AQA A-LEVEL ECONOMICS · 7136

ECONOMICS



MARK SCHEME

3.2.2.2 AGGREGATE DEMAND AND AGGREGATE SUPPLY ANALYSIS

SCORE	PERCENTAGE
/174	%

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1. A

[1]

2. **Areas for discussion include:**

- definitions/explanations: monetary policy, deflation, developed economies
- deflation and the different types (malign v benign)
- the effects of deflation
- the nature of developed economies and different experiences of deflation
- the role of interest rates and the transmission mechanism
- the effects of interest rates on investment, employment, saving and consumption
- the link between long-term saving and long-term investment
- the effectiveness of interest rates at very low levels including negative interest rates
- consideration of the MPC's role, primarily in targeting inflation but also in targeting growth
- consideration of differences in the two economies which may determine the effectiveness of monetary policy
- the use of quantitative easing and consideration of its success
- the possible role of the exchange rate in stimulating the economy
- the use of fiscal policy and fiscal stimulus
- considering how government debt may affect the ability to use fiscal policy
- considering how private-sector debt may influence the effectiveness of policies designed to combat deflation
- consideration of the potential conflicts in policy
- the significance of economic shocks and their impact on policies to tackle deflation.

The use of relevant diagrams to support the analysis should be taken into account when assessing the quality of the candidate's response to the question.

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Level of response	Response	Max 25 marks
5	**Sound, focused analysis and well-supported evaluation that:** • is well organised, showing sound knowledge and understanding of economic terminology, concepts and principles with few, if any, errors • includes good application of relevant economic principles to the given context and, where appropriate, good use of data to support the response • includes well-focused analysis with clear, logical chains of reasoning • includes supported evaluation throughout the response and in a final conclusion.	**21 – 25 marks**
4	**Sound, focused analysis and some supported evaluation that:** • is well organised, showing sound knowledge and understanding of economic terminology, concepts and principles with few, if any, errors • includes some good application of relevant economic principles to the given context and, where appropriate, some good use of data to support the response • includes some well-focused analysis with clear, logical chains of reasoning • includes some reasonable, supported evaluation.	**16 – 20 marks**
3	**Some reasonable analysis but generally unsupported evaluation that:** • focuses on issues that are relevant to the question, showing satisfactory knowledge and understanding of economic terminology, concepts and principles but some weaknesses may be present • includes reasonable application of relevant economic principles to the given context and, where appropriate, some use of data to support the response • includes some reasonable analysis but which might not be adequately developed or becomes confused in places • includes fairly superficial evaluation; there is likely to be some attempt to make relevant judgements but these are not well-supported by arguments **and/or** data.	**11 – 15 marks**
2	**A fairly weak response with some understanding that:** • includes some limited knowledge and understanding of economic terminology, concepts and principles but some errors are likely • includes some limited application of relevant economic principles to the given context **and/or** data to the question • includes some limited analysis but it may lack focus **and/or** become confused • includes some evaluation which is weak and unsupported.	**6 – 10 marks**
1	**A very weak response that:** • includes little relevant knowledge and understanding of economic terminology, concepts and principles • includes application to the given context which, at best, is very weak • includes attempted analysis which is weak and unsupported.	**1 – 5 marks**

[25]

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3.

- inflation, with an explanation perhaps in terms of official UK measurement, how measurement is arrived at, recent experiences, other relevant factors

Explain causes of inflation, eg

included within **cost-push factors** could be:

- the rising cost of oil, which for many firms will be a significant cost of production. As oil costs rise, assuming no fall in other costs of the firm a decision has to be made that either profit margins be narrowed or prices of final output need to rise. One consideration will be the price elasticity of demand for the product in question, i.e. the more inelastic is demand, the more likely consumers will absorb any price increase
- wage costs
- supply-side weaknesses, eg low productivity
- imported inflation, perhaps via exchange rate depreciation

Included within **demand-pull factors** could be

- the demand-pull inflationary process
- the impact of monetary policy
- the impact of fiscal policy
- earnings growth

other factors could also be considered, eg

- expectations
- money supply / monetarist explanation

[15]

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4.

Areas for discussion include:

- definitions/explanations: economic development, MNCs, LEDCs
- positive roles of MNCs in developing nations such as the effects on:
  - employment and job creation
  - economic growth (short-run and long-run)
  - the trade balance (eg increase exports)
  - productivity and international competitiveness
  - infrastructure
  - investment and positive multiplier effects
  - development of human capital
  - knowledge and technological transfer
  - standards of living
- potential negative roles of MNCs in developing nations such as the effects on:
  - the environment
  - the exploitation of workers
  - the destruction of culture
  - the indigenous industries being unable to compete
  - the unfair political influence which MNCs may possess
  - possible tax avoidance
  - the repatriation of profits which is negative on GNP
- explaining the main differences between LEDCs and MEDCs
- examples of MNCs and countries in which they have set up
- the issue that job creation may be limited due to the capital-intensive nature of the FDI and filling management roles from the source nation
- that the role depends upon the objectives of the MNC and that initial positive effects may change over time
- what may happen if the MNC had not been involved in the economy. Would domestic firms have fared better?
- the individual government's ability to control the power of the MNCs may determine whether, on balance, they have a positive impact on development.

The use of relevant diagrams to support the analysis should be taken into account when assessing the quality of the student's response to the question.

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1	**A very weak response that:** • includes little relevant knowledge and understanding of economic terminology, concepts and principles • includes application to the given context which, at best, is very weak • includes attempted analysis which is weak and unsupported.	**1 – 5 marks**

[25]

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5.

Explanation

For defining / explaining • Customs union / free trade area • Pattern of trade • Volume of trade • Trade or exports / imports	**Up to 2 marks per definition or explanation to a maximum of 4 marks**

Award 1 mark for each step in a logical chain of reasoning:

For example: Due to the membership of the EU, there are no internal tariffs **(1 mark)** between the UK and the other 27 member states **(1 mark)** so when trading with another country for example France **(1 mark for example)** the cost of doing so is lower **(1 mark)** and firms will experience lower prices if France has exploited its comparative advantage **(1 mark)** as France has a lower opportunity cost than the UK **(1 mark)** in for example the production of wine **(1 mark for example)** which leads to trade creation **(1 mark)** which increases the volume of imports **(1 mark)** from other members of the EU which affects the pattern of trade in terms of who trades what with who **(1 mark)**. **Other examples include:** Potential for exporting products in which the UK holds a comparative advantage in, economies of scale, potential trade diversion due to common external tariff, retaliation, enforced embargoes.	**Up to 15 marks**
Use of diagrams to help support explanations, e.g. tariff diagram, quota diagram, AD/AS, Economies of scale	**Up to 2 marks per diagram (1 mark for labelling, 1 mark for correct information shown) to a maximum of 4 marks**
Reference to the UK and/or other economies.	**1 mark per reference to a maximum of 2 marks**

Award a **maximum of 10 marks** if both parts of the question are not attempted i.e. the pattern of trade **and** the volume of trade.

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6.

Explanation

For defining/explaining • Budget deficit • Government spending / Taxation • Fiscal policy	**Up to 2 marks per definition or explanation to a maximum of 4 marks**

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Award 1 mark for each step in a logical chain of reasoning

For example: As an economy goes into recession **(1 mark)** there may be decreased investment **(1 mark)** as firms have spare capacity **(1 mark)** which will lead to reduced purchases purchases of capital goods **(1 mark)** which reduces firms outputs **(1 mark)** and also creates a rise in unemployment **(1 mark)** as labour is in derived demand **(1 mark)** which increases government spending on JSA **(1 mark)** and also provides reduced revenue in the form of decreased income tax **(1 mark)** which may cause a fall in consumption **(1 mark)** which means fewer goods and services would be sold **(1 mark)** which reduces indirect tax revenue in the form of VAT **(1 mark)** and possibly firms profits reducing corporation tax **(1 mark)**. Other examples include: Increased reliance on public services / social provision, discretionary government spending, increased cost of government borrowing due to loss of credit rating, nationalisation / re-nationalisation, economic shocks, fiscal mismanagement.	**Up to 15 marks**
Use of diagrams to help support explanations, AD/AS, trade cycle	**Up to 2 marks per diagram (1 mark for labelling, 1 mark for correct information shown) to a maximum of 4 marks.**
Reference to the UK and/or other economies.	**1 mark per reference to a maximum of 2 marks**

[15]

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7.

Level of response	Response	Max 9 marks
3	• is well organised and develops one or more of the key issues that are relevant to the question • shows sound knowledge and understanding of relevant economic terminology, concepts and principles • includes good application of relevant economic principles and/or good use of data to support the response • includes well-focused analysis with a clear, logical chain of reasoning • includes a relevant diagram that will, at the top of this level, be accurate and used appropriately.	**7 – 9 marks**
2	• includes one or more issues that are relevant to the question • shows reasonable knowledge and understanding of economic terminology, concepts and principles but some weaknesses may be present • includes reasonable application of relevant economic principles and/or data to the question • includes some reasonable analysis but it might not be adequately developed and may be confused in places • may include a relevant diagram.	**4 – 6 marks**
1	• is very brief and/or lacks coherence • shows some limited knowledge and understanding of economic terminology, concepts and principles but some errors are likely • demonstrates very limited ability to apply relevant economic principles and/or data to the question • may include some very limited analysis but the analysis lacks focus and/or becomes confused • may include a relevant diagram but the diagram is not used and/or is inaccurate in some respects.	**1 – 3 marks**

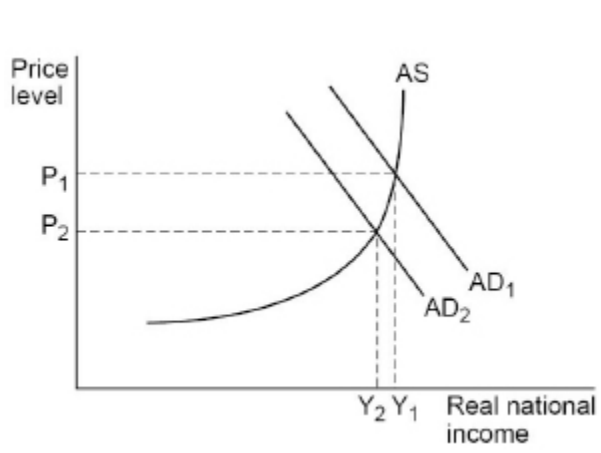
An AD/AS diagram which shows AD shifting left is likely. This may have one shift or multiple shifts. A PPF may also be used to show an economy operating inside its boundary.

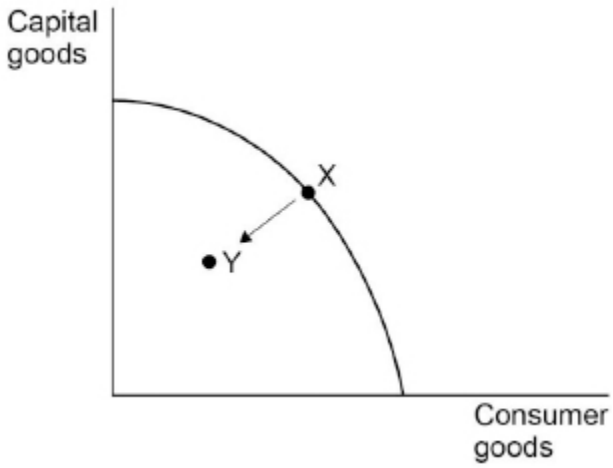
Relevant issues include:

- definitions/explanations: government spending, unemployment, private sector
- explaining areas of reduced government spending such as public goods, merit goods, welfare benefits
- linking the reasons for cutting government spending to the deficit/structural deficit
- explaining that government spending is a component of Aggregate Demand (AD)
- explaining that falling AD is likely to reduce firm's output
- linking falling government spending to a fall in private sector confidence
- linking falling government spending to a reduction in contracts with private sector firms
- linking the falling output to the falling derived demand for labour in the private sector
- explaining negative multiplier effects
- explaining the economy possibly falling into recession
- explaining the long-run effects of people leaving the labour force and the effects on LRAS
- explaining falling business investment due to falling aggregate demand and the existence of spare capacity
- explaining rising cyclical unemployment.

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Expected diagrams are:





[9]

8. **Areas for discussion include:**

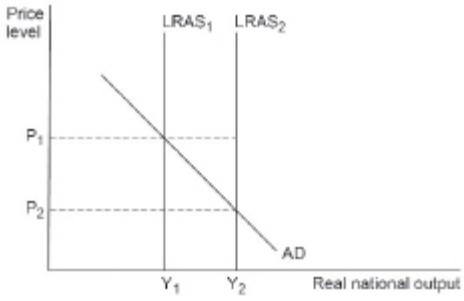
- definitions/explanations: national debt, fiscal policy, taxation
- explaining the effects on economies in terms of the macroeconomic goals
- explaining the effects on the economies in terms of different stakeholder groups such as firms/households/the government
- the benefits of increased national debt by increased government spending on:
  - merit goods such as education and training or healthcare
  - public goods such as roads or defence
  - welfare benefits/social provision
  - the redistribution of income/wealth
  - infrastructure
  - aggregate demand as part of demand management
  - supply-side policies
  - crowding in
- the costs of increased national debt:
  - crowding out
  - lower credit rating and the effect on debt repayments
  - possible inflationary pressure
  - the effects on future generations/possible future tax rises
- considering that a higher national debt may be caused by tax cuts rather than increased government spending and effects such as:
  - incentives to work
  - tax avoidance/evasion
- explaining how global shocks, such as a pandemic, may lead to unavoidable changes in fiscal policy
- considering alternatives to building up national debt to improve economies
- considering the effects of raising tax rates on tax revenue
- considering the current levels of debt and different countries' experiences
- considering equity and efficiency arguments regarding public service provision
- considering possible trade-offs.

The use of relevant diagrams to support the analysis should be taken into account when assessing the quality of the student's response to the question.

[25]

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9. The correct diagram involves an AD/AS diagram illustrating a shift to the right of the LRAS curve. It is not necessary to include the SRAS curve. The use of the Keynesian model is acceptable and should be rewarded.



Response	**Max 4 marks**
Accurately drawn AD/AS diagram showing the initial equilibrium level of output and price level, a rightwards shift in the LRAS curve, an increase in real national output, and a lower equilibrium price level with both axes and all curves and coordinates correctly labelled.	**4 marks**
Accurately drawn AD/AS diagram showing the initial equilibrium level of output and price level, a rightwards shift in the LRAS curve, an increase in real national output, and a lower equilibrium price level, with one label missing or incorrect (axis or curve). **OR** Accurately drawn AD/AS diagram showing the initial equilibrium level of output and price level, a rightwards shift in the LRAS curve, an increase in real national output, and a lower equilibrium price level, with one coordinate missing or incorrect (Y_1 or Y_2 / P_1 or P_2).	**3 marks**
Accurately drawn AD/AS diagram showing the initial equilibrium level of output and price level, a rightwards shift in the LRAS curve, an increase in real national output, and a lower equilibrium price level, with two or more labels missing or incorrect.	**2 marks**
Accurately drawn AD/AS diagram showing the initial equilibrium level of output and price level, with both axes, both original curves and coordinates correctly labelled.	**1 mark**

Labels refer to axes and/or coordinate labels.
Label of x axis can be 'Real GDP', 'Real Output,' 'Output,' 'Y,' 'RNO,' 'NI' and 'National Output.' Do not reward Quantity or Q.
Label of y axis can be 'Price Level,' 'PL,' 'Inflation' and '£'. Do not reward Price or P.

[4]

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10. **Relevant issues include:**

- definitions/explanations: demand-side shocks, supply-side shocks, unemployment
- explaining how unemployment is measured
- explaining the nature of shocks in terms of them being unexpected, unanticipated, exogenous or sudden
- explaining that an unfavourable demand-side shock reduces aggregate demand
- explaining how this affects the derived demand for labour
- examples of how demand-side shocks and explaining why they may cause unemployment such as:
  - an unexpected rise in interest rates causing a fall in borrowing and investment
  - a recession in a major trading partner causing falling export demand
  - a sudden decrease in the money supply, caused by a fall in bank lending damaging consumption and/or investment
- explaining how supply-side shocks may lead to falling real GDP hence a fall in the demand for labour such as:
  - a sudden rise in oil price reducing real national output increasing unemployment
- explaining how supply-side shocks may cause structural unemployment such as:
  - the invention of new technology where capital-intensive production replaces labour-intensive production
  - a country 'opening up' it's markets to trade leading to cheaper imports causing deindustrialisation
- explaining how other supply-side shocks may cause unemployment such as:
  - unexpected increases to benefit payments reducing the incentive to work
  - unanticipated increases in income tax rates creating disincentives to quickly move into a new job
- explaining how supply-side shocks may cause real-wage unemployment such as:
  - rising trade union power, driving up wage expectations, and creating a mismatch between supply and demand

The use of relevant diagrams, such as AD or SRAS shifting to the left, to support the analysis should be taken into account when assessing the quality of the student's response to the question.

Level of response	Response	Max 15 marks
3	**A good response provides an answer that:** • is well organised and develops a selection of the key issues that are relevant to the question • shows sound knowledge and understanding of economic terminology, concepts and principles with few, if any, errors • includes good application of relevant economic principles to the given context and, where appropriate, good use of data to support the response • includes well-focused analysis with clear, logical chains of reasoning.	**11 – 15 marks**
2	**A reasonable response provides an answer that:** • focuses on issues that are relevant to the question • shows satisfactory knowledge and understanding of economic terminology, concepts and principles but some weaknesses may be present • includes reasonable application of relevant economic principles to the given context and, where appropriate, some use of data to support the response • includes some reasonable analysis but which might not be adequately developed or becomes confused in places.	**6 – 10 marks**
1	**A weak response provides an answer that:** • has identified one or more relevant issues • has some limited knowledge and understanding of economic terminology, concepts and principles but some errors are likely • has very limited application of relevant economic principles to the given context and/or data to the question • might have some limited analysis but it may lack focus and/or become confused.	**1 – 5 marks**

[15]

11. **Areas for discussion include:**

- definitions/explanations: foreign direct investment (FDI), living standards
- explaining how living standards can be measured in terms of monetary measures such as GDP per capita
- explaining how living standards can be measured in terms of qualitative factors such as education, health, inequality, the environment, human development and sustainability
- alternative measures of living standards such as the Human Development Index (HDI)
- explaining the benefits of FDI on living standards in terms of:
  - employment
  - incomes and consumption possibilities
  - economic growth and GDP per capita
  - multiplier/accelerator arguments
  - human development/skills progression
  - potential improvements in infrastructure created by MNCs
  - possible health implications of increased formal, regular employment
  - generating more government tax revenue which may be spent on merit/public goods without creating debt
  - crowding in arguments

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- explaining the drawbacks of FDI on living standards in terms of:
  - exploitation of workers by MNCs
  - damages to the environment caused by MNCs
  - possible inflationary pressures causing the cost of living to rise
  - ‘footloose’ industries causing instability in employment for example
  - repatriation of profits acting as a leakage from the circular flow
- considering that governments may not benefit from rising tax revenues as they may have been forced to offer tax breaks
- how global shocks, such as the pandemic, may lead to changes in investment beyond the control of the domestic government
- the alternatives to attracting FDI to improve living standards such as aid and the possible problems of tied aid
- other possible alternatives such as government spending and the potential problems of rising debt
- other possible alternatives such as the promotion of free trade or protectionism and the potential problems of each method
- whether the government should intervene at all or if the free market would provide better solutions
- the possible inequalities caused by FDI and the possible regional differences
- issues such as corruption affecting the distribution of the benefits of FDI.

The use of relevant diagrams to support the analysis should be taken into account when assessing the quality of the student’s response to the question.

Level of response	Response	Max 25 marks
5	**Sound, focused analysis and well-supported evaluation that:** • is well organised, showing sound knowledge and understanding of economic terminology, concepts and principles with few, if any, errors • includes good application of relevant economic principles to the given context and, where appropriate, good use of data to support the response • includes well-focused analysis with clear, logical chains of reasoning • includes supported evaluation throughout the response and in a final conclusion.	**21–25 marks**
4	**Sound, focused analysis and some supported evaluation that:** • is well organised, showing sound knowledge and understanding of economic terminology, concepts and principles with few, if any, errors • includes some good application of relevant economic principles to the given context and, where appropriate, some good use of data to support the response • includes some well-focused analysis with clear, logical chains of reasoning • includes some reasonable, supported evaluation.	**16–20 marks**
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2	**A fairly weak response with some understanding that:** • includes some limited knowledge and understanding of economic terminology, concepts and principles but some errors are likely • includes some limited application of relevant economic principles to the given context and/or data to the question • includes some limited analysis but it may lack focus and/or become confused • includes some evaluation which is weak and unsupported.	**6–10 marks**
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[25]

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