



Rewarding Learning

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

Economics

Assessment Unit AS 2

The National Economy

[AE121]

WEDNESDAY 19 JANUARY, MORNING

MARK SCHEME

- 1 (a) Candidates should describe the trend for the Labour Force Survey (LFS) measure of unemployment.

Starting point 1992 2.7 million (approx)
 End point 2009 2.5 million
 Overall trend marginally downwards by 7.4%.

Other significant features:

- initial rise 1992/1993
- almost continuous fall until late 2005
- low point 1.4 million
- significant recent rise: start 2008 1.6 million to mid 2009 2.5 million.

[2]

Candidates should also describe the trend for the Claimant Count measure of unemployment.

Starting point 1992 2.6 million (approx)
 End point 2009 1.6 million (approx)
 Overall trend significantly downwards by 38.5%.

Other significant features:

- initial rise 1992/1993
- almost continuous fall until late 2005
- low point 0.7 million (approx) in early 2008
- significant recent rise: start 2008 0.7 million to mid 2009 1.6 million.

[2]

Candidates should finally describe the trend in the gap between the two measures of unemployment.

- during 1992/3 there was no significant difference between the two measures
- at mid 2009 the gap was 0.9 million
- the increasing divergence between the two measures has been virtually continuous over the time period.

[2]

Level 1 ([1]–[2])

- candidate provides no significant information on unemployment trends
- there may be a number of isolated points or perhaps some attempt at a narrative but no manipulation of the data nor identification of general trends
- quality of written communication is limited.

Level 2 ([3]–[4])

- candidate provides some information on unemployment trends
- there will be a degree of data manipulation and some identification of general trends
- quality of written communication is satisfactory.

Level 3 ([5]–[6])

- candidate provides extensive and accurate information on unemployment trends
- there will be significant data manipulation and identification of general trends
- quality of written communication is of a high standard.

(b) The Labour Force Survey definition of unemployment requires that a person:

- is without a job, even a part-time one
- has actively sought work in the previous four weeks
- is available to start work within two weeks of the survey.

This therefore includes a number of groups who would not be eligible for Job Seekers Allowance and therefore inclusion in the Claimant Count measure. These are:

- students in full-time education who are seeking part-time employment. The passage estimates that there are a quarter of a million persons in this category
- unemployed persons in their 50s and 60s may have occupational pensions which prevent them receiving JSA
- persons with a working partner whose income is sufficiently high to prevent them receiving JSA
- eligibility for JSA is reviewed at regular intervals.

Level 1 ([1]–[2])

- candidate shows little understanding of the main differences between the two measures of unemployment and of why the LFS count is usually higher
- quality of written communication is limited.

Level 2 ([3]–[4])

- candidate shows some understanding of the main differences between the two measures of unemployment and of why the LFS count is usually higher, however, the explanation may be incomplete or contain minor errors
- quality of written communication is satisfactory.

Level 3 ([5]–[6])

- candidate shows a clear and comprehensive understanding of the main differences between the two measures of unemployment and of why the LFS count is usually higher
- quality of written communication is of a high standard. [6]

(c) There are a number of reasons for this:

- unemployment rates in Northern Ireland are kept artificially low by large numbers of persons claiming incapacity benefits, other than Job Seekers Allowance. These people are not classified as unemployed as they are not available for work
- Northern Ireland has the highest percentage of public sector

workers of any UK region. These jobs are relatively safe and so are protected against the recession

- the low value of the pound against the euro has particularly benefited Northern Ireland because of its land border with the Irish Republic
- Northern Ireland is less dependent on financial services than many other UK regions.

Level 1 ([1]–[2])

- candidate provides little explanation of why Northern Ireland unemployment rates are below the UK average
- there may be a few vague anecdotal points but little economic analysis
- quality of written communication is limited.

Level 2 ([3]–[4])

- candidate provides some explanation of why Northern Ireland unemployment rates are below the UK average
- there will be a degree of economic analysis
- quality of written communication is satisfactory.

Level 3 ([5]–[6])

- candidate provides a clear and comprehensive explanation of why Northern Ireland unemployment rates are below the UK average
- there will be significant economic analysis
- quality of written communication is of a high standard. [6]

- (d) (i)** Unemployment is not having any form of employment but actively seeking work.

Economic inactivity is not having any form of employment but not available for work for a variety of reasons.

[2] for explaining unemployment

[2] for explaining economic inactivity

[4]

- (ii)** There are a number of factors which contribute to economic inactivity, the most important being that for large numbers of people work simply does not pay.

Issues for analysis and discussion include:

- high levels of income tax and national insurance deductions
- availability of benefit to single parents who do not have to demonstrate availability for work
- the ready availability of incapacity benefit, even for minor ailments
- widespread social security fraud, often called “doing the double”.

Level 1 ([1]–[2])

- candidate provides little explanation of the causes of economic inactivity
- there may be a few vague anecdotal points but little economic analysis
- quality of written communication is limited.

Level 2 ([3]–[4])

- candidate provides some explanation of the causes of economic inactivity
- there will be a degree of economic analysis
- quality of written communication is satisfactory.

Level 3 ([5]–[6])

- candidate provides a clear and comprehensive explanation of the causes of economic inactivity
- there will be extensive economic analysis
- quality of written communication is of a high standard. [6]

(e) Frank Field makes two significant proposals for welfare reform.

Firstly, that no one should be on benefit for more than a specific period of time, after which benefit would stop.

Secondly, that instead of the current cumbersome system for trying to determine if someone is seriously seeking employment, there should only be one simple test for this: namely the acceptance of a suitable job offer.

Issues for analysis and evaluation include:

- reduction in overall welfare budget
- reduction in administrative costs associated with assessing whether or not a person is actively seeking employment
- possibility of reduced taxation
- possibility of increased economic growth
- effect on genuine incapacity claimants
- effect on poverty levels and inequality
- possibility of increased crime and disorder.

Level 1 ([1]–[4])

- candidate shows little understanding of Frank Field's proposals nor any evaluation of them
- there will be a few vague comments but no judgement of key issues
- quality of written communication is limited.

Level 2 ([5]–[8])

- candidate shows some understanding of Frank Field's proposals
- there is a degree of evaluation
- quality of written communication is satisfactory.

Level 3 ([9]–[12])

- candidate shows a clear understanding of Frank Field's proposals
- there is in-depth evaluation and judgement
- quality of written communication is of a high standard. [12]

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
- 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
- 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
- quality of written communication is of a high standard. [10]

- (b)** The credit crunch is the term generally used to describe the crisis in world banking which emerged in August 2007. Quite simply, banks both here and in the USA made large amounts 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 bailouts.

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.

Level 1 ([1]–[5])

- candidate provides little analysis of the impact of the credit crunch upon aggregate demand in the UK
- there is no significant use of technical language nor economic models
- quality of written communication is limited.

Level 2 ([6]–[10])

- candidate provides some analysis of the impact of the credit crunch upon aggregate demand in the UK, however, this is likely to be incomplete or contain minor errors
- there is some use of technical language or economic models
- quality of written communication is satisfactory.

Level 3 ([11]–[15])

- candidate provides an accurate and complete analysis of the impact of the credit crunch upon aggregate demand in the UK
- there is significant use of technical language or economic models
- quality of written communication is of a high standard. [15]

(c) The credit crunch created massive deflationary pressures in the economy. The government have attempted to rectify this in a number of ways.

- monetary policy: the Bank of England has reduced its repo rate to 0.5 per cent and introduced a massive programme of quantitative easing. This allows the bank to print money in order to buy assets. So far it has been used to purchase gilt edged securities but its scope could be extended to encompass other assets
- fiscal policy: the government has borrowed heavily in order to support the banks and has effectively taken control of Northern Rock, Lloyds and Royal Bank of Scotland. It has also reduced the rate of VAT to 15 per cent. A “cash for clunkers scheme” has been introduced to increase demand for new cars
- exchange rate policy: talking down the value of the pound, and the use of quantitative easing.

Issues for analysis and evaluation:

- explanation of expansionary monetary policy, including quantitative easing

- impact of monetary policy on exchange rate of pound
- impact of monetary policy on asset prices
- impact of high government borrowing on tax, interest rates and government spending.

Level 1 ([1]–[5])

- candidate shows little understanding of the policies which the authorities have adopted to counter the effects of the credit crunch
- there is no significant evaluation
- quality of written communication is limited.

Level 2 ([6]–[10])

- candidate shows some understanding of the policies which the authorities have adopted to counter the effects of the credit crunch
- 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 shows a clear and comprehensive understanding of the policies which the authorities have adopted to counter the effects of the credit crunch
- there is in-depth evaluation and judgement
- quality of written communication is of a high standard. [15]

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- 3 (a) Nominal GDP is GDP valued at the prices of the year in which it is measured, i.e. not adjusted for inflation.

Real GDP is GDP which has been adjusted for inflation, usually by valuing output at the prices of some previous year.

Appropriate Development.

- explanation of GDP
- explanation of impact of inflation on GDP
- explanation of adjusting for inflation
- numerical example.

Level 1 ([1]–[3])

- candidate shows little knowledge or understanding of real and nominal GDP
- there may be a reference to inflation but its significance is not explained
- quality of written communication is limited.

Level 2 ([4]–[7])

- candidate shows some knowledge and understanding of real and nominal GDP

- there is some explanation of the significance of inflation though this may be incomplete or contain minor errors
- quality of written communication is satisfactory.

Level 3 ([8]–[10])

- candidate shows clear and comprehensive knowledge and understanding of real and nominal GDP
- the significance of inflation is fully and accurately explained
- quality of written communication is of a high standard. [10]

(b) Issues for analysis and discussion include:

- explanation of long-term growth rates
- explanation based on long run aggregate supply curve
- impact of education and training/investment in human capital
- impact of immigration
- impact of investment in physical capital
- impact of supply side policies (explanation of how they stimulate growth)
- impact of change in cultural attitudes, e.g. enterprise culture
- explanation of problems of measurement.

Level 1 ([1]–[5])

- candidate provides little analysis of the factors which determine the long-term growth rate of real GDP
- key issues are missed or their treatment contains major errors
- quality of written communication is limited.

Level 2 ([6]–[10])

- candidate provides some analysis of the factors which determine the long-term growth rate of real GDP
- most key issues are addressed but this may be incomplete or contain minor errors
- quality of written communication is satisfactory.

Level 3 ([11]–[15])

- candidate provides a clear and comprehensive analysis of the factors which determine the long-term growth rate of real GDP
- key issues are addressed accurately
- quality of written communication is of a high standard. [15]

(c) The standard measure of economic growth is the annual percentage increase in real GDP. Using this as a target for government policy creates considerable problems, the most important of which is that this figure makes no allowances for the negative externalities associated with increasing real GDP. The destruction of the environment is often an unwelcome side effect of high levels of economic growth. It is arguable that environmental protection is more important than high growth rates and these should not be an objective of government policy.

Issues for analysis and evaluation include:

- assessment of the impact of high growth rates on the environment

- the costs of global warming
- the material benefits of economic growth
- the possible impact of global warming on economic growth
- possibility of growth based on new low carbon technologies
- reference to the Stern report
- possible impact of economic growth on inequality
- conflict between economic growth and other policy objectives.

Level 1 ([1]–[5])

- candidate shows little understanding of the possible conflict between economic growth and other policy objectives, including environmental protection
- there is no significant evaluation and key issues are not addressed
- quality of written communication is limited.

Level 2 ([6]–[10])

- candidate shows some understanding of the possible conflict between economic growth and other policy objectives, including environmental protection
- 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 shows a clear understanding of the possible conflict between economic growth and other policy objectives, including environmental protection
- there is in-depth evaluation and judgement
- quality of written communication is of a high standard. [15]

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- 4 (a) A rise in the general price level is simply the rate of inflation. So if the CPI rises from 100 to 107 then the rate of inflation is 7 per cent. A rise in the rate of inflation would occur if in the following year the CPI rose to 120. This represents a rate of inflation of 12.1 per cent.

It should be noted that the rate of inflation could fall even though prices were still rising.

Level 1 ([1]–[3])

- candidate shows little understanding of the difference between a rise in the general level of prices and a rise in the rate of inflation
- quality of written communication is limited.

Level 2 ([4]–[7])

- candidate shows some understanding of the difference between a rise in the general level of prices and a rise in the rate of inflation
- there may be an attempt at a numerical example, though typically this will contain minor errors
- quality of written communication is satisfactory.

Level 3 ([8]–[10])

- candidate shows a clear understanding of the difference between a rise in the general level of prices and a rise in the rate of inflation
- there may be an accurate numerical example
- 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.

Level 1 ([1]–[5])

- candidate provides little analysis of the causes of inflation
- 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 analysis of the causes of inflation this may involve an in-depth analysis of one cause or a more limited analysis of two
- quality of written communication is satisfactory.

Level 3 ([11]–[15])

- candidate provides an in-depth analysis of at least two causes of inflation
- quality of written communication is of a high standard. [15]

(c) There are a number of different measures of inflation such as the CPI, the RPI and the PPI. The most widely used of these is the CPI but even this is, at best, a crude estimate of changes in the general price level. Different regions and socio-economic groups will have different rates of inflation and to target one specific estimate may create difficulties for some groups and for the economy as a whole.

Nevertheless, if the authorities were to totally ignore inflationary pressures in the economy then a state of hyper-inflation could easily develop and this could wreak even greater havoc on the economy.

Issues for analysis and evaluation include:

- explanation of problems in measuring inflation

- explanation of specific problems relating to CPI, e.g. exclusion of house price inflation
- explanation of negative impact of inflation on the economy
- explanation of hyper-inflation
- dangers of pursuing an inappropriate inflation target
- reference to Goodhart's Law
- explanation of consequences of failure to meet a target.

Level 1 ([1]–[5])

- candidate shows little understanding of the problems in measuring inflation
- little evaluation of the proposition that controlling it should cease to be a major government priority
- quality of written communication is limited.

Level 2 ([6]–[10])

- candidate shows some understanding of the problems in measuring inflation
- a degree of evaluation of the proposition that controlling it should cease to be a major government priority, however, this is likely to be one-sided or contain minor errors
- quality of written communication is satisfactory.

Level 3 ([11]–[15])

- candidate shows a clear and comprehensive understanding of the problems in measuring inflation
- there is in-depth evaluation and judgement of the proposition that controlling it should cease to be a major government priority
- quality of written communication is of a high standard. [15]

Total

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