Version 1

**General Certificate of Education (A-level)
June 2012**

Economics   **ECON2**

(Specification 2140)

Unit 2: The National 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 events which all examiners participate in and is the scheme which was used by them in this examination. The standardisation process 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 standardisation each examiner analyses a number of candidates' scripts: alternative answers not already covered by the mark scheme are discussed and legislated for. If, after the standardisation process, examiners encounter unusual answers which have not been raised 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.

Advanced Subsidiary Economics

June 2012   **ECON2/1**

Section A: Objective Test (ECON2/1)

The following list indicates the correct answers used in marking the students' responses.

KEY LIST

1.	**C**	**9.**	**A**	**17.**	**D**
2.	**D**	**10.**	**C**	**18.**	**C**
3.	**C**	**11.**	**D**	**19.**	**B**
4.	**B**	**12.**	**A**	**20.**	**B**
5.	**B**	**13.**	**D**	**21.**	**C**
6.	**C**	**14.**	**B**	**22.**	**C**
7.	**A**	**15.**	**D**	**23.**	**B**
8.	**C**	**16.**	**A**	**24.**	**A**
				25.	**D**

Advanced Subsidiary Economics

June 2012   **ECON2/2**
Mark Scheme

Section B: Data Response

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 questions **01**, **02**, **03**, **05**, **06** and **07** of the data response questions 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 marking questions **04** and **08** of the data response questions. The Levels Mark Scheme on the next page identifies five levels representing differences in the quality of work. A range of marks is allocated at 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 (eg 13 marks for Level 3). Move up and 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 levels descriptions. The question-specific mark scheme summarises the information which could be used to answer the question, but without attaching marks to particular issues.

LEVELS OF RESPONSE MARK SCHEME
FOR USE WITH QUESTIONS 04 AND 08 ONLY

AS 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 judgements
Level 5 22-25 marks (mid-point 24) **Good analysis <u>and</u> good evaluation**	Good throughout the answer with few errors and weaknesses	Good application to issues Good use of data to support answer	Relevant and precise with a clear and logical chain of reasoning	Good with a clear final judgement
Level 4 17-21 marks (mid-point 19) **Good analysis <u>but</u> limited evaluation** **OR**	Good throughout the answer with few errors and weaknesses	Good application to issues Good use of data to support answer	Relevant and precise with a clear and logical chain of reasoning	Limited but showing some appreciation of alternative points of view
Reasonable analysis <u>and</u> reasonable evaluation	Good throughout much of the answer with few errors and weaknesses	Some good application to issues. Some good use of data to support answer	Largely relevant and well organised with reasonable logic and coherence	Reasonable, showing an appreciation of alternative points of view
Level 3 10-16 marks (mid-point 13) **Reasonable answer, including some correct analysis but very limited evaluation**	Satisfactory but some weaknesses shown	Reasonable application to issues Reasonable use of data to support answer	Reasonably clear but may not be fully developed and is perhaps confused in places with a few errors present	Superficial, perhaps with some attempt to consider both sides of the issue(s)
Level 2 4-9 marks (mid-point 7) **Weak with some understanding**	Limited and some errors are made	Partial application to issues with some errors Limited use of data to support answer	Partial but confused at times, lacking focus and development Limited logic and coherence	A very basic and simplistic attempt is made which is unsupported by analysis
Level 1 0-3 marks (mid-point 2) **Very weak**	Weak with a number of errors	Little, if any, application to issues No use of data to support answer	Poor and lacking clarity and focus	No relevant evaluation

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.

QUALITY OF WRITTEN COMMUNICATION

Quality of Written Communication (QWC) will be assessed in Questions 04 and 08 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).

EITHER

Context 1

01 Define the term 'structural unemployment' (**Extract C**, lines 15-16).	*(5 marks)*

For an acceptable definition such as: • unemployment that occurs when the demand for labour is less than the supply of labour in an individual labour market • unemployment that results from the decline in a particular industry/sector, region or occupation (at least 2 needed for full marks) • unemployment that results from the decline in a particular industry which leaves people unemployed because they do not have the skills needed by the industries that are growing.	**5 marks**
Full marks should be awarded to a candidate who demonstrates a clear understanding of the term **structural unemployment** even if the definition is not exactly the same as the acceptable examples quoted above.	

If the definition is inaccurate or incomplete award a maximum of 4 marks which may be broken down, for example, as follows:

Unemployment that results from the decline in a particular sector/industry of the economy.	**4 marks**
Unemployment that results from the decline in a particular occupation within the economy.	**4 marks**
Unemployment resulting from a change in the pattern of demand.	**2 marks**
Unemployment resulting from the immobility of labour.	**2 marks**
When people do not have the right skills for the jobs available	**3 marks**
When people are unwilling or unable to move to areas where there are jobs available	**3 marks**
Unemployment resulting from a change in the structure of the economy.	**2 marks**
For stating that structural unemployment is often classified as a form of voluntary unemployment.	**1 mark**
For stating that structural unemployment is long-term unemployment.	**1 mark**
For defining unemployment	**2 marks**
For one or more examples such as: • unemployment in the coal industry as a consequence of it becoming uneconomic to exploit ageing coal seams in the UK • technological unemployment • jobs on a production line being replaced by robots • unemployment due to a fall in demand for a product such as cathode ray TVs • unemployment caused by foreign competition (or changes in comparative advantage) • regional unemployment.	**1 mark per example - up to a maximum of 2 marks for examples**

Maximum of 4 marks if the definition is incomplete or inaccurate.

MAXIMUM FOR PART 01: 5 MARKS

02	Using **Extract A**, identify **two** significant points of comparison between the rate of growth in real GDP and unemployment over the period shown. *(8 marks)*

Award up to 4 marks for each point made.

Identifies a significant point of comparison. Makes accurate use of the data to support the comparison identified. Unit of measurement given accurately.	**4 marks**
Identifies a significant point of comparison. Makes use of the data to support the comparison identified. However, no unit of measurement is given and/or the unit of measurement is used/applied inaccurately and/or the dates aren't quoted or are inaccurate and/or only one piece of data is given when two are needed.	**3 marks**
Identifies a significant point of comparison. No correct use of the data to support the comparison identified.	**2 marks**
Identifies a significant feature of one data series but no comparison is made. Makes use of the data to support the feature identified. Unit of measurement given accurately.	**1 mark**

If a candidate identifies more than 2 significant points of comparison, reward the best two.

Significant points include:
- at the start of the period, unemployment was lower than at the end of the period (rose from 1.7 million to just under 2.5 million) whereas the rate of growth of real GDP was higher at the start of the period (2.5% approx.) than at the end of the period (1.7% approx)
- the lowest rate of growth in real GDP was in the 2nd quarter of 2009 (-6.0% approx.) whereas unemployment was at its lowest in the 1st quarter of 2008 (around 1.6 million) (also allow 2007 Q3 and Q4)
- the highest rates of growth of real GDP were experienced in the 2nd and 3rd quarters of 2007 (just under 3%) whereas unemployment peaked in the 1st quarter of 2010 (just over 2.5 million).
- the rate of growth of real GDP starts to fall after the 3rd quarter of 2007 and continues to fall until the 2nd quarter of 2009 (just under 3.0% to -6.0%), whereas unemployment remains fairly steady until the 2nd quarter of 2008 but then starts to rise rapidly until the 2nd quarter of 2009 (1.6 million to 2.5 million approximately) – or candidates might state that there is an inverse relationship between the rate of growth in real GDP between the 2nd quarter of 2008 and the 2nd quarter of 2009
- between the 2nd quarter of 2009 and the 3rd quarter of 2010 the rate of growth of real GDP rises (-6.0% to 1.7% approx.) but unemployment remains fairly steady (at around 2.5 million).
- in 2007, real GDP growth is relatively high (between 2% and 3%) whereas unemployment is relatively low (at around 1.6 million)
- throughout 2009, GDP growth is negative (e.g. the lowest rate of growth is -6%) whereas unemployment is high (reaching almost 2.5 million)
- the range for GDP growth is from almost 3% to -6% whereas the range for unemployment is from around 1.6 million to around 2.5 million. Allow the statement that 'GDP growth is more volatile than unemployment' as a point of comparison.

A margin of +/- 0.3% is permissible for the figures relating to real GDP growth and a margin of +/- 0.2 million is permissible for the unemployment figures.

MAXIMUM FOR PART 02: 8 MARKS

03	**Extract C** (lines 6 – 8) states that the 'overall growth in aggregate demand is likely to be less than the economy's underlying trend rate of growth and some economists have predicted that unemployment will rise to around 2.7 million'.
	Explain why unemployment is likely to rise if aggregate demand grows more slowly than the underlying trend rate of growth of the economy. *(12 marks)*

For a candidate who provides a relevant definition, eg aggregate demand, unemployment, economic growth, trend rate of growth	**1 mark per definition Up to a maximum of 2 marks**

Award up to 12 marks for each of the following explanations.
2 marks should be awarded for each logical link in the chain of reasoning.

If AD grows more slowly than potential output excess aggregate supply will emerge **(2 marks)**, the economy will experience a negative output gap/spare capacity **(2 marks)**, there will be an involuntary increase in stocks **(2 marks)**, firms will cut back on production **(2 marks)** and since labour is in derived demand **(2 marks)** firms will reduce the number of workers employed and/or unemployment will increase **(2 marks)**. Firms are also likely to reduce employment to cut costs and/or maintain profits **(2 marks)**. This type of unemployment is known as demand-deficient (or cyclical) unemployment **(2 marks)**.	**Up to 12 marks**
Link between rising productivity, aggregate demand and unemployment.	**Up to 12 marks**
Award **up to 4 additional marks** for the use of relevant diagrams, e.g. an AD/AS diagram that shows why the negative output gap increases if AD does not increase as much as AS increases (ie LRAS shifts) **OR** a diagram showing that the negative output gap increases when actual growth is less than trend growth. **OR** an equivalent production possibility diagram showing that the gap between current output and the PPC boundary has increased. To achieve all 4 marks, the size of the output gap, after the increase in AD should be larger than before the increase in AD. However, the candidate does not have to label the output gap on the diagram to achieve the full 4 marks.	**1 mark for initial labelling of axes and curves, up to 3 marks for the information shown** **See below for examples of how marks should be awarded.**
If a candidate uses a diagram to support their explanation, marks may also be awarded for the following type of a written explanation: In the diagram, the trend growth is represented by a rightward shift in the LRAS (or PPC boundary) **(2 marks)**. Since the increase in AD is less than the underlying trend rate of growth the amount of spare capacity in the economy (or the negative output gap) will increase **(2 marks)**, an increase in the amount of spare capacity (negative output gap) means that unemployment has risen **(2 marks)**.	**Up to 6 marks**

If an AD/AS diagram is used, the breakdown of the marks is as follows:

Axes labelled (allow on the vertical axis: Inflation or PL or £ but **not** Price or P; allow on the horizontal axis: Real GDP, National Output, Output or Y but **not** Quantity or Q). Original AD (and AS curve) labelled correctly. Dotted lines and showing the original price level and level of real GDP(PL1 Y1).	**1 mark**
AD shifts to the right by less than LRAS (or AS) shifts to the right	**2 marks**
Dotted lines and the associated labelling showing the new level of real GDP (PL2 Y2).	**1 mark**
Any other relevant feature of the diagram (e.g. the size(s) of the negative output gap(s)).	**1 mark per feature up to a maximum of 2 marks**

Examples of suitable diagrams include:

AD/AS diagram:

The diagram should show a rightward shift in both the AD and LRAS (AS) curves but the LRAS (AS) curve should shift by more than the AD curve to show that the negative output gap increases.
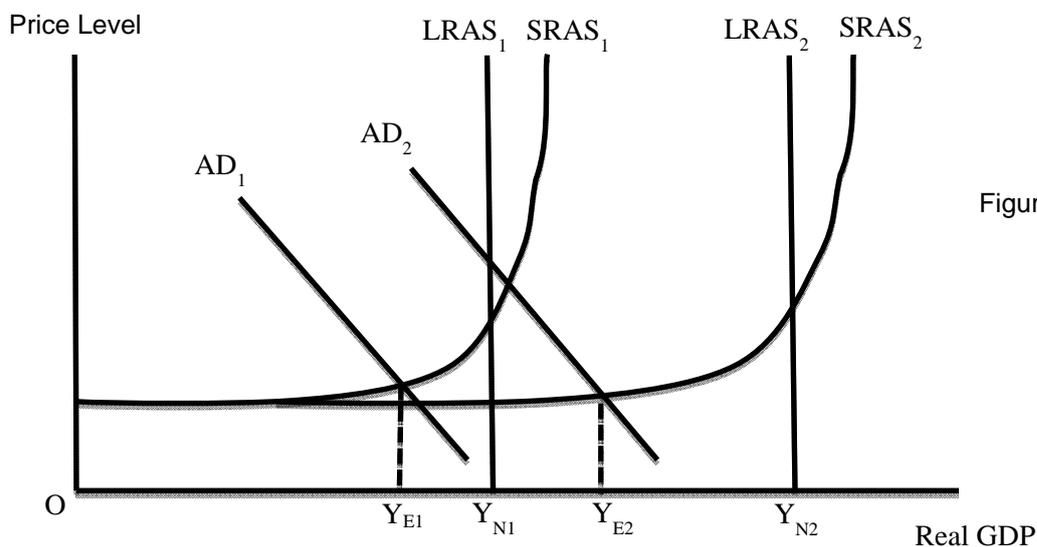

Figure 1

In Figure 1, the negative output gap increases from $(OY_{N1} - OY_{E1})$ to $(OY_{N2} - OY_{E2})$
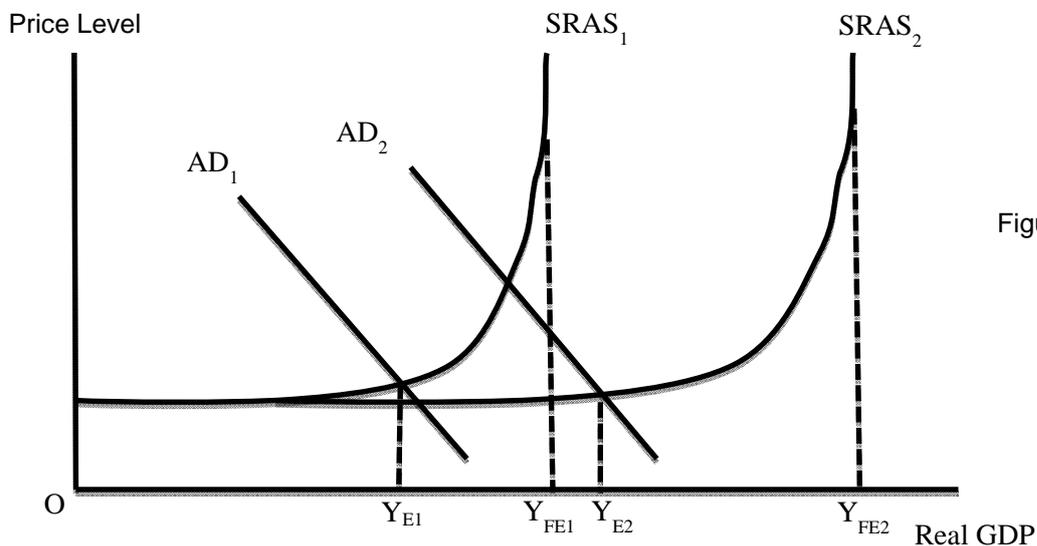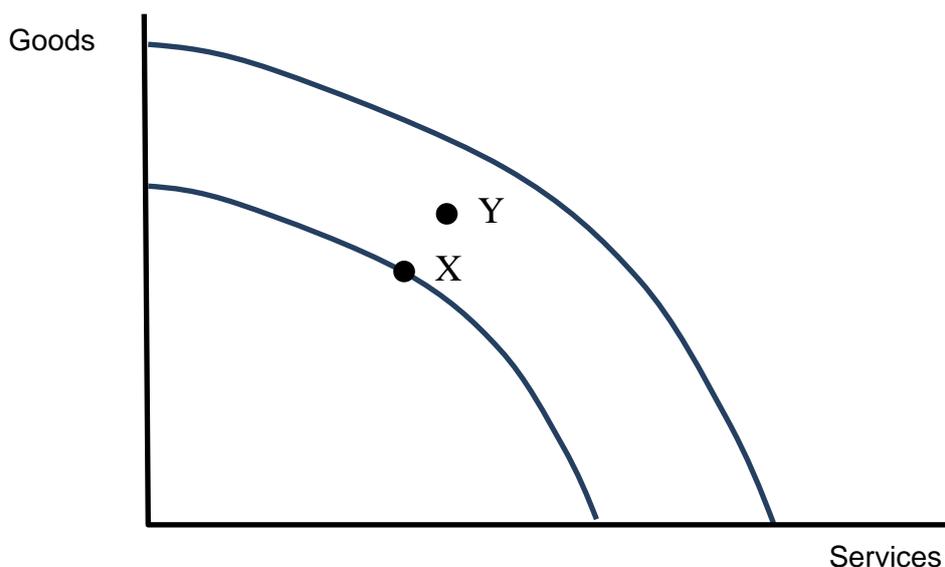

Figure 2

In Figure 2, the negative output gap increases from $(OY_{FE1} - OY_{E1})$ to $(OY_{FE2} - OY_{E2})$

If the AD/AS diagram shows a fall in AD leading to lower output and hence higher unemployment, award a maximum of 2 marks for the diagram. Similarly if the diagram just shows the effect of a rightward shift in AD, a maximum of 2 marks can be awarded.
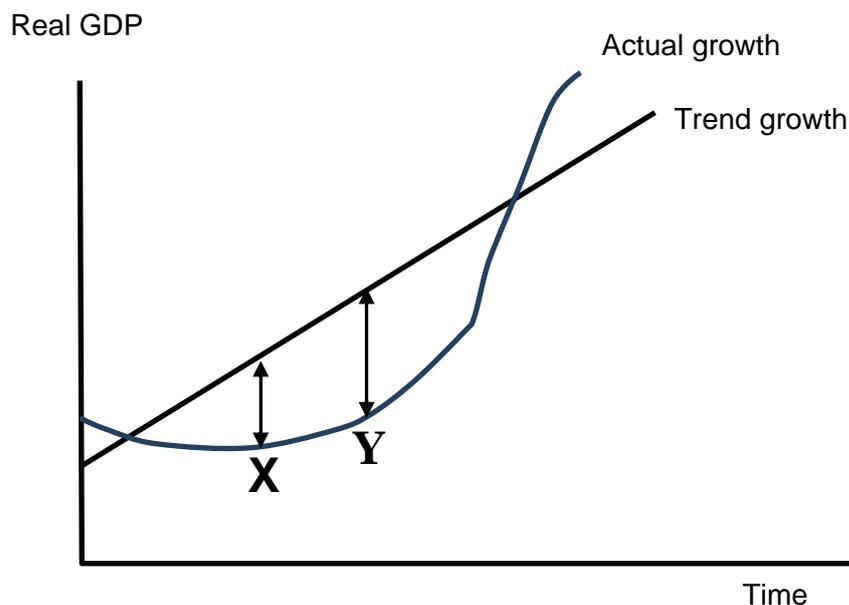
A PPC diagram

The movement from X to Y represents the actual growth of the economy resulting from the increase in AD. The rightward shift in the PPC represents the underlying trend rate of growth. The diagram shows that, since the increase in AD is less than the trend rate of growth, spare capacity (or a negative output gap) will emerge. This means that unemployment will increase.

Point X does **NOT** have to be on the PPC boundary. However, to get full marks for the diagram, the distance between X and Y should be less than the distance between the two PPCs. This means that the negative output gap will be larger at point Y than at point X.

If a PPC diagram is used, the breakdown of the marks is as follows:

Axes labelled (accept any reasonable axis labels, eg consumer goods and capital goods but **NOT** price level and output), the original PPC boundary **and** the original output of the economy.	**1 mark**
The new PPC shifted to the right	**1 mark**
The new level of output that shows an increase in the amount of spare capacity in the economy.	**2 marks**

A trend growth diagram that illustrates the economic cycle

The diagram shows that, over time, as the economy moves from point X to point Y, the size of the output gap increases. This happens because the growth in AD, which determines the actual rate of growth, is less than the underlying trend rate of growth. The amount of spare capacity increases and hence unemployment also increases.

To get full marks for the diagram, the vertical distance between the actual and trend growth lines must be larger at point Y than at point X.

If a trend growth diagram is used, the breakdown of the marks is as follows:

Axes labelled (accept Real GDP, GDP, Output and National Income on the vertical axis but only accept Time on the horizontal axis), the actual growth and trend growth lines (both must be labelled) **and** the point that the economy starts at BEFORE the 'growth in aggregate demand', eg point X in the diagram above.	**1 mark**
The original output gap (**NB** this must be a vertical line showing the vertical distance between the two curves).	**1 mark**
The new position for the economy that shows an increase in the amount of spare capacity in the economy.	**2 marks**

NB **If a candidate's answer only explains why a fall in aggregate demand will cause a rise in unemployment then a MAXIMUM OF 8 MARKS can be awarded for 03, ie the candidate explains why unemployment will increase but doesn't focus upon "AD growing more slowly than the trend rate of growth".**

MAXIMUM FOR PART 03: 12 MARKS

04	**Extract B** (Lines 6 – 8) states: 'Measures designed to reduce the size of the budget deficit mean that it is inevitable that job losses in the public sector will continue during the years ahead.'
	Using the data and your economic knowledge, discuss the view that the measures taken to reduce the size of the budget deficit will inevitably result in a rise in unemployment in the UK. *(25 marks)*

Extracts B and **C** provide some help to candidates and it is expected that they will make use of this material when developing their answers. It is anticipated that good answers will consider why measures to reduce the budget deficit may lead to an increase in unemployment, particularly in the short run, and why it is not necessarily inevitable that such measures will result in higher unemployment.

For this question, an answer should be limited to a maximum of 13 marks if there is no evidence of evaluation.

A maximum of **21 marks** may be awarded if there is no explicit use of the data, eg through the use of quotes or referring explicitly to the extracts.

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)**

Introduction	- Define the budget deficit. - State that reducing the deficit can be achieved by tax increases or cuts in government spending. - Some may recognise that growth in the economy will also help to reduce the deficit. - An outline of types/causes of unemployment.
Developing the response to the question: **Application**	- Display knowledge of the current size of the deficit and the programme for reducing the deficit. - Measures that have been adopted to reduce the deficit and how they are likely to impact on unemployment. - Use of data from **Extract B** to indicate that jobs have been lost in the public sector and that further job losses are likely. - Use of data from **Extract C** to indicate the scale of job losses in the public sector and the creation of new jobs in the private sector. - Knowledge of other developments in the UK and world economy that may have an impact on unemployment.

| Developing the response to the question:

Analysis	• The impact of cuts in public spending on jobs in the public sector. • The way in which cuts to public spending are likely to affect demand for private sector output and hence employment in the private sector. • The impact of tax rises on aggregate demand and hence employment. • The reduction in the deficit as a net withdrawal from the circular flow of income, reducing aggregate demand. • Possible multiplier effects of spending cuts and tax increases • Use of AD/AS diagrams. • Reasons why jobs in the private sector might increase to compensate for the loss of public sector jobs, eg low interest rates, the low exchange rate, returning confidence, renewed growth in the world economy, changes to the welfare system. • The importance of both supply-side and demand-side factors in determining what happens to unemployment.
Evaluation	• Use of the data from **Extracts B** and **C** to support arguments presented. • Use of own knowledge of recent developments in the UK economy, especially what has happened to unemployment since the start of 2011, to help support arguments presented. • Short-run versus long-run consequences of measures to reduce the size of the deficit. • The impact of the reduction in the deficit upon confidence and hence growth in the private sector. • An assessment of whether it is likely that job creation in the private sector is likely to be able to compensate for job losses in the public sector. • The problems of immobility and structural unemployment such as those referred to in **Extract C**. • The importance of the rate of growth of the economy as an influence on the overall level of unemployment • The impact of other policy measures on the overall level of unemployment. • The impact of developments in both the UK and world economy upon the overall level of unemployment.

*Examiners should note that credit can be given for basic evaluation if a candidate simply identifies some reasons why measures to reduce the budget deficit will increase unemployment **and** reasons why unemployment may not increase. Basic evaluation (and good analysis) would allow the answer to achieve low Level 4. Stronger evaluation is provided by candidates who are able to support their view of the impact on unemployment of measures to reduce the budget deficit by the use of evidence and/or sound economic analysis.*

USE THE DETAILED LEVELS MARK SCHEME ON PAGES 5 & 6
WHICH OFFERS FURTHER GUIDANCE

MAXIMUM FOR PART 04: 25 MARKS

OR

Context 2

05 Define the term 'cost-push inflation' (**Extract F**, line 8).	*(5 marks)*

For an acceptable definition such as: • an increase in the price level (or average price of goods and services) caused by a sustained increase in firms' costs of production • where increased costs of production result in firms raising their prices leading to a rise in the price level (prices in general).	**5 marks**
Full marks should be awarded to a candidate who demonstrates a clear understanding of the term cost-push inflation even if the definition is not exactly the same as the acceptable examples quoted above.	

If the definition is inaccurate or incomplete award a maximum of 4 marks which may be broken down, for example, as follows:

Inflation caused by rising costs of production (ie inflation is not defined).	**3 marks**
For accurately defining inflation, eg the rate of increase in the price level.	**2 marks**
For an accurate diagram that correctly illustrates cost-push inflation.	**2 marks**
For stating that cost-push inflation is caused by supply-side factors/a reduction in aggregate supply	**1 mark**
For one or more examples of possible causes of cost-push inflation, such as: (i) Rapidly rising wages/earnings **or** trade union power (ii) Rising commodity/raw material/oil prices (iii) Rising import prices (iv) Increases in indirect taxes (v) Monopoly employers/profit-push inflation (vi) Fall in the exchange rate.	**1 mark per example - up to a maximum of 2 marks for examples**

Maximum of 4 marks if the definition is incomplete or inaccurate

MAXIMUM FOR PART 05: 5 MARKS

06	Using **Extract D**, identify **two** significant points of comparison between CPI inflation and the rate of growth in average earnings over the period shown. *(8 marks)*

Award up to 4 marks for <u>each</u> point made.

Identifies a significant point of comparison Makes accurate use of the data to support the comparison identified Unit of measurement given accurately	**4 marks**
Identifies a significant point of comparison Makes use of the data to support the comparison identified However, no unit of measurement is given and/or the unit of measurement is used/applied inaccurately and/or the dates aren't quoted or are inaccurate and/or only one piece of data is given when two are needed.	**3 marks**
Identifies a significant point of comparison No correct use of the data to support the feature identified.	**2 marks**
Identifies a significant feature of one data series but no comparison is made. Makes use of the data to support the feature identified Unit of measurement given accurately.	**1 mark**

If a candidate identifies more than 2 significant points of comparison, reward the best two.

Significant points include:
- CPI inflation was lower at the start of the period (1.7%) than at the end of the period (3.5%), whereas average earnings were growing more rapidly at the start of the period (4.4%) than at the end of the period (1.4%)
- CPI inflation peaked in the 3rd quarter of 2008 (4.8%), whereas the rate of growth of average earnings peaked in the 1st quarter of 2010 (4.7%)
- CPI inflation was lowest in the 3rd quarter of 2009 (1.2%) whereas the rate of growth of average was earnings lowest in the 1st quarter of 2009 (-0.2%)
- the rate of growth of average earnings is more volatile than CPI inflation (ranges from -0.2% to 4.7% compared to 1.2% to 4.8%)
- up until the 2nd quarter of 2008, the rate of growth of average earnings was always higher than CPI inflation (eg in the 1st quarter of 2007 the rate of growth of average earnings was 4.5% whereas CPI inflation was 2.9%)
- after the 1st quarter of 2008 (approx.), the rate of growth of average earnings and CPI inflation are far more volatile than in the earlier period **OR** after the 2nd quarter of 2008 there are times when CPI inflation is greater than the rate of growth of average earnings and vice versa. Either description must be supported by appropriate statistics
- CPI inflation is always positive whereas the growth of average earnings is negative in one quarter (eg the lowest rate of CPI inflation is 1.2% in the 3rd quarter of 2009 but in the 1st quarter of 2009 average earnings fell by 0.2%).

   In this case, full marks can be awarded if the candidate states the point of comparison but only quotes the figure for the negative growth in average earnings (i.e. in the 1st quarter of 2009 the growth in average earnings was -0.2%). It must be stated that CPI inflation is always positive but it isn't necessary to quote a figure.

A margin of +/- 0.2% is permissible for either data series

MAXIMUM FOR PART 06: 8 MARKS

> **07**   **Extract E** (line 2) states: 'Inflation has increased partly as a result of the fall in the value of the pound….'
>
>   Using an appropriate diagram, explain why a fall in the exchange rate is likely to increase inflation.   *(12 marks)*

The anticipated response for the diagram:
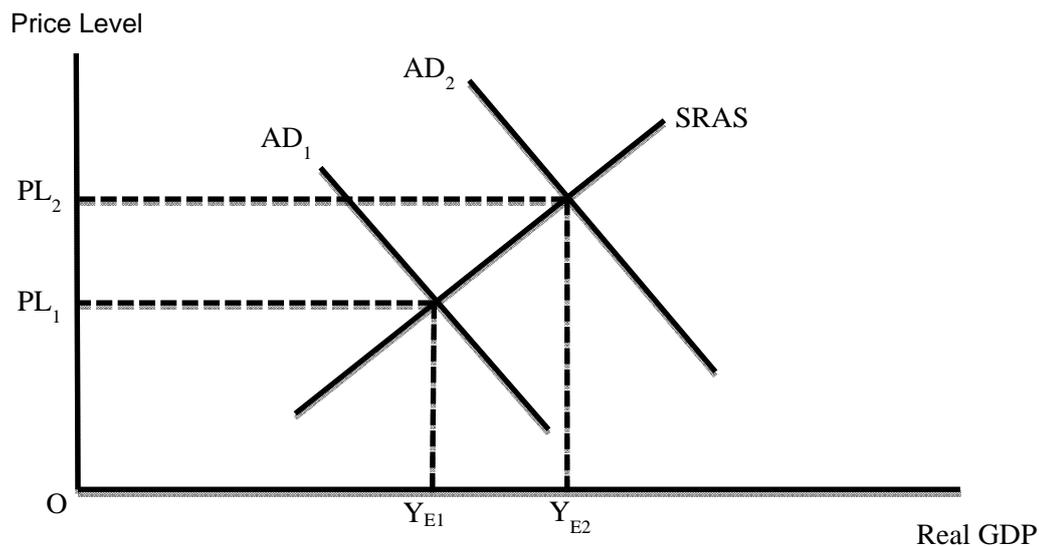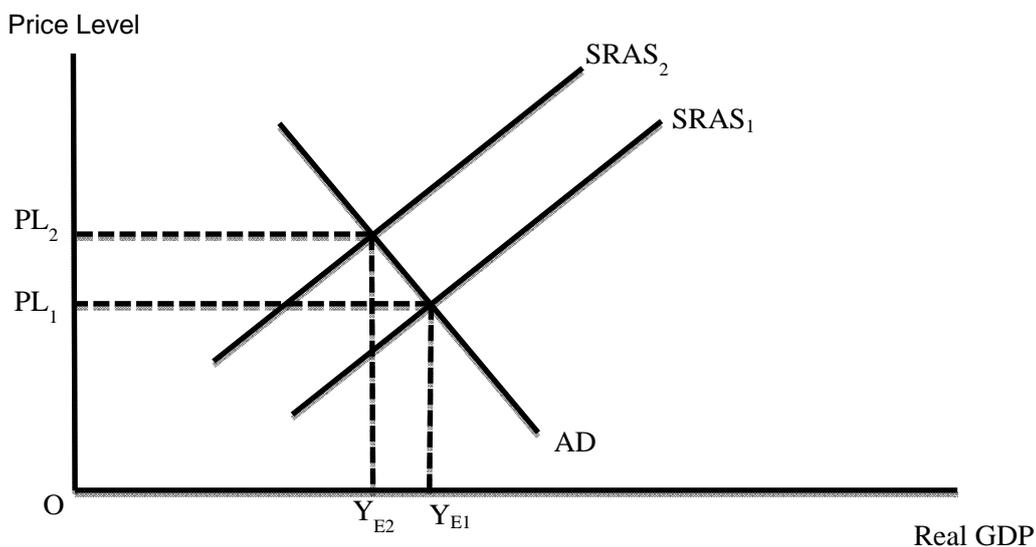
Figure 1

Figure 2

It is anticipated that most candidates will draw Figure 1 which shows that a fall in the exchange rate will improve the competitiveness of domestic products and hence shift AD to the right.

If a candidate draws Figure 2 showing a leftward shift in the SRAS curve, full marks can be awarded provided there is a reasonable explanation, eg the fall in the exchange rate will raise firms' costs due to a rise in the price of raw materials imported from abroad.

Full marks should also be awarded if the candidate shifts AD to the right AND shifts SRAS to the left, i.e. the rightward shift in AD showing the impact of improved competitiveness and the leftward shift in SRAS showing the impact of higher import costs.

Breakdown of the marks for the diagram:

Axes labelled (allow on the vertical axis: Inflation or PL or £ but **not** Price or P; allow on the horizontal axis: Real GDP, National Output, Output or Y but **not** Quantity or Q). Original AD (and AS curve) labelled correctly. Dotted lines and showing the original price level and level of real GDP (PL1 Y1).	**1 mark**
For showing a valid shift in the AD and/or AS curves	**2 marks**
Dotted lines and the associated labelling showing the new price level and new level of real GDP (PL2 Y2)	**1 mark**

Note:
(i) **To earn the first mark in the grid above, all three listed tasks must have been completed.**
(ii) **Acceptable vertical axis labels are Price Level, PL or Inflation but NOT Price.**
(iii) **Acceptable horizontal axis labels are Real National Output, Output, Y or Real GDP but NOT Quantity.**

The anticipated written response:

For providing a relevant definition, eg, exchange rate, inflation, aggregate demand	**1 mark per definition Up to a maximum of 2 marks**

Award up to 10 marks for each of the following explanations. **2 marks should be awarded for each logical link in the chain of reasoning.**	
A fall in the exchange rate will reduce export prices and/or increase the price of imports **(2 marks)** this will increase the demand for UK products **(2 marks)**. The rise in AD will create a buoyant environment in which firms can increase prices **(2 marks)** leading to demand-pull inflation **(2 marks)**. This initial increase in prices will lead to higher wage demands **(2 marks)** increasing firms' costs and hence prices **(2 marks)**.	**Up to 10 marks**
Links between a fall in the exchange rate, import prices, production costs and inflation.	**Up to 10 marks**

Up to a maximum of 10 marks for the written explanation if no diagram is attempted.

MAXIMUM FOR PART 07: 12 MARKS

08	**Extract F** (lines 17 – 19) states: 'In these circumstances, the Monetary Policy Committee of the Bank of England will raise Bank Rate to try to reduce inflation.' Using the data and your economic knowledge, assess the view that the use of interest rates is the best way to control inflation in the UK. *(25 marks)*

Extracts D, **E** and **F** provide some help to candidates and it is expected that they will make use of this material when developing their answers. It is anticipated that good answers will consider the case for relying on the use of interest rates to control inflation and reasons why other instruments of policy may also be important if inflation is to be controlled without damaging other aspects of economic performance.

For this question, an answer should be limited to a maximum of 13 marks if there is no evidence of evaluation.

A maximum of **21 marks** may be awarded if there is no explicit use of the data, eg through the use of quotes or referring explicitly to the extracts.

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)**

Introduction	- define inflation - identify other possible policy measures, eg other elements of monetary policy, fiscal policy and supply-side policies - possible causes of inflation, eg demand-pull factors and cost-push factors.
Developing the response to the question: **Application**	- outline the role of the MPC in controlling inflation in the UK - use of Extract E to identify causes of changes in UK inflation, eg the increase in VAT - use of own knowledge to identify recent changes in the rate of inflation in the UK and the causes of such changes - use of Extract F to identify other possible causes of inflation and to support the analysis of some of the causes of inflation, eg global food prices at record high.

Developing the response to the question: Analysis	- analysis of the demand-pull and cost-push inflationary processes - use of diagrams to help analyse the causes of inflation - explain how interest rates are used to influence aggregate demand - explain why controlling aggregate demand is important if inflation is to be controlled - how rising costs, eg, oil prices, wages and VAT increases, cause inflation – linked to the Extracts and earlier analysis - rising costs as part of the demand-pull inflationary process - the role of interest rates in moderating rising costs, eg wage costs - the use of fiscal policy as an instrument to help control inflation - the role of supply-side policies as a means of moderating inflationary pressures - other monetary instruments that may be used to control inflation, eg restrictions on the growth of money and credit, exchange rate policy - other policies that might be used to try to control inflation, eg, wage controls, trade union reforms.
Evaluation	- the advantages of using interest rates to control inflation, eg, excess demand is the fundamental cause of inflation, effective in reducing aggregate demand, flexibility, can be used as a signal and hence affect inflationary expectations - possible disadvantages of relying on interest rates to control inflation, eg raising interest rates may increase the measured rate of inflation, may not be effective in reducing external cost increases such as rising oil prices, possible conflicts with other policy objectives - use own knowledge and **Extracts E** and **F** to present evidence of the effectiveness of using interest rates to control inflation - the view that, in the long run, the only way to control inflation is to limit the growth of aggregate monetary demand - pros and cons of using fiscal policy to control inflation - pros and cons of using supply-side measures to control inflation - pros and cons of other measures that might be adopted to control inflation - the case for and against using a range of measures to control inflation - the UK as a very open economy in which inflation is strongly affected by events in the rest of the world - interest rates affect the exchange rate and hence can be used to influence the cost of imports - an overall assessment of whether or not the use of interest rates is the best way to control inflation in the UK.

Examiners should note that credit can be given for basic evaluation if a candidate simply identifies some of the arguments for and against relying on interest rates to control inflation. Basic evaluation (and good analysis) would allow the answer to achieve low Level 4. Stronger evaluation is provided by candidates who are able to support arguments both for and against the view that 'the use of interest rates is the best way to control inflation' by the use of evidence and/or sound economic analysis.

USE THE DETAILED LEVELS MARK SCHEME ON PAGES 5 & 6 WHICH OFFERS FURTHER GUIDANCE

MAXIMUM FOR PART 08: 25 MARKS