

**Published Mark Schemes for
GCE A2 Economics**

Summer 2010

Issued: October 2010

MARK SCHEMES (2010)

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.

CONTENTS

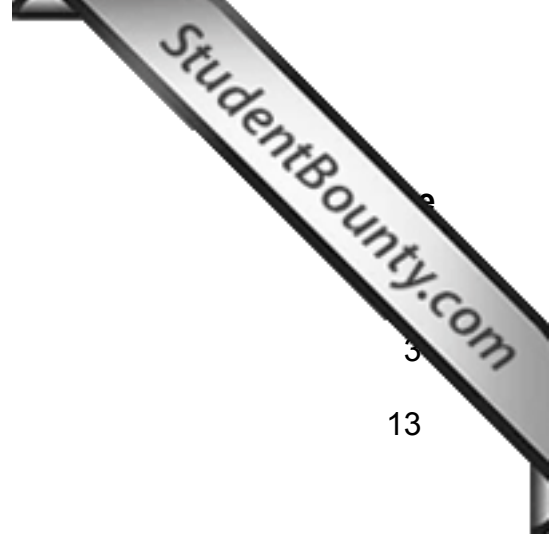
General Marking Instructions

A2 1

3

A2 2

13



General Marking Instructions

These mark schemes are intended to ensure that the A2 examinations are marked consistently and fairly. The mark schemes provide examiners with an indication of the nature and range of candidate responses likely to be worthy of credit. They also set out the criteria which they should apply in allocating marks to candidates' responses. The mark schemes should be read in conjunction with the general marking instructions which apply to all papers.

Quality of candidates' responses

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

Flexibility in marking

The mark scheme is 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. 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 18-year-old candidates. Conversely, marks should only be awarded for valid responses and not given for an attempt which is completely incorrect and 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.

Levels of response

Questions requiring candidates to respond in extended writing are marked in terms of levels of response. In deciding which level of response to award, examiners should look for the 'best fit' bearing in mind that weakness in one area may be compensated for by strength in another. In deciding which mark within a particular level to award to 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 the 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.

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 all questions that require them to respond in extended written form. These questions are marked on the basis of 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 in questions which have three levels of response or the maximum for Level 3 in those which have four levels of response.

For conciseness, quality of written communication is distinguished within levels of response as follows:

Level 1: Quality of written communication is limited.

Level 2: Quality of written communication is satisfactory.

Level 3: Quality of written communication is of a high standard.

Level 4: Quality of written communication is excellent.

In interpreting these level descriptions, examiners should refer to the more detailed guidance provided below:

Level 1 (Limited): The candidate makes only a limited attempt to select and use an appropriate form and style of writing. The organisation of material may lack clarity and coherence. There is little use of specialist vocabulary. Presentation, spelling, punctuation and grammar may be such that intended meaning is not clear.

Level 2 (Satisfactory): The candidate makes a reasonable attempt to select and use an appropriate form and style of writing, supported with appropriate use of diagrams as required. Relevant material is organised with some clarity and coherence. There is some use of appropriate specialist vocabulary. Presentation, spelling, punctuation and grammar are sufficiently competent to make meaning evident.

Level 3 (High Standard): The candidate successfully reflects and uses an appropriate form and style of writing, supported with the effective use of diagrams where appropriate. Relevant material is organised with a high degree of clarity and coherence. There is widespread use of appropriate specialist vocabulary. Presentation, spelling, punctuation and grammar are of a sufficiently high standard to make meaning clear.

Level 4 (Excellent): The candidate successfully reflects and uses the most appropriate form and style of writing, supported with precise and accurate use of diagrams where appropriate. Relevant material is extremely well organised with the highest degree of clarity and coherence. There is extensive and accurate use of appropriate specialist vocabulary. Presentation, spelling, punctuating and grammar are of the highest standard and ensure that meaning is absolutely clear.

New
Specification



StudentBounty.com

ADVANCED
General Certificate of Education
2010

Economics
Assessment Unit A2 1
Business Economics
[AE211]
FRIDAY 28 MAY, AFTERNOON

**MARK
SCHEME**

- 1 (a) The value of both RBS shares and the FTSE has fallen over the period shown on the diagram. The FTSE has lost approximately 33% of its value over the period. RBS' shares have lost about 94% of their value. The biggest drop in price occurred in Oct 09 when RBS shares fell from an indexed value of 60 to 22 which represents a 63% fall.
 [3] for identification of trend and selection of appropriate data
 [2] for manipulation of data to show relative performance [5]
- (b) (i) Investors began selling RBS shares as they were concerned about the level of toxic debt on its books and the fact that it announced the biggest loss in British corporate history. This increased the supply of shares and caused the share price to fall.
 Once the share price began to fall, more and more shareholders began selling their shares and RBS share price eventually collapsed. Source 1 tells us that investors dumped RBS shares in a selling frenzy.
 [2] for an accurately drawn diagram showing supply increasing
 [3] for explanation [5]
- (ii) The turmoil in the banking sector has had a knock on effect on other sectors, with the FTSE 100 falling by approximately 30% since September 08. This occurred because the demand for shares in general fell as investors became wary of potential losses. As it says in Source 1 the number of people willing to buy shares is at a 20 year low.
 [2] for an accurately drawn diagram showing demand decreasing
 [3] for explanation [5]
- (c) The merger between Lloyds and HBOS will lead to the banking market becoming more concentrated. Source 3 tells us that the newly named Lloyds Banking Group will control about 25% of British customers' personal bank accounts and about 28% of the mortgage market.
 This increased concentration is normally assumed to be bad for consumers on the grounds that the consequent reduction in competition will lead to higher prices, poorer quality services, less innovation and less choice.
 On the other hand higher levels of concentration can lead to benefits to consumers since the firms may be able to avail of economies of scale which in turn could lead to lower prices.

Areas for analysis and discussion include:

- Impact on efficiency
- Impact on prices
- Impact on quality
- Increased concentration does not necessarily mean less competition, some highly concentrated industries are fiercely competitive
- Analysis of economies of scale
- Impact on consumer surplus
- Appropriate diagrams

Level 1 ([1]–[3])

Candidate shows little understanding of the impact of greater concentration in UK banking. There is no significant application, analysis or evaluation and quality of written communication is limited.

Level 2 ([4]–[7])

Candidate shows some understanding of the impact of greater concentration in UK banking. There is some attempt at analysis and evaluation and quality of written communication is satisfactory.

Level 3 ([8]–[10])

Candidate shows in-depth understanding of the impact of greater concentration in UK banking. There is significant application, analysis and evaluation of the arguments and quality of written communication is of a high standard. [10]

- (d) Bank nationalisation is much on the agenda across the globe, with an increasing army of supporters saying governments have now no choice but to bite the bullet and seize control of failing institutions. Supporters of bank nationalisation point to the Swedish experience in the early 1990s when struggling banks were nationalised for a short time before being re-privatised. They argue that the current policy of supporting struggling banks has actually caused bank lending to dry up further and force British taxpayers to shoulder the risk of bank debts. Others, however, are opposed to the idea of nationalisation since they believe that governments are inherently inefficient.

Areas for analysis and discussion include:

- Impact of nationalisation on efficiency
- Impact of nationalisation on the quality of service provided
- Competing objectives of banks and governments
- Cost of nationalisation
- Discussion of alternative solutions
- Possibility of getting money back when banks are privatised
- Moral hazard associated with government bailouts
- The need for lending to increase to help stimulate the economy

Level 1 ([1]–[5])

Candidate displays little understanding of the case for and against the nationalisation of the banking industry. There is no significant evaluation of the issues and quality of written communication is limited.

Level 2 ([6]–[10])

Candidate provides some understanding of the case for and against the nationalisation of the banking industry. There is a degree of evaluation though this may lack depth or be one sided. Quality of written communication is satisfactory.

Level 3 ([11]–[15])

Candidate provides a clear and comprehensive understanding of the case for and against the nationalisation of the banking industry. There is significant evaluation and judgement and quality of written communication is of a high standard. [15]

- 2 (a) Price discrimination occurs when a monopolist sells the **same** product in two or more markets at different prices. In other words different consumers pay different prices for the same goods.

To price discriminate the following conditions need to exist.

- The firm must have some market power, i.e. not be a price taker.
- The firm must be able to separate the markets.
- Buyers in different markets must have different elasticities of demand.
- Firms must be able to prevent reselling by those buyers who paid the low price to those who would pay the higher price.

If these conditions exist, firms can charge those with less elastic demand higher prices and therefore gain higher levels of revenue and profit.

Areas for analysis and discussion include:

- appropriate diagram
- appropriate examples
- conditions necessary for price discrimination
- impact on revenue and profits
- distinction between 1st, 2nd and 3rd degree price discrimination
- reference to price-skimming

Level 1 ([1]–[5])

Candidate shows little understanding of why firms price discriminate. Quality of written communication is limited.

Level 2 ([6]–[10])

Candidate shows some understanding of why firms price discriminate but this may be incomplete or contain errors. The answer may be supported by a diagram. Quality of written communication is satisfactory.

Level 3 ([11]–[15])

Candidate shows clear and comprehensive understanding of why firms price discriminate. The answer may be supported by an accurately drawn diagram. Quality of written communication is of a high standard. [15]

- (b) Some people argue that price discrimination should be outlawed since it will lead to some consumers paying a higher price for the product than would be the case if the firm did not discriminate. This means the welfare of consumers (as measured by their consumer surplus) would be reduced. The monopolist on the other hand is able to abuse his market power and gain higher revenue and greater profits and is able to increase his producer surplus at the expense of those with the more inelastic demand. They also argue that price discrimination is often used by firms to drive competitors out of business.

However price discrimination can benefit society since it leads to some consumers (those with relatively elastic demand) paying a lower price. In some cases individuals, who would have previously been unable to consume the good, will be *priced into the market* and would therefore gain welfare. E.g. the high price paid by business users for computer software may allow

the IT company to offer the same software to educational users at much lower prices.

It could also be argued that, since the monopoly can sell more goods by discriminating, it will have more scope to exploit economies of scale. These economies of scale could result in lower costs for the firm and therefore lower prices for all customers.

It could be argued that the monopolist could use some of the extra supernormal profit, earned by discriminating, to fund research and development and therefore lead to greater dynamic efficiency.

Areas for analysis and discussion include.

- appropriate diagram
- appropriate examples
- impact on consumer and producer surplus
- impact on profits
- efficiency of government regulation
- dynamic efficiency
- economies of scale
- price discrimination as an anti-competitive practice

Level 1 ([1]–[7])

Candidate shows little understanding of the arguments for and against the outlawing of price discrimination. There is no significant analysis or evaluation and quality of written communication is limited.

Level 2 ([8]–[13])

Candidate shows some understanding of the arguments for and against the outlawing of price discrimination. There is some attempt at analysis and evaluation and quality of written communication is satisfactory.

Level 3 ([14]–[19])

Candidate shows in-depth understanding of the arguments for and against the outlawing of price discrimination. There is significant analysis and evaluation of the arguments and quality of written communication is of a high standard.

Level 4 ([20]–[25])

Candidate shows clear and comprehensive understanding of the arguments for and against the outlawing of price discrimination. There is a thorough analysis, evaluation and judgement of the arguments and quality of written communication is excellent. [25]

40

- 3 (a) A market is said to be perfectly competitive when individually buyers and sellers believe that their own actions will have no influence on the market price. Perfectly competitive markets rarely exist in the real world however agriculture and market gardening and the foreign exchange markets are the best examples.

The assumptions of perfect competition

1. There is a large number of buyers and sellers who buy and sell such a small amount that they cannot affect market demand or supply.
2. The firms produce homogeneous products
3. There is perfect knowledge of market conditions for both buyers and sellers
4. There are no barriers to entry. Firms are free to enter and leave the industry.

These characteristics mean that the perfectly competitive firm is a price-taker. As a result of these characteristics perfectly competitive firms will only make normal profits in the long run. In long run equilibrium both allocative and productive efficiency is achieved.

Areas for analysis and discussion include:

- appropriate diagram
- appropriate examples
- assumptions of the model
- discussion of allocative and productive efficiency

Level 1 ([1]–[5])

Candidate shows little understanding of a perfectly competitive market. Quality of written communication is limited.

Level 2 ([6]–[10])

Candidate shows some understanding of a perfectly competitive market but this may be incomplete or contain errors. The answer may be supported by a diagram. Quality of written communication is satisfactory.

Level 3 ([11]–[15])

Candidate shows clear and comprehensive understanding of a perfectly competitive market. The answer may be supported by an accurately drawn diagram. Quality of written communication is of a high standard. [15]

- (b) The model of perfect competition requires the existence of a number of highly abstract and unrealistic assumptions. These assumptions should have been outlined in part (a).

Clearly these assumptions are unlikely to be replicated in reality and as a result some economists have argued that the model is of little benefit as a basis for competition policy.

They argue that the theory of contestable markets provides a better framework for analysing the behaviour of firms in the real world (since it does not require product homogeneity nor the existence of a large number of small firms) and therefore it should be used as a basis for competition policy. Indeed it is clear from recent decisions by both the OFT and the Competition Commission that the theory of contestable markets has played a much more prevalent role in

their decision making.

However it should be remembered that the theory of contestable markets is also based on a number of unrealistic assumptions, most notably the absence of barriers to exit (or sunk costs) and perfect knowledge.

As Baumol himself stated “perfectly contestable markets do not populate the world of reality any more than perfectly competitive markets do”.

Areas for analysis and discussion include:

- Assumptions of model of contestable markets
- appropriate diagrams
- appropriate examples
- role of OFT and Competition Commission
- discussion of unrealistic assumptions of perfect competition
- discussion of unrealistic assumptions of contestable markets
- discussion of economic models being used only as a framework or benchmark.

Level 1 ([1]–[7])

Candidate shows little understanding of the view that the theory of contestable markets provides a better framework for analysing the behaviour of firms in the real world and therefore it should be used as a basis for competition policy. There is no significant analysis or evaluation and quality of written communication is limited.

Level 2 (8)–[13])

Candidate shows some understanding of the view that the theory of contestable markets provides a better framework for analysing the behaviour of firms in the real world and therefore it should be used as a basis for competition policy. There is some attempt at analysis and evaluation and quality of written communication is satisfactory.

Level 3 ([14]–[19])

Candidate shows in-depth understanding of the view that the theory of contestable markets provides a better framework for analysing the behaviour of firms in the real world and therefore it should be used as a basis for competition policy. There is significant analysis and evaluation of the arguments and quality of written communication is of a high standard.

Level 4 ([20]–[25])

Candidate shows clear and comprehensive understanding of the view that the theory of contestable markets provides a better framework for analysing the behaviour of firms in the real world and therefore it should be used as a basis for competition policy. There is a thorough analysis, evaluation and judgement of the arguments and quality of written communication is excellent.

[25]

40

- 4 (a) Economies of scale are defined as those advantages of increased size, which lead to falling average costs. Whereas diseconomies of scale are those disadvantages of increased size which lead to increased average costs.

Economies and diseconomies of scale can be classified as either internal or external.

Internal economies and diseconomies of scale arise from the growth of individual firms regardless of what is happening to other firms. Internal economies and diseconomies of scale influence the shape of the LRAC curve. External economies and diseconomies of scale refer to those advantages that a firm receives from being in an industry that is growing. The economies are available to all firms in the industry. External economies and diseconomies of scale influence the position of the LRAC curve.

Areas for analysis and discussion include:

- appropriate diagram
- appropriate examples
- distinction between internal and external economies
- distinction between economies and diseconomies
- impact on LRAC curve

Level 1 ([1]–[5])

Candidate shows little understanding of economies and diseconomies of scale. Quality of written communication is limited.

Level 2 ([6]–[10])

Candidate shows some understanding of economies and diseconomies of scale but this may be incomplete or contain errors. The answer may be supported by a diagram. Quality of written communication is satisfactory.

Level 3 ([11]–[15])

Candidate shows clear and comprehensive understanding economies and diseconomies of scale. The answer may be supported by an accurately drawn diagram. Quality of written communication is of a high standard.

- (b) Internal diseconomies of scale are normally assumed to be the result of management problems. For example:

- In a large organisation it can be difficult to co-ordinate the work of a whole range of different sections and therefore some workers may be under-utilised.
- Large organisations often experience communication problems and therefore important information may get lost or delayed.
- It is also difficult to keep an eye on every worker in a large organisation and therefore slack may occur.
- In large organisations industrial relations can deteriorate and worker morale can suffer which reduces productivity.

It could be argued that advances in technology have made communications systems more effective and have made it easier for firms to keep an eye on staff to ensure slack does not occur. Technology has also made it easier to produce detailed production plans to ensure that all workers are fully utilised

at all times.

Improved management techniques should also help to maintain effective industrial relations which should in turn motivate staff and improve productivity. However experience would seem to suggest that when firms grow beyond a certain point they are likely to experience diseconomies of scale despite investment in technology or the use of modern management techniques.

Areas for analysis and discussion include:

- appropriate diagram
- appropriate examples
- distinction between internal and external diseconomies
- impact on LRAC curve
- reference to decreasing cost industries

Level 1 ([1]–[7])

Candidate shows little understanding of the view that advances in modern technology and improvements in management techniques mean that firms can continue to grow in size without experiencing diseconomies of scale. There is no significant analysis or evaluation and quality of written communication is limited.

Level 2 (8)–[13])

Candidate shows some understanding of the view that advances in modern technology and improvements in management techniques mean that firms can continue to grow in size without experiencing diseconomies of scale. There is some attempt at analysis and evaluation and quality of written communication is satisfactory.

Level 3 ([14]–[19])

Candidate shows in-depth understanding of the view that advances in modern technology and improvements in management techniques mean that firms can continue to grow in size without experiencing diseconomies of scale. There is significant analysis and evaluation of the arguments and quality of written communication is of a high standard.

Level 4 ([20]–[25])

Candidate shows clear and comprehensive understanding of the view that advances in modern technology and improvements in management techniques mean that firms can continue to grow in size without experiencing diseconomies of scale. There is a thorough analysis, evaluation and judgement of the arguments and quality of written communication is excellent.

[25] 40

Total 80



**ADVANCED SUBSIDIARY (AS)
General Certificate of Education
2010**

Economics

Assessment Unit A2 2

The Global Economy

[AE221]

WEDNESDAY 2 JUNE, MORNING

**MARK
SCHEME**

- 1 (a) Protectionism is the view that free trade is injurious and should be restricted in order to protect domestic industries and jobs.

Protectionist policies include tariffs, quotas and subsidies for home industries. In recent years new forms of trade barrier have been developed in order to circumvent WTO regulations. These include consumer protection legislation and administrative barriers.

[2 marks for definition and 3 marks for development] [5]

- (b) The traditional analytical tools of economics all point to protectionist policies as welfare-reducing. In certain limited circumstances a case can be made for some protection for domestic industries, e.g. the infant industry argument.

Issues for analysis include:

- Analysis based on theory of comparative advantage.
- Analysis of consumer and producer surplus.
- Analysis of productive and allocative efficiency.
- Impact on consumer choice.
- Impact on competition and costs.

Level 1 ([1]–[3])

Candidate provides little explanation of why most economists regard protectionist measures as undesirable. There may be vague references to some relevant issues but little development. Quality of written communication is limited.

Level 2 ([4]–[7])

Candidate provides some explanation why most economists regard protectionist measures as undesirable. However, this will be incomplete or contain minor errors. Quality of written communication is satisfactory.

Level 3 ([8]–[10])

Candidate provides a clear and comprehensive explanation why most economists regard protectionist measures as undesirable. Quality of written communication is of a high standard. [10]

- (c) Globalisation is the closer integration of the world's economic and financial systems. It means that events in any one country are likely to have significant repercussions internationally. This is particularly true for events which originate in a large and dominant economy such as the USA. Globalisation has worsened the current economic crisis in a number of ways:

- When there is a fall in aggregate demand in one country this will affect other economies through the demand for exports and imports.
- Many banks and financial institutions lend internationally. A substantial percentage of the sub-prime mortgages in the USA were provided by UK and other banks.
- Many banks have subsidiaries in other countries and receive savings in that country. Icelandic banks were major lenders in the UK economy and this put UK savers at risk due to the threatened collapse of some Icelandic banks.

- Loans were packaged together (securitised) and transferred between banks. So financial institutions throughout the world were indirectly exposed to sub-prime mortgages in the USA.
- As the crisis developed banks were forced to call in loans even from creditworthy borrowers. Western European banks called in loans to eastern European countries such as Poland and this has spread the recession to these states.
- The crisis has created exchange rate volatility which has added to the climate of uncertainty.

Level 1 ([1]–[3])

Candidate provides little analysis of the role of globalisation in worsening the current economic crisis. There may be vague references to some relevant issues but little development. Quality of written communication is limited.

Level 2 ([4]–[7])

Candidate provides some analysis of the role of globalisation in worsening the current economic crisis. However, this will be incomplete or contain minor errors. Quality of written communication is satisfactory.

Level 3 ([8]–[10])

Candidate provides a clear and comprehensive analysis of the role of globalisation in worsening the current economic crisis. Quality of written communication is of a high standard. [10]

- (d) Until recently no-one with the exception of Friedman had seriously questioned the survival of the euro. Now its demise is viewed as a possibility, albeit an unlikely one.

The euro will survive if member states are able to cope with a common interest rate and their inability to devalue as a means of stimulating national economies. This will require a high degree of economic convergence between members and Source 3 makes it clear that this is not the case at present.

Issues for analysis and evaluation include:

- Problems arising from common interest rate.
- Problems arising from inability to devalue.
- Evaluation of the eurozone as optimal currency area.
- Problems arising from immobility of labour.
- Problems arising from different levels of efficiency and productivity in member states.
- Problems arising from lack of economic convergence.
- Political commitment to survival of euro.
- Impact of euro disintegration on single market and EU as a whole.
- Possibility of fiscal transfers from strong economies like Germany to weaker economies such as Italy.

Level 1 ([1]–[5])

Candidate provides little critical examination of Milton Friedman’s view. Key issues are not addressed and quality of written communication is limited.

Level 2 ([6]–[10])

Candidate provides some critical examination of Milton Friedman’s view. However this will lack depth or be one-sided. Quality of written communication is satisfactory.

Level 3 ([11]–[15])

Candidate provides a clear and comprehensive critical examination and judgement of Milton Friedman’s view. Quality of written communication is of a high standard.

[15]

40

2 (a) A complete economic union is the highest level of economic integration which can exist between nation states. It requires:

- Free movement of goods, services and factors of production within the union.
- A common external tariff against imports from outside the union.
- A common currency.
- Harmonisation of economic policies by member states.

It is unlikely that economic union could be achieved in the absence of political integration.

A free trade area is a group of countries who agree to remove all trade barriers between the member states. However each country is free to impose whatever barriers it wants against imports from outside the free trade area.

This allows for the possibility of one member state importing goods from a country outside the free trade area and then re-exporting these to another state within the free trade area.

A customs union represents a higher level of economic integration than a free trade area. In addition to free trade between the member states there is also a common external tariff against imports from outside the customs union. This prevents the kind of re-exporting which can take place within a free trade area.

Both free trade areas and customs unions leave member states free to adopt independent fiscal and monetary policies. They may also have different standards for consumer protection which can be used as a covert trade barrier.

Issues for explanation and analysis include:

- Explanation of economic union.
- Features of a free trade area.
- Problem of re-exporting.
- Features of a customs union.
- Significance of common external tariff.

Level 1 ([1]–[5])

Candidate provides little explanation of how free trade areas and customs unions fall short of full economic union. There may be vague references to issues like tariffs but these are not developed. Quality of written communication is limited.

Level 2 ([6]–[10])

Candidate provides some explanation of how free trade areas and customs unions fall short of full economic union. However this is likely to be incomplete or contain minor errors. Quality of written communication is satisfactory.

Level 3 ([11]–[15])

Candidate provides a clear and comprehensive explanation of how free trade areas and customs unions fall short of full economic union. Quality of written communication is of a high standard. [15]

- (b) The creation of a customs union may lead to both trade creation and trade diversion.

Trade creation exists when free trade amongst the member states of the customs union allows importing nations to buy from a cheaper source and exporting nations to find new markets.

Trade diversion exists when countries have to abandon a cheap source of imports outside the customs union and buy from a more expensive source within it.

The UK experienced trade diversion when it joined the EU and had to replace cheap food imports from Australia and New Zealand with more expensive food imports from other EU states. The net welfare impact depends on the balance between the gains from trade creation and the losses from trade diversion.

Issues for analysis and evaluation include:

- Explanation of trade creation.
- Explanation of trade diversion.
- Welfare implications of trade creation and trade diversion.
- Evaluation of possibility that EU might create dynamic comparative advantage.
- Evaluation of trading blocs like the EU as second best solutions to complete free trade.
- Explanation and evaluation of common agricultural policy.
- Costs of administration of EU.

Level 1 ([1]–[7])

Candidate provides no significant critical examination of the view that customs unions such as the EU distort international trade and damage economic welfare. Key issues are not addressed and quality of written communication is limited.

Level 2 ([8]–[13])

Candidate provides some critical examination of the view that customs unions such as the EU distort international trade and damage economic welfare. Some key issues are addressed though this will lack depth or contain errors. Quality of written communication is satisfactory.

Level 3 ([14]–[19])

Candidate provides a sound critical examination of the view that customs unions such as the EU distort international trade and damage economic welfare. Most key issues are addressed and quality of written communication is of a high standard.

Level 4 ([20]–[25])

Candidate provides a clear and comprehensive critical examination and judgement of the view that customs unions such as the EU distort international trade and damage economic welfare. Key issues are addressed in depth and quality of written communication is excellent. [25]

3 (a) The main elements in the UK balance of payments on current account are as follows:

- Trade in goods which is almost always in deficit.
- Trade in services which is almost always a surplus. The most important item here is the financial services provided by the City of London.
- Income. This includes net investment income from abroad as well as compensation of employees. This item is generally in surplus.
- Current transfers. This includes private transfers such as charitable contributions and government transfers such as contributions to the UN.

The current account balance is the sum of the balances on these 4 items. This is usually a deficit.

Candidates may also explain the geographical pattern of trade.

Level 1 ([1]–[5])

Candidate shows little understanding of the main features of the UK's balance of payments on current account. Quality of written communication is limited.

Level 2 ([6]–[10])

Candidate shows some understanding of the main features of the UK's balance of payments on current account. However this will be incomplete or contain minor errors. Quality of written communication is satisfactory.

Level 3 ([11]–[15])

Candidate shows a clear and comprehensive understanding of the main features of the UK's balance of payments on current account. Quality of written communication is of a high standard. [15]

(b) In recent years governments have tended to ignore the current account deficit on the grounds that it was easily financed by inward capital and financial flows. So corrective action was not taken even when the deficit was a substantial proportion of GDP. However recently (2009) sentiment toward the current account deficit has changed with many economists viewing the large deficits as part of the causes of the credit crunch.

Possible government responses are as follows:

- Deflationary policies to reduce aggregate demand. These include contractionary fiscal and monetary policies which will reduce spending in the economy and hence the demand for imports. Success depends on a highly income elastic demand for imports and there is a downside in terms of higher unemployment and reduced growth.
- Depreciation of the exchange rate. One advantage of remaining outside the euro is the ability to allow the pound to fall in value. This makes UK exports relatively cheaper and UK imports more expensive. Subject to the Marshall Lerner conditions this should lead to an improvement in the balance of payments. One disadvantage of this policy is the possibility of imported inflation.

- Supply side policies. These should improve the balance of payments by making UK products more competitive, hence reducing imports and increasing exports. Unfortunately such policies can be socially divisive and may take a long time to have any impact on the economy.
- Protectionist policies.

Level 1 ([1]–[7])

Candidate provides little critical examination of the main policy options open to national governments in trying to correct a balance of payments on current account deficit. There may be vague references to policies but these are neither explained nor developed. Quality of written communication is limited.

Level 2 ([8]–[13])

Candidate provides some critical examination of the main policy options open to national governments in trying to correct a balance of payments on current account deficit. However this explanation will be incomplete or contain errors. Quality of written communication is satisfactory.

Level 3 ([14]–[19])

Candidate provides a significant critical examination of the main policy options open to national governments in trying to correct a balance of payments on current account deficit. Key issues are explored in some depth and quality of written communication is of a high standard.

Level 4 ([20]–[25])

Candidate provides a clear and comprehensive critical examination and judgement of the main policy options open to national governments in trying to correct a balance of payments on current account deficit. Quality of written communication is excellent. [25]

40

- 4 (a) Less Developed Countries (LDCs) may differ considerably but they do have a number of basic problems which are shared to a greater or lesser extent.

These include:

- Low per capita income.

However it is important to treat these figures with some caution as the poorer the country the greater will be the proportion of output which is not traded in the market economy. Secondly, these income figures are converted to US dollars at the market exchange rate and this may be prone to significant fluctuation.

- Shortage of physical capital.
This includes not just factories and offices but also infrastructural capital such as roads and ports.
- Lower levels of human capital as measured by educational statistics.
- High population growth.
- Health and mortality. Inhabitants of LDCs are likely to endure poorer health and have a lower life expectancy than in First World Countries.
- Structure of the economy. LDCs typically have much greater dependence on agriculture than in developed nations.
- Poor governance and corruption.
- War and the breakdown of the state.

Level 1 ([1]–[5])

Candidate shows little understanding of the main features of Less Developed Countries. There may be vague references to some features but these are not explained or developed. Quality of written communication is limited.

Level 2 ([6]–[10])

Candidate shows some understanding of the main features of Less Developed Countries. However this will be incomplete or contain minor errors. Quality of written communication is satisfactory.

Level 3 ([11]–[15])

Candidate shows a clear and comprehensive understanding of the main features of Less Developed Countries. Quality of written communication is of a high standard. [15]

- (b) The trade not aid debate has become more intense in recent years. Many development economists argue that the foreign aid programmes of the EU and the USA are little more than a smokescreen to divert attention away from the devastating impact which their agricultural protectionism is having upon Africa. This is not an argument for reducing aid but it is an argument for opening up EU and American markets to food exports from Africa.

Issues for analysis and evaluation include:

- Ineffectiveness of aid. Africa has received over \$500 billion dollars of aid but still remains mired in poverty.
- Much aid is siphoned off by corrupt governments and officials. Nigerian president Olesgun Obasanjo said “Corrupt African leaders have stolen at least \$140 billion dollars from their people in the four decades since independence”. Much of this money finds its way back to Western bank accounts or is spent on exported luxury goods from the west.
- Aid gives power to the donor countries who use it to promote economic policies which may not be appropriate for each country. It supports paternalistic attitudes.
- Much aid ends up in the pockets of highly paid “development consultants” from the donor states.
- Much aid is wasted on ill-researched projects which were dreamt up by the donor states and which often gave lucrative contracts to engineering companies from these states.
- Aid played little or no part in the development of countries like China, Thailand and India.
- The potential benefits from trade liberalisation far exceed the aid programmes of the donor states.
- Some aid, especially that channelled through non governmental organisations, funds beneficial projects.
- Aid has helped to increase agricultural productivity through training.
- Not all African governments are corrupt.

Level 1 ([1]–[7])

Candidate provides little critical examination of the view that free trade would do far more for economic development in LDCs than any amount of foreign aid. There may be vague references to some issues but these are not explained or developed. Quality of written communication is limited.

Level 2 ([8]–[13])

Candidate provides some critical examination of the view that free trade would do far more for economic development in LDCs than any amount of foreign aid. However key issues will be missed or there will be errors. Quality of written communication is satisfactory.

Level 3 ([14]–[19])

Candidate provides a significant critical examination of the view that free trade would do far more for economic development in LDCs than any amount of foreign aid. Key issues are explained in some depth and quality of written communication is of a high standard.

Level 4 ([20]–[25])

Candidate provides a clear and comprehensive critical examination and judgement of the view that free trade would do far more for economic development in LDCs than any amount of foreign aid. Quality of written communication is excellent.

[25]

40

Total

80