



**General Certificate of Secondary Education
2011**

Economics

Paper 2

[G9272]

MONDAY 6 JUNE, MORNING

**MARK
SCHEME**

Section A

AVAILABLE
MARKS

- 1 (a) Opportunity cost is the next best alternative foregone when an economic decision is made.

Award [2] for a clear and accurate definition, [1] for a flawed or partial definition.

(AO1: [2]) [2]

- (b) Allow [1] for either example of the £30 million spent on clearing up litter that could be spent on employing 1400 nurses or building five new primary schools.

(AO1: [1]) [1]

- (c) Allow [1] for a valid answer which may include:

- income tax
- value added tax
- rates
- vehicle excise duty
- excise duty on petrol, or alcohol, or tobacco products
- airport tax.

(AO1: [1]) [1]

- (d) The government may want to increase taxes for a number of reasons.

These include:

- to fund a spending plan
- to pay off debt
- to reduce inflation
- to reduce aggregate demand.

Award [1] for identification of a valid reason and [1] for a brief explanation.

(AO2: [2]) [2]

6

- 2 (a) Market price is the price at which the quantity demanded equals the quantity supplied. It is the price at which the demand and supply curves intersect, known as the market clearing price.

Allow [2] for a correct definition. Allow [1] for a partial answer that has some understanding.

(AO2: [2]) [2]

- (b) Allow [1] for showing a shift to the left of the supply curve and [1] for indicating the new higher market price and lower quantity demand and sold.

(AO2: [2]) [2]

- (c) Supermarkets could react in a number of ways. These include:
- increasing supplies of substitutes such as tinned carrots or other fresh vegetables
 - promote other vegetables so as not to lose customers
 - they could import carrots from other suppliers not affected by the bad weather
 - they could simply inform customers that supplies are low or unobtainable.

Allow [1] for identification of a valid action and [1] for a supporting brief explanation. [2]

6

- 3 (a) Inflation is a sustained rise in the general price level over a period of time as measured by a relevant price index, e.g. CPI or RPI.

Money loses its value and people cannot buy as many goods and services.

Award [2] for a clear and accurate definition, [1] for a flawed or partial definition.
(AO1: [2]) [2]

- (b) Causes of inflation are analysed under the headings of cost–push or demand–pull.

Award [2] one cause reasonably outlined. Award [1] for a partial answer that has some understanding.
(AO2: [2]) [2]

- (c) Inflation has a number of effects on the economy. These include:
- “shoe leather costs” – consumers have to make more frequent trips to the bank to obtain cash and spend time analysing price changes
 - “menu costs” – businesses have to spend time and money changing price lists, resetting vending machines, etc.
 - savers lose – if the rate of inflation is higher than the rate of interest then the real value of savings will fall
 - people on fixed incomes lose – they will see the real value of their incomes fall
 - loss of competitiveness – if UK inflation is higher than that of other economies then UK exports will fall and imports will rise.

Award [2] for each reasonable effect outlined. Award [1] for a partial answer that has some understanding.
(AO2: [2]) [2]

- (d) At their monthly meeting, the Monetary Policy Committee may decide not to increase interest rates because they may judge that:
- the problem is not going to continue and will correct itself without their intervention
 - it would cause too much of a reduction in aggregate demand, leading to a rise in unemployment and a slow down in growth
 - this will result in an increase exchange rate of the pound.

Award [1] for stating a reason and [1] for development.
(AO1: [1], AO2: [1])

[2]

Total for Section AAVAILABLE
MARKS

8

20

Section B

AVAILABLE
MARKS

- 4 (a) (i) A mortgage is a loan secured on property repaid over a fixed period of time, usually 25 years or more. Most people purchase a house using a mortgage.

Award up to [2] for a clear explanation.

(AO1: [1], AO2: [1])

[2]

- (ii) A fixed rate mortgage is one where the interest rate is fixed, e.g. 6%, and hence monthly repayments are fixed for a set period of time.

Award up to [2] for a clear explanation.

(AO1: [1], AO2: [1])

[2]

- (iii) A tracker mortgage is one where there is a fixed margin between the mortgage rate and the Bank of England's base rate.

Award up to [2] for a clear explanation.

(AO1: [1]; AO2: [1])

[2]

- (b) (i) Advantages of the fixed rate mortgage are:

- the arrangement fee is lower than the tracker mortgage at £400 in the given data
- repayments will be fixed for an agreed time, usually two years, and this gives certainty to household budgets.

The main disadvantages are:

- repayments could be more expensive than the tracker mortgage if interest rates fall
- people are tied in for a set time period and therefore they cannot take advantage of better deals until their agreement comes to an end.

Allow [2] for an advantage and [2] for a disadvantage.

(AO1: [1], AO2: [2], AO3: [1])

[4]

- (ii) Advantages of the tracker rate are:

- repayments will fall if the Bank of England base rate falls
- since repayments are aligned with changes in base rate, households will not be in the position of owing additional interest should interest rates rise and if the bank only adjusts payments every six months (or year).

Disadvantages are:

- the arrangement fee is usually considerably higher, e.g. at £1000, compared to £400 in the given data
- repayments will rise if base rate rises.

Allow [2] for an advantage and [2] for a disadvantage.

(AO1: [1], AO2: [2], AO3: [1])

[4]

(c) Three ways in which Paula and John could fund the £15,000 deposit include:

- saving up – their joint earnings are £47,000 so their combined incomes are higher than the household average income so there should be some capacity to save
- they could use past savings
- they could borrow from family and/or friends
- they could possibly take out a personal loan from a bank
- they could sell assets such as shares, if they have any, cash in investment products, or turn any other assets that they may own into cash
- use any combination of the above.

Allow [1] for each valid reason and [1] for each brief explanation.

(3 × [2])

[6]

20

5 (a) Between 2008 and 2010 unemployment increased from 1.6 million to 2.5 million, a change of 0.9 million or 56.25% increase.

Award [2] for using data to identify the change, award [1] for partial answer.

(AO2: [2])

[2]

(b) After 2008, economic growth fell from just under 1% to –2.5% and stayed negative throughout most of 2009 indicating that the UK economy was in recession. Towards the end of 2009 the economy experienced positive economic growth at just below 0.5%. The situation improved during 2010 but by the end of the year the modest increase in economic growth was replaced again by a period of negative growth.

Award up to [3] for using data to identify the change in economic growth, the period of recession in 2009 and how this situation developed in 2010.

(AO2: [3])

[3]

(c) As the economy grows output rises and, all other things remaining equal, the demand for labour grows generating an increase in employment and a likely fall in unemployment. When the economy shrinks as it does during a recession the result is a fall in output and a consequent rise in unemployment. This type of unemployment is generally described as demand deficient, cyclical or Keynesian unemployment.

Award up to [3] for a clear description of the links between the two variables.

(AO1: [1], AO3: [2])

[3]

- (d) The budget deficit refers to the difference between government spending and tax revenues. If this is negative it is referred to as a deficit, as the government is unable to cover its spending from tax revenue and has to borrow. The budget deficit has worsened from –£5.2 billion in 2006 to –£131.6 billion in 2009. Initially this was a gradual increase from –£0.6 billion up to 2007, but it increased significantly to –£51.8 billion and then –£131.6 billion by 2008 and 2009 respectively. This is due in a large part to the effects of the recession which has caused government revenue to fall and government spending to rise.

Award [1] for identification of the negative change in the budget deficit, award up to [3] for clearly interpreting the data and the extent of the worsening state of the budget deficit.

(AO2: [2], AO3: [2])

[4]

- (e) The government could use the following policies to help the economy recover from recession:
- fiscal policy that boosts aggregate demand such as a combination of lower taxation and/or increased government spending. This should generate demand and stimulate growth to help move the economy out of recession. This could also be funded by increasing government borrowing. The drawbacks of this policy would be that it may be difficult to borrow the money and it could generate inflation
 - monetary policy could also be used to stimulate the economy and increase aggregate demand. This could involve cutting the interest rate to stimulate an increase in both household and business borrowing. A disadvantage might be that consumers and businesses may be reluctant to borrow even with low interest rates. If successful, increased spending could generate inflation
 - supply-side policies such as increasing spending on education with the aim of improving the quality of the workforce could also be used to help the economy recover from inflation.

Allow [1] for identifying each policy and [3] for explaining each policy up to a maximum of [4]

(2 × [4])

[8]

(AO1: [2], AO2: [2], AO3: [4])

20

Total for Section B

40

Section C

AVAILABLE
MARKS

- 6 (a) Economic resources are categorised as the factors of production; land, labour, capital and enterprise. Supplies of all resources are limited relative to people's wants. For example, there are a limited number of people available to work and the raw materials needed to produce goods are limited. Finding new "natural" resources, such as oil, increases supply for a period but even this is limited. Scarcity of resources results in all individuals, firms and societies having to make choices about how to use them.

Level 0 ([0])

The candidate's response contains no content worthy of credit.

Level 1 ([1]–[2])

(AO1: [2])

Some understanding of idea of scarce resources. Quality of written explanation is limited.

Level 2 ([3]–[4])

(AO1: [3], AO2: [1])

A basic understanding of scarce resources with development of idea of making choices. Quality of written communication is satisfactory.

Level 3 ([5]–[6])

(AO1: [4], AO2: [2])

A clear understanding of scarce resources and the subsequent necessity of making choices. Quality of written communication is of a high standard. [6]

- (b) Market economies allocate resources through the operation of the price mechanism. There are a number of key characteristics:
- private property – all factors of production are privately owned
 - consumer sovereignty – consumers decide what is to be produced. If consumers wish to buy a product, and have the ability to pay, they will create a demand. If more consumers decide to buy the product the demand will increase
 - the profit motive – firms produce goods and services in order to make a profit. If demand increases, firms can earn more money and make more profit. In response to this they shift resources towards producing these goods. Similarly they will endeavour to reduce costs by improving efficiency in order to increase profit
 - prices adjust to market conditions – the resulting changes in demand and supply will affect the prices of goods and resources. In this way, prices act as a signal to move resources from one use to another

Candidates should be credited for the use of demand and supply diagrams.

Level 0 ([0])

The candidate's response contains no content worthy of credit.

Level 1 ([1]–[3])

(AO1: [1], AO2: [2])

One or two features of how resources are allocated in a market economy are outlined. Quality of written explanation is limited.

Level 2 ([4]–[6])

(AO1: [2], AO2: [3], AO3: [1])

A good understanding of how resources are allocated in a market economy. Quality of written communication is satisfactory.

Level 3 ([7]–[9])

(AO1: [3], AO2: [4], AO3: [2])

A comprehensive understanding of how resources are allocated in a market economy. Quality of written communication is of a high standard.

[9]

- (c) The UK government could seek to achieve a more equal distribution of income in a number of ways. These include reforming the tax and benefits system to lower the tax burden on poorer households and increasing it on higher income households. They could also target specific benefits at poorer income households such as tax and pension credits. They could target particular groups such as reducing the cost of university education to lower income households. There are a number of considerations that they need to weigh up. These include:
- government spending on benefits could rise dramatically depending on how generous and targeted the policy. The government will have to consider the possible additional cost to their overall budget
 - if inequality is not tackled effectively, resources could be wasted. Research suggests that children's educational performance improves when poverty is reduced. Therefore money spent on education will be more effective. This in turn will improve the quality of the workforce
 - reducing inequality produces greater inclusion and fewer people feeling alienated from society, hence reduced need to spend on policies and programmes aimed at promoting social inclusion
 - evidence suggests that more equal societies perform better on a range of social and economic indicators (see The Spirit Level)
 - the ethical argument that high levels of inequality are unfair
 - greater equality may remove the incentives needed by a market economy
 - policies to promote greater equality could lead to greater government intervention which might generate inefficiency.

Level 0 ([0])

The candidate's response contains no content worthy of credit.

Level 1 ([1]–[5])

(AO1: [1], AO2: [1], AO3: [3])

A limited understanding of how and why the government should reduce income inequality. Quality of written explanation is limited.

Level 2 ([6]–[10])

(AO1: [2], AO2: [2], AO3: [6])

A more developed understanding of how and why the government should reduce income inequality. Quality of written communication is satisfactory.

Level 3 ([11]–[15])

(AO1: [3], AO2: [3], AO3: [9])

A comprehensive understanding of how and why the government should reduce income inequality. Quality of written communication is of a high standard. [15]

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- 7 (a) The main types of mergers between companies are:
- horizontal integration when two firms in the same industry at the same stage of production merge
 - vertical integration when two companies in the same industry at different stages of production merge
 - lateral integration when two companies in related fields of production merge
 - conglomerate integration when two companies in unrelated business fields merge.

Level 0 ([0])

The candidate's response contains no content worthy of credit.

Level 1 ([1]–[2])

(AO1: [2])

Some understanding of one type of integration. Quality of written explanation is limited.

Level 2 ([3]–[4])

(AO1: [3], AO2: [1])

A basic understanding of two types of integration. Quality of written communication is satisfactory.

Level 3 ([5]–[6])

(AO1: [4], AO2: [2])

A clear understanding of two types of integration. Quality of written communication is of a high standard. [6]

- (b) Companies can compete in a variety of ways:
- on the basis of price, Cadbury can attempt to cut their prices to below that of their rivals
 - advertising, Cadbury can spend money on advertising and promoting their products
 - Cadbury can develop brand names for their products to give them a market niche
 - Cadbury can develop new products which meet new market demand or are of better quality than rival products
 - extend marketing to global customers.

Level 0 ([0])

The candidate's response contains no content worthy of credit.

Level 1 ([1]–[3])

(AO1: [1], AO2: [2])

One or two ways in which companies can compete are outlined but there is little explanation. Quality of written explanation is limited.

Level 2 ([4]–[6])

(AO1: [2], AO2: [3], AO3: [1])

At least two possible means by which companies can compete are described and there is some explanation of these. Quality of written communication is satisfactory.

Level 3 ([7]–[9])

(AO1: [3], AO2: [4], AO3: [2])

Three or more ways in which companies can compete are outlined and explained in detail. Quality of written communication is of a high standard. [9]

- (c) There are a number of advantages and disadvantages of mergers such as:

Advantages

- the merger may lead to economies of scale, improving efficiency and leading to lower costs and prices for consumers
- a larger firm may spend more researching and developing new products which will benefit the consumer
- larger companies may be able to compete more effectively with firms abroad leading to higher growth and the creation of more jobs.

Disadvantages

- the larger firm may be more inefficient due to diseconomies of scale
- a merger may lead to a monopoly which may exploit consumers through higher prices
- there will be a loss of consumer choice.

Level 0 ([0])

The candidate's response contains no content worthy of credit.

Level 1 ([1]–[5])

(AO1: [1], AO2: [1], AO3: [3])

A limited understanding of some of the advantages and disadvantages of mergers. Quality of written explanation is limited.

Level 2 ([6]–[10])

(AO1: [2], AO2: [2], AO3: [6])

A more developed understanding of the advantages and disadvantages of mergers. Quality of written communication is satisfactory.

Level 3 ([11]–[15])

(AO1: [3], AO2: [3], AO3: [9])

A comprehensive understanding of the advantages and disadvantages of mergers. Quality of written communication is of a high standard. [15]

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- 8 (a) The market for housing refers to the general market conditions which indicate the number of houses demanded and supplied at given price ranges over a period of time. In recent years market conditions have resulted in huge rises in house prices during the boom years up to 2008 but following the credit crunch, prices fell sharply. Market prices will adjust in response to changes in market conditions.

Level 0 ([0])

The candidate's response contains no content worthy of credit.

Level 1 ([1]–[2])

(AO1: [2])

Some indication of the concept of the market but it is not applied well to the context of housing. Quality of written explanation is limited.

Level 2 ([3]–[4])

(AO1: [3], AO2: [1])

Some relevant factors about the market for housing are explained to a limited extent. Quality of written communication is satisfactory.

Level 3 ([5]–[6])

(AO1: [4], AO2: [2])

There is a clear explanation of the market for housing. Quality of written communication is of a high standard. [6]

- (b) The price of houses is governed by a number of factors. These include:

Demand

- consumers' income – the higher income levels the higher the demand for housing
- availability of mortgages – most houses are purchased using mortgage finance. The easier it is to obtain a mortgage the higher will be the demand for housing
- interest rates – the higher the rate of interest, the more expensive it will be to repay a mortgage, lowering the demand for houses
- price of substitutes – if rents for rental property increases then the demand for houses will increase
- population – an increase in the population will generate an increase in the demand for houses
- changes in the population structure – e.g. a rise in one-person households has caused an increase in the demand for houses.

Supply

- cost of building materials, workers' wages, etc.
- cost of land
- subsidy for house building
- changes in technology in building industry.

Candidates should be credited if appropriate diagrams are used in their answers.

Level 0 ([0])

The candidate's response contains no content worthy of credit.

Level 1 ([1]–[3])

(AO1: [1], AO2: [2])

One or two factors are outlined but the explanation is limited. Quality of written explanation is limited.

Level 2 ([4]–[6])

(AO1: [2], AO2: [3], AO3: [1])

At least two possible factors are outlined and there is an attempt to explain in detail. Quality of written communication is satisfactory.

Level 3 ([7]–[9])

(AO1: [3], AO2: [4], AO3: [2])

Three factors are outlined and explained in detail. Quality of written communication is of a high standard. [9]

- (c) Falling house prices have both advantages and disadvantages for the economy.

Advantages

- first-time buyers will find it easier to purchase a house assuming they can obtain mortgage finance
- lower income households will find it easier to afford their own home
- rent for privately rented accommodation is likely to fall, which will benefit lower income households who are more likely to rent
- there will be less pressure to develop greenfield sites for housing with corresponding social benefits
- it will limit the increase in consumer debt.

Disadvantages

- households who own their own house will see a decrease in their real wealth as property prices fall
- this may cause a general fall in the level of consumer spending which will cause a fall in growth and a rise in unemployment throughout the economy
- there will be a decrease in the number of houses built leading to falling profits for builders and possible job losses for those in the construction industry, e.g. bricklayers, joiners, architects
- people who bought houses to benefit from capital gains may experience financial problems (negative equity problem)
- there will be a decline in inflationary pressures in the economy.

Level 0 ([0])

The candidate's response contains no content worthy of credit.

Level 1 ([1]–[5])

(AO1: [1], AO2: [1], AO3: [3])

Some understanding of advantages and/or disadvantages. Quality of written explanation is limited.

Level 2 ([6]–[10])

(AO1: [2], AO2: [2], AO3: [6])

Good understanding of some advantages and disadvantages of falling house prices. Quality of written communication is satisfactory.

Level 3 ([11]–[15])

(AO1: [3], AO2: [3], AO3: [9])

Thorough examination of a range of advantages and disadvantages of falling house prices. Quality of written communication is of a high standard. [15]

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- 9 (a) The European Union is an economic union of 27 member states. It is primarily a customs union with free trade between members and a common external tariff. However, it is further integrated with a single market, removing non-tariff barriers to trade and co-ordination of economic, and other policies. A majority of EU members use the euro as their currency.

Level 0 ([0])

The candidate's response contains no content worthy of credit.

Level 1 ([1]–[2])

(AO1: [2])

A vague understanding of what is meant by the EU. Quality of written explanation is limited.

Level 2 ([3]–[4])

(AO1: [3], AO2: [1])

A good understanding of what is meant by the EU. Quality of written communication is satisfactory.

Level 3 ([5]–[6])

(AO1: [4], AO2: [2])

A clear and comprehensive understanding of what is meant by the EU. Quality of written communication is of a high standard. [6]

- (b) EU membership extends the market available to countries in which to trade. If all countries do this then output and consumer welfare are maximised. Consumers benefit from a greater choice of goods and services including some that it may not be possible to produce domestically. Firms may benefit from economies of scale as they are able to sell into larger global markets. Consumer choice is increased.

Smaller EU members have access to very large markets within the EU and they are protected from competition from outside the EU by the common external tariff. Countries are able to specialise in niche markets.

EU membership helps countries compete in a global economy in a number of ways:

- increased market size allows firms to develop economies of scale
- external tariff helps firms compete against cheap imports
- EU structural funds help countries develop infrastructure
- firms can merge within EU to benefit from economies of scale
- internal EU migration allows firms to benefit from lower cost labour
- firms can relocate to lower wage countries within EU.

Level 0 ([0])

The candidate's response contains no content worthy of credit.

Level 1 ([1]–[3])

(AO1: [1], AO2: [2])

Some reasons are given about how EU membership helps countries to compete but these are poorly explained or developed. Quality of written explanation is limited.

Level 2 ([4]–[6])

(AO1: [2], AO2: [3], AO3: [1])

A number of reasons are quite well explained about how EU membership helps countries to compete. Quality of written communication is satisfactory.

Level 3 ([7]–[9])

(AO1: [3], AO2: [4], AO3: [2])

A range of reasons and a comprehensive explanation are given about how EU membership helps countries to compete. Quality of written communication is of a high standard. [9]

- (c) There are a number of possible costs and benefits of the UK adopting the euro. These include:

Costs

- changing the currency in the UK would be expensive
- there would need to be a massive education programme to prepare people for the changeover
- there will be costs to businesses to ensure that all costing and billing is in euro denominations rather than pounds sterling
- prices could rise if there is an upward adjustment to round them off in euros
- if the UK joins the European Central Bank (ECB) and interest rates are higher than the former rates set by the Bank of England's Monetary Policy Committee (MPC), repayments on loans could increase for householders and businesses
- jobs may be lost in the financial services sector.

Benefits

- prices will become more transparent across EU member countries and this will allow easy comparison of prices
- money will not be wasted on conversion charges if trading within the EU
- if ECB interest rates are lower than those that were set by the MPC, households and firms with loans will enjoy cheaper repayments
- people will be able to move to and from the UK without the need to convert currency and this may help the tourist industry.

Level 0 ([0])

The candidate's response contains no content worthy of credit.

Level 1 ([1]–[5])

(AO1: [1], AO2: [1], AO3: [3])

A limited understanding of the costs and benefits of joining the euro and the discussion is not well developed. Quality of written explanation is limited.

Level 2 ([6]–[10])

(AO1: [2], AO2: [2], AO3: [6])

A more developed understanding and discussion of the costs and benefits of joining the euro. Quality of written communication is satisfactory.

Level 3 ([11]–[15])

(AO1: [3], AO2: [3], AO3: [9])

A comprehensive understanding and discussion of the costs and benefits of joining the euro. Quality of written communication is of a high standard. [15]

Total for Section C

Total

AVAILABLE
MARKS

30

30

90