AQA A-LEVEL ECONOMICS · 7136

ECONOMICS



MARK SCHEME

3.2.2.4 AGGREGATE DEMAND AND THE LEVEL OF ECONOMIC ACTIVITY

SCORE	PERCENTAGE
/251	%

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1.

Response:	**Max 4 marks**
• includes evidence that shows that increasing growth in real GDP leads to a reduced deficit in the balance of trade in goods and services. • clearly explains how this data is evidence that increasing growth in real GDP leads to a reduced deficit in the balance of trade in goods and services.	**4 marks**
• includes evidence that shows that increasing growth in real GDP leads to a reduced deficit in the balance of trade in goods and services. • unclear explanation of how this data is evidence that increasing growth in real GDP leads to a reduced deficit in the balance of trade in goods and services..	**3 marks**
• includes evidence that shows that increasing growth in real GDP leads to a reduced deficit in the balance of trade in goods and services. • limited explanation of how this data is evidence that increasing growth in real GDP leads to a reduced deficit in the balance of trade in goods and services.	**2 marks**
• includes evidence that does not clearly show that increasing growth in real GDP leads to a reduced deficit in the balance of trade in goods and services. • no explanation of how this data is evidence that increasing growth in real GDP leads to a reduced deficit in the balance of trade in goods and services.	**1 mark**

Relevant issues include:

- biggest trade deficit £36, 733 million coincides with the fastest growth rate in GDP (3.4%) in 2007
- years of recession (negative growth in GDP) occur when the deficit on balance of trade in goods and services improves in both years (2008 and 2009)
- when growth picks up in 2010 (1.7% from -5.2% in 2009) the deficit on the balance of trade in goods and service deteriorates (£32 852 million from £23 373 million)
- why an increase in the rate of growth of GDP often leads to an increased deficit in the balance of trade in goods and services

[4]

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2.

Areas for discussion include:

- definitions/explanations: inflation, deflation
- explaining the different types of inflation (demand-pull and cost-push)
- explaining the different types of deflation (malign and benign)
- explaining the UK's recent history of inflation and deflation
- explaining the causes of inflation and deflation
- explaining the effects of inflation or deflation upon:
  - individuals, such as inflation causing a higher cost of living
  - borrowers, such as the relative value of debt falling with inflation
  - savers, such as inflation eroding the value of savings
  - those on fixed incomes such as the current government policy of raising JSA at 1% or inflation (whichever is lowest)
  - real interest rates and borrowing
  - firms and investment
  - labour markets, such as individuals with low bargaining power being unable to negotiate higher wages
  - consumption decisions, such as delayed consumption due to deflation
  - international competitiveness
  - activity and stability
- considering the different types of inflation in terms of creeping or hyper-inflation
- considering that inflation may benefit one group but at the expense of another
- considering that the type of deflation may determine the effects
- considering the duration of the inflation or deflation
- considering the ability of the MPC to return to the target of 2% inflation, eg the problem of the lower bound to interest rates (liquidity trap).

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 aren't 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 principle 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 is, at best, very weak • includes attempted analysis which is weak and unsupported.	**1 – 5 marks**

[25]

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6.

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 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 good application of relevant economic principles 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 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 aren't well-supported by arguments and/or data.	**11-15 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 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 analysis which is, at best, very weak • includes attempted evaluation which is weak and unsupported.	**1-5 marks**

Relevant issues and areas for discussion include:

- the stability of the Brazilian economy
- political and social stability
- the rule of law and corruption
- whether the investment is likely to be profitable and whether it is secure
- the nature of any capital controls
- the infrastructure in Brazil
- the skills and abilities of the workforce
- financial and other support from the government
- regulations on business
- the tax regime; both corporate and individual taxes
- availability of finance
- the prospects for future growth of the Brazilian economy
- the size of the Brazilian car market and the potential for future growth
- access and proximity to businesses that can support the car industry, eg component suppliers
- potential for exporting cars from Brazil, eg access to other markets in the Americas
- the prospects for the value of the Brazilian currency, the real, and its stability

[25]

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7.

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 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 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 one or more relevant issues identified • 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 and/or data to the question • might have some limited analysis but it may lack focus and/or become confused.	**1-5 marks**

Relevant issues include:

- impact on employment, unemployment and human capital
- impact on real GDP and aggregate demand
- multiplier and accelerator effects
- effects on long-run growth and productivity
- spill-over effects on other firms
- impact on the balance of payments: exports and import substitution
- impact on the budget balance and public sector debt
- may stimulate spending on improvements to the infrastructure

[15]

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9. C

[1]

12. B

[1]

14. **Relevant issues include:**

- different types of taxes, eg direct v indirect, progressive, proportional and regressive
- taxation as a withdrawal from the circular flow of income
- how an increase in taxation affects aggregate demand
- the relationship between aggregate demand and each of the main objectives of UK macroeconomic policy, ie unemployment, growth, inflation and the balance of payments
- the different demand-side impacts of different tax changes, eg an increase in the rate of VAT versus a rise in the top rate of income tax
- multiplier effects
- the impact of tax changes on the pattern of demand and hence resource allocation, eg raising taxes on demerit goods
- the significance of elasticities of demand.

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.

[15]

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15.

Level of response	An answer that:	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 is expected.

Relevant issues include:

- growth, aggregate demand and potential output
- the impact of faster growth on the size of the output gap
- impact of rising interest rates on aggregate demand
- growth and inflation
- growth and the balance of payments.

[9]

16. B

[1]

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17. In this part of the question, candidates will need to demonstrate that they are able to evaluate issues and arguments to support a conclusion if they are to be awarded **more than 15 marks**.

Where there is no **explicit** reference to the data, award a maximum of **21 marks**.

Level 5	**Good analysis and good evaluation**	**22 to 25 marks** *Mid-Point 24 marks*
Level 4	**Good analysis but limited evaluation** **OR** **Reasonable analysis and reasonable evaluation**	**17 to 21** *Mid-Point 19 marks*
Level 3	**Reasonable including some correct analysis but very limited evaluation**	**10 to 16** *Mid-Point 13 marks*
Level 2	**Weak with some understanding**	**4 to 9** *Mid-Point 7 marks*
Level 1	**Very weak**	**0 to 3** *Mid-Point 2 marks*

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Introduction	• Unemployment • Demand-side / Supply-side • Types of unemployment
Developing the response to the question: **(Application)**	Drawing on the information in the extracts: • Labour market reforms **(Extract E and Extract F)** • EU possibly recovering **(Extract E and Extract F)** • Supply-side reforms **(Extract E)** • Effects on firms / workers **(Extract E)** • Comparisons with other EU countries **(Extract E)** • The current state of the UK labour market and wage growth **(Extract F)** • Subsidies / training / introduction of living wage **(Extract F)** • Benefits cap and limiting JSA **(Extract F)**
(Analysis)	**Arguments as to why demand-side factors may cause further falls:** • Rising real incomes in the UK • Increased confidence • Possible increases in domestic investment • Possible increases in FDI • Multiplier effects • Improved export opportunities (if the EU grows) **Arguments as to why supply-side factors may cause further falls:** • Consideration of the "voluntary" nature of some types of unemployment • Changes to incentives • Changes to benefits forcing people into low paid jobs • Consideration that living wage may actually entice more people into jobs market • So called "carrot and stick" approaches • Changes to structural unemployment • Improvements to mobility (occupational and geographical) • The UK's experiences under the "Work Programme" and government policy • Focus on particular groups, such as the 16-24 age group or the long term unemployed.
Evaluation	• The UK could be approaching NRU / NAIRU / full capacity, the supply-side may be vital in order to gain further improvements • Both approaches are not mutually exclusive, improvements could be made on both at the same time • Some factors may be beyond the control of the UK, e.g. external demand in the EU, is trade a significant issue? • Consideration of regional aspects – unemployment rates mask a regional issue which is very difficult to solve with policies which aren't targeted • Consideration that more jobs may be created but the incomes or conditions provided by those jobs maybe are not as good as others *Examiners should note that, for some of the weaker or average candidates, parts of the above represent quite sophisticated evaluation and so it is important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.*

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Also give credit for	• Reference to the UK / other economies • Diagrams • An overall judgement on the issues raised.

It will only be possible for candidates to consider a few of the above. They may also discuss issues not not mentioned above.

[25]

18.

For defining / explaining • Recession • Economic growth • The trade cycle.	**Up to 2 marks per definition or explanation to a maximum of 4 marks**

Award 1 mark for each logical link in the chain of reasoning:

For example Higher unemployment **(1 mark)** much of which will be cyclical unemployment **(1 mark)** due to a lack of AD which causes disposable incomes to fall **(1 mark)** which leads to further negative multiplier effects **(1 mark)** which may mean even less revenue and profits for firms **(1 mark)**. Firms are also likely to be reluctant to hire new staff due to existing spare capacity **(1 mark)** and may just run down existing stocks **(1 mark)** rather than increase output **(1 mark)** which may exacerbate the unemployment problem and lead to both hysteresis **(1 mark)** and further problems of demotivated "long-term" unemployment **(1 mark)**. Other issues include: Effects on inflation, balance of payments on current account, poverty, and investment.	**Up to 15 marks**
Use of diagrams to help support explanations, e.g. trade cycle, AD/AS	**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]

19.

For defining / explaining • Exchange rates • Appreciation • Different exchange rate systems	**Up to 2 marks per definition or explanation to a maximum of 4 marks**

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Award 1 mark for each logical link in the chain of reasoning

For example A free floating exchange rate is determined by the supply and demand of currency on FOREX **(1 mark)**. Speculative activity **(1 mark)** may occur if it is thought there will be a rise in the interest rate **(1 mark)** of a particular economy which will increase the demand of that currency **(1 mark)** as the returns to saving rise **(1 mark)** if money is placed in an economy's financial institutions **(1 mark)**. As the flow of 'hot money' increases **(1 mark)** this may lead to an appreciation **(1 mark but not to be awarded in addition to definition marks)** such as £1 = $1.46 goes to £1 = $1.50 **(1 mark for examples but not use of the example in the preamble)**. Other examples include: trade flows, productivity rates, inward investment, other speculative activities and government intervention.	**Up to 15 marks**
Use of diagrams to help support explanations, currency diagrams, trade cycles and AD/AS diagrams	**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]

20. **The anticipated diagram would make appropriate use of diagrams, e.g. LRAS shifting right, SRAS shifting right, PPF's or AC curves.**

Relevant issues include:

- Definition of investment.
- Explaining this in terms of a business entity in one country gaining ownership in another.
- Explaining the difference between FDI and portfolio investment.
- Increased foreign direct investment (FDI) by possibly bringing new technology or production processes into an existing firm which may reduce the need for labour to gain the same output and therefore boosts labour productivity.
- Improvements to infrastructure carried out by government capital spending such as improvements to motorways may allow transport costs to fall allowing the company to produce the same output for lower cost and boosts to efficiency and productivity.
- Research and development and increased competition due to FDI.
- Different forms of transport and communication links for infrastructure.

[9]

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21.

Areas for discussion include:

- definitions/explanations: burden of taxation, taxation, direct/indirect taxation, fiscal policy
- explaining the burden of taxation, expressed, for example, as a % of GDP
- describing the current forms of taxation used in the UK and recent changes
- explaining the principals of taxation such as equity
- giving examples of the various direct and indirect taxes
- identifying the differences between progressive, regressive and proportional tax
- the redistributive impact of direct and indirect taxation
- how falling direct taxes may:
    - incentivise work
    - reduce tax avoidance/evasion
    - influence consumption
    - influence investment
    - any other relevant point
- how rising indirect taxes may:
    - affect inflation
    - reduce consumption of demerit goods
    - affect SRAS
    - affect consumption decisions
    - affect wage demands
- evaluating the size of the shift
- evaluating empirical evidence
- evaluating the period of time over which the shift takes place
- policy myopia and political ideology affecting decisions
- the Laffer curve.

The use of relevant diagrams such as the Laffer curve 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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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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22. **Relevant issues include:**

- definitions/explanations: government spending, taxation, economic activity
- explaining the different forms of government spending such as capital/current /transfers
- explaining the levels of government spending
- explaining the reasons for government spending i.e. the redistribution of income and wealth, merit good provision etc.
- explaining how changes in government spending and taxation can influence aggregate demand both directly and indirectly
- explaining discretionary policy
- explaining automatic stabilisers

- explaining the effects of the economic cycle on government spending and taxation
- explaining how changes in government spending could change aggregate supply such as:
  - capital spending on infrastructure
  - training and education
  - subsidies/grants for research and development
  - subsidies/grants for investment
  - tax credits
  - assisted childcare and the effects on labour supply
  - any other relevant point
- multiplier and possible accelerator effects
- explaining the different types of taxation
- explaining how changes in taxation could change aggregate supply such as:
  - reducing income tax creating incentives to work
  - reducing corporation tax allowing firms to retain more profit for investment
  - reducing taxation, possibly making UK firms more competitive abroad and effects on supply
  - using taxation (tariffs) as a form of protectionism, aiding domestic supply
  - any other relevant point.

The use of relevant diagrams such as AD/AS, or labour market diagrams to support the analysis should be taken into account when assessing the quality of the candidate's response to the question.

Note: Unless a candidate considers both government expenditure and taxation, they are unlikely to have 'developed a selection of key issues that are relevant to the question' and therefore unlikely to achieve level 3.

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]

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23.

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.

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**
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[25]

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24. **Areas for discussion include:**

- definitions/explanations: interest rates, monetary policy, economic stability, cyclical instability, credit creation
- explaining the possible effects of low interest rates on:
  - saving and borrowing, including loans and mortgages
  - consumption
  - investment
  - the exchange rate
  - confidence
- explaining the benefits of low interest rates for:
  - growth (long-run and short-run)
  - unemployment
  - inflation or avoidance of deflation
  - the current account of the balance of payments
- explaining the drawbacks of persistently low interest rates such as:
  - inflationary pressure and overheating the economy
  - asset-price and speculative bubbles
  - over-complacency in firms and the build-up of private-sector debt
  - effects on financial institutions and the real economy if people/firms default on their debt repayments
  - effects on the housing market if interest rates need to rise
  - effects on people relying on savings such as pensioners
  - possibly leading to malinvestment and sustaining zombie businesses
- considering why interest rates were low in the first place
- explaining the role of the MPC in setting Bank Rate and the factors taken into consideration when setting the rate
- explaining the monetary policy transmission mechanism
- explanation of alternative schools of thought regarding monetary policy
- the role of other aspects of monetary policy (eg forward-guidance or Q.E.) alongside conventional interest rate policy
- the potential short-term benefits of lower interest rates such as household consumption rising compared to long-term financial burden
- the role of the financial authorities in reducing the possibility of households taking on too much debt.

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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[25]

25. B

[1]

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