

Teacher Resource Bank

GCE Economics

Additional Sample Questions and Mark Schemes

New Specification: Units 1 - 4



ADDITIONAL SAMPLE QUESTIONS AND MARK SCHEMES

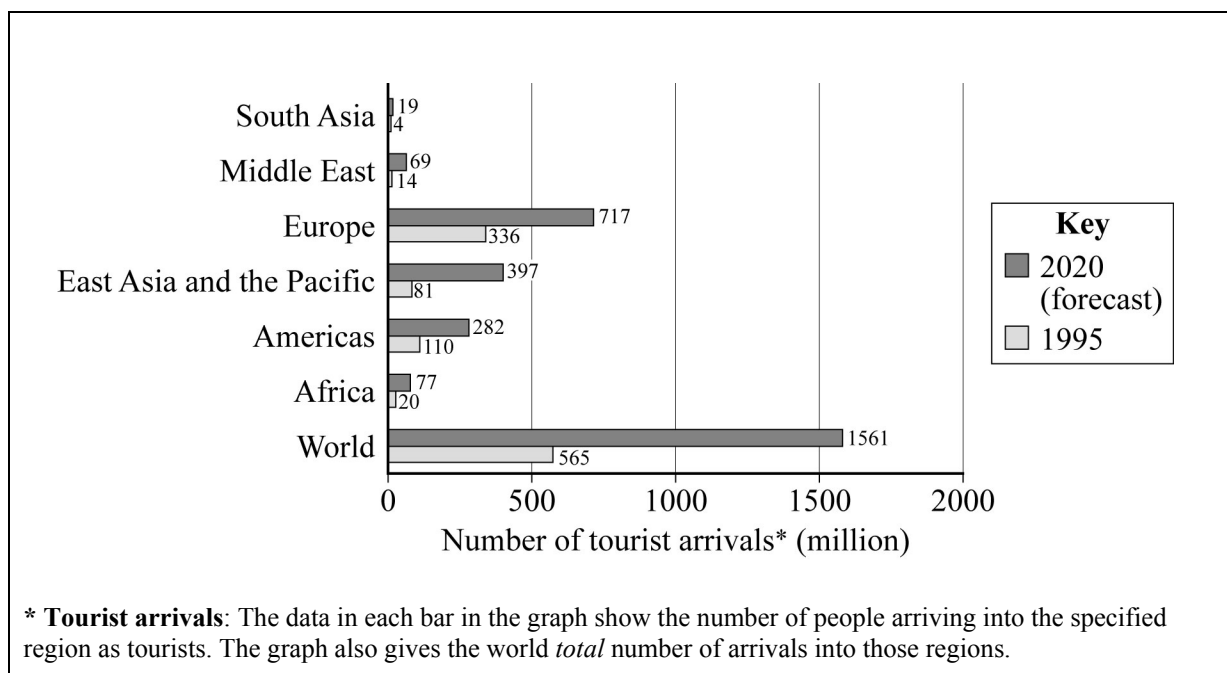
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ECON1: Markets and Market Failure

Total for this question: 50 marks

Study **Extracts A and B**, and then answer **all** parts of the Question which follows.

Extract A: Actual and forecast tourism growth, by region, 1995 and 2020



Extract B: What is our heritage worth?

How much are we willing to pay to see the world's great sights? Should the owners (whether government, private sector or 'not for profit') be increasing or reducing prices? What are the consequences of a 'tax on culture'? 1

Tourists trekking along the Inca Trail to the mountain-top city of Machu Picchu in Peru recently found that the entrance fee was suddenly three times greater than indicated in most tourist guides at home. At the gates of the Taj Mahal in India the admission fee for foreign tourists increased in one recent year by a massive 6000%. Is this sort of increase a 'tax on culture'? If it is a 'tax', is it a simple revenue-raiser or are there other motives for taxation? In an attempt to reduce our carbon footprints, campaigners are calling for hotel bed taxes, airport surcharges, and even admission charges for pedestrians to city central areas in addition to any congestion charges for motorists. 5
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It is not difficult to see why. By 2012, it is estimated that there will be well over a billion tourist trips undertaken globally per year, compared with 600 million in 1999. Cities such as Venice (Italy), which hosted 12 million trippers in 2000, feel overwhelmed. The city council is seriously considering an 'admission fee'. More and more, the preferred policy used by the relevant authorities is rationing through using the market mechanism. 15

Less developed countries with world-class ancient monuments are increasingly discovering

foreign tourists as a source of revenue. It is promised that most of the money taken at Machu Picchu will be ploughed back in the form of improved services such as toilets and campsites. The practice of having a two-tier pricing structure, favouring national residents, but discriminating against foreigners, is becoming more and more widespread. It is argued that if entry prices are too cheap, local communities will make no profit. Therefore, if prices are too cheap there is no incentive for conservation and tourists will destroy the very sights they have come to see.	20
The tourist industry has mixed feelings about such developments, and often argues that cheaper prices benefit both the tourist and the area visited. One problem is that of defining the 'tourist industry'. If you visit a theatre, cinema or restaurant in the centre of London, are these to be classified as 'tourist sites' and should your spending be regarded as tourist income? Are these service providers employed in the 'tourism sector'? Does it make a difference if the customer happens to be a resident of London, or Birmingham, or Berlin?	25 30

Question

- (a) Define the term 'market mechanism' (**Extract B**, line 16). (5 marks)
- (b) Using **Extract A**, identify **two** main features of the pattern of tourism over the period shown. (8 marks)
- (c) **Extract B** (lines 4-6) makes reference to tourists to the mountain-top city of Machu Picchu in Peru finding 'that the entrance fee was suddenly three times greater than indicated in most tourist guides at home'.

Using the concept of price elasticity of demand **and** demand curve diagrams, analyse the possible effects of such a price increase on revenues from entrance fees. (12 marks)

- (d) **Extract B** (lines 9-11) states that 'campaigners are calling for hotel bed taxes, airport surcharges, and even admission charges for pedestrians to city central areas in addition to any congestion charges for motorists'.

Using the data and your economic knowledge, evaluate the case **for** and **against** government intervention in the tourism industry. (25 marks)

Mark Scheme

(a) Define the term ‘market mechanism’ (Extract B , line 16).	<i>(5 marks)</i>
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For an acceptable definition (e.g. the system in a market economy whereby changes in price are determined by the interaction of decisions by consumers and firms (demand and supply) which determines the allocation of scarce resources) **5 marks**

for the above definition but without mentioning resource allocation **4 marks**

Otherwise, if the definition is incomplete, marks may be broken down, for example as follows:

a definition of market economy in terms of consumers and producers **1 mark**

reference to changes in demand affecting price **1 mark**

reference to changes in supply affecting price **1 mark**

reference to changes in price affecting demand **1 mark**

reference to changes in price affecting supply **1 mark**

MAXIMUM FOR PART (a): 5 MARKS

(b) Using Extract A , identify two main features of the pattern of tourism over the period shown.	<i>(8 marks)</i>
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Award up to 4 marks for each valid point made (up to two marks for identification and up to two marks for supporting reference(s) to the data). For example:

- both world tourism and tourism in each region show an upward trend over the period: for example world tourism is forecast to treble from approximately 550 million arrivals to 1550 million arrivals whereas tourism to Africa is expected to quadruple to approximately 80 million arrivals
- Growth rates in East Asia and the Pacific, Asia, the Middle East and Africa are forecast to grow faster over the period than in Europe, from 81 million to 397 million in East Asia and the Pacific, compared to 336 million to 717 million in Europe
- Europe will maintain the highest share of world arrivals at 717 million in 2020
- East Asia and the Pacific will replace the Americas in terms of second-highest share of world arrivals at 397 million compared to 282 million by 2020
- South Asia is expected to continue to have the smallest share of world tourist arrivals by 2020 at 19 million

A maximum of **4 marks** may be awarded if the candidate simply trawls through the data, with no attempt at overview, or does not quote statistics from the bar charts.

If there is some attempt at an overview but also evidence of a trawl, award a maximum of **6 marks** as long as an overview has been attempted and statistics used.

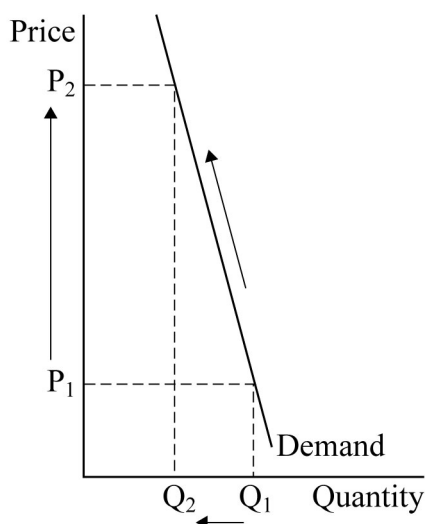
MAXIMUM FOR PART (b): 8 MARKS

(c) **Extract B** (lines 4-6) makes reference to tourists to the mountain-top city of Machu Picchu in Peru finding ‘that the entrance fee was suddenly three times greater than indicated in most tourist guides at home’.

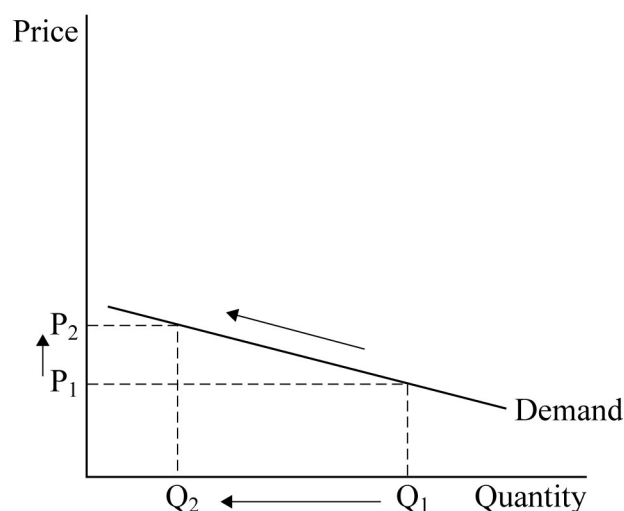
Using the concept of price elasticity of demand **and** demand curve diagrams, analyse the possible effects of such a price increase on revenues from entrance fees. *(12 marks)*

Candidates may draw diagrams similar to the ones below showing the change in total revenues on an elastic and on an inelastic demand curve:

Inelastic Demand Curve Diagram



Elastic Demand Curve Diagram



For candidates who, for the diagrams:

- draw two demand curves accurately labelled with different elasticities **2 marks**
- show the price increase and the change in quantity correctly labelled **2 marks**
- show the original revenue on the diagrams **2 marks**
- show the change in revenue on the diagrams **2 marks**

Maximum of 8 marks for diagrams

For candidates who, for the written explanation:

- accurately define price elasticity of demand and/or give the formula **4 marks**
- explain that an increase in price may lead to a more than proportionate fall in visitor numbers if demand is price elastic resulting in a fall in revenues to tourist sites. The impact on revenue can be illustrated by examples of consumers switching to alternative destinations to help explain the impact. **4 marks**
- for candidates who explain that an increase in price may lead to a less than proportionate fall in visitor numbers if demand is price inelastic resulting in a rise in revenues to tourist sites. The impact on revenue can be illustrated by explaining the inability of visitors to switch to alternatives to help explain the impact. **4 marks**

Maximum of 8 marks for written explanation**MAXIMUM FOR PART (c): 12 MARKS**

(d) **Extract B** (lines 9-11) states that ‘campaigners are calling for hotel bed taxes, airport surcharges, and even admission charges for pedestrians to city central areas in addition to any congestion charges for motorists’.

Using the data and your economic knowledge, evaluate the case **for** and **against** government intervention in the tourism industry. *(25 marks)*

It is anticipated that candidates might begin their answers by briefly considering the issue of market failure and tourism together with some initial reference to the data, before analysing in more detail with evaluative comments.

Candidates will need to demonstrate that they are able to evaluate issues and arguments if they are to be awarded **more than 13 marks**.

Candidates who make a genuine attempt at evaluation should be well rewarded. In the context of this question they might refer to: *the extent to which market failure arises because of tourism; the relative significance of benefits as opposed to costs from tourism; a comparison of different forms of intervention; the effectiveness of different forms of intervention; the role of markets versus the role of government; the problem of identifying tourist industries.*

Candidates should not be awarded above **Level 3** if evaluation does not go beyond the very limited. However, within this constraint, there is scope to award the more implicit evaluation, i.e. where there is some evidence of judgements having been made by candidates as to what are relevant/irrelevant issues.

To gain **Levels 4 or 5**, there needs to be more explicit evaluation along the lines suggested above, and clear evidence of critical/informed comment on issues raised, the ability to make judgements, and the ability to draw conclusions from the material presented.

Candidates should be awarded a maximum of **20 marks** if there is no **explicit** reference to the data or to tourism. Where candidates deal with only one part of the question, a maximum of **16 marks** should be awarded.

Issues and areas for discussion include:

- methods of intervention such as taxation or direct controls
- advantages of particular methods of intervention
- disadvantages of particular methods of intervention
- market failure considerations, e.g. externalities, congestion, conservation
- government failure considerations, e.g. unintended consequences
- short term/long term considerations
- effects on economic efficiency and resource allocation
- role of markets in allocating scarce resources

Also give credit for:

- use of diagrams
- references to the UK and/or other economies
- an overview of the issues raised; a final judgement

**USE THE LEVELS MARK SCHEME FOR
THIS PART OF THE QUESTION (see page 14)**

MAXIMUM FOR PART (d): 25 MARKS

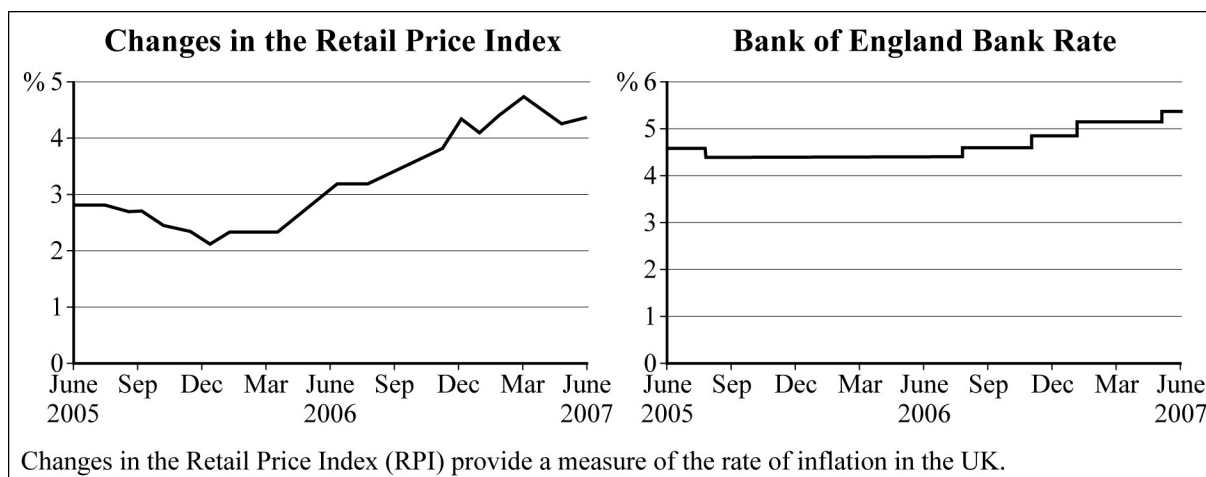
MAXIMUM FOR THIS QUESTION: 50 MARKS

ECON2: The National Economy

Total for this question: 50 marks

Study **Extracts A, B and C**, and then answer **all** parts of the Question which follows.

Extract A: Changes in the Retail Price Index (%) and the Bank of England Bank Rate (base rate) of interest (%), June 2005 to June 2007



Sources: Office for National Statistics/Bank of England

Extract B: It seems to have been all doom and gloom in the summer of 2007

In the summer of 2007, share prices saw significant falls in the UK and across the world; poor weather brought flood damage, and consequently tourism suffered; the housing market and retail sales suffered downturns, with sales of food, drink and furniture being hardest hit.	1
Amidst all the gloom, interest rates have continued their upward trend with the Bank Rate set by the Monetary Policy Committee (MPC) threatening to hit 6%, in order to bring the rate of inflation nearer to the Government's target of 2%, as measured by the Consumer Price Index (CPI). Although in June the CPI measure of inflation was near to this target at 2.4%, the RPI measure of inflation stood at 4.4%, suggesting that inflation remained a problem.	5 10
Interest rate policy remains central to the control of inflation but does not necessarily come without some costs. Credit and mortgages become more expensive and investment can be discouraged. Saving does, however, become more attractive.	
In economic terms, the summer of 2007 has been something of a disaster, especially when, in the same period last year, retailers enjoyed a twin economic boost from a heat wave and the football World Cup.	15

Extract C: The pound soars to a 26-year high against the US \$

The exchange rate of the pound can be one factor influencing the rate of growth of UK Gross Domestic Product (GDP). Recent rises in UK interest rates have attracted overseas funds to the UK, creating a higher demand for pounds and thus causing the value of the pound to rise against some other currencies, including the US \$. It means more good news for British tourists but spells further problems for exporters and, in turn, British industry. Both UK businesses and consumers can, however, benefit from cheaper imports.

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A rising rate of inflation and a stronger pound can damage UK competitiveness. However, we may not need to be too concerned if the supply-side of the economy is able to counteract any negative effects these two factors might otherwise have. Rising labour productivity, low labour costs, more investment, and better quality products, for example, can all give the UK a fighting chance in world markets, even when trends in the rate of inflation and in the exchange rate do not offer much reason for optimism.

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Question

(a) Define the term ‘rate of inflation’ (**Extract B**, line 7). (5 marks)

(b) Using **Extract A**, identify **two** main points of comparison between the UK rate of inflation and the Bank Rate (base rate) of interest over the period shown. (8 marks)

(c) **Extract C** (lines 1 and 2) refers to the exchange rate of the pound as a possible ‘factor influencing the rate of growth of UK GDP’.

Explain the term ‘the exchange rate of the pound’ and analyse **one** way in which a strong pound can influence the rate of growth of UK GDP. (12 marks)

(d) **Extract C** (line 8) suggests that we ‘may not need to be too concerned’ about a rising rate of UK inflation and a stronger pound.

Using the data and your economic knowledge, evaluate the significance for UK macroeconomic performance of **both** a rising rate of inflation **and** a stronger pound. (25 marks)

Mark Scheme

(a) Define the term ‘rate of inflation’ (Extract B , line 7).	<i>(5 marks)</i>
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For an acceptable definition (e.g. the change in average prices in an economy over a given period of time) **5 marks**

For a definition which defines inflation but not the rate of inflation, e.g. a persistent rise in the general price level, or a continuous rise in prices causing money to lose its purchasing power **4 marks**

Otherwise, if the definition is incomplete, marks may be broken down, for example as follows:

define rate of inflation or inflation only with a microeconomic perspective, i.e. referring only to the price rise of a single product or within one industry **1 mark**

refer in their definitions to the current/recent rate of UK inflation (i.e. in the year that the question would be set) but not simply lifting one month’s 2007 figures from the extract **1 mark**

refer to the rate of inflation being measured in the UK by the CPI and/or the RPI **1 mark**

MAXIMUM FOR PART (a): 5 MARKS

(b) Using Extract A , identify two main points of comparison between the UK rate of inflation and the Bank Rate (base rate) of interest over the period shown. <i>(8 marks)</i>
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Award up to 4 marks for each valid point made (up to two marks for identification and up to two marks for supporting reference(s) to the data). For example:

- both the RPI and bank rate show an upward trend over the period
- the RPI shows a more significant change over the period than does the bank rate
- the dip in the RPI starting in June 2005 and continuing to December 2005 is more pronounced than the reduction in the bank rate which then levels out through to the summer of 2006
- the RPI reaches its peak around March 2007, the bank rate around June 2007
- the RPI shows more volatility around December 2006, the bank rate around August 2006

A maximum of **4 marks** may be awarded if the candidate simply trawls through the data, with no attempt at comparison, or does not quote statistics from the graphs.

If there is some attempt at an overview but also evidence of a trawl, award a maximum of **6 marks** as long as a comparison has been attempted and statistics used.

MAXIMUM FOR PART (b): 8 MARKS

- (c) **Extract C** (lines 1 and 2) refers to the exchange rate of the pound as a possible ‘factor influencing the rate of growth of UK GDP’.

Explain the term ‘the exchange rate of the pound’ and analyse **one** way in which a strong pound can influence the rate of growth of UK GDP. *(12 marks)*

For candidates who:

- Explain ‘the exchange rate of the pound’, e.g. the rate at which the pound sterling can be exchanged for another currency and can therefore be regarded as the price of the currency expressed in terms of other currencies (for example, \$2 = £1, or €1.9 = £1). **up to 5 marks**
- Explain ‘the rate of growth of GDP’, e.g. GDP is the value of goods and services produced in an economy per time period and can be calculated by measuring incomes, expenditure or output. The difference between the current year’s GDP and the previous year’s GDP can be expressed in % terms and indicates the rate of growth of GDP. **up to 2 marks**

provide an analysis of how a strong pound can influence the rate of growth of GDP, eg:

- a strong £ will impact on export prices so that the price of UK exports in overseas markets will increase, possibly causing overseas demand for UK exports to fall if demand is price sensitive (3 marks). Given that exports are one component of GDP, the others being consumption, investment and the government sector, we can expect the rate of growth of GDP to be affected unless other components of GDP compensate (2 marks). The impact of a strong pound on export prices can be illustrated by a numerical example or examples to help explain the impact (3 marks). **up to 8 marks**
- a strong pound can cause the prices of imports into the UK to be lower. Cheaper imports of raw materials and energy may provide a boost to UK manufacturing by causing production costs to fall, perhaps benefiting the rate of growth of GDP. However, cheap consumer imports may damage UK manufacturing and this could, in turn, damage the rate of growth of GDP. Use of numerical example(s). **up to 8 marks**
- a strong pound can cause a positive response from UK exporters fighting to save market share in that they review cost structures, e.g. wage costs, and also consider how productivity might be improved to lower unit costs. Taken together, these could more than compensate for the effects of a stronger pound by improving competitiveness in world markets. Use of numerical example(s). **up to 8 marks**
- use diagrams to support their analysis, e.g. supply and demand or AD/AS **up to 2 marks per diagram (1 mark for curve/axes labelling, 1 mark for the information shown) to a maximum of 4 marks**
- make reference to the UK economy **up to 2 marks**

Where a candidate only provides a definition of the exchange rate **or** only provides an analysis for the strong pound affecting the rate of growth, he/she should be limited to **6 marks**.

While reference to the data should be given due credit within the 6 marks awarded for the analysis, candidates who do little more than simply copy from Extract C should be awarded a maximum of **2 marks**.

MAXIMUM FOR PART (c): 12 MARKS

(d) **Extract C** (line 8) suggests that we ‘may not need to be too concerned’ about a rising rate of UK inflation and a stronger pound.

Using the data and your economic knowledge, evaluate the significance for UK macroeconomic performance of **both** a rising rate of inflation **and** a stronger pound.

(25 marks)

It is anticipated that candidates might begin their answers by briefly considering the two issues together with some initial reference to the data, before analysing them in more detail with evaluative comments.

Candidates will need to demonstrate that they are able to evaluate issues and arguments if they are to be awarded **more than 13 marks**.

Candidates who make a genuine attempt at evaluation should be well rewarded. In the context of this question they might: *refer to the obvious increased magnitude of the problem if these two factors occur simultaneously; consider the extent of the inflation problem and the degree of appreciation of the £; the relative significance of higher export prices as opposed to cheaper import prices; a comparison of these issues with other factors which may have more or less impact on performance; the duration of these potential problems; the way in which these two factors interact.*

Candidates should not be awarded above **Level 3** if evaluation does not go beyond the very limited. However, within this constraint, there is scope to award the more implicit evaluation, i.e. where there is some evidence of judgements having been made by candidates as to what are relevant/irrelevant issues.

To gain **Levels 4 or 5**, there needs to be more explicit evaluation along the lines suggested above, and clear evidence of critical/informed comment on issues raised, the ability to make judgements, and the ability to draw conclusions from the material presented.

Candidates should be awarded a maximum of **20 marks** if there is no **explicit** reference to the data or to the UK economy. Where candidates deal with only one part of the question, a maximum of **16 marks** should be awarded.

Issues and areas for discussion include:

- inflation
- the concept of a ‘rising rate of inflation’
- inflation v deflation
- the ability to control an inflation problem
- the role of the MPC and interest rate policy
- inflation and UK competitiveness

- inflation and other aspects of macroeconomic performance, e.g. economic growth
- exchange rate of a currency
- the concept of a ‘stronger pound’
- appreciation v depreciation
- the official willingness/ability to manipulate the exchange rate
- the exchange rate and macroeconomic performance, e.g. the balance of payments on current account, the rate of inflation
- the impact on exports and imports
- the exchange rate and UK competitiveness

- other factors affecting macroeconomic performance, e.g. productivity and other supply-side factors
- the underlying strength or otherwise of the UK economy
- the extent of the problem created by these two issues
- the exacerbation of any problems if there is simultaneous occurrence
- the duration of the problem
- the degree of interaction between these two issues
- the potential relevance of international developments, e.g. the rate of inflation in other countries, the economic cycle within our major trading partners

Also give credit for:

- use of diagrams
- references to the UK and/or other economies
- an overview of the issues raised; a final judgement

**USE THE LEVELS MARK SCHEME FOR
THIS PART OF THE QUESTION (see page 14)**

MAXIMUM FOR PART (d): 25 MARKS

MAXIMUM FOR THIS QUESTION: 50 MARKS

THE LEVELS MARK SCHEME FOR AS

Level Descriptions

In part (d) of the data response questions, approximately half the marks are available to award to candidates who demonstrate that they can evaluate economic arguments and evidence, and make informed judgements. An answer showing no evidence of evaluation, however good the analysis, should be awarded a maximum of 13 marks (in Level 3). The quality of evaluation should be the sole distinction between a Level 4 and Level 5 answer. It is not necessary for the answer to identify a wide range of issues to score the top mark. As indicated below, the **Quality of Written Communication** used should be taken into account when awarding marks.

Level 1: A very weak answer

Few, if any, relevant issues are recognised. Economic concepts and principles are not adequately understood or applied to the question. No satisfactory analysis or evaluation. There might be some evidence of organisation in the answer but generally it fails to answer the question. Descriptions and explanations lack clarity. Spelling, punctuation and grammar may be poor. There is little use of economic terminology.

0 to 6 marks

Mid-Point 4 marks

Level 2: A poor answer but some understanding is shown

One or more relevant issues are recognised. An attempt is made to use basic economic concepts to answer the question but the candidate's explanation may become confused and analysis will therefore be very limited. There may be some attempt to present alternative points of view but any attempt at evaluation is limited or superficial. There is some logic and coherence in the organisation of the answer. The candidate demonstrates some ability to spell commonly used words and to follow the standard conventions of punctuation and grammar. Some use of economic terminology is made but this is not always applied appropriately.

7 to 11 marks

Mid-Point 9 marks

Level 3: An adequate answer with some correct analysis but very limited evaluation

Two or more relevant issues are recognised. The candidate has made a reasonable attempt to apply economic concepts and ideas. A satisfactory understanding of some basic economic concepts and theories is demonstrated and there is some evidence that the candidate can analyse issues. There will be some attempt to present alternative points of view and to evaluate the issues, arguments and/or data. 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. There is some evidence of the correct use of relevant economic terminology.

12 to 16 marks

Mid-Point 14 marks

Level 4: Good analysis but limited evaluation

Two or more relevant issues are identified. Good understanding of basic economic concepts and models is demonstrated. The candidate is able to apply these concepts and models to answer the question. Some appreciation of alternative points of view is shown. Satisfactory use is made of evidence and/or theoretical analysis to evaluate the issues/arguments/economic models identified and to support conclusions. Spelling is generally accurate and the standard conventions of punctuation

and grammar are usually followed. The answer is well organised. Descriptions and explanations are clearly expressed. Appropriate use is made of relevant economic terminology.

17 to 21 marks

Mid-Point 19 marks

Level 5: Good analysis and evaluation

Two or more relevant issues are identified. Good understanding of basic economic concepts and models is demonstrated. The candidate is able to apply these concepts and models to answer the question. Clear understanding of alternative points of view is shown. Good use is made of evidence and/or theoretical analysis to evaluate the issues/arguments/economic models identified and to support conclusions. A clear final judgement is made. Spelling is generally accurate and the standard conventions of punctuation and grammar are usually followed. The answer is well organised. Descriptions and explanations are clearly expressed. Appropriate use is made of relevant economic terminology.

22 to 25 marks

Mid-Point 24 marks

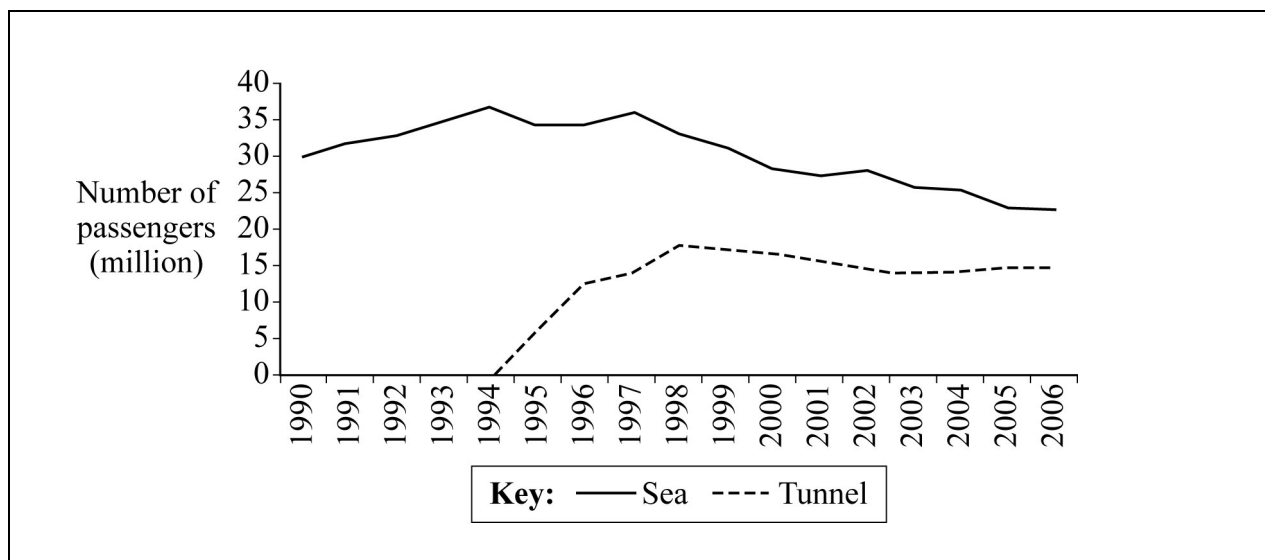
ECON3: Business Economics and the Distribution of Income

THE EUROPEAN UNION CONTEXT

Total for this question: 40 marks

Study **Extracts A, B and C**, and then answer **all** parts of the Question which follows.

Extract A: International sea and channel tunnel passengers



Source: Industry figures

Extract B: A changing market

P&O Ferries is the UK's largest ferry operator, resulting from the mergers of a number of companies, including North Sea Ferries, Irish Ferries, Stena Line and European Ferries. 1

Like other ferry operators, P&O has had to react to developments such as the rise of low-cost, no-frills airlines, and improved services by Eurostar through the channel tunnel linking with continental high-speed rail networks. As well as these threats, there have been some opportunities, such as increased second home ownership by UK nationals in countries like France and Spain. 5

A number of jobs were axed when P&O reviewed the number of ferries in a bid to reduce capacity and lower costs. The company said that France's decision to raise duty on tobacco had hit cross-Channel day trips. There were also allegations that British customs officers were accusing some innocent travellers of intending to re-sell alcohol and tobacco, and confiscating their goods and vehicles. Consumer watchdogs took action in the European Courts, claiming that the UK authorities were undermining the Single European Market's free movement of goods. 10

Low-cost airlines are offering 'headline' prices (excluding extras such as taxes and surcharges) in advertisements which claim fares 'from £9.99', or even less, for trips to France, Spain and other European destinations. One airline even offers 'free seats' (although it charges for each suitcase checked in). In the face of such aggressive marketing, in the half-year before P&O's review of ferries, the revenues of the company's ferry arm dropped from £506 million to £467 15

million, while losses increased from £20 million to £25 million. However, the situation was better at the P&O Group's ports division, where its facilities for handling imports and exports saw an operating profit of £71 million. This is largely due to booming long-distance freight trade, especially with China. That helped the P&O Group as a whole to more than double its operating profits to £113 million. 20

Extract C: Ferry firms raided by EU watchdogs

Cross-channel ferry companies and the channel tunnel operator Eurotunnel have been raided by European Commission inspectors looking for evidence of collusion. It appears that British consumers had written letters of complaint to the UK's Competition Commission complaining that after shopping around for the cheapest cross-channel deal, prices turned out to be surprisingly uniform. While headline prices in the brochures appeared to vary, customers found that once all the discounts and extras in the small print had been accounted for, the end results were very similar. 1
5

Due to the international nature of the business, together with the size of the market, the complaints were forwarded to the competition authorities at the European Union. Commission inspectors also visited the offices of ferry companies in Sweden, Denmark and Germany, taking away both paper files and computer records. A Commission spokesperson said, 'Surprise inspections do not necessarily mean that companies operating in an oligopolistic market are guilty of abusing their market power. We have to gather a lot of evidence before considering a prosecution.' 10

A spokesperson for one of the ferry companies said, 'We are confident that any investigation will show that we are not trying to become a monopoly. If prices are similar it is because fierce competition has driven them all down to low levels, and it is not because of illegal price-fixing agreements.' 15

Question

(a) Using **Extract A**, compare the changes in the numbers of international sea and channel tunnel passengers over the time period shown. (5 marks)

(b) **Extract C** (lines 16-18) states that if "prices are similar it is because fierce competition has driven them all down to low levels, and it is not because of illegal price-fixing agreements".

Analyse how a firm like P&O might behave in an oligopolistic market when setting its prices. (10 marks)

(c) "Surprise inspections do not necessarily mean that companies operating in an oligopolistic market are guilty of abusing their market power" (**Extract C**, lines 12-13).

Using the data and your economic knowledge, discuss whether the government should intervene in the cross-channel travel market. (25 marks)

MARK SCHEME

- (a) Using **Extract A** compare the changes in the numbers of international sea and channel tunnel passengers over the time period shown. *(5 marks)*

Award **1 mark** for each valid point made and **1 mark** for the supporting reference to the data, up to the maximum of **5 marks**.

Points might include

- international sea passengers gently declining over whole period; channel tunnel passengers increasing
- channel tunnel passengers less than international sea passengers throughout entire period
- the gap between the two variables has closed from the beginning to the end of the period
- the number of passengers in both categories is relatively constant from 2000 onwards (neither graph shows growth in recent years)
- there are some upward ‘spikes’ in the sea passengers graph; the tunnel graph rises steeply at the beginning, then levels off without further spikes

A maximum of **2 marks** may be awarded if the candidate simply trawls through the data with no attempt at comparison.

A maximum of **3 marks** may be awarded if there is no use of statistics.

A maximum of **4 marks** may be awarded where there is evidence of an overview having been taken, even though parts of the answer give an impression of a trawl through the data.

MAXIMUM FOR PART (a): 5 MARKS

- (b) **Extract C** (lines 16-18) states that if “prices are similar it is because fierce competition has driven them all down to low levels, and it is not because of illegal price-fixing agreements”.

Analyse how a firm like P&O might behave in an oligopolistic market when setting its prices. *(10 marks)*

For candidates who:

- Discuss theoretical explanations of behaviour, e.g.
 - The kinked demand curve
 - Some sort of games theory
- Discuss possible ways in which oligopolistic firms like P&O set prices, e.g.
 - Price-seeking behaviour/uncertainty
 - Price stickiness
 - Non-price competition
 - Price leadership

- Dominant firm
- Barometric
- Cartels/complex monopoly (seeking abnormal profit)
- Price wars

Up to **5 marks** for developing a basic model of oligopoly behaviour

Up to **5 marks** for relating this to P&O pricing policy

Up to **3 marks** for referring to possible evidence of oligopoly from the data (e.g. mergers indicate a smaller number of firms; a lack of price transparency could indicate non-price competition).

Give credit, up to **3 marks**, for candidates who argue that there is a possibility that P&O might be operating in an oligopolistic **structure**, but its **conduct** might be competitive, (a ferry company spokesman makes a claim along these lines in Extract C).

MAXIMUM FOR PART (b): 10 MARKS

(c) “Surprise inspections do not necessarily mean that companies operating in an oligopolistic market are guilty of abusing their market power” (**Extract C**, lines 12-13).

Using the data and your economic knowledge, discuss whether the government should intervene in the cross-channel travel market. *(25 marks)*

The well-informed candidate might note that government intervention is in practice usually aimed at oligopolies, as opposed to pure monopolies. The oligopolists might be behaving as ‘complex’ monopolies, through collusion for example.

In answer to the general point as to whether intervention is necessary, it is possible that candidates will discuss general reasons why competition is considered preferable to monopoly, for example, because of productive and allocative efficiency.

It might be that government intervention is rendered unnecessary because market forces are automatically creating further competition. The extracts contain strong hints about the potential for increased competition from other modes of transport (the tunnel and low-cost airlines); however, there are hints that the pricing policies of the airlines might not necessarily provide very keen competition, as their true prices might be as obscure and hedged with small print as those of the ferry companies. ‘Perfect knowledge’ is one of the conditions for a perfect market, and would hardly seem to apply here. There is plenty of scope for **evaluation** in discussing these issues.

Evaluation could include an assessment of the pros and cons of government intervention as opposed to non-intervention (or leaving it to market forces). Candidates who include a conclusion that brings together the ‘threads’ of the arguments presented earlier should also be given credit for evaluation.

To achieve **Level 4**, at least 3 relevant issues should be discussed.

To achieve **Level 5**, there should, in addition, be an attempt to provide a more general evaluation of the arguments referred to, in order that a concluding judgement can be made by the candidate.

Where there is no explicit reference to the data, award a maximum of **20 marks**.

There must be evidence of evaluation for candidates to score more than **15 marks**.

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

Issues and areas for discussion include

- Market failure arguments ...
 - Disadvantages of monopolistic behaviour
 - Higher prices
 - Lower output
 - Allocative inefficiency
 - Productive inefficiency
 - Price elasticities of demand are likely to be low (if there are few substitutes)
 - Barriers to entry exist, including massive start-up costs
 - All the above providing a justification for intervention
- Possible methods of government intervention, e.g.
 - Action against mergers (these are mentioned in the data)
 - Forced re-structuring
 - Fines and legal penalties
- Government failure arguments
- Role of increased competition
 - Tunnel and airlines are taking market share
 - However airlines cannot carry vehicles, therefore there is a distinct market
 - the EU could encourage new ferry companies to enter the market
- Give credit for discussion of the ferry company's argument that similar prices arrived at by competition might give a false impression of collusion
- Give credit for possible advantages of collusion, eg:
 - to maintain essential services
 - protect capacity and therefore economies of scale

Also give credit for

- Use of the data
- Reference to UK and EU economies
- Diagrams
- An overall judgement on the issues raised.

**USE THE LEVELS MARK SCHEME FOR
THIS PART OF THE QUESTION (see page 28)**

MAXIMUM FOR PART (c): 25 MARKS

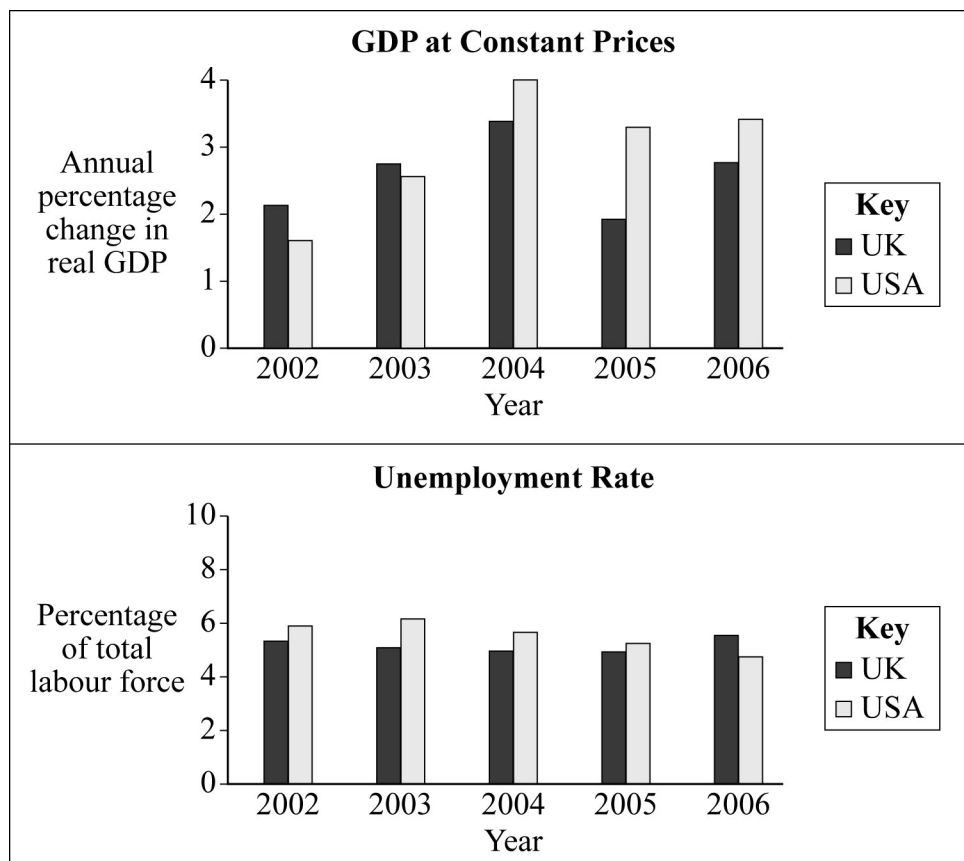
ECON4: The National and International Economy

THE GLOBAL CONTEXT

Total for this question: 40 marks

Study **Extracts A and B**, and then answer **all** parts of the Question which follows.

Extract A: Selected economic indicators for the UK and the USA, 2002 to 2006



Source: adapted from official statistics

Extract B: The world economic outlook, April 2007

Economic activity in Asia continues to expand at a brisk pace, led by very strong growth in both China and India. In China, real GDP expanded by 10.7%. In India, real GDP growth of 9.2% and upward inflationary pressures have prompted the Reserve Bank of India to raise interest rates. With inflationary pressures still strong, a further tightening of monetary policy is likely to be needed.

1

5

Activity in western Europe gathered momentum in 2006. GDP growth in the euro area reached 2.6%, almost double its pace in 2005 and the highest rate since 2000. Germany was the principal engine of growth, fuelled by increased exports and strong investment. Growth in France and Italy was somewhat slower. The unemployment rate in the euro area

fell to 7.6% by the end of 2006, its lowest level in 15 years. Meanwhile, the expansion gained pace in the UK, driven by an acceleration of domestic demand, especially consumption, while investment and export performance remained solid. 10

The drop in oil prices from August 2006 helped to bring CPI inflation in the euro area down to just below 2% by the end of 2006. Wage increases remain contained at low levels, despite labour market tightening. However, euro area growth is projected to remain close to or above potential, and there is the possibility of upward pressure on factor prices. In the UK, buoyant demand and higher energy prices have pushed inflation to its highest level in five years. In recent months, both the European Central Bank and the Bank of England have raised interest rates to try to contain inflationary pressures. 15

At this point, it is too early to judge whether the present expansion in the UK and western Europe reflects an improvement in underlying economic growth or merely a cyclical upswing. Per capita GDP levels in the UK and western Europe have fallen increasingly behind those of the USA since 1995. The growth in labour productivity in Europe has continued to slow whilst productivity in the USA has accelerated. A major factor behind Europe's poor productivity performance compared to the USA relates to the slower take-up of new technologies, particularly rapid advances in information and communications technology. While progress has been made in improving labour utilisation, further reforms are needed to close the gap with the USA. Unemployment is lower and labour force participation rates are higher in the USA than in most European economies. An ageing population is also likely to inhibit growth. Supply-side policies, including reforms to the tax-benefit system that are designed to reduce the replacement ratio (the ratio between benefits received when out of work and the wage earned when in work), may help. 20
25
30

Question

(a) Using the two indicators shown in **Extract A**, compare the economic performance of the UK and the USA between 2002 and 2006. (5 marks)

(b) **Extract B** states that the Reserve Bank of India, the European Central Bank and the Bank of England have increased interest rates in response to inflationary pressures.

Analyse how higher interest rates can help to reduce inflation. (10 marks)

(c) **Extract B** (lines 22-23) states: 'Per capita GDP levels in the UK and western Europe have fallen increasingly behind those of the USA since 1995.'

Using the data and your economic knowledge, assess the policies that could be adopted to improve the underlying rate of economic growth of the UK economy. (25 marks)

Mark Scheme

(a) Using the two indicators shown in **Extract A**, compare the economic performance of the UK and the USA between 2002 and 2006. *(5 marks)*

Annual % change in GDP at constant prices

For candidates who:

state that for the first two years the annual rate of growth in real GDP was higher in the UK than in USA but that in the last three years it was higher in the USA **Up to 2 marks**

use figures to indicate the extent of the difference in the rate of economic growth (e.g. growth in the UK was never more than 0.5% higher than in the USA whereas in 2005 it was approximately 1.3% higher in the USA) **Up to 2 marks**

state that growth rates in each country follow a similar pattern; rising between 2002 and 2004, falling in 2005 before rising again in 2006 **Up to 2 marks**

state that the annual rate of growth in real GDP has been more volatile in the USA than in the UK **1 mark**

use figures to compare the highest and lowest rates of growth over the period (e.g. in the UK the highest and lowest rates of growth were approximately 1.9% and 3.3% respectively whereas in the USA they were around 1.6% and 3.9%) **Up to 2 marks**

Up to a maximum of 3 marks for comparing the annual % change in GDP at constant prices

Unemployment Rate

For candidates who:

state that between 2002 and 2005 unemployment was higher in the USA than in the United Kingdom whereas in 2006 the rate of unemployment in the USA fell below that in the UK (award **1 mark** if the candidate just states that unemployment has been higher in the USA than in the UK)

Up to 2 marks

use figures to indicate the extent of the difference in unemployment rates (e.g. between 2002 to 2003 the difference between unemployment in the United Kingdom and the USA increased from approximately +0.6% to +1.0% whereas between 2003 and 2006 it fell from +1.0% to -0.8%)

Up to 2 marks

state that unemployment peaked in the USA in 2003 but has fallen thereafter, whereas in the United Kingdom unemployment fell until 2005 but rose in 2006 **Up to 2 marks**

use figures to support their comparison **Up to 2 marks**

state that unemployment was lower in the USA at the end of the period than at the start of the period, whereas in the UK unemployment was higher in 2006 than in 2002 **Up to 2 marks**

use figures to indicate the extent of the change in unemployment over the period (e.g. in the USA it has fallen by around 1.2% but in UK it has risen by approximately 0.2%) **Up to 2 marks**

Up to a maximum of 3 marks for comparing the unemployment rate

For candidates who provide an overall conclusion, recognising that at the start of the period the performance of the UK economy was better than the performance of the US economy but that by the end of the period this had been reversed. **1 mark**

A maximum of **2 marks** may be awarded if the candidate simply trawls through the data with no attempt at comparison.

A maximum of **3 marks** may be awarded if there is no use of statistics.

A maximum of **4 marks** may be awarded where there is evidence of an overview having been taken, even though parts of the answer give an impression of a trawl through the data.

MAXIMUM FOR PART (a): 5 MARKS

(b) **Extract B** states that the Reserve Bank of India, the European Central Bank and the Bank of England have increased interest rates in response to inflationary pressures.

Analyse how higher interest rates can help to reduce inflation. *(10 marks)*

For candidates who:

Define inflation, e.g. as ‘the percentage increase in the price level’ or ‘the rate at which prices in general are increasing’ **Up to 2 marks**

Explain why higher interest rates are likely to reduce aggregate demand, for example, candidates might explain the impact of higher interest rates upon:

- the cost of borrowing and hence consumption and investment expenditure;
- mortgage repayments and hence consumption spending;
- the incentive to save;
- asset prices and wealth;
- the exchange rate and competitiveness;
- the rate of growth of the money supply.

Up to 4 marks

Analyse the impact of a reduction in aggregate demand on inflationary pressures in the ‘goods market’. For example, they might consider how lower sales and rising levels of stocks might encourage retailers to lower prices to increase spending. **Up to 5 marks**

Analyse the impact of a reduction in aggregate demand on inflationary pressures in the ‘factor markets’. For example, they might consider the impact of rising unemployment and job insecurity upon wage demands, unit costs and hence prices. The effects on commodity prices, office and factory rents and hence inflation might also be analysed. **Up to 5 marks**

Explain that higher interest rates are likely to lead to an appreciation of the exchange rate and analyse the impact of a rise in the exchange rate upon inflation. Candidates might analyse the effects of a higher exchange rate upon inflation via lower import prices **and/or** lower aggregate demand. **Up to 5 marks**

Explain how an increase in interest rates might affect inflationary expectations and analyse the likely impact of this upon future rates of inflation. **Up to 5 marks**

When awarding marks for the above, give credit to candidates who refer to recent experience in the UK or elsewhere in the world.

Use of relevant diagrams should be rewarded.

Up to 2 marks per diagram

Maximum of 3 marks for diagrams

MAXIMUM FOR PART (b): 10 MARKS

(c) **Extract B** (lines 22-24) states: ‘Per capita GDP levels in the UK and western Europe have fallen increasingly behind those of the USA since 1995.’

Using the data and your economic knowledge, assess the policies that could be adopted to improve the underlying rate of economic growth of the UK economy. **(25 marks)**

Candidates should recognise that supply-side policies are most likely to be employed by governments wishing to increase the underlying rate of growth of an economy. However, they should be given credit for discussing demand-side policies, particularly if they recognise that maintaining aggregate demand at an appropriate level is necessary to help to create a stable economic environment in which firms are more likely to invest and take risks. Ideally, they should also appreciate that simply injecting more demand into the economy is likely to be ineffective and unsustainable.

Some of the better candidates might attempt to link the policies to the reasons that have been identified in the data as contributing to the relatively poor performance of the UK (and other western European economies). They might also use their own knowledge of reasons for relatively lower growth in the United Kingdom. Credit should be given to those who do so.

To achieve a **Level 4**, at least three policies should be discussed.

To achieve **Level 5** there should also be a conclusion that indicates which policy or policies are likely to be most successful in improving the underlying rate of growth of the UK economy. A justification should be included.

Where there is no explicit reference to the data, award a maximum of **20 marks**.

There must be evidence of evaluation to score more than **15 marks**.

Evaluation should include an assessment of the pros and cons of the different policies. Candidates might also attempt to evaluate the use of market oriented solutions compared to those that depend on government intervention in the economy. In addition, candidates who include a conclusion that brings together the ‘threads’ of the arguments presented earlier should also be given credit for evaluation.

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

Issues and areas for discussion include:

- what is meant by ‘the underlying rate of economic growth’
- reasons why UK (and possibly western Europe’s) per capita GDP levels have fallen increasingly behind those of the USA. These reasons include: the slower growth in labour productivity in the UK than in the USA, the slower take-up of new technologies and lower rates of labour utilisation.
- labour market reforms such as: changes to the tax-benefit system, trade union reforms, measures to improve labour mobility, measures to encourage flexible working
- measures designed to make product markets more competitive
- lower rates of taxation on business
- policies designed to increase investment in capital goods
- de-regulation and the reduction of national government/EU imposed controls on industry
- privatisation of state run enterprises
- government support for R&D
- increased investment in education and training
- measures to encourage older people to remain in the labour force for longer
- the use of demand-side policies

Also give credit for:

- relevant use of evidence and examples
- diagrams
- an overall judgement regarding the problems and policies

**USE THE LEVELS MARK SCHEME FOR
THIS PART OF THE QUESTION (see page 28)**

MAXIMUM FOR PART (c): 25 MARKS

MAXIMUM FOR THIS QUESTION: 40 MARKS

THE LEVELS MARK SCHEME FOR A2

Level Descriptions

In part (c) of the data response questions and part (b) of the essay questions, 40% of the marks are available to award to candidates who demonstrate that they can evaluate economic arguments and evidence, and make informed judgements. An answer showing no evidence of evaluation, however good the analysis, should be awarded a maximum of 15 marks (in Level 3). The quality of evaluation should be the sole distinction between a Level 4 and Level 5 answer. As indicated below, the **Quality of Written Communication** used should be taken into account when awarding marks.

Level 1: A very weak answer

Few, if any, relevant issues are recognised. Descriptions and explanations lack clarity. 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. There might be some evidence of organisation in the answer but generally it fails to answer the question. Spelling, punctuation and grammar may be poor. There is little use of specialist vocabulary.

0 to 6 marks

Mid-Point 4 marks

Level 2: A poor answer but some understanding is shown

A few issues are recognised but there is only limited evidence of the candidate's ability to apply relevant economic concepts. Descriptions and explanations are sometimes hard to follow. An attempt is made to answer the question but there is little satisfactory analysis or evaluation. There is some very limited appreciation of the inter-relatedness of economic issues, problems and institutions. There is some limited logic and coherence in the organisation of the answer. 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.

7 to 11 marks

Mid-Point 9 marks

Level 3: An adequate answer with some correct analysis but very limited evaluation

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. There is 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. There is some use of specialist vocabulary which is applied appropriately.

12 to 16 marks

Mid-Point 14 marks

Level 4: Good analysis but limited evaluation

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 answer the question. A clear understanding of the inter-relatedness of economic issues, problems and institutions is demonstrated. The candidate shows the ability to think as an economist making effective use of the economist's 'tool kit' of concepts, theories and techniques. There is some appreciation of alternative points of view. Satisfactory use is made of evidence and/or theoretical

analysis to evaluate the issues/arguments/models identified. The candidate demonstrates some ability to synthesise the arguments presented and come to some relevant conclusions although these might not always be based on evidence presented. Spelling is generally accurate and the standard conventions of punctuation and grammar are usually followed. The answer is well organised. Descriptions and explanations are clearly expressed. A wide range of specialist vocabulary is used with facility.

17 to 21 marks

Mid-Point 19 marks

Level 5: Good analysis and evaluation

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 answer the question. A clear understanding of the inter-relatedness of economic issues, problems and institutions is demonstrated. The candidate shows the ability to think as an economist making effective use of the economist's 'tool kit' of concepts, theories and techniques. There is an appreciation of alternative points of view. Good use is made of evidence and/or theoretical analysis to evaluate the issues/arguments/models identified. The candidate demonstrates the ability to synthesise the arguments presented and come to conclusions which are based on the evidence presented. A clear final judgement is made. Spelling is generally accurate and the standard conventions of punctuation and grammar are usually followed. The answer is well organised. Descriptions and explanations are clearly expressed. A wide range of specialist vocabulary is used with facility.

22 to 25 marks

Mid-Point 24 marks