GCE AS MARKING SCHEME

SUMMER 2017

AS (NEW)
ECONOMICS - UNIT 2
2520U20–1

INTRODUCTION

This marking scheme was used by WJEC for the 2017 examination. It was finalised after detailed discussion at the examiners' conference 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 learner 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.

	Mark scheme	Total
1 (a) (i)	**Using the year 2000 as a base year, calculate the gold price index at its peak.** **AO2: 2 marks** Year 2000, gold price is approx. $400. 2011 – gold price is approx. $1900. Therefore, gold price index for 2011 – using 2000 as a base year – is 475. 4.75 award 1 mark. Accept +- %5 either side (2000 price between 380 and 420; 2011 price between 1805 and 1995). Therefore, provided the maths is correct, you should accept an answer between 522 and 432. **1 mark** One of the figures is within acceptable range (given above) but the other is not. Calculation is otherwise performed correctly.	**2**

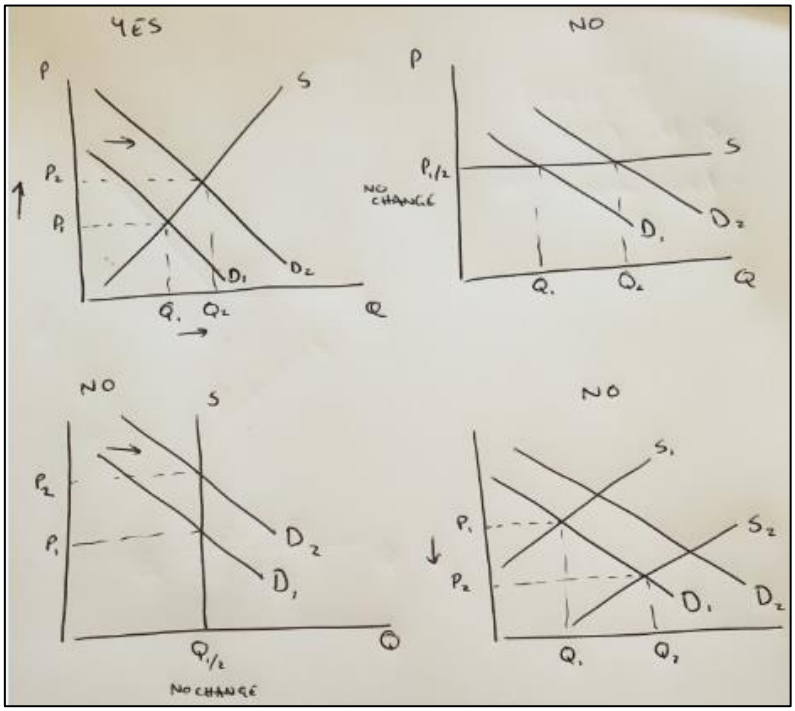
	Mark scheme	Total
1 (a) (ii)	**Using Figure 2, calculate both the mean and median gold supply per year during the 5 year period 2010-2014.** **AO2: 2 marks** Mean is 22051/5 = 4410.2 Accept 4410. Median is 4410. In other words, they are the same! Do not accept any variation. **1 mark** Only one of the figures above is correct.	**2**

1 (a) (iii)	**Using diagrams, evaluate the extent to which an increase in the demand for a product always leads to a corresponding increase in price and quantity.** **[8]**		
Band	**AO1**	**AO3**	**AO4**
	2 marks	**2 marks**	**4 marks**
	Is the diagram correct?	*Is the explanation of demand increasing leading to price and quantity increasing made well?*	*Has the candidate offered a suitable evaluation to the arguments made in AO3?*
2	**2 marks** Demand shifts right and the price increase is clearly shown.	**2 marks** A good explanation of why price and quantity increase.	**3-4 marks** 2 examples of where demand can increase in a market but not lead to an increase in price and/or quantity are explained. Diagrams are not necessary but should be credited if they are used well. Conversely, if there are no diagrams then explanations should be articulate and use technical terminology such as PES etc …
1	**1 mark** Only demand shifts right but price increase is not shown/incorrectly labelled.	**1 mark** Limited explanation which does not convince that candidate understands why price increases.	**1-2 marks** Only one example is offered (and explained) of an example where demand can increase in a market but does not lead to an increase in price and/or quantity. For example, price increases but not quantity or, conversely, quantity increases but not price. 2 examples are offered but they are both limited in their explanation (likely that no diagrams are offered as illustration).
0	**0 marks** No diagram or totally incorrect diagram e.g. supply curve shifting left.	**0 marks** No explanation offered or is incorrect.	**0 marks** No evaluation offered . OR Example offered actually leads to the price AND quantity increases AND therefore not answering the question.

Indicative Content:

AO1 (Diagram)

The top left-hand diagram is the diagram required for AO1.



AO3 (Explanation)

When demand increases for a product this will usually lead to an increase in price. If price didn't change then there would be excess demand between points A and B (an unstable situation). This excess demand creates upward pressure on price, hence leading to price increases.

AO4 (Evaluation)

However, this is not necessarily true in every case. In some instances where PES is perfectly elastic then producers can respond immediately to changes in demand and there will not be an increase in price even though the quantity has increased. Similarly, if PES is perfectly inelastic, price will change but quantity will not.

Similarly, if Supply also shifts right at the same time that demand increases then this will not increase the price since the upwards pressure on price is offset by the downward pressure from the supply curve. Supply shifting left at the same time will increase price but quantity may fall.

The diagrams above could be used in order to support the analysis given in AO4.

Q1 (b)	**Using the data, discuss the extent to which gold and US dollars can be considered to be substitutes.** **[6]**		
Band	**AO1**	**AO2**	**AO4**
	2 marks	**2 marks**	**2 marks**
	Does the candidate demonstrate a good understanding of 'substitutes'?	*Has the data been applied well?*	*Has economic theory been used to evaluate the arguments made?*
2	**2 marks** Understanding of the concept of a substitute good is either explicit through definition or implicit in the quality of the answer.	**2 marks** Excellent use of the data. Relevant content from the data is used to develop and support their argument in AO1 or AO4.	**2 marks** Clear well-reasoned and balanced evaluation that counters the claims made in AO1/2 successfully. Clear reference to economic theory.
1	**1 mark** Partially correct understanding. Some confusion present.	**1 mark** Limited use of the data which doesn't convincingly support the decision in AO1 or AO4 but does help to add some justification.	**1 mark** Limited evaluation. Throwaway remarks without development should not be credited.
0	**0 marks** No understanding. Candidate confuses substitute good with complementary goods.	**0 marks** No use of the data. Confused/incorrect use of the data.	**0 marks** No evaluation offered.

Indicative content:

AO1

Substitutes are goods that perform the same function/satisfy the same need.

OR Substitutes are goods that have a positive XED since the demand for one good falls when the price for the other (second) good increases.

OR Might also link to the idea that as the price of one good goes up the quantity demand of the other good should go up as well.

AO2

The data says that one of the main reasons that people buy gold is so that they can store wealth and then pass this on through the generations. In the same way, many people buy US dollars. It is the world's largest reserve currency (implying that countries hold wealth in dollar reserves). To that end, it can be seen that both gold and US dollars are performing the same function. Thus, they could be argued as substitute goods – that is, goods which perform the same function.

Or one may wish to argue that as dollars increase in value, the relative price of gold falls for people using that currency and therefore may indeed wish to buy more gold when the price of dollars increases – thus, it is – technically – a substitutional relationship.

AO4

However, gold has many different functions – it is used for jewellery and in medical equipment – and thus there is a limited relationship between the 2 goods. They are not strong substitutes.

Similarly, candidates might prefer to talk about the versatility of money and how money has more functions than gold i.e. one can spend it in a shop to buy products. To that end, gold cannot perform those functions and cannot be considered to be a strong substitute.

In addition, in the data it is said that when US dollars fall in price people did not want to hold dollars and they started buying gold instead. Technically, this would mean that the two goods have a complementary relationship. As the price of good A decreases, people buy more good B.

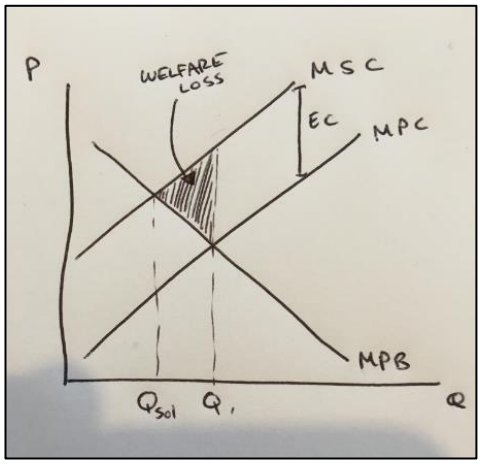
Q1 (c)	**Using an appropriate diagram, explain how gold-mining can lead to market failure.** **[8]**			
Band	**AO1**		**AO2**	**AO3**
	1 mark	**2 marks**	**2 marks**	**3 marks**
	Has the candidate shown a good understanding of market failure?	*Is the diagram correct?*	*Is the answer set in context?*	*Answer fully explains that gold-mining can lead to market failure through good economic analysis*
2		**2 marks** Excellent diagram with all areas clearly identified and labelled. It is completely accurate.	**2 marks** Clear reference to the data. Relevant content from the data is used to develop and support their argument.	**3 marks** Clear well-articulated explanation that gold-mining creates negative externalities on the third party (other market failures accepted if appropriate). Development of this explanation that satisfactorily concludes that the free market provision of gold would not lead to a socially optimum level of output.
1	**1 mark** Understanding of market failure is either explicit through definition or implicit in the quality of the answer.	**1 mark** One major error on the diagram such as welfare loss being drawn in the wrong place or incorrectly identified.	**1 mark** Limited use of the data. Knowledge and understanding may not be applied specifically to the context given in the data.	**1-2 marks** Limited or brief explanation that does not convince that candidate has an excellent grasp of the technical elements of the theory.
0	**0 marks** No understanding of market failure.	**0 marks** Wrong/incorrect diagram. No diagram.	**0 marks** A generic explanation of any market failure and there is no mention of gold-mining.	**0 marks** No valid explanation.

Indicative content:

AO1 (Understanding)

Good definition of Market Failure - for example, it is a misallocation of resources caused by the unrestricted operation of the free market OR it causes net welfare loss to society.

AO1 (Diagram)



AO3 (Explanation)

The Market Failure here is negative externalities in production. The private costs to the firm in mining for gold are shown by the Supply curve (Marginal Private Costs curve). This intersects with the Demand curve (Marginal Private Benefits curve) at Qe – meaning that if gold were to be provided by the free market, Qe units of gold would be made. However, gold-mining leads to a negative spill-over on a third party – a negative externality. This means that that there is an external cost of gold-mining on the third party that is not currently being paid for by either the consumer or the producer. This is represented on the diagram by drawing a Marginal Social Cost curve – which lies above the Marginal Private Cost curve since MSC = MPC + External Costs. The Socially Optimum level of output would be at Qsol. As you can see, Qsol < Qe and therefore we can see that there is an over-production (or over-allocation) of gold in the free market. We can represent the loss to community surplus by shading in the welfare loss triangle ABC – which demonstrates that social costs are greater than private benefits for Qe-Qsol units.

AO2 (Use of data)
Any range of examples from the 'Planet' or 'People' would suffice here. In order to score the full complement of AO2 marks, however, it really should be the explanation in terms of these are impacts on a third party – not the buyer of gold or the seller of gold.

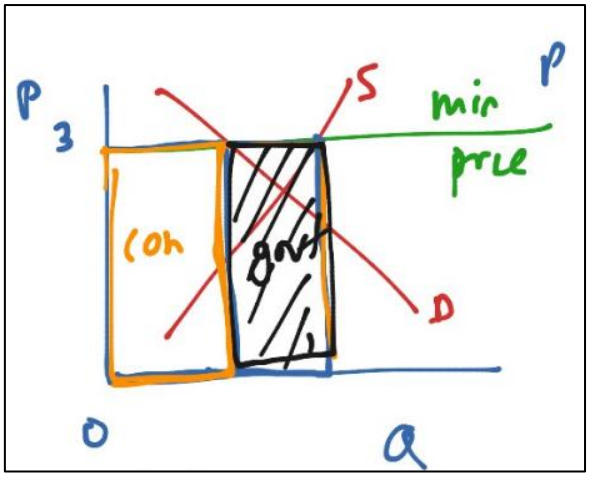
NOTE: It is possible to answer the question using a different market failure (other than NEGATIVE EXTERNALITIES). The examiner can award up to full marks for a different market failure if all elements (the explanation, the diagram, understanding of market failure and application to the context) are still deemed to be satisfactory.

	Mark scheme	Total
Q 1 (d) (i)	**Using Figures 2 and 3, calculate the % of the 2014 total gold supply that was mined in Peru and Ghana.** **AO2: 2 marks** Peru + Ghana = 275.1 Total gold supply = 4410 6.2% Credit correct percentages for separate countries too. **1 mark** Candidate has identified the correct values above (275.1 and 4410) but performs the percentage change calculation incorrectly and so ends up with the incorrect answer. Candidate does not present his/her answer as a %. Candidate adds up Peru and Ghana's total incorrectly although the % change calculation is performed satisfactorily. Do not credit any 'random' numbers in a percentage change calculation – it should be obvious that an attempt has been made to add Peru and Ghana together. Accept % calculation for Peru (39%) and Ghana (24%) separately 1 mark for each.	**2**

Q1 (d) (ii)	**With the aid of a diagram, discuss whether the introduction of a guaranteed minimum price for gold will be beneficial for workers in gold mines in poor countries like Peru and Ghana. [12]**			
Band	**AO1**	**AO2**	**AO3**	**AO4**
	2 marks	**2 marks**	**4 marks**	**4 marks**
	Is the guaranteed minimum price diagram correct?	*Has the answer been set in the context of gold-mining in poor countries?*	*Has relevant economic theory been developed in order to make logical arguments in favour of the discussion?*	*Has economic theory been used to evaluate the arguments made in AO3?*
2	**2 marks** Excellent diagram with all areas clearly identified and labelled. It is completely accurate. Requires quantity demanded and quality supplied to be clearly indicated.	**2 marks** Clear reference to the data. Relevant content from the data is used to develop and support their argument.	**3-4 marks** Candidate fully develops two lines of argument of how a guaranteed minimum price will be beneficial for workers. Max 2 per individual point. Economic theory is correct and well developed at every stage.	**3-4 marks** Clear well-reasoned and balanced evaluation that counters the claims made in AO3 successfully. Clear reference to economic theory. Max 2 per individual point.
1	**1 mark** One major error on the diagram. Any labelling error which could cause confusion in understanding (not price/quantity axis).	**1 mark** Limited use of the data. Knowledge and understanding may not be applied specifically to the context given in the data.	**1-2 marks** Candidate only develops one line of argument of how minimum price for gold will benefit workers. OR Candidate offers two (or more) points but the economic theory is only partially correct or candidate doesn't quite develop the points in terms of benefits for workers satisfactorily. Workers should not be used synonymously with consumers.	**1-2 marks** Limited evaluation. Throwaway remarks without development should not be credited. Max 2 per individual point (regardless of how well it is developed!).
0	**0 marks** Wrong/incorrect diagram. No diagram.	**0 marks** No context to the answer.	**0 marks** No or incorrect analysis.	**0 marks** No evaluation offered.

Indicative Content:

AO1 (diagram)



AO3 (Explanation)

Candidates may make the following arguments:

- Gold is PED inelastic (as it has so many uses and few substitutes). *It could even be argued that it has a positive PED - that as price goes up, it could be argued that demand actually increases (Veblen goods). Therefore, when price increases, revenue should increase and so the extra income can be passed down to workers. This should increase their income, incentive to work, standards of living and taking them out of poverty.
- Guaranteed minimum prices for gold should increase revenue that gold producers can make. The extra money for firms could be used to improve living standards for workers.
- If there is extra profit in the market, this will attract more investment in gold mines to take advantage of higher prices of gold (and this will lead to greater job opportunities).
- The extra profit could be used to pay into community funded projects - therefore the workers themselves can choose how to redistribute their extra money.
- Any sort of min price scheme that involves the government buying up the excess obviously guarantees the firm a future income which should enable them to sign workers up to longer term contracts or to reinvest further and therefore create more jobs.

AO4 (Evaluation)

- Labour market is very unregulated and therefore there is no guarantee that the higher prices will be passed onto workers in the form of higher wages.
- Unless regulation improves, greater job opportunities doesn't necessarily mean higher wages.
- Governments may struggle to buy up the excess and the scheme will not last long. This is particularly true if lots of new suppliers enter the market or gold behaves like an elastic good. Previous min price schemes (like it says in the data) have not worked for similar reasons.
- Min price schemes have often failed because they are so expensive for governments to buy the excess. If this is the case, the government may have less money now to ensure the correct compensation packages, health insurance etc. for the benefit of workers.
- Some countries may look to trade gold at below a 'global' min price. Therefore, those workers are not benefitting. In a sense, some countries may trade on a black market and this will reduce working conditions even further for those gold-miners (as they will be even less regulated).
- If some countries undercut the min price, then sales will fall for the 'high value' gold and jobs will be lost in those countries.
- Min price for gold may create a black market and this will reduce working conditions even further for those gold-miners.
- Min price may not be set above the market equilibrium and therefore it will not be effective at changing anything.
- USA is one the largest producers of gold and yet they have much greater labour market regulations. Therefore it is possible to improve the working conditions of workers without having to impose min prices.
- Data says that gold miners in the developed world already tend to earn more than the national average and therefore the min price on gold may not change things dramatically for them. Therefore, it is difficult to see how a min price scheme could be enforced on a worldwide basis which compromises the whole scheme.

AO2 (Use of data)

- Any range of examples from the 'People' section would suffice here or in order to score the full complement of AO2 marks. However, it really should be the explanation in terms of impact on the workers rather than firms or governments.

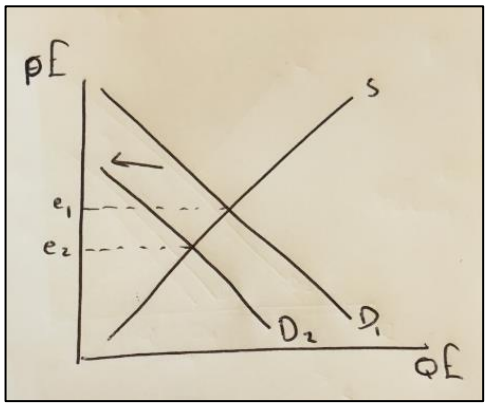
Q 2 (a)	**Using an exchange rate diagram, describe one reason why the 2008 financial crisis may have led to a depreciation of sterling.** **[4]**	
Band	**AO1**	**AO2**
	2 marks	**2 marks**
	Has a relevant factor affecting exchange rates been identified and understood?	*Is the diagram correct?*
2	**2 marks** One correct reason identified and described as to why the depreciation of sterling may have occurred.	**2 marks** Accurately drawn diagram.
1	**1 mark** Factor has been identified only.	**1 mark** One major error on the diagram.
0	**0 marks** No or incorrect factor identified.	**0 marks** No or incorrect factor identified.

Indicative content:

AO1
Allow any plausible factor, but possible points might include:

- UK is selling less exports due to a downturn in the global economy.
- Capital outflow is increasing as savers take their money out of the UK in seek of higher returns elsewhere OR because consumer/business confidence in the UK is low, whilst it is higher elsewhere.
- Capital inflow is decreasing since the economic prospects of the UK during the financial crisis were dismal. Runs on the banks (such as Northern Rock) will have deterred foreign speculators from buying sterling.
- Also, it is acceptable if the argument is made that the Bank of England reduced interest rates in the wake of the financial downturn and this has led to an increase in capital outflows – thus depreciating the ER.

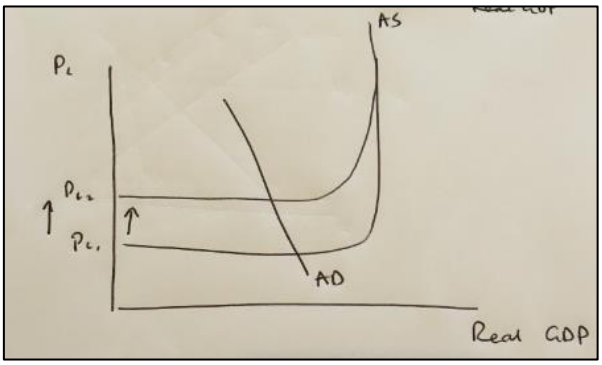
AO2 (Diagram)
Could be D or S moving (or both) given the possible answers for AO1. Look out for any labelling error which could cause confusion in understanding.



Q 2 (b)	**Using an AD/AS diagram, outline how a sharp depreciation of sterling can cause inflation despite weak aggregate demand.** **[4]**	
Band	**AO1**	**AO2**
	2 marks	**2 marks**
	Outline that weak ER causes the cost-push inflation	*Is the diagram correct?*
2	**2 marks** Cost-push inflation identified and good description as to why the depreciation of sterling will lead to it.	**2 marks** Accurately drawn diagram which shows AS curve shifting upwards.
1	**1 mark** Identification that cost-push inflation has occurred but without any real understanding.	**1 mark** One major error on the diagram.
0	**0 marks** No or incorrect factor identified.	**0 marks** Incorrect diagram.

Indicative Content

AO2 (Diagram)



AO1

A depreciation on sterling means that import prices have suddenly increased. As a result of this any firm importing raw materials or component parts (from abroad) – as many UK firms do – will see their costs of production increase. Therefore AS shifts upwards/to the left and this creates upwards pressure on price since firms need to pass on their extra costs to consumers in the form of higher prices.

NB - Demand-Pull

The credit for Q2(b) is primarily for a demonstration of **cost-push inflation**. The candidate should not be penalised for showing demand-pull inflation (because, a priori it will create an increase in AD) but the **candidate should not be gaining marks for demand-pull unless he/she makes it very clear that the effect of the depreciation could overcome the initial weak demand.** I.e. there must be some explicit reference to weak demand in the explanation OR implicitly in the diagram (AD drawn far the left of AS) and that the effect of the ER depreciation has been so great on AD that inflation had been caused. A simple explanation of ER depreciation causing AD to shift right, causing prices to increase is not satisfactory.

Max for demand-pull inflation is 2.

Q2 (c)	**To what extent do you agree with MPC's assessment in early 2015 that "it can simultaneously return inflation to its target level and support economic growth without any fear of conflict between the policy objectives"? [8]**		
Band	**AO1**	**AO3**	**AO4**
	2 marks	**2 marks**	**4 marks**
	Candidate explains how MPC might attempt to deal to return inflation to target AND also how it might attempt to increase growth.	*Has economic theory been well developed to support the argument that MPC can return inflation to target without fear of conflict?*	*Has economic theory been used to evaluate the arguments made in AO1/AO3?*
2	**2 marks** Candidates either directly or implicitly in the answer shows an excellent understanding of how MPC (through Low Bank Rate) can: - return inflation to target - how it might attempt to increase growth **Both objectives must be considered.**	**2 marks** A good analysis. Candidates explains the circumstances under which it is possible to achieve both macro-objectives at the same time. It is not essential to draw diagrams but they should be credited where drawn (and explained).	**3-4 marks** Clear well-reasoned and balanced evaluation that counters the claims made in AO3 successfully. 2 points of evaluation are necessary. Clear reference to economic theory.
1	**1 mark** Only one of the two objectives has been considered.	**1 mark** Partially confused/ incomplete/partially inaccurate analysis.	**1-2 marks** Limited evaluation. 1 good evaluation point only.
0	**0 marks** Question does not refer back to objectives at hand.	**0 marks** No or incorrect analysis.	**0 marks** Throwaway evaluation. No evaluation.

Indicative content.

AO1 (Understanding)

Low interest rates will help to stimulate AD through the transmission mechanism.

- This will help to create economic growth and lower unemployment.
- This will help to create inflationary pressure.

AO3 (Analysis)

- Normally, this would create inflationary pressure but since inflation is currently very low, that is a minor issue. In fact, some inflationary pressure might actually be desirable.
- Given that Monetary Policy can be a slow process, it is unlikely that there will be any inflationary pressure quickly. Bear in mind that bank rate has been low at 0.5% for over 6 years.
- Economic growth is very weak which implies that we have a large output gap and therefore it will take a long time before we reach full capacity and have any sense of inflationary pressure.
- It is important to try and return inflation to target level since we want to avoid deflation (and the idea of people forgoing the expenditure today in order to wait for tomorrow). In that circumstance, economic growth would falter and perhaps begin to decline. So, for the benefit of keeping economic growth positive, we should look to apply some pressure to inflation.

AO4 (Evaluation)

Economic growth might be slow but employment is quite high – i.e. whilst growth is slow, the output gap is not actually that small and therefore we might reach full capacity quicker than they think. Economic slack might be absorbed quicker than they think.

- Low oil and food prices might actually stimulate domestic, and global, demand and this may lead to AD shifting to the right and inflationary pressure occurring.
- It all rather depends on how quickly we reach full capacity. If the effects of a low bank rate act quickly then inflationary pressure might ensue.
- If food and oil prices rise in the meantime then will get inflationary pressure through cost-push factors. Low bank rate at this point will only add to inflationary pressure.

This is not an exhaustive list of issues and examiners should credit logical and well developed arguments both in AO3 and AO4 that are not present here.

Candidates may also consider the wider economic objectives and this can be credited.

	Mark scheme	Total
Q 2 (d)	**What is meant by productivity?** **AO1: 2 marks** Award **2** marks for a good understanding of productivity. Award **1** mark for a limited understanding of productivity. **Indicative content:** Productivity is a measure of output per unit of input. Inputs include labour and capital. Award **1** mark if an example of productivity is calculated.	**2**

Q2 (e)	**With reference to Extract B and economic theory, discuss the extent to which high quality education and training programmes can improve the trade balance and reduce unemployment levels in the UK. [10]**		
Band	**AO2** **2 marks**	**AO3** **4 marks**	**AO4** **4 marks**
	Is the answer developed within the context of the UK economy?	*Does the answer analyse the policies with regard to the two macro-objectives?*	*Has economic theory been used to evaluate the arguments made in AO3?*
2	**2 marks** Clear reference to the data or personal knowledge. Relevant content from the data is used to develop and support their argument.	**3-4 marks** A good analysis of how education and training can improve both the trade balance and unemployment levels.	**3-4 marks** Clear well-reasoned and balanced evaluation that counters the claims made in AO3 successfully. Clear reference to economic theory.
1	**1 mark** Limited use of the data.	**1-2 marks** A limited analysis. Candidate only focusses on one of the macro-objectives. OR A general macro-economic assessment which only superficially touches on trade and/or unemployment.	**1-2 marks** Limited evaluation. Throwaway remarks without development should not be credited.
0	**0 marks** No use of the data.	**0 marks** No or incorrect analysis.	**0 marks** No Evaluation. OR Throwaway remarks.

Indicative Content:

AO3 (Analysis)

- Ed&Trg increases productivity levels. This should decrease costs of production for businesses and, therefore be more competitive in the world. This allows them to decrease price of exports and therefore sell more exports.
- Ed&Trg improves the likelihood that the UK economy can expand into different sectors/industries and therefore they might produce higher quality products that could increase the total number of exports.
- Increases in exports will increase revenue for firms and therefore increase employment.
- Ed&Trg will increase the job prospects of candidates and therefore allow them to be hired more easily.
- Ed&Trg will reduce occupational immobility and firms can satisfy their demand for specialist skills more easily.
- The Alacrity Foundation in Wales will specialise in technological sector and this is the highest growth areas of the future – therefore increasing employment levels.
- The UK suffers from regional inequality and occupational immobility so it will particularly benefit from Ed&Trg programmes.

AO4 (Evaluation)

- Ed&Trg policies are always susceptible to malinvestment in the sense that you may invest money/effort into building a specific set of skills only for that skill not to be in demand anymore once the Ed&Trg course is finished.
- Ed&Trg is no guarantee of success. For every one graduate there may be several who fail to make the mark and therefore the impact on trade/unemployment may not be as great as anticipated.
- Ed&Trg gains are all relative to what other countries are doing with their only Ed&Trg schemes. If another country is conducting them then there may be no increase in exports for the UK since they are unable to bring costs down far enough.
- Trade balance is highly dependent on other variable such as ER – so we could have as much Ed&Trg as we like but it may not make much difference.
- Ed&Trg is expensive and there is an opportunity cost – other strategies to reduce unemployment or improve the trade balance may need to be sacrificed e.g. improved infrastructure.

NOTE: Throwaway evaluation remarks such as Education takes a long time or Education programmes are expensive are not to be **credited unless they are developed in the context of the macro-objectives.**

AO2 (Application)

Candidate shows an excellent understanding of either:
(1) the types of education and training programmes in the UK (which can be gleaned from the data) or (2) an excellent understanding of the main issues affecting the UK economy and how these policies might affect the UK.

Q2 (f)	**To what extent do you agree with the statement: "the supply-side policies of cutting direct taxes and improving infrastructure are more effective strategies for reducing inflation than a rise in interest rates"? [12]**		
Band	**AO1**	**AO3**	**AO4**
	2 marks	**4 marks**	**6 marks**
	Does the answer show a good understanding of both monetary and supply-side policy?	*Has economic theory been well developed to support the argument that monetary policy and supply side policies can be used to reduce inflation rates?*	*Have counter arguments been made and developed?*
3			**5-6 marks** Both policies are evaluated within their own right but also in comparison to each other. Candidate makes a judgement, not necessarily through a conclusion, that one policy is 'better than the other' and justifies it.
2	**2 marks** A good understanding of monetary policy AND supply side policy is either explicit through definition or implicit in the quality of the answer .	**3-4 marks** A good analysis that develops the definitions raised in AO1 fully develops to show how inflation levels can be curbed by the two different policies. Max 2 per policy.	**3-4 marks** Good level of evaluation which tackles both policies and shows why they may not help to curb inflation BUT no attempt to compare them. OR Comparison is present BUT not enough evaluation of each policy in their own right.
1	**1 mark** Limited understanding is demonstrated. Only one of the two policies is obviously understood.	**1-2 marks** A limited analysis. Again, perhaps only one of the policies is developed fully – not both.	**1-2 marks** Limited evaluation.
0	**0 marks** There is no understanding.	**0 marks** Incorrect analysis. No analysis. Answers assert outcomes (i.e. that inflation falls) but with no developed explanation anywhere.	**0 marks** Only throwaway remarks. No evaluation present.

Indicative content:

AO1 (Understanding)

Monetary Policy – interest rates can be increased.

Supply-side policies are government attempts to increase productivity and shift aggregate supply (AS) to the right.

AO3 (Analysis)

Monetary Policy must include at least 2 strands of the transmission mechanism. One strand equals one (AO3) mark.

Explanation of the transmission mechanism and the various component parts:

- It will increase the reward for saving and therefore decrease consumption.
- It will also discourage investment since repayments are now larger.
- It lowers asset process and therefore consumption falls, lowering AD and inflation.
- It will encourage Capital Inflow and therefore lead to an appreciation of the ER – thereby reducing exports and increasing imports. All of which will reduce AD and therefore create downwards pressure on prices.

Also, candidates could bring in the idea of lots of people being on Variable rate mortgages and therefore an increase in interest rates would drive down their disposable income.

**Although not explicitly stated in the question, Monetary Policy could also be explained by an ambitious candidate, through Quantitative Tightening. This should be credited. The Central Bank sells debt on capital markets in order to soak up liquid cash in the economy and thereby reducing both C and I opportunities for new bond-holder, thereby driving down AD and prices. Or, driving up the interest rates on other assets and again increasing the reward for saving rather than spending.

Supply-side policies can be EXPLAINED through examples but it must link to the idea of increasing LRAS or driving down costs through efficiency and/or productivity gains so that inflation is brought under control.

SSPs will shift AS downwards or outwards and thus try to solve inflationary pressures through AS rather than AD. Any reasonable SSPs should be credited as long it is made clear how the AS curve should respond and how this then alleviates inflationary pressure e.g. increasing full capacity, reducing the price of factors of production or increasing productivity.

Just shifting LRAS without explaining the logic of a policy should not be credited.

MAX 2 per policy

AO4 (Evaluation)

There are a number of reasons why ramping up interest rates may fail to reduce inflation.

- If consumer/business confidence is high (i.e. in and just out of a recession), then people and firms will continue to spend regardless of interest rates.
- Interest rates may be relatively higher elsewhere in the world and so speculators may not decide to save in this country – therefore ER does not appreciate.
- Inflation may be caused by cost-push factors rather than demand-pull factors and therefore manipulating AD with monetary policy will have very little affect.
- Throwaway evaluation such as ‘time-lags’ need to be developed in order to be credited at all.

Similarly, SSPs may not alleviate the problems of inflation:

- SSPs may require short-term investment and this will actually have an inflationary effect in the immediate term if AD shifts right.
- Governments are prone to malinvestment and government failure – which means that money may be invested into schemes that don't quite have the required outcome e.g. training programmes that fail to equip people with the right skills, infrastructure projects which don't get off the ground.
- The impact of the SSP may not be seen for a number of years and therefore it is unlikely to have an immediate impact – unlike monetary policy which is arguably a more direct method.
- SSP's may negatively affect some economic groups e.g. flexible labour markets such as zero contract hours and weak trade union representation - even though inflation may be falling.

This is not an exhaustive list of issues and examiners should credit logical and well developed arguments both in AO3 and AO4 that are not present here.