

**Published Mark Scheme for  
GCE A2 Economics**

**January 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.

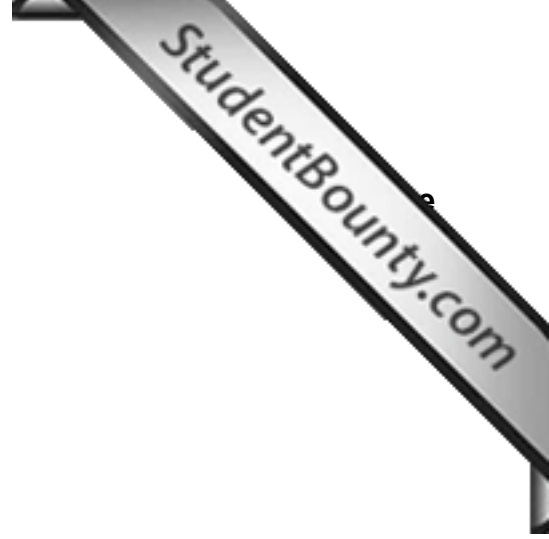
It is important to recognise that in some cases there may well be other correct responses which are equally acceptable to those published: the mark scheme can only cover those responses which emerged in the examination. There may also be instances where certain judgements may have to be left to the experience 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.



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A2 1: Business Economics





New  
Specification



*Rewarding Learning*

**ADVANCED**  
**General Certificate of Education**  
**January 2010**

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## **Economics**

**Assessment Unit A2 1**

*assessing*

**Business Economics**

**[AE211]**

**FRIDAY 29 JANUARY, AFTERNOON**

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# **MARK SCHEME**

## General Marking Instructions

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

### Quality of candidates' responses

In marking the examination paper, examiners will be looking for a quality of response reflecting the level of maturity which may reasonably be expected of 17/18-year-olds which is the age at which the majority of candidates sit the AS/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 17/18-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 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.

- 1 (a) Business class customers are expected to benefit more from the greater competition caused by the open skies agreement since there is more room to cut prices. In the past British Airways and Virgin Atlantic have been able to charge more than £4,000 for a return ticket between Heathrow and JFK Economy class fares however have traditionally been much closer to the average cost of the flight and therefore there is less room to cut fares further and remain profitable.

[1] mark for identifying that business class customers gain more

[2] marks for explaining impact on business customers

[2] marks for explaining impact on economy class customers

- (b) In the long run a business must cover all of its costs if it hopes to continue trading. However in the short-run if a business can cover its variable costs of production it will stay in business in the hope that market conditions improve sufficiently to enable it to make at least normal profits in the long run.

If a firm finds that its revenue is not sufficient to cover its variable costs it will have to shut down its operations.

Source 2 states that Spanish-based airline LTE International suspended operations after telling Spanish authorities it could no longer cover its variable costs.

Areas for analysis and discussion include:

- Distinction between the long run and the short run
- Distinction between the fixed costs and variable costs
- Appropriate diagrams

**Level 1 ([1]–[3])**

Candidate shows little understanding of why some airlines can remain in business despite making a loss while others have to shut down. No attempt is made to represent this in a diagram or if an attempt is made it will contain significant errors. Quality of written communication is limited.

**Level 2 ([4]–[7])**

Candidate shows some understanding of why some airlines can remain in business despite making a loss while others have to shut down. The diagram will support the analysis but may contain some minor errors. Quality of written communication is satisfactory.

**Level 3 ([8]–[10])**

Candidate shows comprehensive understanding of why some airlines can remain in business despite making a loss while others have to shut down. This analysis is supported by a clear and accurate diagram. Quality of written communication is of a high standard.

- (c) To return to profitability a loss making airline needs to either increase the revenue it receives from each customer or reduce the cost of each flight.

Policies which would increase total revenue include

- Charging for extras such as food, priority boarding, baggage handling etc
- Increasing the average price of each seat – demand needs to be inelastic
- Putting more seats in each plane

To cut costs airlines could

- Reduce the number of routes offered
- Reduce the number of flights to each route
- Invest in more fuel efficient planes
- Reduce staffing at both the airport check-in or on each flight

**Level 1 ([1]–[3])**

Candidate shows very limited understanding of the strategies airlines could use to return to profitability. There is no significant analysis, application or evaluation of the issues and quality of written communication is limited.

**Level 2 ([4]–[7])**

Candidate provides some understanding of the strategies airlines could use to return to profitability. There is a degree of analysis and application which may be supported by some degree of evaluation and quality of written communication is satisfactory.

**Level 3 ([8]–[10])**

Candidate provides a clear and comprehensive understanding of the strategies airlines could use to return to profitability. There is significant analysis, application, evaluation and judgement. Quality of written communication is of a high standard.

- (d) The case for increasing the tax on aviation fuel is based on the fact that flights cause significant levels of pollution and therefore contribute to global warming. As stated in the source most of these flights are discretionary and therefore should be taxed in a similar fashion to car journeys.

However, to be truly effective the tax would need to be an international one or it will simply disadvantage UK airlines. It is also argued that the industry already pays an environmental tax through the APD

Areas for analysis and discussion include

- Reference to external costs and market failure
- Impact of higher tax rates on tax revenue – Laffer curve
- Other forms of intervention e.g. regulation etc
- Reference to PED and the impact of tax on number of flights taken
- Comparison of UK and EU duty rates
- Use of appropriate diagrams
- Need for international consistency
- Aviation tax will be applied equally to all firms irrespective of their pollution levels, disadvantaging airlines with modern lower carbon emissions

**Level 1 ([1]–[5])**

Candidate displays little understanding of the case for and against increasing the tax on aviation fuel. 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 increasing the tax on aviation fuel. There is a degree of evaluation though this may lack depth and balance and quality of written communication is satisfactory.

**Level 3 ([11]–[15])**

Candidate provides a clear and comprehensive understanding of the case for and against increasing the tax on aviation fuel. There is significant evaluation and judgement and quality of written communication is of a high standard.

**2 Brown faces revolt over plans for windfall tax on oil companies**

- (a) Super normal profits are defined by economists as “any profit over and above the minimum required to keep factors of production in their current use.

Supernormal profits are profits which exceed what an entrepreneur would normally be expected to earn through the employment of a similar combination of factors of production.

Firms earn supernormal profits whenever the average revenue received for selling goods is greater than the average cost associated with their production.

Entrepreneurs will seek to maximise profit and will therefore allocate their resources to areas where they feel they can make the best return. Therefore supernormal profits play a very important role in allocating scarce resources in a market economy.

Areas for analysis and development include.

- Distinction between normal and supernormal profits
- Use of appropriate diagrams
- Numerical examples
- Reference to barriers to entry
- Role of profit seeking in the allocation of resources
- Supernormal profits may be used to fund research and development

**Level 1 ([1]–[5])**

Candidate shows little understanding of the term supernormal profits. No attempt is made to represent them diagrammatically or to analyse them in terms of costs and revenues. Quality of written communication is limited.

**Level 2 ([6]–[10])**

Candidate shows some understanding of the term supernormal profits. An attempt is made to represent them diagrammatically or to analyse them in terms of costs and revenues. Quality of written communication is satisfactory.

**Level 3 ([11]–[15])**

Candidate shows detailed understanding of the term supernormal profits and the role they play in a market economy. An accurate diagram is drawn or a detailed analysis is provided in terms of costs and revenues. Quality of written communication is of a high standard.

- (b) The argument in favour of a windfall tax is based on the view that oil companies are making huge profits as a result of recent increase in the price of oil and not as a result of any business strategy. The huge profits announced in 2008 by companies such as BP (at a time when households are feeling the effects of the credit crunch) have led to calls for the introduction of a windfall tax and for the revenue generated to be spent on winter fuel allowances or reduction in the tax on fuel.

The oil companies on the other-hand argue that they make most of their profits outside the UK and that imposing a windfall tax would jeopardise their plans for investment in alternative energy sources.

Candidates may answer this question by looking at markets other than oil.

Areas for analysis and discussion include.

- Impact of tax on investment plans
- Impact of tax on prices
- Use of windfall tax revenues
- Impact on efficiency
- Possibility of firms leaving UK to avoid paying higher tax
- Impact of elasticity on the burden of taxation
- Use of appropriate diagrams
- Reference to alternative policies for dealing with supernormal profits

**Level 1 ([1]–[7])**

Candidate shows little understanding of the arguments for and against the introduction of a windfall tax on the profits of highly profitable companies. 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 introduction of a windfall tax on the profits of highly profitable companies. 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 introduction of a windfall tax on the profits of highly profitable companies. There is significant analysis, evaluation and judgement 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 introduction of a windfall tax on the profits of highly profitable companies. There is a thorough analysis, evaluation and judgement of the arguments and quality of written communication is excellent.

**3 Retail banking becomes more concentrated**

- (a) Concentration ratios are the most common method of measuring the combined market share of the top firms in an industry and are therefore used to measure the degree of concentration in an industry.

Concentration ratios typically measure the proportion of the market that is owned by the leading brands or companies in the market. For example they measure how much of total output the top 5, 10 or 15 firms produce.

If the market leaders own a large proportion of the market the market is described as highly concentrated. By contrast where the market leader has a small proportion of the market, the market could be described as highly competitive.

Concentration ratios can be based on a range of variables including the total volume of output in the industry or the total value of output produced.

Clearly the figure for market share will vary according to whether it is based on the value of sales or the volume of sales.

**Level 1 ([1]–[5])**

Candidate shows little understanding of how market concentration can be measured. Quality of written communication is limited.

**Level 2 ([6]–[10])**

Candidate shows some understanding of how market concentration can be measured. Quality of written communication is satisfactory.

**Level 3 ([11]–[15])**

Candidate shows detailed understanding of how market concentration can be measured. Quality of written communication is of a high standard.

- (b) 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.

Some of the recent mergers in the banking industry eg Lloyds and HBOS have created firms with significant market share. In the past these mergers would have fallen foul of competition law.

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
- Use of appropriate diagrams
- Big banks may be 'safer'

**Level 1 ([1]–[7])**

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 ([8]–[13])**

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 ([14]–[19])**

Candidate shows in-depth understanding of the impact of greater concentration in UK banking. There is significant application, analysis, evaluation and judgement 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 impact of greater concentration in UK banking. There is a thorough analysis, evaluation and judgement of the arguments and they are clearly applied to banking. Quality of written communication is excellent.

4 (a) Business makes use of the environment in 3 ways:

Firstly, when it uses the environment as a resource for production. Examples of this are fishing, farming and mining.

Secondly, when it uses the environment as a means of waste disposal as in the case of landfill sites or simply discharging waste gases into the atmosphere.

Thirdly, when it uses the environment as an amenity. Examples of this are tourism and recreation.

Uses 1 and 2 generally have negative impacts on the environment whilst use 3 may have negative or positive environmental impacts or perhaps be environmentally neutral.

Issues for analysis and discussion include:

- Issues relating to the environment as a resource eg deforestation to increase agricultural production, over-fishing etc
- Issues relating to the environment as a means of waste disposal eg CO<sub>2</sub> emissions.
- Issues relating to the environment as an amenity eg hotel building, protection of wildlife for tourism, cleaning of beaches and woodlands etc
- Explanation that business activity may have beneficial environmental impacts
- Use of appropriate diagrams.

**Level 1 ([1]–[5])**

Candidate displays at best a very basic understanding of the impact of business activity upon the environment. The explanation will be vague and lack detail. Quality of written communication is limited.

**Level 2 ([6]–[10])**

Candidate displays some understanding of the impact of business activity upon the environment. The explanation will contain a range of examples though the focus may be narrow. Quality of written communication is satisfactory.

**Level 3 ([11]–[15])**

Candidate displays a comprehensive understanding of the impact of business activity upon the environment. The explanation will be detailed and wide-ranging. Quality of written communication is of a high standard.



(b) Government environmental policy contains 3 basic approaches:

- Regulation. These are laws which either prohibit or require certain activities for environmental reasons. For example the Road Traffic Fuel Obligation requires fuel producers to include at least 2.5% biofuels in their products.
- Green taxation and subsidies. Environmentally damaging activities can be taxed and those which benefit the environment can be subsidised. Government subsidies for biofuel production are an example.
- Tradable pollution permits. Firms are given a permit to produce a given level of pollution. If the firm creates less pollution than its permitted level then it is given a credit which can be sold to another firm which wishes to exceed its permitted level. This has the advantage of flexibility and giving firms an incentive to reduce pollution. In theory it should equate marginal social costs and marginal social benefits.  
Disadvantages of tradable pollution permits include government miscalculation of the optimum quantity of permits to issue and the possibility of speculation and manipulation in the market price of permits.

Issues for analysis and evaluation include:

- Explanation of economic efficiency.
- Explanation of tradable pollution permits.
- Evaluation of advantages and disadvantages of tradable pollution permits.
- Comparison of tradable pollution permits with other government policies
- Use of appropriate diagrams.

**Level 1 ([1]–[7])**

Candidate shows little understanding of the operation of tradable pollution permits nor of how they might contribute to economic efficiency. There is no significant evaluation and quality of written communication is limited.

**Level 2 ([8]–[13])**

Candidate shows some understanding of the operation of tradable pollution permits and how they might contribute to economic efficiency. There is a degree of evaluation though this will tend to be superficial or one-sided. Quality of written communication is satisfactory.

**Level 3 ([14]–[19])**

Candidate shows a clear understanding of the operation of tradable pollution permits and how they might contribute to economic efficiency. There is significant evaluation and judgement. Quality of written communication is of a high standard.

**Level 4 ([20]–[25])**

Candidate shows a clear and extensive understanding of the operation of tradable pollution permits and how they might contribute to economic efficiency. There is significant and measured evaluation, leading to reasoned and balanced judgements. Quality of written communication is excellent.



