



Advanced Extension Award

Economics

6841

Mark Scheme

2007 examination - June series

Mark schemes are prepared by the Principal Examiner and considered, together with the relevant questions, by a panel of subject teachers. This mark scheme includes any amendments made at the standardisation meeting attended by all examiners and is the scheme which was used by them in this examination. The standardisation meeting ensures that the mark scheme covers the candidates' responses to questions and that every examiner understands and applies it in the same correct way. As preparation for the standardisation meeting each examiner analyses a number of candidates' scripts: alternative answers not already covered by the mark scheme are discussed at the meeting and legislated for. If, after this meeting, examiners encounter unusual answers which have not been discussed at the meeting they are required to refer these to the Principal Examiner.

It must be stressed that a mark scheme is a working document, in many cases further developed and expanded on the basis of candidates' reactions to a particular paper. Assumptions about future mark schemes on the basis of one year's document should be avoided; whilst the guiding principles of assessment remain constant, details will change, depending on the content of a particular examination paper.

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ADVANCED EXTENSION AWARD ECONOMICS

June 2007

6841

Mark Scheme

Section A (Data Response Question)

Different parts of **Question 1** are marked in different ways.

Parts (a) and (b) are marked using a ‘points’ marking scheme. Candidates are rewarded for the relevant points identified and their ability to develop the points they make.

Parts (c), (d) and (e) are marked using the ‘Levels of Response Mark Band Descriptors’ given on the next page. Marks should be awarded according to whether the answer demonstrates the skills indicated in the grid on the next page. Marks are to be allocated for:

- Knowledge and Understanding
- Application
- Analysis
- Synthesis and Evaluation

When marking the candidate’s answer, the examiner must indicate where evidence of each of the four skills is demonstrated by using the following key:

K	Knowledge and Understanding
Ap	Application
A	Analysis
E	Synthesis and Evaluation

Each answer will be marked holistically and the level chosen will be the one which **best fits** the answer provided by the candidate.

The mark scheme for the individual parts of the data response question summarises the information, issues and economic ideas that candidates are likely to include in their answers.

Levels of Response Mark Band Descriptors (Question 1: Data Interpretation)		
Level 3	<p>The candidate demonstrates an in-depth knowledge and understanding of relevant economic concepts and theories throughout and applies them with precision and confidence.</p> <p>The candidate selects and uses a variety of appropriate theories and models to analyse problems and issues. An awareness of the inter-relatedness of economic ideas is shown.</p> <p>The candidate effectively synthesises complex information and ideas and constructs coherent arguments to reach well-reasoned, supported judgements and conclusions.</p> <p>The candidate is able to demonstrate the value and limitations of more complex economic concepts and theories and an understanding of the tentative nature of explanations.</p> <p>Complex information and ideas are communicated in a highly effective manner making use of the most appropriate form and style.</p>	<p>14 – 20 marks</p> <p><i>Mid-point 17</i></p>
Level 2	<p>The candidate demonstrates sound knowledge and understanding of most of the economic concepts and theories employed to help answer the question and applies them effectively.</p> <p>The candidate selects and uses appropriate theories to analyse problems and issues. An awareness of the inter-relatedness of economic ideas is shown.</p> <p>The candidate synthesises information and ideas and constructs coherent arguments to reach reasoned judgements and conclusions.</p> <p>The candidate is able to demonstrate the value and limitations of economic concepts and theories and an awareness of the tentative nature of explanations.</p> <p>Complex information and ideas are communicated effectively in an appropriate form and style.</p>	<p>10 – 13 marks</p> <p><i>Mid-point 11/12</i></p>
Level 1	<p>The candidate makes use of relevant economic concepts and theories but understanding is sometimes confused or incomplete. Some ability to apply economic concepts to the question is demonstrated.</p> <p>The candidate selects appropriate economic theories and shows some ability to use these theories to analyse problems and issues. However the analysis is sometimes confused.</p> <p>The candidate shows some ability to construct a coherent argument to reach judgements and conclusions.</p> <p>Some appreciation of the value and limitations of economic concepts and theories may be demonstrated but little awareness of the tentative nature of economic explanations will be shown.</p> <p>Straightforward information and ideas are expressed clearly with some appreciation of an appropriate form and style.</p>	<p>1 – 9 marks</p> <p><i>Mid-point 5</i></p>

Sections B and C (Essay Questions)

The essay questions in Sections B and C (**Questions 2–5**) are marked using the levels of response mark band descriptors given on the next page. Marks should be awarded according to whether the answer demonstrates the skills indicated in the grid on the next page. Marks are to be allocated for:

- Knowledge and Understanding
- Application
- Analysis
- Synthesis and Evaluation

When marking the candidate's answer, the examiner must indicate where evidence of each of the four skills is demonstrated by using the following key:

K	Knowledge and Understanding
Ap	Application
A	Analysis
E	Synthesis and Evaluation

Each answer will be marked holistically and the level chosen will be the one which **best fits** the answer provided by the candidate.

The mark scheme for the individual questions summarises the information, issues and economic ideas that candidates are likely to include in their answers.

Levels of Response Mark Band Descriptors (Questions 2 – 5: Essay Questions)		
Level 3	<p>The candidate demonstrates an in-depth knowledge and understanding of relevant economic concepts and theories throughout and applies them with precision and confidence.</p> <p>The candidate selects and uses a variety of appropriate theories and models to analyse problems and issues. An awareness of the inter-relatedness of economic ideas is shown.</p> <p>The candidate effectively synthesises complex information and ideas and constructs coherent arguments to reach well-reasoned, supported judgements and conclusions.</p> <p>The candidate is able to demonstrate the value and limitations of more complex economic concepts and theories and an understanding of the tentative nature of explanations.</p> <p>Complex information and ideas are communicated in a highly effective manner making use of the most appropriate form and style.</p>	<p>28 – 40 marks</p> <p><i>Mid-point 34</i></p>
Level 2	<p>The candidate demonstrates sound knowledge and understanding of most of the economic concepts and theories employed to help answer the question and applies them effectively.</p> <p>The candidate selects and uses appropriate theories to analyse problems and issues. An awareness of the inter-relatedness of economic ideas is shown.</p> <p>The candidate synthesises information and ideas and constructs coherent arguments to reach reasoned judgements and conclusions.</p> <p>The candidate is able to demonstrate the value and limitations of economic concepts and theories and an awareness of the tentative nature of explanations.</p> <p>Complex information and ideas are communicated effectively in an appropriate form and style.</p>	<p>20 – 27 marks</p> <p><i>Mid-point 23/24</i></p>
Level 1	<p>The candidate makes use of relevant economic concepts and theories but understanding is sometimes confused or incomplete. Some ability to apply economic concepts to the question is demonstrated.</p> <p>The candidate selects appropriate economic theories and shows some ability to use these theories to analyse problems and issues. However the analysis is sometimes confused.</p> <p>The candidate shows some ability to construct a coherent argument to reach judgements and conclusions.</p> <p>Some appreciation of the value and limitations of economic concepts and theories may be demonstrated but little awareness of the tentative nature of economic explanations will be shown.</p> <p>Straightforward information and ideas are expressed clearly with some appreciation of an appropriate form and style.</p>	<p>1 – 19 marks</p> <p><i>Mid-point 10</i></p>

Total for this question: 80 marks

1(a) Extract A shows changes in the US balance of payments on current account and changes in the US Federal Government's budget balance.

Explain how the changes in the US Federal Government's budget balance may have affected the US balance of payments on current account. *(10 marks)*

For candidates who:

define a government's budget balance: **1 mark**

define the balance of payments on current account: **1 mark**

identify that, since 2000, both the US budget and current account deficits have increased: **1 mark**

identify any other relevant feature of the data **1 mark**

Maximum of 3 marks for definitions and data identification

explain that an increase in the budget deficit increases aggregate demand for output: **up to 4 marks**

explain how an increase in aggregate demand increases imports: **up to 4 marks**

make any other relevant point, e.g. increased aggregate demand
deflecting domestic supply away from exports **up to 2 marks per point**

use the data: **up to 4 marks**

UP TO AN OVERALL MAXIMUM OF 10 MARKS

1(b) 'The laws of demand and supply imply that a nation experiencing a current account deficit should witness a depreciation in its currency, if capital flows remain unchanged' (**Extract C**, lines 1-2).

With the help of a diagram, explain this statement.

(10 marks)

For the diagram:

For candidates who:

draw a supply and demand diagram to show a market-clearing or equilibrium exchange rate, with the axes and coordinates correctly labeled:

2 marks

show the effect of a trade deficit causing the exchange rate to fall to eliminate the deficit:

2 marks

(The diagram can illustrate the effect of increased demand for imports shifting the supply curve for the currency rightward, and/or the effect of reduced demand for exports shifting the demand curve for the currency leftward)

Maximum of 4 marks for a diagram or diagrams

For the written explanation:

For candidates who:

explain the meaning of a depreciation in a currency:

up to 2 marks

explain that a current account or trade deficit may mean that supply of the country's currency is greater than demand for the currency on foreign exchange markets:

up to 4 marks

explain how the resulting excess supply of the currency causes the exchange rate to fall:

up to 4 marks

make any other relevant point, e.g. the impact of items in the current account other than exports and imports:

up to 2 marks per point

Maximum of 6 marks if a relevant diagram is not included in the answer

UP TO AN OVERALL MAXIMUM OF 10 MARKS

1(c) 'Bringing the US Federal Government's budget back into balance will require a politically unpopular combination of tax increases and spending cuts' (**Extract D**, lines 7-8).

Assess the case **for** and **against** bringing a government's budget, such as the US Federal Government's budget, back into balance. (20 marks)

Award **no more than 5 marks** for an answer that considers only how a combination of tax increases and spending cuts could bring the budget back into balance. Award **no more than 11 marks** for an answer that does this, and goes on to discuss why this may be politically unpalatable, but does not address the case for as well as the case against bringing the budget back into balance. An answer that addresses the question in a superficial way should reach Level 2. A greater depth of knowledge and reasonable evaluation should reach Level 3.

Issues, analysis and areas for discussion include:

- Relevant focus on the issue posed by the question
- Cyclical and/or structural causes of a budget deficit
- Economic arguments in favour of deficit financing
- The disadvantages of deficit financing, e.g. inflationary pressures, crowding out
- Economic arguments in favour of a balanced budget
- The disadvantages of a balanced budget, e.g. loss of a demand management lever
- Automatic stabiliser arguments
- Appreciation of Keynesian and/or free-market approaches
- Relevant political factors

Also give credit for:

- Relevant use of data and/or candidate's knowledge
- Relevant use of evidence
- Overall assessment

Candidates should be rewarded for using appropriate diagrams to support their analysis.

Use the Levels of Response Mark Band Descriptors (Data Interpretation) to award marks for this question

UP TO AN OVERALL MAXIMUM OF 20 MARKS

1(d) 'Since the world-wide economic slowdown of 2001, America's insatiable appetite for imports has been one of the mainstays of the global economy' (**Extract D**, lines 18-19).

Assess the possible effects on the global economy resulting from action taken by the US Federal Government to reduce America's imports of goods and services. (20 marks)

Good answers will focus on US import demand as a source of aggregate demand in non-US economies, relating this to possible deficiency in the other components of aggregate demand in non-US economies. Reward appropriate application of circular flow theory, discussion of leakages and withdrawals of spending, and of multiplier effects. Good answers might also relate the question to the benefits of free trade and trade liberalisation, and then on to the adverse effects on the global economy if the US action spurs world-wide protectionism. Another approach might be to relate the question to expenditure-reducing deflation to reduce imports, rather than to the expenditure-switching effects of import controls.

Issues, analysis and areas for discussion include:

- The causes of the USA's demand for imports
- The effect of American demand for imports on countries in the rest of the world
- Application of aggregate demand theory, circular flow theory, multiplier effects etc
- Linkages to trade theory
- The possible effects of US protectionist policies
- The effects of other forms of action the US might implement, e.g. deflationary policies, managed depreciation

Also give credit for:

- Relevant use of data and/or candidate's knowledge
- Relevant use of evidence
- Overall assessment

Candidates should be rewarded for using appropriate diagrams to support their analysis.

Use the Levels of Response Mark Band Descriptors (Data Interpretation) to award marks for this question.

UP TO AN OVERALL MAXIMUM OF 20 MARKS

1(e) For **either** the US economy **or** the global economy, discuss the advantages **and** disadvantages of inward capital investment into the USA. *(20 marks)*

Award **no more than 5 marks** for an answer that considers only the meaning of inward capital investment into the USA. Award **no more than 9 marks** for an answer that considers the effects on either the USA or the global economy, but does not address advantages or disadvantages. An answer that relevantly addresses advantages and disadvantages for the US economy or for the global economy should reach Level 3. For an answer that discusses both the US economy and the global economy, only the better of the two discussions should be rewarded.

Issues, analysis and areas for discussion include:

- The nature of inward capital investment
- Understanding of differences between different types of inward investment, direct, portfolio and short term
- Relation of inward investment to the financing of the US current account deficit
- Discussion of different rates of return on investments located in different countries
- Advantages for the US of attracting inward investment, e.g. access to a supply of savings
- Advantages for other countries of investing in the USA, e.g. for overseas-based MNCs
- Disadvantages for the US of inward investment, e.g. losing control of industries
- Disadvantages for other countries of investing in the USA, e.g. loss of jobs and growth prospects at home

Also give credit for:

- Relevant use of data and/or candidate's knowledge
- Relevant use of evidence
- Overall assessment

Candidates should be rewarded for using diagrams to support their analysis.

Use the Levels of Response Mark Band Descriptors (Data Interpretation) to award marks for this question.

UP TO AN OVERALL MAXIMUM OF 20 MARKS

SECTION B: Markets and Market Failure

2 'A few weeks ago an interesting experiment was undertaken at the Brussels food fair. A new shop was opened selling boxes of Belgian chocolates. On the first day, the price was set at €9 for each box. Sales went well. The next day the price was raised to €15 per box. Steeped in economic theory, you might think that demand now declined. Wrong. Demand doubled. On the third day the price was lowered to €2 for each box. Demand for the chocolates collapsed.'

Source: adapted from an article by PAUL DE GRAUWE, *Financial Times*, 13 January 2006

In the light of this information, evaluate the view that firms should **always** charge high prices rather than low prices. (40 marks)

An answer which addresses the question, but which makes no use of the information in the prompt, should be restricted to a maximum mark of mid-Level 2 (23/24). To reach Level 3, an answer must discuss the case for charging high and low prices, and make some reference to the information in the prompt, e.g. by referring to an exception to the 'law of demand', perhaps related to Veblen goods and/or to the fact that informational problems lead to consumers interpreting a high price as being a sound indicator of a good's quality. Reward relevant discussion of factors that might justify either high or low prices, such as the exploitation of monopoly power, the decision to charge limit prices, the decision to charge predatory prices, the decision to charge higher prices at peak times, the decision to price discriminate.

Issues, analysis and areas for discussion include the following:

- Relating the information in the prompt to an exception or exceptions to the law of demand
- Relating pricing policy to a firm's business objective(s), especially to profit maximisation
- Particular reasons for a high pricing policy, e.g. goods of exclusive consumption, skim pricing exploitation of monopoly power, discriminatory prices
- Particular reasons for a low pricing policy, e.g. limit pricing, predatory pricing, reacting to market contestability
- Consideration of the word 'always' in the question
- Relevant application of the theory of the firm e.g. price takers v price makers
- Application of elasticity

Also give credit for:

- Relevant use of the prompt and the candidate's knowledge
- Relevant use of evidence
- Overall assessment

Candidates should be rewarded for using diagrams to support their analysis.

Use the Levels of Response Mark Band Descriptors (Essays) to award marks for this question.

OVERALL MAXIMUM OF 40 MARKS

3 Using economic theory, evaluate the view that there is no point in a particular country, such as the UK or the USA, implementing economic policies to reduce global warming, because the problem cannot be addressed effectively through action taken by a national government.

(40 marks)

Answers that consider methods of reducing global warming, without any reference to the effect of policies undertaken by a country, acting on its own, should be restricted to a maximum mark at the bottom of Level 2 (20/21). The word *effectively* is a key word in this question. Candidates who do not address the implications of this word should be restricted to a maximum mark of mid-Level 2 (23/24), however good the rest of the answer. Answers should consider the international nature of global warming, and the fact that individual countries experience the effects of global warming ‘imported’ via actions undertaken by other countries, regardless of their own activities. Credit answers that argue that whatever action is undertaken now, it will have little or no effect on the continuation of global warming resulting from economic activity already undertaken. Level 3 can, however, be reached without the inclusion of this argument, provided the international nature of the problems is addressed in some depth. While the UK and USA are mentioned as ‘prompts’ in the question, candidates can mention other countries. Good answers might argue that because of the size of the US economy, action undertaken in the USA can have more effect than action taken by a smaller economy. Other large countries, such as Russia, China and India might also be mentioned.

Issues, analysis and areas for discussion include the following:

- Understanding of the meaning of global warming
- Relating global warming to market failure, and in particular to the effects of negative externalities
- Understanding of appropriate policies to reduce negative externalities
- Relating such policies to the reduction of global warming
- Global warming as an international problem which a national government has little ability to influence
- Recognition of the fact that the ‘supra-national’ nature of global warming means that international cooperation and policy implementation is needed
- Discussion of the implication of the word ‘effectively’ in the question
- Awareness that the best that might be achievable is the slowing down, rather than the reduction, of global warming

Also give credit for:

- Relevant use of the candidate’s knowledge
- Relevant use of evidence
- Overall assessment

Candidates should be rewarded for using diagrams to support their analysis.

Use the Levels of Response Mark Band Descriptors (Essays) to award marks for this question.

OVERALL MAXIMUM OF 40 MARKS

SECTION C: The National and International Economy

4 'Although high oil prices can have important demand-side effects on the economy, they may also have significant supply-side effects. While the resulting lower than anticipated growth might indicate a shortage of demand, it might just as easily indicate a reduction in the economy's supply potential.'

Source: adapted from an article by STEPHEN KING, *The Independent*, 6 March 2006

Evaluate the demand-side **and** supply-side effects that might result from higher oil prices.

(40 marks)

An answer that considers only demand-side **or** supply-side effects, without any evaluation of their relative effects should be restricted to a maximum of mid-Level 1 (10 marks). An answer that evaluates only demand-side **or** supply-side effects, should be restricted to a maximum of mid-Level 2 (23/24 marks). An answer that provides a basic evaluation of **both** demand-side **and** supply-side effects, should be restricted to a maximum of top-Level 2 (27 marks). Reasonably developed evaluation is needed to reach Level 3.

For an oil importer, demand-side effects include greater spending on imports, leakages of aggregate demand, negative multiplier effects. The supply-side effects include rising business costs, cost-push inflation. For an oil exporter, the demand-side effects include increased exports, an injection of aggregate demand, positive multiplier effects. The supply-side effects are the same as those for an oil importer, but the oil-exporter may be able to use oil-earnings to build up the economy's supply side, e.g. Dubai.

Issues, analysis and areas for discussion include the following:

- Understanding of the meaning of demand-side and supply-side effects
- Explanation and analysis of how higher oil prices may induce demand-side effects
- Explanation and analysis of how higher oil prices may induce supply-side effects
- Understanding that the effects may differ for different economies, e.g. oil producers versus oil importers;
- Making use of the information in the prompt relating to lower than anticipated growth
- Application of the AD/AS macroeconomic model

Also give credit for:

- Relevant use of the candidate's knowledge
- Relevant use of evidence
- Overall assessment

Candidates should be rewarded for using diagrams to support their analysis.

Use the Levels of Response Mark Band Descriptors (Essays) to award marks for this question.

OVERALL MAXIMUM OF 40 MARKS

5 Do you agree that globalisation is simply a name for the processes through which rich countries exploit poor countries? Justify your answer. *(40 marks)*

Good answers might argue that certain of the processes of globalisation, e.g. MNCs employing cheap labour or moving polluting industries to poor countries can involve exploitation, but that other processes, e.g. higher incomes resulting from investment and trade liberalization, are not exploitative. Very good answers might back up such discussion with the use of evidence. An answer that fails to provide reasonable understanding of the meaning of globalisation should be restricted to Level 1, as should an answer that does not consider the meaning of exploitation. An answer that provides only a basic evaluation, together with adequate explanation of the meaning of globalisation and exploitation, should be restricted to a maximum of top-Level 2 (27 marks). Fuller evaluation is needed to reach Level 3.

Issues, analysis and areas for discussion include the following:

- Understanding the meaning of globalisation
- Provision of a reasonable definition or definitions of globalisation
- Identification and development of particular aspects of globalisation or the processes of globalisation. e.g. liberalisation of trade, impact of multinational corporations
- The impact of globalisation on the whole of the world economy
- The impact of globalisation on rich countries (or developed countries)
- The impact of globalisation on poor countries (or developing countries)
- Discussion of the meaning of exploitation
- Identifying and discussing the good and bad effects of globalisation

Also give credit for:

- Relevant use of the candidate's knowledge
- Relevant use of evidence
- Overall assessment

Candidates should be rewarded for using diagrams to support their analysis.

Use the Levels of Response Mark Band Descriptors (Essays) to award marks for this question.

OVERALL MAXIMUM OF 40 MARKS