A-level
ECONOMICS
7136/2

PAPER 2 National and international economy

Mark scheme

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Mark schemes are prepared by the Lead Assessment Writer and considered, together with the relevant questions, by a panel of subject teachers. This mark scheme includes any amendments made at the standardisation events which all associates participate in and is the scheme which was used by them in this examination. The standardisation process ensures that the mark scheme covers the students' responses to questions and that every associate understands and applies it in the same correct way. As preparation for standardisation each associate analyses a number of students' scripts. Alternative answers not already covered by the mark scheme are discussed and legislated for. If, after the standardisation process, associates encounter unusual answers which have not been raised they are required to refer these to the Lead Examiner.

It must be stressed that a mark scheme is a working document, in many cases further developed and expanded on the basis of students' reactions to a particular paper. Assumptions about future mark schemes on the basis of one year's document should be avoided; whilst the guiding principles of assessment remain constant, details will change, depending on the content of a particular examination paper.

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System Name	Description
Highlight	Highlight an issue
Cross	Incorrect
REP_BIG	Repetition
SEEN	Seen
?	Unsure/unclear/somewhat confusing
Off Page Comment	May be used to make a comment
AN	Analysis
Tick	Correct
NAQ	Not answering question
KU	Knowledge and understanding
APP	Application
BOD	Benefit of the doubt
On Page Comment	Text box
EVAL	Evaluation
IR	Irrelevant

Level of response marking instructions

Level of response mark schemes are broken down into levels, each of which has a descriptor. The descriptor for the level shows the average performance for the level. There are marks in each level.

Before you apply the mark scheme to a student's answer read through the answer and annotate it (as instructed) to show the qualities that are being looked for. You can then apply the mark scheme.

Step 1 Determine a level

Start at the lowest level of the mark scheme and use it as a ladder to see whether the answer meets the descriptor for that level. The descriptor for the level indicates the different qualities that might be seen in the student's answer for that level. If it meets the lowest level then go to the next one and decide if it meets this level, and so on, until you have a match between the level descriptor and the answer. With practice and familiarity you will find that for better answers you will be able to quickly skip through the lower levels of the mark scheme.

When assigning a level you should look at the overall quality of the answer and not look to pick holes in small and specific parts of the answer where the student has not performed quite as well as the rest. If the answer covers different aspects of different levels of the mark scheme you should use a best fit approach for defining the level and then use the variability of the response to help decide the mark within the level, ie if the response is predominantly level 3 with a small amount of level 4 material it would be placed in level 3 but be awarded a mark near the top of the level because of the level 4 content.

Step 2 Determine a mark

Once you have assigned a level you need to decide on the mark. The descriptors on how to allocate marks can help with this. The exemplar materials used during standardisation will help. There will be an answer in the standardising materials which will correspond with each level of the mark scheme. This answer will have been awarded a mark by the Lead Examiner. You can compare the student's answer with the example to determine if it is the same standard, better or worse than the example. You can then use this to allocate a mark for the answer based on the Lead Examiner's mark on the example.

You may well need to read back through the answer as you apply the mark scheme to clarify points and assure yourself that the level and the mark are appropriate.

Indicative content in the mark scheme is provided as a guide for examiners. It is not intended to be exhaustive and you must credit other valid points. Students do not have to cover all of the points mentioned in the Indicative content to reach the highest level of the mark scheme.

An answer which contains nothing of relevance to the question must be awarded no marks.

Below is the levels of response marking grid to be used when marking any 25 mark 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**
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 principles are shown 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**

Section A

Context 1 **Total for this context: 40 marks**

0 1 *Using the data in **Extract A**, calculate the GDP per capita for Costa Rica in 2015/2016 to the **nearest dollar**.*

[2 marks]

Response	**Max 2 marks**
For the correct answer ($14,204) with the $ sign.	**2 marks**
For a correct answer ($14,204) but without the $ sign **and/or** not to the nearest $. **Or** For the correct method but the wrong answer, to the nearest $ **and** with the $ sign.	**1 mark**

Calculation: $69.6bn/4.9m = $14,204.08 = $14,204 (to the nearest $)

Note: a correct method would include 69.6bn/4.9m or equivalent but not 69.6/4.9.

MAXIMUM FOR QUESTION 01: 2 MARKS

0 2 *Explain how the data in **Extract A** indicate living standards may be higher in the UK than in the USA.*

[4 marks]

Response	**Max 4 marks**
• includes evidence that shows that living standards in the UK are higher than in the USA • clearly explains how this data is evidence that living standards are higher in the UK than the USA	**4 marks**
• includes evidence that shows that living standards in the UK are higher than in the USA • unclear explanation of how this data is evidence that living standards in the UK are higher than in the USA	**3 marks**
• includes some limited evidence that shows that living standards in the UK are higher than in the USA • limited explanation of how this data is evidence that living standards in the UK are higher than in the USA	**2 marks**
• includes evidence that does not clearly show that living standards in the UK are higher than in the USA • no explanation of how this data is evidence that living standards in the UK are higher than in the USA.	**1 mark**

Relevant issues include:

- the meaning of the term 'living standards'
- the mean years of schooling is higher in the UK (13.3 years) compared to the USA (13.2 years) indicating the UK may have a more educated population
- the infant mortality rate is lower in the UK (4.2 per 1000 births) compared to the USA (6.5 per 1000 births) indicating the UK has better healthcare
- the Gini coefficient is lower in the UK (0.33) compared to the USA (0.41) indicating that there is lower inequality in the UK which could be linked to living standards being higher for some people on lower incomes
- CO_2 emissions are lower in the UK (6.2 tonnes per capita) than the USA (16.1 tonnes per capita) indicating less environmental pollution in the UK.

MAXIMUM FOR QUESTION 02: 4 MARKS

0 3 ***Extract B*** *(lines 8–9) states 'If injections into an economy's circular flow of income increase, then this may generate multiple increases in GDP.'*

With the help of a diagram, explain how an increase in injections may generate multiple increases in an economy's GDP.

[9 marks]

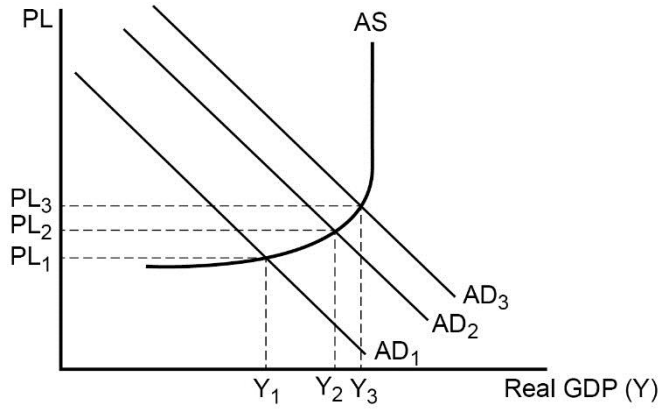
Level of response	Response	Max 9 marks
3	• is well organised and develops one or more of the key issues that are relevant to the question • shows sound knowledge and understanding of relevant economic terminology, concepts and principles • includes good application of relevant economic principles and/or 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 rightward on more than one occasion is expected. The first shift showing the initial impact of the injection, and the further shift(s) indicating the subsequent multiplier effect. However, if there is only one shift, accompanied by a written explanation that incorporates the multiplier effect, this is also acceptable.

Relevant issues include:

- definitions/explanations: the multiplier, GDP, the short-run, circular flow of income, injections, marginal propensity to consume
- explaining reasons for an increase in the injections into the circular flow: investment, government spending, exports
- linking the rise in injections to rising AD
- the impact of rising AD on employment, disposable income, consumption and investment
- explaining the multiplier effect and formula, the marginal propensity to consume and their impact on the size of the increase in AD
- explaining the effect of the propensities to withdraw on the size of the multiplier, ie the MPS, MPT and MPM
- explaining the effects of increased investment and government spending on AS and output
- explaining the overall impact on GDP.

Possible diagram:



MAXIMUM FOR QUESTION 03: 9 MARKS

0 4 ***Extract B*** *(lines 13–15) states 'If real GDP goes up, the economy is doing well; this is associated with higher incomes, more jobs and higher spending'.*

Using the data in the extracts and your knowledge of economics, assess the view that to improve the living standards of their citizens, governments across the world should prioritise achieving economic growth.

[25 marks]

Areas for discussion include:

- definitions/explanations: long-run economic growth, short-run economic growth, living standards
- explaining the links between a higher GDP or real GDP/capita and living standards
- explaining why economic growth may lead to improved living standards through:
  - increased employment and disposable incomes
  - more consumption possibilities
  - improved public services and merit good provision
  - a reduction in absolute poverty
- explaining why economic growth may lead to worsening living standards through:
  - inflation and its effects on individuals such as those on fixed incomes or those with low wage-bargaining power
  - the negative externalities of production such as pollution or deforestation
  - the using up of scarce resources
  - inequality
  - stress/loss of leisure time
- explaining the methods by which the government could stimulate short-run economic growth through:
  - expansionary fiscal policies such as decreasing income tax rates or increased government spending
  - expansionary monetary policies such as decreasing interest rates or increasing the money supply (although this may not directly be controlled by the government)
- explaining the methods by which the government could stimulate long-run economic growth through:
  - interventionist supply-side policies such as increased provision of education and training
  - market based supply-side policies such as lowering corporation tax
- the difference between achieving short-run and long-run economic growth
- considering what "happiness" means and whether material well-being correlates with happiness
- considering that it may depend upon the country in question, for example many LEDCs may require economic growth at a faster rate than many developed economies
- considering the objective of economic growth in comparison to the other objectives
- considering whether long-run economic growth can be achieved and the subsequent improvement in living standards
- considering the effects and/or trade-offs of economic growth depend where the economy is in the economic cycle.

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.

Use the level mark scheme on page 4 to award students marks for this question.

MAXIMUM FOR QUESTION 04: 25 MARKS

Context 2 **Total for this context: 40 marks**

0 5 *Using the data in **Extract D** (Figure 3), calculate, to the **nearest pound**, the amount of income tax payable for someone in Scotland earning £13 500.*

[2 marks]

Response	**Max 2 marks**
For a correct answer £314 (with the £ sign) (allow £313).	**2 marks**
For a correct answer but without the £ sign **and/or** not to the nearest £. **Or** For the correct method but the wrong answer, to the nearest £ **and** with the £ sign.	**1 mark**

Calculation:

£13 500 - £11 850 = £1650 £1650 x 0.19 = £313.50 = £314.00 (to the nearest £)

MAXIMUM FOR QUESTION 05: 2 MARKS

0 6 *Explain how the data in **Extract D** (Figure 2) show that the UK's public finances have been improving since 2010.*

[4 marks]

Response:	**Max 4 marks**
• includes evidence that shows that the UK's public finances have been improving since 2010 • clearly explains how this data is evidence that the UK's public finances have been improving since 2010	**4 marks**
• includes evidence that shows that the UK's public finances have been improving since 2010 • unclear explanation of how this data is evidence that the UK's public finances have been improving since 2010	**3 marks**
• includes some limited evidence that shows that the UK's public finances have been improving since 2010 • limited explanation of how this data is evidence that the UK's public finances have been improving since 2010	**2 marks**
• includes evidence that does not clearly show that the UK's public finances have been improving since 2010 • no explanation of how this data is evidence that the UK's public finances have been improving since 2010.	**1 mark**

Relevant issues include:

- the meaning of 'improved public finances'
- the deficit has fallen from the start (£140bn) to the end (£20bn)
- tax receipts have increased from start (£550bn in 2009/10) to finish (£830bn in 2020/11)
- tax receipts have increased each and every year, the smallest increase being between 2011/12 (£600bn) and 2012/13 (£610bn)
- government spending didn't increase in every year (although it almost did) – in 2010/11 and 2011/12 it remained at (£720bn) however tax revenue increased over this time
- the rate of increase of tax receipts is greater than that of government spending. Tax receipts increased from £550bn to £830bn over the period (an increase of 50.9%) compared to government spending which went from £690bn to £850bn (an increase of 23.2%)
- considering that the deficit has fallen in real terms or as a proportion of GDP.

MAXIMUM FOR QUESTION 06: 4 MARKS

0 7 ***Extract E*** *(lines 11–12) states 'If growth could be increased, the budget deficit would fall much faster.'*

With the help of a diagram, explain why a higher rate of economic growth is likely to reduce the budget deficit.

[9 marks]

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**

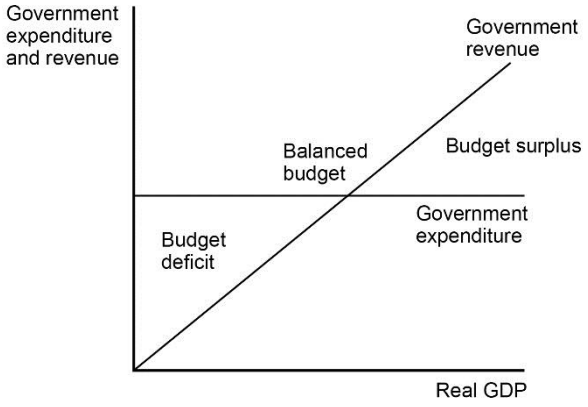
An AD/AS diagram which shows AD shifting rightward may be used. An economic cycle diagram showing the economy gaining a higher GDP is also acceptable.

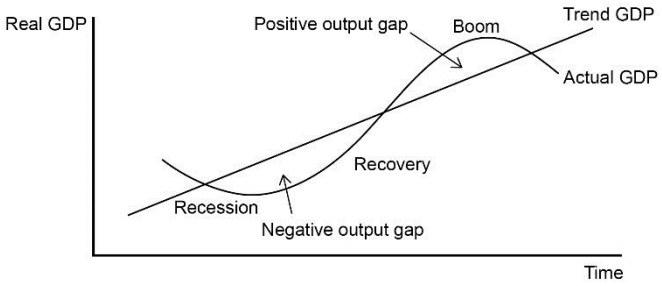
Some of the best students may include a diagram that has GDP on the horizontal axis and taxation plus government spending on the vertical axis. The diagram will show tax revenue increasing with GDP and probably, government spending falling as GDP rises. The diagram reflects how the cyclical deficit changes as GDP changes.

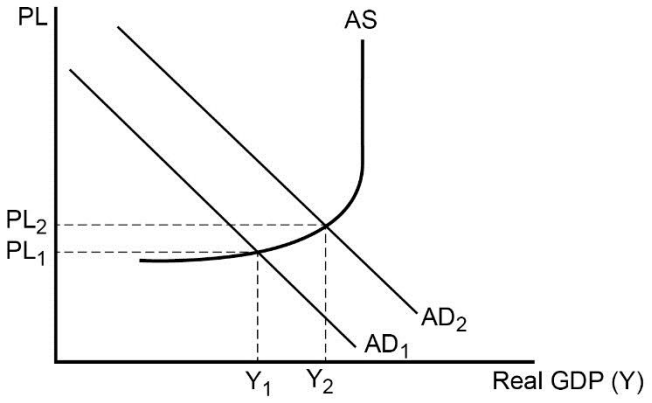
Relevant issues include:

- definitions/explanations: economic growth, budget, budget deficit
- explaining reasons for rising AD such as any cause of a rise in C+I+G+(x-m)
- linking the rise in AD to increased output, an increased derived demand for labour and falling cyclical unemployment
- linking falling unemployment to a reduction in government spending on benefits (eg JSA)
- linking rising GDP and falling unemployment to a rise in tax receipts (ie income tax)
- linking rising GDP to increased spending and consumption causing VAT receipts to rise
- linking rising GDP to increased spending and company profits causing corporation tax receipts to rise.

Possible diagrams:







MAXIMUM FOR QUESTION 07: 9 MARKS

0 8 ***Extract F*** *(line 1) states 'In most of the UK, reducing the budget deficit has focused on austerity rather than tax rises.'*

Using the data in the extracts and your knowledge of economics, evaluate the view that there is a strong case for significant increases in UK income tax rates.

[25 marks]

Areas for discussion include:

- definitions/explanations: income tax rates, taxation, tax thresholds, fiscal policy, budget deficit
- considering the possibility that tax rate increases may cause a rise or fall in tax revenue
- explaining the potential positive effects of raising income tax rates and possible rising tax receipts on:
  - deficit reduction
  - structural and cyclical deficits
  - the national debt
  - reducing the crowding-out effect
  - maintaining/improving credit ratings
  - debt interest payments
  - inequality
  - financing public spending without building up further debt
- explaining the potential negative effects of rising income tax rates and possible falling tax revenue due to:
  - disincentives to work and the effects on the replacement ratio
  - tax avoidance
  - tax evasion
  - other effects such as 'brain-drain'
- explaining the principles of taxation
- explaining and analysing the Laffer-curve
- explaining the difference between supply-side and demand-side effects of raising income tax
- explaining the effects of income tax rises on the labour market
- explaining the effects of tax rises on consumption
- explaining the progressive nature of income tax
- explaining the potential difficulties of a 'more-complex' taxation system
- considering the increased possibility of fiscal drag
- considering the benefits/drawbacks of tax increases compared to government spending cuts
- considering which income groups the tax rises may apply to (higher income earners only?)
- considering the effects may depend upon the stage in the economic cycle the UK is in
- considering whether deficit reduction is desirable or necessary.

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.

Use the level mark scheme on page 4 to award students marks for this question.

MAXIMUM FOR QUESTION 08: 25 MARKS

Section B

Below is the levels of response marking grid which should be used to mark the 15 mark questions

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**

Section B

Essay 1 **Total for this essay: 40 marks**

0 9 *Explain why the value of a currency may fall in a floating exchange rate system.*

[15 marks]

Relevant issues include:

- definitions/explanations: exchange rate, floating exchange rate, depreciation, the role of the FOREX market
- giving examples of depreciation (such as a numerical example)
- explaining that the value of a currency is determined by the demand for and supply of the currency
- explaining why a fall in demand for or increase in supply of currency will lead to a fall in the equilibrium exchange rate
- identifying and explaining reasons why the demand for currency may fall such as:
  - a fall in exports
  - a fall in inward FDI
  - a fall in tourism
  - a fall in the interest rate causing a reduction in hot money flows into the country
  - speculation
- identifying and explaining reasons why the supply of a currency may increase such as:
  - a rise in imports
  - a rise in FDI going abroad
  - a rise in tourism to another country
  - a fall in interest rates leading to a rise in hot money flows out of a country
  - speculation
- explaining government intervention which may occur if the floating exchange rate is not a "free" float.

The use of relevant diagrams, such as a diagram showing the supply of and demand for currencies, to support the analysis should be taken into account when assessing the quality of the student's response to the question.

Use the levels mark scheme on page 15 to award students marks for this question.

MAXIMUM FOR QUESTION 09: 15 MARKS

1 0 *Assess the view that a depreciation of the pound against other currencies is likely to improve the UK's macroeconomic performance.*

[25 marks]

Areas for discussion include:

- definitions/explanations: macroeconomic performance, depreciation
- explaining the causes of a depreciation in the currency
- explaining the impact of depreciation on the price of imports or exports
- explaining the impact of a depreciation of the pound on economic growth
  - such as the effects on AD
  - such as the potential rise in FDI
- explaining the impact of a depreciation of the pound on unemployment
  - such as a rise in exports and the subsequent increase in the derived demand for labour
- explaining the impact of a depreciation of the pound on inflation
  - such as the impact on demand-pull inflation from rising exports
  - such as the increased cost of raw materials or other imports
- explaining the impact of a depreciation of the pound on the current account of the balance of payments
  - such as increased international competitiveness and a rise in exports
  - such as the relative price of foreign goods becoming more expensive and a fall in imports
- considering the extent of the fall in currency and its subsequent impacts
- considering whether the currency self-corrects to some extent
- considering short-run and long-run implications of depreciation, eg on economic growth
- considering the Marshall-Lerner condition, elasticities and the 'J-curve' effect
- considering whether it has any impact in the long run, eg will the inflationary impact of the depreciation erode its effects?
- considering the short-run and long-run impact of a fall in the exchange rate on living standards.

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.

Use the levels mark scheme on page 4 to award students marks for this question.

MAXIMUM FOR QUESTION 10: 25 MARKS

Essay 2 **Total for this essay: 40 marks**

1 1 *Explain how the monetary policy transmission mechanism works when the Monetary Policy Committee (MPC) raises Bank Rate.*

[15 marks]

Relevant issues include:

- definitions/explanations: monetary policy, transmission mechanism, Bank Rate, interest rates
- the role of the MPC in achieving 2% +/- 1% CPI inflation and supporting the government's objectives regarding growth and employment
- explaining how a rise in Bank Rate may reduce household consumption:
  - due to a rise in saving
  - due to credit becoming more expensive
  - due to variable rate mortgages becoming more expensive
- explaining how a rise in Bank Rate may reduce investment:
  - due to credit becoming more expensive
  - due to investment appraisal being unfavourable
  - more pessimism
- explaining how a rise in Bank rate may appreciate the exchange rate:
  - due to a rise in demand for the currency and/or a fall in supply of the currency on the FOREX (hot money flows)
- the impact on asset prices and the consequent wealth effects
- explaining how all of the above affect AD.

The use of relevant diagrams such as AD/AS or the supply of and demand for currency, to support the analysis should be taken into account when assessing the quality of the student's response to the question.

Use the levels mark scheme on page 15 to award students marks for this question.

MAXIMUM FOR QUESTION 11: 15 MARKS

1 2 *Evaluate the view that strict rules and regulations on financial markets are essential to help create a more stable economy.*

[25 marks]

Areas for discussion include:

- definitions/explanations: financial markets, macroeconomic stability, financial stability
- relating rules and regulations to the FPC, FCA, and PRA and explaining the functions of each of the regulatory bodies
- explaining both micro and macro prudential regulation
- giving examples, such as explaining the build up to the last major financial crisis in the UK in 2007/08
- explaining systemic risk and the impacts on the real economy in terms of:
  - growth
  - unemployment
  - inflation
  - government finances
- explaining liquidity ratios and the 'stress-testing' of banks
- explaining the role of other economic agents in attempting to create macroeconomic stability
  - such as the MPC's role in price stability and helping achieve the government's objectives for growth and unemployment
  - such as the OBR's role in monitoring the impact of government budgetary changes
  - such as the EU's rules regarding fiscal stability
  - such as the Basel accords
- considering the possibility of government failure in banking or regulatory capture
- considering financial market failure, speculative bubbles and moral hazard
- considering that too much regulation may cause 'banking brain-drain' and damage the UK's financial services industry in the long-run
- considering the relative success (or failure) of current regulations or improvements that can be made to the system
- considering the possibility of market failure in banking such as asymmetric information in financial products
- considering that economic stability is much more than just financial stability
- considering that some external economic shocks may not be fully insulated against.

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.

Use the levels mark scheme on page 4 to award students marks for this question.

MAXIMUM FOR QUESTION 12: 25 MARKS

Essay 3 **Total for this essay: 40 marks**

1 3 *Explain the main causes of a rise in inflation.*

[15 marks]

Relevant issues include:

- definitions/explanations: inflation, cost-push inflation, demand-pull inflation, the general price-level, price indices
- explaining possible causes of rises in demand-pull inflation through an increase in the components of AD such as:
  - increased consumption due to the falling unemployment
  - increased investment due to falling interest rates
  - increased government spending due to a discretionary policy to raise welfare spending, eg pensions
  - increased exports due to higher economic growth in a trade partner
  - decreased imports and increased exports due to a depreciation in the currency
  - a rise in the money supply supporting the monetarist view and using the Fisher equation
- explaining possible causes of rising cost-push inflation through an increase in the costs of the factors of production such as:
  - rising wage costs
  - rising raw material costs
  - rising commodity prices such as oil
- explaining external shocks which may impact upon inflation
- explain microeconomic issues which may impact upon inflation such as rising housing costs affecting the RPI measure or possible collusion in energy markets affecting domestic fuel prices
- explaining possible short-run reasons for increases in prices and long-run reasons.

The use of relevant diagrams to support the analysis such as rising AD/AS should be taken into account when assessing the quality of the student's response to the question.

Use the levels mark scheme on page 15 to award students marks for this question.

MAXIMUM FOR QUESTION 13: 15 MARKS

1 4 *Evaluate the view that inflation is always preferable to deflation.*

[25 marks]

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.

Use the levels mark scheme on page 4 to award students marks for this question.

MAXIMUM FOR QUESTION 14: 25 MARKS