

**Economics**

Advanced GCE **A2 7812**

Advanced Subsidiary GCE **AS 3812**

**Mark Schemes for the Units**

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**June 2006**

**3812/7812/MS/R/06**

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### Advanced Subsidiary GCE Economics (3812)

#### MARK SCHEMES FOR THE UNITS

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**Mark Scheme 2881  
June 2006**

**Subject-specific Instructions**

- 1 The paper is to be marked to AS standard.
- 2 Marking should be positive: marks should not be subtracted for errors or inaccuracies.
- 3 In assessing quantitative answers, the 'own figure rule' (OFR) must be applied, i.e. a candidate must be given credit for calculations which, though wrong, are consistent with an earlier error.
- 4 The Mark Scheme refers to possible issues/content that candidates might use. These suggestions are neither exhaustive nor necessarily required.
- 5 The quality of written communication will be assessed in the answer to the final part question.

A set number of marks for written communication is not a requirement. However, where a levels of response mark scheme is used, the following general criteria for assessing the quality of written communication will apply. These criteria are integrated within the more specific levels of response shown in the individual mark schemes for each appropriate question.

**Level 4**

Complex ideas have been expressed clearly and fluently using a style of writing appropriate to the complex subject matter. Sentences and paragraphs, consistently relevant, have been well structured, using specialist technical terminology where appropriate. There may be few, if any, errors of spelling, punctuation and grammar.

(3 marks representing the appropriate level of written communication are embedded in this level of response.)

**Levels 2 and 3**

Relatively straightforward ideas have been expressed clearly and quite fluently, using an appropriate style of writing. Arguments are generally relevant, though may occasionally stray from the point and are broadly logical and coherent. There will be some errors of spelling, punctuation and grammar, but these will not be intrusive or totally obscure the meaning.

(2 marks representing the appropriate level of written communication are embedded in these levels of response.)

Level 1

Simple ideas have been expressed, generally in a style lacking clarity and fluency. Arguments will have limited coherence and structure, often being of doubtful relevance to the main focus of the question. There are errors of spelling, punctuation and grammar, which will be noticeable and intrusive. Writing may lack legibility.

(1 mark representing the above level of written communication is embedded in this level of response.)

Exceptionally, answers which are assessed as L1, L2 or L3 from the individual unit mark scheme criteria may be awarded an additional mark for the quality of their written communication in any particular and appropriate question, if the standard attained falls outside the embedded criteria for the Quality of Written Communication stated above. This flexibility is available where the Quality of Written Communication is linked to a Levels of Response mark scheme only.

No additional QWC marks can be awarded if the initial mark is zero.

- (a) (i) Describe the 'economic problem'. [2]

Resources are scarce (1)  
Wants are unlimited (1)

A general idea that choices have to be made (1) General problems of allocation (1)

- (ii) Explain how the economic problem can be applied to you as a consumer. [2]

A consumer has limited income means (1)  
In relation to the wants and needs of individuals (1) General idea of choice (1)

Answers must explicitly relate to the individual consumer.

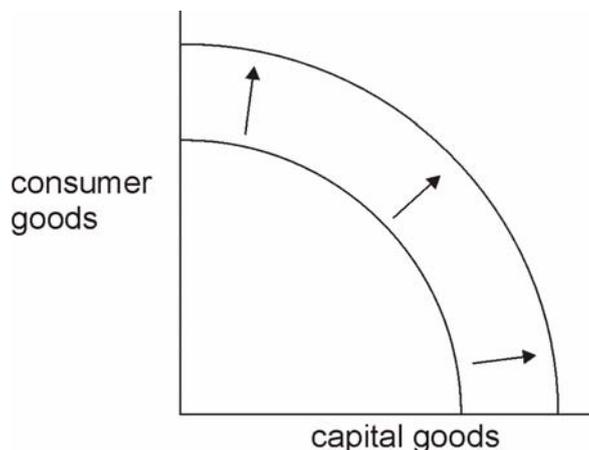
- (b) (i) Briefly describe what is meant by a Production Possibility Curve (PPC) for an economy. [2]

The PPC shows what an economy can produce (1)  
Here shows the various combinations as possibilities for consumer goods and capital goods (1)

All other factors e.g. technical progress are assumed constant (1)  
Production on the PPC indicates productive efficiency (1) or full employment (1)  
Boundary between what is attainable and unattainable (1)  
Using existing resources (1)

Up to a maximum of 2 marks. Opportunity cost – (0)

- (ii) On the diagram in your answer booklet, show the effect of an advance in technology on the economy. Explain what this means for this economy. [3]



On the diagram the whole of the PPC will shift outwards (1). PPC will shift to the right (1). This means that more of both types of goods can be produced (1). Consumers and producers are better off (1). Consistent with economic growth (1) improved productive efficiency (1).

Up to a maximum of 3 marks.

Alternatively, the PPC might pivot showing that more of one type of good can be produced. Accept this if explanation is consistent. Up to 3 marks.

- (iii) Explain how the diagram below can be used to show the concept of opportunity cost. [4]

Up to 2 marks for a definition of opportunity cost e.g. in terms of the next best alternative foregone. 1 mark for each aspect of opportunity cost.

As the economy reallocates resources from A to B, the increase in capital goods is at the opportunity cost of producing fewer consumer goods (2). Vague idea of re-allocation of resources (1). Short term loss/long term gain (1).

- (c) (i) The schedule below shows the market demand for the product of a monopoly.

Price per unit (£)	Quantity demanded per week (millions)
6	2
5	3
4	4
3	5
2	6

- Define the term 'demand'. [2]

Quantity of a product that consumers wish to buy (1) and are able to buy (1)  
At various prices per period of time (1). Relationship between quantity demanded and price (1).

1 mark for a general understanding e.g. 'what we want'

- (ii) Market research has estimated that, as price falls from £5 to £4 per unit, the price elasticity of demand is (-) 1.0.

Is this consistent with the data in the schedule above? Explain your answer. [2]

No (1)

The answer should be 1.67 (1), accept 1.6 – 1.7

OR

Relevant calculation (1) Explanation in words referring to different proportionate changes (1)

Up to a maximum of 2 marks

An explanation must be attempted – 'No' on its own (0)

- (d) Discuss whether price is always the most important determinant of demand for a product. [6]

Up to 4 marks for reference to

- income
- prices of complements and substitute
- taste/behavioural factors

3 max for any one determinant other than price. A list lacking any elaboration – 2 marks.

Up to 2 marks for discussion of the relative importance of the determinants of demand.

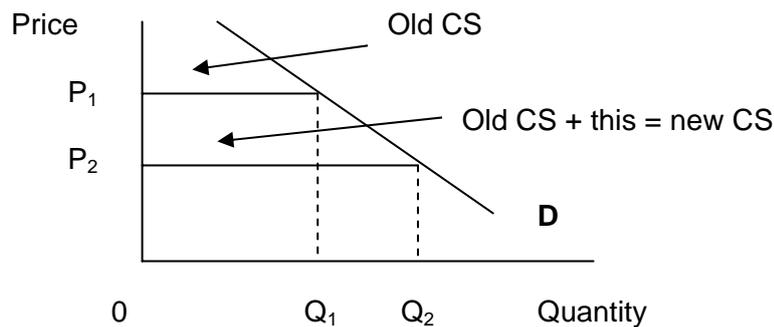
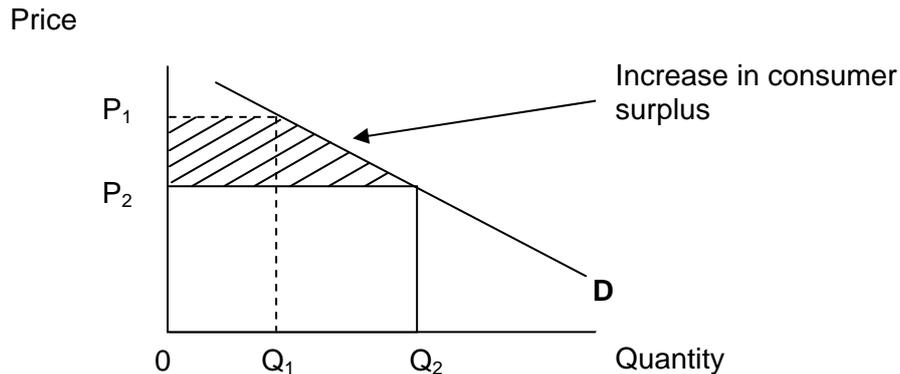
NB Discussion can include reference to elasticity.

- (e) (i) Explain what is meant by consumer surplus. [2]

For a correct definition such as 'the difference between the value placed on what is consumed and the price that is paid for that amount of consumption.' (2)

1 mark for general idea.

- (ii) Using a diagram, explain the effect that a fall in the price of a product will have on consumer surplus. [5]



- 1 – correct axes
- 1 – D labelled
- 2 – change in consumer surplus
- 1 – old consumer surplus
- 1 - new consumer surplus

4 marks for a correctly labelled diagram, showing area under demand curve and above price line, with up to 1 additional mark for a statement that consumer surplus increases.

Correct diagram only with labels and area of change in consumer surplus identified (4).

Up to 5 marks maximum.

(f) (i) **State three characteristics of a monopoly.** [3]

1 mark each for

- One firm (25% of market share)
- High barriers to entry
- Lack of close substitutes
- Price maker
- Long run excess profits
- Price discrimination
- Perfect knowledge
- Unique product

Up to 3 marks maximum.

**\*(ii) Discuss the extent to which monopoly is a realistic market structure.** [12]

The aim of this question is for candidates to consider the above characteristics of monopoly and whether these characteristics can actually apply to result in a real life monopoly. A good answer will take this approach and then consider some actual examples. Reference to 40% market share as a dominant monopoly is useful.

- |    |   |               |
|----|---|---------------|
| L4 | For a discussion of the extent to which monopoly is a realistic market structure.                                 | <b>(7-12)</b> |
| L3 | For an analysis of the behaviour of a monopolist.   | <b>(5-6)</b>  |
| L2 | For an application of knowledge and critical understanding of the characteristics of monopoly. Example is enough. | <b>(3-4)</b>  |
| L1 | For knowledge and understanding of some monopolistic characteristics.   | <b>(1-2)</b>  |

### **Possible subject responses to part f(ii)**

L1 (1-2 marks) For knowledge and understanding of some of the characteristics of a monopoly.

These answers are likely to not go far beyond (correct) answers to the previous part. So examples could include:

- Market dominated by one firm/one firm only
- High barriers to entry
- Abnormal profit in short and long run
- Monopolist is price maker
- Monopoly firm can also be the industry
- Unique product in most cases

Not all the above though need be included for 2 marks

- L2 (3-4 marks) For an application of knowledge and critical understanding of the characteristics of monopoly.

Examples

- Application in terms of real examples such as Royal Mail, Microsoft, Dyson Vacuum Cleaners, monopoly train operating company.
- Application in terms of 25% definition used by Competition Commission and/or 40% definition of a dominant monopoly.
- Critical understanding can be seen as an elaboration of the characteristics stated for L1.

- L3 (5-6 marks) For an analysis of the behaviour of a monopolist.

The key to recognising analysis is that the characteristics of monopoly should be extended/deepened a little to analyse how they influence the behaviour of a monopolist in a market.

Examples

- Market dominance/high barriers to entry allow a monopolist to fix high prices.
- In turn these may result in abnormal profits in the short and long run.
- These aspects of behaviour often result in a monopolist having a 'bad' image.
- A monopolist is able to price discriminate.
- Output is likely to be lower than in a more competitive market structure.
- Existence of economies of scale can constitute a high barrier to entry.

- L4 (7-12 marks) For a discussion of the extent to which monopoly is a realistic market structure

The evaluation comes through discussing 'the extent' to which monopoly is a realistic market structure.

Examples

- The 25% and 40% market share benchmarks used by the Competition Commission are indicative of the view that monopolistic behaviour can occur in markets where a firm has <100% market share.
- The applied examples could be qualified in terms of a discussion of the extent to which a firm is a monopolist consistent with the 'realistic' word in the question

See 9 marks as the benchmark for a reasonable discussion. Award up to 12 marks where the 'extent' aspect is clearly evidenced and evaluated.



**Mark Scheme 2882  
June 2006**

**Subject-specific Instructions**

- 1 The paper is to be marked to AS standard.
- 2 Marking should be positive: marks should not be subtracted for errors or inaccuracies.
- 3 In assessing quantitative answers, the 'own figure rule' (OFR) must be applied, i.e. a candidate must be given credit for calculations which, though wrong, are consistent with an earlier error.
- 4 Mark Scheme refers to possible issues/content that candidates might use. These suggestions are neither exhaustive nor necessarily required.
- 5 The quality of written communication will be assessed in the answer to the final part question.

A set number of marks for written communication is not a requirement. However, where a levels of response mark scheme is used, the following general criteria for assessing the quality of written communication will apply. These criteria are integrated within the more specific levels of response shown in the individual mark schemes for each appropriate question.

**Level 4**

Complex ideas have been expressed clearly and fluently using a style of writing appropriate to the complex subject matter. Sentences and paragraphs, consistently relevant, have been well structured, using specialist technical terminology where appropriate. There may be few, if any, errors of spelling, punctuation and grammar.

(3 marks representing the appropriate level of written communication are embedded in this level of response.)

**Levels 2 and 3**

Relatively straightforward ideas have been expressed clearly and quite fluently, using an appropriate style of writing. Arguments are generally relevant, though may occasionally stray from the point and are broadly logical and coherent. There will be some errors of spelling, punctuation and grammar, but these will not be intrusive or totally obscure the meaning.

(2 marks representing the appropriate level of written communication are embedded in these levels of response).

**Level 1**

Simple ideas have been expressed, generally in a style lacking clarity and fluency. Arguments will have limited coherence and structure, often being of doubtful relevance to the main focus of the question. There are errors of spelling, punctuation and grammar, which will be noticeable and intrusive. Writing may lack legibility.

(1 mark representing the above level of written communication is embedded in this level of response).

Exceptionally, answers which are assessed as Level 1, Level 2 or Level 3 from the individual unit mark scheme criteria may be awarded an additional mark for the quality of their written communication in any particular and appropriate question, if the standard attained falls outside the embedded criteria for the Quality of Written Communication stated above. This flexibility is available where the Quality of Written Communication is linked to a Levels of Response mark scheme only.

No additional QWC marks can be awarded if the initial mark is zero.

**(a) (i) What is meant by the term ‘private costs’? [1]**

A cost faced by the decision maker themselves (1 mark).

A cost faced by someone who is directly involved in the transaction / production / consumption decision (1 mark).

A cost to the firm / producer / consumer / first party (1 mark).

A cost which is internal to a market (1 mark).

The difference between social and external cost (1 mark).

The cost of a factor of production (1 mark).

**(ii) Using the extract, identify one possible private cost that may result from upgrading the A303 to a dual carriageway. Explain your answer. [3]**

Identification: 1 mark for any relevant private cost, for example:

- labour or construction costs
- the £337 million construction cost
- any other relevant construction cost for the dual carriageway

Explanation: An additional 2 marks are available:

This is an example of a private cost because it is a cost paid by those making the decision / building the road (1 mark) and has no impact upon those outside the decision making process / does not effect third parties / does not effect others (1 mark).

Both elements of explanation are needed in order to receive full marks.

**(iii) What is meant by the term ‘external costs’? [1]**

1 mark for recognising that it is a cost imposed upon an innocent party/third party.

1 mark for stating that an external cost is a negative spill over effect or the harmful side effect of an action on another person.

1 mark for stating that an external cost arises where social cost exceeds private cost.

1 mark for the vague idea that it is a cost imposed upon someone outside the decision making process OR a cost imposed upon someone not using the good.

1 mark for stating that it is a cost imposed upon others in the community / society

No marks for the simple statement that it is a cost on an external party.

- (iv) Using the extract, identify one possible external cost that may result from upgrading the A303 road to a dual carriageway. Explain your answer. [3]

Identification: 1 mark for any relevant external cost, for example:

- damage to the landscape (accept “damage to environment”).
- loss of habitats for bats, otters and dormice (accept “damage to wildlife”).
- damage to sites of special scientific interest.
- damage to an area of outstanding natural beauty.
- worsening of pollution & global warming.

Explanation: An additional 2 marks are available:

2 marks for a clear statement that these are external costs because they represent costs imposed upon an innocent third party OR it is a spillover effect.

1 mark for a vague statement that it is a harmful side effect OR that it has a bad effect upon others OR that it is a bad effect on the surrounding area.

1 mark for a general idea that it has a negative effect on others / society.

(Note: for full marks, clear economics needs to be used in the explanation).

- (b) The government may make use of cost-benefit analysis to choose between the two proposed solutions.

- (i) Describe what is meant by cost-benefit analysis. [2]

Two separate factors need to be identified here:

A clear statement that CBA is a decision making tool OR a method which is used to come to a decision OR a technique for assessing the desirability of a project OR a method used by the government to allocate resources (1 mark).

It compares / weighs up the costs and benefits of different projects OR compares the advantages and disadvantages of each project. (1 mark).

Both factors need to be identified for 2 marks.

**(ii) How might the government use cost-benefit analysis to decide which is the better solution? [2]**

2 marks are available for a clear statement as to the use of CBA in decision making, for example:

- governments choose the project which has the greatest net social benefit
- governments choose the option where social benefit exceeds social cost by the greatest amount.

(Note: for 2 marks there must be reference to social costs/benefits or net social benefits and also to how the decision will be made).

1 mark is available for a simple statement such as:

- the government will compare the costs and benefits of the different projects (must refer to both costs and benefits here).

**(iii) Using the extract, identify and explain the measurement problem involved in using cost-benefit analysis in this context. [4]**

2 marks are available for accurate reference to the article, for example:

- damage to hedgerows (accept "damage to the environment")
- destruction of habitats of bats, dormice & otters (accept "damages wildlife/nature")
- adverse effects on the landscape
- damage to a site of special scientific interest (SSSI)
- damage to an area of outstanding natural beauty
- more cars will be travelling greater distances (accept "greater pollution")
- worsens the problem of global warming
- relevant benefits eg increased speed of traffic / increased traffic flow

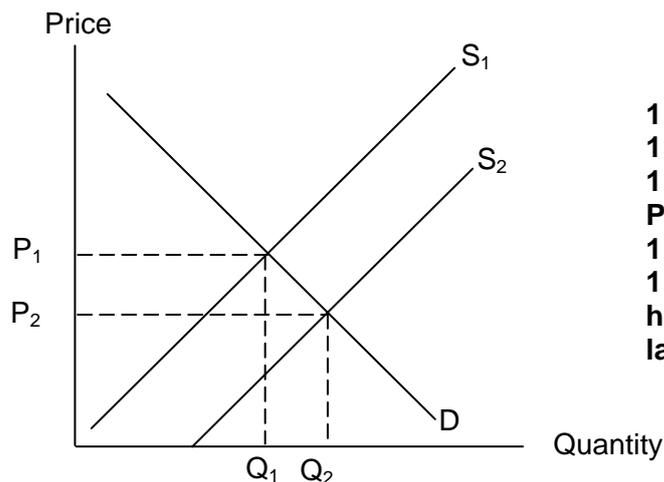
2 marks are available for relevant analysis of why these are a problem for CBA:

- what factors should be included/measured? When should we stop measuring?
- with factors such as external costs and benefits it is difficult to identify the scale of the problem (or quantify/attach numerical values to the scale of the problem)
- even if the scale of the problem is known, it is also difficult to place monetary values on costs / benefits
- setting monetary values involves a degree of subjectivity - some people will value certain factors more highly than others ie involves value judgements / possible bias
- factors / values will change during the course of the investigation and over time
- If incorrect monetary values are used then wrong decisions will be taken resulting in a misallocation of resources. In order for these external costs to be accurately measured it may cost the government a great deal of time and money in research.
- difficult to decide probabilities of events occurring.

(c) One alternative to building new roads would be to encourage greater provision of bus and rail services.

(i) Using a diagram, analyse the effect of giving subsidies to the providers of such services.

Up to 6 marks are available for a basic diagram, as shown below. Accept either supply and demand approach or costs/benefits approach (ie MPC/MPB).



1 mark for original supply curve  
 1 mark for original demand curve  
 1 mark for labelling both axes (accept P/Q)  
 1 mark for new supply curve to right  
 1 mark for original equilibrium (must have equilibrium lines and P/Q labelled)

Up to 6 marks are available for the explanation:

1 mark for explaining that a subsidy is a payment by the government (to a producer)

1 mark for recognising that the subsidy effectively lowers costs of production

1 mark for recognising that a subsidy will shift the supply curve to the right OR that supply will increase OR that a subsidy will encourage a firm to supply more of a good OR that more of a good or service (ie public transport) will be provided

1 mark for stating that this will lead to lower prices (fares) being charged (do not accept "price changes from P1 to P2" as this lacks clear indication of direction).

1 mark for stating that there will be an extension in demand OR that consumers will demand more of this product (do not reward candidates who have shown this as a shift in demand) OR 1 mark for stating that consumers will buy more of a product.

1 mark for explaining that the effect that the subsidy has on output depends upon what the PED is.

Maximum mark available is 10.

**(ii) Comment upon the likely limitations of using subsidies in this case. [3]**

Any relevant point of discussion/evaluation can gain 3 marks if well developed. Likewise, three basic statements of relevant evaluation can receive 3 marks.

Possible evaluation includes:

- The financial cost to the government (and possible opportunity cost issues)
- The success of the subsidy depends upon the level at which it is set (it should be set equal to the external benefits of public transport)
- The effectiveness depends upon PED – the subsidy will have limited effect if there is inelastic demand (as is likely with bus and rail services)
- If producers fail to pass the subsidy on to consumers in the form of lower prices then consumers will not use public transport more. In other words, what use does the firm make of the subsidy?
- May encourage greater inefficiency if firms become reliant upon subsidies
- Subsidising public transport may not work if it is perceived to be an inferior substitute to cars as motorists will be less likely to switch.
- Time lag – it takes time to organise new timetables, buy buses and train drivers etc. Therefore a subsidy will have less impact in the short term

A simple statement which is not developed will receive 1 mark. A statement with basic explanation gains 2 marks. One point well explained can gain up to 3 marks.

**(d) The building of new roads in the UK may well give rise to the problem of negative externalities.****(i) Explain why negative externalities are an example of market failure. [4]**

1 mark for recognising that negative externalities arise where social costs exceed private costs (accept diagram) OR where people ignore their external costs

1 mark for stating that this means that consumers / producers will be paying too little for their goods and services OR that prices are lower than they should be

1 mark for recognising that this leads to over consumption / over production OR that supply is greater than it should be OR that output is too high

1 mark for recognising that there will be a misallocation of resources

1 mark for stating that over production results in allocative inefficiency OR that resources are not allocated efficiently OR that there is inefficiency

1 mark for recognising that this occurs because too many scarce resources are being used up producing goods and services which society does not want

Maximum of 4 marks

- (ii) Economists have proposed several different policies to solve the problems created by negative externalities. These include taxation, regulation and the use of pollution permits.

Discuss how effective any one of these policies may be in correcting the market failure caused by negative externalities. [12]

Candidates are expected to write about one policy only. The following levels of response mark scheme should be applied:

Level 4	For a discussion of the effectiveness of such a policy	7-12 marks
Level 3	For an analysis of how such a policy would correct negative externalities	5-6 marks
Level 2	For an application of knowledge and critical understanding of the policy to relevant examples	3-4 marks
Level 1	For knowledge and understanding of what the policy is	1-2 marks

**More specifically for the different policies:**

**Taxation:**

Candidates who simply provide a list of relevant taxes (eg land fill tax, Vehicle Excise Duty) will receive no more than level 2. Answers which then go on to say that taxation makes individuals take into account the full costs of their actions and therefore solve the problem of the negative externality will receive up to level 3 (An accurate, relevant diagram will also gain a level 3 mark).

For level 4, candidates are expected to discuss the problems of using taxation. It is expected that each point of discussion should be accompanied by some elaboration. Relevant evaluation could include:

- Taxes are inherently inflationary and therefore damage the international competitiveness of the UK (or other relevant macro-economic comment)
- The problems of deciding at what levels the tax should be set at – if set too low then they will have no impact but if too high then will have too big an impact. In other words, the success of the tax depends upon whether the government has perfect information.
- The costs of collecting and enforcing these taxes could be significant
- Possible adverse distributional effects
- Taxes will be less effective in reducing over production if PED is inelastic

**Regulation:**

Candidates will receive level 2 for simple examples of regulation such as permitted levels of discharge or M.O.T's. In order to receive a level 3 mark, the candidate needs to look specifically at how this solves market failure. For example this could be achieved by candidates stating that if individuals break laws/regulations then they will be fined and that this leads to a change in their behaviour. Level 4 answers will be expected to introduce evaluation/discussion as to the problems of regulation AND include some basic elaboration of each point.

Relevant evaluation could include:

- What level the regulation should be set at – what is the 'right' level of regulation?
- The costs of enforcement and policing (and possible opportunity cost issues)
- The possibility of black markets being set up to avoid regulation
- The fact that regulation works against the market and is a non market based solution
- Effective regulation needs to be worldwide in order for it to be effective

**Pollution Permits:**

Level 1 answers will involve simple knowledge as to what the permit system is.

Level 2 answers will provide examples of how pollution permits could be applied.

Level 3 answers will go on to analyse how such tradeable permits will reduce pollution because firms will now have to pay to purchase any additional permits which are required by law. Relevant analysis for level 3 could refer to the market for tradable pollution permits, with the market price of permits being set by the supply of permits (from low polluting firms) and the demand for permits (from higher polluters needing more permits).

A level 4 answer will introduce evaluation/discussion AND basic elaboration of each point, for example:

- Enforcement issues – if pollution permits are to be successful then firms need to be regularly policed and inspected. This clearly will be expensive and therefore involves an opportunity cost issue.
- Can we actually be sure who caused the pollution in the first place? ie do we know who is to blame?
- What level of permits should be issued to begin with? This is the most important issue, as if too many are issued (possibly by governments under political pressure) then the price will collapse and the system will be rendered ineffective.

- Is it possible to accurately measure emissions? If output levels are used as a guide to pollution then this ignores the possibilities of low emission technology.
- Permits lead to increased costs for firms which will damage their international competitiveness. This could lead to inflation if firms pass on higher costs to consumers.
- Pollution permits will only be effective if introduced on a global basis as firms will otherwise switch production from one country to another.



**Mark Scheme 2883**  
**June 2006**



**General Instructions**

- 1 The paper is to be marked to AS standard.
- 2 Marking should be positive: marks should not be subtracted for errors or inaccuracies.
- 3 Where this marking approach is employed, candidates should be regarded as achieving the highest level of response, which accurately describes their answer. They do not necessarily pass through all lower levels of response, but it is usually expected that higher level answers will clearly build on some of the key supporting elements of lower levels.
- 4 In assessing quantitative answers, the 'own figure rule' (OFR) must be applied, i.e. a candidate must be given credit for calculations which, though wrong, are consistent with an earlier error.
- 5 The mark scheme refers to possible issues/content that candidates might use. These suggestions are neither exhaustive nor necessarily required.
- 6 The quality of written communication will be assessed in the answer to part (e).

As a level of response mark scheme is used here, the following general criteria for assessing the quality of written communication will apply. These criteria are integrated within the more content-specific levels of response shown in the individual mark schemes for each appropriate question.

**Level 4**

Complex ideas have been expressed clearly and fluently using a style of writing appropriate to the complex subject matter. Sentences and paragraphs, consistently relevant, have been well structured, using specialist technical terminology where appropriate. There may be a few, if any errors of spelling, punctuation and grammar. (3 marks representing the appropriate level of written communication are embedded in this level of response.)

**Levels 2 and 3**

Relatively straightforward ideas have been expressed clearly and quite fluently, using an appropriate style of writing. Arguments are generally relevant, though may occasionally stray from the point, and are broadly logical and coherent. There will be some errors of spelling, punctuation and grammar, but these will not be intrusive or totally obscure the meaning.

(2 marks representing the appropriate level of written communication are embedded in these levels of response).

**Level 1**

Simple ideas have been expressed, generally in a style lacking clarity and fluency. Arguments will have limited coherence and structure, often being of doubtful relevance to the main focus of the question. There are errors of spelling, punctuation and grammar, which will be noticeable and intrusive. Writing may lack legibility.

(1 mark representing the above level of written communication is embedded in this level of response.)

Exceptionally, answers which are assessed as L1, L2 or L3 from the individual unit mark scheme criteria may be awarded an additional mark for the quality of their written communication in any particular and appropriate questions, if the standard attained falls outside the embedded criteria for the Quality of Written Communication stated above. This flexibility is available where the Quality of Written Communication is linked to Levels of Response mark scheme only.

No additional QWC marks can be awarded if the initial mark is zero.

- (a) (i) **Define Gross Domestic Product (GDP) (line 4).** [2]

1 mark for total output/income/expenditure.  
1 mark for what is produced/earned/spent in a country/economy.

- (ii) **Define inflation (line 5).** [2]

1 mark for defining inflation as a rise in prices/the price level, price index.  
1 mark for reference to a sustained rise/over time/over a period.  
1 mark for reference to a rise in the general or average price level.  
1 mark for fall in the value or purchasing power of money.

- (b) (i) **Using Fig. 1, explain whether the government was expected to have a budget surplus or deficit in 2004-05.** [2]

### A good report

Government spending and taxation can be altered to influence economic activity. Fig. 1 shows projected UK government spending and income for 2004-05.

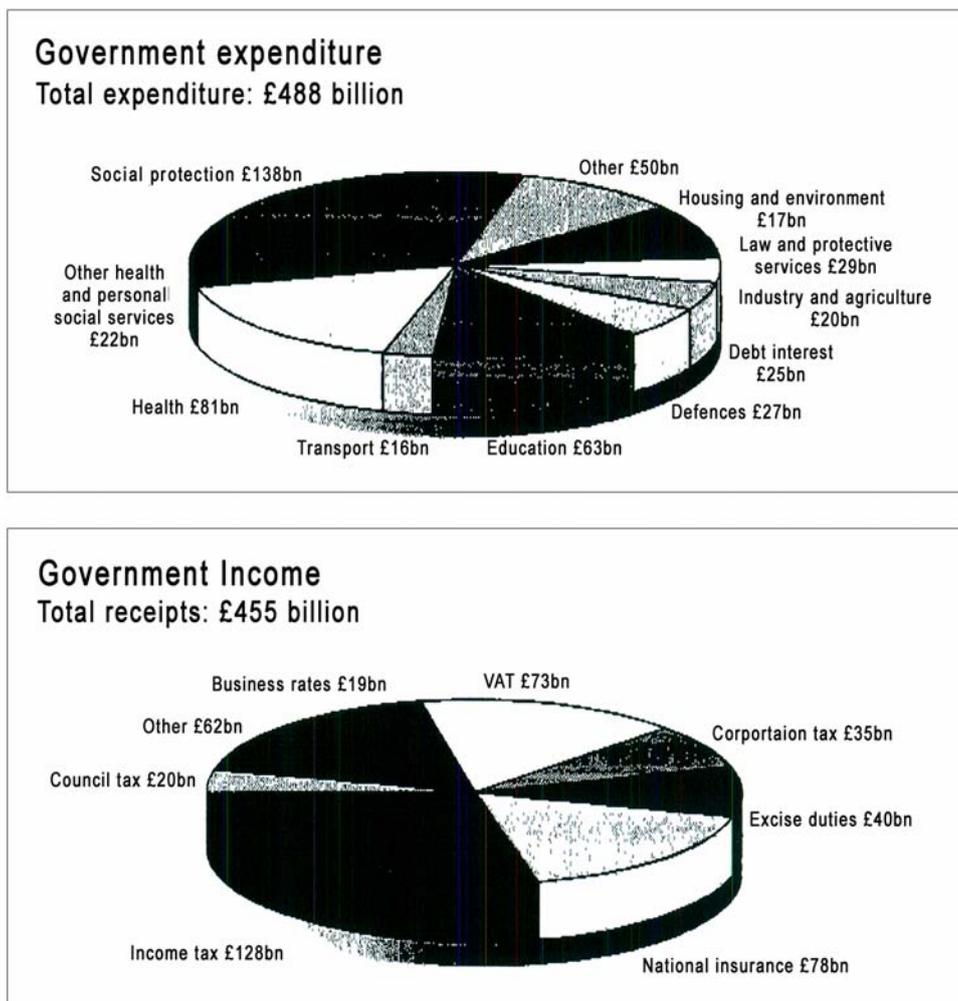


Fig. 1

1 mark for budget deficit.  
1 mark for deficit as expenditure exceeds tax revenue.  
1 mark for deficit is expected to be £33bn.

(ii) Using an aggregate demand and aggregate supply diagram, analyse the effects of a decrease in government spending on an economy. [6]

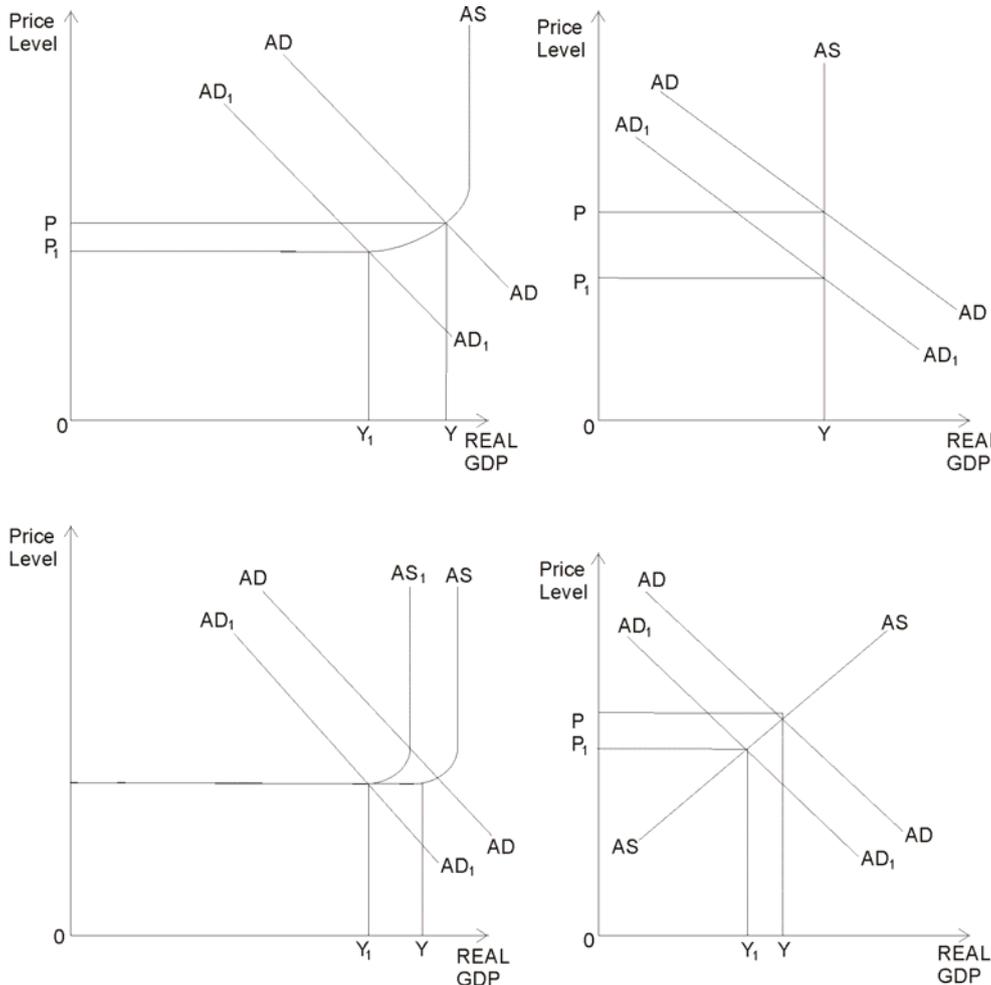


Fig. 2

Accurate diagram = up to a maximum of 4 marks.

- 1 mark for axes correctly labelled (i.e. macro labels).
- 1 mark for AD and AS curves correctly labelled.
- 1 mark for shift of AD curve to the left.
- 1 mark for original equilibrium position.
- 1 mark for new equilibrium position.
- 1 mark for shift of AS curve to the left

Accurate explanation = up to a maximum of 3 marks.

- 1 mark for noting that the AD curve will shift to the left (if not shown on the diagram).
- 1 mark for noting effect will depend on the shape of the AD curve.
- 1 mark for government spending is a component of aggregate demand.
- 1 mark for noting there will be a multiplier effect.
- 1 mark for effect on output.
- 1 mark for effect on price level.
- 1 mark for effect on employment/unemployment.
- 1 mark for decrease in government spending on education, training and/or health care will affect productivity.
- 1 mark for lower productivity will reduce productive capacity (LRAS).
- Up to 2 marks for explanation that effects on the price level and output will depend on initial position on AS curve.

**(c) Taxation is a leakage from the circular flow. Identify the other two leakages. [2]**

1 mark for savings.

1 mark for imports.

**(d) (i) 'The balance of payments, however, was a concern because of a growing current account deficit'. (lines 6-7) What is meant by a current account deficit? [3]**

1 mark for idea of deficit.

1 mark for reference to imports and exports.

1 mark for mentioning a component.

**(ii) State and explain two possible causes of a growing current account deficit. [4]**

1 mark for each of two reasons e.g. exports growing less rapidly than imports, lack of price competitiveness, lack of quality competitiveness, high incomes at home, low incomes abroad, high value of the currency.

1 mark in each case of explanation e.g. lack of price competitiveness of domestic goods will reduce demand for exports and so export revenue whilst increasing demand for imports and import expenditure. This will increase any trade in goods deficit.

**(e) (i) State and explain two possible costs of unemployment. [4]**

1 mark for two possible costs e.g. loss of potential output, lower potential living standards, lower tax revenue, government spending on benefits, higher NHS costs, crime.

1 mark for explanation in each case e.g. if employment was higher, there would be higher incomes and spending and so the government would receive more direct and indirect tax revenue.

**(ii) Comment on the effectiveness of one supply-side policy a government could take to reduce unemployment. [8]**

1 mark for a relevant supply-side policy identified e.g. education, training, privatisation, deregulation, cut in income tax.

Up to 4 marks for explanation of how measure may reduce employment.

Up to 3 marks for discussion of the advantages and disadvantage/s or limitations of the policy e.g. may increase productive potential, may reduce inflationary pressure, may be expensive, can take a long time to take effect, may not produce the desired response.

**(f) Discuss whether economic growth is always desirable. [12]**

Comments may include it will depend on how the economic growth is achieved, whether economic growth is sustainable, how evenly the benefits are distributed, the current levels of real GDP and trade-offs.

The potential costs include opportunity cost of forgone consumer goods (if the economy is operating at full capacity), damage to the environment, increased stress, deterioration in the quality of life. The potential benefits include higher living standards, increased life expectancy, reduction in poverty, improved public services, increased international bargaining power.

Level 4	For a discussion of the potential costs and benefits of economic growth with some evaluation.	<b>(7-12)</b>
Level 3	For an analysis of the potential costs and benefits.	<b>(5-6)</b>
Level 2	For an awareness of the potential costs and benefits.	<b>(3-4)</b>
Level 1	For some knowledge of economic growth.	<b>(1-2)</b>

**Further guidance:**

Level 1 For some knowledge of economic growth. (1 – 2 marks)

Examples:

Economic growth is an increase in real GDP/the country's output.

Economic growth is measured by percentage changes in real GDP.

Economic growth is an increase in the productive potential of the economy/ shift to the right of the AS curve/PPC.

Level 2 For awareness of the potential costs and benefits. (3 – 4 marks)

Identification of possible benefits and/or costs.

Examples.

Economic growth means higher living standards. It may also lead to reduced poverty and better public services.

It may also cause pollution and depletion of non-renewable resources.

Level 3 For an analysis of the potential costs and benefits. (5 – 6 marks)

Explaining particular benefits and costs of economic growth.

Examples

Economic growth may increase people's living standards. Producing more goods and services enables people to consume more products and so have higher material living standards.

Poverty may be reduced as some of the extra tax revenue raised may be used to e.g. increase benefits, spend on schemes to train the unemployed.

An economy can grow quickly by using up non-renewable resources. For instance, over-fishing will raise the output of the fishing industry but deplete fishing stocks.

Level 4 For a discussion of the potential costs and benefits of economic growth with some evaluation. (7 – 12 marks)

Assessment of particular benefits and costs and/or overall assessment.

Examples:

Economic growth can raise material living standards but not everyone may benefit if the extra income generated is unevenly distributed. Real GDP per capita may rise but this is

only an average. Some people may experience no increase in income and so may even experience a fall in income.

Economic growth can reduce poverty but the extent it does this will depend on the rate of economic growth and how effective are the measures that the government spends the extra tax revenue on.

How beneficial economic growth is depends on whether it is sustainable or not. If an economy is growing by depleting non-renewable resources and/or creating pollution, future generations may not be able to benefit from the same rate of economic growth.

A steady rate of economic growth is more beneficial than one which fluctuates. This is because it will make it easier to plan and is likely to encourage investment.

**Note:**

For mentioning that economic growth may cause/be accompanied by inflation = Level 2

For explaining how economic growth may cause inflation = Level 3.

For recognising that it is short term economic growth that may cause inflation and that long term economic growth reduces inflationary pressure = Level 4.



**Mark Scheme 2884  
June 2006**

**Subject-specific Instructions**

- 1 The paper is to be marked to Advanced GCE standard.
- 2 Marking should be positive: marks should not be subtracted for errors or inaccuracies.
- 3 Candidates should be regarded as achieving the highest level of response which accurately describes their answer. They do not necessarily pass through all lower levels but it is usually expected that higher level responses will clearly build on some of the key supporting elements of lower levels.
- 4 In assessing quantitative answers, the 'own figure rule' (OFR) must be applied, i.e. a candidate must be given credit for calculations which, though wrong, are consistent with an earlier error.
- 5 Mark Scheme refers to possible issues/content that candidate might use. These suggestions are neither exhaustive nor necessarily required.
- 6 Quality of Written Communication will be assessed in the Section B essay.

A set number of marks for written communication is not a requirement. However, where a levels of response mark scheme is used, the following general criteria for assessing the quality of written communication will apply. These criteria are integrated within the more specific levels of response shown in the individual mark schemes for each appropriate question.

**Level 4**

Complex ideas have been expressed clearly and fluently using a style of writing appropriate to the complex subject matter. Sentences and paragraphs, consistently relevant, have been well structured, using specialist technical terminology where appropriate. There may be few, if any, errors of spelling, punctuation and grammar.

[3 marks representing the appropriate level of written communication are embedded in this level of response.]

**Levels 2 and 3**

Relatively straightforward ideas have been expressed clearly and quite fluently, using an appropriate style of writing. Arguments are generally relevant, though may occasionally stray from the point, and are broadly logical and coherent. There will be some errors of spelling, punctuation and grammar, but these will not be intrusive or totally obscure the meaning.

[2 marks representing the appropriate level of written communication are embedded in these levels of response.]

**Level 1**

Simple ideas have been expressed, generally in a style lacking clarity and fluency. Arguments will have limited coherence and structure, often being of doubtful relevance to the main focus of the question. There are errors of spelling, punctuation and grammar, which will be noticeable and intrusive. Writing may lack legibility.

[1 mark representing the above level of written communication is embedded in this level of response.]

Exceptionally, answers which are assessed as L1, L2 or L3 from the individual unit mark scheme criteria may be awarded an additional mark for the quality of their written communication in any particular and appropriate question, if the standard attained falls outside the embedded criteria for the Quality of Written Communication stated above. This flexibility is available where the Quality of Written Communication is linked to a Level of Response mark scheme only as in Section B of all A2 optional units.

**Q1 (a) Identify one conclusion about the UK from each of Figs. 1 and 2.**

1 mark each, for any valid conclusions.

Most likely, Chart 1 – Net migration into the UK was much greater 1998-2002 than in the previous 4 years.

Chart 2 – Far smaller % of foreign workers in UK in 2002 than in many other affluent countries. [2]

**(b) Using the extracts, explain two benefits to the UK economy which are argued to result from immigration.**

For each benefit, 1 for identification and 1 for explanation, linking immigration to the economic benefit.

Possible benefits from the passages – reduction of skills shortages; lower costs to employers; greater government tax revenues; broader spread of talent and risk taking, etc. [4]

**(c) Comment on the view on immigration that “meanwhile, it is the employers who benefit“ (lines 22-23).**

2 for explanation of the way in which employers benefit, via greater availability and lower wage costs.

2 for valid comment, which must express some valid downside, either that others benefit too (the immigrants) or that there are disadvantages too for employers (e.g. non-suitability of the immigrant workers/native workers). [4]

**(d) “...we should allow markets to work by paying more to those whose skills are in short supply“ (lines 16-17). Use supply and demand analysis to explain this statement.**

2 for correct use of S and D analysis.

2 for explanation. [4]

**(e) “I would question the ethics of encouraging people to migrate from poor to rich countries“ (lines 14-15). Discuss the view expressed here.**

2 for Identifying and explaining economic reasons for the migration, in terms of relative earnings in UK and in source countries.

4 for evaluative discussion, which might focus on benefits to the migrating individuals, on disadvantages to ‘home’ countries, and/or on consequences for UK workers.

Basically 3 for discussion of benefits and 3 for disadvantages – though no more than 5 if a reasoned conclusion is not given. [6]

**Q2 (a) Explain how a profit-maximising employer will choose the quantity of labour employed.**

Identification, and explanation, that profit-maximisation requires that an employer will choose the quantity of labour at which its marginal revenue product equals its marginal factor cost, in principle. Definition of each of these. MRP as being determined by MPP and product price, though in different ways according to whether the product is or is not sold in a perfectly competitive industry. MFC as being related to the wage, in different ways according to whether the labour market is or is not perfectly competitive. Assumptions underlying the above model.

L3 For an explanation with assumptions made clear. **7-10**

L2 For application of knowledge and critical understanding, perhaps focusing only on basic MRP. **4-6**

L1 For knowledge and understanding of demand for labour only. **1-3**

**(b) For an occupation of your choice, discuss the extent to which its average rate of pay is determined by demand from employers.**

Explanation of pay determination as being a function of both supply- and demand-side influences. Explanation of influences on supply in any given occupation-pay in other occupations, aptitudes and abilities, non-pay net advantages, trade unions etc. Choice of occupation, and explanation of D-&S-factors specific to it. Short run/long run distinction. Evaluation focusing on relative importance of S-&D-side influences, in chosen occupation.

L4 For discussion focusing on relative importance, 'extent to which'. **9-15**

L3 Analysis of relevant S & D influences on pay. **6-8**

L2 Application of knowledge and critical understanding of S & D factors re chosen occupation. **3-5**

L1 Knowledge and understanding of the pay within and/or knowledge of the chosen occupation. **1-2**

**Q3 (a) Explain why firms operating under conditions of monopolistic competition are less efficient than those in perfect competition.**

Characteristics of both perfect competition and monopolistic competition, with emphasis on price taker/maker and homogenous/differentiated products as crucial differences. Explanation of short and long-run equilibrium price and output positions in each market structure. Meanings of 'efficiency', both productive and allocative. Explanation of differences in efficiencies.

L3 For an explanation linking differences in efficiencies to behaviour in the two market structures. **7-10**

L2 For application of knowledge and critical understanding only, perhaps on equilibrium positions. **4-6**

L1 For knowledge and understanding of the two market structures. **1-3**

**(b) Discuss the view that the emergence of low-cost airlines in the UK in recent years has made the market for air travel more efficient.**

Interpretation of 'low cost airlines' and explanation of effect of their emergence on the market structure of the air travel market. Explanation of barriers to entry, and their reduction, in the market. Impact on firms' behaviour in terms of price, output, profit and 'efficiency'. Discussion of possible changes in long-run efficiency X- efficiency economies of scale, investment and innovation, bankruptcies/consolidation, etc.

L4 For a discussion, weighing possible pros and cons for efficiency **9-15**

L3 For an analysis of the impact on behaviour of firms. **6-8**

L2 For application of knowledge and critical understanding of the entry of new, low cost competitors. **3-5**

L1 Knowledge and understanding of the air travel market. **1-2**

**Q4 Inequality of wealth is a major cause of inequality of income. It follows that the UK government, if it wishes to achieve a significant reduction in income inequality, should introduce a wealth tax.**

**(a) Explain how inequality of income and inequality of wealth are inter-related.**

Distinction between income (as a flow, over time) and wealth (as a stock, at a moment of time). Explanation of meaning of inequality of distribution (of either). Explanation of how inequality of wealth between individuals/households is likely to generate inequality of income – greater wealth generating greater income in itself (e.g. from interest, dividends, rent), and also better employment opportunities, leading to higher wages. Explanation of how inequality of income causes differential opportunities to accumulate wealth.

- |    |  |             |
|----|--|-------------|
| L3 | For an explanation of the two-way relationship   | <b>7-10</b> |
| L2 | For application of knowledge and critical understanding only, perhaps only one-way relationship. | <b>4-6</b>  |
| L1 | For knowledge and understanding of income and wealth.  | <b>1-3</b>  |

**(b) Discuss the view that taxation aimed at reducing inequality of wealth is the best way for a UK government to reduce inequality of income.**

Explanation of how taxation might be used to reduce the inequality of wealth- inheritance tax, capital transfer tax, wealth tax, mainly. Evaluation, with explanation, of possible consequences, mainly on distribution of income (though others possible too – e.g. on migration, on government revenues). Explanation of other possible policies aimed at reducing inequality of income – e.g. progressive taxation, means tested benefits, minimum wage. Evaluation, linked to 'best way'.

- |    |  |             |
|----|--|-------------|
| L4 | Evaluative discussion, focusing on effectiveness of policies and the 'best way'. | <b>9-15</b> |
| L3 | Analysis of inequality-reducing policies.  | <b>6-8</b>  |
| L2 | Application only, on relevant UK tax policies (wealth and/or income)             | <b>3-5</b>  |
| L1 | Knowledge only of UK inequalities.   | <b>1-2</b>  |



**Mark Scheme 2885  
June 2006**

**Subject-specific Instructions**

- 1 The paper is to be marked to Advanced GCE standard.
- 2 Marking should be positive: marks should not be subtracted for errors or inaccuracies.
- 3 Candidates should be regarded as achieving the highest level of response which accurately describes their answer. They do not necessarily pass through all lower levels but it is usually expected that higher level responses will clearly build on some of the key supporting elements of lower levels.
- 4 In assessing quantitative answers, the 'own figure rule' (OFR) must be applied, i.e. a candidate must be given credit for calculations which, though wrong, are consistent with an earlier error.
- 5 Mark Scheme refers to possible issues/content that candidates might use. These suggestions are neither exhaustive nor necessarily required.
- 6 Quality of Written Communication will be assessed in the Section B essay.

A set number of marks for written communication is not a requirement. However, where a levels of response mark scheme is used, the following general criteria for assessing the quality of written communication will apply. These criteria are integrated within the more specific levels of response shown in the individual mark schemes for each appropriate question.

**Level 4**

Complex ideas have been expressed clearly and fluently using a style of writing appropriate to the complex subject matter. Sentences and paragraphs, consistently relevant, have been well structured, using specialist technical terminology where appropriate. There may be few, if any, errors of spelling, punctuation and grammar.

[3 marks representing the appropriate level of written communication are embedded in this level of response.]

**Levels 2 and 3**

Relatively straightforward ideas have been expressed clearly and quite fluently, using an appropriate style of writing. Arguments are generally relevant, though may occasionally stray from the point, and are broadly logical and coherent. There will be some errors of spelling, punctuation and grammar, but these will not be intrusive or totally obscure the meaning.

[2 marks representing the appropriate level of written communication are embedded in these levels of response.]

**Level 1**

Simple ideas have been expressed, generally in a style lacking clarity and fluency. Arguments will have limited coherence and structure, often being of doubtful relevance to the main focus of the question. There are errors of spelling, punctuation and grammar which will be noticeable and intrusive. Writing may lack legibility.

[1 mark representing the above level of written communication is embedded in this level of response.]

Exceptionally, answers which are assessed as L1, L2 or L3 from the individual unit mark scheme criteria may be awarded an additional mark for the quality of their written communication in any particular and appropriate question, if the standard attained falls outside the embedded criteria for the Quality of Written Communication stated above. This flexibility is available where the Quality of Written Communication is linked to a Levels of Response mark scheme only as in Section B of all A2 optional units.

- 1 (a) Describe what is meant by contestability in a market. [2]

The extent to which potential competition exists in a market.

(2)

Award 1 mark for a vague idea or for reference to the characteristics of contestability in a market e.g. few barriers to entry, low sunk costs etc.

For 2 marks must have clear reference to key characteristics of contestability.

- (b) 'The Competition Commission did not expect that this reduction in competition would be offset by the entry of new companies or by the expansion of services provided by other existing bus operators' (lines 11-13).

State and explain two possible reasons why other bus companies may not enter the market. [4]

1 mark for identifying valid reason up to 2 max

1 mark for explanation up to 2 max

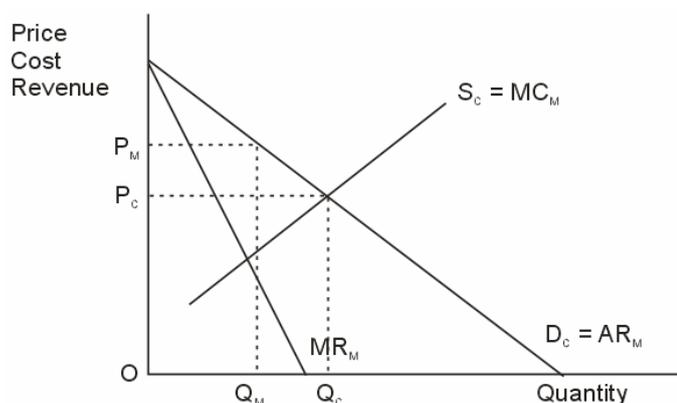
e.g. barriers to entry may exist such as gaining a license or costs of developing a brand name to be able to compete with FirstGroup

Only normal profits are being earned therefore new entrants not enticed into industry – reward any attempt to refer to lack of profitability etc (1 mark if implicit).

Can accept more than one barrier to entry.

- (c) Economic theory indicates that greater competition is in the best interests of consumers.

- (i) Use a diagram to explain why this is the case. [4]



Price higher and quantity lower in equilibrium in monopoly compared with a more competitive market.  $P=MC$  in competitive market.  $P>MC$  in monopoly i.e. competitive market allocatively efficient.

Up to 3 marks for diagram if accurate and correctly labelled.

Up to 2 marks for critical understanding and analysis of diagram applied to question set.

Reward other appropriate diagrams.

For simple D/S diagram using diagram and basic AS explanation (2 marks).

Needs further analysis to gain full marks, ie increase in consumer surplus, increase in allocative efficiency, greater choice (1).

- (ii) Comment on the likely effects of the transfer of the rail franchise to FirstGroup on economic efficiency in the public transport market in Scotland. [4]**

Requires knowledge of economic efficiency. Evaluation in terms of whether the transfer will provide productive efficiency (minimum AC) and/or allocative efficiency (providing the public transport customers want). Likely effects depend on the objectives of FirstGroup and the resolve of the independent official to prevent restrictive practices. There is still competition from private transport for some (but not all) passengers.

Level 3 For a commentary on the effects of transfer on economic efficiency perhaps to include role of official. – doesn't need to be both ways, could be 'effect depends upon....'. **3-4**

Level 2 For an application of knowledge and critical understanding leading to some explanation of the effects on economic efficiency i.e. possible costs or benefits. **2**  
(Max 2 for lack of specific application.)

Level 1 For knowledge and understanding of economic efficiency. **1**

- (d) Discuss the likely benefits to the local community of an integrated bus and rail service. [6]**

Requires a critical understanding and explanation of transport integration as applied in this example. Benefits in terms of seamless journey through better information systems, improved ticketing arrangements, better interchanges etc. Most are benefits to individuals. Evaluation could consider whether these benefits will be realised, potential problems and also wider benefits to local community such as reduced congestion/greater efficiency if public transport becomes more attractive.

Level 3 For a discussion of benefits to the local community of an integrated bus and rail service. Could be size of benefits or possible costs. **5-6**

Level 2 For an application of knowledge and critical understanding leading to consideration of potential benefits/costs of an integrated bus and rail service. **3-4**

Level 1 For knowledge and understanding of an integrated bus and rail service. Explanation required for 2 marks. **1-2**

**Section B**

Answer **one** question.

**2 One of the problems of achieving a more sustainable transport policy is dealing with peaked demand.**

**(a) Explain the consequences for passenger transport providers of the peaked demand which they inevitably face. [10]**

Transport takes place over space and time but the demand is not spread evenly over the network or time of day, week and year. Results in peaking where demand is concentrated at particular times in particular locations. Nature of derived demand for both passenger and freight transport and how this gives rise to peaked demand. The consequences of peaked demand are largely congestion (but not just roads; rail and air could also be considered) and other increased costs they will face as a result i.e. in this case the public transport providers are the third party. Explanation of such increased costs should be rewarded but also costs associated with oversupply off-peak.

Level 3 For an explanation of the consequences for public transport providers of peaked demand. **7-10**

Level 2 For an application of knowledge and critical understanding of the costs associated with peaked demand for public transport providers. **4-6**

Level 1 For knowledge and understanding of peaked demand. **1-3**

**(b) Discuss how government policy can manage passenger transport in more sustainable ways. [15]**

Understanding/explanation of sustainability and sustainable policy. Explanation/evaluation of possible policies with reference to sustainability. Need for more integrated transport policy and preference given to public transport in urban areas (particularly at peak times). Use of fiscal incentives and regulation/traffic management to achieve this. Better solution may be to spread the peak – which pricing policies may incentivise – but ultimately this involves changing attitudes and land use; clear link to derived demand.

Level 4 For a discussion of how government policy can manage transport in more sustainable ways. **9-15**

Level 3 For an analysis of sustainable government transport policy. **6-8**

Level 2 For an application of knowledge and critical understanding of how government policy could be sustainable. **3-5**

Level 1 For knowledge and understanding of sustainability and/or transport policies. **1-2**

**3 Even though more and more passengers are flying each year to more and more destinations, much controversy still surrounds the provision of additional airport capacity.**

**(a) Explain the economic benefits of constructing new airports and runways. [10]**

Benefits can be both private and external.

Private benefits ; those accruing to organisations building the airport/runway such as revenue gained; could also be the benefits gained by passengers paying for tickets generated by the increase in capacity.

External benefits; those going to third parties such as reduction in congestion at other airports, increased business to UK including tourism, reduced unemployment. Arguments should consider reduced costs or increased benefits to third parties.

Diagrams should be rewarded if incorporated into answer.

Level 3 For an explanation of the economic benefits of constructing new airports/runways. Analysis of private and external required at top end. **7-10**

Level 2 For an application of knowledge and critical understanding of the economic benefits of constructing new airports/runways. **4-6**

Level 1 For knowledge and understanding of the economic benefits of constructing new airports/runways. **1-3**

**(b) Discuss the extent to which forecasts of demand for air travel should be used as the basis for decisions on airport capacity in the UK. [15]**

Forecasts of demand give broad indication of capacity required based on past trends and best understanding of future events but are bound to be uncertain. Need to question whether growth in capacity is an efficient allocation of resources; sustainability is a relevant issue. Is there a need for CBA in order to compare full social costs with full social benefits; analysis of private and external costs; difficulties in identifying and putting monetary values on externalities; choice of discount rate affecting outcome? Could be problems with use of forecast trends if demand is more regional. CBA may give a better indication of need for potential projects but should be used with caution i.e. as an aid to decision making.

Level 4 For a discussion of the extent to which forecasts of demand for air travel should be used as the basis for decisions on airport capacity. **9-15**

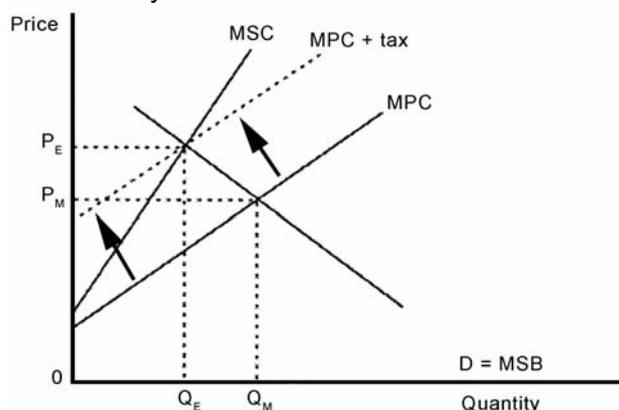
Level 3 For analysis of how forecasts or CBA could be used for decisions on airport capacity. **6-8**

Level 2 For an application of knowledge and critical understanding of how forecasts or CBA could be used for decisions on airport capacity. **3-5**

Level 1 For knowledge and understanding of forecasts or CBA not applied. **1-2**

- 4 (a) Using a diagram, explain how taxation can be used to make the operators of goods vehicles pay the full social costs of their use. [10]

Explanation of track costs argument (term not required). Diagram to show internalisation of external cost via pollution taxes and/or road user charges with appropriate explanation in terms of reducing overconsumption and therefore contribute to a more efficient resource allocation; social efficiency particularly if full social costs are correctly identified.



- Level 3 For an explanation, with appropriate diagram, of how taxation can be used to make goods vehicles pay the full social costs of their use. 7-10
- Level 2 For an application and critical understanding of how taxation can be used to make goods vehicles pay the full social costs of their use. 4-6
- Level 3 For knowledge and understanding of effect of taxation or full social costs. 1-3
- (b) Discuss the likely economic effects of increased road haulage operating costs on the freight transport industry, its customers and the economy as a whole. [15]

Increased operating costs for freight transport industry leads to a fall in supply (although demand is relatively inelastic- reasons could be given) and some bankruptcies. Costs could be passed on to customers i.e. other businesses and ultimately consumers. Depending on XED between modes customers may switch notably to rail. If this is not possible (and probably even if it is) final prices will rise. Could lead to loss of UK competitiveness if taxes not raised elsewhere- possible unfavourable effects on BoP; but economy may be more allocatively efficient; other modes would have to increase capacity. Examples from fuel protest showing possible public disapproval. Evaluation could emphasise which effects are most likely and why based on relevant theory.

- Level 4 For a discussion of likely economic effects of increased operating costs on any of the freight transport industry, its customers and the economy as a whole. All must be covered at the top end. 9-15
- Level 3 For an analysis of likely economic effects of increased operating costs on any of the freight transport industry, its customers and the economy as a whole. 6-8
- Level 2 For application of knowledge and critical understanding of how increased operating costs can impact on any of three; lacks analysis. 3-5
- Level 1 For knowledge and understanding of effects of increased operating costs. 1-2

**Mark Scheme 2886**  
**June 2006**

**Subject-specific Instructions**

- 1 The paper is to be marked to Advanced GCE standard.
- 2 Marking should be positive: marks should not be subtracted for errors or inaccuracies.
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- 4 In assessing quantitative answers, the 'own figure rule' (OFR) must be applied, i.e. a candidate must be given credit for calculations which, though wrong, are consistent with an earlier error.
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- 6 Quality of Written Communication will be assessed in the Section B essay.

A set number of marks for written communication is not a requirement. However, where a levels of response mark scheme is used, the following general criteria for assessing the quality of written communication will apply. These criteria are integrated within the more specific levels of response shown in the individual mark schemes for each appropriate question.

**Level 4**

Complex ideas have been expressed clearly and fluently using a style of writing appropriate to the complex subject matter. Sentences and paragraphs, consistently relevant, have been well structured, using specialist technical terminology where appropriate. There may be few, if any, errors of spelling, punctuation and grammar.

[3 marks representing the appropriate level of written communication are embedded in this level of response.]

**Levels 2 and 3**

Relatively straightforward ideas have been expressed clearly and quite fluently, using an appropriate style of writing. Arguments are generally relevant, though may occasionally stray from the point, and are broadly logical and coherent. There will be some errors of spelling, punctuation and grammar, but these will not be intrusive or totally obscure the meaning.

[2 marks representing the appropriate level of written communication are embedded in these levels of response.]

**Level 1**

Simple ideas have been expressed, generally in a style lacking clarity and fluency. Arguments will have limited coherence and structure, often being of doubtful relevance to the main focus of the question. There are errors of spelling, punctuation and grammar which will be noticeable and intrusive. Writing may lack legibility.

[1 mark representing the above level of written communication is embedded in this level of response.]

Exceptionally, answers which are assessed as L1, L2 or L3 from the individual unit mark scheme criteria may be awarded an additional mark for the quality of their written communication in any particular and appropriate question, if the standard attained falls outside the embedded criteria for the Quality of Written Communication stated above. This flexibility is available where the Quality of Written Communication is linked to a Levels of Response mark scheme only as in Section B of all A2 optional units.

- 1 (a) **Explain two reasons why a multinational company, such as GM, might choose to expand in China.** [4]

Rising demand (1), result of rising incomes (1), more profit or market share (1) = (2)

Lower production cost (1), relatively low factor incomes (1), more competitive (1) = (2)

Less restrictive (1), attitude of govt to MNCs (1), more freedom to operate (1) = (2)

Alternative points to be approached in same way through influence and its cause or effect.

- (b) (i) **State three economic features typical of the 'Asian Tiger' group of newly industrialised countries.** [3]

Rapid economic growth (1), exporters of manufactures (1), trade oriented (1), targeted government intervention (1), encouragement of markets (1), increasing labour productivity (1).  
Accept other reasonable suggestions.

- (ii) **Using Fig. 1, how closely does China's experience of development match that of Taiwan and South Korea?** [3]

Less increase in GDP per head (1), increase at slower rate (1), same general pattern (1), 20 to 30 years behind (1), data insufficient to tell (1).  
Accept appropriate identification.

- (c) **With reference to the information provided, comment on China's possible position in Rostow's stages of growth model.** [4]

Basic recognition of model (1), industrialisation suggests take-off or drive to maturity (1), nature of industry suggests drive to maturity (1), low car ownership suggests not yet mass consumption (1), a well-argued point may merit (2).  
Accept alternative, reasoned interpretations.

- (d) **Discuss the effects that an expanding market for cars might have on a country's economic development.** [6]

Development might be helped by more employment, rising incomes, capital input, additional skills, greater mobility, higher quality of life. These may be the result of production or ownership.

Development may be harmed by industrialisation, externalities, migration, foreign ownership, cultural change.

The link to development rather than growth needs to be made at some point, other wise maximum of (4) marks.

A link to economic development and only one side to maximum of (4) marks.

No link to economic development and only one side to maximum of (3) marks.

A well argued point may merit (2) marks.

- 2 (a) **Explain the limitations of using changes in a country's Gross Domestic Product (GDP) as a measure of changes in its level of economic development.** [10]

GDP may be more relevant as a measure of material living standards/economic growth than development. It needs to be expressed per capita and in real terms to make a better comparison. It may still be inaccurate because of unreliable statistics and under-recording of the informal economy. Development requires additional information relating to non-material elements such as poverty, health and education. The equality of distribution of GDP, what it is spent on and the circumstances of the particular country also need to be considered. GNP may be a better measure than GDP.

This should be set in a development context.

L3 For an explanation of the limitations of GDP for development measure. (7-10)

L2 For application of knowledge and critical understanding of GDP weaknesses. (4-6)

L1 For knowledge and understanding of nature of GDP and development. (1-3)

- (b) **Discuss the extent to which the Human Development Index (HDI) is a satisfactory measure of development.** [15]

The HDI is a composite measurement which includes real GDP per capita at ppps, life expectancy, adult literacy and years of schooling in a weighted format. This reflects the standard of living, longevity and knowledge. The components are combined to give a single value between 0 and 1. The HDI can be adjusted to take into account income distribution and can be disaggregated for individual groups of regions. In these ways it improves on GDP, gives a simple comparison and reflects important elements of development. It is open to criticisms for the continuing omissions e.g. access to clean water and the elements which it is unable to measure e.g. political freedom. It has its own issues such as the equal weighting of the components and the difficulty in measuring quality as opposed to quantity. Other measures such as the HPI and MEW may be alternatives. A higher level 4 answer may illustrate with specific references.

L4 For a discussion of extent to which HDI is satisfactory. (9-15)

L3 For analysis of strengths or weaknesses of HDI. (6-8)

L2 For application of knowledge and critical understanding of nature of HDI. (3-5)

L1 For knowledge and understanding of the basis of HDI. (1-2)

**3 (a) Explain the importance to a developing economy of**

- **multilateral foreign aid into the country and**
- **capital outflows from the country.** **[10]**

Multilateral foreign aid is granted officially on concessionary terms by international institutions. It provides a flow of finance and resources which otherwise would not be available. It avoids the conditionality of bilateral aid and the interest rates of market loans. For the most part it helps developing economies, although it may encourage dependency or debt.

Capital outflows refers to the loss of capital funds by a developing economy as a result of opportunities abroad, uncertainty and instability within its economy. It may be citizens moving their funds abroad for better returns or foreign investors removing their money as a crisis develops. In either case the finance available for investment is reduced and uncertainty is increased. This is harmful to the domestic economy, the balance of payments and exchange rate.

L3 For an explanation of the importance of the concepts. **(7-10)**

L2 For application of knowledge and critical understanding of developing economies. **(4-6)**

L1 For knowledge and understanding of the two concepts. **(1-3)**

**(b) Discuss the view that developing economies may be expected to have current account deficits for the foreseeable future.** **[15]**

Some aspects of a typical developing economy's trade pattern support the likelihood of a deficit, namely reliance on primary products with falling real prices, exporting of manufactured goods faced by trade barriers, the need to import capital good and to pay for financial services and debt service and the repatriation of PDI by multinationals. The maintenance of over-valued exchange rates has also hindered trade. Some developments and the performance of some economies undermine the assertion. Oil exporting countries (particularly with small populations) and the newly industrialised countries with strong manufactured exports have achieved surpluses. The growth in income elastic tourism, the increase in foreign remittances, the forgiveness of debt repayments and the possibility through WTO negotiations of increased free trade offer the hope of better trade performances. A higher level 4 answer may show awareness of recent developments.

L4 For a discussion of likelihood of continuing deficits. **(9-15)**

L3 For analysis of weakness or strength of DC's current account. **(6-8)**

L2 For application of knowledge and critical understanding developing economies. **(3-5)**

L1 For knowledge and understanding of the elements of the current account. **(1-2)**

- 4 (a) **Explain how the domestic population problems of developing economies weaken their ability to develop.** [10]

Population problems within developing economies, include rapid population growth, worsening dependency ratios, population migration and rising death rates from HIV/AIDS. In the short run the need to provide for the greater number of dependants with a smaller workforce means a problem in raising living standards. The demand on productive resources outstrips their supply and levels of health and education may fall. In the longer run there is more pressure on governments to provide job opportunities, to cope with urbanisation and to control environmental impacts.

L3 For an explanation of population impact on development. (7-10)

L2 For application of knowledge and critical understanding of the effects of problems. (4-6)

L1 For knowledge and understanding of the nature of population problems.(1-3)

- (b) **Discuss the extent to which international migration is likely to promote economic development.** [15]

Migration may be both outward and inward. The loss of nationals is sometimes referred to as the 'brain drain' and suggests the loss of younger, talented professionals who will not be contributing to domestic development. The developing economy may have invested heavily in their education and training. They may send remittances back, which may provide more income (and foreign currency) than lower paid domestic employment or unemployment. They may learn skills which they bring back to their country of origin. Generally it is thought to be detrimental. Developing economies may experience a (temporary) inflow of employees of MNCs and workers with aid organisations. These will raise productivity, introduce skills and knowledge to the benefit of the host economy. The outcomes may be viewed from the standpoint of a developed country. A higher level 4 answer may consider both directions of migration.

L4 For a discussion of the impact of international migration on development. (9-15)

L3 For analysis of benefits or harm from international migration. (6-8)

L2 For application of knowledge and critical understanding of international migration to developing economies. (3-5)

L1 For knowledge and understanding of the nature of international migration. (1-2)



**Mark Scheme 2887  
June 2006**

**Subject-specific Instructions**

- 1 The paper is to be marked to Advanced GCE standard.
- 2 Marking should be positive: marks should not be subtracted for errors or inaccuracies.
- 3 Candidates should be regarded as achieving the highest level of response which accurately describes their answer. They do not necessarily pass through all lower levels but it is usually expected that higher level responses will clearly build on some of the key supporting elements of lower levels.
- 4 In assessing quantitative answers, the 'own figure rule' (OFR) must be applied, i.e. a candidate must be given credit for calculations which, though wrong, are consistent with an earlier error.
- 5 Mark Scheme refers to possible issues/content that candidates might use. These suggestions are neither exhaustive nor necessarily required.
- 6 Quality of Written Communication will be assessed in the Section B essay.

A set number of marks for written communication is not a requirement. However, where a Levels of Response mark scheme is used, the following general criteria for assessing the quality of written communication will apply. These criteria are integrated within the more specific levels of response shown in the individual mark schemes for each appropriate question.

**Level 4**

Complex ideas have been expressed clearly and fluently using a style of writing appropriate to the complex subject matter. Sentences and paragraphs, consistently relevant, have been well structured, using specialist technical terminology where appropriate. There may be few, if any, errors of spelling, punctuation and grammar.

[3 marks representing the appropriate level of written communication are embedded in this level of response.]

**Levels 2 and 3**

Relatively straightforward ideas have been expressed clearly and quite fluently, using an appropriate style of writing. Arguments are generally relevant, though may occasionally stray from the point, and are broadly logical and coherent. There will be some errors of spelling, punctuation and grammar, but these will not be intrusive or totally obscure the meaning.

[2 marks representing the appropriate level of written communication are embedded in these levels of response.]

**Level 1**

Simple ideas have been expressed, generally in a style lacking clarity and fluency. Arguments will have limited coherence and structure, often being of doubtful relevance to the main focus of the question. There are errors of spelling, punctuation and grammar which will be noticeable and intrusive. Writing may lack legibility.

[1 mark representing the above level of written communication is embedded in this level of response.]

Exceptionally, answers which are assessed as L1, L2 or L3 from the individual unit mark scheme criteria may be awarded an additional mark for the quality of their written communication in any particular and appropriate question, if the standard attained falls outside the embedded criteria for the Quality of Written Communication stated above. This flexibility is available where the Quality of Written Communication is linked to a Levels of Response mark scheme only as in Section B of all A2 optional units.

1 (a) Define real GDP. [2]

1 mark for definition of (nominal) GDP e.g. a measure of a country's output (income or expenditure).

1 mark for definition of real e.g. takes into account inflation. GDP measured in constant rather than current prices

(b) Fig. 1 shows that the rate of real GDP growth increased between 2003 and 2004. Explain one possible cause of this increase [2]

Various possibilities for this short term increase including:

- an increase in demand side factors  $C + I + G + (X-M)$
- a beneficial change in supply side factors such as higher productivity or lower factor input prices

1 mark for identification of cause

1 mark for explanation of how/why causal factor results in an increase in real GDP.

(c) (i) Explain how the rate of real GDP growth might influence the current account on the Balance of Payments. [4]

There are a number of valid ways of approaching this question

Growth in real GDP could lead to a fall in net exports (X-M). Increased income will lead to higher spending on all normal products including imports. Assuming exports do not change or rise by a smaller amount, the current account is likely to worsen.

If real GDP growth raises inflation, the price competitiveness of British firms may be undermined and net exports could fall, again worsening the current account.

Candidates who argue that the cause of growth was based on supply side improvements may argue, for example, that increased productivity could lower unit labour costs. *Ceteris paribus*, this would improve the price competitiveness of British firms and may result in an increase in net exports and an improvement in the current account.

Accept any valid approach – in each case time lags may complicate the causal relationship.

Up to 3 marks for consideration of *either* export *or* import of goods/services  
For 4 marks candidates must consider *net* exports *or* make explicit their assumptions about the other components of the current account (e.g. investment income and transfers).

(ii) Explain whether the data in Figs. 1 and 2 between 2001 and 2004 support this expected relationship. [2]

The variety of possible responses to 1ci is reflected in the data.

There is no obvious single concurrent relationship between the variables in this period (1).

This could be due, for example, to (variable) time lags (1) or the influence of other specified factors apart from the rate of economic growth (1).

Explanatory reference to specific and relevant data – up to 2 marks

(d) Fig. 2 shows the current account on the Balance of Payments and Fig. 3 shows the change in oil prices.

(i) To what extent might the rise in the current account deficit on the Balance of Payments from the second to the third quarter of 2004 (lines 10-11) be caused by the factors other than oil price changes?

[4]

In this period (2004 Q2 to Q3), the oil price rise is substantial and the current account has deteriorated significantly. The significance of this for the UK depends on a number of factors including the extent to which the UK is a net oil importer or exporter. The narrowing of positive 'trade gap' in oil (line 10) over the period actually continued so that the UK became a net oil-importer in the middle of 2004.

Relevant non-oil factors to be considered include the exchange rate (especially \$:£), a deterioration in international competitiveness of UK firms, relative income growth in the UK and our major export markets

Up to 3 marks for consideration of the causal influence of *either* oil or 'non-oil' factors.

For 4 marks, candidates must explicitly consider the extent of the influence of *both* oil *and* 'non-oil' factors

(ii) Discuss the likely impact of the oil price increase on the domestic performance of the UK economy.

[6]

The increase in oil prices will, *ceteris paribus*, shift the short-run aggregate supply curve to the left causing a fall in output, income and expenditure. As a consequence, it is likely that the aggregate price level and unemployment would both rise.

Candidates should explain and discuss issues in relation to the domestic performance of the economy.

Up to 3 marks for analysis

Up to 4 marks for discussion

**2 (a) Explain two possible causes of a rise in the rate of unemployment. [10]**

Candidates should define the rate of unemployment and could explain its increase in terms of either supply side or demand side factors. Given the way it is calculated, technically a rise in the unemployment rate could occur because of changes in the denominator as well as the numerator – even if the level of unemployment (LFS measure) remained unchanged, a fall in the size of the ‘economically active’ workforce would lead to a rise the rate of unemployment.

Demand side explanations could be used to analyse a decrease in AD caused by fall in injections (G, X or I) or a rise in withdrawals (T, M and S). An increase in the rate of interest should be linked to AD via the effect on C, I and X-M (through domestic income and the ER. Alternatively answers may refer to supply side causes. For example, deterioration in labour market flexibility or a rise in unit labour costs caused by lower productivity or higher wage rates.

L3 For an explanation of two causes of a rise in the rate of unemployment. **(7-10)**

L2 For an application of knowledge and critical understanding of two causes of a rise in the rate of unemployment. **(4-6)**

L1 For a knowledge and understanding of two causes of a rise in the rate of unemployment. **(1-3)**

Note: Where only one cause is covered, use up to middle of each level.

**(b) Discuss the extent to which changes in government spending and taxation should be used by the UK government to control the rate of unemployment. [15]**

Candidates can take a range of approaches. It might be argued that demand management, through fiscal policy, is inappropriate unless there is a large negative output gap – even then, there will be range of issues to do with, including for example, multiplier values, timing of the intervention, time lags and the monetary consequences of the fiscal stimulus.

Some will argue that supply-side ‘fiscal’ policies could be used to improve the incentive to work, or to encourage skill acquisition through education and training. The impact of such policies raises some similar issues e.g. timing, financing, time lags. Candidates may also discuss the likely effectiveness of policies aimed at improving incentives or raising the quality of human capital.

Good candidates will refer to the existence of fiscal rules which, if followed, will impose certain constraints on fiscal intervention.

L4 For a discussion of the extent to which fiscal policy should be used to control unemployment. **(9-15)**

L3 For analysis of how the UK government might use fiscal policy to control unemployment. **(6-8)**

L2 For application of knowledge and critical understanding of how the UK government might use fiscal policy to control unemployment. **(3-5)**

L1 For knowledge and understanding of how fiscal policy might control the rate of unemployment. **(1-2)**

- 3 (a) **With the aid of a diagram, explain the reasons why the demand for money might change.** [10]

Candidates could usefully define the terms money and liquidity before identifying the motives (transactions, precautionary, speculative) which influence the preference for liquidity/demand for money (Md).

The liquidity preference schedule ( $Md = f(r)$  ceteris paribus), provides an appropriate conceptual framework to consider how changes in interest rates affect the opportunity cost of holding money and cause expectations of future interest rate levels to be revised. These, in turn, influence the decision to buy marketable assets or to hold money. The nature and range of substitute assets for money will be a major influence on the overall impact interest rates have on Md. This will be reflected in the interest elasticity of demand for money.

Nominal GDP and financial innovation will be the principal determinants of the underlying conditions of Md and changes to these variables are likely to shift the liquidity preference schedule.

- L3 For an explanation of the three reasons why the demand for money might change to include a diagram. (7-10)
- L2 For application of knowledge and critical understanding of the demand for money. (4-6)
- L1 For knowledge and understanding of the demand for money. (1-3)

- (b) **Discuss whether an increase in the rate of inflation in the UK always and solely results from an increase in the money supply.** [15]

Although inflation is ultimately a monetary phenomenon, the relationship between monetary growth and inflation is complex and more ambiguous in the short term. During this time period, an increase in the rate of inflation might be caused by factors other than the growth of any single monetary aggregate. These other factors might include higher factor input prices and lower factor productivity.

The monetary transmission mechanism and the QTM ( $MV = PQ$ ) both provide helpful conceptual frameworks within which analysis and discussion of the monetary causes of inflation could be undertaken. Candidates could use either approach, the best may use both.

- L4 For a discussion of the extent to which an increase in the rate of inflation in the UK is always and solely caused by money supply growth. (9-15)
- L3 For analysis of the link between money supply growth and inflation and one other potential cause of inflation. (6-8)
- L2 For application of knowledge and critical understanding of the link between money supply and inflation. (3-5)
- L1 For knowledge and understanding of the relationship between a change in the money supply and the rate of inflation. (1-2)

- 4 (a) **Explain how an increase in a government's budget deficit might affect an economy.** [10]

An increase in the budget deficit is most likely to be caused by either an increase in government expenditure or a decrease in government revenues (accept tax alone). Candidates are expected to explain either the impact of a rise in G through an analysis of the impact of an increase in injections or a fall in T through the impact on a fall in withdrawals on an economy but not necessarily both.

Any of these changes would be expected to lead to an increase in AD and initiate the multiplier process. The effects on the economy will probably be shown using AS/AD curves. Candidates should develop this approach by referring to the impact on key variables including nominal GDP, inflation, unemployment and the balance of payments.

- L3 For an explanation of how an increase in a budget deficit might affect an economy. (7-10)
- L2 For an application of knowledge and critical understanding of how a budget deficit might affect an economy. (4-6)
- L1 For a knowledge and understanding of how a budget deficit might affect an economy. (1-3)

- (b) **Discuss the extent to which a change in the performance of the UK economy might cause the government's budget deficit or surplus to change.** [15]

The relationship between performance and the budgetary position could be analysed by looking, for example, at the impact of faster nominal GDP growth and lower unemployment on tax revenue and welfare spending.

Discussion could focus on the nature and magnitude of such changes in economic performance, the significance of structure of the tax and welfare systems, the nature and enforcement of fiscal rules and the policy priorities of government. In the long run, of course, a country's economic performance is a major determinant of the affordability of any fiscal stance.

- L4 For a discussion of the extent to which a change in the performance of the UK economy might cause changes in the budgetary position. (9-15)
- L3 For analysis of the link between performance and the UK's budgetary position. (6-8)
- L2 For application of knowledge and critical understanding of how a change in the performance of the UK economy might affect the government's budget. (3-5)
- L1 For knowledge and understanding of what is meant by a change in the performance of the UK economy. (1-2)

**Mark Scheme 2888**  
**June 2006**

**Subject-specific Instructions**

- 1 The paper is to be marked to Advanced GCE standard.
- 2 Marking should be positive: marks should not be subtracted for errors or inaccuracies.
- 3 Candidates should be regarded as achieving the highest level of response which accurately describes their answer. They do not necessarily pass through all lower levels but it is usually expected that higher level responses will clearly build on some of the key supporting elements of lower levels.
- 4 In assessing quantitative answers, the 'own figure rule' (OFR) must be applied, i.e. a candidate must be given credit for calculations which, though wrong, are consistent with an earlier error.
- 5 Mark Scheme refers to possible issues/content that candidates might use. These suggestions are neither exhaustive nor necessarily required.
- 6 Quality of Written Communication will be assessed throughout this paper.

A set number of marks for written communication is not a requirement. However, where levels of response mark schemes are used, the following general criteria for assessing the quality of written communication will apply. These criteria are integrated within the more specific levels of response shown in the individual mark schemes for each appropriate question.

**Level 4**

Complex ideas have been expressed clearly and fluently using a style of writing appropriate to the complex subject matter. Sentences and paragraphs, consistently relevant, have been well structured, using specialist technical terminology where appropriate. There may be few, if any, errors of spelling, punctuation and grammar.

[3 marks representing the appropriate level of written communication are embedded in this level of response.]

**Levels 2 and 3**

Relatively straightforward ideas have been expressed clearly and quite fluently, using an appropriate style of writing. Arguments are generally relevant, though may occasionally stray from the point, and are broadly logical and coherent. There will be some errors of spelling, punctuation and grammar, but these will not be intrusive or totally obscure the meaning.

[2 marks representing the appropriate level of written communication are embedded in these levels of response.]

**Level 1**

Simple ideas have been expressed, generally in a style lacking clarity and fluency. Arguments will have limited coherence and structure, often being of doubtful relevance to the main focus of the question. There are errors of spelling, punctuation and grammar which will be noticeable and intrusive. Writing may lack legibility.

[1 mark representing the above level of written communication is embedded in this level of response.]

Exceptionally, answers which are assessed as L1, L2 or L3 from the individual unit mark scheme criteria may be awarded an additional mark for the quality of their written communication across this paper as a whole if the general standard attained falls outside the embedded criteria for the Quality of Written Communication stated above.

- 1 (a) Use Extract 1 to compare regional GDP per capita between  
 - Ireland and the UK [3]  
 - Greece and the Czech Republic [3]

### Synoptic knowledge

Data handling skills are being tested here, so explicit comparisons are required rather than data regurgitation which scores zero marks.

The data is rooted in Module 2883.

### Section 5.3.1 Government macro-economic policy objectives and indicators of national economic performance

The use of data to measure economic performance, including international comparisons, in broad terms.

Students have further developed both skills and content in modules 2886 and 2887.

### Section 5.6.1 - The concept of development

Differentiated development within developed economies.

### Section 5.7.1 - The performance of the UK economy

The distribution of income.

Comparison of recent UK economic performance with that of other countries.

### Outline of content

*Comparisons must be expressed in terms of GDP per capita and not income, wages or wealth.*

*Valid comparisons might include (the bullet point lists are not intended to be exhaustive – other valid comparisons should be credited):*

#### **Ireland and the UK**

- *average regional GDP per capita is higher in Ireland than in the UK*
- *average regional GDP per capita in both countries is higher than the EU25 average*
- *there is greater (less) regional disparity in GDP per capita in the UK (Ireland) than in Ireland (the UK)*
- *GDP per capita in Ireland's richest region is roughly 50% higher than in the poorest region, whereas in the UK this difference is greater at 330%*
- *GDP per capita in the poorest region of the UK (Ireland) is lower (higher) than that in Ireland (the UK)*
- *the capital city of both countries has the highest GDP per capita*

#### **Greece and the Czech Republic**

- *average regional GDP per capita is higher in Greece than it is in the Czech Republic (accept similar)*
- *average regional GDP per capita in both countries is lower than the EU25 average*
- *there is greater (less) regional disparity in GDP per capita in the Czech Republic (Greece) than in Greece (the Czech Republic)*
- *GDP per capita in the capital city of both countries is higher than the regional average*
- *only the Czech Republic's capital city has the highest GDP per capita*
- *the Czech Republic's poorest region has a GDP per capita slightly smaller than Greece's poorest region*
- *the Czech Republic's richest region has a GDP per capita significantly higher than Greece's richest region*

1 mark each for valid comparisons between the stated countries to a maximum of 3 marks. Where comparisons are quantified with valid data manipulation an additional mark should be awarded.

Zero marks for comparisons expressed in terms of GDP per capita and not income, wages or wealth.

- (b) According to some estimates, the rise in the labour force participation rate accounts for half of Ireland's GDP growth in the 1990s (Extract 2). Using an aggregate demand and aggregate supply diagram, analyse how an increase in an economy's labour force participation rate raises its GDP growth.** [9]

**Synoptic knowledge**

This question is rooted in concepts first introduced in Module 2883.

**Section 5.3.1 - Government macro-economic policy objectives and indicators of national economic performance**

The meaning of employment/unemployment.

**Section 5.3.2 - Aggregate demand and aggregate supply: the determinants of output, employment and prices**

The constituents of, and influences upon, aggregate demand.

The factors which influence aggregate supply – labour.

How aggregate demand and supply analysis can be used to illustrate macro-economic issues.

**Section 5.3.3 - The application of macro-economic policy instruments**

The nature and impact of supply-side policies.

The nature of supply-side economics and the scope of supply-side policies.

The use and effects of these policies on the rate of economic growth.

These concepts have been further applied and developed in different contexts in Modules 2886 and 2887.

**Outline of content**

*The stem of this question relates to the stimulus material in Extract 2. Without explicit economic analysis to explain the connection between labour force participation rates and economic growth a Level 3 mark cannot be awarded.*

*The most appropriate framework for analysing how an increase in an economy's labour force participation rate raises its GDP growth is that provided by AD/AS.*

*Using the AD/AS framework candidates should be able to explain how an increase in labour force participation rates raise the productive potential of an economy. This causes a rightward shift of the AS curve. Where this coincides with an increase in employment there will also be an increase in AD. The quality of explanation should be used to differentiate marks awarded in L3. A response which does not recognise that labour force participation rates impact on both the demand and supply sides of the economy should be awarded a mark at the bottom of the appropriate level.*

**Level 3**

For explicit economic analysis of how an increase in an economy's labour force participation rate raises its GDP growth, with explicit, focused and explained use of an AD/AS diagram. **[7-9]**

*For Level 3 marks the AD/AS diagram must have the following labels:*

**Vertical axis** = Price Level (or Inflation) or Average Price or General Price

**Horizontal axis** = Real GDP or GDP or Real Output or National Income

**Aggregate Demand** = AD

**Aggregate Supply** = AS

**Level 2**

For an application of knowledge and critical understanding (ie no economic analysis or lack of AD/AS diagram or inaccurate diagram) of how an increase in an economy's labour force participation rate raises its GDP growth, lacking explicit economic analysis of the causal links. **[4-6]**

**Level 1**

For knowledge and understanding of the terms labour force participation rates **and/or** GDP growth only. **[1-3]**

- 2 **Comment upon the extent to which tax competition between member states of the EU is “harmful”.** [10]

**Synoptic knowledge**

**Section 5.1.3 – Firms and how they operate**

Costs. Revenue.

**Section 5.2.1 – Economic efficiency within competitive markets**

Allocative and productive efficiency.

**Section 5.2.3 – Making choices and the impact of government intervention on market outcomes and economic efficiency**

The way governments intervene in markets through taxation. The impact of this form of intervention. The ways in which governments might create rather than remove distortions.

**Section 5.3.1 – Government macro-economic policy objectives and indicators of national economic performance**

Meaning of GDP, employment/unemployment, balance of payments, growth.

**Section 5.3.2 – Aggregate demand and aggregate supply: the determinants of output, employment and prices**

Constituents of, and influences on, AD and AS. How AD/AS analysis can be used to illustrate macro-economic problems and issues.

**Section 5.3.3 - The application of macro-economic policy instruments**

The nature and impact of fiscal policy.

**Section 5.3.4 – Structure and essential determinants of international transactions**

The pattern of trade.

**Section 5.8.1 – The ‘New Europe’**

A perspective on integration over the past 10 years or so. The meaning and nature of integration. Forms of integration (nature of economic unions) and the barriers to the free movement of goods, services and factors of production.

**Section 5.8.2 – The SEM and EMU**

The SEM – removal of non-tariff barriers. Distinction between an economic and monetary union. Macro-economic policy implications of a monetary union. Future prospects.

**Outline of content**The harm created by tax competition

Problems of tax competition for individual economies. For example, impact on tax revenues with consequent reduction in public expenditure. The reduction in AD through the displacement of FDI elsewhere in the EU (ie the case of Germany).

Problems of tax competition for the EU as a whole. The distortion of the allocation of resources within the EU. Impact on the efficient operation of the SEM.

Problems for businesses. The costs of compliance with different regimes.

The benefits of tax competition

Benefits for individual economies. For example, raising AD and AS and consequently the level and / or rate of growth of GDP.

Benefits for EU as a whole. Attracting FDI from outside the EU (extra-EU FDI). Impact on the EU economy.

Extent to which tax competition is / isn't harmful

Depends on whether FDI is simply displaced within the EU or whether level of FDI is increased. This determines whether tax competition is a zero sum gain – one country's gain is another's loss – or a positive sum gain (higher FDI, spillover/positive externalities of growth in one EU member state).

Depends on whether there is a need to cut government expenditure – by raising the tax base, cuts in corporate tax rates may raise tax revenue not reduce it. Depends on the significance of any cuts in government expenditure – e.g. what is cut? (current or capital expenditure, welfare state, infrastructure). Depends on the level of development of the economy – some may be affected more than others.

Depends on extent to which location decisions are made SOLELY on rates of corporation tax e.g. differences in corporate tax rates are only one factor, others include labour productivity, unit labour costs, government regulation etc

Depends on level of economic integration – e.g. impact of tax competition may be considered more significant in country which has given up monetary policy sovereignty by joining the eurozone.

**Level 4**

For a commentary upon the extent to which tax competition between member states of the EU is 'harmful'. **[8-10]**

For marks in Level 4 to be awarded, candidates must do more than simply explain the two sides – e.g. the 'harm' and benefit of tax competition. They must make explicit JUDGEMENTS on the arguments raised by examining their scale or significance and what the extent of the 'harm'/benefit depends upon.

**Level 3**

For explicit economic analysis of the 'harm' created by tax competition between member states **and/or** the benefits. **[5-7]**

**Level 2**

For an application of knowledge and critical understanding (ie no economic analysis) of the 'harm' created by tax competition between member states **and/or** the benefits. [3-4]

In this level candidates will show an understanding of the impacts of tax competition but will not analyse these impacts using economic terms and concepts.

**Level 1**

For knowledge and understanding of the nature of tax competition only. **[1-2]**

Answers that examine the pros and cons of tax harmonisation can gain credit where the response considers the adverse consequences of tax competition.

No credit can be given for the problems of harmonising taxes.

- 3 **Comment upon the extent to which the 10 new member states (EU10) of the European Union (EU) might be able to raise their GDP per capita levels by a significant amount.** [15]

### **Synoptic knowledge**

This question draws upon candidates' understanding of concepts first introduced in Module 2883.

### **Section 5.3.1 - Government macro-economic policy objectives and indicators of national economic performance**

The meaning of Gross Domestic Product (GDP). The costs, benefits and sustainability of economic growth. Possible conflicts between policy objectives.

### **Section 5.3.3 – The application of macro-economic policy instruments**

The nature and impact of fiscal, exchange rate and supply-side policies. Demand management through fiscal and monetary policies. Exchange rate policy and its effects on aggregate demand. The nature of supply-side economics and the scope of supply-side policies. The use and effects of these policies on the rate of economic growth.

### **Section 5.3.4 – Structure and essential determinants of international transactions**

The nature and benefits of change.

The context for the question is provided by Module 2888.

### **Section 5.8.1 - The 'New Europe'**

### **Section 5.8.2 - The Single European Market (SEM) and Economic and Monetary Union (EMU)**

### **Section 5.8.3 - The transition economies of Europe**

### **Outline of content**

*GDP per capita levels of the EU10 are significantly below those of the EU25. The extent to which the EU10 can raise their GDP per capita levels towards the EU average is dependent on their relative rates of economic growth. At present their GDP growth rate is higher than both the eurozone economies and the EU15 (Extract 3). In some cases these differences in rates of economic growth are significant: three times the rate of growth of the eurozone economies for Estonia and Lithuania. Candidates should explore the causes of economic growth in both the short and long term and relate these to the question set. For example, they might argue that high rates of economic growth created by increases in AD alone would be unsustainable and would be likely to conflict with the policy objective of low inflation – indeed they may fail to meet the convergence criteria set by the EC for eurozone membership. Only 4 of the EU10 currently satisfy the EMU inflation and budget deficit criteria. This clearly constrains their ability to raise economic growth through fiscal policy. Supply side improvements are preferable both in terms of economic theory and the context of EU membership. Extract 5 shows how the EU10 have both lower employment rates and productivity than the non-eurozone economies. With the exception of Hungary, Malta, Slovakia and Poland the EU have little scope for 'catch-up' with respect to the eurozone economies in terms of employment rates. Improvements in rates of economic growth, then, can only be sustained by increases in labour productivity. If these are achieved the rightward shift in AS would generate non-inflationary, sustainable economic growth. This would raise their GDP per capita levels in the long run. The extent to which labour productivity can be increased depends on many factors, which candidates should explore as part of their commentary. Fiscal constraints may limit government expenditure on education, training and infrastructure. Improvements in the private sector may be dependent on the scope, significance and nature of FDI. Competitive pressures of the SEM may provide a spur, but are likely to be weak given low labour costs disguise poor*

*productivity. The extent and significance of EU support through regional policy could be explored as a determinant of supply side improvements. The key distinction is the extent to which current rates of GDP growth are sustainable within the EU and within the medium to long term.*

**Level 4**

For a commentary upon the extent to which the 10 new member states (EU10) of the European Union (EU) can raise their GDP per capita levels by a significant amount.

**[10-15]**

**Level 3**

For explicit economic analysis of factors enabling **and/or** constraining an increase in the GDP per capita levels of the 10 new member states (EU10) of the European Union (EU).

**[5-9]**

**Level 2**

For an application of knowledge and critical understanding (ie no economic analysis) of how the 10 new member states (EU10) of the European Union (EU) **can/cannot** raise their GDP per capita levels.

**[3-4]**

**Level 1**

For knowledge and understanding of GDP per capita levels only.

**[1-2]**

- 4 Discuss the extent to which membership of the eurozone is of benefit to an individual country's macroeconomic performance. [20]

**Synoptic knowledge**

Section 5.3.1 – Government macro-economic policy objectives and indicators of national economic performance.

Section 5.3.2 – Aggregate demand and aggregate supply: the determinants of output, employment and prices

Section 5.3.3 – The application of macro-economic policy instruments

Section 5.3.4 – Structure and essential determinants of international transactions

Section 5.8.1 – The 'New Europe'

Section 5.8.2 – The SEM and EMU

Section 5.8.3 – The transition economies of Europe

**Outline of content**

*Expected benefits for macro-economic performance include:*

- *higher GDP growth;*
- *lower inflation;*
- *lower unemployment;*
- *increased trade.*

*These benefits should be analysed using economic concepts (probably within an AD/AS framework). This could be done by relating the micro-economic benefits of eurozone membership to macro-economic performance. For example, reduced transactions, reduced exchange rate risk and greater price transparency are, in theory at least, likely to result in higher AD (increased eurozone consumption, higher cross border and inward investment, increased net trade through greater competitiveness. Supply side improvements (increased AS) result from lower costs of production, greater factor mobility and competition effects.*

*Potential costs for macro-economic performance include:*

- *the loss of monetary policy sovereignty;*
- *the constraint on fiscal policy;*
- *the lack of fiscal transfers between countries;*
- *the perceived deflationary bias of eurozone monetary policy.*

*Again, these should be related analytically to macro-economic performance.*

- *The extent of the benefits should be explicitly evaluated by candidates for L4 marks to be awarded. The factors which determine the extent of the benefits for an individual country include:*
- *the degree of economic convergence with the rest of the eurozone;*
- *the extent to which an individual country is susceptible to asymmetric shocks;*
- *the degree of labour market flexibility and mobility.*

*Clearly these should be explained rather than stated for high L4 marks to be awarded.*

*The focus of responses should be explicit. This is not a question on the general pros and cons of membership of the eurozone. Candidates should be explicit on how membership impacts on macro-economic performance, in terms of GDP growth, unemployment, inflation and balance of payments considerations. The requirement to examine the extent of the benefit for an individual country's performance may well be addressed in a number of different ways by candidates. Candidates could examine the extent of the benefits for one country (most likely the UK). Others might illustrate benefits for some countries and draw a comparison with costs for others. Either approach is acceptable. Extract 3 provides time series data on GDP growth*

performance for individual countries and for groups of countries within the EU (eurozone, non-eurozone and recent accession states – the EU10). This clearly provides much in terms of stimulus. The best candidates will analyse and discuss the relevance of the data and offer much more besides in terms of what is meant by macro-economic performance. They are likely to access high marks in L3 (for analysis) and L4 (for evaluative discussion). Weaker candidates will refer to the data, but descriptively without examining critically the extent to which this data provides evidence on comparative economic performance. Such responses are unlikely to progress much beyond L2, unless there is clear economic analysis of why differences in GDP growth might be related to membership of the eurozone. The best candidates may well draw out what determines the extent of the benefits/costs for an individual country (eg issues related to real convergence). In doing so they are likely to be achieving high marks in L4 of the mark scheme. Lower level evaluation will probably outline benefits and costs without adequately addressing the “to what extent” aspect of the question.

Contextual knowledge and understanding of the economies of the EU may well help some candidates to engage in evaluative discussion. Some of this context is provided by the pre-issued stimulus material. It must be emphasised that contextual knowledge is not a pre-requisite for higher marks in L4. It is simply one route amongst many that may be adopted by some candidates.

#### **Level 4**

For an evaluative discussion (underpinned by economic analysis) of the extent to which membership of the eurozone is of benefit to an individual country’s macro-economic performance. **[12-20]**

*Candidates at the lower end of this level are likely to realise that membership may damage economic performance but not address the extent to which aspect of the question.*

*Candidates at the top end of this level will draw out the factors which determine the extent of the benefits either theoretically, through case studies or through contextual knowledge and understanding of the EU economies.*

#### **Level 3**

For analysis of how membership of the eurozone is **or** is not of benefit to an individual country’s macro-economic performance. **[5-11]**

#### **Level 2**

For an application of knowledge and critical understanding of how membership of the eurozone is **or** is not of benefit to an individual country’s macro-economic performance. **[3-4]**

*Candidates in this level will not offer any analytical explanation of how macro-economic performance is affected by eurozone membership.*

#### **Level 1**

For knowledge and understanding of the benefits and costs of eurozone Membership or macro-economic performance. **[1-2]**

*Candidates in this level will not relate their knowledge and understanding of the economics of a monetary union to the economic performance of an individual member country.*

*Alternatively candidates may not relate their knowledge of economic performance to the eurozone e.g. they may look at the impact on performance of either membership of the EU or the SEM.*

**Advanced GCE (Economics) (3812/7812)  
June 2006 Assessment Series**

Unit Threshold Marks

Unit		Maximum Mark	a	b	c	d	e	u
2881	Raw	45	33	29	25	22	19	0
	UMS	90	72	63	54	45	36	0
2882	Raw	45	34	30	26	23	20	0
	UMS	90	72	63	54	45	36	0
2883	Raw	45	35	30	26	22	18	0
	UMS	120	96	84	72	60	48	0
2884	Raw	45	33	30	27	24	21	0
	UMS	90	72	63	54	45	36	0
2885	Raw	45	34	31	28	25	22	0
	UMS	90	72	63	54	45	36	0
2886	Raw	45	30	27	24	22	20	0
	UMS	90	72	63	54	45	36	0
2887	Raw	45	31	27	24	21	18	0
	UMS	90	72	63	54	45	36	0
2888	Raw	60	43	38	33	28	23	0
	UMS	120	96	84	72	60	48	0

Specification Aggregation Results

Overall threshold marks in UMS (i.e. after conversion of raw marks to uniform marks)

	Maximum Mark	A	B	C	D	E	U
<b>3812</b>	300	240	210	180	150	120	0
<b>7812</b>	600	480	420	360	300	240	0

The cumulative percentage of candidates awarded each grade was as follows:

	A	B	C	D	E	U	Total Number of Candidates
<b>3812</b>	22.7	45.8	64.7	79.3	89.1	100	5619
<b>7812</b>	31.3	59.0	80.3	93.3	98.9	100	4446

**4446 candidates aggregated this series**

For a description of how UMS marks are calculated see;  
[www.ocr.org.uk/OCR/WebSite/docroot/understand/ums.jsp](http://www.ocr.org.uk/OCR/WebSite/docroot/understand/ums.jsp)

Statistics are correct at the time of publication



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