cea

Rewarding Learning

ADVANCED SUBSIDIARY (AS)
General Certificate of Education
2017

Economics

Assessment Unit AS 2

The National Economy

[AE121]

MONDAY 22 MAY, 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. Some material may be included in the mark scheme for the benefit of teachers and pupils preparing for future examinations. Candidates are not expected to have provided this information. Such material is printed in the mark scheme in italics.

Levels of response

Questions requiring candidates to respond in extended writing are marked in terms of levels of response. In deciding which level of response to award, examiners should look for the "best fit" bearing in mind that weakness in one area may be compensated for by strength in another. In deciding which mark within a particular level to award to any response, examiners are expected to use their professional judgement. The following guidance is provided to assist examiners.

> **Threshold performance:** Response which just merits inclusion in the level and should be awarded a mark at or near the bottom of the range.

> **Intermediate performance:** Response which clearly merits inclusion in the level and should be awarded a mark at or near the middle of the range.

> **High performance:** Response which fully satisfies the level description and should be awarded a mark at or near the top of the range.

Marking calculations

In marking answers involving calculations, examiners should apply the "own figure rule" 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 all 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 selects 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)** Candidates should make some of the following points of comparison:

- The RPI measure of inflation in March 2005 was 3.1%. In July 2015 it was 1%. This is a fall of 2.1 percentage points or 68%.
- CPI measure of inflation in March 2005 was 1.8%. In July 2015 it was zero. This is a fall of 1.8 percentage points or 100%
- The RPI measure of inflation was much more volatile than the CPI measure. Its high point was 5.5% in 2011. Its low point was in June 2009 when it was –1.6%. This is a range of 7.1 percentage points.
- The low point for CPI inflation is zero in July 2015. Its high point was 5.1% in 2011. This is a range of 5.1 percentage points.
- Both indices fell rapidly in the period 2008/2009 though the RPI fall was greater.
- Both indices rose in the period 2009/2011
- Both indices fell in the period 2011/2015.

Level 1 ([1]–[2])
Candidate provides little comparison of the trends in RPI and CPI. There is likely to be a purely narrative approach with no reference to volatility or longer run trends. Quality of written communication is limited.

Level 2 ([3]–[4])
Candidate provides some comparison of the trends in RPI and CPI. There will be some reference to volatility or trends covering more than one year, though data manipulation will be limited or contain errors. Quality of written communication is satisfactory.

Level 3 ([5]–[6])
Candidate provides a clear comparison of the trends in RPI and CPI. There will be a detailed explanation of volatility and trends covering more than one year. There will be extensive and accurate data manipulation. Quality of written communication is of a high standard.   [6]

(b) The UK Consumer Price Index (CPI) is based on the Living Costs and Food Survey (formerly the Family Expenditure Survey), conducted by the Office of National Statistics (ONS). This determines the range of items to be included in the CPI as well as the weights to be attached to each item. Each year less popular items drop out and new types of spending are added.

In 2015 sat navs and yoghurt drinks were removed from the index and E-cigarettes and streaming music subscriptions were added.

Each item is attributed a weight which reflects its percentage of typical household expenditure.

In 2015 the 3 highest weighted items were:
Transport   14.9%
Housing and household services   12.8%
Restaurants and hotels   12.1%

The average price for each item over a range of retail outlets is derived by monthly survey of 100 000 prices covering 520 items and covering 150 geographical locations. This survey is conducted by the ONS.

Each item in the CPI will have a weighting and a price index. This information allows the ONS to construct the overall CPI index as follows:

ITEM	PRICE INDEX (P)	WEIGHTING (W)	W × P
A	105	50	5250
B	90	30	2700
C	80	20	1600
		SUM W × P	9550

The sum of (W × P) is then divided by the sum of the weights (100) to get the overall CPI which in this case is 95.5. This tells us that prices have fallen by 4.5 per cent since the base year.

Level 1 ([1]–[2])
Candidate provides little explanation of how the CPI is constructed. There may be vague references to price and household spending but these will lack depth and clarity. Quality of written communication is limited.

Level 2 ([3]–[4])
Candidate provides some explanation of how the CPI is constructed. There will be a reference to weights and how they affect the overall index but this will lack development or contain errors. Quality of written communication is satisfactory.

Level 3 ([5]–[6])
Candidate provides a clear explanation of how the CPI is constructed. The importance of weights and how they affect the overall index will be accurately demonstrated. Quality of written communication is of a high standard. [6]

(c) A high value for the pound against the currencies of our major trading partners such as the Eurozone nations affects the UK's rate of inflation in a number of ways:
- The prices of imported items such as white goods will fall in line with the rise in the exchange rate
- There will be a knock-on impact on production costs as imported commodities become cheaper. The aggregate supply curve will shift to the right
- Aggregate demand will be reduced as exports become more expensive and imports become cheaper. The AD curve will shift to the left.

Level 1 ([1]–[2])
Candidate provides little explanation of the impact of a strong pound on the UK's rate of inflation. There may be vague references to export and import prices but no significant economic analysis. Quality of written communication is limited.

Level 2 ([3]–[5])
Candidate provides some explanation of the impact of a strong pound on the UK's rate of inflation. There will be a degree of explanation of the effect on export and import prices but this will not be developed. Quality of written communication is satisfactory.

Level 3 ([6]–[8])
Candidate provides a comprehensive explanation of the impact of a
strong pound on the UK's rate of inflation. The effect on export and import
prices will be clearly explained and this will be extensively and accurately
developed. Quality of written communication is of a high standard.   [8]

(d) An asset price bubble exists when the price of an asset such as property or
shares increases at rapid and probably unsustainable rate. An expansionary
monetary policy creates this in 2 ways:
- Because the returns on cash are so low, investors are more prepared to
  invest in other assets, hence increasing the demand for such assets
- Because the costs of borrowing are so low investors are more prepared
  to borrow in order to invest in these assets. Companies buying back
  their own shares is a good example of this.

Level 1 ([1]–[2])
Candidate provides little explanation of how an expansionary monetary
policy can lead to the creation of asset price bubbles. There will be no
significant economic analysis and quality of written communication is limited.

Level 2 ([3]–[5])
Candidate provides some explanation of how an expansionary monetary
policy can lead to the creation of asset price bubbles. There will be a degree
of economic analysis though this will be incomplete or contain errors and
quality of written communication is satisfactory.

Level 3 ([6]–[8])
Candidate provides a clear explanation of how an expansionary monetary
policy can lead to the creation of asset price bubbles. There will be accurate
economic analysis, involving some reference to asset allocation and quality
of written communication is of a high standard.   [8]

(e) The record low Bank of England base rate of 0.5 per cent was first
introduced in 2009 in response to the then economic crisis. It was widely
seen as a short term measure but it has remained in place for over 6 years.
With the economic crisis apparently a thing of the past, many analysts feel
that the time has come for rates to return to a more normal level.

Issues for analysis and evaluation include:
- The level of CPI inflation
- The level of underlying inflation
- The level of wage inflation
- The level of unemployment
- Trends in productivity
- The state of the Balance of Payments on current account
- Impact of higher rates on value of Pound
- The strength of the recovery
- Impact of significantly higher interest rates on economic growth and
  unemployment
- The state of the world economy, e.g. slow down in China
- Discussion of what constitutes a "significant" increase.

Level 1 ([1]–[4])
Candidate provides little critical examination of the view that the Bank of

England should significantly increase the level of UK interest rates. There is no significant economic analysis though some relevant issues may be touched upon. Quality of written communication is limited.

Level 2 ([5]–[8])
Candidate provides some critical examination of the view that the Bank of England should significantly increase the level of UK interest rates. There is a degree of economic analysis but this will be narrow in focus or contain errors. Quality of written communication is satisfactory.

Level 3 ([9]–[12])
Candidate provides an in depth critical examination and judgement of the view that the Bank of England should significantly increase the level of UK interest rates. There is extensive and accurate economic analysis and quality of written communication is of a high standard.   [12]

AVAILABLE MARKS

40

2 **(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
- Explanation of why nominal GDP is usually higher than real GDP.

Level 1 ([1]–[3])
Candidate provides little explanation of the difference between real and nominal GDP. There may be vague references to inflation but its significance is not explained and quality of written communication is limited.

Level 2 ([4]–[7])
Candidate provides some explanation of the difference between real and nominal GDP. There is a degree of 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 provides a clear and comprehensive explanation of the difference between real and nominal GDP. The significance of inflation is fully and accurately explained and quality of written communication is of a high standard. [10]

(b) The long run aggregate supply curve (LRAS) shows the relationship between the level of real GDP and the price level when the economy is at its full potential level of output. At this point all resources are fully employed and increased prices cannot induce firms to produce more. Hence the LRAS is vertical. If the economy is to increase production then more resources or better use of existing resources is required. This will be reflected in a rightward shift in the LRAS.

Issues for analysis and discussion include:
- Explanation of LRAS.
- Explanation of impact of increase in workforce, perhaps due to immigration
- Explanation of impact of investment in physical capital.
- Explanation of impact of government investment in infrastructure.
- Explanation of impact of investment in human capital.
- Explanation of impact of new technology.
- Explanation of supply side policies.

Level 1 ([1]–[5])
Candidate provides little analysis of the factors which might cause a rightward shift in the long run aggregate supply curve. Key issues are missed or treated in a superficial manner and quality of written communication is limited.

Level 2 ([6]–[10])
Candidate provides some analysis of the factors which might cause a rightward shift in the long run aggregate supply curve. Most key issues are addressed though the analysis may contain minor errors or be incomplete. Quality of written communication is satisfactory.

Level 3 ([11]–[15])
Candidate provides an in-depth analysis of the factors which might cause a rightward shift in the long run aggregate supply curve. Key issues are thoroughly addressed and quality of written communication is of a high standard. [15]

AVAILABLE MARKS

(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.

Furthermore growth does not guarantee an increase in the welfare of all a nation's citizens as it may be associated with increasing inequality.

Issues for analysis and evaluation include:
- The material benefits of economic growth
- Assessment of the impact of high growth rates on the environment and the costs of global warming
- The possible impact of global warming on economic growth through factors such as extreme climate variations
- Possibility of growth based on new low carbon technologies
- Possible impact of economic growth on inequality
- Conflict between economic growth and other policy objectives.

Level 1 ([1]–[5])
Candidate provides little explanation of either the benefits or the negative aspects of economic growth. There is no significant evaluation of the view that it should cease to be an objective of government economic policy and quality of written communication is limited.

Level 2 ([6]–[10])
Candidate provides some explanation of both the benefits and the negative aspects of economic growth. There is a degree of evaluation of the view that it should cease to be an objective of government economic policy but this may lack depth or be one-sided. Quality of written communication is satisfactory.

Level 3 ([11]–[15])
Candidate provides a comprehensive explanation of both the benefits and the negative aspects of economic growth. There is in depth judgement and evaluation of the view that it should cease to be an objective of government economic policy. Quality of written communication is of a high standard. [15]

40

3 **(a)** Aggregate demand has 4 basic components:

1   Consumption (C): Spending by households on goods and services.
2   Investment (I): Spending by firms on investment goods both fixed capital and increases in stocks
3   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. It does not include transfer payments such as welfare payments
4   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) 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 the net exports component of aggregate demand.

Level 1 ([1]–[5])
Candidate provides little 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 contain errors. 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 accurately and quality of written communication is of a high standard. [15]

(c) A basic definition of a balanced budget is a situation where there is equality between government revenue, mostly from taxation, and government expenditure. However it would be unrealistic and probably undesirable for the government to attempt to achieve this on a permanent basis.

Issues for analysis and discussion include:
- Explanation of balanced budget
- Distinction between current and capital spending
- Analysis of link between economic cycle and government finances
- Need for government to run either a budget surplus or a budget deficit depending on the state of the economy
- The social impact of reduced government spending
- Historical and international examples.

Level 1 ([1]–[5])
Candidate provides little evaluation of the desirability of a permanently balanced budget. Key issues are not addressed and quality of written communication is limited.

Level 2 ([6]–[10])
Candidate provides some evaluation of the desirability of a permanently balanced budget. Key issues are addressed though this will be incomplete or contain minor errors and quality of written communication is satisfactory.

Level 3 ([11]–[15])
Candidate provides an in-depth evaluation and judgement of the desirability of a permanently balanced budget. Key issues are addressed in detail and quality of written communication is of a high standard. [15]

40

4 **(a)** The main macro-economic objectives of government are:

- High levels of employment and low levels of unemployment
- High but sustainable rates of economic growth
- Low levels of inflation. The official target is around 2 percent 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.

Government will have other objectives whose importance may vary over time. These include environmental protection and a more equitable distribution of income and wealth.

Level 1 ([1]–[3])
Candidate shows no significant understanding of the government's main macro-economic objectives. There may be vague references to one or two objectives but no detailed explanation. Quality of written communication is limited.

Level 2 ([4]–[7])
Candidate shows some understanding of the government's main macro-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 macro 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) A basic problem of macro-economic management is that policies which are appropriate for one objective may be detrimental for another.

There are several examples of such conflicts:
- Inflation and unemployment
- This conflict or trade off is represented in the Phillips curve which shows high inflation being associated with low unemployment
- The rationale for this relationship is that low unemployment normally requires high levels of aggregate demand and one side effect of this can be a high rate of inflation
- Balance of payments current account equilibrium and unemployment
- Correcting a current account deficit can often be achieved by deflationary policies which reduce the demand for imports. However reducing aggregate demand can drive the economy into recession and cause unemployment
- Economic growth and inflation
- Short term spurts of economic growth can be achieved by expansionary fiscal or monetary policies. Unfortunately these expansionary policies may also cause inflation
- There are numerous other examples of policy conflicts involving issues such as protecting the environment or achieving a "fairer" society.
- Some economists argue that the significance of such conflicts can be

AVAILABLE
MARKS

reduced by the successful implementation of supply side policies. These will shift the LRAS to the right and enable the economy to achieve both low inflation and high growth. In this case the objectives are complements rather than alternatives.

Level 1 ([1]–[5])
Candidate provides little explanation of policy conflicts. There may be a reference to one or two but no significant economic analysis of their causes. Quality of written communication is limited.

Level 2 ([6]–[10])
Candidate provides some explanation of policy conflicts. There will be a reference to one or two and a degree of economic analysis of their causes. However the explanation will lack depth or contain errors. Quality of written communication is satisfactory.

Level 3 ([11]–[15])
Candidate provides a clear and comprehensive explanation of policy conflicts. It would be expected that at least two would be analysed in some depth. Quality of written communication is of a high standard.   [15]

(c) In the UK the average income of the richest 10 per cent is almost 10 times as large as that of the poorest 10 per cent. *The OECD average is 9.5 and in France and Germany it is around 7.*

Between 2005 and 2011 the average income of the poorest 10 per cent in the UK fell 2 per cent in real terms.

In the UK the share of income of the top 1 per cent of income earners increased from 6.7 per cent in 1981 to 12.9 per cent in 2011.

Income inequality in the UK has been well above the OECD average for 3 decades and many governments have attempted to reverse this trend but with little or no success. The major problem is that redistributional policies tend to create disincentives to enterprise and growth.

Issues for analysis and evaluation include:
•   Explanation and evaluation of policies to achieve a more equitable distribution of income
•   Explanation and evaluation of means testing of benefits
•   Explanation of Laffer curve
•   Explanation of disincentive effect of policies to achieve a more equitable distribution of income
•   Social benefits of greater equality, e.g. reduced crime, improvements in health
•   International comparisons, e.g. Scandinavian countries.

Level 1 ([1]–[5])
Candidate shows little understanding of how a more equitable distribution of income could be achieved. There is no significant evaluation of the view that this should be a government's top economic priority and quality of written communication is limited.

	AVAILABLE MARKS

Level 2 ([6]–[10])
Candidate shows some understanding of how a more equitable distribution of income could be achieved. There is a degree of evaluation of the view that this should be a government's top economic priority. However this is likely to lack depth or be one-sided and quality of written communication is satisfactory.

Level 3 ([11]–[15])
Candidate shows a clear and comprehensive understanding of how a more equitable distribution of income could be achieved. There is in-depth evaluation and judgement of the view that this should be a government's top economic priority and quality of written communication is of a high standard. [15]

40

Total 80