



ASSESSMENT and
QUALIFICATIONS
ALLIANCE

Mark scheme January 2004

GCE

Economics

Unit ECN5

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General Instructions

Marks awarded to candidates should be in accordance with the following mark scheme and examiners should be prepared to use the full range of marks available. The mark scheme for most questions is flexible, permitting the candidate to score full marks in a variety of ways. Where the candidate's response to a question is such that the mark scheme permits full marks to be awarded, full marks **MUST** be given. A perfect answer is not necessarily required for full marks. But conversely, if the candidate's answer does not deserve credit, then no marks should be given.

Occasionally, a candidate may respond to a question in a reasonable way, but the answer may not have been anticipated when the mark scheme was devised. In this situation, **OR WHENEVER YOU HAVE ANY DOUBT ABOUT THE INTERPRETATION OF THE MARK SCHEME**, you must in the first instance telephone your team leader to discuss how to proceed.

Two approaches have been used in the construction of the mark scheme:

- (i) **An 'issue' based approach.** The mark scheme for parts (a) and (b) of the data response question and part (a) of the essay questions adopts this approach. The questions do not generally require that the candidate demonstrates evaluative skills although some explanation and analysis may be expected. The mark scheme lists the marks that can be awarded for particular issues (and associated development) that the candidate might include in the answer. Marks awarded for development should take into account the Quality of Written Communication used by candidates as indicated on page 5 of this mark scheme.
- (ii) **A 'levels' approach.** This approach is used for parts (c) and (d) of the data response question and part (b) of the essay questions. The mark scheme summarises the information required to answer the question, but without attaching marks to particular issues. Marks should be awarded according to whether the answer displays the skills indicated by the five Mark Band Descriptors or "Levels of Skill" included in the mark scheme. The Mark Band Descriptors are set out on page 4. When using a 'levels' mark scheme the marker **must** identify where a particular skill is being demonstrated. The **key** to be used to identify the skill is shown on page 5. The level chosen should be the one which **best fits** the answer provided by the candidate. It is **not** intended that the answer should satisfy every statement in the level description.

APPLYING THE ‘LEVELS’ MARK SCHEME**Levels of Response Mark Band Descriptors****Level 1**

Few, if any, relevant issues are recognised. Economic concepts and principles are not adequately understood or applied to the question and its context. No satisfactory analysis or evaluation. Little, if any, appreciation of the inter-relatedness of economic issues, problems and institutions. A poorly organised response which generally fails to answer the question. Descriptions and explanations lack clarity. Spelling, punctuation and grammar may be poor. There is little use of specialist vocabulary.

0 to 5 marks (*Mid-Point: 3 marks*)

Level 2

A few issues are recognised but there is only limited evidence of the candidate's ability to apply relevant economic concepts. An attempt is made to answer the question but there is little satisfactory analysis or evaluation. Some very limited appreciation of the inter-relatedness of economic issues, problems and institutions. A poorly organised answer which does not have a clear structure. Descriptions and explanations are sometimes hard to follow. The candidate demonstrates some ability to spell commonly used words and to follow the standard conventions of punctuation and grammar. Some use of specialist vocabulary is made but this is not always applied appropriately.

6 to 10 marks (*Mid-Point: 8 marks*)

Level 3

A few issues are recognised. The candidate has attempted to apply relevant economic concepts and ideas to the question and its context. A reasonable understanding of some concepts and theories is demonstrated. However, the evaluation of the issues, arguments and evidence is limited or superficial. Some understanding of the inter-relatedness of economic issues, problems and institutions. There is some logic and coherence in the organisation of the answer. The candidate is generally able to spell commonly used words and usually follows the standard conventions of punctuation and grammar. Some descriptions and explanations are easy to understand but the answer may not be expressed clearly throughout. Some use of specialist vocabulary which is applied appropriately.

11 to 17 marks (*Mid-Point: 14 marks*)

Level 4

Several relevant issues are identified. Good understanding of some economic concepts and principles is demonstrated. The candidate is able to apply these concepts and principles to the context to help answer the question. There is some appreciation of alternative points of view. Satisfactory use is made of evidence and/or theoretical analysis to evaluate the issues and arguments identified. Good understanding of the inter-relatedness of economic issues, problems and institutions is demonstrated. Shows the ability to think as an economist making effective use of the economist's 'tool kit' of concepts, theories and techniques. Spelling is generally accurate and the standard conventions of punctuation and grammar are usually followed. The answer is well organised. Descriptions and explanations are usually clearly expressed. A wide range of specialist vocabulary is used with facility.

18 to 24 marks (*Mid-Point: 21 marks*)

Level 5

Several relevant issues are identified. Good understanding of economic concepts and principles is demonstrated throughout. The candidate is able to apply these concepts and principles to the context to help answer the question. There is an appreciation of alternative points of view. Good use is made of evidence and/or theoretical analysis to evaluate the issues and arguments identified. The candidate demonstrates the ability to synthesise the arguments presented and come to a reasonable conclusion albeit tentative. A clear understanding of the inter-relatedness of economic issues, problems and institutions is demonstrated. Shows the ability to think as an economist making very effective use of the economist's 'tool kit' of concepts, theories and techniques. Spelling is accurate and the standard conventions of punctuation and grammar are followed. The answer is well organised. Descriptions and explanations are expressed with clarity throughout. Extensive use of specialist vocabulary which is applied adeptly and with precision.

25 to 30 marks (*Mid-Point: 28 marks*)

THE KEY TO BE USED WHEN USING THE ‘LEVELS’ MARK SCHEME

- D** Where a particular economic term is correctly **DEFINED** in order to help the candidate to answer the question properly.
- I** Where a relevant **ISSUE** is raised by the candidate.
- K** Where the candidate demonstrates **KNOWLEDGE** of recent developments or features of the economy which help enhance the candidate’s response to the question. This should also be used where the candidate quotes relevant examples.
- Ap** Where the candidate demonstrates the ability to **APPLY** knowledge and **CRITICAL UNDERSTANDING** to problems and issues.
- A** Where the candidate demonstrates the ability to **ANALYSE** the problem using appropriate economic ideas.
- E** Where the candidate **EVALUATES** and makes judgements about the significance of various issues and arguments.

QUALITY OF WRITTEN COMMUNICATION

The Mark Band Descriptors, which are used for assessing Question 1 (d) and part (b) of the essay questions, incorporate statements which relate to the Quality of Written Communication used by the candidates.

However, it is also important to assess Quality of Written Communication **whenever** candidates produce answers using continuous prose. When applying an issue based mark scheme, examiners must take into account the following when deciding how many marks to award for development:

- (i) use of an appropriate form and style of writing to organise relevant information clearly and coherently;
- (ii) use of specialist vocabulary, where appropriate;
- (iii) legibility of handwriting;
- (iv) accuracy of spelling, punctuation and grammar.

Synoptic Assessment

All questions in this unit are synoptic. Therefore, candidates will need to demonstrate that they are able to think as an economist and to use effectively the economist’s ‘tool kit’ of concepts, theories and techniques.

They should demonstrate that they:

- understand the inter-relatedness of many economic issues, problems and institutions;
- understand how certain economic concepts, theories and techniques may be relevant to a range of different contexts;
- can apply concepts, theories and techniques in analysing economic issues and problems and in evaluating arguments and evidence.

SECTION A**1****Total for this question: 50 marks**

- 1 (a) For the period 1990 to 1999, compare the changes in the nominal price and the real price of Microsoft's Windows operating system for personal computers that are shown in **Extract A**.
(4 marks)

For candidates who:

define both the nominal price and the real price: **1 mark**

state that both the nominal price and the real price fell over the period: **1 mark**
and back this up with statistics: **1 mark**

state that the real price fell by a greater amount: **1 mark**
and back this up with statistics: **1 mark**

state that the one exception for both the nominal price and the real price was in 1995: **1 mark**
and back this up with statistics: **1 mark**

Do not award marks for explanation of the price changes. However award **1 mark** if a candidate explains that whenever the nominal price falls at a time when prices in general are rising, the real price must also fall, but by less than the fall in the nominal price.

Maximum of 2 marks if there is no comparison over the period

Maximum of 3 marks if there is no accurate use of the data

MAXIMUM FOR PART (a) 4 MARKS

1 (b) **Extract C** (lines 5-6) states that monopolies “maximise profits by charging a price that is higher than would exist in a perfectly competitive market”. With the use of a diagram, explain the price charged **and** the level of output produced by a profit-maximising monopolist.

(6 marks)

For candidates who:

state that profit maximisation occurs when $MR = MC$: **1 mark**

explain this further **1 mark**

explain a monopolist's profit-maximising level of output: **Up to 2 marks**

only 1 mark if there is no reference to the diagram

2 marks if written answer makes accurate reference to diagram

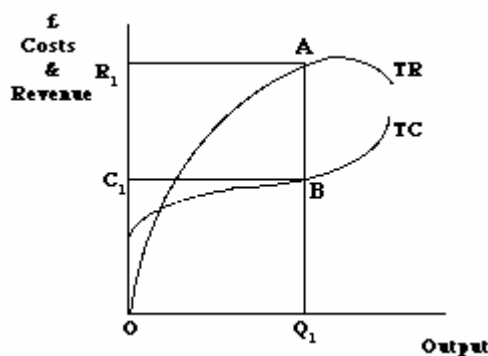
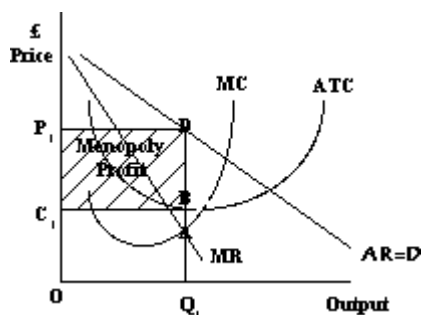
illustrate a monopolist's profit-maximising level of output on a diagram: **Up to 2 marks**

explain how the profit-maximising price is determined in a monopoly: **Up to 2 marks**

only 1 mark if there is no reference to the diagram

2 marks if written answer makes accurate reference to diagram

illustrate a monopolist's profit-maximising price on a diagram: **Up to 2 marks**



Reward in a similar way an answer which uses TR and TC curves, though in this case, the monopolist's price may not be discussed properly or illustrated.

Maximum of 3 marks for a written explanation with no diagram

Maximum of 3 marks for a diagram with no written explanation

Maximum of 4 marks for an answer that only explains output, or only explains price

MAXIMUM FOR PART (b) 6 MARKS

1 (c) **Extract D** (lines 3-4) states that “when prices exceed marginal costs, economic inefficiency and resource misallocation occur”. Analyse how the price set by a monopolist may affect economic efficiency **and** resource allocation. (10 marks)

Full marks can be earned by an answer restricted to analysis of standard monopoly equilibrium, providing it explains fully why $P > MC$ leads to an allocatively inefficient outcome and hence to resource misallocation. Candidates may use efficiency concepts other than allocative efficiency e.g. productive efficiency, though a good answer based solely on allocative efficiency and inefficiency can earn full marks. Very good answers may also analyse factors not mentioned in the data, such as limit pricing and the possible improvements in efficiency and resource allocation resulting from economies of scale and improvements in dynamic efficiency. Reward relevant analysis of X-inefficiency, though as this concept is not in the specification, it is not required for full marks.

Issues and areas for discussion and explanation include:

- productive inefficiency because the monopoly fails to minimise average costs;
- productive efficiency because the monopoly benefits from economies of scale;
- allocative inefficiency because $P > MC$;
- dynamic efficiency resulting from the incentive to innovate;
- effects of other aspects of monopoly pricing such as limit pricing and price discrimination.

Candidates should be rewarded for including relevant diagrams to support their analysis, provided the diagrams are accurate and adequately labelled.

LEVEL 1

The candidate who does not attempt any analysis, but whose answer identifies and then describes at least one efficiency concept, probably productive efficiency, but possibly allocative efficiency

1 to 3 marks

LEVEL 2

At the top of the range, the candidate analyses monopoly equilibrium in terms of allocative inefficiency, but the analysis is not completely correct. At the bottom the range, the candidate analyses monopoly equilibrium solely in terms of productive inefficiency, or the answer is restricted to statements such as "barriers to entry mean that the monopoly has no incentive to eliminate waste".

4 to 7 marks

LEVEL 3

At the top of the range, the candidate provides a full analysis of monopoly equilibrium in terms of allocative inefficiency and links this convincingly to resource misallocation. At the bottom of the range, the candidate provides some analysis of monopoly equilibrium in terms of allocative inefficiency, but although the analysis is not complete, the answer includes analysis of at least one other relevant concept such as economies of scale, limit pricing, or dynamic efficiency.

8 to 10 marks

MAXIMUM FOR PART (c) 10 MARKS

1 (d) Using the data and your economic knowledge, evaluate the view that, in all cases, a government should break up monopolies and replace them with a number of smaller competitive firms.

(30 marks)

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

Explanation/analysis is needed to reach Level 3, and some evaluation building on the analysis is required to score 19 marks or higher (Levels 4 and 5). An answer which explains how a monopoly may exploit its monopoly power, but which does not address the issue posed by the question, should be restricted to Level 2. An answer which goes further and discusses the benefits of competition reaches Level 3. To reach Level 4, the limitations of "monopoly busting", and possibly alternative policies, should be analysed. A Level 5 answer will show this awareness and discuss alternatives in more depth or breadth. Drawing relevantly on the stimulus material about Microsoft's behaviour can also raise the level achieved, but analysis and some evaluation is needed to reach the higher levels.

Issues and areas for discussion include:

- The meaning of monopoly power;
- How monopoly power may be used to exploit consumers;
- How the use of monopoly power may benefit consumers;
- The extent to which dominant firms may be able to exploit monopoly power;
- Contestable market theory;
- Advantages of breaking up dominant firms;
- Disadvantages of breaking up dominant firms;
- Advantages and disadvantages of alternative policies to breaking up dominant firms;
- Government failure;
- Relevant use of evidence;
- Overall quality of the evaluation.

USE THE LEVELS MARK SCHEME ON PAGES 4 & 5

MAXIMUM FOR PART (c) 30 MARKS

SECTION B**Each question carries 50 marks****2**

2 (a) Explain the economic reasons for privatisation.

*(20 marks)***For candidates who:**

explain the meaning of privatisation in terms of the transfer of assets etc. from public to private ownership: **Up to 2 marks**

give examples: **1 mark per example up to a maximum of 2 marks**

explain any other aspect of privatisation e.g. competitive tendering: **1 mark per aspect**

identify an economic reason for privatisation (e.g. revenue raising/cutting government borrowing, the belief that private ownership is more efficient etc.) **2 marks per reason**

explain/develop each reason: **Up to a further 8 marks per reason**

explain that different reasons were given for different privatisations in the UK: **Up to 4 marks**

explain that reasons given after privatisation may have been different from reasons given before privatisation: **Up to 4 marks**

explain reasons (if different) for privatisation by governments in other countries: **Up to 4 marks**

discuss the relative significance of the reasons explained: **Up to 4 marks**

No marks are available for explaining the case against privatisation, or for assessing the case for and against privatisation.

Maximum of 5 marks if answer is restricted to definition and examples of privatisation.

Maximum of 13 marks if only one economic reason for privatisation is explained.

MAXIMUM FOR PART (a) 20 MARKS

2 (b) Do you agree that certain economic activities, such as producing electricity from nuclear energy, and running railways and air traffic control, should be undertaken by the state rather than by private sector companies? Justify your answer. (30 marks)

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

Most candidates will probably relate their answers to one or more of the examples stated in the question, but it is possible (though probably difficult) to earn full marks by discussing economic activities other than those prompted by the question. Good candidates are likely to argue that the three activities in the question are the three least successful privatisations, and that the privatisation of other economic activities may be fully justified.

Explanation/analysis is needed to reach Level 3, and some evaluation building on the analysis is required to score 19 marks or higher (Levels 4 and 5). Answers which merely agree or disagree with the assertion, but fail to display analytical or evaluatory skills, will not reach Level 3. Analytical skills will be displayed when the candidate relates possible advantages and/or disadvantages of privatisation and/or state ownership to particular markets, industries or economic activities, or to other relevant examples. Evaluatory skills will be displayed when the candidate assesses the performance of already-privatised industries or the likely future performance of activities, were they to be privatised.

Issues and areas for discussion include:

- How in theory privatisation may improve economic performance;
- How in theory privatisation may harm economic performance;
- How in theory state ownership may improve economic performance;
- How in theory state ownership may harm economic performance;
- Case for the state providing public goods and / or merit goods;
- Criteria for evaluating industry performance;
- Particular activities that might perform best under private ownership;
- Particular activities that might perform best under state ownership;
- Application of private and social cost and benefit analysis;
- Government failure;
- Relevant reference to examples in the question;
- Use of other relevant examples;
- Relevant use of evidence.

USE THE LEVELS MARK SCHEME ON PAGES 4 & 5

MAXIMUM FOR PART (b) 30 MARKS

3

3 (a) Explain why markets may fail to provide public goods **and** under-provide merit goods.
(20 marks)

For candidates who:

explain the meaning of a public good: **Up to 2 marks**

provide examples of a public good: **1 mark each, up to a maximum of 2 marks**

explain the meaning of a merit good: **Up to 2 marks**

provide examples of a merit good: **1 mark each, up to a maximum of 2 marks**

explain why because of the property of non-excludability (or the free-rider problem) markets may fail to provide any quantity at all of a pure public good: **Up to 6 marks**

explain that because of government intervention, markets may fail to provide public goods: **Up to 3 marks**

explain that because of the property of non-rivalry, markets may under-provide quasi or non-pure public goods: **Up to 6 marks**

explain why merit goods may be under-provided in a market, because people cannot afford to buy them: **Up to 3 marks**

explain why because of informational problems, or because of the distinction between short-run and long-run private benefits, markets may under-provide merit goods: **Up to 6 marks**

explain that because of short-sightedness (myopia) people may under-consume merit goods: **Up to 3 marks**

explain that because of government intervention, markets may fail to provide merit goods: **Up to 3 marks**

Maximum of 5 marks if answer is restricted to definitions

Maximum of 12 marks if only public goods or merit goods are explained

MAXIMUM FOR PART (a) 20 MARKS

3 (b) Critically evaluate the view that government provision of public goods and merit goods will always eliminate market failure. (30 marks)

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

The expected content may link to the answer to that for part (a), before explaining how government policies such as direct provision, compulsion and subsidy, may promote greater provision of both public goods and merit goods. Such answers will provide analysis, but evaluation requires assessment of whether such intervention only partially, or completely, closes the divergency between private and social cost and benefit, or perhaps leads to over-provision. Explanation/analysis is needed to reach Level 3, and some evaluation building on the analysis is required to score 19 marks or higher (Levels 4 and 5). To reach Level 2, the candidate must explain how, in principle, government provision might ensure the socially optimal provision of either public goods or merit goods. To reach Level 3 explanation must be extended to both public goods and merit goods. To reach a low Level 4 there must be analysis of why socially optimal provision may not be ensured for either public goods or merit goods, and some evaluation of the strength of the arguments introduced. Level 5 answers will be strong on evaluation and analysis with respect to both public goods and merit goods.

Issues and areas for discussion include:

- The meaning of socially optimal level of consumption;
- The meaning of the privately optimal level of consumption;
- Distinction and divergencies between private and social costs and benefits;
- Relevant use of diagrams;
- Market failure;
- Government failure;
- Policy intervention will not correct market failures unrelated to public and merit goods;
- Use of examples and evidence.

USE THE LEVELS MARK SCHEME ON PAGES 4 & 5

MAXIMUM FOR PART (b) 30 MARKS

4

4 (a) Explain why the distribution of income in the United Kingdom is unequal. (20 marks)

For candidates who:

explain the meaning of the distribution of income: **Up to 2 marks**

use Lorenz curve diagram and/or gini coefficient to show/measure inequality in the distribution of income: **Up to 3 marks**

describe current or recent inequalities in the distribution of income: **Up to 3 marks**

state that inequality results from the operation of market forces in the labour market: **1 mark**

develop this explanation in terms of the demand for different types of labour: (developed explanation of the MRP of different workers will earn all 5 marks) **Up to 5 marks**

illustrate points made with a relevant labour market diagram or diagrams: **Up to 5 marks**

develop this explanation in terms of the supply of different types of labour: **Up to 5 marks**

state that inequality is explained by market power in labour markets of different degrees of competitiveness: **1 mark**

develop this explanation: **Up to 5 marks**

state any other reason for inequality e.g. different endowments of wealth (and the effect of inheritance); the nature of capitalism; low pay in the public sector versus high pay in the private sector: **1 mark per reason**

develop the explanation: **Up to 5 marks per explanation**

Maximum of 8 marks for an answer explaining the unequal distribution of *wealth*, with no accurate mention of *income*

MAXIMUM FOR PART (a) 20 MARKS

4 (b) Assess the economic benefits **and** costs of government intervention which aims to make the distribution of income considerably more equal. *(30 marks)*

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

The expected answer will first identify and then explain how methods of intervention (e.g. progressive taxation, welfare benefits) may reduce income inequalities. The explanation should provide the skill of analysis. Evaluation will be displayed by assessment of benefits (such as effectiveness and efficiency in reducing income inequality) and costs (such as disincentive effects). To reach Level 5, the answer must identify at least two methods of intervention, and then analyse and evaluate both the benefits and the costs of the methods identified. Very good analysis and evaluation of benefits (or costs) with some discussion and evaluation of the other can reach Level 4, as can some analysis and evaluation of both, but in an answer slightly lacking in development. Good analysis but little or no evaluation can reach Level 3. Some evaluation building on analysis is required to score 19 marks or higher (Levels 4 and 5).

Issues and areas for discussion include:

- Methods of intervention such as progressive taxation and welfare benefits;
- Explanation of benefits of particular methods of intervention for individuals;
- Explanation of benefits of particular methods of intervention for the economy;
- Explanation of costs of particular methods of intervention for individuals;
- Explanation of costs of particular methods of intervention for the economy;
- Discussion of winners and losers;
- Discussion of efficiency gains and/or losses;
- Discussion of welfare gains and/or losses;
- Discussion of static versus dynamic effects;
- Application of equity criteria;
- Overall assessment of costs and benefits.

USE THE LEVELS MARK SCHEME ON PAGES 4 & 5

MAXIMUM FOR PART (b) 30 MARKS