

Economics

Advanced GCE **A2 7812**

Advanced Subsidiary GCE **AS 3812**

Mark Schemes for the Units

January 2007

3812/7812/MS/R/07J

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Advanced Subsidiary GCE Economics (3812)

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**Mark Scheme 2881
January 2007**

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, ie 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 what is meant by a market.** [2]

For a clear description eg where buyers and sellers (1) meet to trade/ exchange (1) agree prices (1).

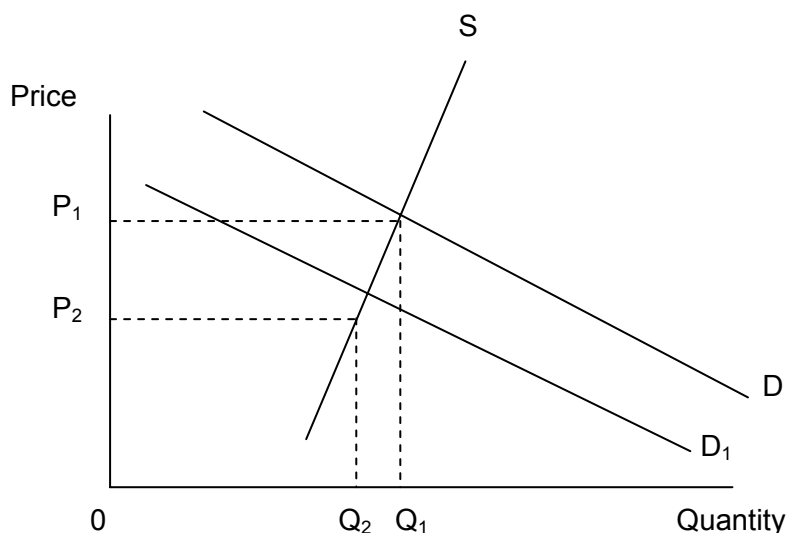
Award 1 mark for a vague definition.

- (ii) **Using the information provided give two examples of different markets in which the Royal Mail operates.** [2]

Award 1 mark for

- Universal postal market/(national) collection and delivery of mail
- Bulk mail market for at least 4000 items
- Private mail
- Business mail
- Postal market/ services
- Delivering mail on a 'last mile' basis for competitors

- (b) **Using a supply and demand diagram, explain how the market for postal services has been affected by the increased use of e-mail and mobile phone texting (lines 8 to 10).** [4]



Up to 3 marks for a correctly labelled diagram.

- Correctly labelled axes (1)
- Downward shift of D (1)
- Correctly identified equilibrium positions (1)

plus up to 2 additional marks for an explanation of

- Increased use of e-mail and mobile phone texting
- The quantity demanded and price have fallen.

(c) The supply of first and second class postal services in the UK was likely to have been relatively inelastic until January 2006.

(i) Explain what is meant by inelastic supply. [2]

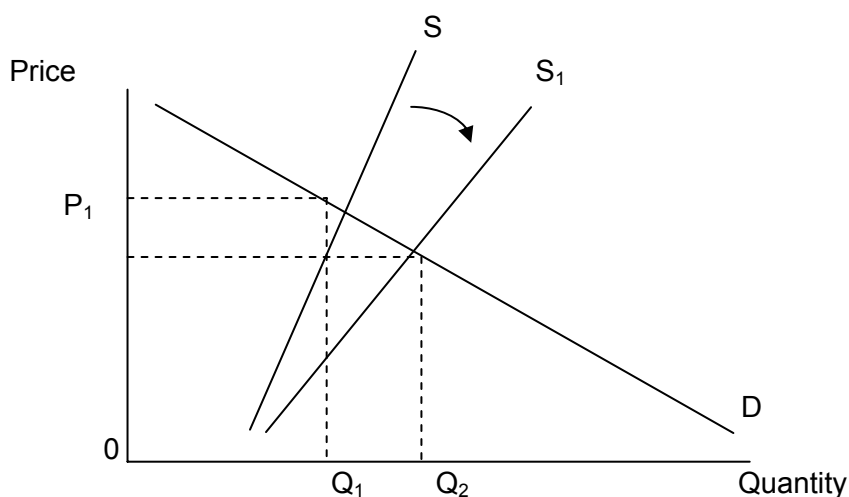
For a clear description eg the supply of goods is only slightly affected (does not react in the same proportion as the change in price) by any change in price - 2 marks.
(2 marks for a correct numerical example.)

Award 1 mark for a vague idea that does not refer to change.

Award 1 mark for a correct formula $\% \Delta QS / \% \Delta P$.

Award 1 mark if explanation is in terms of 'not affected' by price change.

(ii) Using a supply and demand diagram, explain how that market for first and second class postal services might be affected by increased competition from January 2006. [4]



Up to 3 marks for a correct diagram

- Shift to right of S (1)
- Original equilibrium (1)
- New equilibrium position (1)

plus some additional marks for explanations

- Rightward S shift indicates more competitors enter the market
- Prices will fall and Qs will increase
- Extent of change depends on price elasticity of demand.

- (d) (i) **Define economies of scale.** [2]

For a clear definition E.g. a fall in long run average costs (2) or a definition that refers to falling average/unit costs (1) as output expands (1) as the **scale** of the business increases (1).

- (ii) **State and explain one economy of scale from which the Royal Mail may benefit.** [3]

Various possibilities including:

- Managerial: specialist managers can be responsible for different aspects of the business
- Purchasing: supplies such as vehicles and red paint can be bought in bulk
- Technical: bar code technology and post codes reduce handling costs
- Specialisation: Royal Mail has the collection and delivery network in place

1 mark for recognition plus 1 mark for elaboration. Benefit in terms of falling average unit costs (1) as the size of the business increases (1) in the long run (1).

- (e) (i) **Explain what is meant by the term barriers to entry.** [2]

For a clear definition eg anything that prevents a new firm from moving into a market – 2 marks.

Award 1 mark for a more general answer where 'new' is not understood.

- (ii) **State and explain two examples of barriers to entry into the UK postal market.** [6]

Various possibilities including:

- Universal postal obligation prior to liberalisation – legal barrier
- High set up costs especially if seeking to operate 'last mile' function
- Continuing monopoly power of Royal Mail
- Uncertainty over Royal Mail's charges
- Licence from Postcom for new entrants
- High sunk costs
- Royal Mail as an established brand
- Ability to charge lower prices due to economies of scale.

Award 1 mark for recognition plus 1 mark for a clear elaboration and 1 mark for why it constitutes a barrier to entry for a new firm.

- (f) **Comment upon why new entrants into the postal market, such as UK Mail and Business Mail, may not necessarily maximise profits.** [6]

Various possibilities including:

- Satisficing : New entrants into the market might be satisfied with survival in the first instance, particularly if they have tried to break in to the universal market
- They might not have the necessary information needed to know whether profits are being maximised
- Sales maximisation might be the immediate objective in order to inflict maximum damage to Royal Mail's monopoly
- They may use penetration pricing to gain a foothold in the market.

Up to 3 marks for a relevant explanation/application.

Up to 3 marks for a comment.

One possibility well explained and with comment can gain full marks.

4 marks maximum (2+2) if no application to Royal Mail or if answer refers only to making and not maximising profits.

- (g) **Discuss the extent to which the Royal Mail might still be regarded as a monopolist after the changes outlined in the article.** [12]

The information provided indicates that prior to liberalisation, the Royal Mail had a monopoly in the UPO sector, although its market in bulk mail and junk mail is being put under pressure from new entrants, some of whom are powerful national postal providers. The key to monopoly power is therefore the strength of barriers to entry. The extent of Royal Mail's future monopoly power will depend on how successful new entrants are in gaining market share. This could also depend upon the extent to which rival networks are set up or whether new entrants choose to agree costs to use the Royal Mail network. It is also relevant to discuss the extent to which the postal market can be separated from other types of communication activity. There is no information on the profits being earned by Royal Mail.

- L4 For a discussion of the extent to which the Royal Mail is still a monopolist (7-12)
- L3 For an analysis of Royal Mail's monopoly power after liberalisation (5-6)
- L2 For an application of knowledge and critical understanding of the evidence relating to the Royal Mail's monopoly power (3-4)
- L1 For knowledge and understanding of monopoly (1-2)

See additional notes on subject content.

Possible subject responses and further advice on part (g)

The key point about this question is that it is concerned with the extent to which the Royal Mail is **still a monopolist after the changes** to its licence brought in from January 2006.

Taking evidence from the article

- Before Jan 2006**
- Royal Mail had legal protection of UPO for letters that cost £1 or less to deliver
 - It further was the only company that had its own national post box network and delivery system
 - Competition in the bulk delivery market had been introduced since 1999.
- After Jan 2006**
- Competitors can now enter the former UPO market; they can have own post boxes and delivery systems
 - New entrants must be licensed by Postcom
 - Bulk postal delivery competition is still present and continues to use RM's 'last mile' service
 - Competitors can now in theory agree a price with RM to deliver all mail, not just bulk mail
 - Competition from increased use of e-mail and texting is still a threat.

There is no evidence provided of Royal Mail's market share in the bulk market, where it competes with others; no evidence of Royal Mail's profits.

Level 1 (1-2 marks)

Answers at this level will contain no more than a **theoretical knowledge and understanding** of monopoly; for example, high barriers to entry, excess profits in short and long run, very high market share, price maker.

Level 2 (3-4 marks)

Answers at this level will contain an **application** of knowledge and critical understand of Royal Mail's monopoly power from January 2006 (see above).

Level 3 (5-6 marks)

Answers at this level must be **analytical**. They should take some or all of the features of Royal Mail's monopoly power from January 2006 and develop these features using economic analysis. For example, reference could be made to Royal Mail's monopoly providing benefits from economies of scale, the company's ability to determine prices for competitors to use the last mile system due to the high set up costs, the Royal Mail brand and its extensive network of post boxes.

Level 4 (7-12 marks)

Answers at this level must **discuss** the extent to which the Royal Mail is still a monopolist. This could be a before and after approach or just concentrate on the evidence available from January 2006. Valid discussion could be made of the extent to which Royal Mail is still a monopolist or is no longer a monopolist, using the content set out above.

9 marks should be the benchmark for a reasonable discussion, with some points looking at both sides. Award up to 12 marks where the 'extent' aspect is clearly evidenced and evaluated. (Do not be afraid to give full marks even though all of the content points may not have been covered).

**Mark Scheme 2882
January 2007**

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, ie 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) Furniture is classified by economists as a private good.**(i) State two characteristics of a private good. [2]**

- 1 mark for excludability
- 1 mark for rivalry / diminishability
- 1 mark for rejectability

Maximum of 2 marks available.

(ii) Using the characteristics identified in part (i), explain two reasons why furniture is a private good. [4]

2 marks for a clear explanation of the principle of rivalry:

- If one person consumes the product then others can't benefit from it (1 mark)
- Therefore competing consumers are, in essence, rivals for the products (which are limited in their availability) (1 mark)

1 mark for basic explanation/application of rivalry, for example, if one person has the good, others can't get it.

2 marks for clear explanation of the principle of excludability:

- Firms selling furniture attach a price to it before it is sold (which makes the good excludable). (1 mark). Those unable to afford/pay the price of the furniture will be excluded from the benefits of the good. (1 mark)
- Alternatively, the furniture can be locked away by the owners (1 mark) and therefore non payers can be excluded from the benefits of the product. (1 mark)

1 mark for basic explanation/application of excludability, for example, if people can't buy it then they will be excluded.

DO NOT award simple repetition of what the characteristics of a private good are.

- (b) (i) **What is meant by a national minimum wage?** [1]

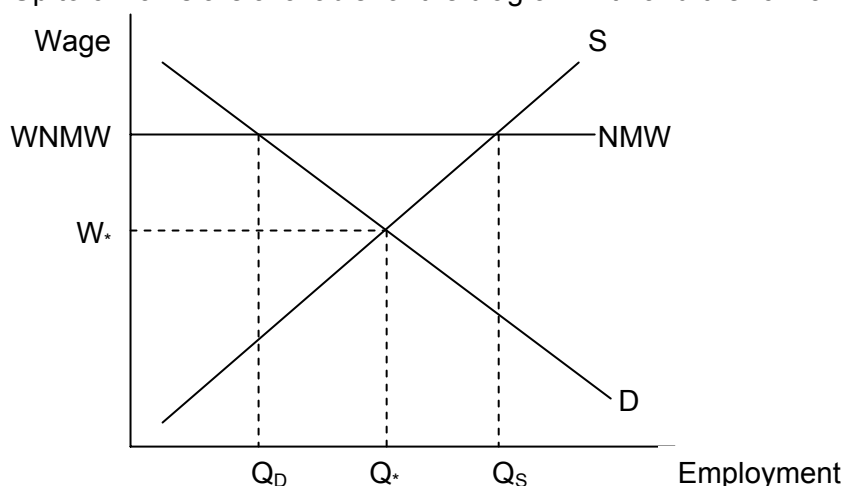
1 mark for a simple statement that it is the legally enforced minimum level of payment which someone is to be paid

OR for a vague idea in terms of minimum payment which a worker receives (1 mark)
 OR the lowest possible wage which a worker can be paid (1 mark) OR the minimum level of wages set by the government (1 mark) OR a price floor applied to the labour market (1 mark).

Note: do not reward "a price control applied in the labour market" as this is taken from the text. Likewise, do not reward "minimum level of pay".

- (ii) **Using a supply and demand diagram, explain what impact the introduction of a national minimum wage is likely to have on the labour market.** [10]

Up to 6 marks are available for the diagram with a further 6 marks for explanation.



- 1 mark for axes (wage/employment OR wage/quantity OR price/quantity)
- 1 mark for original supply curve
- 1 mark for original demand curve
- 1 mark for original equilibrium
- 1 mark for clearly labelled minimum wage line (either above or below equilibrium)
- 1 mark for indication of new quantity demanded and supplied (Q_D/Q_S or Q_1/Q_2)

Possible explanation could include:

To be effective, the NMW needs to be set above equilibrium (1 mark).

At a higher wage there will be a contraction/fall in demand for labour from Q^* to Q_D on the diagram (1 mark).

There will also be an extension/rise in labour supply from Q^* to Q_S as more workers will be willing to offer their labour at a higher wage rate (1 mark).

Excess supply of labour (or a surplus of labour) results (1 mark) which represents unemployment (1 mark)

The extent of the effect on unemployment depends upon the elasticities of demand and supply (1 mark) OR any other relevant reference to PES/PED. For example, if PES and PED are inelastic, then the resulting level of unemployment will be lower.

(c) **The use of a national minimum wage is one method of government intervention aimed at reducing income inequality.**

(i) **Comment upon whether or not a national minimum wage will be effective in reducing income inequality.** [6]

Up to 2 marks are available for basic analysis of how a minimum wage will attempt to solve inequality. This could include:

- A minimum wage will raise the wages / incomes received by low paid workers (1 mark)
- This will reduce the gap between rich and poor (1 mark)
- A minimum wage effectively creates a 'floor' below which wages cannot fall below (1 mark)
- It provides an incentive for the unemployed to look for jobs (1 mark)

Up to 4 marks are available for relevant commentary which could include any of the following points:

- The possibility of increased unemployment (especially in labour intensive industries and those with very low wages)
- If unemployment does result, the scale of this will be determined by the elasticities of supply and demand for labour
- A minimum wage may well be ineffective in tackling problems such as poverty if low pay is not the main cause of the inequality. In other words, it will only reduce income inequality for those who are in work.
- By paying all workers a minimum wage this will not target those specifically in low income families and may well help many middle income households where the 2nd or 3rd wage earners receive a pay rise ie is NMW poorly focused?
- What level should the minimum wage be set at? Too high and there may well be unemployment. Too low and it will not reduce inequality.
- If other, higher paid, workers successfully fight to maintain wage differentials then inequality will not be reduced

One point of discussion which is well made can receive all 4 marks. Likewise, several points which are made in less detail can still receive all 4 marks.

- (ii) **Identify and explain two other methods of intervention which a government could use to reduce inequality.** [4]

2 marks for the identification of any relevant policies to include:

- Taxation (progressive tax eg income tax)
- Subsidies on the prices of goods and services
- Maximum prices to lower the price of necessity goods
- Means tested benefits which increase the incomes of lower income groups (accept reference to Job Seekers' Allowance)
- Tax credits which are aimed at low income groups (eg the working families tax credit)
- A maximum wage policy aimed at restricting the earnings of top income groups in society
- Government provision of goods and services
- Legislation (such as the Equal Pay Act) aimed at reducing inequality
- Education and training to enable workers to gain skills, thereby improving their job prospects

A further 2 marks are available for explanation/elaboration of how such policies would work in reducing inequality. Any relevant elaboration of the policy which attempts to explain how this will tackle income inequality is acceptable.

(d) In the article, Harrison Lewis claims that “increased competition is good for everyone in that it raises efficiency” (line 12-13).

(i) Define each of the following terms:

- **Productive efficiency** [2]

Where production takes place at the lowest point of the AC curve OR at the point of minimum efficient scale OR at lowest unit cost (2 marks).

Where production occurs where $MC=AC$ (2 marks).

Where production uses as few scarce resources as possible (2 marks).

Where production takes place at a point on the PPF (2 marks).

Where maximum output is achieved (1 mark) from the minimum number of resources (1 mark).

Where production occurs at the lowest cost (1 mark)

- **Allocative efficiency** [2]

Where scarce resources are used to produce those goods and services which consumers demand (2 marks).

Where the firm produces where $P=MC$ (2 marks).

Where production makes the best use of scarce resources (1 mark).

For a vague idea that it is using resources in their most efficient way (1).

Where it is producing those goods which consumers want but lacking any reference to resources (1 mark).

Where production occurs at a point where $MSB=MSC$ (2 marks)

- **Pareto efficiency** [2]

Where it is impossible to make one person better off (1 mark) without making anyone else worse off (1 mark)

A vague idea of the above statement gains 1 mark

Where an economy is productively and allocatively efficient (2 marks).

1 mark for some idea of productive efficiency being present/producing at minimum AC, producing along the PPF.

1 mark for some idea of allocative efficiency being present ($P=MSC$).

(ii) **Discuss whether increased competition will always lead to an improvement in economic efficiency.** [12]

Level 4	For discussion of whether or not increased competition will raise economic efficiency	7-12 marks
Level 3	For an analysis of why increased competition will or will not raise economic efficiency	5-6 marks
Level 2	For an application of knowledge and critical understanding of why increased competition may lead to increased economic efficiency	3-4 marks
Level 1	For knowledge and understanding of economic efficiency only.	1-2 marks

Level 1 answers will simply show a very basic understanding of what economic efficiency is. As soon as an answer starts to explain the different types of economic efficiency that exist then this can receive a Level 2 answer.

Candidates that go on to analyse and explain why increased competition leads to improved productive and allocative efficiency will receive a Level 3 mark.

Answers which clearly discuss why increased competition may not lead to increased economic efficiency can receive a Level 4 mark.

NOTE: Level 4 answers must develop discussion which is directly linked to the question asked ie why competition does not raise economic efficiency. Simple statements which list the potential drawbacks of competition which are not linked to economic efficiency will not reach Level 4.

Possible Level 4 answers:

- Increased competition may see the potential loss of economies of scale (natural monopoly argument) and therefore productive inefficiency may arise.
- Monopoly may in fact create an incentive for firms to innovate and to invest more to produce exactly those goods and services which consumers want. Supernormal profit may be used for Research and Development which could generate long run, dynamic efficiency gains.
- If competition does not take the form of price competition (ie if non price competition is used) then this will not necessarily lead to productive efficiency being achieved if average costs are not minimised.
- Increased competition may result in firms attempting to 'cut corners' by reducing private costs at the expense of increased pollution and external costs. Therefore, if increased competition results in the creation of negative externalities then allocative inefficiency will be created.
- If increased competition occurs, it may prove to be difficult for firms to work out exactly what consumer preferences are and therefore there will not be a rise in allocative efficiency if there is imperfect information in the market.
- Whether or not increased efficiency results will depend upon the scale of the increase in competition generated. For example, if only a very small number of

firms enter the national market then this may not be significant enough to generate increased economic efficiency.

- Increased competition may result in firms attempting to cut costs by reducing product quality. This will be allocatively inefficient if consumers are demanding high quality products.

Possible Level 3 answers:

Candidates must develop clear analysis of productive and allocative efficiency here and explain why increased competition leads to increased efficiency

Candidates can receive the top mark for the level (6 marks) by analysing only one type of efficiency very well.

- Competition will lead to greater allocative efficiency as firms have to produce exactly those goods and services which people want, otherwise they will go bankrupt
- Increased competition also leads to greater productive efficiency as firms will compete on price and in order to lower their prices they will have to cut their costs in the first place
- Greater competition also removes the possibility of 'X inefficiency' with companies no longer being complacent as there is the very real threat of competition.

Possible Level 2 answers:

- The candidate explains either increased productive or allocative efficiency
- There is simply an explanation of how competitive markets are more efficient and the answer fails to respond to the question which asks for a discussion of increased competition.

Possible Level 1 answers:

- These would involve a simple explanation, in general terms as to what is meant by economic efficiency, making no reference to productive or allocative efficiency.

**Mark Scheme 2883
January 2007**

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 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, ie 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.

- 1 a) i) **Define economic growth. (line 3)** [2]
- 2 marks for a rise in real GDP/increase in productive capacity.
1 mark for rise in GDP/output.
- ii) **Define balance of trade in goods. (line 5)** [2]
- 2 marks for export revenue minus import expenditure on goods/ exports minus imports of goods.
1 mark for reference to exports and imports/ exports/ imports.
1 mark for stating it is a part of the current account of the balance of payments.
- b) **What is meant by:**
- i) **Cost-push inflation** [2]
- ii) **Demand-pull inflation?** [2]
- 1 mark for cost-push inflation is caused by an increase in costs of production.
1 mark for cost-push inflation is represented by a shift of the AS curve to the left.
1 mark for an example of a specific cause of cost-push inflation eg a rise in raw material costs, rise in the price of oil, rise in wages.
1 mark for cost-push inflation may be associated with a fall in output.
1 mark for demand-pull inflation is caused by an increase in aggregate demand.
1 mark for an example of a specific cause of demand-pull inflation eg a rise in the money supply, government spending, consumption, net exports.
1 mark for demand-pull inflation arises when AD increases by more than AS/occurs close to or at the full employment level/associated with a positive output gap.
1 mark for demand-pull inflation is illustrated by a shift to the right of the AD curve.
1 mark for demand-pull inflation may be associated with a rise in output.
- iii) **From the information provided, comment on whether Italy was experiencing cost-push or demand-pull inflation in 2005.** [6]
- 1 mark for stating it is cost-push or not demand-pull.
Up to 3 marks for good explanation of each reason given why it is cost push/ not demand pull inflation.

- c) i) **Calculate Italy's unemployment rate for May 2005 (lines 10-11). Show your working.** [2]

2 marks for correct answer ie 8%

1 mark for process ie $\frac{\text{unemployed}}{\text{workforce}} \times 100$ or $\frac{2.16\text{m}}{27\text{m}} \times 100$

- ii) **Explain two fiscal policy measures that a government could use to reduce unemployment.** [6]

1 mark for each of two fiscal policy measures identified eg rise in government spending, cut in taxation, rise in government spending on education, cut in income tax, cut in VAT.

1 mark for each basic explanation eg higher government spending on education will raise AD, higher government spending on education will raise skills.

1 mark for each of two further elaborations eg higher AD will encourage firms to expand and take on more workers, more skilled people will be more occupationally and geographically mobile/more productive.

- d) **If a country's aggregate demand curve was moving in the direction as shown in Fig 1, explain why its Central Bank might lower its rate of interest.** [5]

1 mark for need to increase aggregate demand.

Up to 3 marks for why aggregate demand needs to be increased.

Up to 4 marks for how a cut in interest rates could increase aggregate demand.

- e) **Italian producers are facing increased competition from firms in China. Explain two possible ways in which Italian consumers may benefit from that increased competition.** [6]

1 mark for each of two ways identified eg lower prices, better quality, more choice, higher living standards, innovation.

1 mark for each of two basic explanations eg lower prices due to cheaper Chinese products, better quality due to Chinese firms being better at producing certain products, selecting from a greater number of producers increases the range of products on offer, the products may be bought with less money, one way to enter new markets to innovate.

1 mark each for each of two further elaborations eg more competition from Chinese firms may force Italian firms to keep costs and prices lower, higher competition may force Italian firms to improve quality of their products, Chinese firms may create more choice by both producing similar to and different from Italian firms, more products in total may be purchased, higher competition can stimulate both domestic and foreign firms to use new equipment and introduce new products.

f) **Discuss the economic consequences of unemployment.** [12]

The consequences of unemployment are influenced by the number of people unemployed, the duration and type of unemployment. For instance, long term unemployment is more serious than short-term unemployment. The longer people are out of work, the more difficult it becomes for them to find another job. This is because they lose out on training and advances in technology and becomes less confident. Some may even lose the work habit.

L4 For a discussion of the economic consequences of unemployment. (7-12)

L3 For an analysis of the economic consequences of unemployment. (5-6)

L2 For an application of knowledge and critical understanding of the economic consequences of unemployment. (3-4)

L1 For knowledge and understanding of unemployment. (1-2)

L1 For knowledge and understanding of unemployment. (1 – 2)

Examples:

- Unemployment is a situation where people who are willing and able to work are without jobs.
- Unemployment is measured by the Labour Force Survey and the claimant count.
- Unemployment can be reduced by cutting income tax, cutting interest rates, increasing government spending and introducing supply-side policies.

L2 For an application of knowledge and critical understanding of the economic consequences of unemployment. (3 – 4)

- Unemployment means a loss of potential output, lower tax revenue and increased government spending.
- Those unemployed may experience a loss in income, health problems and difficulty obtaining another job.

L3 For an analysis of the economic consequences of unemployment. (5 – 6)

- Unemployment means that not all economic resources are being used. This means that real GDP is below what it could be. The economy is not producing on its PPC, The loss of potential output means that material living standards are lower than they might be.
- Unemployment means that the government has to spend more on unemployment related benefits. This again involves an opportunity cost. Government spending on other areas, e.g. health and education may have to be reduced or taxation raised.
- Unemployment means forgone tax revenue, both direct and indirect. This may mean that the government reduces its spending on areas such as education and health care.
- Unemployment will reduce a people's income if state benefits are lower than the wages they were earning.
- Unemployment, by lowering material living standards, can make people more susceptible to a range of illnesses including asthma. By reducing people's sense of self esteem it can also lead to mental health problems. A decline in people's physical and mental health will increase the burden on the NHS.

- L4 For a discussion of the economic consequences of unemployment. (7 – 12)
- The economic consequences of unemployment are influenced by the scale of unemployment. The greater the unemployment, the greater the loss in potential output and tax revenue and the greater the amount that has to be paid out in benefits.
 - A government may not be concerned if unemployment is 3%, or close to 3%. This is because this rate is considered to be around the full employment level.
 - Long term unemployment is more serious than short term unemployment. The longer people are out of work, the more difficult they are likely to find work. This is because their skills become out of date and they may lose the work habit.
 - Frictional unemployment is less significant than structural and cyclical unemployment. This is because it is short term and usually on a relatively small scale.
 - Unemployment can bring some benefits. Having some unemployment can provide some flexibility, can reduce inflationary pressure by keeping down wage rates and aggregate demand and can mean that some people have time to reassess their career choices and to become better trained.
 - As governments seek to keep unemployment low, it suggests that the costs of unemployment exceed any potential benefits.

**Mark Scheme 2884
January 2007**

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, ie 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.

- 1 (a) **What is meant by ‘median personal income for women rose in real terms’ (lines 4-5)?** [3]

(1) for identifying median as a form of average; (1) for identifying the meaning of personal income (given in the text); (1) for correct interpretation of in real terms.

- (b) **Identify from the extracts two ways in which the economic position of women relative to men has improved in recent years.** [2]

(1) for identification of each of 2 valid statements (eg increase from 46% to 53%, or 31% v 13%, in Extract 1; £158k v £142k from Extract 2). [2]

- (c) (i) **Explain one possible reason why demand for the skills of graduates has increased. (lines 25-27).** [2]

(1) for identification plus (1) for explanation of a valid reason. This should relate to MRP, at least by implication, for the full 2 marks.

- (ii) **With reference to Extract 2, use supply and demand analysis to explain briefly why the earnings advantage of graduates over non-graduates has fallen in recent years.** [3]

Increase in the demand for graduates (1) with a greater increase in supply (1), leading to a fall in the average relative wage (1).

NB: Diagram is not required, though of course could be helpful in providing a convincing explanation.

Max of 2 marks if diagram only, not explained.

- (d) **Comment on possible reasons why ‘Thirty years after the Equal Pay Act came into force, female full-time workers still earn almost a fifth less than men per hour.’ (lines 8-10).** [4]

(2) for explanation of at least one reason why the disparity might still persist, in spite of the Act. This could be in terms of actual discrimination (even though it is illegal), or women choosing to work in relatively low-paid employment, or “glass ceiling” arguments.

(2) for valid commentary on at least one reason – eg on failure of government to enforce the law, or women choosing work for non-financial reasons, or not seeking top jobs, etc.

- (e) **Discuss one measure which the UK government might include in a ‘strategy on female poverty’. (line 15).** [6]

(1) for identification plus (1) for explanation of a valid method. This is probably most likely to be a method which concentrates on the pay element of income, but need not do so.

(4) for evaluative discussion, on the extent to which the method might be effective – or, indeed, desirable. In principle this is (2) for positives re the chosen method plus (2) for possible difficulties.

NB Maximum of 3 marks only for a standard minimum wage answer.

2 (a) **Explain, with examples, the meaning of contestability in a market.** [10]

Explanation of the essence of contestability as the absence, or otherwise, of effective barriers to entry and/or exit in the market. (An answer may link to traditional market structures, but does not need to.) An answer needs to consider potential as well as actual barriers, and to consider exit as well as entry barriers to get above (7). Relevant examples need to be given to illustrate points made.

L3 For an explanation of the term contestability, covering potential and actual barriers to entry, and barriers to exit, with relevant exemplification.

Must have both exit and potential for more than 8 marks.
Also a maximum of 8 marks will be awarded if there are no examples.

[7-10]

L2 For application of knowledge and critical understanding of the term, with at least one relevant example.

[4-6]

L1 For knowledge and understanding only of the term.

Maximum of 3 marks if solely on competition/market structures.

[1-3]

(b) **With reference to one leisure market of your choice, discuss the extent to which lack of contestability enables excessive profit to be made.** [15]

Choice of a relevant market. Explanation of the relationship between lack of contestability, or existence of significant barriers, in general, and profitability of the firms in the market. Interpretation of "excessive profit", linked to the concept of normal profit. Importance of the time horizon – short-run – short-run or long-run. Discussion of the extent of contestability, linked to profitability, in the chosen leisure market.

L4 For a discussion, focusing on the extent to which there is a link between contestability and profit in the chosen market.

[9-15]

L3 For an analysis of link between contestability and profit.

[6-8]

L2 For the application of knowledge and critical understanding of contestability in chosen market.

[3-5]

L1 For knowledge and understanding of chosen leisure market only.

NB. The OFR applies here. I.e. if contestability is interpreted as competitiveness in part (a), then accept this in part (b) so as not to penalise twice for the same error.

[1-2]

- 3 (a) **Explain the economic functions performed by wage differentials in a market economy.** [10]

Meaning of the term wage differentials, wage being identified as the reward to the factor of production labour. Thus wage differentials serve as differential rewards to different units/categories of labour. Main function is to act as a signalling device, indicating where there is a greater demand than supply at the current wage; and so as an incentive for labour to shift, whether between employers or occupations. Distinction between differentials in the short-run and the long-run.

L3 For an explanation of the functions performed in both short- and long-run [7-10]

L2 For an application of knowledge and critical understanding of one valid function in a market economy.

Or for an answer which focuses on determination of wage differences. [4-6]

L1 For knowledge and understanding only of the term wage differentials. [1-3]

- (b) **Discuss the view that government policies aimed at reducing wage differentials always do more harm than good.** [15]

Explanation of possible objectives of a government wishing to reduce wage differentials – probably mainly in the area of income inequalities and equity, but also possibly to improve the functioning of the labour market, and labour market failure. Explanation of relevant policies – eg relating to minimum wage, restriction on high earnings, education and training. Evaluation of policies, explaining their possible disadvantages and assessing their overall desirability.

L4 For a discussion, focusing on “more harm than good”. [9-15]

L3 For an analysis of at least two policies, and their impact on wage differentials. [6-8]

L2 For an application of knowledge and critical understanding of at least one policy option. [3-5]

L1 For knowledge and understanding of at least one relevant policy. [1-2]

NB (i) For a standard minimum wage answer only, maximum of 6 marks – though can award up to 9 if worthwhile evaluation is included.

NB (ii) No credit for progressive taxation only.

- 4 (a) **Explain how the extent of inequality can be compared between two nation such as the UK and France.** [10]

Meaning of inequality (eg of income or wealth). Explanation of method(s) of measurement – which could be in diagram form (eg Lorenz Curve) or numerically (eg %age going to successive deciles). (NB One valid measure is sufficient.) Explanation of how the extent of inequality can be compared using the chosen method.

L3 For an explanation of valid method of comparison. [7-10]

L2 For an application of knowledge and critical understanding of a method of measurement. [4-6]

L1 For knowledge and understanding of inequality only. [1-3]

- (b) **Discuss how a government can best tackle the problem of regional income inequality.** [15]

Explanation of average incomes and of possible reasons for regional differences in them. Issue of real v nominal. Explanation of possible government policies to alleviate extent of regional differences – eg those aimed to increase geographical mobility of labour, relocation of government agencies, education and training, incentive to firms to locate. Evaluation of such policies, focusing on “best tackle” – may consider effectiveness, and/or undesirable side-effects (though it would be equally acceptable to challenge the need for such policies).

L4 For a discussion, focusing on “how best tackle”. [9-15]

L3 For an analysis of at least two relevant policies. [6-8]

L2 For an application of knowledge and critical understanding of at least one relevant policy. [3-5]

L1 For knowledge and understanding of regional differences only. [1-2]

NB Maximum of 6 marks if candidate tackles the question of income inequality within any particular region.

**Mark Scheme 2885
January 2007**

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, ie 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) **Using Fig 1 summarise the effect of deregulation on the market for taxi services.**

1 mark for both experienced an increase in the number of taxis.

1 mark for both experienced a fall in the number of customers waiting over 5 minutes.

1 mark for any accurate attempt to compare experience of Sheffield and Cambridge. [2]

- (b) **Using an example explain why the demand for taxi services is a derived demand.**

1 mark for relevant example of any journey purpose for a taxi such as going to school or a journey home after a night out.

1 mark for critical understanding of derived demand in the example give – the taxi service itself not being demanded but the need for the journey ie to get to school or to get home. [2]

- (c) **Comment on the extent to which local economies benefit from the provision of taxi services.**

2 marks for explanation/analysis of how taxi services can benefit the local economy eg providing more custom for businesses such as nightclubs; providing greater integration such as taxi journeys to and from rail stations; creating employment opportunities; innovation in terms of taxi buses resulting in greater efficiency.

2 marks for evaluative commentary on extent to which this will benefit local economies eg multiplier effect due to increased trade provided by taxi services; possible positive or negative externalities resulting from taxi services; contrasting view that it is activities of local economies such as nightclubs that creates demand for taxis and therefore it is suppliers of taxi services that benefit from activities in local economy. 1 mark for statement that other factors are more important to success of local economies. [4]

- (d) (i) State two characteristics of contestability in a market.

1 mark for each characteristic stated x 2.

Eg freedom of entry and exit, costless exit, number of firms in industry irrelevant.

[2]

- (ii) Explain how a reduction in regulation would lead to greater contestability in the market for taxis services.

2 marks for application and critical understanding of how a reduction of regulation leads to greater contestability. For example increasing the number of taxi licences lowers barriers to entry (1) and increases competition (1).

2 marks for further explanation/analysis of how this may occur in the market for taxi services. More licences increase potential competition but even if quantity of taxis does not rise the incumbent taxi firms may already have been earning normal profit or have to reduce prices or increase service quality to deter potential entrants.

[4]

- (iii) Discuss the likely impact of further deregulation of taxi services on the efficiency of local transport.

Level 3 Judgement of impact of deregulation on economic efficiency underpinned by appropriate theory and specifically applied to local transport. Examples could include; reduction of costs may be at expense of safety and some regulation therefore important; deregulation particularly important in areas where there is less competition and abuse of monopoly power by incumbent taxi firms.

5–6

Level 2 Some evaluative discussion of whether such deregulation will increase efficiency eg depends on the extent of deregulation, provision of alternative transport services, reaction of incumbent firms and potential competitors. Consideration of safety could also be relevant.

3–4

Level 1 Explanation of impact of deregulation on economic efficiency eg reducing AC of taxi service (productive) and providing taxi services customers want (allocative) by increasing the threat of competition.

1–2

[6]

2 (a) Explain the determinants of demand for a passenger transport mode of your choice.

Overall demand based on derived demand. Factors influencing choice of chosen mode; price, price of substitutes/complements, income, tastes and preferences which can be determined by convenience, reliability, safety, speed in comparison with other modes. Reward use of PED, YED and XED.

- Level 3** For an explanation of the determinants of demand for a particular mode of passenger transport – will cover derived demand as well as modal choice at top end. **7–10**
- Level 2** For application of knowledge and critical understanding of the determinants of demand for a mode of passenger transport. **4–6**
- Level 1** For knowledge and understanding of the determinants of demand for a mode of passenger transport. **1–3**
[10]

(b) Discuss the effectiveness of using taxes and subsidies to switch passengers from private car to local bus and rail transport.

Taxes on private car use to include different types of taxes; an analysis/discussion of such taxes. Types of subsidies for local bus and rail transport. Possible use of hypothecation. Analysis of impact of taxes and subsidies – shifts of supply curves and influencing demand through changes in price. Appropriate diagrams not a requirement but to be expected and should be rewarded where explanation is appropriate. Effectiveness in terms of PED, XED and even YED for local buses and whether subsidies are used to reduce prices or just to cover losses. May need other policies to increase XED of intermodal switch by making mass transport more convenient, reliable, comfortable to meet customer needs.

- Level 4** For a discussion of the effectiveness of fiscal measures to switch passengers from private cars to mass transport underpinned by appropriate analysis and at top end offering clear informed judgement on effectiveness. **9–15**
- Level 3** For an analysis of the effect of taxes and subsidies in an attempt to switch passengers from private cars to mass transport. **6–8**
- Level 2** For an application of knowledge and critical understanding of the use of taxes and subsidies to encourage intermodal switching ie price of substitutes (may be implicit but not analysed). **3–5**
- Level 1** For knowledge and understanding of the use of taxes and subsidies as a means of encouraging modal switch. **1–2**
[15]

3 (a) Explain how the costs associated with road traffic congestion lead to a misallocation of resources.

Explanation of costs of congestion in terms of private and external costs. $MSC > MPC$. Explanation of costs on third parties; time costs (opportunity cost), cost of increased vehicle use, cost of increase in accidents, increased costs for vehicle operators. Reward appropriate diagram showing $MSC > MSB$. Also increased private costs – idea of mutual externality. Environmental costs should not be rewarded unless specifically referred to as increasing due to congestion. Outcome in terms of overconsumption; welfare loss.

- Level 3** For an explanation of how costs associated with traffic congestion lead to a misallocation of resources – emphasis on both effects on third parties and overconsumption at top end. **7–10**
- Level 2** For application of knowledge and critical understanding of how costs associated with traffic congestion lead to a misallocation of resources i.e. shows idea of overconsumption without explicit explanation **4–6**
- Level 1** For knowledge and understanding of costs associated with traffic congestion and/or market failure but not linked. **1–3**
[10]

(b) Discuss the effectiveness of increasing the supply of road space to reduce traffic congestion.

Analysis of how increasing supply of road space can reduce congestion and hence costs of traffic congestion (both private and external). Reward use of diagram if it includes an appropriate explanation. Effectiveness in terms of short run benefits but possible long run increases in demand as costs fall (increased PED of car use/road haulage in long run). Explanation of reasons for this in terms of convenience etc. Possible discussion of other policies perhaps used in conjunction with selective road building (links to sustainability) but must be focussed on question.

- Level 4** For a discussion of the effectiveness increasing the supply of road space to reduce traffic congestion. Clear judgements on effectiveness underpinned by appropriate analysis at top end. **9–15**
- Level 3** For an analysis of how increasing road space can reduce congestion. **6–8**
- Level 2** For an application of knowledge and critical understanding of how increasing road space can reduce congestion without explanation/analysis eg long run v short run. **3–5**
- Level 1** For knowledge and understanding of use of road building to reduce traffic congestion. **1–2**
[15]

4 (a) Explain the benefits of an integrated transport policy.

Benefits of an integrated transport policy both in terms of reduced costs for freight companies and passengers due to seamless journeys etc and also that an overall integrated transport policy improves planning for businesses and passengers. Benefits to economy include co-ordinated policies that reduce market failure by switching demand from private transport to mass transport eg use of hypothecated funds from road user charging to promote local transport initiatives.

Level 3 For an explanation of the benefits of an integrated transport policy. Must explain benefits in terms of more than of an integrated system at top end ie must make reference to policy.

7–10

Level 2 For application of knowledge and critical understanding of the benefits of an integrated transport policy eg in terms of coordination of network and overall policy.

4–6

Level 1 For knowledge and understanding of the benefits of an integrated transport policy.

**1–3
[10]**

(c) Discuss the extent to which the present structure of the UK rail industry contributes towards an integrated transport policy.

Explanation of present structure of UK rail industry and link between component parts. Network Rail, TOCs and franchises etc. including arrangements for freight. Link to integration; some fragmentation of services due to franchises but this has been recognised in recent distribution of franchises. Concept of natural monopoly applied to UK rail industry. Links between franchises and other transport operators such as buses and trams. Position of rail overall transport policy.

Level 4 For a discussion of the extent to which the present structure of the UK rail industry contributes towards an integrated transport policy. Judgements required linking explanation of both rail industry and ITP eg considering the extent to which the UK rail industry is a natural monopoly and therefore needs to be run as a monopoly to allow greater integration.

9–15

Level 3 For an analysis of the present structure of the UK rail industry and some attempt to apply this to an ITP.

6–8

Level 2 For an application of knowledge and critical understanding of the present structure of the UK rail industry and some attempt to apply this to an ITP – will lack analysis.

3–5

Level 1 For knowledge and understanding of use of the present structure of the UK rail industry.

**1–2
[15]**

**Mark Scheme 2886
January 2007**

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, ie 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) (i) **Explain what is meant by primary production.** [2]

Producing raw materials, natural resources, commodities (1), from mining, agriculture, forestry or fishing (1).

- (ii) **Explain why developing economies, such as Peru, rely on primary production.** [3]

Idea of absolute/comparitive advantage (1), natural resources (1), cheap, abundant, unskilled labour (1), or lack of skilled labour (1) and capital/technology (1) which promote alternative production.

- (iii) **Explain two possible disadvantages to economies such as Peru of being so dependent on one industry.** [4]

Two from:

Vulnerable to unfavourable changes (1) – few alternative industries (1).

Low incomes/low standard of living (1) – restricted jobs, demand for labour (1).

Lack of sustainability (1) – over-concentration exhausting resources (1).

Unstable incomes/conditions (1) – impact of external shocks (1).

Limited choice and prospects (1) – restricted range of occupations (1).

Need to import (1) – restricted range of production (1).

Two cases of 1 mark for identification + 1 mark for explanation.

- (b) **Comment on how the mining activities of Newmont might have affected economic development in Peru.** [5]

Raised by higher incomes, jobs, exports and social programmes (up to 3 marks), lowered by environmental impact, harm to other producers, loss of economic sovereignty, loss of profits, narrow benefit and social disruption (up to 3 marks), reasoned conclusion (1).

Up to a maximum of 3 marks for analysis and 2 marks for evaluation.

- (c) **Discuss the policies the Peruvian government might use to control the expansion of mining.** [6]

Analysis of methods such as nationalisation, regulation (laws, taxes) or leaving to market forces. Up to 2 marks maximum.

Evaluation of methods up to 4 marks maximum, examined from the point of view of efficiency, effectiveness, side effects and equity and linked to development.

The conflict between removing harms while retaining benefits is a central issue.

- 2 (a) **Using the Harrod-Domar model, explain why countries have achieved different levels of development.** [10]

The Harrod-Domar model links growth to the savings ratio and capital to output ratio ($g=s/k$). The higher the savings ratio or the lower the capital to output ratio the greater will be the growth rate. The growth results from the savings to investment relationship. Growth is a contributory influence on development. The model highlights important factors influencing growth and therefore the different levels of development. Different economies have displayed different abilities to generate saving and investment resulting from their individual circumstances: Income levels, financial institutions and attitudes are important. East Asian Tiger economies have been particularly successful, while Sub Saharan Africa has not succeeded. Other factors, such as levels of enterprise, natural resources and competence of government are important.

- L3** For an explanation of why countries have achieved different levels of development (7-10)
- L2** For an application of knowledge and critical understanding of the operation of the model (4-6)
- L1** For knowledge and understanding of the elements of the model (1-3)

- (b) **Discuss whether a developing country should rely on its own sources of funding or seek foreign direct investment in order to promote development.** [15]

Domestic funding would include saving, reserves and government tax revenue. Foreign direct investment is carried out by multinational companies and may involve finance with support and staffing. Domestic funding would aid control and allow priorities but may be limited and come with high opportunity costs. FDI may be available but may be conditional and pay more attention to the interests of the MNC. The stage of development of the economy may limit the choice of the country. The least developed may settle for whatever form is available while newly industrialised may have their own source or be in a better position to regulate external funds.

A higher level 4 answer may contrast the position of countries at different levels of development. A basic L4 answer may discuss advantages and disadvantages of internal and external finance.

- L4** For a discussion of the alternative sources of development funding (9-15)
- L3** For an analysis of either source (6-8)
- L2** For an application of knowledge and critical understanding of the sources (3-5)
- L1** For knowledge and understanding of the sources (1-2)

- 3 (a) Explain the economic consequences of the relatively large informal sector found in many developing countries. [10]**

The informal sector is the part (approx 50%) of the urban economy characterised by ease of entry, small-scale operation, limited technology, labour-intensive methods and family ownership. It is unregulated but includes both legal and illegal activities. Workers in the sector earn lower wages, are less productive and have less protection than those in the formal sector. The sector provides employment, often for migrants, output and a source of potential for the formal sector. Governments often ignore the sector and try to discourage it, although it might be a source of tax revenue. Consequences are both beneficial and harmful.

L3 For an explanation of the sector's economic consequences **(7-10)**

L2 For an application of knowledge and critical understanding of the sector's operations **(4-6)**

L1 For knowledge and understanding of the sector's features **(1-3)**

- (b) Discuss the ability of the governments in developing countries to promote and manage economic development. [15]**

The governments of developing economies will understand the problems they face and have a set of priorities. They may have personnel educated and trained abroad and familiar with recent economic thinking. They will have the possibility of support from international institutions. Against this they may lack the resources to implement policy, elements of the economy may be outside their control, they may have corrupt bureaucracies, may lack competence at different levels of government and may set anti-developmental priorities. The problems they face may be the result of external factors beyond their control and the narrow base of the economy may make them very susceptible to external shocks. Policies once implemented may face conditions which cause them to fail. East Asian economies supply examples of competent economic management, while sub-Saharan Africa has a record of failed economic management. A higher L4 may show awareness of particular examples of contrasting success. A basic L4 may discuss the degrees of competence of government in the task.

L4 For a discussion of the government's competence in promoting and managing economic development **(9-15)**

L3 For an analysis of the government's strengths or weaknesses in managing and promoting economic development **(6-8)**

L2 For an application of knowledge and critical understanding of economic management in the development context **(3-5)**

L1 For knowledge and understanding of the methods of economic management **(1-2)**

4 While most economies have floating exchange rates, some developing economies maintain a fixed exchange rate.

(a) Explain the importance of a stable exchange rate to a developing country.

[10]

The exchange rate affects a developing economy through its international transactions. ER fluctuations will affect export and import prices and the country's income and expenditure. This will channel through to employment, growth and inflation. A fluctuating ER may deter foreign investment and affect the value of foreign debt. Without stability international trade may reduce, speculation may occur, long-run planning will become difficult and the standard of living may suffer. Developing countries are particularly vulnerable given the current account deficits faced by many and their need to use international trade as an engine for growth.

L3 For an explanation of the importance of a stable exchange rate for a developing economy **(7-10)**

L2 For an application of knowledge and critical understanding of the outcomes of ER fluctuations **(4-6)**

L1 For knowledge and understanding of the outcomes of ER fluctuations **(1-3)**

(b) Discuss whether it is appropriate for the government of a developing country to pursue a policy of non-intervention in international trade.

[15]

Free trade will involve the absence of tariffs quotas and subsidies etc. Countries should be able to trade and benefit from comparative advantage. This should result in greater efficiency and higher global welfare. This would depend on similar action by other countries to ensure equal opportunities to all. This approach would be in line with a market oriented policy. There are arguments such as the infant industry case, the terms of trade case and the unfair trade practices case, which can be justified to allow a poor country the use of protection in its attempt to develop. Successful developing countries have used export promotion as a means of improving their economic development, while import substitution has proved less successful. The greater success of East Asia relative to South America has been attributed to the difference in approach.

A higher L4 may refer to the experience of different developing countries. A basic L4 may discuss the advantages and disadvantages of the approach to international trade.

L4 For a discussion of a policy of non-intervention by the government of a developing country in international trade **(9-15)**

L3 For an analysis of the benefits or drawbacks of non-intervention by the government of a developing country in international trade **(6-8)**

L2 For an application of knowledge and critical understanding of international trade **(3-5)**

L1 For knowledge and understanding of the conditions for free trade **(1-2)**

**Mark Scheme 2887
January 2007**

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, ie 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) (i) One component of the current account is 'trade in goods'. State two other components of the current account. [2]

- Trade in services (or one example) 1 mark
- Investment income (IPD) (or one example) 1 mark
- Transfers (private and official) (or one example) 1 mark

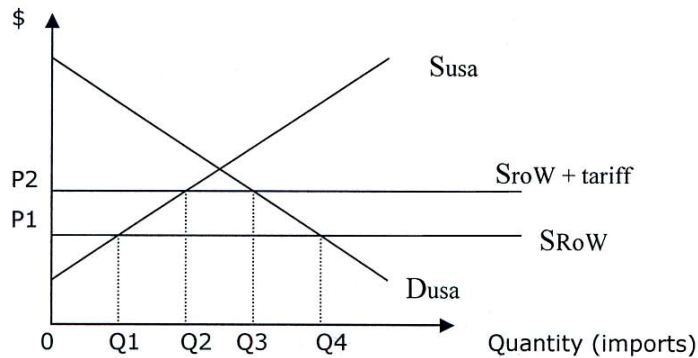
(ii) Explain one possible economic reason why the UK's current account position with the USA is different from its current account position with Germany. [3]

- Identification of relative current account position – surplus with US > deficit with Germany 1 mark
- Structural factors - international competitiveness (incl. ER)
- Cyclical factors - different stages of economic cycle

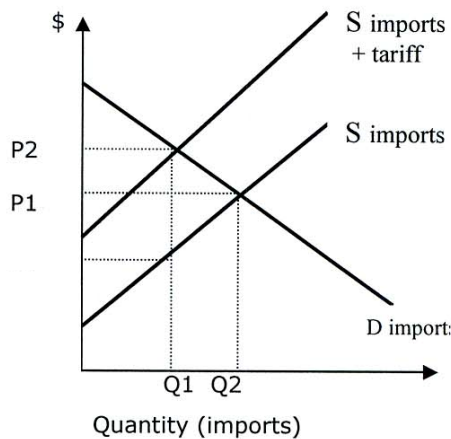
Statement of one valid reason 1 mark
 Explanation up to 2 marks

(b) (i) With the use of a diagram, explain how the use of tariffs in the USA would 'reduce imports into the USA'. (lines 12-14) [4]

Up to 2 marks for diagram which correctly shows the impact of tariff (see below)



Also accept



Up to 2 marks for an explanation of how tariffs reduce the volume of imports by changing relative prices

- (ii) **Comment on the extent to which greater use of tariffs alone could solve the current account difficulties of a country such as the USA.** [5]

Explanation of how tariffs reduce import expenditure (value)

Relevant discussion points include:

- Role of demand and supply elasticities
- Impact of retaliation
- Role of exports
- Extent to which reduced tariffs alone can solve such large deficits
- Other approaches ER realignment, contractionary fiscal policy, supply side improvements.

Up to 3 marks for analysis of how tariffs may **OR** may not solve the CA difficulties

Up to 2 marks for comment.

- (c) **Discuss the possible consequences for the UK economy of continued growth in its current account deficit.** [6]

Benefits include material benefits of greater access to cheaper products; external deficit allows faster growth of domestic demand without inflationary pressures.

Problems include impact on AD, output and employment, indicator of underlying structural problems, impact on financial and capital accounts, sustainability of deficit re financial flows and ER.

Credit candidates who refer to trading patterns in Fig 1 and 2.

Up to 2 marks for analysis of consequences

Up to 4 marks for discussion of consequences.

- 2 In its annual assessment of the UK, the Organisation for Economic Co-operation and Development said that it was increasingly concerned about the UK government's budget deficit. This deficit was expected to rise to nearly £37 billion (over 3% of GDP) in 2005/06.**

- (a) Explain the factors that influence the size of a government's budget deficit.**

[10]

A budget deficit occurs when government spending exceeds government income. Candidates should demonstrate awareness of the structural and cyclical influences on each of these variables - any change in either or both can influence the nature and magnitude of a fiscal imbalance. Structural influences relate both to planned spending (current, capital and transfers) and to planned tax rates and allowances. Cyclical influences relate to the impact that variations in the level of economic activity have on, for example, welfare benefits and tax revenue.

L3 For an explanation of the structural and cyclical influences on the budget deficit. **7-10**

L2 For an application of knowledge and critical understanding of the structural/cyclical influences on the budget deficit. **4-6**

L1 For a knowledge and understanding of what a budget deficit is or a series of assertions related to the budget deficit. **1-3**

- (b) Discuss whether the UK government should be concerned about the size of its budget deficit.** **[15]**

The UK government has two fiscal rules (the Golden Rule and the Sustainable Investment rule) reflecting its 'concern' about the potential costs of budget deficits but also of their potential benefits. These rules allow for cyclical variations (through the operation of automatic stabilisers), distinguish between capital and current spending, and recognise the important interrelationships between fiscal policy and monetary policy, something which is necessary for effective target based monetary policy operated by an independent central bank.

Candidates should be aware of the positive and negative effects of deficits on both AD and AS. Positive benefits include demand stimulus to overall economic activity, the microeconomic effects of tax-cuts, supply-side spending on areas such as health, transport, education, as well as equity issues related to any beneficial redistributive impact the policies may have. Possible adverse effects include the overheating consequences (internal and external) of an excessive stimulus to AD, the monetary side effects of financing a deficit (including the impact on the National Debt) as well as possible disincentive effects of direct and indirect state provision. Candidates may also comment on the nature and significance of the political, economic and social constraints which may make it difficult to reduce a deficit.

L4 For a discussion of the advantages and disadvantages of budget deficits in the UK context. **9-15**

L3 For analysis of why the UK government should **OR** should not be concerned about a budget deficit. **6-8**

L2 For applying this knowledge to the UK economy or critical understanding of relevant issues. **3-5**

L1 For descriptive knowledge of relevant issues or relevant assertions about the consequences of budget deficits. **1-2**

- 3 UK Government supply-side policies have created a more dynamic and flexible labour market. Between 1997 and 2005, claimant count unemployment fell by over 40% yet earnings growth was lower than expected.**

- (a) Explain how supply side policies can lower the level of unemployment [10]**

Candidates should explain how reforms in areas such as education and training, tax/benefit system, labour market reforms (eg to Trade Unions) might increase flexibility and raise employment.

Supply side policies can improve the way labour markets function by making them more flexible in a variety of ways. Such flexibility has a number of dimensions (functional, locational, temporal, numerical and financial) and should result in a more highly-skilled, mobile and employable workforce that is better able to adapt to a changing economic environment. This is likely to lower the equilibrium level of unemployment (NRU and NAIRU can both be accepted but are not required).

- L3** For an explanation of how supply side policies can lower the level of unemployment. **7-10**
- L2** For application of knowledge and critical understanding of supply side influences on unemployment. **4-6**
- L1** For descriptive knowledge of supply side policies or a series of relevant assertions related to falling unemployment. **1-3**

- (b) Discuss whether the UK government should ever be concerned about the economic consequences of falling unemployment. [15]**

Answers to this question should discuss the costs and benefits of lower unemployment. Candidates should show awareness of the benefits of falling unemployment (lowering the costs of unemployment) as well as the problems if unemployment falls 'too far'. These problems are likely to emerge if unemployment falls below the equilibrium level of unemployment (NAIRU/NRU). The likely inflationary impact of such 'overheating' should comment on why rising inflation may be undesirable. Such concerns are likely to be reduced if the fall in unemployment is due to a fall in NAIRU/NRU.

Candidates may also discuss other issues such as the measurement of unemployment, the adverse social consequences of falling unemployment if this is achieved through making labour markets more flexible.

- L4** For a discussion of the advantages and disadvantages of falling employment. **9-15**
- L3** For analysis of why a government should OR should not be concerned about falling unemployment. **6-8**
- L2** For application of knowledge and critical understanding of consequences of falling unemployment. **3-5**
- L1** For descriptive knowledge of relevant issues or relevant assertions about the consequences of falling unemployment. **1-2**

- 4 In both 2005 and 2006, UK GDP was expected to grow by 2.7% despite a slowdown in the growth of consumer spending to an annual rate of 1.9%.**

- (a) Explain the factors that are likely to cause a slowdown in the growth of consumer spending. [10]**

The question asks candidates to explain a slowdown in the growth of spending rather than a fall. Candidates therefore need to demonstrate an awareness of the nature of the relationships between the variables and that the balance of 'opposing forces' is such that consumption spending would be still increasing but at a lower rate.

Candidates should focus on key variables such as real disposable income, interest rates and the availability of credit, wealth and attitudes to 'thrift'/debt as the main determinants of consumption spending.

- L3** For an explanation of the factors contributing to a slowdown in growth of consumption spending. **7-10**
- L2** For an application of knowledge and critical understanding of the factors that influence consumer spending. **4-6**
- L1** For knowledge of influences on consumption spending. **1-3**

- (b) Discuss whether a slowdown in the growth of consumer spending should ever be a cause for concern for economic policy makers in the UK. [15]**

Candidates should consider the relative advantages of slower consumption spending growth in different circumstances.

One advantage would be following a period of at or above-trend growth when continued and excessive increases in consumer spending may lead to inflationary and current account problems in an overheated economy. A slower period of consumption spending growth may allow a cooling down of the economy, a rebalancing of AD and AS, of household finances (eg if debt levels had risen) and of the components of AD (eg a rise in investment spending or net exports). As the stimulus suggests, in such circumstances, growth may not falter.

Consumption spending, however, is the largest single component of AD and a major influence on material living standards. Policy makers (the government and the Bank of England) would become concerned if such a slowdown was sustained and/or led to a growing negative output gap with adverse effects on unemployment, public finances and living standards in general.

- L4** For a discussion of the advantages and disadvantages of a slowdown in consumption spending in the UK context. **9-15**
- L3** For analysis of why policy makers should OR should not be concerned with a slowdown in consumer spending. **6-8**
- L2** For application of knowledge and critical understanding of consequences of a slowdown in consumer spending. **3-5**
- L1** For descriptive knowledge of relevant issues or relevant assertions about the consequences of changes in consumption spending. **1-2**

**Mark Scheme 2888
January 2007**

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, ie 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) Using the data in Fig 1 of Extract 1, describe the trend in gas consumption and production in Europe from 1987 to 2004. [6]

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 2881.

Section 5.1.2 Competitive markets and how they work

Demand, Supply.

Outline of content

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

Gas production

Trend	Quantification of trend
<i>Production of gas has risen over the whole period 1987 – 2004</i>	<i>Production has risen by 16.6%</i>
<i>Production has not increased continuously</i>	
<i>Production fell in the period 1991 – 1995</i>	<i>Production in this period fell by 7.7%</i>
<i>Rate of growth of production is highest at the end of the period, from (1997) 2001 – 2004</i>	<i>16.6% growth from 1997, same rate of change in this period as in the whole period</i>

Gas consumption

Trend	Quantification of trend
<i>Consumption has increased over the whole period 1987 – 2004</i>	<i>Consumption has risen by 23.3%</i>
<i>Consumption has not increased continuously</i>	
<i>Consumption fell in the period 1991 – 1995</i>	<i>Consumption in this period fell by 7.5%</i>
<i>Rate of growth of consumption is highest at the end of the period, from (1997) 2001 – 2004</i>	<i>18% growth from 1997</i>
<i>Consumption outstrips production continuously from 1989</i>	
<i>Gap between consumption and production grows until 2002</i>	

1 mark each for valid description of the trend. Where descriptions are quantified, with valid data manipulation, an additional mark should be awarded.

Descriptions should be of TRENDS, not year by year regurgitation of the data which scores 0 marks. Credit can be given for valid description of the following sub-periods:

- (i) 1987 – 1991 (ii) 1991 – 1994 / 5 (iii) 1997 - 2004

Up to 3 marks for trend in consumption

Up to 3 marks for trend in production

Up to 3 marks for relationship between the two.

Maximum 6 marks

- (b) **Using a supply and demand diagram, analyse the likely reasons for the rise in the wholesale price of gas in Europe from 1999 – 2004.** [9]

Synoptic knowledge

This question is rooted in concepts first introduced in Module 2881.

Section 5.1.2 – Competitive markets and how they work

Demand. Determinants of demand in product markets. Market demand curves.

Distinction between movements along, and shift of, demand curves.

Supply. Determinants of supply in product markets. The supply curve for the market as a whole. Distinctions between movements along, and shifts of, supply curves.

Market Equilibrium. Determination of equilibrium price and quantity. Changes in demand and supply and effects of changes on equilibrium price and quantity.

These concepts have been further applied and developed in different contexts in Modules 2884 and 2885.

Outline of content

There are references in the introduction to the stimulus material to a range of factors which have resulted in changes in both the demand and supply of gas in the EU – increased imports (implication of transporting gas = higher cost of supply), interruptions to the supply of gas from Russia (reduction in supply), market concentration and lack of competition in the EU (restrictions of supply), monopolies and the restriction of supply, barriers to entry.

Extract 1, Fig 1 shows rising consumption (higher demand) and consumption in excess of production (excess demand).

Extract 1, Fig 3 shows decline in reserves relative to production, resources depletion and reduced supply.

Using the demand and supply framework, candidates should be able to explain a range of reasons why the price of natural gas in the EU has increased. Expect to see diagrams with both a rightward shift of demand and a leftward shift of supply and consequent increase in price. The quality of explanation should be used to differentiate marks awarded in L3. A response which does not recognise rising price is due to changes in both demand and supply should be awarded a mark at the bottom of the appropriate level.

Knowledge and understanding marks (diagram)

1 mark for correct axes labels (price and quantity or P and Q)

1 mark for original demand and supply curves (correctly drawn and labelled)

1 mark for original equilibrium position

Application and critical understanding marks (diagram)

1 mark for rightward shift of demand

1 mark for leftward shift of supply

1 mark for new equilibrium position

Analysis marks

Up to 3 marks for an analytical explanation of the reasons for the shifts – reasons **must** be related to possible changes in the factors affecting demand and / or supply (ie statements relating shift in demand to increase in consumption in Extract 1 is application and not analysis and scores 0 marks)

Maximum of 1 mark where analysis is confined to description of shifts in the diagram
For full marks, analysis can relate to either demand or supply factors

- 2 **Comment on the impact on EU businesses of the rise in the wholesale price of gas since 1999.** [10]

Synoptic knowledge

Section 5.1.3 – Firms and how they operate

Costs. Revenue. Profit. Short and long run distinction.

Market operations of firms. The spectrum of competition – main forms of market structure: monopoly, monopolistic competition and oligopoly.

Section 5.1.2 – Competitive markets and how they work

Elasticity of demand.

Section 5.2.1 – Economic efficiency within competitive markets

Productive efficiently.

Section 5.3.4 – Structure and essential determinants of international transactions

The pattern of trade.

Outline of content

Impact of rising costs of production on firms. Impact on prices. Relevance of price elasticity of demand in product markets and proportion of total costs accounted for by energy costs. Relevance of the market structure in which businesses operate. Extent and significance of international competition. Implications for competitiveness relative to firms outside the EU. Extent to which firms can absorb higher costs in lower profit margins. Extent to which other costs can be reduced or productivity increased to compensate for higher energy costs. Extent to which higher price of natural gas encourages a switch in energy use. Extent to which energy substitutes are viable. Extent to which the supply of gas is competitive – ie alternative suppliers and ability to shop around.

Level 4

For a commentary on the impact on EU business(es) of the rise in the EU price of natural gas since 1997. [8-10]

Level 3

For explicit economic analysis of the impact on EU business(es) of the rise in the EU price of natural gas since 1997. [5-7]

Level 2

For an application of knowledge and critical understanding (ie no economic analysis) of the impact of the rise in the EU price of natural gas since 1997. [3-4]

Level 1

For knowledge and understanding of the impact of the rise in the EU price of natural gas since 1997. [1-2]

3 Comment on the case for promoting greater competition in EU energy markets. [15]

Synoptic knowledge

Candidates could draw upon a wide range of concepts to analyse and comment upon the case for promoting competition. Most obviously, the question lends itself to a microeconomic case for but we might see candidates approaching the question in terms of the EU single market or the performance of the EU economy as a whole – ie the Lisbon Agenda of competitiveness.

Section 5.1.2 – Competitive markets and how they work

Demand, supply and price determination. Consumer surplus.

Section 5.1.3 – Firms and how they operate

Market operations of firms. The spectrum of competition – main forms of market structure: monopoly, monopolistic competition and oligopoly.

Section 5.5.2 and 5.6.2 – Theories of market structure and competitive behaviour

The models of perfect competition, monopolistic competition, oligopoly and monopoly. The concept of contestability in markets and comparisons of outcomes in terms of prices, output, profits and efficiency.

Section 5.2.1 – Economic efficiency within competitive markets

The conditions for efficient allocation of resources including the concepts of allocative, productive and Pareto efficiency. Competition and the efficient allocation of resources.

Section 5.2.2 – Why markets may not work efficiently

Market dominance

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

The meaning of Gross Domestic Product (GDP).

Section 5.3.3 – The application of macro-economic policy instruments

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.

The context for the question is provided by Module 2888.

Section 5.8.2 – The Single European Market (SEM)

Outline of content

Explanation and analysis of the case for promoting greater competition in EU energy markets. Productive and allocative efficiency. Impact on prices and consumer welfare. The market failures of monopoly power. Change in market structure. Determination of prices and market signals regarding scarcity of resources. Benefits of competition and contestability. Separation of natural monopoly elements of gas supply from competitive elements. Benefits to consumers, to include EU business. Impact on the supply side performance of the EU economy and its global competitiveness.

Commentary on the case for could take many forms, including an attempt to establish importance of the factors above and/or consideration of the case against. Relevant issues include – extent to which market forces produce an optimal depletion of non-renewable resources, extent to which managed prices are more desirable than volatile prices, environmental impact of lower prices of natural gas, sustainability issues. Role of the government in influencing energy use – issues related to the security of supply.

Level 4

For a commentary on the case for promoting greater competition in EU energy markets.

NB where candidates present a theoretical case for promoting competition and consider only theoretical arguments against promoting competition a Level 4 mark should not be awarded (see Level 3 descriptor below) [10-15]

Level 3

For explicit economic analysis of either the case for **or** the case against promoting competition in EU energy markets.

Analysis of the case for **or** against promoting competition must be in the context of the EU energy markets and not simply theoretical.

Purely theoretical analysis of the case for **or** against promoting competition (ie no reference whatsoever to the EU energy markets) = max 7 marks

Purely theoretical analysis of the case for **and** against promoting competition (ie no reference whatsoever to the EU energy markets) = max 9 marks [5-9]

Level 2

For an application of knowledge and critical understanding (ie no economic analysis) of the case for **and/or** the case against promoting greater competition in EU energy markets.

[3-4]

Level 1

For knowledge and understanding of the case for or against only.

[1-2]

- 4 **Discuss the policies which EU member states could adopt to reduce the market failures arising from the EU's energy consumption and production.** [20]

Synoptic knowledge

Section 5.2.1 – Economic efficiency within competitive markets

The conditions for efficient allocation of resources including the concepts of allocative, productive and Pareto efficiency. Competition and the efficient allocation of resources.

Section 5.2.2 – Why markets may not work efficiently

The causes and consequences of why markets may not work efficiently. The market failures of externalities. The unequal distribution of income.

Section 5.2.3 – Marketing choices and the impact of government intervention on market outcomes and efficiency

The way governments, in pursuit of their economic, social and distributional objectives, intervene in markets to correct market failure, for example, through taxation, subsidies, price controls, state provision, regulation, information provision and competition policy. The impact of these forms of intervention on markets. The ways in which governments may create rather than remove distortions.

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 5.3.4 – Structure and essential determinants of international transactions

Section 5.8.1 – The 'New Europe'

Outline of content

It is expected that candidates will analyse and discuss more than one policy to reduce the market failures arising from the EU's energy consumption and production. It should be clear from the candidates' response how the policy reduces market failure either energy use or energy production. The explanation should be analytical rather than descriptive to reach L3 of the mark scheme.

It is possible that discussion could take the form of consideration of the advantages of a given policy – there is reference in Extract 5(a) to the argument that market based solutions such as emissions trading schemes are able to achieve environmental objectives at least cost. To gain L4 marks for such an approach, however, the nature of the efficiency savings must be explained – ie firms choose whether to pay for emissions or to reduce emissions based on the price of the permits and the cost of the technology required to abate emissions. No one method of emissions reduction/abatement is imposed on firms – the market decides.

It is more likely that discussion of the policies will focus on the problems of the policies, given the nature of the stimulus material. Expect to see reference to international competitiveness effects, government failure, income distribution, problems of allocation of permits.

The highest marks in L4 should be reserved for candidates who develop their discussion/evaluation by consideration of how the benefits of the policies can be increased relative to the costs. For example, how international competitiveness problems can be tackled, how compensation can be achieved through the benefits system to ensure that the taxation approach is less regressive and how fuel poverty can be addressed.

Expect to see most answers concentrating on taxation and emissions trading scheme/pollution permits. Reward equally those responses which choose alternative policies – eg subsidisation of renewable forms of energy generation and energy conservation.

Level 4

For an evaluative discussion (underpinned by economic analysis) of the policies which EU Member States could adopt to reduce the market failures arising from the EU's energy consumption and production. Responses in this level must be underpinned by economic analysis – the analysis offered may be less than that seen in the one-sided response which is awarded a L3 mark. Candidates at the top end of this level will draw out the factors which determine the extent of the advantages and disadvantages of one or more of the policies.

Two policies considered with two sides (eg advantages, disadvantages) = max 16 marks
Where there is an attempt to judge the different approaches (eg extent of the advantages / disadvantages, how benefits of a policy approach can be increased relative to costs) and to reach a reasoned conclusion = 17+ marks

[12-20]**Level 3**

For analysis of the policies which EU Member States could adopt to reduce the market failures arising from the EU's energy consumption and production.

Purely theoretical analysis of one side = max 8 marks

Purely theoretical analysis of both sides = max 11 marks

[5-11]**Level 2**

For an application of knowledge and critical understanding of the policies which EU Member States could adopt to reduce the market failures arising from the EU's energy consumption and production. Candidates in this level may well consider pros and cons of the chosen policies but will not offer any analysis of the two sides – ie award a mark in this level for a descriptive approach to the question.

[3-4]**Level 1**

For knowledge and understanding of the policies which EU Member States could adopt to reduce the market failures arising from the EU's energy consumption and production.

[1-2]

**Advanced GCE Economics (3812/7812)
January 2007 Assessment Series**

Unit Threshold Marks

Unit		Maximum Mark	a	b	c	d	e	u
2881	Raw	45	33	29	25	21	18	0
	UMS	90	72	63	54	45	36	0
2882	Raw	45	32	28	25	22	19	0
	UMS	90	72	63	54	45	36	0
2883	Raw	45	35	31	27	24	21	0
	UMS	120	96	84	72	60	48	0
2884	Raw	45	32	28	25	22	19	0
	UMS	90	72	63	54	45	36	0
2885	Raw	45	34	31	28	26	24	0
	UMS	90	72	63	54	45	36	0
2886	Raw	45	33	30	27	24	21	0
	UMS	90	72	63	54	45	36	0
2887	Raw	45	33	29	26	23	20	0
	UMS	90	72	63	54	45	36	0
2888	Raw	60	46	41	36	32	28	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
3812	300	240	210	180	150	120	0
7812	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
3812	16.3	41.3	63.0	81.5	93.5	100.0	196
7812	12.5	35.0	75.0	92.5	100.0	100.0	53

249 candidates aggregated this series.

For a description of how UMS marks are calculated see;
http://www.ocr.org.uk/exam_system/understand_ums.html

Statistics are correct at the time of publication

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