GCE A LEVEL MARKING SCHEME

SUMMER 2025

A LEVEL
ECONOMICS – COMPONENT 3
A520U30-1

About this marking scheme

The purpose of this marking scheme is to provide teachers, learners, and other interested parties, with an understanding of the assessment criteria used to assess this specific assessment.

This marking scheme reflects the criteria by which this assessment was marked in a live series and was finalised following detailed discussion at an examiners' conference. A team of qualified examiners were trained specifically in the application of this marking scheme. The aim of the conference was to ensure that the marking scheme was interpreted and applied in the same way by all examiners. It may not be possible, or appropriate, to capture every variation that a candidate may present in their responses within this marking scheme. However, during the training conference, examiners were guided in using their professional judgement to credit alternative valid responses as instructed by the document, and through reviewing exemplar responses.

Without the benefit of participation in the examiners' conference, teachers, learners and other users, may have different views on certain matters of detail or interpretation. Therefore, it is strongly recommended that this marking scheme is used alongside other guidance, such as published exemplar materials or Guidance for Teaching. This marking scheme is final and will not be changed, unless in the event that a clear error is identified, as it reflects the criteria used to assess candidate responses during the live series.

GENERAL MARKING GUIDANCE

Positive Marking

It should be remembered that learners are writing under examination conditions and credit should be given for what the learner writes, rather than adopting the approach of penalising him/her for any omissions. It should be possible for a very good response to achieve full marks and a very poor one to achieve zero marks. Marks should not be deducted for a less than perfect answer if it satisfies the criteria of the mark scheme, nor should marks be added as a consolation where they are not merited.

For each question there is a list of indicative content which suggest the range of economic concepts, theory, issues and arguments which might be included in learners' answers. This is not intended to be exhaustive and learners do not have to include all the indicative content to reach the highest level of the mark scheme.

The level-based mark schemes sub-divide the total mark to allocate to individual assessment objectives. These are shown in bands in the mark scheme. For each assessment objective a descriptor will indicate the different skills and qualities at the appropriate level. Learner's responses to questions are assessed against the relevant individual assessment objectives and they may achieve different bands within a single question. A mark will be awarded for each assessment objective targeted in the question and then totalled to give an overall mark for the question.

Section A

<table>
<tr><td>1</td><td>1</td><td colspan="2">Using diagrams, explain how both an increase in the scale of a firm and an increase in the scale of an industry could lead to a rise in a firm's average costs. [10]</td></tr>
<tr><td colspan="2" rowspan="2">Band</td><td>AO1</td><td>AO3</td></tr>
<tr><td>6 marks</td><td>4 marks</td></tr>
<tr><td colspan="2">3</td><td>5-6 marks
Excellent knowledge
Excellent, accurate diagrams illustrating a rise in average cost as a result of internal and external diseconomies of scale.

There is a clear sense that the meaning of an increase in scale is understood.

Relevant factors which might cause unit costs to rise are identified for each diagram.

Excellent use of terminology</td><td></td></tr>
<tr><td colspan="2">2</td><td>3-4 marks
Good knowledge

Diagrams are better on one of the two elements of the question than the other.

Or diagrams are strong but the meaning of an increase in scale is less clear.

Relevant factors are identified which might cause unit costs to rise.</td><td>3-4 marks
Good analysis

An accurate and comprehensive explanation of how both an increase in the scale of firm and industry could cause a firm's average costs to rise.

There are strong chains of reasoning showing why unit costs will be higher.</td></tr>
<tr><td colspan="2">1</td><td>1-2 marks
Limited knowledge

Diagrams are weak, containing inaccuracies and errors. There is very little understanding of what is meant by scale

Limited use of relevant terminology.</td><td>1-2 marks
Limited analysis

Either only one of the two elements of the question is explained well,

or

both are explained but lack detailed chains of reasoning of the link between relevant factors and the reason that unit costs will be higher.</td></tr>
<tr><td colspan="2">0</td><td>0 marks
No valid understanding.</td><td>0 marks
No valid analysis.</td></tr>
</table>

Indicative content

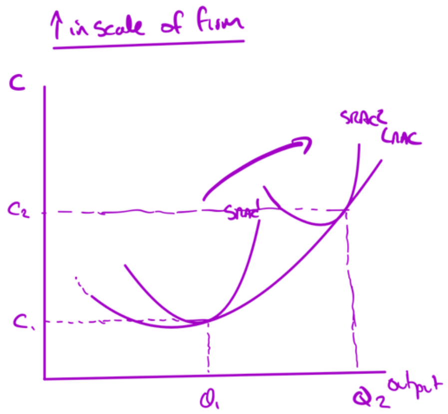
AO1

AO1 focuses on the integration of relevant diagrams and the identification of relevant factors.

An increase in the scale of the firm may trigger internal diseconomies of scale, resulting in higher unit costs. A change in scale for the firm means that there is an increase in all factors of production (the firm's capacity), not just an increase in output.

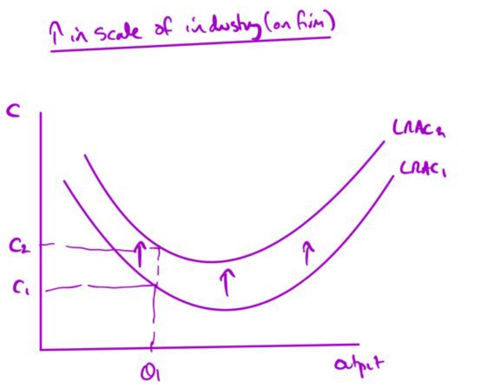
Possible relevant factors to be identified:

Scale of firm



Communication
Coordination
Control
Demotivation

Scale of industry



Competition for scarce factors of production
Possible risk of increased regulation
Possible issues with pressure on local resources (e.g. transport) if the industry is agglomerated.

AO3

AO3 focuses on the chain of reasoning explaining why it is that unit costs will be driven up in each case.

An increase in the scale of the firm:

Communication:
Larger firms are likely to have more layers of management or more need to rely on written forms of communication. This may slow down the speed of decision taking, damaging productivity and therefore driving up unit costs.
Larger firms may end up operating across a number of time zones, making it more difficult to take decisions, again damaging productivity.

Coordination
Large organisations tend to be more complex, making it hard to ensure that resources are in the right place at the right time. Hence, if components necessary for production in a manufacturing setting don't arrive, time will be wasted, driving up costs. Likewise in a service sector setting, if a restaurant, for example, over orders supplies, these will be wasted.

Control
Larger organisations have more staff, making it more difficult (in principle) to control. This leads to the possibility of lower productivity as a result of a less focused workforce, pushing up costs

Demotivation
There is a risk in larger organisation that employees fell like small cogs in a giant machine and lack a connection to their work. If motivation falls, this can be linked to higher labour turnover, higher absenteeism, lower productivity, increased risk of theft all of which can increase costs.

An increase in the scale of the industry:

Greater competition for a limited supply of skilled workers can drive up wages.
Greater competition for land can drive up rents.
Increased regulatory attention can drive up red tape costs.

1	2	Discuss whether all firms should aim to maximise their profits. [20]		
Band		**AO1**	**AO3**	**AO4**
		6 marks	**6 marks**	**8 marks**
3		**5-6 marks** **Excellent knowledge** Wide range of factors is identified on the desirability or otherwise of firms maximising their profits. Excellent use of relevant terminology	**5-6 marks** **Excellent analysis** Excellent analysis of why a firm should aim to maximise its profits. There is good depth of analysis stemming from strong chains of reasoning.	**6-8 marks** **Excellent evaluation** A well-developed two-sided answer that looks at both sides of the argument over whether firms should aim to maximise their profits. The answer comes to a reasoned judgment as to the circumstances under which profit maximisation might or might not be desirable for a firm.
2		**3-4 marks** **Good knowledge** A range of factors is identified on the desirability or otherwise of firms maximising their profits. A narrower range of points is covered than band 3 (perhaps focusing heavily on one side of the debate).	**3-4 marks** **Good analysis** Good analysis of why a firm should aim to maximise its profits. The answer may have a good line of argument, but clarity, range and depth of analysis may be lacking.	**3-5 marks** **Good evaluation** A strong two-sided answer with effective points on both sides of the argument being made. There are strong chains of reasoning explaining the counterarguments as to why firms might not aim to maximise their profits.
1		**1-2 marks** **Limited knowledge** Limited range of factors is identified on the desirability or otherwise of firms maximising their profits. There are significant gaps in knowledge.	**1-2 marks** **Limited analysis** Limited analysis of why a firm should aim to maximise its profits. Chains of reasoning are undeveloped and/or superficial and the answer lacks the use of key economic concepts.	**1-2 marks** **Limited evaluation** The answer is two-sided but counterarguments are not well developed and/or unconvincing.
0		**0 marks** No valid knowledge or understanding.	**0 marks** No relevant analysis	**0 marks** No relevant evaluation.

Indicative content

AO1/AO3

Maximising profits will mean that a firm will have higher retained profits which can then be reinvested in the business. Such profits are a low-cost source of finance and may allow:

- Cheap funds to expand the scale of the business, allowing for further profits in the longer run – this expansion could be in the form of either organic growth of M&A activity.

- Reinvestment of profits into R&D. This might lead to:

    - an improvement in processes, allowing costs to be driven down (dynamic efficiency), which might, in turn, result in lower prices and greater competitiveness for the firm.
    - an improvement in products, producing higher quality of existing products or a range of innovative new products again helping a firm to become more competitive.

- Greater ability to pay dividends to shareholders. This may attract further investment in the longer term, help to support the firm's share price, reducing the chance of a hostile takeover bid and may reduce shareholder activism.

- Greater ability to pay off previously acquired debts, improving longer term performance and enhancing survival chances in the event of a downturn. Profits may be held in the form of liquid assets (Apple's cash pile) again providing a buffer against downturn and creating the financial flexibility to take advantage of opportunities.

- In the case of smaller, owner-run firms the profits are the reward for the owner's effort and may well be their income, therefore allowing a higher standard of living.

AO1/AO4

Short term profit maximisation might be undesirable because:

It may lead to longer term damage – pushing prices up or cutting costs to increase short term returns may damage the firm's reputation and reduce their long-term profit stream.

If profit maximisation involves cutting employees' wages or forcing higher productivity, again this might be counterproductive in the longer term if labour turnover starts to increase.

High short-term profits might attract new entrants into the market – it might make more sense to adopt a limit-pricing type strategy to ensure greater long term profits – therefore the answer to the question might depend on a firm's time horizon.

Not all firms prioritise short term profits – they may have other objectives:

- In recession, firms might be more interested in survival, therefore prioritising cash flow or cost reduction over profit maximisation
- Some firms may be willing to sacrifice short term profits in favour of growth/size/market share – again this might be with the intention of creating more profits in the longer term.
- Some firms may have completely different objectives, such as social and community objectives – organisations like Wikipedia or Mozilla appear not to be focused on generating short term profit

- Smaller, owner-run, organisation may prefer to trade off lower profits for greater leisure time, instead focusing on maximising quality of life; the process of literally maximising profits may be more trouble than its worth.

Profit maximisation might not be a sensible aim because it is simply impossible to achieve due to lack of effective information – might make more sense to aim for large rather than maximum profit.

Judgement

Might depend on the current situation of the firm in terms of its size, ownership, current situation and the external environment. A focus on profits may therefore be more sensible for some firms at certain times than for others.

Allow any other relevant points.
The answer is reversible.

2	1	**Explain the main factors that determine the level of contestability in a market** **[10]**	
Band		**AO1**	**AO3**
		6 marks	**4 marks**
3		**5-6 marks** **Excellent knowledge** Excellent, accurate and comprehensive understanding of the factors that determine levels of contestability. At least two factors are fully understood. Excellent use of relevant terminology.	
2		**3-4 marks** **Good knowledge** Good understanding of factors that determine contestability. Detail may be lacking in one of the factors identified. Good use of relevant terminology.	**3-4 marks** **Good analysis** An accurate and comprehensive analysis of the factors that determine levels of contestability. There are strong chains of reasoning.
1		**1-2 marks** **Limited knowledge** Some recognition of the factors that determine contestability but development lacks detail. Limited use of relevant terminology.	**1-2 marks** **Limited analysis** Limited analysis of the factors that determine levels of contestability, Chains of reasoning may not be fully developed.
0		**0 marks** No valid understanding.	**0 marks** No valid analysis.

Indicative content.

AO1

Contestability – the extent to which easy or difficult for a new firm to enter a market. A contestable market is a market where companies can enter and leave freely with low sunk costs.
Factors which determine the contestability of a market include:

- Economies of scale and start-up costs.
- Sunk costs.
- Vertical integration.
- Brand loyalty
- Technology/patents.
- Market knowledge and expertise.
- Legal barriers.
- Activities of incumbent firms eg use of limit pricing.

AO1 centres on an understanding of what the factor that is identified means.

AO3

AO3 looks at the link between the factor that has been identified and the contestability of the market. Hence it is looking at **how and why** the relevant factor makes a market more difficult to enter or leave.

Allow any other relevant points.

<table>
<tr><td>2</td><td>2</td><td colspan="3">To what extent is it desirable that all markets should become more contestable? [20]</td></tr>
<tr><td colspan="2" rowspan="2">Band</td><td>AO1</td><td>AO3</td><td>AO4</td></tr>
<tr><td>6 marks</td><td>6 marks</td><td>8 marks</td></tr>
<tr><td colspan="2">3</td><td>5-6 marks
Excellent knowledge

Detailed knowledge and understanding of the desirability or otherwise of more contestable markets.
Both breadth and depth of coverage is excellent.
Excellent use of relevant terminology.</td><td>5-6 marks
Excellent analysis

Excellent analysis of the desirability of more contestable markets.
There are strong chains of reasoning in the analysis.</td><td>6-8 marks
Excellent evaluation

A well-developed two-sided answer that looks at both sides of contestability.
The answer comes to a reasoned judgment as to the circumstances in which contestability is likely to be more or less desirable.</td></tr>
<tr><td colspan="2">2</td><td>3-4 marks
Good knowledge

Good understanding of the desirability or otherwise of more contestable markets.
A narrower range of points is covered (perhaps focusing heavily on one side) or understanding is more superficial.</td><td>3-4 marks
Good analysis

Good analysis of the desirability of more contestable markets.
The answer may have a good line of argument, but clarity and depth of analysis may be lacking.</td><td>3-5 marks
Good evaluation

A strong two-sided answer with effective points on both sides of the argument made.
There are strong chains of reasoning explaining the counterarguments as to why an increase in contestability might not be desirable.</td></tr>
<tr><td colspan="2">1</td><td>1-2 marks
Limited knowledge

Limited understanding of the desirability or otherwise of more contestable markets.
There are significant gaps in both knowledge and understanding.</td><td>1-2 marks
Limited analysis

Limited analysis of the desirability of more contestable markets.
Chains of reasoning are undeveloped and/or superficial, and the answer lacks the use of key economic concepts.</td><td>1-2 marks
Limited evaluation

The answer is two-sided, but counterarguments are not well developed and/or unconvincing.</td></tr>
<tr><td colspan="2">0</td><td>0 marks

No valid knowledge or understanding.</td><td>0 marks

No relevant analysis.</td><td>0 marks

No relevant evaluation.</td></tr>
</table>

Indicative content.

AO1/AO3

Due to freedom of entry and exit, existing firms always face the threat of new firms entering the market.

The threat of competition may force firms to cut prices closer to MC/the competitive equilibrium (allocative efficiency). Increased consumer and community surplus. Competitive threat creates increased incentives for firms to cut costs (reducing x-inefficiency).
Potentially a greater number of firms in the market increases choice for consumers and increased competition drives up quality. Increased incentives for firms to respond to consumer preferences (allocative efficiency).

Threat of competition may force firms to innovate, creating dynamic efficiency.

Higher levels of competition will reduce the need for government intervention/regulation.

Contestability may create macro benefits – less sticky prices, potential growth from innovation, a more favourable trade balance.

The key to the difference between AO1 and AO3 is that AO1 shows an understanding of the benefit that is brought and AO3 shows how contestability will bring that benefit about.

AO1/AO4

Less likely to benefit from dynamic efficiency as firms may not make supernormal profits/only normal profits.

Contestability may create the risk of a short-term focus among incumbents, restricting investment and dynamic efficiency.

Contestability could lead to an excessive focus on cost cutting (to allow low prices) resulting in the risk of a race to the bottom.

Lowering entry barriers brings firms into the market who may not have the expertise to be successful in the long run (e.g. UK energy market).

Lowering entry barriers can lead to confusion for consumers, wasteful duplication and poorer service (bus deregulation 1986).

Judgement: Possible lines of argument:
Desirability will depend on the type of industry e.g. some are natural monopolies i.e. water. Some industries for strategic/security/safety reasons need to be incontestable i.e. nuclear power. It depends what is meant by ‘desirable’.
The relative importance of the points made in each side of the argument.

Allow any other relevant points.
The answer is reversible.

Section B

3	1	Explain the factors that might cause consumption in an economy to rise. [10]	
Band		**AO1**	**AO3**
		6 marks	**4 marks**
3		**5-6 marks** **Excellent knowledge** Excellent, accurate and comprehensive understanding of the factors that could cause consumption to rise. **At least** two factors are fully understood. Excellent use of relevant terminology.	
2		**3-4 marks** **Good knowledge** Good understanding of factors that could cause consumption to rise. Detail may be lacking in one of the factors identified. Good use of relevant terminology.	**3-4 marks** **Good analysis** An accurate and comprehensive analysis of the factors that could cause consumption to rise. There are strong chains of reasoning between the factor identified and the reason that consumption might rise.
1		**1-2 marks** **Limited knowledge** Some recognition of the factors that could affect consumption. Limited use of relevant terminology.	**1-2 marks** **Limited analysis** Limited analysis of how the factor identified might cause consumption to rise. Chains of reasoning may not be fully developed in terms of the explanation of the link between the factor identified and consumption.
0		**0 marks** No valid understanding.	**0 marks** No valid analysis.

Indicative content

AO1

Focuses on the identification of relevant factors and an understanding of what that factor means.
Key factors affecting household consumption include:

- Rising GDP/household income
- Falling interest rates
- Easier access to credit
- Falling direct and indirect tax rates
- Rising consumer confidence/negative expectations about the economy
- Rising asset prices
- Low levels of household debt

Allow other relevant factors that are linked to aggregate consumption.

AO3

Focuses the chain of reasoning between the factor and consumption.
Hence it looks at **how and why** the factor identified will actually cause a rise in household consumption.

- Rising GDP/household income Increases disposable income, meaning that consumers should have more discretionary income as well. Therefore, consumption should rise.
- Falling interest rates make borrowing less expensive and saving less attractive. A reduced incentive to save may therefore increase consumption. Less expensive credit may mean that consumers bring forward purchases and lower mortgage interest rates may increase consumers' discretionary incomes, again causing consumption to rise.
- Likewise, easier access to credit allows consumers to bring forward consumption rather than being constrained by their current income.
- Falling direct and indirect tax rates. Lower direct taxes will increase disposable income, meaning that consumers can consume more. Indirect taxes may lower the price level, increasing consumers' real income and therefore again allowing consumers to spend more.
- Rising consumer confidence. This will particularly affect major purchases as consumers are more willing to commit to sacrificing savings/taking on debt if the future economic outlook is good.
- Rising asset prices can both increase confidence (wealth effect) and also make it easier to use assets as collateral against loans. Rising share prices improve consumers' ability to sell these assets to finance consumption and may cause long term savers (e.g. those looking to build up a pension pot – target savers) to save less, hence increasing consumption.
- Low levels of household debt make it easier to take on additional debt to increase consumption.

Allow any other relevant points.

<table>
<tr><td>3</td><td>2</td><td colspan="3">Discuss whether an increase in consumption is likely to be good for the UK economy. [20]</td></tr>
<tr><td colspan="2" rowspan="2">Band</td><td>AO1</td><td>AO3</td><td>AO4</td></tr>
<tr><td>6 marks</td><td>6 marks</td><td>8 marks</td></tr>
<tr><td colspan="2">3</td><td>5-6 marks
Excellent knowledge

Wide range of factors is identified on the desirability or otherwise of an increase in consumption.

Excellent use of relevant terminology.</td><td>5-6 marks
Excellent analysis

Excellent analysis of how an increase in consumption might be good for the UK economy, covering a wide range of economic impacts in depth.

There is good depth of analysis stemming from strong chains of reasoning.</td><td>6-8 marks
Excellent evaluation

A well-developed two-sided answer that looks at both sides of the effects of an increase in consumption on the UK economy.

The answer comes to a reasoned judgment as to the circumstances an increase in consumption is likely to be good for the UK economy.</td></tr>
<tr><td colspan="2">2</td><td>3-4 marks
Good knowledge

A range of factors is identified on the desirability or otherwise of an increase in consumption.

A narrower range of points is covered than band 3 (perhaps focusing heavily on one side of the debate).</td><td>3-4 marks
Good analysis

Good analysis of how an increase in consumption might be good for an economy.

The answer may have a good line of argument, but clarity, range and depth of analysis may be lacking.</td><td>3-5 marks
Good evaluation

A strong two-sided answer with effective points on both sides of the argument being made.

There are strong chains of reasoning explaining the counterarguments as to why an increase in consumption might not be good for an economy.</td></tr>
<tr><td colspan="2">1</td><td>1-2 marks
Limited knowledge

Limited range of factors is identified on the desirability or otherwise of an increase in consumption.

There are significant gaps in knowledge.</td><td>1-2 marks
Limited analysis

Limited analysis of how an increase in consumption might be good for an economy.

Chains of reasoning are undeveloped and/or superficial, and the answer lacks the use of key economic concepts.</td><td>1-2 marks
Limited evaluation

The answer is two-sided, but counterarguments are not well developed and/or unconvincing.</td></tr>
<tr><td colspan="2">0</td><td>0 marks

No valid knowledge or understanding.</td><td>0 marks

No relevant analysis</td><td>0 marks

No relevant evaluation.</td></tr>
</table>

Indicative content

AO1/AO3

An increase in consumption will increase AD, being a significant part of it in most developed economies. This initial increase in AD is likely to trigger a multiplier effect within the economy. This should lead to both actual growth and job creation.

Rising consumption may increase the profitability of firms, leading to greater innovation, investment and dividends for shareholders. Likewise, rising consumption creates a greater incentive for firms to invest in the first place.

Rising consumption should lead to an increase in the government's tax base. Higher consumption should lead directly to an increase in indirect tax receipts. Increased GDP and employment should lead to higher income tax and NI. Greater profitability in companies should lead to an increase in corporation tax revenue.

Band 3 of AO3 requires UK context

Allow any other relevant points.

AO1/4

Rising consumption may be inflationary if AD rises at a rate faster than its underlying capacity can grow/if unemployment falls below the NAIRU/economy is close to full capacity. This can drive up inequality, damage international competitiveness and so on.

Rising consumption can lead a worsening current account as some of the increase in AD which results will be met from abroad. This can create issues with the exchange rate or with compensating inflows on the financial and capital account of the balance of payments.

Rising consumption is likely to be associated with increases environmental consequences and negative externalities. It may run against a net zero agenda. According to the New Economic Foundation, for example, one person in the United States will, by 4am in the morning of 2 January, already have been responsible for the equivalent in climate change causing carbon emissions that a Tanzanian would take a whole year to generate. Similarly, rising consumption may be unsustainable in terms of resource depletion – peak oil and so on.

Rising consumption may be financed by increased household debt, which may drive up inequality if taken on by those unable to afford it. If consumption is financed by drawing down on savings, then this may mean that people are saving less for retirement.

Likewise, rising consumption may be associated with rising levels of societal discontent; some research suggests that happiness stems from relative wealth and possessions rather than absolute wealth meaning that rising consumption may increase feelings of insecurity in some groups and trigger pressure to conform.

Rising consumption may suppress the savings ratio, depending on whether or not it rises as a percentage of GDP. High savings through the banking system can trigger higher levels of investment, creating sustainable growth (Harrod Domar).

Band 3 of AO4 requires UK context

Allow any other relevant points

Judgement:
Likely to depend on the state of the economy. The closer the economy is to some sort of supply side constraint; the more likely inflation is to arise.

Much may depend on *which* economy we are talking about – what it the current level and proportion of GDP that consumption forms.

Much may depend on the sectors in which the bulk of the rising consumption occurs and the size of any increase in consumption.

Band 3 of AO4 requires UK context

Allow any other relevant points

The answer is reversible.

4	1	Explain how a price index to measure the rate of inflation is constructed. [10]	
Band		**AO1**	**AO3**
		6 marks	**4 marks**
3		**5-6 marks** **Excellent knowledge** Excellent, accurate and comprehensive understanding is shown of the key elements needed to construct an index. Excellent use of relevant terminology.	
2		**3-4 marks** **Good knowledge** Good understanding shown of the key elements needed to construct an index. There may be minor gaps in knowledge and understanding. Good use of relevant terminology.	**3-4 marks.** **Good analysis** A good accurate and comprehensive analysis of the process through which a price index is constructed. There are strong chains of reasoning showing how the key elements are combined to create an index.
1		**1-2 marks** **Limited knowledge** Limited understanding shown of the key elements needed to construct an index. There are significant gaps in knowledge and understanding.	**1-2 marks** **Limited analysis** A limited analysis of the process through which a price index is constructed. Chains of reasoning are unclear about how the elements are combined, but there is some logic shown.
0		**0 marks** No valid understanding.	**0 marks** No valid analysis.

Indicative content.

AO1

Knowledge and understanding are shown of the key elements necessary to create a price index:

The concept of an index – a value which represents changes in a variable compared with its base level.
Weights – reflect the importance of an item in a basket of goods and services, reflecting the proportion of the overall expenditure in the basket on that one item (or a range of items take).
The construction of a basket to reflect the spending patterns of target households
The collection of the prices/price changes of a wide range of goods and services drawn from a range of outlets.

AO3

Focuses on how the elements of AO1 are combined to create a price index. Hence it focuses on the process of creation rather than the component parts.

1. The price index is given a base year value of 100.
2. A weighting is given to the importance of each product or service in the typical basket of goods chosen to calculate the index. To achieve this in the UK the Living Costs and Food Survey measures what people spend their money on. From finding out typical consumption patterns, this body can create a typical basket of goods and the weights. Changes in prices of selected items are measured by the Office of National Statistics.
3. To measure the change in price for each product in the index % increases are added to the base year value of 100. Thus a 5% rise in price will mean the index for that particular product becomes 105.
4. The data is converted into the weighted index – multiply each product's weight by the price index and add these up to create the total weighted index.
5. Divide the total weighted index by the total weights and this will give a value for the new index.

Allow any other relevant points.

<table>
<tr><td>4</td><td>2</td><td colspan="3">Discuss whether a reversal of quantitative easing could be effective in bringing inflation down to its target level. [20]</td></tr>
<tr><td colspan="2" rowspan="2">Band</td><td>AO1</td><td>AO3</td><td>AO4</td></tr>
<tr><td>6 marks</td><td>6 marks</td><td>8 marks</td></tr>
<tr><td colspan="2">3</td><td>5-6 marks
Excellent knowledge

Excellent understanding of the process of reverse QE and inflation.
Breadth and depth of coverage and use of terminology are excellent.</td><td>5-6 marks
Excellent analysis

An excellent analysis of the effectiveness of reversing QE in reducing inflation to its target level.
There are strong chains of reasoning in the analysis.</td><td>6-8 marks
Excellent evaluation

An excellent critical evaluation of the effectiveness of reversing QE in reducing inflation, that looks at both sides of the debate.
The answer comes to a reasoned judgment as to the circumstances in which reverse QE is likely to be effective in reducing inflation to its target level.</td></tr>
<tr><td colspan="2">2</td><td>3-4 marks
Good knowledge

Good understanding of the process of reverse QE and inflation.
A narrower range of points is covered or understanding is more superficial.
Good use of terminology.</td><td>3-4 marks
Good analysis

A good analysis of the effectiveness of reversing QE in reducing inflation.
The answer may have a good line of argument but clarity and depth of analysis may be lacking.</td><td>3-5 marks
Good evaluation

A strong two-sided answer with effective points on both sides of the argument being made.
There are strong chains of reasoning explaining the counterarguments as to why QT might not be effective in reducing inflation.</td></tr>
<tr><td colspan="2">1</td><td>1-2 marks
Limited knowledge

Limited understanding of reverse QE and inflation.
There are significant gaps in both knowledge and understanding.</td><td>1-2 marks
Limited analysis

Limited analysis of the effectiveness of reversing QE in reducing inflation.
Chains of reasoning are undeveloped and/or superficial and the answer lacks the use of key economic concepts.</td><td>1-2 marks
Limited evaluation

The answer is two-sided but counterarguments are not well developed and/or unconvincing.</td></tr>
<tr><td colspan="2">0</td><td>0 marks

No valid understanding.</td><td>0 marks

No valid analysis.</td><td>0 marks

No relevant evaluation.</td></tr>
</table>

Indicative content.

AO1

Reversal of QE implies QT although some candidates may mention tapering which is slowing the amount of bond purchases.
QT is a deflationary monetary policy carried out by central banks also known as balance sheet normalisation.
QT reverses QE, contracting rather than expanding a central bank's balance-sheet.
Candidates should understand the process of reversing QE-the sale of bonds (gilts and/or corporate bonds) to the markets/commercial banks.
The result is a fall in bond prices due to the increase supply of bonds but a rise in yields as there is an inverse relationship between the price and yield.

AO3

The increase in yield will feed into higher long term interest rates which will possibly reduce investment and increase mortgage interest rates negatively affecting consumption. This should reduce AD and inflation.
Rising bond yields will be likely to cause a fall in the prices of other assets such as shares and property as investors switch to higher yielding bonds. This reduction in wealth will also be likely to put downward pressure on AD and inflation.
QT will also in theory reduce the money supply as when commercial banks buy bonds this reduces their liquidity and their ability to lend. A fall in the money supply should reduce inflation (MV=PT/PQ/PY).

A fall in AD will increase competition in both product and labour markets (as unemployment rises) suppressing the wage-price spiral (workers find it harder to ask for pay rises and firms find it more difficult to increase prices).

AO4

QT is only one of many influences on the rate of inflation and so may be offset by upward inflationary pressures elsewhere – expansionary fiscal policy, for example.
QT will have little effect on inflation if its cause is cost push related.
The impact is also likely to depend on the level of inflationary expectations.
Difficulty in knowing as yet the transmission mechanism of how QT leads to lower inflation as it is still a relatively recent policy.
QT may cause financial markets to become more volatile due to the lack of liquidity. A sudden shift in the amount of money available can lead to major price adjustments and destabilise the value of assets. Hence QT has to be fairly modest and thus may have negligible effect on inflation.
The impact of changes/reductions in the money supply on the rate of inflation is controversial – many economists are sceptical of MV=PT/PQ/PY.

Judgement:
The Bank of England will continue to use the rate of interest as its main policy to meet the inflation target.
QT may be restricted by the government because of its links to the sale of new gilts.
QE/QT links to inflation have not been significantly recognised by the Bank of England.

Allow any other relevant points.
The answer is reversible.

Section C.

5	1	**Explain why high levels of public sector debt can be an obstacle to economic development in low-income countries (LEDCs). [10]**

Band	**AO1**	**AO3**
	6 marks	**4 marks**
3	**5-6 marks** **Excellent knowledge** There is an excellent knowledge of the problems generated by high levels of public sector debt. Depth and breadth of understanding are present.	
2	**3-4 marks** **Good knowledge** Answers in this band will have a good knowledge of the problems generated by high levels of public sector debt but will be lacking in either depth of understanding or range of issues.	**3-4 marks** **Good analysis** There is logical development and clear analysis as to how the problems created by high levels of public sector debt will negatively impact economic development.
1	**1-2 marks** **Limited knowledge** Some knowledge of what is meant by high levels of public sector debt and the issues that it creates is shown.	**1-2 marks** **Limited analysis** Chains of reasoning are generally not well developed and are less convincing in terms of explaining how economic development will be restricted.
0	**0 marks** No relevant knowledge or understanding present.	**0 marks** No valid analysis present.

Indicative content

High levels of debt may mean that debt service costs (repayment and interest) restrict a government's ability to spend on infrastructure and health and education, each of which is important for creating higher living standards.

High levels of public sector debt may mean that there is less potential for tax cuts which could be used to stimulate economic growth and hence possibly development.

High levels of public debt imply a risk of crowding out of private sector investment as competition for funds through financial markets drives up interest rates and restricts the availability of funds.

High levels of public sector debt may lead to an increase in bond yields making it more expensive for governments to refinance debt, increasing debt service payments. The decrease in perceptions of creditworthiness may make it harder for countries to access capital markets, making it harder to borrow for long term development projects.

High levels of public sector debt may mean that foreign investors fear tax increases/spending cuts/instability and are therefore less likely to invest; FDI may fall possibly limiting growth and development.

Allow any other relevant points.

5	2	Discuss whether an increase in FDI into low-income countries (LEDCs) is likely to lead to an increase in economic development. [20]		
Band		**AO1**	**AO3**	**AO4**
		6 marks	**6 marks**	**8 marks**
3		**5-6 marks** **Excellent knowledge** Detailed knowledge and understanding of the desirability or otherwise of an increase in FDI into low-income countries. Both breadth and depth of coverage is excellent. Excellent use of relevant terminology.	**5-6 marks** **Excellent analysis** Excellent analysis of how an increase in FDI lead to an increase in economic development, covering a wide range of economic impacts in depth. There are strong chains of reasoning in the analysis.	**6-8 marks** **Excellent evaluation** A well-developed two-sided answer that looks at both sides of the economic development impacts of an increase in FDI. The answer comes to a reasoned judgment as to the circumstances in which an increase in FDI into low-income countries is likely to lead to an increase in economic development.
2		**3-4 marks** **Good knowledge** Good understanding of the desirability or otherwise of an increase in FDI into low-income countries. A narrower range of points is covered (perhaps focusing heavily on one side of the debate) or understanding is more superficial.	**3-4 marks** **Good analysis** Good analysis of how an increase in FDI might be good for an economy. The answer may have a good line of argument, but clarity, range and depth of analysis may be lacking.	**3-5 marks** **Good evaluation** A strong two-sided answer with effective points on both sides of the argument being made. There are strong chains of reasoning explaining the counterarguments in terms of why FDI might not be beneficial for economic development.
1		**1-2 marks** **Limited knowledge** Limited understanding of the desirability or otherwise of an increase in FDI into low-income countries. There are significant gaps in both knowledge and understanding.	**1-2 marks** **Limited analysis** Limited analysis of how an increase in FDI might be good for an economy. Chains of reasoning are undeveloped and/or superficial, and the answer lacks the use of key economic concepts.	**1-2 marks** **Limited evaluation** The answer is two-sided, but counterarguments are not well developed and/or unconvincing.
0		**0 marks** No valid knowledge or understanding.	**0 marks** No relevant analysis	**0 marks** No relevant evaluation.

Indicative content

AO1/AO3

FDI can increase investment, increasing the overall level of AD, hence creating positive multiplier effects, increasing GDP and the tax base. This can create employment and generate the funds for additional public spending, which can contribute to increased living standards and economic development.

Some FDI may come with infrastructure alongside it or as part of the deal. This increase in infrastructure can improve economic growth and also feed into higher living standards, depending on the type of infrastructure that is built.

FDI may create jobs directly, raising GDP per capita, improving living standards and improving the tax base.

FDI may lead to an increase in skills and technology inside the economy, contributing to growth, sectoral shift and jobs in new sectors, which can again increase living standards.

FDI may allow primary product dependent economies to add value to basic commodities, improving the trade balance and increasing growth.

Increased inward FDI may create competition for local firms, forcing them to become more efficient, again driving growth and possibly development.

Allow any other relevant points.

AO1/4

FDI may increase GDP but GNI as a result of the repatriation of profits. Likewise, MNCs might not pay much in the way of tax inside the country if tax avoidance schemes are used.

MNCs might be more likely to exploit the workforce or the environment, since they have less accountability. Likewise, they may simply be interested in exploiting natural resources in the short term until they are used up.

In some cases, there are dangers that MNCs may exert undue influence on sovereign governments because of their disproportionate impact on the economy (this will vary from country to country).

Jobs might not in fact be created – MNCs may bring their own workforce and competition from MNCs may destroy jobs in local firms.

Firms may be footloose – as wages start to rise they may relocate, leaving country at risk of falling into the middle income trap.

FDI may drive up income inequality as only a small number of workers in a small range of sectors might actually benefit.

Risk of Dutch disease if the FDI is rapid and in response to the discovery of a natural resource.

Allow any other relevant points.

Judgement

Much will depend on the nature of FDI and the initial level of development of the economy. For example, if FDI is leading to a diversification of the economic base of an economy and if the economy already has strong infrastructure and effective institutions, then the threats from FDI are more likely to be mitigated than if the economy has low GDP and the FDI is coming into resource extraction.

The answer is reversible.

6	1	**Explain what is meant by a country's terms of trade and explain two factors that could cause it to worsen.** **[10]**	
Band		**AO1**	**AO3**
		6 marks	**4 marks**
3		**5-6 marks** **Excellent knowledge** Detailed understanding of the concept the TOT. At least two factors are fully understood. Excellent use of relevant terminology.	
2		**3-4 marks** **Good knowledge** Good understanding of the concept the TOT. There may be errors or gaps in understanding shown in one of the factors or only one factor is fully understood. Good use of relevant terminology.	**3-4 marks** **Good analysis** A good, accurate and comprehensive analysis of the factors that could cause the TOT to deteriorate, anchored into the formula. There are strong chains of reasoning.
1		**1-2 marks** **Limited knowledge** Limited understanding of the concept of the TOT. There are significant gaps in knowledge and understanding shown throughout the answer. Limited use of terminology.	**1-2 marks** **Limited analysis** Limited analysis of the factors that determine that could cause the TOT to deteriorate. Chains of reasoning may not be fully developed.
0		**0 marks** No valid understanding.	**0 marks** No valid analysis.

Indicative content.

AO1

Centres on knowledge of the terms of trade and **understanding** of the factors which might affect it.

The terms of trade is the real value of countries' exports in terms of their imports. The terms of trade index measure the relative prices of a country's exports and imports.

Terms of Trade (TOT) = (Index of Export Prices / Index of Import Prices) × 100

Factors which affect the terms of trade include:
Nominal exchange rates.
Domestic inflation vs international inflation.
Global commodity prices.
Productivity and factor input costs.
Protectionism.

AO3

Centres on how the factors identified might trigger a deterioration in the terms of trade.

A fall in/deterioration in the TOT occurs when export prices fall relative to import prices. Possible factors that can cause this to happen include:

A depreciation in the exchange rate leading to a rise in import prices in domestic currency terms, relative to the price of exports.

A fall in domestic inflation relative to competitor countries – the export prices of the economy will therefore fall relative to the price of imports, other things being equal.

Technological advances/productivity improvements: Innovations can expand the supply of goods, potentially leading to a decline in export prices and a deterioration in TOT.

A sharp rise in global commodity prices as a result of supply shocks will worsen the terms of trade for commodity importing economies.

The imposition of a tariff on imports making them more expensive.

If a country such as an LEDC only imports manufactured goods and only exports primary goods, then over time the terms of trade will worsen. (Prebisch-Singer hypothesis).

Allow any other relevant points.

6	2	**Evaluate the view that a worsening in a country's terms of trade is good for its economy.** **[20]**		
Band		**AO1**	**AO3**	**AO4**
		6 marks	**6 marks**	**8 marks**
3		**5-6 marks** **Excellent knowledge** Excellent understanding of the impact of deteriorating TOT on different macroeconomic indicators in the economy. Breadth and depth of coverage is excellent. Excellent use of relevant terminology.	**5-6 marks** **Excellent analysis** An excellent analysis of the impact of a deteriorating TOT on different macroeconomic indicators There are strong chains of reasoning in the analysis.	**6-8 marks** **Excellent evaluation** An excellent critical evaluation of the impact of a deteriorating TOT on macroeconomic indicators that looks at both sides of the issue. The answer comes to a reasoned judgment as to the circumstances in which a deterioration in the terms of trade is likely to be more or less desirable.
2		**3-4 marks** **Good knowledge** Good understanding of the impact of a deteriorating TOT on the economy. In places the answer may lack depth and coverage of the different macroeconomic indicators and may be incomplete. A good use of appropriate terminology.	**3-4 marks** **Good analysis** A good analysis of the impact of a deteriorating TOT on macroeconomic indicators. The answer may have a good line of argument, but clarity and depth of analysis may be lacking.	**3-5 marks** **Good evaluation** A strong two-sided answer with effective points on both sides of the argument being made. There are strong chains of reasoning.
1		**1-2 marks** **Limited knowledge** Limited understanding of the impact of a deteriorating TOT on the economy. There are significant gaps in both knowledge and understanding.	**1-2 marks** **Limited analysis** Limited analysis of the impact of a deteriorating TOT on macroeconomic indicators. Chains of reasoning are undeveloped and/or superficial, and the answer lacks the use of key economic concepts.	**1-2 marks** **Limited evaluation** The answer is two-sided, but counterarguments are not well developed and/or unconvincing.
0		**0 marks** No valid knowledge or understanding.	**0 marks** No relevant analysis	**0 marks** No relevant evaluation.

Indicative content.

AO1/AO3

A deterioration in the terms of trade may indicate an improvement in price competitiveness. This is because import prices have risen more than export prices, perhaps showing that exports are more price competitive. In the medium-term demand for exports may rise and lead to an improvement in the current account.

The improvement in the current account will increase AD and via the multiplier GDP. There will be a rise in employment due to the rise in export demand and fall in imports boosting the domestic economy.

If the terms of trade have deteriorated because of a fall in the currency, low domestic inflation, improvements in efficiency and productivity then this may well stimulate growth.

AO1/AO4

A deterioration in the terms of trade may reduce the standard of living as more exports have to be sold to pay for the same volume of imports.

It could make the price of imported new technology/capital goods more expensive, which might limit productivity growth impacting on the growth in real wages and living standards.

It could also reduce export revenue as exports are cheaper and make it harder to pay foreign external debt.

If the deteriorating TOT is as a result of rising import prices as a result of a fall in the exchange rate this could lead to a rise in cost push inflation and maybe a wage price spiral.

A deteriorating TOT due to rising commodity prices may restrict access to essential raw materials, damaging growth and development.

For low-income countries, deteriorating terms of trade might lead to additional pressure on agriculture – to grow cash crops (increasing the risk of famine) or to use land more intensively, resulting in the risk of soil degradation.

Any improvement in the current account as a result of a fall in the exchange rate depends on the Marshall-Lerner condition and also the extent to which exports sell on price alone.

Judgement

Essentially much depends on the reason that terms of trade have deteriorated. Some reasons are much more favourable than others. It will also depend on the economic structure of the economy and the flexibility of product and labour markets in terms of its ability to cope with any short of shock, together, inevitably with the extent to which the terms of trade have actually deteriorated and whether the deterioration is expected to be long or short term.

Allow any other relevant points.
The answer is reversible.

AO grid

		AO1	AO2	AO3	AO4	Total
1	**1**	6		4		10
1	**2**	6		6	8	20
2	**1**	6		4		10
2	**2**	6		6	8	20
3	**1**	6		4		10
3	**2**	6		6	8	20
4	**1**	6		4		10
4	**2**	6		6	8	20
5	**1**	6		4		10
5	**2**	6		6	8	20
6	**1**	6		4		10
6	**2**	6		6	8	20
		36	**0**	**30**	**24**	**90**