

GCE AS
Economics
Summer 2009

Mark Scheme

Issued: October 2009

MARK SCHEMES (2009)

Foreword

Introduction

Mark Schemes are published to assist teachers and students in their preparation for examinations. Through the mark schemes teachers and students will be able to see what examiners are looking for in response to questions and exactly where the marks have been awarded. The publishing of the mark schemes may help to show that examiners are not concerned about finding out what a student does not know but rather with rewarding students for what they do know.

The Purpose of Mark Schemes

Examination papers are set and revised by teams of examiners and revisers appointed by the Council. The teams of examiners and revisers include experienced teachers who are familiar with the level and standards expected of 16- and 18-year-old students in schools and colleges. The job of the examiners is to set the questions and the mark schemes; and the job of the revisers is to review the questions and mark schemes commenting on a large range of issues about which they must be satisfied before the question papers and mark schemes are finalised.

The questions and the mark schemes are developed in association with each other so that the issues of differentiation and positive achievement can be addressed right from the start. Mark schemes therefore are regarded as a part of an integral process which begins with the setting of questions and ends with the marking of the examination.

The main purpose of the mark scheme is to provide a uniform basis for the marking process so that all the markers are following exactly the same instructions and making the same judgements in so far as this is possible. Before marking begins a standardising meeting is held where all the markers are briefed using the mark scheme and samples of the students' work in the form of scripts. Consideration is also given at this stage to any comments on the operational papers received from teachers and their organisations. During this meeting, and up to and including the end of the marking, there is provision for amendments to be made to the mark scheme. What is published represents this final form of the mark scheme.

It is important to recognise that in some cases there may well be other correct responses which are equally acceptable to those published: the mark scheme can only cover those responses which emerged in the examination. There may also be instances where certain judgements may have to be left to the experience of the examiner, for example, where there is no absolute correct response – all teachers will be familiar with making such judgements.

The Council hopes that the mark schemes will be viewed and used in a constructive way as a further support to the teaching and learning processes.

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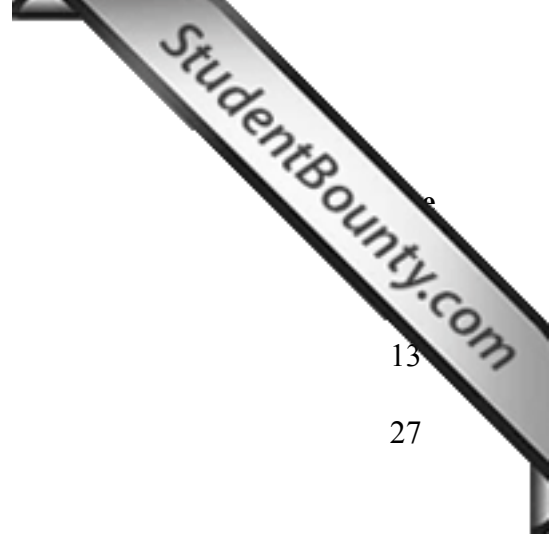
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Rewarding Learning

**ADVANCED
General Certificate of Education
2009**

Economics

Assessment Unit A2 1

assessing

Module 3: Production and Competition

[A2E11]

TUESDAY 26 MAY, MORNING

MARK SCHEME

General Marking Instructions

This mark scheme is intended to ensure that the A2 examination is marked consistently and fairly. The mark scheme provides markers with an indication of the nature and range of candidate responses that will be worthy of credit. It also sets out the criteria which they should apply in allocating marks to candidate responses. The mark scheme should be read in conjunction with these general marking instructions which apply to all papers.

Quality of candidates' responses

In marking the examination papers, examiners will be looking for a quality of response reflecting the level of maturity which may reasonably be expected of an 18-year-old which is the age at which the majority of candidates sit their A2 examinations.

Unanticipated responses

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

Positive marking

Examiners are encouraged to be positive in their marking, giving appropriate credit for valid responses rather than penalising candidates for errors or omissions. Examiners should make use of the whole of the available mark range for any particular question and be prepared to award full marks for a response which is as good as might reasonably be expected for an 18-year-old A2 candidate. Conversely, marks should only be awarded for valid responses and not given for an attempt which is completely incorrect or inappropriate.

Types of mark schemes

Mark schemes for questions which require candidates to respond in extended written form are marked on the basis of levels of response which take account of the quality of written communication. These questions are indicated on the cover of the examination paper.

Other questions which require only short answers are marked on a point for point basis with marks awarded for each valid piece of information provided.

Marking calculations

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

Quality of written communication

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

Levels of response

General descriptions of levels of response in terms of each assessment objective and the quality of written communication are given in the following table. These descriptions are intended to assist examiners in judging candidates' performance when they produce answers unanticipated by the detailed mark scheme for each question and to provide guidelines for examiners in assessing the appropriate level of response in respect of the quality of written communication.

The detailed mark schemes for each question relate these levels of response to the content of the relevant question. In deciding which mark within a particular level to award any response, examiners are expected to use their professional judgement. The following guidance is provided to assist examiners.

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

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

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

General Marking Criteria

Level of Performance	Assessment Objective	AO1 Knowledge and Understanding	AO2 Application	AO3 Analysis	AO4 Evaluation and judgement
BENEATH THRESHOLD		There may be limitations in the candidate's grasp of theoretical principles, resulting in an excessively narrow focus on the issues involved in the question.	The candidate tends to make unsubstantiated generalisations, and superficial assumptions, lacking any real awareness of contemporary events.	The candidate is likely to confuse hypotheses with facts and does not successfully account for divergences between theoretically predicted and actual outcomes of events or decisions in a real economy.	The candidate finds it difficult to pinpoint strengths or limitations of economic models and theories in explaining real world issues and problems, or to compare and contrast alternative strategies or policy instruments.
LEVEL 1					
LEVEL 2		The candidate shows sufficient knowledge of economic theory for the main issues involved in the question to be satisfactorily identified.	The candidate makes valid connections between theoretical principles and real-world events.	The candidate shows ability to identify causes of economic problems and is able to relate these insights to real economies.	The candidate shows some awareness of the strengths and limitations of different economic models, theories, decisions and policies, and attempts to support observation with appropriate references.
LEVEL 3		The candidate has a detailed knowledge of economic theory and shows a clear understanding of its significance in the specific contexts of the question.	The candidate relates concepts to situations and problems in real economies with some skill and can explain contemporary events while supporting conclusions with evidence.	The candidate is aware of the implications of hypotheses and distinguishes between association and causation in contemporary economic problems, offering valid suggestions as to how these may be addressed.	The candidate is able to critically examine alternative economic models, theories, arguments and policies in the analysis of economic problems and demonstrates the ability to evaluate the outcomes of economic decisions, supporting this with accurate reference or relevant examples.
HIGH GRADE		The candidate successfully selects and uses an appropriate form and style of writing, supported with the effective use of diagrams where appropriate. Material is organised with a high degree of clarity, coherence and widespread use of appropriate specialist vocabulary. Presentation, spelling, punctuation and grammar are of a sufficiently high standard to make meaning absolutely clear.			

- 1 (a) • This is an example of horizontal integration.
 • Horizontal integration is a merger between two firms at the same stage in the production of the same good or service.

[2] for each point explained [4]

- (b) The European airline industry displays three features of oligopoly:
 (1) There is a relatively small number of airlines,
 (2) There is a degree of interdependence and in some cases collusion between them,
 (3) There is likely to be significant non-price competition.

[3] for each feature explained and related to airline industry
 [2] for explanation of oligopoly but not related to airline industry
 Constrained maximum of [6] [6]

Level 1 ([1]–[2])

Candidate gives little explanation of why the European airline industry might be viewed as oligopolistic and quality of written communication is limited.

Level 2 ([3]–[4])

Candidate gives some explanation of why the European airline industry might be viewed as oligopolistic. However this will be incomplete or lack depth. Quality of written communication is satisfactory.

Level 3 ([5]–[6])

Candidate gives a clear and comprehensive explanation of why the European airline industry might be viewed as oligopolistic and quality of written communication is of a high standard.

- (c) There are four factors which contribute to the difficult trading conditions:
- Rising oil prices which push up the cost of flying
 - The economic slow down which has reduced demand for air travel
 - Competition from low-cost airlines has forced BA to keep ticket prices down at the same time as it is facing higher costs
 - Overcapacity on some routes has made it difficult to fill aircraft

Level 1 ([1]–[2])

Candidate provides little analysis of why airlines are experiencing “the worst trading environment the industry has ever faced”. Quality of written communication is limited.

Level 2 ([3]–[4])

Candidate provides some analysis of why airlines are experiencing “the worst trading environment the industry has ever faced.” However this may be incomplete or contain errors. Quality of written communication is satisfactory.

Level 3 ([5]–[6])

Candidate provides a clear, accurate and comprehensive analysis of why airlines are experiencing “the worst trading environment the industry has ever faced.” Quality of written communication is of a high standard. [6]

- (d) The low-cost airlines have introduced a number of “stealth price hikes” by charging for services which passengers had previously assumed to be part of the ticket price. Hence they have been able to advertise cheap fares whilst increasing the overall price to passengers.
Examples of this include charging for checking in luggage and reducing the baggage allowance so that passengers could be charged for excess baggage.

[2] for explaining the general strategy

[2] for a well explained example

[4]

- (e) The European Commission will have to consider a number of issues when deciding whether or not this proposed merger should be allowed to proceed.

These include:

- Effect of merger upon firms’ costs and efficiency
- Possibility that cost savings might be passed on to the consumer
- Impact of reduced choice and competition upon ticket prices and service to customers
- Possibility that control of landing slots at Heathrow will act as a barrier to entry to new airlines
- Analysis based on theory of contestable markets
- Possibility that BA would go bankrupt without the proposed merger

Level 1 ([1]–[3])

Candidate shows little understanding of the issues involved in the proposed merger. There is no evaluation of the view that it should be blocked, and quality of written communication is limited.

Level 2 ([4]–[7])

Candidate shows some understanding of the issues involved in the proposed merger. There is a degree of evaluation of the view that it should be blocked, though this may lack depth or be one-sided.

Quality of written communication is satisfactory.

Level 3 ([8]–[10])

Candidate shows a clear understanding of the issues involved in the proposed merger. There is in-depth evaluation, including a balanced conclusion, of the view that it should be blocked, and quality of written communication is of a high standard. [10]

(Answer **one** question)

- 2 (a) Normal profit is a level of profit which is just sufficient to keep existing firms in business but not sufficient to attract new firms. It will be a return on capital which is just above the market rate of interest, meaning the proprietors are slightly better off than they would be by selling the business and putting the proceeds in the bank.
Normal profit is included as a cost of production and so will be achieved when average cost equals average revenue.

Level 1 ([1]–[2])

Candidate shows little knowledge or understanding of normal profit. There is no significant development through diagrams, technical language or appropriate examples. Quality of written communication is limited.

Level 2 ([3]–[4])

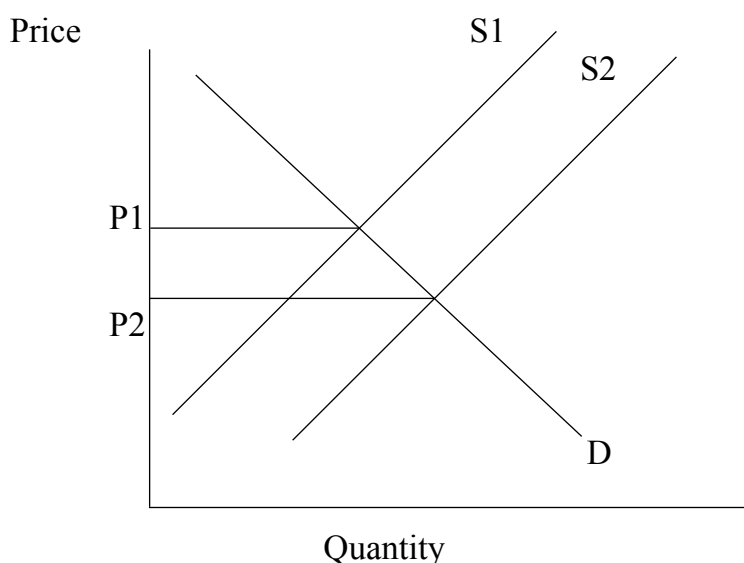
Candidate shows some knowledge and understanding of normal profit. There is a degree of development through diagrams, technical language or appropriate examples. Quality of written communication is satisfactory.

Level 3 ([5]–[6])

Candidate shows detailed knowledge and understanding of normal profit. There is significant development through diagrams, technical language or appropriate examples. Quality of written communication is of a high standard.

[6]

- (b) The long-run equilibrium of the firm in perfect competition is one in which only normal profits are earned.
This is the result of the existence of perfect knowledge and the absence of barriers to entry, hence supernormal profits will inevitably attract in new firms, increasing supply and reducing price until only normal profits are earned.



S1 is the supply curve whilst supernormal profits are earned and before the entry of new firms.

S2 is the supply curve after the entry of additional firms.

The original price of P1 allowed firms to earn supernormal profits but the new price of P2 allows them only normal profits.

All of this analysis may operate in reverse if firms are operating at a loss in the short run. In this case firms will leave the industry, causing price to rise until losses are eliminated and normal profits are restored.

Candidates should also illustrate this process by examining costs, revenue and profit for the individual firm in perfect competition.

Level 1 ([1]–[4])

Candidate provides little explanation of the relevant features of perfect competition. There is no significant economic analysis through diagrams, technical language or economic models, and quality of written communication is limited.

Level 2 ([5]–[8])

Candidate provides some explanation of the relevant features of perfect competition. There is a degree of analysis through diagrams, technical language and economic models, and quality of written communication is satisfactory.

Level 3 ([9]–[12])

Candidate provides a clear explanation of the relevant features of perfect competition. There is extensive analysis through diagrams, technical language and economic models, and quality of written communication is of a high standard. [12]

- (c) The model of perfect competition requires the existence of a number of highly abstract and unrealistic conditions.

Firstly, there must be so many buyers and sellers that no individual buyer or seller has sufficient market share to have any influence on market price. Secondly, all firms must produce an identical (homogenous) product so that there is no reason for buyers to prefer the output of one firm to that of any other firm. This precludes the existence of branding or any form of product differentiation.

Thirdly, there cannot be any barriers to the entry or exit of firms to and from the industry which is why only normal profits may be earned in the long run. Fourthly, it is assumed that both firms and consumers are in possession of all relevant information when making decisions. Otherwise known as perfect knowledge this condition has a number of implications, not least the existence of only one price throughout the entire market for the product. Finally, it is required that all firms face similar cost functions so that no firm has a cost or technological advantage.

Clearly these conditions are most unlikely to be replicated in the real world. They do however provide a benchmark against which “real” world situations may be compared. However, some economists have argued that it is pointless to strive for an impossible ideal when the more realistic alternative of contestable markets is achievable.

The theory of contestable markets describes a world in which producers find themselves in a similar situation to perfect competition without having to meet all the conditions for perfect competition. Contestable market theory focuses not on the number of competing firms within the industry but on the potential entrants who might enter the industry if the profits were sufficiently high.

This requires entry barriers to be sufficiently low as to permit new entrants and also that there be no significant sunk costs which might prevent firms withdrawing from the industry.

Where these conditions exist it is possible for hit-and-run competition to take place. Hence existing firms live in constant fear of hit-and-run type competition and the only thing which can deter such entrants is that prices and profits are too low to make it attractive. So normal profits can be achieved even in the absence of perfect competition. However a perfectly contestable market is just as unrealistic as a perfectly competitive one.

Level 1 ([1]–[4])

Candidate displays only a limited understanding of the relative merits of perfect competition and contestable markets as economic models. There is little attempt at making judgements or stating conclusions. Quality of written communication is limited.

Level 2 ([5]–[8])

Candidate displays some understanding of the relative merits of perfect competition and contestable markets as economic models. There are significant attempts at making judgements, prioritising arguments or presenting conclusions. However, this will lack depth or be one-sided. Quality of written communication is satisfactory.

Level 3 ([9]–[12])

Candidate displays a clear understanding of the relative merits of perfect competition and contestable markets as economic models. There is extensive evidence of making judgements, prioritising arguments and presenting conclusions. Quality of written communication is of a high standard. [12]

30

- 3 (a) In the short run the firm will have some costs which will remain FIXED no matter what the level of output. It will also have costs which VARY directly with the level of output. In the long run the firm will be able to adjust all of its factor inputs and hence all of its costs so that there are no fixed costs. Some costs have both a fixed and variable element.

Maximum [3] for definition and [3] for explanation and development

Level 1 ([1]–[2])

Candidate shows little understanding of the difference between a firm's costs in the short run and the long run. There is no significant development, and quality of written communication is limited.

Level 2 ([3]–[4])

Candidate shows some understanding of the difference between a firm's costs in the short run and the long run. There is a degree of development, and quality of written communication is satisfactory.

Level 3 ([5]–[6])

Candidate shows a clear understanding of the difference between a firm's costs in the short run and the long run. There is significant development, and quality of written communication is of a high standard. [6]

- (b) A firm's long-run average cost curve is based on the existence of increasing and decreasing returns to scale as a result of economies and diseconomies of scale. Candidates should explain these and the impact which they have on long-run average cost. Most candidates will explain the traditional U-shaped curve but credit will also be given for an explanation of the L-shaped curve.

Issues for analysis and discussion include:

- Explanation of connection between returns to scale and long-run average costs
- Explanation of economies and diseconomies of scale
- Explanation of the "envelope" type relationship between long and short-run average costs curves
- Explanation of L-shaped curve
- Explanation of cost elevation and slope of the curve
- Appropriate diagrams

Level 1 ([1]–[4])

Candidates will typically display some awareness of the shape of a firm's long-run average cost curve but provides no significant analysis of the factors which determine it. Quality of written communication is limited.

Level 2 ([5]–[8])

Candidates display an awareness of the shape of a firm's long-run average cost curve and some analysis of the factors which determine it. However, this analysis is likely to be confined to an explanation of economies and diseconomies of scale with no reference to the "envelope" relationship nor the L-shaped curve. Quality of written communication is satisfactory.

Level 3 ([9]–[12])

Candidates provide an in-depth analysis of the shape of a firm’s long-run average cost curve and this will go beyond an explanation of economies and diseconomies of scale. Quality of written communication is of a high standard.

[12]

(c) The Internet has radically transformed the environment in which UK firms operate.

It has allowed relatively small firms to compete with large firms without the need for expensive premises and associated high fixed costs. Obvious examples are travel agents, betting exchanges, banks and so on. It is perfectly possible to sell holidays, financial services and a range of other products via the Internet and to do so with a minimum of set up costs.

The Internet has also revolutionised the ease with which documents and data can be transferred. E-mailing is cheaper and quicker than postal services and there has been a consequential reduction in costs.

Consumers are now better informed than ever and there are significantly fewer opportunities for firms to engage in price discrimination and to earn abnormal profits.

Issues for analysis and discussion include:

- Explanation of working of net
- Electronic communication
- Internet advertising
- Reduced premises costs
- Reduced communication costs
- Possible increased equipment costs
- Possible increased training costs
- Consumers are closer to perfect knowledge
- Large firms may also benefit from the Internet.

Level 1 ([1]–[4])

Candidate shows little awareness of the impact of the Internet upon the business environment in the UK. There is no significant evaluation of how firms are likely to be affected. Quality of written communication is limited.

Level 2 ([5]–[8])

Candidate shows some awareness of the impact of the Internet upon the business environment in the UK. There is a degree of evaluation of how firms are likely to be affected. However, this may lack depth or be one-sided. Quality of written communication is satisfactory.

Level 3 ([9]–[12])

Candidate shows extensive awareness of the impact of the Internet upon the business environment in the UK. There is widespread evaluation including a balanced conclusion of how firms are likely to be affected. Quality of written communication is of a high standard.

[12]

30

Total

60



Rewarding Learning

**ADVANCED
General Certificate of Education
2009**

Economics

Assessment Unit A2 2

assessing

Module 4: The International Economy

[A2E21]

FRIDAY 29 MAY, MORNING

MARK SCHEME

General Marking Instructions

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Unanticipated responses

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Types of mark schemes

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Other questions which require only short answers are marked on a point for point basis with marks awarded for each valid piece of information provided.

Marking calculations

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

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Levels of response

General descriptions of levels of response in terms of each assessment objective and the quality of written communication are given in the following table. These descriptions are intended to assist examiners in judging candidates' performance when they produce answers unanticipated by the detailed mark scheme for each question and to provide guidelines for examiners in assessing the appropriate level of response in respect of the quality of written communication.

The detailed mark schemes for each question relate these levels of response to the content of the relevant question. In deciding which mark within a particular level to award any response, examiners are expected to use their professional judgement. The following guidance is provided to assist examiners.

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

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

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

General Marking Criteria

Level of Performance BENEATH THRESHOLD	Assessment Objective	AO1 Knowledge and Understanding	AO2 Application	AO3 Analysis	AO4 Evaluation and judgement
LEVEL 1		<p>There may be limitations in the candidate's grasp of theoretical principles, resulting in an excessively narrow focus on the issues involved in the question.</p>	<p>The candidate tends to make unsubstantiated generalisations, and superficial assumptions, lacking any real awareness of contemporary events.</p>	<p>The candidate is likely to confuse hypotheses with facts and does not successfully account for divergences between theoretically predicted and actual outcomes of events or decisions in a real economy.</p>	<p>The candidate finds it difficult to pinpoint strengths or limitations of economic models and theories in explaining real world issues and problems, or to compare and contrast alternative strategies or policy instruments.</p>
LEVEL 2		<p>The candidate shows sufficient knowledge of economic theory for the main issues involved in the question to be satisfactorily identified.</p>	<p>The candidate makes valid connections between theoretical principles and real-world events.</p>	<p>The candidate shows ability to identify causes of economic problems and is able to relate these insights to real economies.</p>	<p>The candidate shows some awareness of the strengths and limitations of different economic models, theories, decisions and policies, and attempts to support observation with appropriate references.</p>
LEVEL 3		<p>The candidate has a detailed knowledge of economic theory and shows a clear understanding of its significance in the specific contexts of the question.</p>	<p>The candidate relates concepts to situations and problems in real economies with some skill and can explain contemporary events while supporting conclusions with evidence.</p>	<p>The candidate is aware of the implications of hypotheses and distinguishes between association and causation in contemporary economic problems, offering valid suggestions as to how these may be addressed.</p>	<p>The candidate is able to critically examine alternative economic models, theories, arguments and policies in the analysis of economic problems and demonstrates the ability to evaluate the outcomes of economic decisions, supporting this with accurate reference or relevant examples.</p>
HIGH GRADE		<p>The candidate successfully selects and uses an appropriate form and style of writing, supported with the effective use of diagrams where appropriate. Material is organised with a high degree of clarity, coherence and widespread use of appropriate specialist vocabulary. Presentation, spelling, punctuation and grammar are of a sufficiently high standard to make meaning absolutely clear.</p>			

- 1 (a) The current account section of the balance of payments consists primarily of payments in connection with the export and import of goods and services. However, it does also contain figures for income and current transfers.

Goods [1]
 Services [1]
 Income [1]
 Transfers [1] [4]
 Just list with no explanation, maximum [2]

- (b) There are a number of significant differences between the UK and the Irish balance of payments on current account. These include:

- Ireland has trade in goods surplus (22 459m Euros) whilst the UK has a significant deficit (£89 515m)
- Ireland has trade in services deficit (2869m Euros) whilst the UK has a surplus (£38 331m)
- Ireland has a large deficit on income (28 608m Euros) whilst the UK has a surplus (£5302m)
- although Ireland's deficit is smaller in absolute terms, it is a greater percentage of GDP

[2] for each point identified and developed
 [1] for identifying a difference which is not economically significant,
 e.g. UK has a larger balance of payments deficit than Ireland [6]

Level 1 ([1]–[2])

Candidate fail to identify any major differences between the UK and Ireland's balance of payments on current account. Any points made are peripheral or wrongly interpreted and quality of written communication is limited.

Level 2 ([3]–[4])

Candidate identifies some of the major differences between the UK and Ireland's balance of payments on current account. However key points are missed. Quality of written communication is satisfactory.

Level 3 ([5]–[6])

Candidate identifies all major differences between the UK and Ireland's balance of payments on current account and makes some use of the data. Quality of written communication is of a high standard.

- (c) • The significant difference between Irish and UK **trade in goods** is due to Ireland having a larger manufacturing base than the UK, much of which has been created by high levels of FDI. Ireland being a net food exporter is another important factor
- A totally different picture is apparent in **trade in services**. The UK surplus is due to the success of the City of London as a financial centre. Similar facilities are not available in Ireland which is a net importer of services
 - The negative **income** figure for Ireland is partly a reflection of its success in attracting the FDI which gave it a surplus in trade in goods. Foreign manufacturers will repatriate much of their profits, hence creating a net outflow. The UK has a net inflow because of the large number of UK firms operating overseas

- The Irish deficit is relatively higher because the summation of the credits and debits represents a higher percentage of GDP
- Maximum of [3] for any point well explained and developed
 Constrained maximum of [6] [6]

Level 1 ([1]–[2])

Candidate provides no significant explanation of any of the major differences between the UK and Ireland’s balance of payments on current account and quality of written communication is limited.

Level 2 ([3]–[4])

Candidate provides some explanation of the major differences between the UK and Ireland’s balance of payments on current account. However this may be incomplete or lack depth and quality of written communication is satisfactory.

Level 3 ([5]–[6])

Candidate provides a clear and comprehensive explanation of two major differences between the UK and Ireland’s balance of payments on current account. Alternatively this level may be achieved by a less detailed explanation of 3 differences. Quality of written communication is of a high standard.

(d) The significance of the magnitude of any economic variable can only be assessed by placing it in context. This can be done in two ways:

- Adjusting the figures to remove the impact of inflation, i.e. measuring the size of the deficit in real terms by using the constant prices of some previous year
- Expressing the deficit as a percentage of the size of the nation’s economy, i.e. as a percentage of GDP. For example, the Irish deficit is smaller than the UK deficit but represents a larger percentage of Irish GDP. Furthermore, if the deficit increases at a slower rate than the rate of economic growth then it will decline as a percentage of GDP
- The figures relate to only one year and may not be part of a general trend
- The economic significance of a current account deficit in general terms

[3] for each point explained
 Constrained maximum of [6] [6]

Level 1 ([1]–[2])

Candidate provides little explanation of why the increase in the UK current account deficit might not be as significant as it appeared. There may be references to inflation and economic growth but no significant explanation. Quality of written communication is limited.

Level 2 ([3]–[4])

Candidate provides some explanation of why the increase in the UK current account deficit might not be as significant as it appeared. There will be references to inflation and economic growth with a degree of explanation. Quality of written communication is satisfactory.

Level 3 ([5]–[6])

Candidate provides a clear and comprehensive explanation of why the increase in the UK current account deficit might not be as significant as it appeared. There will be references to inflation and economic growth with extensive explanation. Quality of written communication is of a high standard.

- (e) The Balance of Payments is similar to any record of receipts and payments in that every payment had to be financed by a similar receipt otherwise it could not have taken place. Foreign borrowing and drawing on reserves are regarded as receipts and if these items are added to net investment flows then the balance of payments should balance and sum to zero as shown below. In the event that the recorded data does not produce a zero balance, then this is corrected by the inclusion of the ‘net errors and omissions’ item.

Balance of Payments Anyland	
Current Account Balance	–80
Financial and Capital Account Balances	70
Net errors and omissions	<u>10</u>
Overall Balance	<u>0</u>

Level 1 ([1]–[2])

Candidate shows little understanding of the composition of the balance of payments and is unable to provide an explanation of why the overall account must always balance. Quality of written communication is limited.

Level 2 ([3]–[5])

Candidate shows some understanding of the composition of the balance of payments and gives a degree of explanation as to why the overall account must always balance. However, this is likely to be incomplete or contain minor errors. Quality of written communication is satisfactory

Level 3 ([6]–[8])

Candidate shows a clear understanding of the composition of the balance of payments and provides a comprehensive and accurate explanation of why the overall account must always balance. Quality of written communication is of a high standard. [8]

- (f) When the UK, in common with most of the world’s major economies, operated under a fixed exchange rate regime this was actually the case. A persistent balance of payments deficit would undermine the value of the pound forcing the government to increase interest rates or engage in support buying of sterling in forex markets. Rates would have been increased irrespective of their impact on growth and unemployment; so to all intents and purposes the balance of payments and the value of the pound was the government’s main economic priority.
 Under a floating exchange rate regime governments can take a much more relaxed view of the external balance and in recent years have tended to virtually ignore it as a policy objective.
 However a persistent and significant deficit is economically significant and corrective measures will eventually have to be taken:

Issues for analysis and evaluation include:

- Assessment of significance of deficit
- Impact on exchange rate
- Fixed and floating exchange rates
- Floating rates as automatic corrective mechanism for balance of payments deficits
- Impact on employment
- Impact on investor confidence
- Problems of borrowing to finance deficit
- Historical and international examples

Level 1 ([1]–[3])

Candidate shows little understanding of the government's main economic priorities. There is no evaluation of the relative importance of reducing a balance of payments deficit in comparison to the other priorities. Quality of written communication is limited.

Level 2 ([4]–[7])

Candidate shows some understanding of the government's main economic priorities. There is a degree of evaluation of the relative importance of reducing a balance of payments deficit in comparison to the other priorities. However, this may lack depth, or be one-sided. Quality of written communication is satisfactory.

Level 3 ([8]–[10])

Candidate shows a clear understanding of the government's main economic priorities. There is a meaningful evaluation of the relative importance of reducing a balance of payments deficit in comparison to the other priorities and this is supported by a balanced conclusion. Quality of written communication is of a high standard.

[10]

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(Answer **one** question)

- 2 (a) A single market has all the features of a customs union but contains some additional levels of economic integration. Its purpose is to eliminate all trading differences so that businesses can trade anywhere within the single market on exactly the same basis as they trade in their own domestic market. To achieve this will require a number of reforms:
- Identical product standards between countries
 - Harmonisation of tax rates between countries
 - Single European currency
 - Removal of all trade barriers
 - Free movement of capital and labour

Level 1 ([1]–[2])

Candidate displays no significant understanding of the features of the Single European Market and quality of written communication is limited.

Level 2 ([3]–[5])

Candidate displays some understanding of the features of the Single European Market though this is likely to be incomplete. Quality of written communication is satisfactory.

Level 3 ([6]–[8])

Candidate displays a clear and comprehensive understanding of the features of the Single European Market and quality of written communication is of a high standard. [8]

- (b) Membership of the EU has affected Northern Ireland in a variety of ways:
- The CAP has provided generous subsidy payments to Northern Ireland farmers and since agriculture is the Province's largest private sector employer this is a significant fiscal transfer
 - Northern Ireland has received substantial payments from the European Social and Regional funds
 - Discussion of additionality and whether or not EU funding has simply replaced UK central government funding
 - Enlargement has reduced the funds available to Northern Ireland
 - Enlargement has brought an influx of migrant labour. This has helped local employers and consumers but some groups of workers have experienced downward pressure on wages and increased competition for employment
 - Membership has made Northern Ireland a more attractive place for FDI

Level 1 ([1]–[5])

Candidate provides no significant analysis of the impact of EU membership upon the Northern Ireland economy. Quality of written communication is limited.

Level 2 ([6]–[11])

Candidate provides some analysis of the impact of EU membership upon the Northern Ireland economy. However, this will be incomplete or contain minor errors. Quality of written communication is satisfactory.

Level 3 ([12]–[16])

Candidate provides a clear and accurate analysis of the impact of EU membership upon the Northern Ireland economy. Quality of written communication is of a high standard.

[16]

- (c) UK membership of the Euro was once a hotly debated political issue. This seems (September 2008) to be no longer the case with a political consensus that membership is unlikely to happen for the foreseeable future.

Issues for analysis and evaluation include:

- Transition costs, e.g. changing slot machines etc.
- Reduced transaction cost for trade and travel
- Increased specialisation and efficiency as a result of reduced transaction costs
- More opportunities to achieve economies of scale
- Greater price transparency should lead to downward pressure on prices
- Problems arising from a common interest rate throughout the Euro zone area
- Problems arising from inability to devalue currency as a means of correcting imbalances
- Specific issues for Northern Ireland arising from sharing land border with Euro zone country
- Increased FDI

Level 1 ([1]–[5])

Candidate displays no significant understanding of the issues involved in UK membership of the Euro. There is no serious evaluation and quality of written communication is limited.

Level 2 ([6]–[11])

Candidate displays some understanding of the issues involved in UK membership of the Euro. There is a degree of evaluation, though this may lack depth, or be one-sided. Quality of written communication is satisfactory.

Level 3 ([12]–[16])

Candidate displays a clear understanding of the issues involved in UK membership of the Euro. There is in-depth evaluation, including a balanced conclusion, and quality of written communication is of a high standard. [16]

40

- 3 (a) A country has absolute advantage in trade in a particular good with another country if it can produce that good using fewer resources. This usually means that its cost will be lower in money terms.

A country has comparative advantage in trade in a particular good with another country if it can produce it at a lower opportunity cost. In other words comparative advantage is based on relative rather than absolute efficiency. In this model a nation should specialise in the production of the item in which it has the greater efficiency advantage over its trading partner.

The two models could be illustrated using numerical examples.

Level 1 ([1]–[2])

Candidate displays no significant understanding of either absolute or comparative advantage. There may be vague references to efficiency but this is not developed, and quality of written communication is limited.

Level 2 ([3]–[5])

Candidate displays some understanding of both absolute and comparative advantage. However, this explanation will be incomplete or contain minor errors. Quality of written communication is satisfactory.

Level 3 ([6]–[8])

Candidate gives a clear explanation of both absolute and comparative advantage and highlights the difference between them. Quality of written communication is of a high standard.

[8]

- (b) David Ricardo who developed the model of comparative advantage in the early 19th century argued that specialising according to the concept of comparative advantage would increase the total value of world output and create higher levels of economic growth. This would still be true even when one country had an absolute advantage over another in both products. Trade could still benefit both so long as they had different opportunity cost ratios. The more efficient nation should specialise in the sector in which its advantage was most marked and discontinue production of the other item, hence releasing resources for the more valuable item.

Issues for analysis and discussion include:

- Assumptions of the model of comparative advantage such as zero transport costs
- The two country, two product model
- Analysis showing different opportunity cost ratios
- Analysis showing increased welfare for both consumers and producers as a result of specialisation and trade

Level 1 ([1]–[5])

Candidate gives no significant explanation how the theory of comparative advantage may cause a nation to import products which it could produce more cheaply itself. There is no credible attempt at a numerical example, and quality of written communication is limited.

Level 2 ([6]–[11])

Candidate gives a partial explanation how the theory of comparative advantage may cause a nation to import products which it could produce more cheaply itself. There is a credible attempt at a numerical example though this may contain errors. Quality of written communication is satisfactory.

Level 3 ([12]–[16])

Candidate gives a clear explanation how the theory of comparative advantage may cause a nation to import products which it could produce more cheaply itself. There is an accurate numerical example, and quality of written communication is of a high standard. [16]

- (c) The theory of comparative advantage is a simple model based on a number of unrealistic assumptions such as zero transport and other transaction costs. Since these conditions are unlikely to be replicated in the real world it follows that conclusions based on the theory may be flawed.

Issues for evaluation and discussion include:

- The immobility of resources
- The time taken for adjustment may be so long as to make the process irrelevant
- Economies of scale may create dynamic comparative advantage
- Infant industries may grow and achieve dynamic comparative advantage
- The gains from trade may be unevenly distributed
- Possibility of validity of comparative advantage as a decision making instrument

Level 1 ([1]–[5])

Candidate displays little understanding of the conditions attached to the theory of comparative advantage and provides no evaluation of the validity of using the theory to justify free trade. Quality of written communication is limited.

Level 2 ([6]–[11])

Candidate displays some understanding of the conditions attached to the theory of comparative advantage and provides a degree of evaluation of the validity of using the theory to justify free trade. However, this may lack depth or be one-sided. Quality of written communication is satisfactory.

Level 3 ([12]–[16])

Candidate displays a clear understanding of the conditions attached to the theory of comparative advantage and provides in-depth evaluation of the validity of using the theory to justify free trade. There is a balanced conclusion, and quality of written communication is of a high standard. [16]

- 4 (a) Formal barriers are clear and open. They are import controls, such as tariffs and quotas, imposed by governments and are there for the specific purpose of restricting imports.

Hidden barriers are imposed when a government wishes to restrict imports without doing so formally. This might be because of membership of the EU or not wishing to be in breach of WTO regulations. In these circumstances governments will twist health and safety regulations or customs procedures so as to place obstacles in the way of imports.

A classic example of this is the French decree in 1982 that all Japanese videocassette recorders had to pass through the tiny customs post at Poitiers. This effectively restricted imports without any formal import control. Other examples are the French ban on British beef long after BSE had been eliminated and the EU ban on American beef which has been injected with growth hormones.

Level 1 ([1]–[2])

Candidate displays little understanding of formal and hidden trade barriers and fails to explain the difference between them. Quality of written communication is limited.

Level 2 ([3]–[5])

Candidate displays some understanding of formal and hidden trade barriers and gives a basic explanation of the difference between them. Quality of written communication is satisfactory.

Level 3 ([6]–[8])

Candidate displays a clear understanding of formal and hidden trade barriers and gives a detailed explanation of the difference between them. Appropriate examples are given. Quality of written communication is of a high standard.

[8]

- (b) Business owners and trade unions are the most vociferous lobbyists for protectionist measures. They argue that cheap imports represent some form of “unfair” competition and if not restricted will result in the closure of firms and the loss of jobs.

Consumers on the other hand are very happy with cheap imports. Most of us enjoy relatively cheap clothing and electrical goods and few would wish to pay more in order to protect local businesses and jobs.

Issues for analysis and discussion include:

- Impact of barriers on producer surplus
- Impact of barriers on consumer surplus
- Impact of barriers on government revenue
- Net impact of barriers on overall national welfare
- Environmental impact of barriers
- Evaluation of fair and unfair competition
- Issues surrounding infant and strategic industries

Level 1 ([1]–[5])

Candidate provides little economic analysis of the impact of trade barriers upon an economy. Quality of written communication is limited.

Level 2 ([6]–[11])

Candidate provides some economic analysis of the impact of trade barriers upon an economy. However, this is likely to be incomplete or contain minor errors. Quality of written communication is satisfactory.

Level 3 ([12]–[16])

Candidate provides a clear and accurate economic analysis of the impact of trade barriers upon all economic agents, including consumers. Quality of written communication is of a high standard. [16]

- (c) European and American farmers receive high levels of government support and protection. In the EU this is administered through the CAP which is the largest single item in the EU budget, representing over 40% of total spending. Farmers are protected against cheaper food imports from low cost producers by tariff barriers. Third world farmers find it difficult to export to the EU and the USA because of protectionist measures and face competition in their own domestic markets from subsidised European and American exports. It was the issue of Indian protection against subsidised food exports which finally collapsed the Doha world trade talks.

Issues for analysis and evaluation include:

- Explanation of the regime of support for European and American agriculture
- Evaluation of arguments for this support, e.g. need to treat agriculture as a strategic industry
- Costs of agricultural support to taxpayers and food consumers
- Impact of agricultural protection on third world producers
- Experience of countries like New Zealand which have abolished government support for agriculture
- Positive externalities from a well maintained countryside

Level 1 ([1]–[5])

Candidate shows little understanding of the issues involved in removing government support and protection from agriculture. There is no significant evaluation, and quality of written communication is limited.

Level 2 ([6]–[11])

Candidate shows some understanding of the issues involved in removing government support and protection from agriculture. There is a degree of evaluation, though this will lack depth, or be one-sided. Quality of written communication is satisfactory.

Level 3 ([12]–[16])

Candidate shows a clear understanding of the issues involved in removing government support and protection from agriculture. There is an extensive evaluation, including a balanced conclusion, and quality of written communication is of a high standard. [16]

Total

40

80



Rewarding Learning

ADVANCED
General Certificate of Education
2009

Economics

Assessment Unit A2 3

assessing

**Module 5: Economic Development
and the Environment and
Module 6: Financial Economics**

[A2E31]

WEDNESDAY 3 JUNE, AFTERNOON

MARK SCHEME

General Marking Instructions

Mark schemes are intended to ensure that the A2 examination is marked consistently and fairly. Each mark scheme provides markers with an indication of the nature and range of candidate responses likely to be worthy of credit. It also sets out the criteria which they should apply in allocating marks to candidate responses. The mark scheme should be read in conjunction with these general marking instructions which apply to all papers.

Quality of candidates' responses

In marking the examination papers, examiners will be looking for a quality of response reflecting the level of maturity which may reasonably be expected of an 18-year-old which is the age at which the majority of candidates sit their A2 examinations.

Unanticipated responses

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

Positive marking

Examiners are encouraged to be positive in their marking, giving appropriate credit for valid responses rather than penalising candidates for errors or omissions. Examiners should make use of the whole of the available mark range for any particular question and be prepared to award full marks for a response which is as good as might reasonably be expected for an 18-year-old A2 candidate. Conversely, marks should only be awarded for valid responses and not given for an attempt which is completely incorrect or inappropriate.

Types of mark schemes

Mark schemes for questions which require candidates to respond in extended written form are marked on the basis of levels of response which take account of the quality of written communication. These questions are indicated on the cover of the examination paper.

Other questions which require only short answers are marked on a point for point basis with marks awarded for each valid piece of information provided.

Marking calculations

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

Quality of written communication

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

Levels of response

General descriptions of levels of response in terms of each assessment objective and the quality of written communication are given in the following table. These descriptions are intended to assist examiners in judging candidates' performance when they produce answers unanticipated by the detailed mark scheme for each question and to provide guidelines for examiners in assessing the appropriate level of response in respect of the quality of written communication.

The detailed mark schemes for each question relate these levels of response to the content of the relevant question. In deciding which mark within a particular level to award any response, examiners are expected to use their professional judgement. The following guidance is provided to assist examiners.

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

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

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

General Marking Criteria

Level of Performance	Assessment Objective	AO1 Knowledge and Understanding	AO2 Application	AO3 Analysis	AO4 Evaluation and judgement
BENEATH THRESHOLD		There may be limitations in the candidate's grasp of theoretical principles, resulting in an excessively narrow focus on the issues involved in the question.	The candidate tends to make unsubstantiated generalisations, and superficial assumptions, lacking any real awareness of contemporary events.	The candidate is likely to confuse hypotheses with facts and does not successfully account for divergences between theoretically predicted and actual outcomes of events or decisions in a real economy.	The candidate finds it difficult to pinpoint strengths or limitations of economic models and theories in explaining real world issues and problems, or to compare and contrast alternative strategies or policy instruments.
LEVEL 1					
LEVEL 2		The candidate shows sufficient knowledge of economic theory for the main issues involved in the question to be satisfactorily identified.	The candidate makes valid connections between theoretical principles and real-world events.	The candidate shows ability to identify causes of economic problems and is able to relate these insights to real economies.	The candidate shows some awareness of the strengths and limitations of different economic models, theories, decisions and policies, and attempts to support observation with appropriate references.
LEVEL 3		The candidate makes a reasonable attempt to select and use an appropriate form and style of writing, supported with appropriate use of diagrams. Relevant material is organised with some clarity and coherence and some use of specialist vocabulary. Presentation, spelling, punctuation and grammar are sufficiently competent to make meaning evident.	The candidate relates concepts to situations and problems in real economies with some skill and can explain contemporary events while supporting conclusions with evidence.	The candidate is aware of the implications of hypotheses and distinguishes between association and causation in contemporary economic problems, offering valid suggestions as to how these may be addressed.	The candidate is able to critically examine alternative economic models, theories, arguments and policies in the analysis of economic problems and demonstrates the ability to evaluate the outcomes of economic decisions, supporting this with accurate reference or relevant examples.
HIGH GRADE		The candidate successfully selects and uses an appropriate form and style of writing, supported with the effective use of diagrams where appropriate. Material is organised with a high degree of clarity, coherence and widespread use of appropriate specialist vocabulary. Presentation, spelling, punctuation and grammar are of a sufficiently high standard to make meaning absolutely clear.			

Module 5: Economic Development and the Environment

- 1 (a) Organic farming is agriculture without use of genetically-modified crops, chemical fertilisers and pesticides, and livestock growth enhancers.

It may be harmful to the environment for the following reasons:

- It will be necessary for the world at least to sustain current levels of food production
- Organic methods of producing food may use seed which is more prone to disease or attack by pests, and involve use of non-chemical fertilisers which give lower yields than chemical ones
- More land would need to be cultivated and possibly more energy expended for the same amount of food as current technologically-aided farming methods yield
- Making more land available for agriculture may mean more deforestation with consequently more global warming

Level 1 ([1]–[2])

Candidates show little understanding of how organic farming may harm the environment. They may understand some relevant concepts but are unable to explain the real limitations of organic farming. Quality of written communication is limited.

Level 2 ([3]–[4])

Candidates show some understanding of how organic farming may actually harm the environment and why current technologically-aided farming methods may be more efficient. Quality of written communication is satisfactory.

Level 3 ([5]–[6])

Candidates show a clear insight into possible problems posed by increased use of organic farming methods. Quality of written communication is of a high standard. [6]

- (b) The key issue is that it is not only subsidised imports from MEDCs which threaten sales of the produce of African farmers, but that many products on sale in African markets may have been produced more efficiently elsewhere, as in the case of unsubsidised rice grown in Asia. African producers may not have identified the areas in which they have comparative advantage.

Award up to [4] for the insight in the first sentence above. Up to [2] may be earned, depending on quality of presentation, if the answer concentrates on explaining how subsidies affect domestic and external markets. [1] may be awarded for digression into standard analysis of apparent benefits/actual drawbacks of tariffs if this is the sole content of the answer [4]

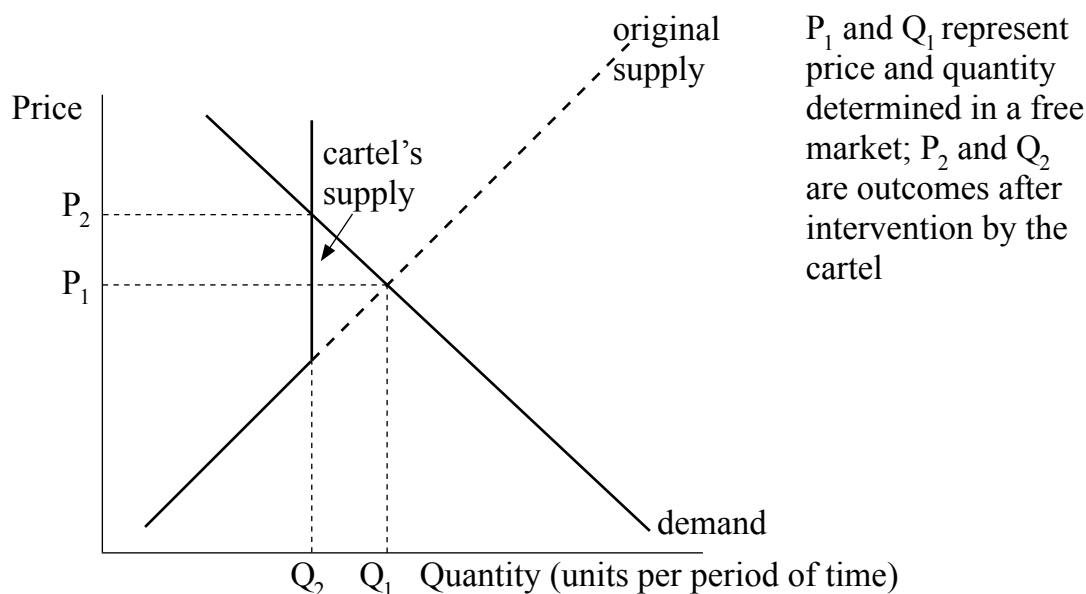
- (c) (i) An international cartel is an **organisation of producers in different countries**, which aims to **fix the prices of their products** in world markets by controlling supply. OPEC is an example of such a cartel.

Inclusion of each of the points emboldened should earn [1] [2]

(ii) A basically competent answer will demonstrate the following analysis: Cartels exist to try to raise the prices of their products by restricting supply. The artificial market shortage they create causes equilibrium price to rise.

A cartel restricts supply to a particular level and creates an artificial supply curve. This may be illustrated below.

Candidates will, however, earn credit for diagrams which show any movement of all or part of the supply curve to the left of an original position.



Candidates with additional insight will explain that the effects on price of a given quantity reduction in supply will be much greater, the lower the respective elasticities of supply and demand for the products in question.

Level 1 ([1]–[2])

Candidates provide little analysis of how a cartel of coffee producing nations could influence the price of coffee. They do not progress much beyond identifying the relevant information from the passage. Quality of written communication is limited.

Level 2 ([3]–[5])

Candidates provide some analysis of how a cartel of coffee producing nations could influence the price of coffee. They examine the intended effects of the operation of a cartel, although some elements may not be wholly accurate. Quality of written communication is satisfactory.

Level 3 ([6]–[8])

Candidates provide a clear analysis of how a cartel might affect world coffee prices, and demonstrate some understanding of factors which might limit the success of such schemes. Quality of written communication is of a high standard.

[8]

- (d) Good answers will include two evaluative elements – firstly, of the proposition that retailers in MEDCs may be guilty of exploiting “Fairtrade” for commercial gain (as strategies for branding and price discrimination, or for promotional purposes) and secondly, of the supposed benefits of Fairtrade itself.

Issues, analysis and areas for discussion include:

- consideration of such cases as the “Costa Coffee” example
- comparisons with other commercial “initiatives” – e.g. on environmental issues
- recognition that provision of Fairtrade ranges does respond to consumer demand
- mention of differences in goals of real-world enterprises
- defence of Fairtrade on grounds detailed in paragraph 6
- risk that Fairtrade premiums may mask changes caused by market forces and thus cause inefficient allocation of resources to endure longer than necessary
- negative impact on producers who miss out on “Fairtrade” status
- possibilities for political interference by NGOs and external agencies

Level 1 ([1]–[3])

Candidates show little understanding of the relevant issues. Such points as are presented lack evaluation and there is no formal conclusion. Quality of written communication is limited.

Level 2 ([4]–[7])

Candidates show some understanding of the relevant issues and there is a degree of evaluation of the proposition. However, this may lack both balance and depth. Quality of written communication is satisfactory.

Level 3 ([8]–[10])

Candidates show a clear understanding of the relevant issues and there is genuine evaluation, which recognises both sides of each of the main issues involved. Arguments are summarised in a balanced conclusion. Quality of written communication is of a high standard.

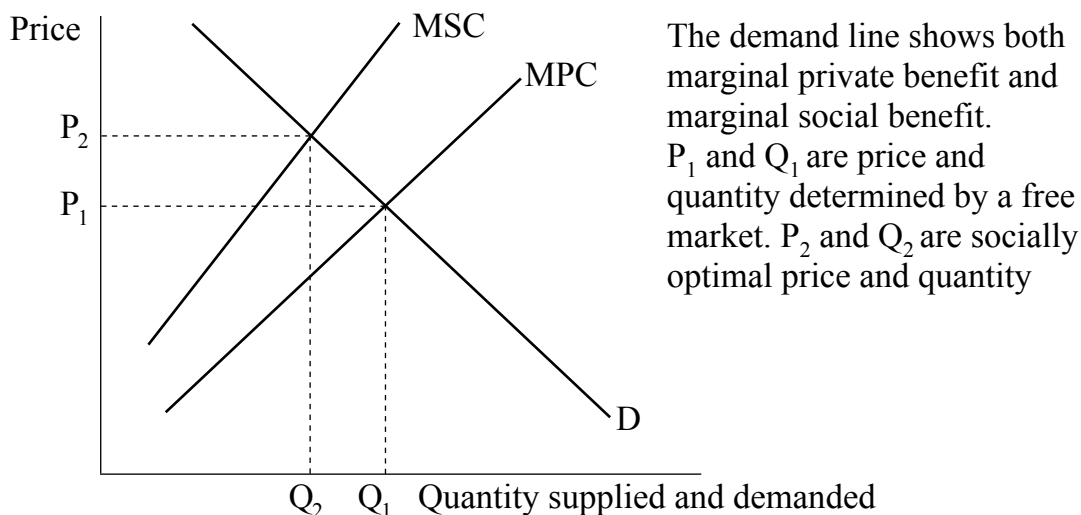
[10]

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(Answer **one** question)

- 2 (a) Negative environmental externalities arise when the marginal social costs of production of goods or services exceed the marginal private costs. If producers are able to avoid bearing the costs of some side-effect of their activity, such undesirable consequences as noise, pollution or destruction of habitats may be imposed on their neighbours or society as a whole. Positive environmental externalities may include the contribution some farming may make to beauty of landscape or development of a variety of habitats for wildlife.

Suitable ideas for development:



- Graphical illustration – note that it is possible for positives to be illustrated, too
- Different examples of externalities

Level 1 ([1]–[2])

Candidates may offer a partially correct definition. There may be improper use of technical terms or little or no development of the idea. Quality of written communication is limited.

Level 2 ([3]–[4])

Candidates define the concept(s) competently. Technical terms are generally used accurately and there may be some appropriate development of ideas. Quality of written communication is satisfactory.

Level 3 ([5]–[6])

Candidates define the concept(s) correctly, making accurate use of technical terms and developing ideas with an accurate diagram, good examples or both. Quality of written communication is of a high standard. [6]

- (b) Governments may try to reduce such negative environmental externalities as emission of greenhouse gases by intervention, persuasion, prohibition or simulation of market conditions.

Non-government agencies may campaign to influence producer behaviour directly, or by orchestrating pressure from consumers.

Issues, analysis and areas for discussion include:

- systems of taxation –
governments may use Pivovian taxes (imposing tax equal to the external costs to engineer socially optimal levels of production) or other punitive or deterrent taxes
- possible direction of tax revenue to offset damage caused by production
- empowerment of victims of externalities through the legal system to recover damages from producers
- legislation to outlaw undesirable side-effects of production
- subsidising alternative forms of production or methods of reducing externalities
- issue of tradable permits to firms, licensing certain amounts of the undesirable by-product in question and thus providing incentives for increased efficiency in reducing negative externalities

Level 1 ([1]–[4])

Candidates' answers are restricted in scope, detail and accuracy.

Quality of written communication is limited.

Level 2 ([5]–[8])

Candidates identify at least two possible counter-measures and explain them reasonably competently though the explanation may lack depth or contain minor errors. Quality of written communication is satisfactory.

Level 3 ([9]–[12])

Candidates explain in depth at least three measures by which negative externalities might be reduced. Quality of written communication is of a high standard. [12]

- (c) There are several significant issues posed by the question; possible problems of conflicting political objectives; comparative effectiveness of “green” policies; actual difficulties facing any particular organisation taking action by itself; and need for overall balance in policy, recognising that weak governments in failing economies have very little control over almost any of the problems facing them. Effective evaluation might involve questioning if current approaches urged by campaigners really are the best solutions to environmental problems.

Additional areas for analysis and discussion include:

- reference to political problems historically encountered by governments.
With taxation policy, for example, a plan to make heating fuel subject to the standard rate of value-added tax was abandoned, and a special rate of 5 per cent introduced instead; pressure groups greet every increase in road fuel duty with high-profile protests; and a 2007 proposal retrospectively to increase the annual rate of vehicle tax on cars with higher fuel consumption attracted hostility and criticism from all sides of UK politics

- identification of what those who have elected a government really want as opposed to what they feel they should indicate in surveys that they “want”
- risk of revenue loss if taxes are set at levels which **do** deter consumption
- problems of securing and ensuring compliance with international agreements
- the apparently successful implementation of the Climate Change Levy
- success of the carbon permit trading market
- “free rider” issues
- difficulties involved in monitoring and enforcing all types of control
- the extent to which “green” policies really are pursued *governments might in all cases prefer popularity to ecological responsibility*
- virtual impossibility of success through unilateral action *politicians’ time and ingenuity might be more profitably spent seeking international co-operation; for example, there is no value in imposing certain taxes within a particular country if people can obtain the same goods or services elsewhere in currently open trading conditions; imposition of burdens on domestic industries might lead to migration of firms or supply by even more environmentally unfriendly producers: similar problems affecting all policy instruments when used in a national “vacuum”*

Level 1 ([1]–[4])

Candidates display little understanding of the relevant issues and there is no significant evaluation. Quality of written communication is limited.

Level 2 ([5]–[8])

Candidates demonstrate some understanding of some of the issues involved and there is a degree of evaluation though this may lack depth. Quality of written communication is satisfactory.

Level 3 ([9]–[12])

Candidates display a clear understanding of the main issues. There is significant evaluation including a balanced conclusion, and quality of written communication is of a high standard. [12]

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- 3 (a) Development is a continuing process which may affect a region, a country or a group of countries. It entails creation or consolidation of frameworks, systems and institutions for improvements in welfare. In this context, welfare includes social, emotional and material well-being.

Suitable ideas for extension:

- contrast with definition of economic growth
- Maslow's "hierarchy of needs"
- characteristics of more and/or less economically developed countries
- assessment of development by such measures as the UN Development Programme's Human Development or Human Poverty Indices
- criteria for the measurement of economic development
taken in conjunction with representative statistics on income per head, these include data on life expectancy, access to health services and clean water, rates of literacy and ease of obtaining information or means of external communication

Level 1 ([1]–[2])

Candidates show little understanding of economic development. There is partial definition without significant development. Quality of written communication is limited.

Level 2 ([3]–[4])

Candidates show some understanding of economic development but fail to extend the ideas. Alternatively, a definition of growth followed by useful and accurate additional ideas should reach this level. Quality of written communication is satisfactory.

Level 3 ([5]–[6])

Candidates show a clear understanding of economic development giving an accurate definition which is supported by extensive development. Quality of written communication is of a high standard. [6]

- (b) Research in development economics continues to be funded by powerful international bodies such as the United Nations or the World Bank. Thus it is difficult to stay completely up-to-date. Interested candidates may be aware of valid contributions to development theory not included here. Approaches may classify theories associated with particular economists or simply by general categories. Answers which just concentrate skilfully and comprehensively on the factors identified in various theories could reach the lower range of level 3.

Issues, analysis and areas for discussion include:

- theories involving the development of a nation's comparative advantage *this may be seen as either requiring government sponsorship, through subsidy and protective tariff, or its direct opposite – removing restrictions on free markets*
- structural theories, such as the Fisher/Clark and Lewis models *these involve the progression from primary through secondary to tertiary sectors of the economy, accompanied by migration of population from rural to urban areas*

- linear progression theories, such as the ideas of Harrod and Dormar, Rostow and Solow;
these all build on the experience of the more economically developed countries and all stress the importance of savings and investment.
Solow refines these by a focus on the pace and nature of technological progress
- dependency theories, notably developed by such economists as Furtado
these are based on assumptions that poorer countries are locked into production to meet the demands of powerful trading partners, and that the key to development is the emergence of fully independent (not always democratic) political systems
- neo-classical theories, asserting that development arises out of growth
with these, the assumption is that free markets create most efficiently the conditions for economic take-off, and that market forces identify economically advantageous areas for industrial specialisation most quickly and accurately
- investigations such as those of Chenery and her collaborators into how MEDCs may actively help to “kick-start” economic development
Chenery identifies “gaps” in economies of LEDCs which enlightened policies in more prosperous countries may help close; skills gaps may be eliminated through technical assistance, savings gaps countered by foreign assistance with investment projects and trade gaps $[X < M]$ ended by genuinely open and fair trade
- attempts such as Michael Todaro’s to integrate ideas into a holistic model

Level 1 ([1]–[4])

Candidates show little understanding of any theories of economic development. Typical answers will be confined to vague assertions, and quality of written communication is limited.

Level 2 ([5]–[8])

Candidates show some understanding of developmental theories but answers will typically lack precision and detail. Quality of written communication is satisfactory.

Level 3 ([9]–[12])

Candidates show a clear and detailed understanding of the models they have chosen to describe, and summarise with insight the factors they identify as influencing economic development. Quality of written communication is of a high standard. [12]

- (c) There is a number of routes towards a good answer. “Bad” government may include the corrupt, the authoritarian and the incompetent. Sustainable development involves husbandry of resources as well as stewardship of the environment. All these factors are relevant, in the context of both MEDCs and LEDCs. Generally speaking, as far as LEDCs are concerned, all the available evidence is that political liberalisation and human and economic development go hand in hand. However, this does not mean that democratic institutions would be sufficient to generate sustainable economic development, nor that some development may not take place under totalitarian regimes. Democratic governments may consist of individuals who are ill-informed or lack foresight.

Other issues, analysis and areas for discussion include:

- historical examples of effects of introduction of democratic institutions
- issues of causality – might economic growth lead to political liberalisation?
- theoretically – but debatably – increased accountability/reduced corruption
- possibility of greater safeguards over use of funds of international agencies
- increased incentives for foreign direct investment in stable regimes
- increased incentives to domestic enterprise – *more efficient operation of the role of profits and of supposed “trickle-down” effects*
- recognition that problems faced by some LEDCs may be too complex for one-dimensional solutions – *however desirable in itself, the introduction of democracy may be no “quick fix” for countries which have chronic difficulties with unfavourable dependency ratios, lack of infrastructure or worsening environment*
- importance of property rights in encouraging economic activity
- the idea that ‘bad’ government may include unscrupulous support by developed countries of corrupt and authoritarian regimes.

Level 1 ([1]–[4])

Candidates shows little understanding of how bad government might act as a barrier to economic development. There is no significant evaluation of the proposition, and quality of written communication is limited.

Level 2 ([5]–[8])

Candidates show some understanding of relevant issues and there is a degree of evaluation though this may lack depth. Quality of written communication is satisfactory.

Level 3 ([9]–[12])

Candidates show a clear and detailed understanding of relevant issues. There is an in-depth evaluation of the proposition and this is supported by a balanced conclusion. Quality of written communication is of a high standard.

[12]

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Section B**Module 6: Financial Economics**

- 1 (a) • Public sector debt as a percentage of GDP has increased continuously from 2004 until 2008
- In 2004 public sector debt was 32.6 per cent of GDP and rose to 38.3 per cent of GDP in 2008
 - The largest increase in terms of basis points was from 2004 till 2005
 - The smallest increase in terms of basis points was from 2006 till 2007
 - The charge was 5.7 basis points or a 17.5% increase

[1] for every relevant point made up to a maximum of [3] [3]
if no manipulation of data, award [1]

- (b) An economic slowdown would be likely to have a detrimental effect on public finances. This would be for a number of reasons:
- higher unemployment will cause the government to pay out more in social welfare payments
 - higher unemployment will reduce the revenue from income tax
 - there will be less consumer spending and so indirect tax returns, such as VAT and excise duties, will fall
 - there will be pressure on company profits and so corporation tax returns will fall

[2] for each point well explained up to a maximum of [6] [6]

Level 1 ([1]–[2])

Candidate gives no significant analysis of the impact of an economic slow down upon government finances and quality of written communication is limited

Level 2 ([3]–[4])

Candidate gives some analysis of the impact of an economic slow down upon government finances. However, this will be incomplete or contain minor errors and quality of written communication is satisfactory

Level 3 ([5]–[6])

Candidate gives a clear and comprehensive analysis of the impact of an economic slow down upon government finances and quality of written communication is of a high standard

- (c) Gordon Brown's two principles for controlling public finances are:
- the golden rule which states that government should borrow only for investment over the course of the economic cycle. This means that at the end of the cycle any increase in debt should be matched by an increase in capital assets
 - the sustainable investment rule that the total of all government debt should not exceed 40 per cent of GDP

For detailed explanation of the golden rule [4].

For explanation of sustainable investment rule [2]

Level 1 ([1]–[2])

Candidate gives no significant explanation of Gordon Brown's two principles. They may be identified but there is not development and quality of written communication is limited

Level 2 ([3]–[4])

Candidate gives some explanation of Gordon Brown's two principles but this will be incomplete or contain minor errors. Quality of written communication is satisfactory

Level 3 ([5]–[6])

Candidate gives a clear and comprehensive analysis of Gordon Brown's two principles and quality of written communication is of a high standard

(d) There are a number of ways in which politicians can put a favourable gloss on poor economic figures:

- Firstly they define the time frame of the economic cycle in a manner which best suits the figures. This would enable them to select a time period over which there had been no borrowing for current expenditure. In this way the golden rule can effectively be manipulated
- The distinction between current and capital expenditure is not clear cut. For example, training can fit into either category depending on the nature and the recipients of the training. Once again this allows a favourable gloss to be put on data which clearly does not conform to the golden rule
- The sustainable investment rule can also be massaged. The passage states that government spending on the Northern Rock rescue package has not been added to the national debt but that had it been so, then the 40 per cent limit would have been breached already

[2] for each point explained

[6]

Level 1 ([1]–[2])

Candidate gives no significant explanation of how politicians can manipulate economic statistics. Some of the methods may be identified but there is no development and quality of written communication is limited

Level 2 ([3]–[4])

Candidate gives some explanation of how politicians can manipulate economic statistics but this will be incomplete or contain minor errors. Quality of written communication is satisfactory

Level 3 ([5]–[6])

Candidate gives a clear and comprehensive explanation of how politicians can manipulate economic statistics and quality of written communication is of a high standard

(e) Many of the arguments for an independent body to control fiscal policy are similar to those advanced for an independent central bank to control monetary policy.

The possibility of political manipulation of economic policy for narrow electoral purposes is relevant to both fiscal and monetary policy. If it were important to keep monetary policy out of the political domain then surely the same must apply to fiscal policy. Also there is the issue of competence and professionalism. Politicians are not always great economists and may make foolish and ill-informed decisions.

Issues for analysis and evaluation include:

- need to separate economic decision-making from political gamesmanship
- need for professionals to make important economic decisions
- record of Bank of England in conducting monetary policy. Is this a good precedent?
- need to convince foreign investors that fiscal policy is in safe hands
- need to convince economic agents in the UK that fiscal policy will not be used to prevent recessions. So firms and unions trying to push up prices and wages will be aware of the consequences of their actions
- need to keep inflationary wage demands in check. Unions must be aware that governments cannot borrow to grant high public sector pay awards
- importance of credibility in economic policy. Can this be achieved when it is subject to political manipulation?
- when fiscal policy is in the hands of politicians, they are accountable to the electorate for their decisions
- the record of the Bank of England's Monetary Policy Committee is not beyond criticism
- there is no reason to suppose that independent "experts" will necessarily have a sound grasp of fiscal policy than professional politicians

Level 1 ([1]–[3])

Candidate shows little understanding of the issues surrounding the establishment of an independent body to control fiscal policy. There is no evaluation of the proposal, and quality of written communication is limited.

Level 2 ([4]–[6])

Candidate shows some understanding of the issues surrounding the establishment of an independent body to control fiscal policy. There is a degree of evaluation of the proposal, though this may lack depth or be one-sided and quality of written communication is satisfactory.

Level 3 ([7]–[9])

Candidate shows a clear understanding of the issues surrounding the establishment of an independent body to control fiscal policy. There is in-depth evaluation of the proposal and this includes a balanced conclusion. Quality of written communication is of a high standard. [9]

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(Answer **one** question)

- 2 (a) A gilt-edged security is bond issued by the government with a redemption date of one year or more from the date of issue. These may be purchased by investors either when they are issued by the government or at some subsequent date through the gilt-edged market. Both the redemption value and the annual rate of interest (coupon) are guaranteed by the government. However, sellers in the gilt-edged market have no guarantees as to the price they will receive.

An ordinary share is a certificate of part ownership of a company. Ordinary share holders may receive a proportion of the company's profits by way of an annual dividend payment. However, unlike the interest payment on a gilt-edged security this is not guaranteed. Neither is the company under any obligation to buy back any of its shares after they have been issued. So ordinary shares entail significantly more risk than gilt-edged securities.

Level 1 ([1]–[2])

Candidate shows little understanding of the basic features of gilt-edged securities and ordinary shares. Their differences are not explored, and quality of written communication is limited.

Level 2 ([3]–[4])

Candidate shows some understanding of the basic features of gilt-edged securities and ordinary shares. Their differences are explored but not in great detail, and quality of written communication is satisfactory.

Level 3 ([5]–[6])

Candidate shows a clear understanding of the basic features of gilt-edged securities and ordinary shares. Their differences are fully explored, and quality of written communication is of a high standard. [6]

- (b) The Stock Exchange is market for those who wish to trade in financial securities. Most people associate it with trading in the ordinary (equity) shares in companies. However, there are also markets for gilt-edged securities, preference shares and corporate bonds. Average prices or indices are calculated for a range of different securities, the most common of which is the FTSE which tracks the average value of the top 100 shares on the London market.

Issues for analysis and discussion include:

- the ability to resell shares makes it easier for companies to issue shares and raise finance
- the freedom to buy and sell shares makes it easier for companies to launch take over bids. Many argue that this process is essential for the smooth working of a capitalist economy
- listed companies are required to publish extensive accounts and reports so investors should be fully informed when they make investment decisions
- the financial expertise of those who work in the Stock Exchange is highly regarded internationally and many foreign investors place funds through UK financial institutions. This has a beneficial impact on the UK balance of payments

Level 1 ([1]–[4])

Candidate provides little analysis of the role of the Stock Exchange in the UK economy. Key functions are missed, and quality of written communication is limited.

Level 2 ([5]–[8])

Candidate provides some analysis of the role of the Stock Exchange in the UK economy. Most of the key functions are explained though this may contain errors or be incomplete. Quality of written communication is satisfactory.

Level 3 ([9]–[12])

Candidate provides an accurate and comprehensive analysis of the role of the Stock Exchange in the UK economy. All key functions are explained in detail and quality of written communication is of a high standard. [12]

- (c) Assessing the overall state of an economy is not a simple matter. There are a vast number of economic indicators which may not all point in the same direction. The state of the London Stock Exchange is one such indicator.

Issues for analysis and evaluation and discussion:

- there are a number of indicators of the state of the London stock market, e.g. FTSE 100, FTSE 250, FTSE small cap, AIM. These may not all give the same picture
- explanation of share prices as the present value of estimated future profits of a company. So share prices should be a forward-looking indicator of the prospects for UK businesses
- share prices do not always mirror the state of the economy. It is not unusual for share prices to rise during a recession
- high levels of spending on imports may be bad for the balance of payments but good for the profits of retailers selling imports
- share prices reflect the proportion of profits within GDP, however this may be at the expense of wages and the welfare of employees
- share prices are prone to waves of hysteria and euphoria, what Alan Greenspan called “irrational exuberance”. In the 1990s there was the so called “dot com bubble” in shares in technology companies

Level 1 ([1]–[4])

Candidate displays little understanding of the significance of the prices of stocks and shares. There is no significant evaluation of the proposition that they are a good indicator of the state of the UK economy, and quality of written communication is limited.

Level 2 ([5]–[8])

Candidate displays some understanding of the significance of the prices of stocks and shares. There is a degree of evaluation of the proposition that they are a good indicator of the state of the UK economy. However this may lack depth or be one-sided. Quality of written communication is satisfactory.

Level 3 ([9]–[12])

Candidate displays a clear understanding of the significance of the prices of stocks and shares. There is in-depth evaluation, including a balanced conclusion, of the proposition that they are a good indicator of the state of the UK economy. Quality of written communication is of a high standard. [12]

- 3 (a) Narrow money is money which can be spent directly, i.e. it can easily be used as a medium of exchange. This consists mainly of cash and balances in current accounts which can be transferred by cheque or debit card. The official measure of narrow money is M0. This is cash in circulation outside the Bank of England plus UK banks operational deposits with the Bank of England. Broad money is all those items which comprise narrow money plus a range of other financial instruments which can easily be converted to cash. In the UK this is measured by M4.

Level 1 ([1]–[2])

Candidates shows little understanding of the main features of narrow and broad money or of the differences between them. Quality of written communication is limited.

Level 2 ([3]–[4])

Candidates shows some understanding of the main features of narrow and broad money and of the differences between them. Quality of written communication is satisfactory.

Level 3 ([5]–[6])

Candidates shows a clear understanding of the main features of narrow and broad money and of the differences between them. Quality of written communication is of a high standard. [6]

- (b) Banks cannot create money in the form of notes and coin (Northern Irish and Scottish banks may issue their own notes but must keep an equivalent amount in Bank of England notes). However, they can create money by lending to their customers and hence adding to the volume of bank deposits which is, of course, part of the money supply.

Issues for analysis and discussion include:

- explanation of bank balance sheet, distinction between liquid and illiquid assets
- explanation of credit creation process
- explanation of deposit multiplier
- role of Bank of England
- role of FSA

Level 1 ([1]–[4])

Candidate provides little explanation of the process by which banks may create money. Key issues such as the deposit multiplier are ignored, and quality of written communication is limited.

Level 2 ([5]–[8])

Candidate provides some explanation of the process by which banks may create money. Most key issues are addressed though the exposition may be incomplete or contain minor errors. Quality of written communication is satisfactory.

Level 3 ([9]–[12])

Candidate provides a clear explanation of the process by which banks may create money. All key issues are addressed and quality of written communication is of a high standard. [12]

- (c) The Northern Rock bank was the first UK bank to get into severe financial difficulties in September 2007. It lacked the funds to repay the depositors who wished to withdraw their savings and had to be rescued by the government which nationalised the bank and guaranteed the security of customers’ savings. The government plans to run the bank as a going concern and then to sell it back to the private sector.
Subsequent to this a number of other UK banks experienced similar financial difficulties and had to be rescued by the government

Issues for analysis and evaluation include:

- cost to the taxpayer of the rescue package. This has significantly increased as more banks experienced financial difficulties bank lending
- possible domino effect, leading to the collapse of the entire banking system
- risks involved in fractional banking
- failure of FSA to properly monitor bank lending.
- wider impact on macro economy of a major bank collapse
- moral issue of rescuing a badly run business. If it’s ok to save some banks then why not every business in financial difficulties
- opportunity cost at the use of taxpayer’s money

Level 1 ([1]–[4])

Candidate shows little understanding of the issues involved in the government granting financial support to the banking system. There is no significant evaluation of the decision, and quality of written communication is limited.

Level 2 ([5]–[8])

Candidate shows some understanding of the issues involved in the government granting financial support to the banking system. There is a degree of evaluation of the decision, though this will lack depth or be one-sided. Quality of written communication is satisfactory.

Level 3 ([9]–[12])

Candidate shows a clear understanding of the issues involved in the government granting financial support to the banking system. There is in-depth evaluation of the decision, and this includes a balanced conclusion. Quality of written communication is of a high standard. [12]

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Secton B	60
Total	60