication is satisfactory.

Level 3 ([11]–[15])

Candidate provides a clear and comprehensive explanation of the problems faced by the UK government in attempting to achieve its economic objectives. There will be references to a range of issues, accompanied by accurate and relevant economic analysis. Quality of written communication is of a high standard.

[15]

- (c) The policy instruments available to government fall under four broad headings:
- monetary policy
 - fiscal policy
 - supply side policies
 - exchange rate policy.

Issues for analysis and evaluation include:

- explanation of monetary policy and how it can be either expansionary or contractionary depending on the objective being pursued
- explanation of the problems in monetary policy, e.g. impact on exchange rates, possibility of creation of asset price bubbles
- 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
- explanation of supply side policies
- explanation of the problems in supply side policies, e.g. social divisions, time-lags
- explanation of impact of exchange rate changes on the macro-economy
- 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 shows little understanding of the policies which the governments could adopt to control the macro-economy recession. There may be references to some policies but little explanation and no significant evaluation. Quality of written communication is limited.

Level 2 ([6]–[10])

Candidate shows some understanding of the policies which the governments could adopt to control the macro-economy recession. Some policies will be explained and there will be a degree of evaluation. Quality of written communication is satisfactory.

Level 3 ([11]–[15])

Candidate shows a clear and comprehensive understanding of the policies which the governments could adopt to control the macro-economy recession. There will be accurate explanation and in-depth evaluation and quality of written communication is of a high standard. [15]

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3 Tighter monetary policy needed to control inflation

(a) Monetary policy is the manipulation of interest rates and other monetary variables by government in order to achieve its economic objectives.

The most commonly used instruments of monetary policy are:

- control of interest rates and in particular the rate at which the Bank of England lends to the banking system
- quantitative easing where the Bank of England buys securities from commercial banks in order to increase their liquidity
- regulation and supervision of the banking system.

Monetary policy can be expansionary or contractionary depending on the economic objective which governments wish to pursue.

Level 1 ([1]–[3])

Candidate provides little explanation of monetary policy. There may be vague references to interest rates but little economic analysis and quality of written communication is limited.

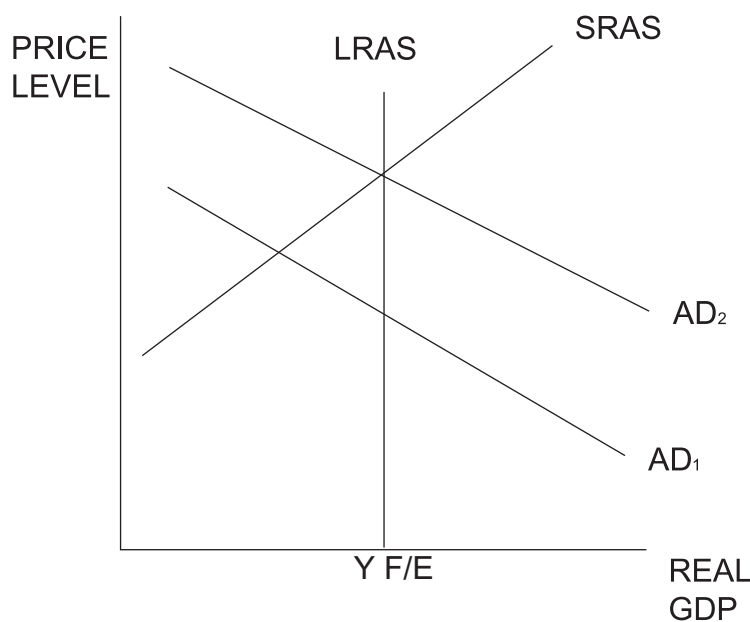
Level 2 ([4]–[7])

Candidate provides a partial explanation of monetary policy. There will be some economic analysis but this is likely to be superficial or contain errors. Quality of written communication is satisfactory.

Level 3 ([8]–[10])

Candidate provides a clear and comprehensive explanation of monetary policy. This will contain clear and accurate economic analysis, and quality of written communication is of a high standard. [10]

(b)



The economy is in short run equilibrium at the intersection of AD_1 and SRAS. Since the economy is below its full employment potential it is in an output gap situation. An expansionary monetary policy shifts aggregate demand from AD_1 to AD_2 and the economy returns to its full employment potential but at a higher price level.

Issues for analysis and discussion include:

- explanation of expansionary monetary policy
- explanation of output gap
- use of AD and AS analysis to explain impact of expansionary monetary policy.

Level 1 ([1]–[5])

Candidate provides no significant explanation of the impact on an economy with a negative output gap of an expansionary monetary policy. Any attempt at AD and AS analysis is seriously flawed and quality of written communication is limited.

Level 2 ([6]–[10])

Candidate provides some explanation of the impact on an economy with a negative output gap of an expansionary monetary policy. There is a serious attempt at AD and AS 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 impact on an economy with a negative output gap of an expansionary monetary policy. There is flawless AD and AS analysis and quality of written communication is of a high standard. [15]

- (c) The monetarist explanation of inflation is that if the money supply rises at a rate faster than the economy's economic growth rate then this can only result in inflation. So if the economy grows by 5 per cent and the money supply rises by 10 per cent then the economy will experience inflation of 5 per cent. Hence monetarist economists assert that the most effective way of controlling inflation is to reduce the rate of expansion of the money supply.

However, many economists believe that there can be other ways of controlling inflation. These include a contractionary fiscal policy, a strong exchange rate and increasing real output by the use of supply side policies.

Issues for analysis and explanation include:

- explanation of monetarist view of inflation
- weakness in monetarist view, e.g. is velocity of circulation a constant?
- explanation of demand pull inflation
- weaknesses in demand pull theory, e.g. can it exist without monetary accommodation?

- explanation of cost push inflation
- weaknesses in cost push theory, e.g. can it also exist without a monetary accommodation?
- impact of supply side policies on the economy.

Level 1 ([1]–[5])

Candidate shows little understanding of how inflation may be controlled. There is no significant comparison of different policies. Quality of written communication is limited.

Level 2 ([6]–[10])

Candidate shows some understanding of how inflation may be controlled. There is some comparison of different policies and a degree of evaluation of their relative merits. Quality of written communication is satisfactory.

Level 3 ([11]–[15])

Candidate shows a clear and comprehensive understanding of the various policies which can be used to control inflation. There is detailed comparison and in-depth of evaluation and judgement of these policies. Quality of written communication is of a high standard. [15]

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4 UK National Income rises by 2%

- (a) Micro-economics is the study of individual markets within an economy. Typical micro-economic issues are the markets for:
- labour
 - housing
 - transport
 - food
 - oil.

Macro-economics is concerned with the study of the economy as a whole. Typical macro-economic issues are:

- the economy's total output of goods and service
- total employment and unemployment
- the general price level throughout the entire economy.

In practice micro and macro economic issues frequently overlap. For instance, a downturn in an individual market such as housing may have a significant impact on the level of aggregate demand.

Level 1 ([1]–[3])

Candidate shows little understanding of the difference between micro and macro economics. There are a few isolated examples but no clear explanation. Quality of written communication is limited.

Level 2 ([4]–[7])

Candidate shows some understanding of the difference between micro and macro economics. There are a few examples but the explanation will be incomplete or contain minor errors. Quality of written communication is satisfactory.

Level 3 ([8]–[10])

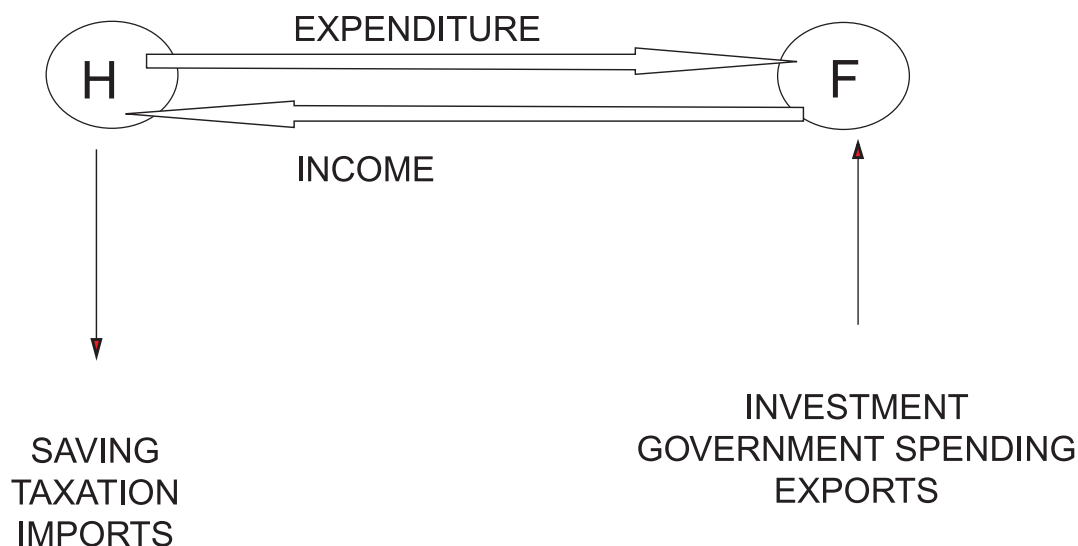
Candidate shows a clear and comprehensive understanding of the differences between micro and macro economics. There is a clear explanation supported by relevant examples. Quality of written communication is of a high standard.

[10]

(b) The circular flow of income and expenditure model of the economy is based on four economic agents:

- (i)** Firstly, the households who are buyers in product markets and sellers in factor markets.
- (ii)** Secondly, the firms who are sellers in product markets and buyers in factor markets.
- (iii)** Thirdly, the government which is a purchaser of goods and services and finances this by collecting taxes from firms and households.
- (iv)** 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.



Withdrawals from the circular flow consist of saving, tax and imports.

Injections are investment, government spending and exports.

An increase in an injection such as investment will cause an increase in the equilibrium level of national income.

Issues for analysis and explanation include:

- explanation of circular flow model
- explanation of investment
- explanation of equilibrium level of national income
- explanation of impact of increase in investment on level of national income
- explanation of second round effects where an increase in national income causes a rise in withdrawals and equilibrium is restored.

Level 1 ([1]–[5])

Candidate provides little explanation of how an increase in investment will affect the circular flow of income and expenditure. There is no significant economic analysis, and quality of written communication is limited.

Level 2 ([6]–[10])

Candidate provides some explanation of how an increase in investment will affect the circular flow of income and expenditure. 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 an increase in investment will affect the circular flow of income and expenditure. There is accurate and appropriate economic analysis, and quality of written communication is of a high standard. [15]

- (c) National income is the total output of a nation's resources no matter where they are located. Hence it includes the output of UK-owned firms in other countries but excludes the output of foreign-owned firms in the UK population. Allowance is made for the depreciation of fixed capital assets and ignores the environmental damage which production may have caused.

When estimates of this damage are deducted then our welfare improvements rates become much less impressive. This is particularly true of China which has enjoyed spectacular rates of growth for many years but at the expense of significant pollution levels.

There are a number of other weaknesses in using national income as a measure of economic welfare.

Issues for analysis and evaluation include:

- explanation of how welfare is measured using real per capita national income
- explanation of environmental damage as a consequence of economic activity
- problems of valuing this damage
- explanation of other weaknesses in national income as a measure of welfare, e.g. unequal distribution of income, defence expenditure, etc.

Level 1 ([1]–[5])

Candidate displays little understanding of the weaknesses of national income as a measure of welfare. There is no significant evaluation of the view that it does not give a true indication of economic welfare, and quality of written communication is limited.

Level 2 ([6]–[10])

Candidate displays some understanding of the weaknesses of national income as a measure of welfare. There is a degree of evaluation of the view that it does not give a true indication of economic welfare, and quality of written communication is satisfactory.

Level 3 ([11]–[15])

Candidate displays a clear and comprehensive understanding of the weaknesses of national income as a measure of welfare. There is in-depth evaluation, and judgement, of the view that it does not give a true indication of economic welfare, and quality of written communication is of a high standard.

[15]

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Total

80