GCE A LEVEL MARKING SCHEME

SUMMER 2023

A LEVEL
ECONOMICS - COMPONENT 3
A520U30-1

INTRODUCTION

This marking scheme was used by WJEC for the 2023 examination. It was finalised after detailed discussion at examiners' conferences by all the examiners involved in the assessment. The conference was held shortly after the paper was taken so that reference could be made to the full range of candidates' responses, with photocopied scripts forming the basis of discussion. The aim of the conference was to ensure that the marking scheme was interpreted and applied in the same way by all examiners.

It is hoped that this information will be of assistance to centres but it is recognised at the same time that, without the benefit of participation in the examiners' conference, teachers may have different views on certain matters of detail or interpretation.

WJEC regrets that it cannot enter into any discussion or correspondence about this marking scheme.

GENERAL MARKING GUIDANCE

Positive Marking

It should be remembered that learners are writing under examination conditions and credit should be given for what the learner writes, rather than adopting the approach of penalising him/her for any omissions. It should be possible for a very good response to achieve full marks and a very poor one to achieve zero marks. Marks should not be deducted for a less than perfect answer if it satisfies the criteria of the mark scheme, nor should marks be added as a consolation where they are not merited.

For each question there is a list of indicative content which suggest the range of economics concepts, theory, issues and arguments which might be included in learners' answers. This is not intended to be exhaustive, and learners do not have to include all the indicative content to reach the highest level of the mark scheme.

The level-based mark schemes sub-divide the total mark to allocate to individual assessment objectives. These are shown in bands in the mark scheme. For each assessment objective a descriptor will indicate the different skills and qualities at the appropriate level. Learner's responses to questions are assessed against the relevant individual assessment objectives and they may achieve different bands within a single question. A mark will be awarded for each assessment objective targeted in the question and then totalled to give an overall mark for the question.

Section A

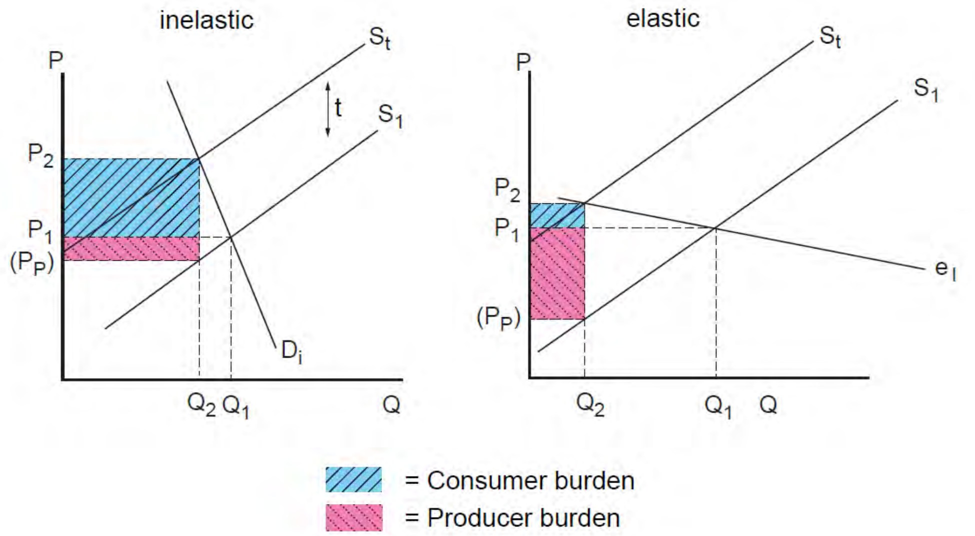
1. (a) Using diagrams explain how different values of price elasticity of demand (PED) might affect the incidence of an indirect tax on different products [10]

	AO1	AO3
Band	**6 marks**	**4 marks**
3	**5-6 marks** **Excellent knowledge.** Good diagram or diagrams that correctly show the incidence of tax for both elastic and inelastic goods.	
2	**3-4 marks** **Good knowledge.** A diagram which makes an attempt to show the incidence of tax. The diagrams contain errors, but the overall sense is correct. OR A diagram which accurately shows tax revenue for the government	**3-4 marks** **Good analysis.** Well-developed chains of reasoning explaining clearly **why** the incidence of tax falls more heavily on the consumer when demand is price inelastic and, on the producer, when demand is price elastic. Economic theory is well used.
1	**1-2 marks** **Limited knowledge.** Some attempt at diagrams is made, with supply shifting correctly, but the link to incidence is not present or is incorrect. Or Supply shift is incorrect, but accurate knowledge of elastic and inelastic demand curves is present.	**1-2 marks** **Limited analysis.** Both diagrams have some chains of reasoning which are not fully developed. Use of economic theory is more limited because the explanation of why each party bears more of the incidence is not clearly explained.
0	**0 marks** Diagrams are incorrect.	**0 marks.** No valid analysis.

Indicative content:

AO1:

Tax incidence in this context shows how the burden of tax is split between consumers and producers (not necessary to state this for credit).



AO3:

In the elastic case, consumers are not prepared to accept much of an increase in price, perhaps because of the presence of substitutes. As a result, price rises by far less than the full amount of the tax. This means that the consumer burden is relatively low, because price rises only slightly above the equilibrium. The producer, however, has to accept a much lower price (Pp) once the tax has been paid, meaning that they are forced to absorb most of the tax.

In the inelastic case, there are (perhaps) fewer substitutes. As a result, the tax is passed on to consumers because they have no real alternative. In this case, price rises by a far higher proportion of the tax, meaning that consumers end up paying most of it. Unless demand is totally inelastic, the producer will still have to absorb some of the tax, but the final revenue per unit received will be higher than in the elastic case.

(b) **Discuss, using economic theory, whether a cut in price by a firm is likely to increase its profitability.** **[20]**

	AO1	**AO3**	**AO4**
Band	**6 marks**	**6 marks**	**8 marks**
3	**5-6 marks** **Excellent knowledge.** Knowledge of a good range of factors affecting the advisability of price cuts is shown making good reference to both revenue and cost factors.	**5-6 marks** **Excellent analysis.** Chains of reasoning between price cuts and profits are well developed, making use of both elasticity/other pricing theory issues and unit cost factors. A clear line of argument is made as to why profits might either rise or fall. Diagrams may be used to support analysis, but these are not required.	**6-8 marks** **Excellent evaluation.** Strong two-sided answer that comes to an overall judgement supported by the underlying discussion. Evaluation is clearly present **either** in well-integrated judgements **or** a well-judged final overview. Factors that it depends on are likely to have been explored.
2	**3-4 marks** **Good knowledge.** Knowledge of a range of factors affecting the advisability of price cuts is shown making good reference to revenue or cost factors.	**3-4 marks** **Good analysis.** Chains of reasoning between price cuts and profits are developed, making use of either elasticity/other pricing theory issues or unit cost factors. Hence the answer focuses primarily on either revenue or costs rather than profit. A line of argument is made as to why profits might either rise or fall. Diagrams may be used to support analysis, but these are not required.	**3-5 marks** **Good evaluation.** Strong counter-arguments are made with chains of reasoning existing between the impact of price cuts on revenue, costs and profits, arguing the reverse of the AO3 case. Some evaluative points may lack development and the answer lacks a reasoned judgement.
1	**1-2 marks** **Limited knowledge.** Superficial knowledge of factors affecting the advisability of price cuts is shown making some reference to revenue or cost factors.	**1-2 marks** **Limited analysis.** There is a link between a fall in price and profit and some explanation is present, but economic theory is not generally used.	**1-2 marks** **Limited evaluation**. Some counter-arguments are made but chains of reasoning may not be fully developed. Technical detail is weak or absent.
0	**0 marks** No knowledge or understanding shown.	**0 marks** No relevant analysis.	**0 marks** No valid evaluation present.

AO1

The advisability of price cuts will depend on:

The level of competition in the market
The likely response of competitors
The PED of the firm's product
The extent to which the firm has spare capacity
The proportion of fixed relative to variable costs
The firm's current profit margin (how high price is above unit costs)
The likelihood of either internal economies or diseconomies of scale.
How well the firm promotes its price cut.
The market structure in which the firm operates.
Whether the firm is currently operating at the profit maximising output.

Credit any other relevant ideas.

AO3/4

General:

Answers which split the answer into reasons profits might rise and then reasons profits might fall can receive full credit for AO3 and 4 (although Band 3 AO4 will require a developed final judgement as well).

Specific:

- On the revenue side, much will depend on whether or not demand is price elastic. If demand is price inelastic, then total revenue will fall. Barring an exceptionally improbable cost structure, this will therefore mean that profits will fall too (revenue falls, but output increases, meaning that total cost will almost certainly rise). If economies of scale are very significant though, it might be possible that the increase in scale will actually reduce total cost (but it is extremely unlikely that anyone will argue this and it certainly isn't required).

- If demand is price elastic, then revenue will rise because a cut in price will cause demand to rise more than proportionally. Other things being equal, this might result in an increase in profits. This, however, will depend on unit costs. A cut in price will reduce the margin (or even cut price below unit cost) which may mean that although revenue rises, costs (in total) might rise even more.

- On the costs side, apart from the points made above, the impact may depend on whether or not the increase in output allows the firm to cut unit costs, or whether it suffers from diminishing returns in the short run.

- Other issues might relate to market structure, with answers referring to interdependence in oligopoly and the risk of price wars (with the implication of price inelastic demand, but this might not be made explicit). Other candidates may argue that in monopoly markets there is little point because of the relatively low level of PED (answers are likely to argue that demand is absolutely inelastic but allow this).

- Some responses may look at markets where non-price competition is prevalent, such as high-end luxury goods, where price cuts might not lead to increases in profits, particularly if the value of a luxury brand might be damaged.

- Some answers might relate to pricing theory. They might argue that a price cut might be part of price discrimination or that it might be part of some sort of price skimming strategy. Likewise, some might argue that a price cut might be part of a limit pricing strategy to prevent long-run entry or predatory pricing to secure a monopoly position – hence a SR/LR profit view. Those with understanding of behavioural economics might discuss the risks of establishing a new price anchor. All of these should be fully credited as valid analytical alternatives to simple elasticity points.

- Some answers might point out that if the firm is already at the profit maximising output, then any change in price will reduce profit. This should be fully credited if explained using MC/MR theory.

- Credit any other relevant theoretical development as AO3/4 accordingly.

2. (a) Explain using examples what is meant by horizontal, vertical and conglomerate mergers. [10]

	AO1	AO3
Band	**6 marks**	**4 marks**
3	**5-6 marks** **Excellent knowledge.** An excellent comprehensive knowledge and understanding of all three types of integration is shown with examples	
2	**3-4 marks** **Good knowledge.** Good knowledge of all three types or integration is shown with examples but may lack some detail/contain inaccuracies. Comprehensive knowledge and understanding of two types of integration are shown with examples	**3-4 marks** **Good analysis.** A strong chain of reasoning is shown in the explanation with effective and detailed use of examples showing why they represent a particular type of integration.
1	**1-2 marks** **Limited knowledge.** Some knowledge and understanding of the three types of integration is shown but it is superficial/inaccurate/missing/example may not be present.	**1-2 marks** **Limited analysis.** Chain of reasoning is incomplete or lacks clarity. The analysis lacks detail or is superficial in nature.
0	**0 marks** No knowledge shown.	**0 marks** No valid analysis.

Indicative content.

AO1

The main types of integration are:

Horizontal integration:
Here, businesses in the same industry and which operate at the same stage of the production process.

Backward vertical integration:
This involves acquiring a business operating earlier in the supply chain – e.g. a retailer buys a wholesaler, a brewer buys a hop farm, a package holiday firm buys an airline.

Forward vertical integration:
This involves acquiring a business further up in the supply chain – e.g. a vehicle manufacturer buys a car parts distributor, a brewery buys a pub chain.

Conglomerate integration:
This involves the combination of firms that are involved in unrelated business activities in different sectors of the economy.

AO1-Potential Examples

Use of examples to develop a strong chain of reasoning for each type of integration.

- Sainsbury-ASDA is an example of a horizontal merger.
- Orange and T-Mobile networks is a horizontal merger.
- Allow the example of Google's acquisition of Fitbit as a form of vertical integration, with Google becoming more customer facing, or as a conglomerate merger, as Google looks to diversify markets.
- BP acquired Chargemaster the UK's largest electric car charging firm (vertical)
- Tesco purchase of Booker (vertical)
- General Electric, Samsung and Tata have grown via conglomerate mergers.
- Other plausible examples are acceptable as long as the merger is used effectively to demonstrate the type of integration being explained.
- Mention of proposed mergers that have not been approved by regulators are acceptable as relevant examples.

AO3

Developing a chain of reasoning which links the merger examples to the type of merger.

Some possible routes to AO1/AO3

AO1 from the definition and the example. AO3 from the associated development

Horizontal: A horizontal merger is one between two firms at the same stage of production selling related products. An example would be Sainsbury and Asda, who are both retailers. In this case, both firms are in the final stage of production, reselling items that they have bought from suppliers. They are both in the same sector, meaning that a merger would lead to one large supermarket chain instead of two smaller ones - this makes it horizontal integration.

Vertical: Two related firms at different stages of production. An example might be if Tesla was to take over Cornish Lithium. In this case the two firms are related because Tesla used Lithium in its batteries. Cornish lithium therefore supplies the product that Tesla uses in its cars. Therefore, if Tesla was to takeover Corish Lithium, this would be a backward vertical merger (closer to the raw material source).

A different example might be Guinness taking over Grand Met. Guinness was a beer maker and Grand Met a chain of pubs and hotels. If Guinness was to take over Grand Met, it could now sell its beer through Grand Met's outlets. Hence the supply chain would now be integrated making it a vertical merger, forward in this case (closer to the consumer)

Conglomerate: Two unrelated firms join together. If Ford was to take over Asda, this would be a firm in one sector (vehicle production) joining one in another - food retail. there are clearly very few horizontal or vertical overlaps between these two firms, making it a conglomerate merger

AO1 from the definition and example and AO3 from the associated development

Horizontal: A merger between Sainsbury and Asda is the merger of two firms in the same stage of production-tertiary. This is therefore a horizontal merger and will result in a larger company. This may enable the firm to exploit economies of scale which may help to improve profit margins or increase their market share and therefore overall revenue.

Vertical: A merger between Tesla and Cornish Lithium would be between a primary producer and a manufacturing firm, different stages of production and therefore a vertical merger (Backward toward the source of raw materials). This would enable the company to secure a supply chain of a scare raw material vital to the production of their products.

Vertical: A merger between Guinness and Grand Met (toward the customer) would increase the potential outlet for Guinness products and potentially increase sales.

Conglomerate: If Ford was to acquire Asda. Two firms merge from different industries/sectors. This might enable Ford to spread their business risk by diversifying their activities.

(b) Evaluate the costs and benefits of mergers to both firms and their customers. **[20]**

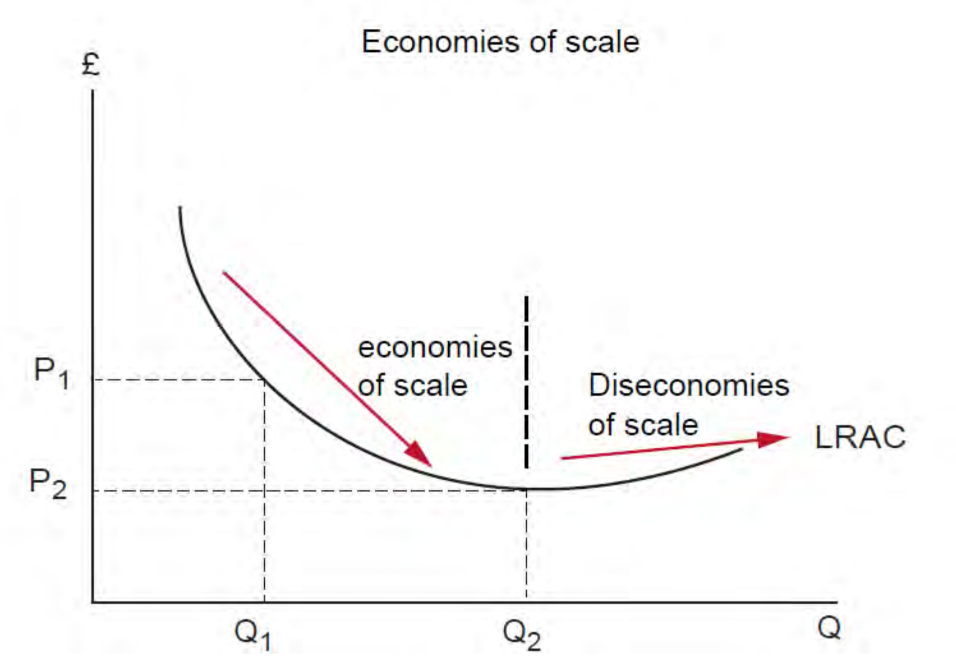
	AO1	AO3	AO4
Band	**6 marks**	**6 marks**	**8 marks**
3	**5-6 marks** **Excellent knowledge.** An excellent knowledge and understanding of the costs and benefits of mergers to both firms and customers is demonstrated.	**5-6 marks** **Excellent analysis.** Strongly developed line of argument and chain of reasoning of the cost and benefits of mergers to firms and customers.	**6-8 marks** **Excellent evaluation.** A well-developed two-sided answer which looks at the relative merits of mergers to both firms and customers. Learner comes to a reasoned judgment as to the extent to which mergers are in general beneficial or not.
2	**3-4 marks** **Good knowledge.** Knowledge of the costs and benefits of mergers to firms and customers is good but there may be a lack of detail or understanding shown in places.	**3-4 marks** **Good analysis.** A good chain of reasoning is generally evident although there may be less depth of analysis with either firms or customers.	**3-5 marks** **Good evaluation.** A strong two-sided answer which argues the relative costs and benefits of mergers to both firms and customers without coming to a final reasoned judgement.
1	**1-2 marks** **Limited knowledge.** Knowledge and understanding of the costs and benefits of mergers lacks detail/clarity.	**1-2 marks** **Limited analysis.** Chains of reasoning are weak or are superficial in nature in the analysis of both firms and customers.	**1-2 marks** **Limited evaluation.** Evaluation is very limited. A few evaluative points are made but merely as assertions. The points made are not developed and are superficial.
0	**0 marks** No knowledge or understanding shown.	**0 marks** No relevant analysis.	**0 marks** No valid evaluation present.

Indicative content.

AO1/AO3

Benefits of mergers

- Economies of scale – bigger firms more efficient – lower costs passed on to consumers in lower prices.
- More profit enables more research and development – higher future profits/market share/increased competitiveness for firm – consumers enjoy better quality products.
- Struggling firms can benefit from new management – improved future profitability.
- Merged firms are beneficial if they operate in a sector which is close to a natural monopoly thus lower costs – lower prices for consumers.
- Mergers enable a domestic firm to compete more effectively against powerful overseas rivals.



Costs of mergers

- Increased market share can lead to monopoly power and higher prices for consumers and less choice. Firms subject to investigation by CMA/bad publicity. Possible use of monopoly diagram – welfare loss.
- A larger firm may experience diseconomies of scale – e.g. harder to communicate and coordinate thus lower profits/less competitive – consumers pay higher prices.
- Many mergers fail to produce the benefits – profits/synergies – that are expected clash of management cultures. (Daimler Benz + Chrysler)
- Mergers may make the market less contestable/dominance of large firms – fewer new entrants - consumers have less choice/higher prices in the future.
- Mergers cause firms to be so dominant they suffer X-inefficiency/invest less/less R&D –consumers suffer from poor quality goods.

AO4

- Costs and benefits of a merger will depend on the specific firms involved and the sector of the economy they operate in. Use of examples.
- The effects of a merger depend on the type of merger involved- is it horizontal? vertical? conglomerate?
- How significant are the economies of scale benefits of the merger?
- To what degree will there be a significant reduction in competition as a result of the merger? Will the merger restrict, distort and prevent competition?
- Cost and benefits of a merger take time to emerge.
- Overall when assessing costs and benefits there is a need to look at each merger on a case-by-case basis.
- Degree of contestability in different merger scenarios.

Section B

3. (a) Explain why some economies have might higher rates of unemployment than others. [10]

	AO1	AO3
Band	**6 marks**	**4 marks**
3	**5-6 marks** **Excellent knowledge.** Knowledge of a wide range of factors affecting the level of unemployment is shown on both the demand and supply side. Understanding of what the factors mean is present.	
2	**3-4 marks** **Good knowledge.** Knowledge of a wide range of factors affecting the level of unemployment is shown.	**3-4 marks** **Good analysis.** There is logical development and clear analysis. There are well developed chains of reasoning between the factor identified and the level of unemployment.
1	**1-2 marks** **Limited knowledge.** Only a basic knowledge of the factors that affect the level of unemployment is shown.	**1-2 marks** **Limited analysis.** Reasoning is generally not well developed but some attempt is made to explain how unemployment is affected.
0	**0 marks** No knowledge or understanding shown.	**0 marks** No valid analysis present.

Indicative content

AO1

Demand side:
Cyclical unemployment. Occurs in economic downturns.

Supply side:
Frictional. Adjustment period between people leaving one job and finding another. Linked to issues around information, legislation and motivation amongst others.

Structural/labour market inflexibilities. May be linked to occupational issues (skills mismatch) or geographical (regional immobility).

Classical/Real wage. Sticky wage issues.

AO3

- Cyclical: in an economic downturn, AD falls, meaning that the demand for firms' products falls. As a result, they need to cut costs to stay afloat. Hence, they may need to cut back on labour. Given that demand is falling in other sectors too, these workers may be unable to find jobs, making unemployment higher.

- Frictional. Present in most economies but may be worse in some than others. When workers leave one job, they might not instantly be able to find another because of job search times, legislative requirements such as criminal record checks or simply that benefit levels are high enough that they don't need to find a job quickly. Therefore, unemployment will be higher in such economies.

- Structural. Available skills might not match in-demand jobs, therefore even though AD might be high, unemployment might persist because firms do not wish to hire and then train workers to do the job due to the costs involved. Alternatively, the jobs available might not be in the areas of high unemployment and workers may be unable (house prices etc.) or unwilling (social factors etc.) to relocate. Therefore, unemployment will remain high.

- Real wage. If wage (or non-wage) costs are high then workers may price themselves out of a job, especially in times of recession. If structural factors mean that wages are inflexible, then real wages may be stuck above equilibrium, meaning that firms will be unable to afford to employ all of the workers looking for jobs.

(b) **Discuss whether achieving low unemployment or low inflation should be the more important policy objective for a government. [20]**

	AO1	AO3	AO4
Band	**6 marks**	**6 marks**	**8 marks.**
3	**5-6 marks** **Excellent knowledge.** Wide ranging knowledge of the costs of both high unemployment and inflation (or the benefits of low u/e and inflation)	**5-6 marks** **Excellent analysis.** Strongly developed line of argument as to why both the objectives are desirable.	**6-8 marks** **Excellent evaluation.** A well-developed two-sided answer which looks at the relative merits of both low unemployment and inflation as policy objectives. Learner comes to a reasoned judgment as to the extent to the circumstances under which each objective might be the more important.
2	**3-4 marks** **Good knowledge.** Good knowledge of the costs of both high unemployment **or** inflation (or the benefits of low u/e or infl) is shown.	**3-4 marks** **Good analysis.** Strongly developed line of argument as to why one of the objectives is desirable, but there is less depth of analysis on the other objective.	**3-5 marks** **Good evaluation.** A strong two-sided answer which argues the relative merits of both unemployment and inflation without coming to a final reasoned judgement.
1	**1-2 marks** **Limited knowledge.** A limited knowledge of the costs of high inflation and/or unemployment is shown with a limited range of superficial points.	**1-2 marks** **Limited analysis.** Some analysis of the benefits of low unemployment and inflation is present.	**1-2 marks** **Limited evaluation.** Evaluation is very limited. A few evaluative points are made but merely as assertions. The points made are not developed and are superficial.
0	**0 marks** No knowledge or understanding shown.	**0 marks** No valid analysis.	**0 marks** No valid evaluation present.

Indicative content

AO1/3

Low unemployment is desirable because:

- It reduces the government's budget deficit, meaning that national debt will be rising more slowly. Therefore, reduced opp cost, lower risk of crowding out and credit rating issues.
- Less risk of social and health issues associated with high unemployment.
- Less risk of deskilling/hysteresis and therefore long-run damage to the NAIRU.
- Less waste of resources, avoids Pareto inefficiency and so on.
- Credit other relevant points.

Low inflation is desirable because:

- It avoids redistributive issues such as fiscal drag, transfer of income away from fixed income groups and from savers to borrowers.
- It avoids making the country's goods internationally uncompetitive (supporting the current account) and also reduces the risk of a sharp correction in the exchange rate which would drive up living costs.
- It creates greater certainty and confidence among businesses, therefore promoting investment, innovation and longer-term growth.
- It reduces information gaps in markets, making it easier for consumers to compare prices, therefore increasing competition levels and making inefficient firms more obvious. Hence, may also promote long-term growth.
- Menu and shoe leather costs avoided.

AO4

There are many evaluative routes for this essay, including (but not limited to):

- Neither is necessarily desirable in absolute terms: Low inflation isn't necessarily desirable because of the risk of deflation, as in Japan. Low unemployment may create skills shortages in key sectors, stifling innovation and growth and damaging cost competitiveness.

- May depend on how the policy objective is achieved. If demand-side driven, low inflation may entail the risk of recession whereas low unemployment may risk triggering an inflationary spiral. Supply side solutions may be more benevolent, with reductions in skills mismatch and regional unemployment allowing the NAIRU to be reduced and therefore low unemployment can be achieved without the risk of inflationary pressure. Likewise, supply side solutions to low inflation may be centred around competition and efficiency which may support growth and jobs.

4. (a) Explain the factors that could cause (i) the short run and (ii) the long run aggregate supply curves to shift position. [10]

	AO1	AO3
Band	**6 marks**	**4 marks**
3	**5-6 marks** **Excellent knowledge.** Knowledge of a wide range of factors affecting the position of the short and long run AS curves is shown. Understanding of what the factors mean is present.	
2	**3-4 marks** **Good knowledge.** Knowledge of a range of factors affecting the position of SRAS and LRAS curves is present but may be less convincing for either SRAS or LRAS. Good coverage of either SRAS OR LRAS	**3-4 marks** **Good analysis.** There is logical development and clear analysis. There are well developed chains of reasoning between the factor identified and how it affects the position of the SRAS and LRAS curves.
1	**1-2 marks** **Limited knowledge.** Only a basic knowledge of the factors that affect the position of the SRAS and LRAS is shown.	**1-2 marks** **Limited analysis.** Reasoning is generally not well developed but some attempt is made to explain how the SRAS and LRAS are affected.
0	**0 marks** No knowledge or understanding shown.	**0 marks** No valid analysis.

Indicative content.

Causes of shifts in short run aggregate supply (SRAS)

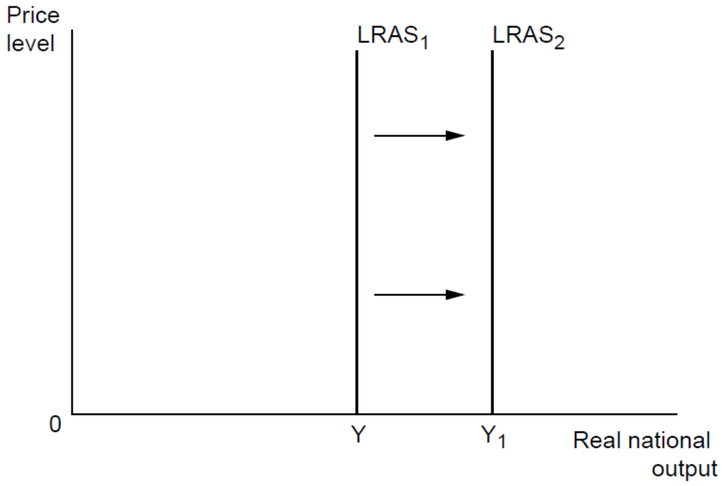
Shifts in the position of the short run aggregate supply are caused by changes in the conditions of supply for different sectors of the economy:

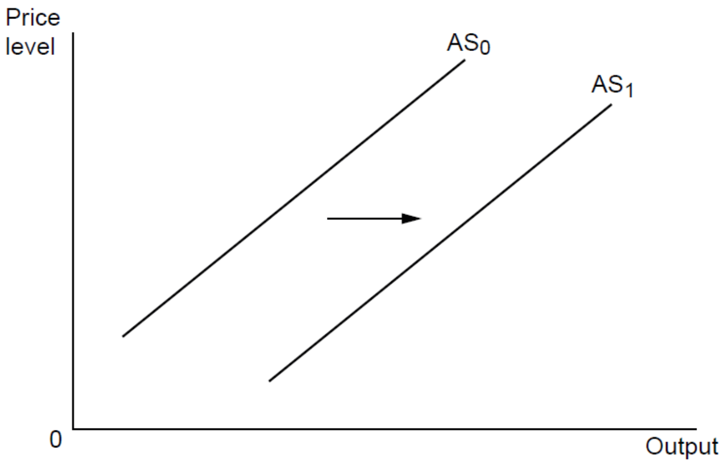
- Employment costs: e.g. wages, employment taxes. A change in unit labour costs affected by the level of labour productivity will affect the position of the SRAS. A change in the national minimum wage or employers' national insurance contributions.
- Costs of other inputs e.g. commodity prices such as oil, raw materials. A fall in the exchange rate can increase the prices of imported products and shift the SRAS.
- Impact of government e.g. environmental taxes such as carbon duties & business regulations, business rates, rents etc which affect the costs of production will affect the SRAS curve.

Causes of shifts in the long run aggregate supply (LRAS)

- Any change that alters the trend growth rate shifts LRAS. A rise in trend growth will shift LRAS to the right. A fall in the natural rate of unemployment will shift LRAS to the right.
- Improvements in productivity and efficiency or an increase in the stock of capital and labour resources will cause LRAS to shift to the right. Increased levels of economic activity levels among working age population.
- An increase in the size of the productive capital stock of a country will also shift out the LRAS e.g. arising from the effects of infrastructure investment or an injection of investment from overseas (FDI).
- The implementation of successful supply side policies will shift the LRAS to the right.
- The results of innovation and enterprise will shift LRAS.
- Natural disasters will shift LRAS left and long-term unemployment will shift LRAS left as a result of hysteresis.

Credit factors with affect both SR and LRAS
Source: tutor2u. (adapted)
Possible use of diagrams





(b) Assess the effectiveness of monetary policies for an economy in recession. **(20)**

	AO1	AO3	AO4
Band	**6 marks**	**6 marks**	**8 marks**
3	**5-6 marks** **Excellent knowledge.** An excellent knowledge and understanding of the meaning of monetary policy and its different instruments.	**5-6 marks** **Excellent analysis.** Excellent analysis of how monetary policy can affect an economy in a recession. Clear line of argument and strong chains of reasoning.	**6-8 marks** **Excellent evaluation.** A well- developed two-sided answer that looks at the relative merits of monetary policy in a recession. The answer comes to a reasoned judgement as to the extent to which monetary policy can be effective in helping an economy recover from a recession.
2	**3-4 marks** **Good knowledge.** A good knowledge and understanding of the meaning of monetary policy and its instruments although the range of policies and depth of understanding may be limited.	**3-4 marks** **Good analysis.** A good analysis of how monetary policy affects an economy in a recession. There is a good line of argument, but overall analysis and the chain of reasoning may lack detail and/or clarity.	**3-5 marks** **Good evaluation.** A strong two-sided answer with effective points on both sides of the argument, but which never directly answers the question set in terms of coming to a reasoned conclusion as to the effectiveness of monetary policy. A good analysis of the other side of the case (from the AO3 mark) is present or points are very well qualified.
1	**1-2 marks** **Limited knowledge.** Knowledge and understanding of monetary policy and its instruments. The points made are superficial and range is limited	**1-2 marks** **Limited analysis.** A superficial analysis of how monetary policy affects an economy in recession which lacks detail and a clear chain of reasoning.	**1-2 marks** **Limited evaluation.** Evaluation is very limited. A few evaluative points are made as to the effectiveness of monetary policy but merely as assertions.
0	**0 marks** No knowledge or understanding shown.	**0 marks** No relevant analysis.	**0 marks** No valid evaluation present.

Indicative content.

AO1/AO3

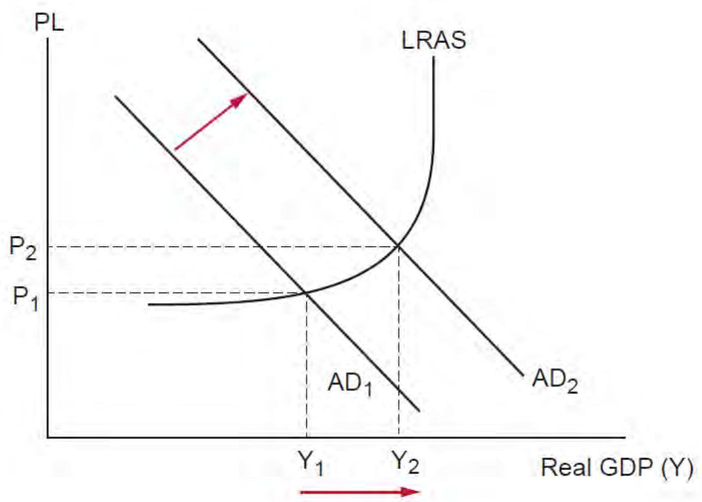
Understanding of the meaning of recession (fall in GDP in two consecutive quarters) and monetary policy (policies involving the price and supply of money designed to affect economic activity)
Monetary policies: short term interest rates set by the MPC, quantitative easing, supply and availability of credit and manipulation of exchange rates. During a recession the central bank/Bank of England would engage in an expansionary monetary policy:

The Central Bank/Bank of England could cut interest rates to increase aggregate demand (AD) in the economy.

- Lower interest rates make it cheaper to borrow; this encourages firms to invest and consumers to spend boosting AD.
- Lower interest rates reduce the cost of mortgage interest repayments. This gives households greater disposable income and encourages increased consumer spending and thus AD.
- Lower interest rates reduce the incentive to save and for people to spend.
- Lower interest rates reduce the value of the pound, making exports cheaper and increase export demand (AD). A depreciation of the pound also makes imports more expensive reducing import spending and boosting AD.

The Central Bank/Bank of England could pursue a policy of quantitative easing to increase the money supply and reduce long-term interest rates. Quantitative Easing means that the Central bank creates money electronically and then uses this created money to buy government bonds from commercial banks. This should:

- Increase the monetary base and cash reserves of commercial banks, which should enable higher bank lending increasing AD.
- Reduce interest rates/yields on bonds which should help investment by firms (increasing AD) and making borrowing cheaper for the government (potentially increasing AD).



The rise in AD should as shown in the above diagram leads to higher GDP and lower unemployment.

AO4

Factors which make monetary policy less effective.

- If business and consumer confidence is low, then people/firms may not want to invest or spend, despite lower interest rates (animal spirits).
- In a recession, commercial banks may not have funds to lend, therefore although the Central Bank cuts base rates, it is still difficult to get a loan from a bank.
- Commercial banks may not pass the base rate cut on in lower rates to their customers.
- Lower interest rates will not help homeowners with fixed rate mortgages.
- QE has arguably had less than significant effects on the economy in recent years– may prevent a recession from becoming a depression.
- Countries in fixed exchange rate systems or a single currency (EMU) cannot depreciate their exchange rate.
- During a recession if inflation becomes very low or negative monetary policy is less effective. Negative inflation drives up real interest rates and therefore reduces the power of monetary policy. Since it is hard to reduce nominal interest rates below zero, monetary policy may eventually become completely ineffective.

Judgement:

Effectiveness of monetary policy depends on:

- How serious is the recession? Is it domestic or global? – the deeper and more global the recession the weaker the effects of monetary policy.
- Depends on the interest elasticity level in the economy.
- How close is the economy to a liquidity trap?
- Can interest rates be allowed to fall below zero?

Section C

5. (a) Explain, using diagrams, why exchange rates can be volatile. [10]

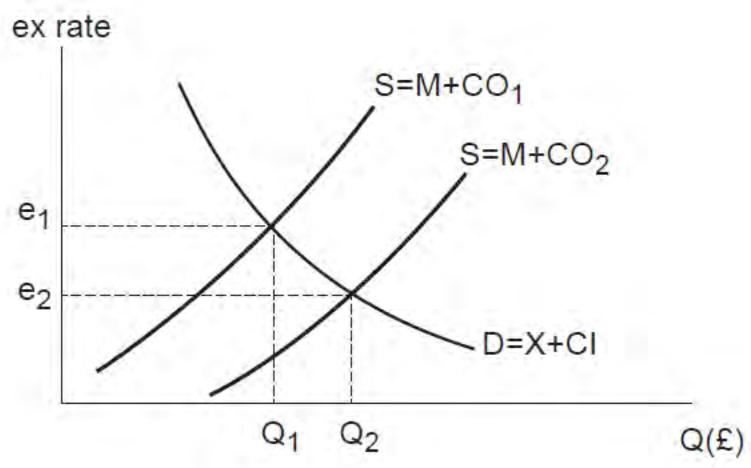
	AO1	AO3
Band	**6 marks**	**4 marks**
3	**5-6 marks** **Excellent knowledge.** Good diagrams illustrating exchange rate changes with detailed outlines of both demand and supply factors. The linkage to both factors is excellent.	
2	**3-4 marks** **Good knowledge.** Good diagram(s) illustrating exchange rate changes which show either: Demand **or** supply with good linkage of factor(s) **or** Both supply and demand are covered, but the linkage is less good.	**3-4 marks** **Good analysis.** Well-developed explanation of factors causing exchange rates to be volatile rather than simply changing.
1	**1-2 marks** **Limited knowledge.** Some attempt at diagrams to illustrate exchange rate changes with linkage to some factors, but points are superficial and poorly linked	**1-2 marks** **Limited analysis.** Explanation of factors causing exchange rates to be volatile are less well-developed.
0	**0 marks** Diagrams are incorrect.	**0 marks** No valid analysis.

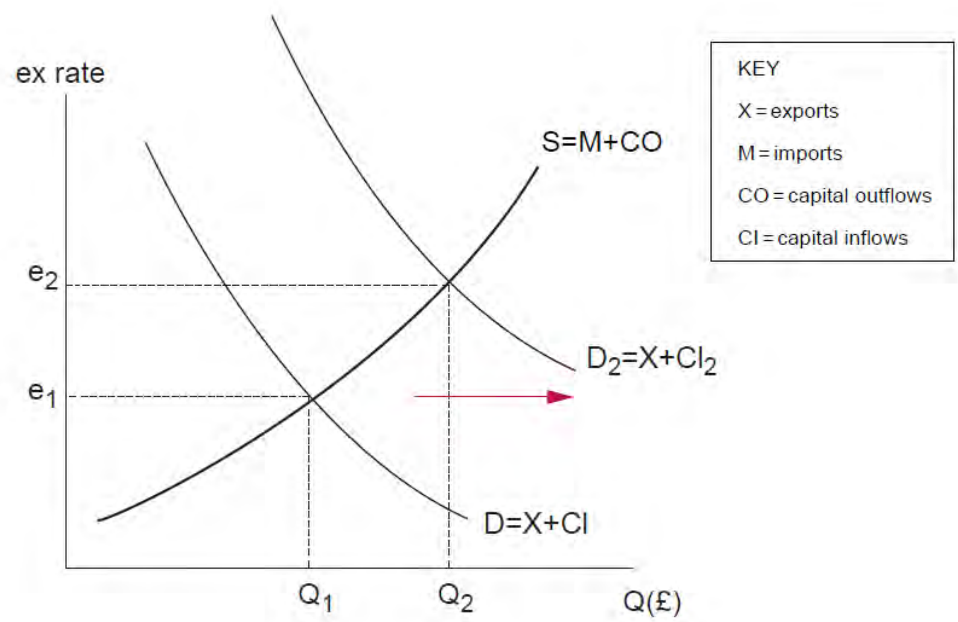
Indicative content

AO1

Factors that can cause changes in exchange rates in general include:

- Changes in the trade/current account position
- Changes in interest rates
- Changes in actual or forecast growth
- Government or central bank policy announcements
- Any factor which impacts the underlying strength of the economy and therefore affects returns on financial and physical assets.
- Any other relevant factors which can affect demand or supply of £





AO3

The key to AO3 is engagement with the nature of volatility of exchange rates rather than just change over time.
Volatility-sudden, siginificant and perhaps unexpected changes in an exchange rate in a short period of time or regular price fluctuations including smaller changes sustained over a longer period of period of time.

Indicative content – Reward any relevant factors which develops a level of engagement with the concept of exchange rate volatility.

Possible examples include (but not restricted to):

- Exchange rates can be volatile due to the potential for extremely large changes in supply and demand as a result of short-term capital flows (hot money, speculative sales and purchases).

- Exchange rates can be volatile due to fluctuations in global commodity prices particularly for significant producers or consumers of these commodities.

- Exchange rates can be volatile due to the nature of the FOREX market in terms of speed of transactions and automated trading algorithms than can accentuate and accelerate movements in price.

(b) **Discuss whether a policy of keeping a country's exchange rate below its equilibrium level is likely to be economically beneficial for that country.** **[20]**

	AO1	AO3	AO4
Band	**6 marks**	**6 marks**	**8 marks.**
3	**5-6 marks** **Excellent knowledge.** Excellent knowledge of the effects of an undervalued exchange rate. The answer shows an awareness of a number of points on either side of the question some positive some negative.	**5-6 marks** **Excellent analysis.** Excellent analysis of how an undervalued exchange rate affects an economy either positively or negatively. Clear line of argument and strong chains of reasoning.	**6-8 marks** **Excellent evaluation.** Well- developed two-sided answer that looks at the relative merits of an undervalued exchange rate. The answer comes to a reasoned judgement as to the extent to which the effects of an undervalued exchange rate are likely to be positive or negative.
2	**3-4 marks** **Good knowledge.** Good knowledge of the effects of an undervalued exchange rate. Range on one side may be limited.	**3-4 marks** **Good analysis.** A good analysis of how an undervalued exchange rate affects an economy either positively or negatively. There is a good line of argument, but overall analysis and the chain of reasoning may lack detail and/or clarity.	**3-5 marks** **Good evaluation.** A strong two-sided answer with effective points on both sides of the argument, but which never directly answers the question set in terms of coming to a reasoned conclusion. A good analysis of the other side of the case (from the AO3 mark) is present or points are very well qualified.
1	**1-2 marks** **Limited understanding.** A limited knowledge of the effects of an undervalued exchange rate. The points made are superficial and range is limited on both sides.	**1-2 marks** **Limited analysis.** A superficial analysis of the positive or negative effects which lacks detail and a clear chain of reasoning.	**1-2 marks** **A limited evaluation.** Evaluation is very limited. A few evaluative points are made but merely as assertions. Or Counterarguments (negatives or positives depending on which side is credited as AO3) are present, but the points made are not developed and superficial.
0	**0 marks** No knowledge or understanding shown.	**0 marks** No relevant analysis.	**0 marks** No valid evaluation present.

Indicative content

A top-level response will have a focus on the undervaluation of the exchange rate as a policy option of a government.

AO1

An under-valued:

- exchange rate should lead to exports becoming cheaper and imports more expensive.
- exchange rate should improve the current account balance.
- exchange rate should improve AD
- exchange rate may make the economy more attractive for long term capital inflows.
- exchange rate might be inflationary
- exchange rate might increase the cost of basic goods from abroad, worsening inequality.
- exchange rate might invite retaliatory action from trading partners.
- exchange rate might allow foreign acquisition of valuable assets too cheaply.
- Keeping the exchange rate low will involve sales of domestic currency and purchase of forex, allowing the economy to build up reserves.

AO3

An under-valued:

- exchange rate should lead to exports becoming cheaper in forex terms and imports more expensive in local currency terms, therefore improving the current account balance and increasing AD as exporters receive more orders and local firms competing with importers become more price competitive.

- exchange rate may make the economy more attractive for long term capital inflows because both financial and physical assets are cheaper in foreign exchange terms. Hence land, for example, can be bought relatively cheaply, which may attract FDI both because of the high expected return but also because the low exchange rate should also be favourable for exporting.

- Keeping the exchange rate low will involve sales of domestic currency and purchase of forex, allowing the economy to build up reserves. These reserves are likely to be invested abroad (financial account deficit) allowing the country to develop its ownership of foreign financial and physical assets, providing a stream of forex earnings in the longer term, boosting primary income flows and helping to support the current account.

AO4

- An under-valued exchange rate, however, has the impact of driving up the price of basic imported goods and services, which may harm living standards, particularly of low-income groups. Firms depending on imports of components and raw materials may be damaged too.

- The impact however is likely to depend on the extent to which the economy has spare capacity and the relative price elasticity of demand for imports and exports (Marshall-Lerner stuff – what do we export and import and so on).

- However, the risk is that in the absence of regulation, foreign ownership of key sectors may become too easy creating risks in the longer term.

- Accusations of currency manipulation may mean that trading partners retaliate if they perceive the undervaluation to be a deliberate tactic to gain an unfair advantage.

- A weak exchange rate should lead to exports becoming cheaper in forex terms and imports more expensive in local currency terms, therefore improving the current account balance and increasing AD.

- A weak exchange rate policy is likely to create growth through X and I rather than consumption, which may mean that the benefits of growth do not accrue to the majority of the population, benefiting business owners and their employees more than households more generally.

- It may depend on for how long the exchange rate is held below the equilibrium level and for what reason – as part of a stabilisation programme, for example, it is less likely to attract retaliatory action from abroad but may not be perceived as long-term enough to have much impact on the behaviour of import/exporters and investors.

6. (a) Explain why a non-EU member such as Norway might become part of the single market. [10]

	AO1	AO3
Band	**6 marks**	**4 marks**
3	**5-6 marks** **Excellent knowledge.** Excellent knowledge and understanding shown of a wide range of reasons why a country might become part of the SEM.	
2	**3-4 marks** **Good knowledge.** Good knowledge of reasons why a country might become part of the SEM. Range may be limited or there may be some depth of understanding lacking.	**3-4 marks** **Good analysis.** Well-developed chains of reasoning explaining clearly **why** membership of the SEM may be desirable for a country. There is logical development and clear analysis.
1	**1-2 marks** **Limited knowledge.** Limited knowledge of reasons why a country might become part of the SEM. Few reasons are identified and/or explanations are superficial/ lacking in detail with limited understanding shown.	**1-2 marks** **Limited analysis.** Chains of reasoning are not well developed as to why membership of the SEM may be desirable for a country. Analysis may not be logical and lacking in clarity.
0	**0 marks** No knowledge shown.	**0 marks** No valid analysis.

Indicative content.

AO1/AO3

The EU Single Market is based on the “four freedoms”: free movement of goods, services, people and capital.

Why might a non-EU member want to join the single market?

1. Trade creation means that trade is stimulated as a result of free access to a market of over 500m people. Trade is frictionless between members of the single market.
2. The exploitation of marketing economies of scale by local firms as their markets expand by exporting to a new ‘domestic market.’
3. Lower production costs as a result of scale economies. Integrated supply chains/JIT.
4. Lower prices as a result of lower costs and increased competition.
5. Common production standards, which reduces information failure allowing consumers to make more rational choices.
6. Technology transfer as a result of increased investment flows between members.

7. Transfer of skills across the single market. Mutual recognition of qualifications.
8. Increased labour mobility enabling wage costs to converge, and unemployment to be spread more evenly between members.
9. Increased capital mobility which increases its relative supply in each country, and enables businesses to grow and innovate.
10. Increased remittance flows between workers resident in one country and families remaining in another country.
11. Co-operation on common projects of mutual benefit, such as green energy research.
12. Single market members attract FDI from other parts of the world.

Source: Economics Online (adapted).

(b) **Evaluate the effects of membership of the Economic Monetary Union (EMU) (the euro zone) on an EU member state.** **[25]**

	AO1	**AO3**	**AO4**
Band	**6 marks**	**6 marks**	**8 marks**
3	**5-6 marks** **Excellent knowledge.** Excellent knowledge of the effects of EMU membership on EU members. The answer shows an awareness of a number of points on either side of the question some positive some negative.	**5-6 marks** **Excellent analysis.** Excellent analysis of how EMU membership affect an EU economy either positively or negatively. Clear line of argument and strong chains of reasoning.	**6-8 marks** **Excellent evaluation.** Well- developed two-sided answer that looks at the relative merits of EMU membership. The answer comes to a reasoned judgement as to the extent to which EMU membership is likely to be positive or negative.
2	**3-4 marks** **Good knowledge.** Good knowledge of the effects of EMU membership on EU members. Range of points on one side may be limited.	**3-4 marks** **Good analysis.** A good analysis of how EMU membership affects an EU economy either positively or negatively. There is a good line of argument, but overall analysis and the chain of reasoning may lack detail and/or clarity.	**3-5 marks** **Good evaluation.** A strong two-sided answer with effective points on both sides of the argument, but which never directly answers the question set in terms of coming to a reasoned conclusion. A good analysis of the other side of the case (from the AO3 mark) is present or points are very well qualified
1	**1-2 marks** **Limited knowledge.** A limited knowledge of the effects of EMU membership on EU members. The points made are superficial and range is limited on both sides.	**1-2 marks** **Limited analysis.** A superficial analysis of the positive or negative effects of how EMU membership affects an EU economy which lacks detail and a clear chain of reasoning.	**1-2 marks** **Limited evaluation**. Evaluation is very limited. A few evaluative points are made but merely as assertions. Or Counterarguments (negatives or positives depending on which side is credited as AO3) are present, but the points made are not developed and superficial.
0	**0 marks** No knowledge or understanding shown.	**0 marks** No relevant analysis.	**0 marks** No valid evaluation present.

Indicative content.

EU states becoming members of EMU must meet the convergence criteria.

Positive effects.

Trade and investment:

- Lower transactions costs for exporters and investors.
- The Euro reduces exchange rate uncertainty thus firms can predict the cost of imported raw materials and can set the price of their exports and are more likely to invest.
- Boost to tourism and labour mobility by eliminating conversion costs.
- Less currency risk as there is less threat of devaluation.
- May attract more FDI from outside the EU.
- Single currency membership allows countries to benefit fully from the single market – trade creation.

Financial support.

- Access to the ECB as a lender of last resort/rescue packages in time of economic crisis seen during the Covid-19 pandemic.
- Reduced risk from external shocks.
- Membership of EMU makes it easier for smaller member states to borrow.
- Countries are under pressure to keep inflation/public sector debt low.

Negative effects.

- Set up costs of replacing the old currency with the euro.
- Loss of control of monetary policy (interest rates set by the ECB)
- The Growth and Stability Pact means that there are limits on government borrowing, national debt and fiscal policy.
- No opportunity to devalue the currency which is a problem for weaker economies when trading both inside and outside the EU. Germany and Greece use the same currency.
- New EMU member states will have to accelerate structural reforms to improve competitiveness inside the euro which might lead to structural unemployment.
- Membership exposes a country to future fiscal bail outs of struggling member states.
- Eurozone is managed by the ECB with a deflationary bias leading to higher unemployment.
- Costs of leaving are high with big short-term problems

Judgement.

- Many countries especially small economies have joined the euro in recent years without problems but other larger economies from southern Europe have struggled. Estonia v Italy?
- Doubtful whether the single currency is an optimal currency area.
- Need for a fiscal union going forward.
- The effects of EMU membership need to be examined on a country-by-country basis.

	AO1	**AO2**	**AO3**	**AO4**	**QS**	**Total**
Section A						
1, 2 (a)	6	0	4	0	0	**10**
1, 2 (b)	6	0	6	8	0	**20**
Section B						
3, 4 (a)	6	0	4	0	0	**10**
3, 4 (b)	6	0	6	8	0	**20**
Section C						
5, 6 (a)	6	0	4	0	0	**10**
5, 6 (b)	6	0	6	8	0	**20**
	36	**0**	**30**	**24**	**0**	**90**
	32-36	0	27-32	23-27		