

Version 1.0



General Certificate of Education June 2011

Economics

ECON4

**Unit 4: The National and International
Economy**

Final

Mark Scheme

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 Level Economics Unit 4

General Instructions

Marks awarded to candidates should be in accordance with the following mark scheme and examiners should be prepared to use the full range of marks available. The mark scheme for most questions is flexible, permitting the candidate to score full marks in a variety of ways. Where the candidate's response to a question is such that the mark scheme permits full marks to be awarded, full marks **MUST** be given. A perfect answer is not necessarily required for full marks. But conversely, if the candidate's answer does not deserve credit, then no marks should be given.

Occasionally, a candidate may respond to a question in a reasonable way, but the answer may not have been anticipated when the mark scheme was devised. In this situation, **OR WHENEVER YOU HAVE ANY DOUBT ABOUT THE INTERPRETATION OF THE MARK SCHEME**, you must in the first instance telephone your team leader to discuss how to proceed.

Two approaches have been used in the construction of the mark scheme.

- (i) **An issue based approach.** The mark scheme for parts **01**, **02**, **04** and **05** of the data response questions and the first part of each essay question adopts this approach. The mark scheme lists the marks that can be awarded for particular issues (and associated development) that the candidate might include in the answer.
- (ii) **A levels approach.** This approach is used for parts **03** and **06** of the data response questions and the second part of each essay question. The Levels Mark Scheme on the next page identifies five levels representing differences in the quality of work. A range of marks is allocated to each level. First decide the level into which an answer falls. The level chosen should be the one which **best fits** the answer provided by the candidate. It is **not** intended that the answer should satisfy every statement in the level description. Then think in terms of awarding the mid-point mark which has been identified for that level (e.g. 13 marks for Level 3). Move up or down from this notional mark by considering the extent to which the answer meets the level description overall. Strength in one skill can outweigh weakness in another. When using the Levels Mark Scheme the marker **must** identify where a particular skill is being demonstrated. The **key** to be used to identify the skill is given after the level descriptions. The question-specific mark scheme summarises the information which could be used to answer the question, but without attaching marks to particular issues.

THE LEVELS MARK SCHEME FOR A2

LEVELS OF RESPONSE MARK SCHEME FOR USE WITH QUESTIONS 03, 06, 08, 10 AND 12 ONLY

A2 LEVELS OF RESPONSE	AO1 KNOWLEDGE and UNDERSTANDING of theories, concepts and terminology	AO2 APPLICATION of theories, concepts and terminology	AO3 ANALYSIS of economic problems and issues	AO4 EVALUATION of economic arguments and evidence, making informed judgments
<p>Level 5 22-25 marks (mid-point 24)</p> <p>Good analysis and good evaluation</p>	<p>Good throughout the answer with few errors and weaknesses</p>	<p>Good application to issues</p> <p>Where appropriate, good use of data to support answer</p>	<p>Relevant and precise with a clear and logical chain of reasoning</p> <p>Good awareness of the inter-relatedness of economic issues</p>	<p>Good with a clear final judgement</p>
<p>Level 4 17-21 marks (mid-point 19)</p> <p>Good analysis <u>but</u> limited evaluation</p> <p style="text-align: center;">OR</p> <p>Reasonable analysis and reasonable evaluation</p>	<p>Good throughout the answer with few errors and weaknesses</p>	<p>Good application to issues</p> <p>Where appropriate, good use of data to support answer</p>	<p>Relevant and precise with a clear and logical chain of reasoning</p> <p>Good awareness of the inter-relatedness of economic issues</p>	<p>Limited but showing some appreciation of alternative points of view</p>
<p>Level 3 10-16 marks (mid-point 13)</p> <p>Reasonable answer, including some correct analysis but very limited evaluation</p>	<p>Good throughout much of the answer with few errors and weaknesses</p>	<p>Some good application to issues</p> <p>Where appropriate, some good use of data to support answer</p>	<p>Largely relevant and well organised with reasonable logic and coherence</p> <p>Some awareness of the inter-relatedness of economic issues</p>	<p>Reasonable, showing an appreciation of alternative points of view</p>
<p>Level 2 4-9 marks (mid-point 7)</p> <p>Weak with some understanding</p>	<p>Satisfactory but some weaknesses shown</p>	<p>Reasonable application to issues</p> <p>Where appropriate, reasonable use of data to support answer</p>	<p>Reasonably clear but may not be fully developed and is perhaps confused in places with a few errors present</p> <p>Quite well organised with some logical development</p>	<p>Superficial, perhaps with some attempt to consider both sides of the issue(s)</p>
<p>Level 1 0-3 marks (mid-point 2)</p> <p>Very weak</p>	<p>Limited and some errors are made</p>	<p>Partial application to issues with some errors</p> <p>Where appropriate, limited use of data to support answer</p>	<p>Partial but confused at times, lacking focus and development</p> <p>Limited logic and coherence</p>	<p>A very basic and simplistic attempt is made which is unsupported by analysis</p>
<p>Level 1 0-3 marks (mid-point 2)</p> <p>Very weak</p>	<p>Weak with a number of errors</p>	<p>Little, if any, application to issues</p> <p>Where appropriate, no use of data to support answer</p>	<p>Poor and lacking clarity and focus</p>	<p>No relevant evaluation</p>

THE KEY TO BE USED WHEN USING THE LEVELS MARK SCHEME

- D** Where a particular economic term is correctly **DEFINED** in order to help the candidate to answer the question properly.
- I** Where a relevant **ISSUE** is raised by the candidate.
- K** Where the candidate demonstrates **KNOWLEDGE** of recent developments or features of the economy which help enhance the candidate's response to the question. This should also be used where the candidate quotes relevant examples.
- Ap** Where the candidate demonstrates the ability to **APPLY** knowledge and **CRITICAL UNDERSTANDING** to problems and issues.
- An** Where the candidate demonstrates the ability to **ANALYSE** the problem using appropriate economic ideas.
- E** Where the candidate **EVALUATES** and makes judgements about the significance of various issues and arguments.

Synoptic Assessment

All questions in this unit are synoptic. Therefore, candidates will need to demonstrate that they are able to think as an economist and to use effectively the economist's 'tool kit' of concepts, theories and techniques.

They should demonstrate that they:

- understand the inter-relatedness of many economic issues, problems and institutions
- understand how certain economic concepts, theories and techniques may be relevant to a range of different contexts
- can apply concepts, theories and techniques in analysing economic issues and problems and in evaluating arguments and evidence.

QUALITY OF WRITTEN COMMUNICATION

Quality of Written Communication (QWC) will be assessed in Questions 03, 06, 08, 10 and 12 only.

Candidates will be assessed according to their ability to:

- ensure that text is legible, and that spelling, grammar and punctuation are accurate, so that meaning is clear
- select and use a form and style of writing appropriate to purpose and complex subject matter
- organise information clearly and coherently, using specialist vocabulary when appropriate.

No specific marks are awarded for QWC.

However, examiners should take into account QWC when determining the mark to be awarded for an answer. This means an answer could be taken either up (for exceptional QWC) or down (for very poor QWC) by 1 mark (and no more).

CONTEXT 1**Total for this Context: 40 marks**

01 Using **Extract A**, identify **two** significant features of the macroeconomic indicators shown for 2008. *(5 marks)*

Award one mark for each significant feature identified and up to two marks for the supporting reference to the data, up to a maximum of 5 marks ('significant' such as highs/lows, major changes/trends over a period of time). Significant points might include:

- the UK has by far the lowest inflation rate (3.6% compared to the worst performing country: Ghana 16.5%)
- Ghana and Mozambique have the highest real GDP growth figures (7.3% and 6.8% respectively)
- the UK has the lowest real GDP growth figure
- Ghana and Mozambique also have the highest per capita GDP growth figures (4.6% and 4.7% respectively)
- all the countries shown have positive GDP growth ranging from 0.7% for the UK and 7.3% for Ghana
- the range of real per capita GDP growth is 4.6%, with the UK having 0.1% and Mozambique 4.7%
- of the African economies shown, Botswana has the lowest real GDP growth of 2.9%
- although Ghana has the highest real GDP growth (7.3%), it also has the worst inflation figure (16.5%).

For each point made, award a maximum of **1 mark** for use of data if % signs are not shown **or**, when referring to real GDP or real GDP per capita, growth or change in these measures is not mentioned.

A maximum of **2 marks** may be awarded if the candidate simply trawls through the data.

A maximum of **2 marks** may be awarded if there is no use of statistics which support the point(s) being made.

A maximum of **4 marks** may be awarded where there is evidence of an overview (one valid point is included with data) even though other parts of the answer give the impression of a few statistics chosen at random.

If a candidate identifies more than two significant features, reward the best two.

MAXIMUM FOR PART 01: 5 MARKS

02 Extract B (line 1) argues: ‘Economists can generally agree on the causes of economic growth’.

Explain the term ‘economic growth’ **and** analyse **two** ways in which economic growth can be achieved. (10 marks)

For candidates who:

Explain the term economic growth, eg

- define the term by referring to a rise in real GDP
- refer to actual growth and/or a rise in the productive capacity of the economy with reference to potential growth
- explain the term with reference to long-run aggregate supply and/or an economy’s production possibility frontier
- make further reference to the measurement of GDP by considering the various components and the significance of ‘real’.

**Up to 2 marks per definition and up to 2 marks for further explanation,
or where there is no definition, up to 4 marks per explanation,
to a maximum of 4 marks (including diagrams)**

Analyse **two** causes of economic growth, eg

- investment (**1 mark**) which can have consequences for the supply-side and demand-side of an economy (**1 mark**) by increasing productive capacity (**1 mark**) and by contributing to aggregate demand (**1 mark**) respectively
- stimuli to aggregate demand
- productivity
- innovation and technological change
- government policy
- increasing the volume of resources
- improving the quality of resources, eg training of labour
- a reallocation of resources between different sectors of the economy
- improving general efficiency and competitiveness
- general improvement in the supply side of an economy.

**Award 1 mark for each logical link in a chain of reasoning
Up to 4 marks per cause analysed
(1 mark for identification and up to 3 marks for analysis)**

Make use of diagrams **in the analysis**

**Up to 2 marks per diagram
(1 mark for labelling, 1 mark for correct information shown)
to a maximum of 3 marks**

Reward references to the UK/other economies

1 mark per reference up to a maximum of 2 marks

A candidate can be awarded a maximum of **8 marks** if only the explanation and one cause are analysed or for just two causes analysed with no attempt at the first part of the question.

If a candidate analyses more than two ways, reward the best two.

MAXIMUM FOR PART 02: 10 MARKS

03	<p>Extract B (lines 33-34) argues that ‘the living standards of developed countries, including the UK, will be affected by economic growth in Africa’.</p> <p>Using the data and your economic knowledge, assess the view that living standards in the UK are likely to benefit from sustained economic growth in the economies of Africa.</p> <p style="text-align: right;"><i>(25 marks)</i></p>
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It is hoped that candidates will clarify how living standards might be measured and then provide a balanced assessment of how the economic expansion of Africa could impact on UK growth and hence living standards in their widest sense. It is anticipated that candidates will move to a discussion of living standards via references to economic growth.

Level 5	Good analysis <u>and</u> good evaluation	22-25 marks (mid-point 24)
Level 4	Good analysis <u>but</u> limited evaluation OR Reasonable analysis <u>and</u> reasonable evaluation	17-21 marks (mid-point 19)
Level 3	Reasonable answer, including some correct analysis but very limited evaluation	10-16 marks (mid-point 13)
Level 2	Weak with some understanding	4-9 marks (mid-point 7)
Level 1	Very weak	0-3 marks (mid-point 2)

Where there is no **explicit** reference to the data, award a maximum of **21 marks**.

There must be evidence of evaluation for candidates to score more than 15 marks.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these and/or other issues in the time available.

Issues and areas for discussion include:

Introductory:

- sustained economic growth
- living standards
- reference to general living standards in the UK
- criteria on which judgements are to be made.

Developing a response to the question

Application:

- line 5 GDP per capita as a basic measure of living standards; higher growth may lead to higher GDP per capita in the UK
- lines 17-19 references to aspects of the quality of life, which may or may not benefit from economic growth
- lines 29-31 Africa as a major supplier of raw materials which could facilitate UK economic growth and thus impact on living standards
- lines 36-37 Africa as a potential competitor to the UK in the world economy with a possible adverse impact on UK growth and living standards

Analysis:

- how UK manufacturing might benefit from African demand for manufactured goods and components and hence contribute to economic growth
- the potential, eventual competition for UK manufacturing and a consequent adverse impact on growth
- the potential benefits to UK financial services helping African development, providing further stimulus to this traditionally successful growth sector
- investment opportunities opening up in Africa
- greater accessibility to African raw materials and energy supplies, helping to facilitate UK economic growth
- benefits to other UK services, e.g. tourism
- an assessment of the net effects on UK economic growth and therefore on living standards
- the impact on employment, the more successful and competitive Africa becomes, and hence on average incomes
- the possible adverse impact on manufacturing regions of the UK, while more service-based regions may benefit, so adversely affecting disposable income in the former
- the overall impact on income per head depending on the UK response to developments in Africa
- the impact on UK living standards if African development begins to allow successful encroachment on other UK markets
- growth and the quality of life, allowing a widening out of the discussion on living standards.

Evaluation:

- a comparison of short run and long run effects
 - the economic changes in Africa may be so gradual and piece-meal as to have little measurable impact on the UK
 - however, countries such as Mozambique growing rapidly in the last decade, albeit from lowly positions, may bring pressure to the developed world sooner than was originally thought
 - the net effect may be small if Africa compensates for the decline of other UK markets (temporary or permanent)
 - the potential benefits of African expansion in the context of UK recession, opening up markets which had not been envisaged just a few years earlier
-

- the difficulty of making generalisations, eg parts of Africa providing new sources of energy and raw materials to help UK growth while others begin to present competition for UK manufacturing
- the possibility of having to avoid generalisations because of the diverse character of the continent, so that comments on the potential impact on the UK economy and its living standards are only pertinent to individual economies; stark contrasts between various parts of Africa are likely to persist
- the possibility of complementarity, eg African expansion of secondary activities requiring and stimulating the UK tertiary sector.
- the environmental impact and the increasing demand on resources arising from growth in Africa, possibly impacting on the UK, eg higher oil prices.

Examiners should note that it may be possible to award some marks for basic evaluation such as for a general account of the pros and cons of growth in the context of living standards, with no attempt to place it into the context of the UK/Africa and with only limited reference to living standards. However, this must be considered as low-level evaluation and awarded accordingly. Marginally more credit could be given to this type of evaluation if placed in the context of the countries concerned.

Also give credit for:

- relevant use of evidence and examples not contained in the data
- diagrams
- an overall judgement on the issues raised

**USE THE LEVELS MARK SCHEME FOR THE MARKING OF THIS PART
OF THE ANSWER**

MAXIMUM FOR PART 03: 25 MARKS

CONTEXT 2**Total for this context: 40 marks**

- 04** Using **Extract C**, identify **two** significant features of the government budget balances shown for the period 2007 to 2010. *(5 marks)*

Award one mark for each significant feature identified and up to two marks for the supporting reference to the data, up to a maximum of 5 marks (significant such as highs/lows, major changes/trends over a period of time). Significant points might include:

- all economies had borrowing requirements in all years with the exception of Ireland in 2007 (+ 0.1% of GDP)
- the range of values within the data is 13.4%
- all economies show an increase in the borrowing requirement over the period, although that of Italy does stabilise at 5.6% of GDP 2009/2010. The borrowing requirement of France, for example, rises from 2.7% of GDP to 7.1%, Greece from 3.6% to 12.7%
- 2010 has the highest borrowing requirement of the period with an average of 10.4% amongst the economies shown
- 2007 has the lowest borrowing requirement of the period with an average of 2.06% amongst the economies shown
- the forecast figures for 2009 and 2010 show a significant deterioration on the actual figures for 2007 and 2008, with Ireland, for example, moving from +0.1% to -13.3%
- Greece has the highest average borrowing requirement (8.45%) over the period, but with Ireland and the UK not far behind at 8.15% and 8.13% of respectively
- Italy displays the least change (-1.5% to -5.6%), Ireland the greatest change (+0.1% to -13.3%).

For each point made, award a maximum of **1 mark** for use of data if there is not at least one explicit mention of % of GDP.

A maximum of **2 marks** may be awarded if the candidate simply trawls through the data **and/or** does not, in any part of the answer, show an understanding of the significance of negative values by explicit reference to either deficit or surplus.

A maximum of **2 marks** may be awarded if there is no use of statistics which support the point(s) being made.

A maximum of **4 marks** may be awarded where there is evidence of an overview (one valid point is included with data) even though other parts of the answer give the impression of a few statistics chosen at random.

If a candidate identifies more than two significant features, reward the best two.

MAXIMUM FOR PART 04: 5 MARKS

05 Extract D (lines 22-23) argues that government spending ‘can initiate a powerful stimulus to an economy through the multiplier process’.

Explain ‘the multiplier process’ **and** analyse its possible impact on an economy’s unemployment **and** economic growth. (10 marks)

For candidates who:

Explain

- by first defining the multiplier, eg the amount by which an increase in injections into the circular flow of money will increase total income in the economy
- by referring to the various injections into the circular flow and perhaps providing the contrast with leakages or withdrawals
- by providing a formula or formulae
- the process by relating the multiplier to aggregate demand, GDP etc.

**Up to 2 marks per definition and up to 2 marks for further explanation
or where there is no definition, up to 4 marks per explanation
to a maximum of 4 marks (including diagrams)**

Analyse the impact on unemployment, eg:

- the multiplier may be initiated by an increase in government capital expenditure, eg on road building **(1 mark)**. This not only creates jobs in the road-building sector **(1 mark)** but, as these workers begin to spend their income, jobs are also created in other sectors **(1 mark)** and so unemployment in the economy can be reduced **(1 mark)**
- exports and job creation
- private sector investment and job creation
- income changes across the economy.

Analyse the impact on economic growth, eg:

- if the multiplier serves its purpose and stimulates AD **(1 mark)**, by increasing incomes and household consumption **(1 mark)**, this will stimulate domestic production to some extent **(1 mark)** and this will cause a rise in actual growth as measured by GDP **(1 mark)**
- the impact of an investment-induced multiplier on AD and on productive capacity, and hence potential growth
- the impact of an export-led multiplier on AD with the potential for supply-side benefits also
- to the extent that the multiplier process may help sustain AD, it will make it less likely that capacity will be ‘destroyed’, eg plant being scrapped, and this may have beneficial consequences for future economic growth.

**Reward each step in a logical chain of reasoning
up to 8 marks maximum for the analysis**

Make use of diagrams **in the analysis**.

**Up to 2 marks per diagram
(1 mark for labelling, 1 mark for correct information shown)
to a maximum of 3 marks**

Reward references to the UK/other economies

1 mark per reference to a maximum of 2 marks

A candidate can be awarded a maximum of **8 marks** if only the explanation and one effect are analysed **or** for just two effects analysed with no attempt at the first part of the question.

MAXIMUM FOR PART 05: 10 MARKS

06	Extract D (lines 27-28) states that ‘the impact of the increased government borrowing arising from budget deficits across the EU is of concern amongst some economists’.
	Using the data and your economic knowledge, assess the impact on the UK economy of increased government borrowing by EU governments. (25 marks)

It is hoped that candidates will place the answer firmly into the context of the EU and not simply base the answer on the impact of the UK borrowing requirement, so that any final judgement is sufficiently comprehensive and relevant.

Level 5	Good analysis <u>and</u> good evaluation	22-25 marks (mid-point 24)
Level 4	Good analysis <u>but</u> limited evaluation OR Reasonable analysis <u>and</u> reasonable evaluation	17-21 marks (mid-point 19)
Level 3	Reasonable answer, including some correct analysis but very limited evaluation	10-16 marks (mid-point 13)
Level 2	Weak with some understanding	4-9 marks (mid-point 7)
Level 1	Very weak	0-3 marks (mid-point 2)

Where there is no **explicit** reference to the data, award a maximum of **21 marks**.

There must be evidence of evaluation for candidates to score more than **15 marks**.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these and/or other issues in the time available.

Issues and areas for discussion include:

Introductory:

- government borrowing
- budget deficit
- PSNCR as one technical measure
- the EU fiscal position as a whole
- the Stability and Growth Pact
- proposals for some regulation of fiscal policy independent of government
- criteria for measuring the impact.

Developing a response to the question

Application:

- line 3 reference to Keynesian economics and tolerance of deficits because of the benefits they can bring
- lines 21-22 reference to the multiplier process and aggregate demand
- lines 28-29 the potential impact of borrowing on interest rates and (line 40) on inflation
- lines 36-39 EU fiscal stimulus counterbalancing any loss of business and consumer confidence

Analysis:

- the reasons behind the increased borrowing
- the benefits of government spending
- the benefits of tax cuts
- the potential impact of increased borrowing on interest rates within the EU and whether greater differences emerge between interest rates in the euro area members of the EU and non-euro members of the EU
- the dangers of 'crowding-out' of private sector activity amongst member countries
- the uncertainty that increasing borrowing can create for households and businesses
- the potential impact on the nation's international credit rating and hence on its ability to borrow in the future on favourable terms
- the possibility of seeking help from, for example, the IMF and the impact of this
- the economic pain associated with eventual remedial measures such as spending cuts and tax increases
- the impact on the UK if EU fiscal expansion generally provides a stimulus to the UK economy
- the impact on the value of the euro and the implications of this for the external value of the pound
- any problems which emerge may become EU-wide problems making recovery even harder to achieve
- measuring the impact in terms of growth, jobs and prices.

Evaluation:

- the relevance of the scale of borrowing
- assessment in terms of the **net** impact, eg do the benefits clearly outweigh any problems?
- the economic context in which the borrowing is taking place, eg recession or recovery
- whether the fiscal policy is accompanied by monetary expansion and the possible impact of this combination of expansionary policy
- the perceived costs associated with fiscal balance or surplus
- the speed with which borrowing can be reduced
- the confidence that households and businesses have in government efforts to stabilise the fiscal position
- whether the EU is at one with fiscal policy around the world or very much out on a limb.

Examiners should note that it may be possible to award some marks for basic evaluation such as for a general account of the pros and cons of borrowing, or of higher public spending and/or higher taxation, but with no attempt to place it into the context of the UK and the EU. However, this must be considered as low-level evaluation and awarded accordingly. If these pros and cons are put into the context of the UK and EU, perhaps with an explicit attempt to prioritise, greater credit can be given.

Also give credit for:

- relevant use of evidence and examples not contained in the data
- diagrams
- an overall judgement on the issues raised

**USE THE LEVELS MARK SCHEME FOR THE MARKING OF THIS PART
OF THE ANSWER**

MAXIMUM FOR PART 06: 25 MARKS

Section B

Essay 1**Total for this essay: 40 marks**

07 Explain possible reasons for an economy moving from a period of prosperity to one of recession. *(15 marks)*

For candidates who:

Define/explain economic growth and/or recession, perhaps with reference to GDP, criteria for identifying parts of the economic cycle, the UK experience of recent years

up to 2 marks for a definition**Up to a further 2 marks for an explanation
to a maximum of 4 marks**

Explain possible reasons, eg

- an economic shock such as higher oil prices **(1 mark)**. Higher oil prices may then impact on inflation since oil can be a significant cost of production **(1 mark)** and can adversely affect households' cost-of-living **(1 mark)**. Anti-inflation policy may need to be used **(1 mark)** such as higher interest rates **(1 mark)** but such a response, especially if too severe, might slow the economy too much **(1 mark)**. This and the declining confidence of households and businesses may bring about a downturn and eventual recession **(1 mark)**
- other external economic shocks, such as the global banking crisis or recession amongst our major trading partners for whatever reason
- deterioration in domestic leading sectors such as construction and the car industry
- high levels of demand domestically causing demand-pull inflation and remedial action by the authorities follows which inadvertently plunges the economy into recession
- government failure to take remedial action quickly enough or the wrong type of action or inadequate action as the macroeconomy deteriorates for whatever reason
- a slump in private sector investment with no compensatory activity in the public sector
- any other valid point.

Award 1 mark for each logical link in a chain of reasoning**Up to 7 marks per explanation****(1 mark for identification and up to a further 6 marks for the explanation)**

Make use of diagrams in the analysis.

Up to 2 marks per diagram**(1 mark for labelling, 1 mark for correct information shown)****Up to a maximum of 4 marks for diagrams****MAXIMUM FOR PART 07: 15 MARKS**

08 Assess the contribution which supply-side reforms might make in helping avoid major recessions. *(25 marks)*

It is hoped that candidates will be able to display a good knowledge of recent supply-side reforms (both government policy and private sector initiatives) and then be able to arrive at an informed judgement by relating the impact of them to demand-side initiatives.

Level 5	Good analysis <u>and</u> good evaluation	22-25 marks (mid-point 24)
Level 4	Good analysis <u>but</u> limited evaluation OR Reasonable analysis <u>and</u> reasonable evaluation	17-21 marks (mid-point 19)
Level 3	Reasonable answer, including some correct analysis but very limited evaluation	10-16 marks (mid-point 13)
Level 2	Weak with some understanding	4-9 marks (mid-point 7)
Level 1	Very weak	0-3 marks (mid-point 2)

There must be evidence of evaluation for candidates to score more than **15 marks**.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these and/or other issues in the time available.

Issues and areas for discussion include:

Introductory:

- the economic cycle with particular reference to recession
- the nature of supply-side reforms
- brief reference to alternative policies for helping recovery
- macroeconomic objectives.

Developing a response to the question:

- more detailed references to supply-side reforms such as welfare-to-work, mobility policies, training and education
- the way in which supply-side reforms may help reduce conflict between macroeconomic objectives such as growth and inflation
- supply-side reforms helping to achieve sustained growth
- supply-side reforms and the UK experience
- policies designed to influence aggregate demand (AD)
- a balanced approach to managing the economy, for example, managing AD with the short/medium term in mind while developing supply-side reforms designed to have a long-term impact.

Evaluation:

- consequences may all depend on the nature and scale of the reforms
- is 'avoidance' wishful thinking when alleviation is probably a more realistic aspiration, especially when placed in an international context?
- supply-side reforms can give an underlying strength to an economy which might help avoid recessions
- global recession which impacts on any one economy may require an immediate (perhaps Keynesian) response on the demand side and continuing demand-management policies
- the limited immediate relevance of supply-side reforms whatever the economic shock suffered
- the inability of markets to deal at all with serious shocks to the macroeconomy even where there have been supply-side reforms
- such a response may also be seen as most appropriate even if a downturn is peculiar to one economy
- the benefits of supply-side reforms becoming apparent in a global recession when other economies begin to recover
- a strong impetus for supply-side reforms may only appear **because** of a recession rather than as a consequence of recession (and so the changes in the economic cycle come first)
- the prospect that supply-side reforms can help sustain periods of high economic growth and prevent any downturn, e.g. they help avoid or control inflation as an economy grows.
- it should not always be assumed that recessions have no benefits, eg providing an impetus to efficiency drives and structural reform, and supply-side reforms may ease this process
- the value of comparing interventionist versus free-market supply-side measures.

Examiners should note that it may be possible to award some marks for basic evaluation such as for a general account of the pros and cons of supply-side reforms, but with no attempt to place them into the context of the question or to prioritise them explicitly. This must be considered as low-level evaluation and awarded accordingly.

Also give credit for:

- reference to the experiences of other economies
- diagrams
- an overall judgement on the issues raised.

**USE THE LEVELS MARK SCHEME FOR THE MARKING OF THIS PART
OF THE ANSWER**

MAXIMUM FOR PART 08: 25 MARKS

Essay 2**Total for this essay: 40 marks**

09 Explain how inflation is measured in the UK through indices such as the Retail Prices Index (RPI) and the Consumer Prices Index (CPI). *(15 marks)*

For candidates who:

Define/explain inflation and/or index numbers in a general sense and/or refer to UK inflation

Up to 2 marks for a definition

**Up to a further 2 marks for any explanation
to a maximum of 4 marks**

Explain how inflation is measured in the UK with reference to, eg:

- the concept of a 'basket' of goods and services to include all types of household spending **(1 mark)**, including food, restaurant meals, tobacco **(1 mark)** but with some exclusions from the RPI, for example, interest charges on credit cards **(1 mark)**. The prices of a large and varied sample of products in the basket are gauged **(1 mark)**. A wide range of retail venues is chosen in about 150 places around the UK **(1 mark)**. The goods and services for which prices are recorded are known as 'representative items' of which there are 650 **(1 mark)**. Their movement is taken to represent the price changes for all goods and services covered by the index **(1 mark)**.
- an inflation index as a measure of average prices and of price changes not price levels. So, for example, for RPI with Jan 1987 = 100, the index was 209.8 in January 2008 compared to 201.6 a year earlier. An annual inflation rate of 4.1% can be calculated from these data
- Family Expenditure Survey
- the concept of the 'average family'
- the system of weighting
- comparison between indices, eg the RPI, CPI, RPIX, TPI (only the first two are cited in the specification)
- any other valid feature of measurement using indices.

**Reward each step in a logical chain of reasoning
up to 15 marks**

Make use of diagrams **in the analysis**.

Up to 2 marks per diagram

(1 mark for labelling, 1 mark for correct information shown)

Up to a maximum of 4 marks for diagrams

MAXIMUM FOR PART 09: 15 MARKS

10 To what extent might it be argued that inflation is preferable to deflation? (25 marks)

It is anticipated that candidates will review the various consequences of both inflation and deflation, a review interspersed with evaluative comments, before arriving at a final judgement. Examiners should reward well an informed, relevant discussion and conclusion.

Level 5	Good analysis <u>and</u> good evaluation	22-25 marks (mid-point 24)
Level 4	Good analysis <u>but</u> limited evaluation	17-21 marks (mid-point 19)
	OR Reasonable analysis <u>and</u> reasonable evaluation	
Level 3	Reasonable answer, including some correct analysis but very limited evaluation	10-16 marks (mid-point 13)
Level 2	Weak with some understanding	4-9 marks (mid-point 7)
Level 1	Very weak	0-3 marks (mid-point 2)

There must be evidence of evaluation for candidates to score more than **15 marks**.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these and/or other issues in the time available.

Issues and areas for discussion include:

Introductory:

- the concept of price stability/price instability
- definitions of inflation and deflation
- the UK experience of recent years
- the UK Government's setting of an inflation target
- price stability as a desired objective and its relationship with other macroeconomic objectives.

Developing a response to the question:

- inflation damaging competitiveness with a potential impact on the balance of payments on current account
- anti-inflation policies which are potentially harmful to the economy
- the impact on business and household confidence
- the impact on real income and hence real spending power
- the ultimate damage to economic growth and jobs
- deflation as being far less common than inflation in many economies
- the impact on real incomes and real purchasing power
- the dangers of consumer postponement of purchases hoping that prices will fall further

- the impact on profits
- the impact of lower profits and lower business confidence on investment
- the potential benefits of reflationary policies
- the benefits of falling prices to competitiveness
- the possible harm done to growth and jobs
- the impact on creditors/debtors
- whether one is more/less anticipated than the other

Evaluation:

- the extent of the problem, i.e. how significant the rate of inflation or deflation is
- the length of time in which prices rise or fall
- the potential benefits of mild inflation which might not be said of mild deflation
- the relative ease/difficulty of executing, and making effective, policies to deal with either of the problems
- the simultaneous experience of other countries
- whichever problem prevails, the danger of the authorities overshooting targets, eg. quantitative easing and low interest rates bringing too much reflation and hence more inflation
- the difficulty of making a judgement without more detailed information on an actual occurrence and the events surrounding it
- both inflation and deflation have redistributive effects and it is impossible to predict which might be the more beneficial
- a realistic conclusion is that, whatever the relative impact, neither may be desirable and the authorities should be aiming for a period of sustained price stability

Examiners should note that it may be possible to award some marks for basic evaluation such as for a general account of the pros and cons of inflation and/or deflation, but with no attempt to place them into the context of the question or to prioritise them explicitly. This must be considered as low-level evaluation and awarded accordingly.

Also give credit for:

- reference to the experiences of other economies
- diagrams
- an overall judgement on the issues raised

**USE THE LEVELS MARK SCHEME FOR THE MARKING OF THIS PART
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MAXIMUM FOR PART 10: 25 MARKS

Essay 3**Total for this essay: 40 marks**

11 Explain the factors which may lead to a rise in the exchange rate of a currency within a floating exchange rate system. (15 marks)

For candidates who:

Define/explain

- exchange rate
- exchange rate system
- appreciation of exchange rate
- floating exchange rate system, perhaps with comparative reference to fixed exchange rate systems.

Up to 2 marks per definition/explanation to a maximum of 4 marks

Explain how the exchange rate of a currency may be caused to rise within a floating exchange rate system, eg

- trade flows **(1 mark)**. As exports are demanded there will be a greater demand for the currency of the exporting country **(1 mark)** by those overseas customers buying those exports and being required to pay with the foreign currency in question **(1 mark)**. The country concerned will be importing goods and services. This will require buyers to sell the domestic currency **(1 mark)** in order to buy foreign currencies with which to buy imports **(1 mark)**. The increase in demand for the currency arising from higher export sales may be greater than the increase in supply of the currency arising from increased imports **(1 mark)**, all other things being equal, the exchange rate will rise **(0 marks – this final step repeats what is in the question)**.
- net inward investment
- speculative movements resulting in increased purchases of the currency
- ‘dirty floating’, i.e. official intervention in the foreign currency market in a floating exchange rate system in order to buy the currency
- higher interest rates relative to other comparable countries
- external economic stimuli, eg a strong and sustained US recovery which can be related to trade and/or investment flows
- external shocks, eg a banking crisis
- any other relevant factor.

Award 1 mark for each logical link in a chain of reasoning**Up to 7 marks per explanation****(1 mark for identification and up to a further 6 marks for the explanation)**

For those candidates who adopt a basic supply and demand approach to the question without citing specific determining factors such as trade, award a maximum of **10 marks** for the answer as a whole.

Make use of diagrams **in the analysis**.**Up to 2 marks per diagram****(1 mark for labelling, 1 mark for correct information shown)****Up to 4 marks (2 + 2) for a more complex diagram****eg showing the ‘dirty floating’ process****Up to a maximum of 6 marks for diagrams****MAXIMUM FOR PART 11: 15 MARKS**

12 Evaluate the possible macroeconomic consequences for an economy of a rise in the exchange rate of its currency. *(25 marks)*

It is hoped that candidates will briefly explain the macroeconomic criteria by which consequences can be measured, before providing some discussion of the potential impact of appreciation and arriving at a final judgement.

Level 5	Good analysis <u>and</u> good evaluation	22-25 marks (mid-point 24)
Level 4	Good analysis <u>but</u> limited evaluation OR Reasonable analysis <u>and</u> reasonable evaluation	17-21 marks (mid-point 19)
Level 3	Reasonable answer, including some correct analysis but very limited evaluation	10-16 marks (mid-point 13)
Level 2	Weak with some understanding	4-9 marks (mid-point 7)
Level 1	Very weak	0-3 marks (mid-point 2)

There must be evidence of evaluation for candidates to score more than **15 marks**.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these and/or other issues in the time available.

Issues and areas for discussion include:

Introductory:

- appreciation versus depreciation of currency
- criteria for measuring macroeconomic consequences
- exchange rate systems.

Developing a response to the question:

- the potential impact on economic growth as exports perhaps become more difficult to sell overseas
- the possible stimulus to growth as imports of raw materials and energy become cheaper
- the possible benefits to inflation as lower demand for exports reduces pressure on domestic production and resources and imports of goods and services are cheaper
- the impact on employment as cheap imports threaten domestic production and hence jobs and as the overseas demand for exports falls away
- the impact on a significant tourist industry in the economy concerned and hence on growth and jobs in an expanding sector of an increasingly service economy
- the impact on the balance of payments on current account given relative changes in exports and imports of goods and services
- the strong currency making inward investment less attractive, perhaps affecting growth and jobs.

Evaluation:

- the extent of the rise in the exchange rate
- the external value of the currency from which the rise begins to take place
- the significance of the exchange rate factor compared to other influences on the macroeconomy
- whether or not exports have been an important, or sole, cause of growth for an economy
- elasticity conditions for exports and imports
- the period of time in which the appreciation lasts
- the role of speculators in terminating the rise
- the effectiveness/speed of a corrective market mechanism or a decision to 'dirty float'
- the state of the world economy as the appreciation takes place, eg might a prosperous world merely absorb higher prices arising from a country's exchange rate appreciation?

Examiners should note that it may be possible to award some marks for basic evaluation such as for a general account of the pros and cons of appreciation, but with minimal reference to the macroeconomy. However, this must be considered as low-level evaluation and awarded accordingly.

Also give credit for:

- reference to the UK/other economies
- diagrams
- an overall judgement on the issues raised

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MAXIMUM FOR PART (12): 25 MARKS

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