



*Rewarding Learning*

**ADVANCED SUBSIDIARY (AS)  
General Certificate of Education**

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## **Economics**

**Assessment Unit AS 2**

*assessing*

**Managing the National Economy**

**[SEC21]**

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## **Assessment**

**MARK  
SCHEME**

Users are strongly recommended to study the General Marking Instructions at the beginning. Particular attention to guidance on levels of response, making calculations and quality of written communication will make the mark scheme easier to understand and apply.

## General Marking Instructions

This mark scheme is intended to ensure that the AS examinations are marked consistently and fairly. The mark scheme provides examiners with an indication of the nature and range of candidate responses likely to be worthy of credit. It also sets out the criteria which they should apply in allocating marks to candidates' responses. The mark scheme should be read in conjunction with these general marking instructions which apply to all papers.

### Quality of candidates' responses

In marking the examination papers, examiners will be looking for a quality of response reflecting the level of maturity which may reasonably be expected of 17-year-olds, which is the age at which the majority of candidates sit their AS examinations.

### Flexibility in marking

The mark scheme is not intended to be totally prescriptive. For many questions, there may be a number of equally legitimate responses and different methods by which the candidates may achieve good marks. No mark scheme can cover all the answers which candidates may produce. In the event of unanticipated answers, examiners are expected to use their professional judgement to assess the validity of answers. If an answer is particularly problematic, then examiners should seek the guidance of the Supervising Examiner for the paper concerned.

### Positive marking

Examiners are encouraged to be positive in their marking, giving appropriate credit for valid responses rather than penalising candidates for errors or omissions. Examiners should make use of the whole of the available mark range for any particular question and be prepared to award full marks for a response which is as good as might reasonably be expected for 17-year-old candidates. Conversely, marks should only be awarded for valid responses and not given for an attempt which is completely incorrect or inappropriate.

### Types of mark schemes

Mark schemes for questions which require candidates to respond in extended written form are marked on the basis of levels of response which take account of the quality of written communication. These questions are indicated on the cover of the examination paper. Other questions which require only short answers are marked on a point for point basis with marks awarded for each valid piece of information provided. Some material may be included in the mark scheme for the benefit of teachers and pupils preparing for future examinations. Candidates are not expected to have provided this information. Such material is printed in the mark scheme in italics.

### Levels of response

Questions requiring candidates to respond in extended writing are marked in terms of levels of response. In deciding which level of response to award, examiners should look for the "best fit" bearing in mind that weakness in one area may be compensated for by strength in another. In deciding which mark within a particular level to award to any response, examiners are expected to use their professional judgement. The following guidance is provided to assist examiners.

**Threshold performance:** Response which just merits inclusion in the level and should be awarded a mark at or near the bottom of the range.

**Intermediate performance:** Response which clearly merits inclusion in the level and should be awarded a mark at or near the middle of the range.

**High performance:** Response which fully satisfies the level description and should be awarded a mark at or near the top of the range.

### Marking calculations

In marking answers involving calculations, examiners should apply the “own figure rule” so that candidates are not penalised more than once for a computational error.

Consider the following example of a question worth 4 marks in total. Candidates are told that the 2019 value of a simple index of prices (base 2012=100) is 125.00. There follows a simple table showing weights and percentage price increases in the year to 2022, and for 2 marks, the first part of the question requires candidates to calculate the rate of inflation during that year.

The answer should have been 4%, but the candidate miscalculates the outcome as 2.8%. So much of the required method was already illustrated that any wrong answer earns zero marks.

The second part (worth 2 marks) asks candidates to calculate the index value for 2020 (base 2012=100)

A correct method of calculation, using correct figures, would have been  $125 \times 1.04 = 130.00$

An AS candidate using this correct method but substituting their own derived figure of 1.028 would arrive at an answer of 128.50, which, in these circumstances, earns 2 marks.

### Quality of written communication

Quality of written communication is taken into account in assessing candidates’ responses to all questions that require them to respond in extended written form. These questions are marked on the basis of levels of response. The description for each level of response includes reference to the quality of written communication. Where the quality of candidates’ economics is not matched by the quality of written communication, marks awarded will not exceed the maximum for Level 2 in questions which have three levels of response or the maximum for Level 3 in those which have four levels of response.

For conciseness, quality of written communication is distinguished within levels of response as follows:

Level 1: Quality of written communication is limited.

Level 2: Quality of written communication is satisfactory.

Level 3: Quality of written communication is of a high standard.

In interpreting these level descriptions, examiners should refer to the more detailed guidance provided below:

**Level 1 (Limited):** The candidate makes only a limited attempt to select and use an appropriate form and style of writing. The organisation of material may lack clarity and coherence. There is little use of specialist vocabulary. Presentation, spelling, punctuation and grammar may be such that intended meaning is not clear.

**Level 2 (Satisfactory):** The candidate makes a reasonable attempt to select and use an appropriate form and style of writing, supported with appropriate use of diagrams as required. Relevant material is organised with some clarity and coherence. There is some use of appropriate specialist vocabulary. Presentation, spelling, punctuation and grammar are sufficiently competent to make meaning evident.

**Level 3 (High Standard):** The candidate successfully selects and uses an appropriate form and style of writing, supported with the effective use of diagrams where appropriate. Relevant material is organised with a high degree of clarity and coherence. There is widespread use of appropriate specialist vocabulary. Presentation, spelling, punctuation and grammar are of a sufficiently high standard to make meaning clear.

		AVAILABLE MARKS
<p><b>1.</b> For calculation of 2018 population in index number form as 129.18 (62169/48125 × 100) [3] Up to [2] for correct methodology but error in calculation or presentation A candidate who produces the correct answer without any evidence of how they arrived at that answer would receive the full 3 marks. An incorrect answer without any evidence of how it was arrived at would receive 0 marks even if an examiner could guess at where the error was made. A candidate who provided evidence of the correct method but clearly made an inputting error would receive 2 marks. A candidate who for example presented the answer as 129.18% would also receive 2 marks. A candidate who arrived at an answer of 29.18 based on a simple percentage change calculation of would receive 1 mark.</p>		3
<p><b>2</b> A direct tax is a tax which is levied upon an individual or organisation- for example income tax, national insurance or corporation tax An indirect tax on the other hand is a tax which is levied upon a good or service. For example VAT or excise duty.</p> <p>For clear explanation of difference between direct and indirect tax [2] For appropriate examples in each case [2] A candidate need only give one example in each case to gain the 2 application marks. Two or more examples of a direct tax with no example of an indirect tax (or vice versa) would gain only 1 mark. A candidate who gives two or more examples in each case but where one example is incorrect will not lose any of the application marks. This candidate could still gain full marks so long as they clearly and accurately explained the difference between direct and indirect taxes. However, it is often the case that errors in the examples reflect an imperfect explanation of the difference in direct and indirect taxes and hence the candidate may only be awarded 1 of the available 2 marks for the explanation.</p>		4
<p><b>3 (a)</b> For calculation of economically active population as 33,810,000 [2] For correct methodology but error in calculation [1] Or for calculation of economically active population as 33,297,000 [1] A candidate who produces the correct answer without any evidence of how they arrived at that answer would receive the full 2 marks. An incorrect answer without any evidence of how it was arrived at would receive 0 marks even if an examiner could guess at where the error was made. A candidate who provided evidence of the correct method but clearly made an inputting error would receive 1 mark. A candidate who presented the answer as 33,810 would also receive 1 mark.</p> <p><b>(b)</b> For calculation of ILO unemployment rate as 4.17% [2] For correct methodology but error in calculation or presentation [1] A candidate who produces the correct answer without any evidence of how they arrived at that answer would receive the full 2 marks. An incorrect answer without any evidence of how it was arrived at would receive 0 marks even if an examiner could guess at where the error was made. A candidate who provided evidence of the correct method but clearly made an inputting error (for example 41.7%) would receive 1 mark. A candidate who presented the answer as 4.17 (without the % sign) would also receive 1 mark. An answer of 4.35% (based on an incorrect methodology of 1,411/32,399) would receive 0 marks.</p>		

(c) The ILO unemployment figure includes some people that are not included in the Claimant Count

- people whose partner works more than 24 hours a week
- young people under 18 who are looking for work but do not take up the offer of a Youth Training place
- students looking for part-time work or vacation work
- people who have left their job voluntarily
- people with savings of over £16,000.

Up to 2 marks for explanation of each valid reason

A candidate will be awarded up to 2 marks for any accurate and valid point – even if it is not identified on the mark scheme. Where a candidate gives more than 2 reasons please select the 2 reasons worthy of the highest score when calculating a mark for this question. A candidate who for example states that the “ILO figure is higher because it includes people whose husbands have a job and those who have savings” would receive 2 of the available 4 marks. [4]

AVAILABLE  
MARKS

8

4 For calculation of percentage change in real GDP as 15.51% [4]

$$£1037 \div 125 \times 110 = £912.56$$

$$912.56 - 790/790 \times 100 = 15.51\%$$

Up to [3] for correct methodology but error in calculation or presentation

A candidate who produces the correct answer without any evidence of how they arrived at that answer would receive the full 4 marks. An incorrect answer without any evidence of how it was arrived at would receive 0 marks even if an examiner could guess at where the error was made.

A candidate who provided evidence of the correct method but clearly made one simple inputting error would receive 3 marks.

A candidate who provided evidence of the correct method but made more than one simple inputting error would receive up to 2 marks.

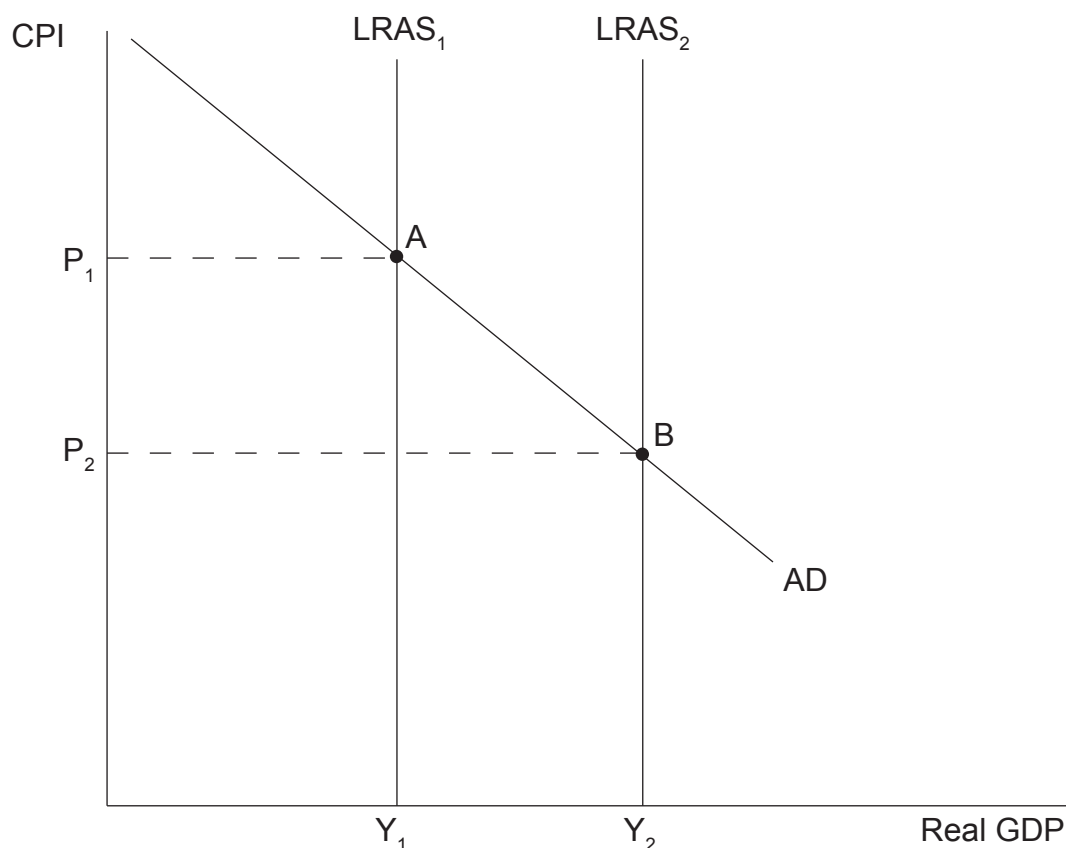
A candidate who arrived at an answer of 31.27% based on a simple percentage change in GDP calculation of would receive 0 marks

An answer of 16.27%, based on a calculation of the percentage change in GDP minus the absolute change in the CPI (31.27%-15%) would receive 1 mark.

An answer of 17.63%, based on a calculation of the percentage change in GDP minus the percentage change in the CPI (31.27%-13.64%) would receive 3 marks.

4

- 5 Neoclassical economists argue that effective supply side policies will shift the LRAS curve to the right and hence lead to higher levels of employment and economic output (GDP) and will also reduce the average price level as shown in the diagram below. The lower prices should also make US goods more competitive internationally and hence should reduce the USA's deficit on the current account of the balance of payments.



**Issues and areas for analysis include:**

- Analysis of likely impact of supply side policies on key macroeconomic objectives
- Reference to key macroeconomic objectives
- Distinction between the long run and the short run
- Explanation and or examples of supply side policies
- Appropriate diagram

**Level 1 ([1]–[2])**

A basic response provides an answer that demonstrates:

- Basic knowledge and understanding of relevant terminology, concepts, principles and models.
- Basic application of relevant economic principles, terminology, concepts and models to the context of the question; limited use of relevant data, and diagrams where relevant, to address the issues in the question.
- Basic analysis; may lack focus.
- A low quality of written communication.

At this level a candidate may make some vague reference to a governments macroeconomic objectives and may state that supply side policies help to achieve these. However, they will not provide any analysis (diagrammatic or otherwise) to support this assertion. Alternatively, they may attempt to draw a

diagram but this diagram will contain significant errors (for example they may use a microeconomic diagram rather than a macroeconomic diagram).

**Level 2 ([3]–[4])**

A good response provides an answer that demonstrates:

- Good knowledge and understanding of relevant terminology, concepts, principles and models.
- Good application of relevant economic principles, terminology, concepts and models to the context of the question; where relevant, data and diagrams are used reasonably to address the issues in the question.
- Good analysis in relation to the impact on economic agents; analysis may not be developed fully or may have some inaccuracy at times.
- A good quality of written communication.

At this level a candidate will demonstrate clear knowledge and understanding of supply side policies and macroeconomic objectives. They will state that supply side policies shift the LRAS to the right and may provide some analysis to support this assertion, however this analysis may be unclear or incomplete. A diagram will be drawn but it may be incomplete or contain some minor errors.

**Level 3 ([5]–[6])**

An excellent response provides an answer that demonstrates:

- Excellent accurate knowledge and understanding of relevant terminology, concepts, principles and models.
- Excellent application of relevant economic principles, terminology, concepts and models to the context of the question; where relevant, data and diagrams are used effectively to address the issues in the question.
- Well focused, relevant analysis used accurately and appropriately in relation to the impact on economic agents.
- An excellent quality of written communication.

At this level the candidate will provide a clear and precise analysis of the impact of supply side policies in helping a government meet its key macroeconomic objectives. This analysis will be supported by a clear and accurately labelled diagram.

[6]

**AVAILABLE  
MARKS**

6

**Section Total**

**25**

- 6 (a) • All the G7 countries have experienced a fall in productivity growth after the financial crisis. But this fall has been most significant in the UK.
- Prior to the financial crisis (97-07) the UK had the second highest level of productivity growth in the G7- with productivity growing on average by 2.09% per year.
  - Productivity growth in the UK was 0.09 percentage point below the fastest growing economy the US and 0.4 percentage points above Germany (0.5 above Japan and France)
  - After the financial crisis productivity growth fell to 0.19% per year a fall of 1.9 percentage points, leaving the UK second from bottom in the productivity growth league table
  - UK is now 0.8 percentage points below US (0.6 behind Germany 0.7 behind Japan and Canada)

Up to [2] for narrative comparison of productivity growth in the UK before and after the crisis with the other G7 countries

A candidate who scores 1–2 marks may simply state that UK productivity growth decreased after the financial crisis in 2008 (1 mark) and may state that the fall in the UK was greater than in any other country (1 mark).

Up to [3] for appropriate use of data

To gain marks for the appropriate use of data candidates need to use the data to make effective comparisons. For example, the candidate may compare the fall in productivity growth in the UK (1.9 percentage points) to the fall in another country such as Canada or Japan. To gain all 3 marks the candidate would need two separate points of comparison. [5]

- (b) Productivity measures the amount of economic output that is produced by a unit of labour input. The output of a country is measured by its gross domestic product (GDP). Whereas the input is normally measured in two ways – by total hours worked or by the number of workers in employment. The data in fig 1 uses the first of these.

There are two key reasons why it may be difficult to accurately measure productivity.

Firstly it may be difficult to accurately measure the GDP of a country. The UK has a relatively large public sector and a relatively large services sector – it is extremely difficult to accurately measure the value of output in both of these sectors and hence the GDP figure may not accurately reflect the output of the country.

Secondly it is also difficult to accurately measure the number of hours worked in an economy, not least because of the difficulty in estimating the number of hours worked by undocumented workers.

If either the GDP figure or the number of hours worked figure is inaccurate then so too will be the figure for productivity.

**Issues and areas for analysis include:**

- Explanation of how productivity is measured
- Explanation of why it is difficult to accurately measure GDP



- Explanation of why it is difficult to accurately measure the number of hours worked
- Appropriate examples

**Level 1 ([1]–[2])**

A basic response provides an answer that demonstrates:

- Basic knowledge and understanding of relevant terminology, concepts, principles and models.
- Basic application of relevant economic principles, terminology, concepts and models to the context of the question; limited use of relevant data, and diagrams where relevant, to address the issues in the question.
- Basic analysis; may lack focus.
- A low quality of written communication.

At this level a candidate may demonstrate some knowledge and understanding of how productivity is measured but may not provide any explanation or analysis as to why it might be difficult to measure accurately. Alternatively, a candidate may make a limited attempt to explain why productivity is difficult to measure but will depend too heavily on the source material.

**Level 2 ([3]–[4])**

A good response provides an answer that demonstrates:

- Good knowledge and understanding of relevant terminology, concepts, principles and models.
- Good application of relevant economic principles, terminology, concepts and models to the context of the question; where relevant, data and diagrams are used reasonably to address the issues in the question.
- Good analysis in relation to the impact on economic agents; analysis may not be developed fully or may have some inaccuracy at times.
- A good quality of written communication.

At this level a candidate may demonstrate clear knowledge and understanding of how productivity is measured and may provide some explanation or analysis as to why it might be difficult to measure accurately, though this analysis is likely to be unclear or incomplete. For example, a candidate might well explain why GDP is difficult to measure accurately but ignore the issue regarding the number of hours worked (or vice versa).

**Level 3 ([5]–[6])**

An excellent response provides an answer that demonstrates:

- Excellent accurate knowledge and understanding of relevant terminology, concepts, principles and models.
- Excellent application of relevant economic principles, terminology, concepts and models to the context of the question; where relevant, data and diagrams are used effectively to address the issues in the question.
- Well focused, relevant analysis used accurately and appropriately in relation to the impact on economic agents.
- An excellent quality of written communication.

At this level a candidate will demonstrate clear knowledge and understanding of how productivity is measured and analyse effectively why it might be difficult to measure accurately. This analysis will cover both of the key areas identified in the source material and mark scheme. [6]

(c) There are a number of factors which could explain the low productivity of the UK. Some of these include:

- Relatively low rates of infrastructure investment – successive UK government have failed to adequately invest in the infrastructure required (particularly road, rail and air transport capacity) to allow firms to operate effectively. Hence infrastructure bottlenecks have developed particularly around the south east which reduces the productivity of companies in the UK
- Lack of capital investment and low rates of spending on research and development – New machinery and equipment make workers more productive, however UK firms have been slow to invest particularly since 2008. For some this lack of capital investment is at least in part a result of immigration which has kept labour costs low and hence made capital relatively less attractive. In addition, the UK *devotes much less of its GDP to research spending than other G7 nations.*
- Poor skills of the labour force – A growing number of economists have expressed concerns about the educational skills of the UK labour force and the motivational and organisational skills of management. *They argue that Britain has one of the highest rates of functional illiteracy among adults, together with fewer workers with higher skills (at degree level or above) compared to the United States and fewer workers with intermediate and vocational skills compared to Germany and Japan.*
- Over-regulation of industry and commerce and a lack of competition – Many free market economists argue that UK industry is over regulated and as a result firms are unable to make the changes required to improve their productivity. They also identify a lack of competitive pressures in some industries as a source of inefficiency and hence low productivity.
- UK has a relatively large public sector – some economists point to the size of the UK public sector as a significant factor in explaining its poor productivity. The public sector is widely regarded as being less productive than the private sector (due to the absence of a profit motive). The UK's relatively large public sector means that its overall productivity is more greatly impacted by this than a country such as the US which has a smaller public sector.
- Low interest rates – some economists argue that the historically low interest rates in the UK since 2008 have actually reduced productivity since it has allowed inefficient “zombie companies” – (those which can only survive with the benefit of extremely low interest rates) to remain in business. They argue that these low interest rates have slowed the process of creative destruction and hence these inefficient firms have remained in business and reduced UK productivity.
- Difficulty in accessing finance – small firms in the UK have long complained about the difficulties they face in accessing the capital or finance required to invest in new machinery and equipment.

### Level 1 ([1]–[3])

A basic response provides an answer that demonstrates:

- Basic knowledge and understanding of relevant terminology, concepts, principles and models.
- Basic application of relevant economic principles, terminology, concepts and models to the context of the question; limited use of relevant data, and diagrams where relevant, to address the issues in the question.

AVAILABLE  
MARKS

- Basic analysis; may lack focus.
- A low quality of written communication.

At this level a candidate will demonstrate only limited knowledge and understanding of the reasons for the low productivity in the UK. The answer is likely to rely heavily on the source material for inspiration. There may be a limited attempt to develop the reasons identified in the source material however this analysis will lack accuracy or be incomplete.

### **Level 2 ([4]–[6])**

A good response provides an answer that demonstrates:

- Good knowledge and understanding of relevant terminology, concepts, principles and models.
- Good application of relevant economic principles, terminology, concepts and models to the context of the question; where relevant, data and diagrams are used reasonably to address the issues in the question.
- Good analysis in relation to the impact on economic agents; analysis may not be developed fully or may have some inaccuracy at times.
- A good quality of written communication.

An answer at this level is likely to show knowledge and understanding of the reasons for the low productivity in the UK. Clear use will typically be made of the information in the source material but this is likely to be supplemented with additional points or further development.

### **Level 3 ([7]–[9])**

An excellent response provides an answer that demonstrates:

- Excellent accurate knowledge and understanding of relevant terminology, concepts, principles and models.
- Excellent application of relevant economic principles, terminology, concepts and models to the context of the question; where relevant, data and diagrams are used effectively to address the issues in the question.
- Excellent, relevant analysis used accurately and appropriately in relation to the impact on economic agents.
- An excellent quality of written communication.

At this level the candidate will provide a clear and detailed knowledge and understanding of the reasons for the low productivity in the UK. The factors identified in the source material will be developed and additional relevant factors are likely to be discussed. [9]

- (d) Some economists argue that increasing productivity should be the government's number one economic priority. They argue that increasing productivity will mean that the country can generate greater output from the same amount of input and hence shift the PPF or the LRAS curve to the right.

Specifically they argue that higher productivity can lead to:

- Improved competitiveness and trade performance: Productivity growth and the lower unit costs that come with it are key determinants of the competitiveness of British firms in global markets. Hence improving productivity will improve the UK Balance of Payments position.
- Lower average costs: The cost savings associated with higher productivity can be passed onto consumers in the form of lower prices, which reduces inflation and can increase real disposable income.

- Higher profits: Efficiency gains are a source of larger profits for companies which can be re-invested to support the long term growth of the business.
- Higher wages: If workers are more efficient and productive then businesses can afford to pay them higher wages.
- Economic growth: All of the above factors will in turn lead to higher levels of economic growth and hence lead to a rise in living standards.

However, others argue that the government should be more concerned with trying to reduce unemployment and income inequality as these are things that concern ordinary citizens much more than an abstract concept such as productivity.

**Issues, analysis and areas for discussion include:**

- Reference to benefits of improved productivity- improved trade performance, lower prices, higher wages etc
- Reference to alternative economic priorities – unemployment, inflation, inequality, etc
- Reference to benefits of targeting alternative objectives- social benefits of reduced unemployment and inequality etc
- Reference to difficulty in measuring productivity and hence difficulty in targeting it
- Appropriate examples
- Appropriate diagrams – appropriate diagrams may include but are not limited to:
  - Diagram showing AS curve shifting to the right
  - Diagram showing PPF shifting to the right

**Level 1 ([1]–[5])**

A basic response provides an answer that demonstrates:

- Basic knowledge and understanding of relevant terminology, concepts, principles and models.
- Basic application of relevant economic principles, terminology, concepts, and models to the context of the question. Some limited use of data, and diagrams where relevant, in relation to the context of the question.
- Basic analysis; analysis may lack focus.
- Judgement(s) unsupported.
- A low quality of written communication.

An answer at this level is likely to show limited understanding of the benefits to the UK economy of improving productivity and may refer in vague terms to issues such as higher output or increases in living standards. The answer may well be one sided and provide no real evaluation of the view that improving productivity should be the governments number one economic priority. An attempt may be made to draw a diagram however it is likely to contain significant errors.

**Level 2 ([6]–[10])**

A good response provides an answer that demonstrates:

- Good knowledge and understanding of relevant terminology, concepts, principles and models.
- Good application of relevant economic principles, terminology, concepts, and models to the context of the question; where relevant,

some reasonable use of data and diagrams in relation to the context of the question.

- Good analysis in relation to the impact on economic agents; analysis may not be developed fully or may have inaccuracies at times.
- Reasonable judgement(s) building on analysis.
- A good quality of written communication.

An answer at this level is likely to show clear knowledge and understanding of the benefits to the UK economy of improving productivity. An attempt will be made to critically examine the view that improving productivity should be the government number one economic priority, possibly through a discussion of alternative economic priorities or of the difficulties in trying to improve productivity. This examination however may lack scope or depth. While there is no requirement to do so, candidates in this level may use diagrams to support their analysis. If so, these diagrams are likely to be incomplete or contain minor errors.

### **Level 3 ([11]–[15])**

An excellent response provides an answer that demonstrates:

- Excellent accurate knowledge and understanding of relevant terminology, concepts, principles and models.
- Excellent application of relevant economic principles, terminology, concepts and models to the context of the question; where relevant, data and diagrams are used effectively to address the issues in the question.
- Well focused, relevant analysis used accurately and appropriately in relation to the impact on economic agents.
- Informed judgements that directly address the issues in the question and reach clear conclusions built on analysis.
- An excellent quality of written communication.

At this level the candidate will provide a clear and detailed examination of the view that improving productivity should be the government number one economic priority. The candidate will typically discuss the impact of improved productivity on areas such as, international competitiveness, inflation, and living standards though other relevant areas may be explored. The candidate is also likely to discuss alternative economic priorities or the difficulties in trying to measure and hence target productivity. While there is no requirement to do so candidates in this level may use diagrams to support their answer. If so, the diagrams will be accurate and will be used effectively to support the evaluation. [15]

35

- 7 A fall in the value of the pound against the euro could have wide ranging effects on the UK economy. As is often the case in economics, there will be both winners and losers. Whether the fall in the value of the pound against the euro is a good thing or not depends on the balance of winners and losers.

**Issues, analysis and areas for discussion include:**

- The falling ER makes UK exports less expensive and imports more expensive, and therefore could help to reduce current account deficit
- This in turn leads to money entering the circular flow and therefore causes an increase in AD
- This increase in AD could reduce the negative output gap and demand deficient unemployment.
- Because firms are no longer forced to reduce price to compete, they may receive higher profit margins. This may lead to an increase in investment which can positively impact on AD and LRAS.
- The weak pound makes UK labour costs appear less expensive when priced in a foreign currency. This is likely to lead to an increase in foreign direct investment.
- However the weaker pound may lead to inflation, because, imports are dearer which has a direct effect on the CPI and can cause cost push inflation. Also the demand for exports increases which increased aggregate demand and causes demand-pull inflation.
- The weaker pound will also reduce the purchasing power of domestic consumers. This has a negative effect on consumer welfare.
- A weaker pound may make it more difficult for the UK government to borrow money from foreigners
- Appropriate examples
- Appropriate diagrams- appropriate diagrams may include but are not limited to:
  - AD/AS diagrams showing the impact of a fall in the exchange rate on output, employment and prices

**Level 1 ([1]–[7])**

A basic response provides an answer that demonstrates:

- Basic knowledge and understanding of relevant terminology, concepts, principles and models.
- Basic application of relevant economic principles, terminology, concepts, and models to the context of the question; some limited use of data, and diagrams where relevant, in relation to the context of the question.
- Basic analysis; analysis may lack focus.
- Judgement(s) unsupported.
- A low quality of written communication.

An answer at this level is likely to show some understanding of the likely impact of a fall in the exchange rate on the UK economy. The analysis of these impacts will typically lack depth and may be limited in scope to just those mentioned in the stimulus paragraph. Alternatively, the answer may be one sided and provide no real evaluation of the impact of a fall in the ER on the UK economy. Attempts may be made to draw diagrams however they are likely to contain significant errors.

**Level 2 ([8]–[14])**

A good response provides an answer that demonstrates:

- Good knowledge and understanding of relevant terminology, concepts, principles and models.
- Good application of relevant economic principles, terminology, concepts, and models to the context of the question; some reasonable use of data, and diagrams where relevant, in relation to the context of the question.
- Good analysis in relation to the impact on economic agents; analysis may not be developed fully or may have inaccuracies at times.
- Reasonable judgement(s) building on analysis.
- A good quality of written communication.

An answer at this level is likely to show clear knowledge and understanding of the likely impact of a fall in the exchange rate on the UK economy. The candidate may discuss a number of potential macroeconomic impacts and there will be some attempt to apply these to economic agents in the UK. Some attempt will be made to examine the likely costs and benefits of a fall in the exchange rate though this examination may lack depth or scope. Candidates in this level are likely to use diagrams to support their analysis, though these diagrams may be incomplete or contain minor errors.

**Level 3 ([15]–[20])**

An excellent response provides an answer that demonstrates:

- Excellent accurate knowledge and understanding of relevant terminology, concepts, principles and models.
- Excellent application of relevant economic principles, terminology, concepts and models to the context of the question; where relevant, data and diagrams are used effectively to address the issues in the question.
- Well focused, relevant analysis used accurately and appropriately in relation to the impact on economic agents.
- Informed judgements that directly address the issues in the question and reach clear conclusions built on analysis.
- An excellent quality of written communication.

At this level the candidate will provide a clear and detailed evaluation of the likely impact of a fall in the exchange rate on the UK economy. The answer will consider the potential costs and benefits of the fall in the exchange rate on economic agents in the UK and will refer to many of the points highlighted in the mark scheme. While there is no requirement to do so, candidates in this level are likely to use diagrams to support their answer. If so, the diagrams will be accurate and will be used effectively to support the evaluation. [20]

**AVAILABLE  
MARKS**

20

- 8 Deflation is a sustained fall in the general level of prices. Because high rates of inflation are normally regarded as being a significant economic problem some people mistakenly believe that deflation or falling prices must by definition be a good thing. However this is not the case. While there may be some benefits of deflation, it too can cause significant problems in the economy as was the experience of Japan in the 1990's and early 2000's.

**Issues, analysis and areas for discussion include:**

- Disadvantages of deflation
  - Falling prices encourage people to delay purchases (particularly for big ticket item) as they believe goods will be cheaper in the future. This reduction in consumer spending can in turn lead to a fall in AD and hence lower economic growth.
  - Deflation increases the real rate of interest and hence acts like an unintended tightening of monetary policy. These higher real interest rates can reduce AD and hence leads to lower employment and growth.
  - Deflation causes the real value of debt to increase and hence makes it harder for individuals and firms to service that debt. This in turn can reduce AD and growth.
  - Deflation causes real wages to increase which can, according to classical economists cause real wage unemployment.
  
- Advantages of deflation
  - If one country experiences deflation, while others experience inflation, that country can become more competitive internationally. The deflation experienced by Japan at the start of the 21st Century was accompanied by a sharp rise in Japanese exports.
  - If the deflation has been caused by an increase in economic efficiency and a shift to the right of the LRAS curve it may actually benefit the economy since it would be accompanied by higher GDP.
  
- Disadvantages of inflation
  - Inflation causes domestic goods to become less competitive relative to foreign-made goods. Therefore, the demand for domestic products will fall and the demand for imported goods and services will increase. This reduction in international competitiveness can lead to a balance of payments current account deficit.
  - This balance of payments deficit will lead to a withdrawal of money from the circular flow. This will in turn decrease aggregate demand and have a negative impact on employment levels and the rate of economic growth.
  - Inflation can also lead to uncertainty, which in turn decreases investment by firms. This reduction in investment will also lead to a fall in AD but will also cause the LRAS curve to shift to the left.
  - People on fixed incomes (such as pensioners) will suffer as prices rise since their real income will be reduced.
  - Savers will suffer, as real interest rates will be reduced and the real value of the capital saved will be reduced.
  - When inflation occurs, people may feel worse off, even when they are not and this can impact upon consumer confidence. If confidence falls AD will fall which again can lead to a reduction in employment and growth.



- When inflation occurs firms will have to change their price lists and brochures which will add to the firm's costs.
- Appropriate examples
- Appropriate diagrams

### Level 1 ([1]–[7])

A basic response provides an answer that demonstrates:

- Basic knowledge and understanding of relevant terminology, concepts, principles and models.
- Basic application of relevant economic principles, terminology, concepts, and models to the context of the question; some limited use of data, and diagrams where relevant, in relation to the context of the question.
- Basic analysis; analysis may lack focus.
- Judgement(s) unsupported.

An answer at this level is likely to demonstrate knowledge of the difference between inflation and deflation but show limited understanding of how deflation (or inflation) can be a significant economic issue. The answer may well be one sided and provide no real evaluation of the view that deflation is a far greater economic problem than inflation.

### Level 2 ([8]–[14])

A good response provides an answer that demonstrates:

- Good knowledge and understanding of relevant terminology, concepts, principles and models.
- Good application of relevant economic principles, terminology, concepts, and models to the context of the question; some reasonable use of data, and diagrams where relevant, in relation to the context of the question.
- Good analysis in relation to the impact on economic agents; analysis may not be developed fully or may have inaccuracies at times.
- Reasonable judgement(s) building on analysis.
- A good quality of written communication.

An answer at this level is likely to show clear knowledge and understanding of the negative impact of deflation on an economy. An attempt will be made to critically examine the view that deflation is a far greater economic problem than inflation possibly through a discussion of the negative impacts of both deflation and inflation on an economy or through some discussion of how some economic agents might benefit from deflation. This examination however may lack scope or depth. While there is no requirement to do so, candidates in this level may use diagrams to support their analysis. If so, these diagrams are likely to be incomplete or contain minor errors.

### Level 3 ([15]–[20])

An excellent response provides an answer that demonstrates:

- Excellent accurate knowledge and understanding of relevant terminology, concepts, principles and models.
- Excellent application of relevant economic principles, terminology, concepts and models to the context of the question; where relevant, data and diagrams are used effectively to address the issues in the question.
- Well focused, relevant analysis used accurately and appropriately in relation to the impact on economic agents.
- Informed judgements that directly address the issues in the question and reach clear conclusions built on analysis.
- An excellent quality of written communication.

At this level the candidate will provide a clear and detailed examination of the view that deflation is a far greater economic problem than inflation. The candidate will typically discuss the negative impacts of both deflation and inflation on an economy and this discussion is likely to be balanced by consideration of the potential benefits of deflation in certain circumstance. While there is no requirement to do so candidates in this level may use diagrams to support their answer. If so, the diagrams will be accurate and will be used effectively to support the evaluation. [20]

**Total**

AVAILABLE MARKS
20
80