

Economics

Advanced GCE **A2 7812**

Advanced Subsidiary GCE **AS 3812**

Mark Schemes for the Units

January 2009

3812/7812/MS/R/09J

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All Examiners are instructed that alternative correct answers and unexpected approaches in candidates' scripts must be given marks that fairly reflect the relevant knowledge and skills demonstrated.

Mark schemes should be read in conjunction with the published question papers and the Report on the Examination.

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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

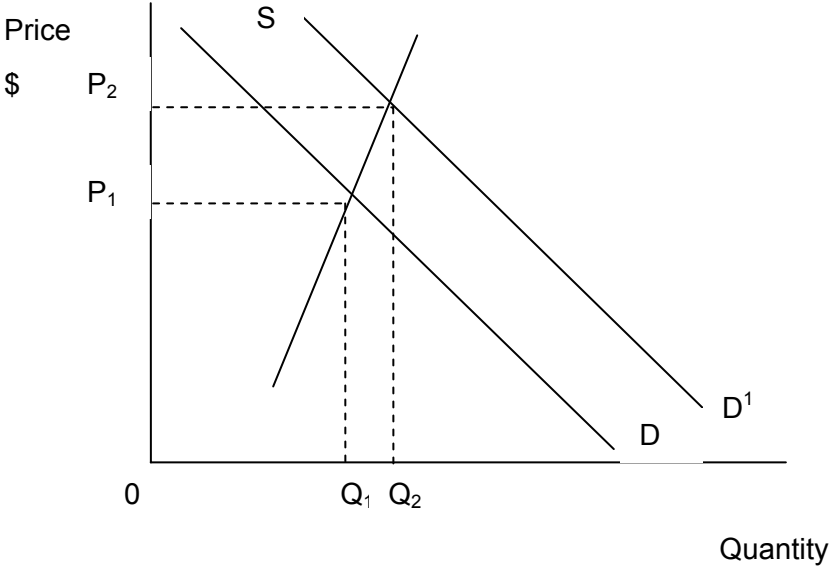
Simple ideas have been expressed, generally in a style lacking clarity and fluency. Arguments will have limited coherence and structure, often being of doubtful relevance to the main focus of the question. There are errors of spelling, punctuation and grammar, which will be noticeable and intrusive.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

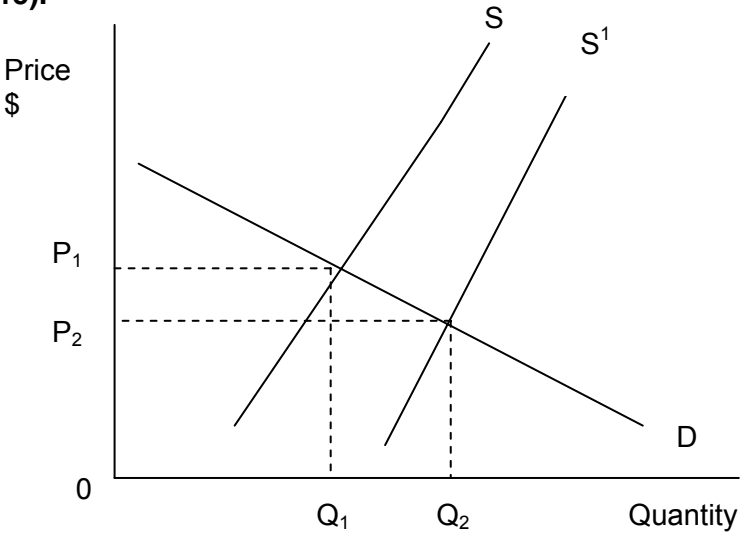
(1 mark representing the above level of written communication is embedded in this level of response)

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.

2881 The Market System

Question	Expected Answer	Grade
(a) (i)	<p>Define the term 'demand'.</p> <p>Award 1 mark for each of</p> <ul style="list-style-type: none"> the ability (effective demand) willingness to buy a particular product. <p>Quantity Demanded at each individual Price (1 mark)</p> <p>Candidates must get the idea of both elements across, i.e. willingness and ability to buy, in order to score both marks.</p>	2
(ii)	<p>Using the information provided, explain TWO reasons for the increasing demand for uranium.</p> <p>Four reasons are given in the second paragraph. These are</p> <ul style="list-style-type: none"> rising incomes greater environmental concerns rising price of oil Rising demand for nuclear generated energy – rising demand for uranium (derived demand argument) <p>Award 1 mark each for</p> <ul style="list-style-type: none"> recognition of reason- as above elaboration as to how this leads to an increase in demand for uranium. Must explicitly state why there is an increase in demand. 	2x2 marks 4
(iii)	<p>Using a demand and supply diagram, show how an increase in demand has affected the market price of uranium.</p> 	

Question	Expected Answer	Grade
	<p>Award 1 mark each for</p> <ul style="list-style-type: none"> correctly labelled axes shift of D original equilibrium position new equilibrium position 	4
(b) (i)	<p>Using the information provided, explain why the price elasticity of supply for uranium is inelastic.</p> <p>Definition of PES (1) or formula (1) Existing mines are working at full capacity (1) It can take up to 10 years to develop a new mine (1) High set up costs (1) This means that the supply is slow to respond to changes in the market price. (1) The use of a correct arithmetic example to confirm Supply is inelastic (2)</p> <p>Maximum three marks</p>	3
(ii)	<p>Using a demand and supply diagram, explain how the opening of the Cigar Lake mine will affect the market price of uranium (line14-15).</p> 	
	<p>Up to 2 marks for a correct diagram, to include shift to right of S(1) change in equilibrium price and quantity (1)</p> <p>Up to 2 marks for an explanation that includes reference to the effects of a substantial increase in quantity supplied in a market, eg ↓ equilibrium price, downward pressure on price following earlier ↑ in demand. Both elements, ↓ P and ↑ Q, are needed in written explanation for both marks.</p>	4

Question	Expected Answer	Grade
(c)	<p>Comment on whether uranium producers are likely to earn high profits in the future.</p> <p>Up to 3 marks for application / analysis of determinants of future high profits.</p> <p>1 mark for general agreement that high profits will continue. 2 – 3 marks if backed by limited analysis.</p> <p>Profit is the difference between total revenue and total costs(1)</p> <p>Evidence provided points to increased demand in the future (1)</p> <p>Recent price hike seems likely to persist (1)</p> <p>Award up to 3 marks for relevant commentary, for example</p> <ul style="list-style-type: none"> • no firm projections are included in information • a good return seems highly likely given the monopolistic nature of providers • high profits are a reward for high capital investment. • No guarantee that demand will remain buoyant. • No idea what future developments might bring. <p>Award 1 mark for a mention, plus up to 2 further marks for some elaboration of this point, commenting on whether high profits will be earned in the future.</p>	6
(d) (i)	<p>Describe what is meant by the term ‘barriers to entry’.</p> <p>One mark for each of:</p> <p>These restrict (1) <u>new firms</u> from entering a market (1)</p>	2
(ii)	<p>State and explain TWO barriers to entry that might apply to firms considering starting to mine uranium.</p> <p>Various possibilities including</p> <ul style="list-style-type: none"> • high set up costs • economies of scale that apply to existing large producers • government regulations, given the strategic nature of uranium as a resource • non-economic factors that might affect their operations in developing countries like Namibia <p>Award 1 mark for identification; up to 2 marks for explanation as to why it is <u>a barrier to entry to new firms</u>. Candidate must clearly explain how the suggested example does create a barrier to entry for the full 3 marks.</p>	6
(e) (i)	<p>State TWO characteristics of a monopoly.</p> <p>One mark for each of two of the following</p> <p>Various possibilities such as</p> <ul style="list-style-type: none"> • single seller/25% market share in practice • high barriers to entry • firm is a price maker • unique product • patented product • excess profits in long run • price discrimination • lack of perfect knowledge 	2

Question	Expected Answer	Grade
(ii)	<p>Discuss the likely economic effects of private monopolies controlling the supply of a vital resource such as uranium.</p> <p>In theory, a monopoly has certain disadvantages which include (allocative and productive) inefficiency, excessive profits, exploitation of consumers, lack of competition. On the other hand, monopolies may have certain advantages such as benefits from economies of scale, research and development issues, ensuring resources are not over-exploited.</p> <p>For L4, the comment should specifically focus on private monopolies in control of a vital resource such as uranium.</p>	12
Level 4	For a discussion of the relative advantages and disadvantages of a monopoly in this context.	7-12
Level 3	For an analysis of the theoretical advantages or disadvantages of monopoly.	5-6
Level 2	For an application of knowledge and critical understanding of monopoly.	3-4
Level 1	For knowledge and understanding of some aspects of monopoly.	1-2

Possible subject examples for Levels 1-4

Level 1 (1-2 marks)

Elaboration or extension of some of the characteristics of monopoly as stated above in (e) (i)

Level 2 (3-4 marks)

Answers in this level will draw upon the material provided to include a critical understanding of monopoly. For example:

- high profits earned by uranium in Namibia;
- market power of the new Canadian mine, although its market share is below 25 % of the world total.

Level 3 (5-6 marks)

A simple analysis only is required. For 5 marks, it should be recognized that monopolies, in theory, produce less and charge higher prices compared to firms operating in more competitive markets. Reference to only one of the points, i.e. price or output, will limit the mark to 5.

Level 4 (7-12 marks)

An answer at this level should include a discussion of:

- the extent to which monopolies can bring advantages and disadvantages (up to 9 marks)
- whether the private sector should be left to manage and exploit a strategic resource like uranium (10-12 marks).

The general advantages / disadvantages of monopoly applied and analysed but without fully addressing the question set, up to 9 marks.

For 10-12 marks candidates must clearly discuss the likely consequences of uranium production remaining in the hands of private sector monopoly firms.

QWC applies to this question.

2882 Market Failure & Government Intervention

- (a) (i) Define the term 'merit good'. [2]

Candidates can take the positive externality approach or the information failure approach:

Positive externality approach:

2 marks for a statement which makes clear use of economics such as:

- goods for which social benefit exceeds private benefit (or $SB - PB$)
- goods which generate external benefits
- goods which have positive externalities associated with them
- goods which generate benefits to third parties

1 mark for a basic understanding such as:

- goods which are beneficial for society / the community
- goods which benefit others
- goods which have an impact upon a third party (but lacking a clear idea that it is a benefit)

Information failure approach:

2 marks for a statement which makes clear use of economics, such as:

- merit goods exist when people fail to see the full (social) benefit of their actions and when consuming the good
- people fail to realise how beneficial these goods are for them
- goods which are better for consumers than they realise

1 mark for a basic understanding such as:

- they are goods which are associated with information failure (but lacking development of this)
- they are goods which are under-consumed/under-produced (in a free market)

(ii) Explain why lighthouses are often described as a public good. [2]

One mark for stating each of the following characteristics:

- Non rivalry/non diminishability (1 mark)
- Non excludability (1 mark)
- Non rejectability (1 mark)
- Non divisibility (1 mark)

Alternatively, accept answers which clearly apply the above terms/explain them without actually explicitly referring to them. (1 mark for the application of each term)

(b) (i) Define the term 'external benefit'. [2]

2 marks for the use of clear economics:

- an external benefit exists when the social benefit of an activity exceeds the private benefit (2 marks)
- a positive effect on a third party (2 marks)
- a positive spill over effect (2 marks)
- a situation where a benefit is gained by a third party (2 marks)
- where the person who receives the benefit is outside the decision making process (2 marks)

1 mark for answers lacking clear economics:

- a benefit to someone else (1 mark)
- a positive side effect (1 mark)
- a by-product of an action OR the effect of one person's actions on someone else (1 mark)
- a spill over effect (1 mark as lacks reference to the type of spill over effect)
- a benefit to the public / society / the community (1 mark)

- (ii) **State and explain TWO external benefits which arise from the consumption of healthcare.** [4]

The key point here is that candidates must identify benefits to people other than the consumer (ie what is the benefit to the 3rd party?)

Two marks for the basic identification of two relevant external benefits, for example:

- Lower absenteeism rates from work
- Greater productivity if workers are no longer ill
- Less chance of workers spreading illness to others
- Reduced disease / less illness amongst society OR a fitter / healthier nation
- Reduced government spending (as a result of fewer health problems)
- Relatives seeing family members getting healthier
- Accept specific health benefits too eg treatment for drug addiction which benefits society from reduced crime
- Accept benefit from lower unemployment in terms of reduced government spending on benefits
- Increased workforce

A further mark is available for elaboration of each factor. The relevant development must explain why it is a benefit to 'others' or to society. For example, lower rates of absenteeism will save firms money.

Answers need to develop a reason as to why / how exactly it benefits society. Therefore the simple statement that "this is an external benefit because it benefits society" does not get a mark unless there is some idea of why this benefit arises.

(iii) Explain why the existence of external benefits may give rise to market failure.**[4]**

One mark for the clear, explicit statement that goods which produce external benefits will be under-consumed/under-produced

Up to a further three marks for clear development of this; for example:

- consumers only take into account private benefits rather than the full social benefit OR that consumers will not be fully aware of the true benefits of the good OR that external benefits are ignored
- this results in demand for the product being lower in the free market than society would prefer (hence under-consumption)
- this means that too few resources are allocated towards the production of these goods/service
- this represents a misallocation of resources
- this will result in an inefficient use of resources OR that the resulting allocation of scarce resources is allocatively inefficient

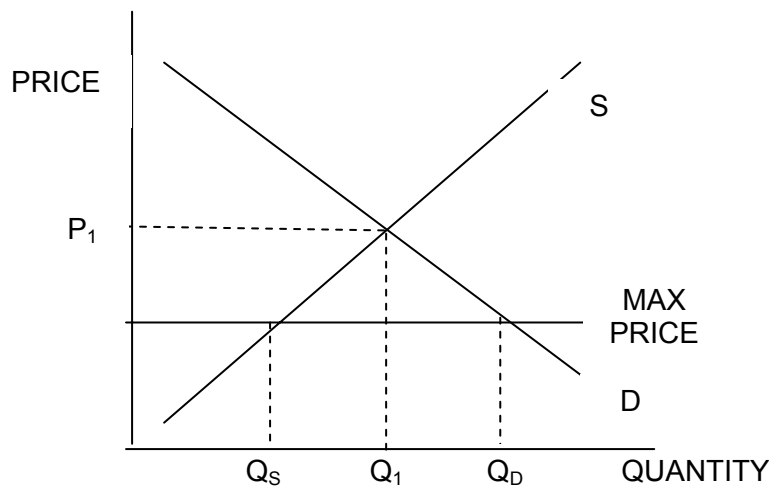
(c) One policy option which may be used by a government to solve income inequality is to introduce a maximum price on products.**(i) Explain what is meant by a 'maximum price'.****[2]**

Two marks for a clear explanation, for example: a legal (or statutory) limit beyond which prices are not able to rise

One mark for a simple statement such as:

- a maximum level beyond which prices cannot rise
- where the purchase price cannot exceed a certain level
- a price set by the government to prevent a producer setting a price too high
- a price ceiling
- a price set below equilibrium

(ii) Using a diagram, analyse the impact of a maximum price on a market. [10]



- 1 mark for both axes
- 1 mark for original equilibrium position (must have equilibrium lines)
- 1 mark for original demand AND supply
- 1 mark for maximum price (*)
- 1 mark for labelling/identifying new, higher, demand (accept Q2)
- 1 mark for labelling/identifying new, lower, supply (accept Q3)

* Allow maximum price labelled as P2 as long as this has been identified as being the maximum price in the text / explanation

6 marks maximum for the diagram

A further six marks are available for the explanation:

- to be effective, a maximum price must be set below equilibrium OR the maximum price will be set below equilibrium price
- a maximum price will result in the price charged for the product falling
- at this lower price there will be an extension of demand for the product
- at the same time, there will be a contraction of supply (as firms are less willing to produce the products as they will be making lower profits)
- overall this results in excess demand/disequilibrium (accept clear labelling of diagram showing area of excess demand) OR shortages result
- the impact of the maximum price depends upon the elasticities of supply and demand for the product
- the impact of the maximum price depends upon how far below equilibrium it is set

Maximum of 6 marks available for explanation and 10 marks max for the question

(iii) Comment on the effectiveness of ONE other policy which could be used by a government to reduce income inequality. [7]

One mark is available for the identification of any relevant policy, for example:

- progressive income tax (accept increased taxes on high income groups OR lower taxes on low income groups)
- subsidies (on the prices of basic necessities)
- (a rise in the) national minimum wage
- means tested benefits (eg Income Support)

Two further marks are available for relevant analysis of how such a policy may work.

The first mark is awarded for elaboration of what the policy can do and the second for the explanation of how it would reduce income inequality.

For example:

A more progressive income tax system would increase the incomes of low income groups OR decrease the incomes of high income groups (1 mark) which lowers the gap between high & low income groups (1 mark)

Alternatively, accept the view that higher rates of income tax provide additional revenue for the government which could be spent on benefits (or services) (1 mark). This then closes the gap between high and low income groups (1 mark).

Higher minimum wages rates will raise wages / incomes (1 mark) and will therefore close the gap between rich and poor (1 mark)

Subsidies will make many of the goods/services bought by low income groups cheaper (1 mark) which will enable them to buy more with their income (1 mark)

Benefits will raise the incomes received by low income groups (1 mark) and should therefore close the gap between high and low income groups (1 mark)

A further four marks are available for relevant comment/evaluation which addresses the issue of how effective such a policy may be. Relevant evaluation may include:

Progressive taxes:

- Possible disincentive impact of increased taxes
- Potential for tax evasion
- Lower income taxes for low income groups could reduce tax revenues
- How progressive will the tax system be? The more progressive it is, the more inequality will be reduced

Rises in the national minimum wage:

- Possible increases in unemployment (particularly amongst younger workers)
- Inflationary impact of rises in NMW
- What level to raise the NMW to?

- Question of who will benefit. Rises in NMW may well be poorly targeted and helping middle income groups (with 2nd/3rd wage earners) rather than being targeted particularly at low income groups
- Rises in NMW will not help pensioners and the unemployed

Subsidies:

- Cost to the government (and possible opportunity cost issues?)
- What size should the subsidy be?
- Which goods should be subsidised (if the wrong goods receive subsidies then they could well benefit higher income groups as much as low income groups)

Benefits:

- Cost to the government (and possible opportunity cost issues?)
- Benefits would need to be targeted to low income groups to be effective
- How big should the increase in benefits be?
- Possible disincentive to work and rise in voluntary unemployment?
- Stigma of claiming benefits may well deter many possible claimants and therefore result in the policy being unsuccessful in reducing inequality
- How many would actually gain from such a move?

A single, relevant point of evaluation, well developed can gain all 4 marks. At the same time, 4 separate evaluative comments can gain all 4 evaluative marks.

- (d)* In order to decide whether or not to build new hospitals, cost-benefits analysis may be used. Discuss how cost-benefit analysis could be applied to the building of a new hospital. [12]

Level 4	For a discussion of the effectiveness of C.B.A.	7-12 marks
Level 3	For analysis of how C.B.A. will be used to decide whether or not a new hospital should be built.	5-6 marks
Level 2	For an application of knowledge and critical understanding of how C.B.A. may be used.	3-4 marks
Level 1	For knowledge and understanding of what cost-benefit analysis (C.B.A.) is/description only.	1-2 marks

Level 1 answers will have only a basic idea of what C.B.A. is and will fail to develop this/apply this in the context of the building of a new hospital.

Level 2 answers will involve some application of relevant costs/benefits which could be used in this context. For example, the cost of labour used in the construction/the cost of materials/the extra congestion/pollution caused during the construction phase and also the possible loss of scenery/environmental damage if it is built on a green field site.

Level 3 answers will involve clear analysis of how C.B.A. will be used in order to come to a decision.

An answer which simply states that the project will be undertaken where benefits exceed costs by the greatest amount will receive a low Level 3 mark, whilst a candidate who develops this to look at social benefits exceeding social costs will receive a higher Level 3 mark.

Level 4 answers will need to develop relevant points of evaluation/comment in order to gain more than seven marks. Such points may include:

- the difficulty of attaching monetary values to various costs/benefits measured in CBA
- the difficulty of which costs/benefits to include
- the problems of taking in to account future costs/benefits when making decisions today
- the problems caused by uncertainties. This is particularly marked here as it is difficult to tell by how much the economy will benefit from lower absenteeism/ higher productivity as a result of greater capacity to treat patients within the NHS
- the subjective nature of C.B.A. and the possibility of political interference
- the cost of undertaking C.B.A. may be extremely high implying the existence of opportunity cost

2883 The National & International Economy

- (a) Define the term 'monetary policy' (line 6). [2]

2 marks for monetary policy influences the cost and supply of money.

1 mark each for each of two policy instruments identified, ie changes in interest rates, money supply and exchange rate.

1 mark for demand management/control aggregate demand/control inflation/influence macroeconomic objectives.

- (b) Using the information in Fig 1:

- (i) identify the year in which the price level was at its lowest. [1]

1 mark for 2002.

- (ii) describe the relationship between unemployment and inflation in Kazakhstan between 2002 and 2006. [4]

1 mark for identifying a largely inverse relationship.

1 mark for stating that the unemployment rate fell over the period.

1 mark for stating that the inflation rate had an upward trend.

1 mark for noting 2004 was an exception to the general trend/ the inflation rate fluctuated.

1 mark for noting that the unemployment rate was higher than the inflation rate at the start of the period.

1 mark for noting that the inflation rate was higher than the unemployment rate at the end of the period.

1 mark for noting that the inflation rate is more volatile than unemployment.

No marks for just the reproduction of data.

(Note: reference to a Phillips curve relationship should be rewarded but is not required).

Maximum 4 marks

- (c) State and explain ONE supply-side measure a government could use to reduce inflation. [4]

1 mark for identification of a relevant supply-side policy measure, eg deregulation, education, privatisation, training.

Up to 3 marks for explaining how it could reduce inflation.

1 mark for shifting aggregate supply curve to the right/increase AS.

1 mark for why it shifts/increases AS.

1 mark for impact on inflation. E.g. improved education would make workers more productive. This would shift the AS curve to the right. Higher productive capacity/lower prices should reduce inflationary pressure.

Maximum of one mark for cut in interest rate to stimulate investment but 0 marks if limited to aggregate demand.

Maximum 4 marks

- (d) (i) **What is meant by 'cyclical unemployment'? (line 18)** [2]

2 marks for unemployment caused by a lack of aggregate demand.

1 mark for unemployment is caused by a lack of demand/it is demand deficient unemployment/occurs when aggregate labour market is not in equilibrium, economy is in recession, downturn in economic cycle, negative output gap.

- (ii) **With reference to lines 19 - 21, identify and explain ONE other cause of unemployment in Kazakhstan.** [2]

1 mark for structural/regional or frictional unemployment.

1 mark for reference to some industries declining whilst others expanding or lack of labour mobility.

1 mark for how a lack of labour mobility may cause unemployment.

Maximum 2 marks

- (iii) **Describe ONE way of measuring unemployment.** [2]

1 mark for claimant count or labour force survey/ILO measure.

1 mark for claimant count includes those claiming and receiving unemployment benefit/job seekers' allowance or reference to based on ILO approach/a survey method.

Exemplify labour force survey/ILO measures.

- (e) **Using an aggregate demand and aggregate supply diagram, analyse the effects of an increase in investment on an economy.** [7]

Up to 5 marks for an accurate diagram.

1 mark for axes correctly labelled (ie macro labels).

1 mark for AD and AS curves correctly labelled.

1 mark for shift of AD curve to the right.

1 mark for shift of AS curve to the right.

1 mark for initial equilibrium shown by lines drawn to the axes.

1 mark for new equilibrium shown by lines drawn to the axes.

Up to 4 marks for written explanation.

1 mark for noting investment is a component of AD/an injection.

1 mark for noting there will be a multiplier effect.

1 mark for noting an increase in AS will increase productive capacity.

1 mark for effect on real GDP.

1 mark for effect on price level.

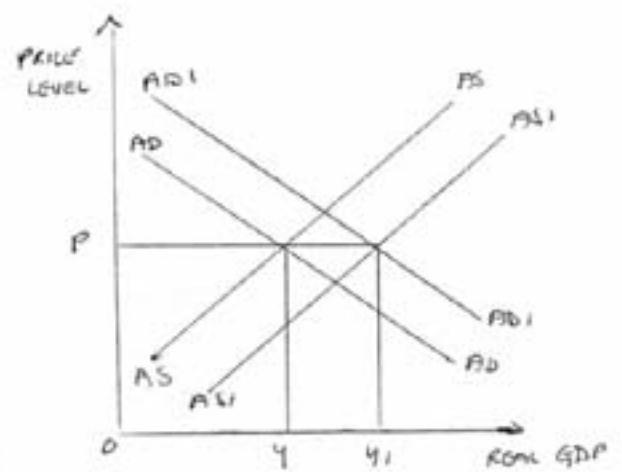
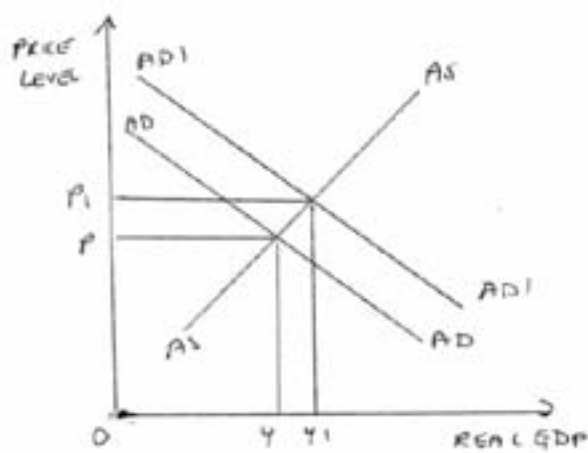
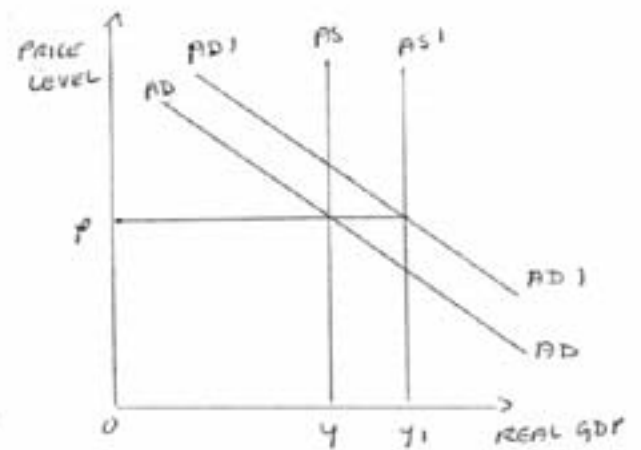
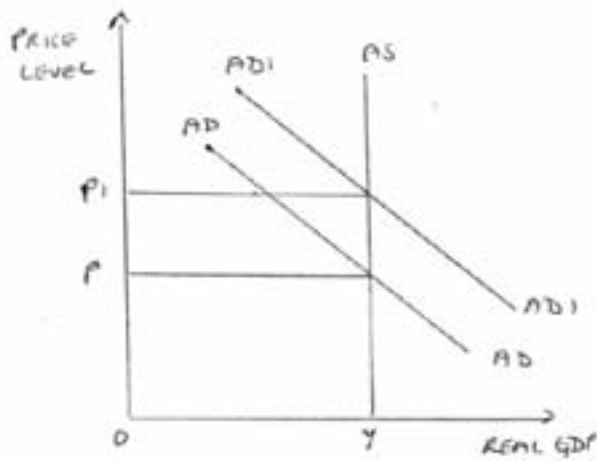
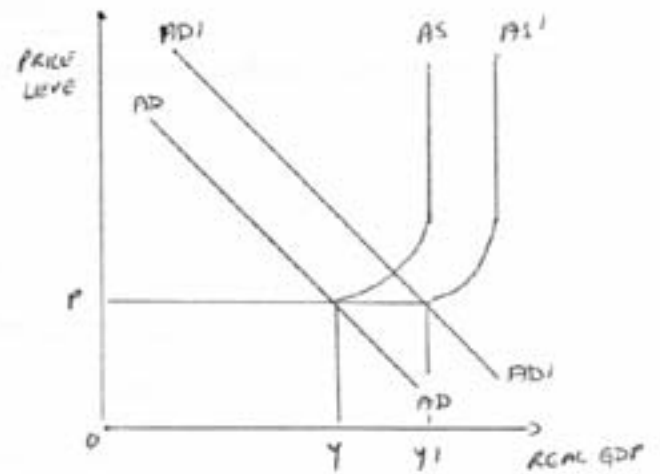
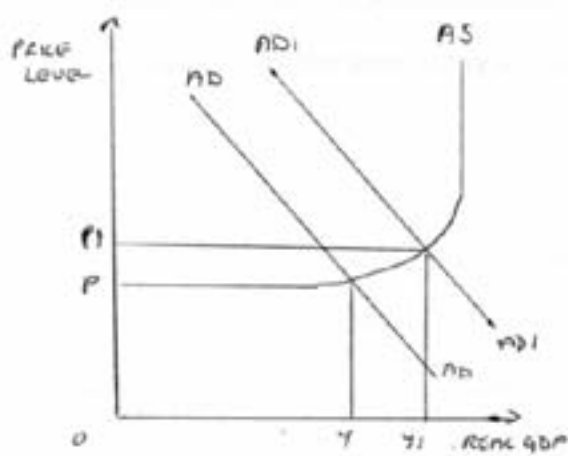
1 mark for effect on employment.

1 mark for valid link to balance of payments via increase in AS/increase in AD.

Up to 2 marks for explanation that outcome will depend on the initial position.

Up to 2 marks for explanation that outcome will depend on the relative sizes of the shifts of AD and AS curves.

Maximum 7 marks



- (f) (i) Calculate the value of Kazakhstan's exports in 2006. [1]

1 mark for \$39bn.

- (ii) What is the difference between free trade and protectionism? [2]

2 marks for free trade is not restricted by tariffs etc whereas protectionism imposes barriers to international trade.

1 mark for idea of either free trade or protectionism.

- (iii) A country decides to remove all the import tariffs it imposes. Comment on whether this is likely to worsen its trade balance. [6]

Up to 3 marks for explanation.

1 mark for explaining likely effect on the price of imports on the domestic market – fall in price.

1 mark for explaining likely effect on expenditure on imports – increase expenditure.

1 mark for explaining likely impact on the gap between export revenue and import expenditure – widen gap/narrow gap.

Up to 4 marks for evaluation. Evaluative comments may include:

- the impact will be influenced by whether other countries remove tariffs
- the level at which tariffs are set
- whether domestic firms become more competitive
- the price elasticity of demand for imports.

One evaluative comment well developed could gain the full 3 evaluative marks.

- (g) **Discuss the effectiveness of a rise in government spending in promoting economic growth.** [12]

A discussion of the effectiveness of a rise in government spending in promoting economic growth. Evaluative comments may focus on the different impact in the short and long run, what the spending is on, adverse side-effects, the initial level of spare capacity.

Candidates may approach this question from the aggregate demand and/or the aggregate supply supply-side. An AD/AS diagram may be included but is not essential.

- L4** For a discussion of the effectiveness of a rise in government spending in promoting economic growth. (7 – 12)
- L3** For an analysis of the effectiveness of a rise in government spending on promoting economic growth. (5 – 6)
- L2** For an application of knowledge and critical understanding of a rise in government spending in promoting economic growth. (3 – 4)
- L1** For knowledge and understanding of economic growth. (1 – 2)

Examples of possible content at different levels:

L4 For a discussion of the effectiveness of a rise in government spending in promoting economic growth. (7 – 12)

Evaluative comments may include:

- the extent to which an increase in AD will cause output to rise will depend on the level of spare capacity
- the impact will depend on what the government spend the money on. In the longer run spending on education, for instance, is likely to be more effective than spending on benefits as it will raise productive capacity
- the impact may be offset by a rise in taxation
- there is a risk that higher government spending may lead to demand-pull inflation
- the measure is more likely to be effective if the government has calculated the size of the multiplier accurately
- the distinction between short run and long run economic growth
- time lag if explained

L3 For an analysis of the effectiveness of a rise in government spending on promoting economic growth. (5 – 6)

Explanation of how a rise in government spending may promote economic growth by increasing AD and/or AS. Government spending is a component of aggregate demand. Higher AD may encourage firms to produce more goods and services. Government spending will also raise productive capacity if it increases the quality or quantity of resources. (A diagram may be included).

L2 For an application of knowledge and critical understanding of a rise in government spending in promoting economic growth. (3 – 4)

Recognition that a rise in government spending will increase AD and/or AS national output/productive capacity.

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

Definition of economic growth in terms of an increase in real GDP and/or an increase in productive capacity.

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.

2884 Economics of Work and Leisure

Section A

- 1 (a) (i) **Using Fig. 1 summarise the main trends in the distribution of disposable income in the UK between 1981 and 2006.** [3]

Up to 2 marks for valid points on trends over the period

1 mark for correct interpretation re distribution of income [eg that a rise in the Gini coefficient means a rise in the degree of inequality]

The trends points could be:- rise in coefficient. In the 1980s; roughly constant from about 1990 until 2005 [or 2002], though with some fluctuations; general fall 2002-5; etc – accept any valid statement which is not merely data regurgitation.

- (ii) **Comment on one possible reason for the change in income inequality in the UK between 2005 and 2006.** [4]

The marks should be allocated 2 marks for a valid explanation, 2 marks for a relevant comment. Any sensible suggested reason should be accepted – 1 mark for a statement of it + 1 mark for the link to the rise in inequality. The comment should then relate to the given reason, and qualify or extend it in some way. [eg a reason might be large rises in executive pay, proportionately greater than those on lower incomes – see Extract 1 – with a comment to the effect that the impact on distribution of disposable income overall depends on how many people are involved, and on the degree of progressiveness of taxes on income]. Another possible reason might be the increase in the number employed at minimum wage [or below] - eg immigrants. N.B An OFR should be applied here, an answer can still gain comment marks even if the reason incorrectly refers to a decrease in income inequality.

- (b) **Use the information in Extract 1 to calculate by how much the real basic salaries of the directors of the UK's 100 largest companies increased between 2005 and 2006.** [3]

The marks should be split 1 mark for recognition of the meaning of “real”, by subtraction of the figure of 2.3%, plus 1 mark for correctly using the figure 5%, plus a final 1 for giving an answer [approx] 2.7%. N.B Strictly = $105/102.3 \times 100 = 102.64 - 100 = 2.64\%$

- (c) **Explain the concept of marginal revenue product as the basis of the determination of pay.** [4]

Up to 2 marks for explanation of MRP as addition to firm's revenue from employing an extra worker, as a function of both physical productivity and the product price.

Up to 2 further marks for explanation of MRP as the basis of pay determination.

- (d) **Discuss the view expressed in Extract 1 that “exceptional performance should be rewarded”.** [6]

Up to 3 marks for explanation of, and arguments in favour of, the statement. The explanation should link to the relationship between MRP and pay, at least implicitly, applied to the case of “top directors”, with arguments such as incentives linked to international competitiveness.

Up to 3 further marks for arguments which counter the view – for example relating to income inequality and unfairness, or effects on worker morale and disincentives.

Section B

- 2 (a) **Some workers may respond to a rise in their hourly pay by choosing to work more hours, whilst others may choose to work the same or even fewer hours. Use income and substitution effects to explain why this is the case. [10]**

Hourly wage as the price of an hour of leisure, given that work/income and leisure are opportunity cost trade-offs. Income effect of a rise in hourly pay as rise in demand for the normal good leisure, – so fewer hours of work offered. Substitution effect as fall in demand for it as leisure becomes more expensive. Hence, overall effect depends on the preferences/priorities of any particular worker.
NB diagram useful, though not a requirement.

Level 3	For clear explanation of different possible overall effects	(7-10)
Level 2	For partially correct explanation of income and substitution effects	(4-6)
Level 1	For basic knowledge and understanding only of work/leisure trade-off	(1-3)

NB. If effects are understood but incorrectly named, or not combined to give total effect, answer should be placed in L2.

- (b) **The government decides to reduce the standard rate of income tax. Discuss the possible effects of this change on hours worked and on the economy. [15]**

Meaning of standard rate of income tax. Explanation of possible effects – eg on total government tax revenue, and so on government budget position; on hours worked by individuals and in total; on incentives and hence productivity and total output. Discussion of factors influencing the relative sizes of such effects, and hence of the overall impact.

Level 4	For evaluative discussion covering a range of relevant issues in a two-sided way NB Max of 12 marks if only one issue is considered	(9-15)
Level 3	For explanation of at least one effect of the policy	(6-8)
Level 2	For application of knowledge and critical understanding of the policy	(3-5)
Level 1	For basic knowledge only of meaning of the policy	(1-2)

- 3 (a) **Explain why the level of profit can vary considerably between one oligopolistic industry and another.** [10]

Identification of the characteristics which make an industry oligopolistic. Explanation of how firms determine prices and output in an oligopoly – using such concepts as market leadership, price stability, price wars, interdependence. Explanation of possible different levels of profit in such an industry; this might be via variations in levels of demand, for example; but it might equally be a function of differences between structure of and/or behaviour in, the industries themselves. Thus, price wars would mean lower [or indeed negative] profit in the short term – but perhaps greater profit in the longer term if the price war was ‘successful’; or lack of barriers to entry/exit might mean lower profit than in an oligopoly which is less contestable.

NB

- answers may use the concept of contestability, but are not required to.
- although examples are not actually requested, credit should be given where they are used appropriately.

Level 3	For clear explanation of profit variation in oligopoly	7-10
Level 2	For application of knowledge and critical understanding of some aspects of behaviour of firms in oligopolistic industries	4-6
Level 1	For basic knowledge only of characteristics of oligopoly, or an answer focused on profit not linked to oligopoly	1-3

NB Up to 7 marks maximum for answer on oligopolist's profit in short - and long - run.

- (b) **Discuss the impact of recent technological change on the efficiency and the profitability of firms in a leisure market of your choice.** [15]

Explanation of choice of chosen leisure market, and of the nature of recent technological change in it. [The chosen market need not be one of the four named in the specification, but it must be in the leisure sector. Examples might be TV broadcasting, with developments in satellite and digital technology, or package holidays, with development of internet technology.] There needs, then, to be a consideration of the market structure of the chosen market, with an explanation of the determination of profitability and efficiency in it both before and after the impact of the identified technological change. Evaluation is likely to focus on the extent of the changes in profit and/or efficiency, and/or of the possibility of there being countervailing effects.

Level 4	For an evaluative discussion of possible effects on both profit and efficiency NB An answer which considers only one of profit and efficiency can score a max of 12 marks	9-15
Level 3	For an explanation of the determination of profit and efficiency in the appropriate market structure	6-8
Level 2	For application of knowledge and limited critical understanding only of the chosen leisure market	3-5
Level 1	For knowledge only of the identified technological change	1-2

- 4 (a) **Explain the effects which trade unions can have on the determination of relative wages.** [10]

Identification of the nature of trade unions. Explanation of objectives and behaviour of TU, with links to different forms of activity. The main emphasis is likely to be on restriction of labour supply; examples would include insisting on restrictions on entry qualifications, causing supply to be lower and/or more inelastic; or strike threats to gain pay rises, causing supply curve to be non-existent at certain levels of pay. However the impact can also be on the demand side – eg. productivity bargaining to increase the demand [mrp]. Overall impact on determination of relative wages, including as between workers who are and are not in well-organised and effective trade unions.

Level 3	For clear explanation of at least 2 effects including on relative wages	7-10
Level 2	For a single basic explanation of an impact of Trade Unions	4-6
Level 1	For basic knowledge only of trade unions	1-3

- (b) **Discuss the extent to which UK governments should concentrate their efforts on policies which aim to make the labour market operate more flexibly.** [15]

Explanation of meaning of more flexible operation of the labour market – in terms of greater occupational and geographical mobility, for example; or with greater freedom for employers to employ and/or dispense with workers. Identification of different labour market policies, with explanation of the impact of each – to increase extent of labour market flexibility on the one hand, and to achieve other objectives [eg. minimum wages, non-discrimination] on the other. Evaluation of the effects of these policies. Evaluative discussion of the extent to which a government should concentrate its efforts on one type or the other.

Level 4	For an evaluative discussion, focused on to what extent NB An answer which considers one type of policy only, however well evaluated, can score a max of 12 marks	9-15
Level 3	For an explanation of at least one relevant government policy in the labour market	6-8
Level 2	For application of knowledge and critical understanding of meaning of flexible lab mkt	3-5
Level 1	For basic knowledge only of one relevant policy	1-2

2885 Transport Economics

- 1 (a) State and explain TWO economic reasons for the private ownership of many of the UK's main airports. [4]

1 mark for each correct identification up to a maximum of two, plus a further 1 mark for each of two explanations.

Possible reasons include:

Incentives for management to increase efficiency (1) otherwise shareholder pressure will be applied (1) or to increase profits (1)

Increased investments to upgrade terminals (1) as private sector can attract large funds through share issues (1)

Increased competition (1) with explanation (1)

Two different ways of increasing efficiency can be rewarded if explained appropriately.

Maximum 2 marks

- (b) (i) What is meant by the term 'market dominance'? [2]

Increasing or high consolidation (share) within a market (1), increasing monopoly power (1) with ability to set prices above average cost (1)

Maximum 2 marks

- (ii) Comment on the extent to which BAA has a dominant market position. [4]

Explanation of BAA's dominant position (2 marks)

Use of relevant data. BAA has more than 25% market share therefore designated a monopoly. As over 40% can also be considered a dominant monopoly.

Commentary on extent of BAA's dominant market position (2 marks)

More dominant in London and South East with use of relevant data.

Competition does exist with other transport modes particularly for short haul trips.

High barriers to entry such as high set up costs/regulation.

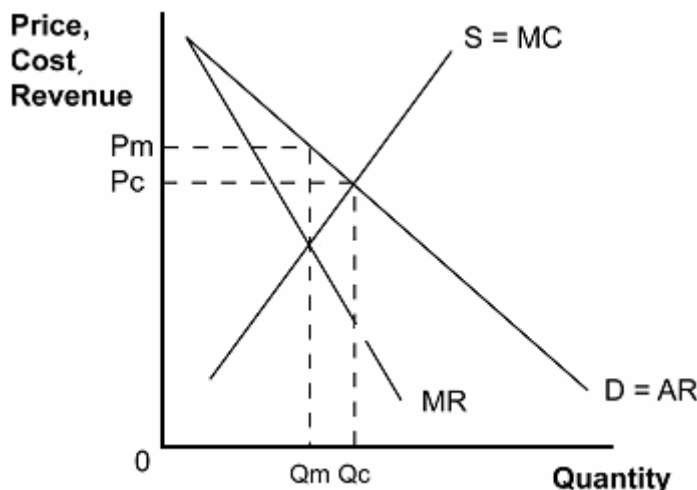
Reward reference to recent decision reducing BAA's dominant position.

Level 2 Commentary on extent of BAA's dominant market position **3-4**

Level 1 Explanation of BAA's dominant market position. **1-2**

- (c) Ryanair welcomed the decision to refer BAA to the Competition Commission, arguing it was "good news for consumers" (lines 11-12).

- (i) With the aid of a diagram, explain why economic theory suggests that competition is in the best interest of consumers. [4]



Up to 2 marks for a diagram

Up to 3 marks for an explanation

Reward any diagram that shows decreased price and increased output due to competition (or reverse).

For 3-4 marks there must be some development other than decreased price, increased output, i.e. in terms of efficiency gains or increased consumer surplus above following increased competition (or reverse).

- (ii) Discuss the economic case for increasing competition in the provision of airports and their facilities. [6]

Increased competition should improve efficiency as airports seek to reduce average costs in order to reduce prices to airline companies/passengers using their services. Facilities should improve (allocative efficiency). Evaluation could include; cutting costs may be detrimental to safety, etc; possible loss of scale economies and, therefore, increases in average costs; present structure more likely to raise the necessary finance for investment (due to abnormal profits); regulators in place to ensure consumer is not abused.

Level 3 Evaluative discussion of economic case for increasing competition with clear application to provision of airports and their facilities.

5-6

Level 2 Evaluative comment giving some consideration in favour of maintaining BAA's dominant position in addition to explaining the case of increasing competition.

3-4

Level 1 Explanation of case for increasing competition in airports and their facilities.

1-2

- 2 (a) Explain the determinants of demand for rail passenger transport. [10]

Analysis in terms of derived demand and demand function; price of rail transport, price of complements, price of substitutes, income (rail considered to be a normal or even luxury good), tastes and preferences (particularly convenience/reliability against private car), etc. Needs specific and clear application to rail passenger transport.

Level 3 For an explanation of the determinants of demand for rail passenger transport. 7-10

Level 2 For application of knowledge and critical understanding of the determinants of demand for rail passenger transport. 4-6

Level 1 For knowledge and understanding of the determinants of demand for rail passenger transport. 1-3

- (b) Discuss the impact of growing demand for rail transport services on rail infrastructure and on transport sustainability. [15]

Increased demand for rail has placed present infrastructure under great pressure causing congestion on the rail system, delays and need for increased maintenance; increases in price will encourage increased supply of operations (larger trains, longer stations) but in the long run increased investment is required on the infrastructure which will involve high cost and much short term delay. Sustainability defined; sustainability enhanced if demand for rail increases at the expense of road transport; explanation in terms of intergeneration resource (including land) use. Not limited to passenger; freight can be rewarded in this section.

Level 4 For a discussion of the impact of growing demand for rail transport services on rail infrastructure and on transport sustainability. 9-15

Level 3 For an analysis of the impact of growing demand for rail transport services on rail infrastructure and/or on transport sustainability. 6-8

Level 2 For an application of knowledge and critical understanding of the impact of growing demand for rail transport services on rail infrastructure and/or on transport sustainability. 3-5

Level 1 For knowledge and understanding of growing demand for rail transport/rail infrastructure/sustainability. 1-2

3 (a) Explain the private and external costs associated with traffic congestion.

[10]

Private costs defined in terms of costs incurred and paid for by parties causing the congestion; costs of time, vehicle user costs. These costs also imposed on third parties, ie other motorists. Motorists both cause external costs and have such costs imposed on them. Requires clear explanation of such external costs. Also increased environmental pollution as a result of less efficient car use. Reward diagrams, but these are not a requirement (neither is an explanation of market failure).

Level 3 For an explanation of the private and external costs associated with traffic congestion. **7-10**

Level 2 For an application of knowledge and critical understanding of the private and external costs associated with traffic. **4-6**

Level 1 For knowledge and understanding of the costs associated with traffic or just knowledge and understanding of external and private costs. **1-3**

(b) Discuss, with the aid of examples, the effectiveness of using the cost benefit approach when appraising transport infrastructure projects.

[15]

Cost benefit analysis explained; idea of using full social cost and benefit; explanation of private and external benefit; application to transport infrastructure projects (reward responses that provide a number of contexts). Problems with some models, eg COBA and how this has been adapted. Problems with estimations of externalities (more credit to be gained if estimates and inherent inaccuracies are explained. Judgements based on effectiveness, eg in terms of efficient resource allocation.

Level 4 For a discussion of the effectiveness of using the cost benefit approach when appraising transport infrastructure projects (with clear use of examples at top end). **9-15**

Level 3 For an analysis of the use of cost benefit approach when appraising transport infrastructure projects. **6-8**

Level 2 For an application of knowledge and critical understanding of the use cost benefit approach when appraising transport infrastructure projects.

Level 1 For knowledge and understanding of cost benefit analysis / transport infrastructure projects. **1-2**

- 4 (a) Explain how the negative externalities caused by transport users result in a misallocation of resources. [10]

Negative externalities explained as third party effects, outside the market; examples of such caused by transport users (congestion, environmental pollution, noise, blight, etc.), with explanation of effect on third party. Explanation of market failure in terms of overproduction as transport users do not take external costs into account and, therefore, price is lower and demand higher than social optimum. Reward use of a diagram, but this is not a requirement.

Level 3 For an explanation of how the negative externalities caused by transport users result in a misallocation of resources. **7-10**

Level 2 For an application of knowledge and critical understanding of how the negative externalities caused by transport users result in a misallocation of resources. **4-6**

Level 1 For knowledge and understanding of how the negative externalities caused by transport users result in a misallocation of resources. **1-3**

- (b) Discuss the extent to which taxes levied on transport users correct the misallocation of resources such users cause. [15]

Explanation of different taxes levied on transport users (fuel taxes, vehicle excise duty, road user charging). Analysis of impact of such taxes – use of diagram to be rewarded - to internalise the externalities. Evaluation could be in terms of taxes need to be linked to external costs eg fuel taxes linked to environmental pollution, road user charges for congestion. Vehicle excise duty not linked to use. Also problems of not setting tax at right level due to estimation problems.

Level 4 For a discussion of the extent to which taxes levied on transport users correct the misallocation of resources such users cause. **9-15**

Level 3 For an analysis of how the taxes levied on transport users correct the misallocation of resources such users cause or analysis of problems associated with taxes on transport users. **6-8**

Level 2 For an application of knowledge and critical understanding of the use of taxes on transport users. **3-5**

Level 1 For knowledge and understanding of the taxes levied on transport users. **1-2**

2886 Economics of Development

- 1 (a) **State and explain two obstacles to development which resulted directly from the exit of the Indonesians in 1999.** [4]

Infrastructure: loss of transport and buildings (1) + inefficiency in production (1)
 Officials: loss of labour (1) + reduced leadership, skills and competence (1)
 Livestock: loss of food source (1) + health and income issues (1) any 2 points.

- (b) (i) **Identify two reasons why the estimate of US\$150 per head in rural areas may understate the standard of living.** [2]

Existence of subsistence (1), low cost of living (1), perceived needs (1), under-recording of income (1), informal economy (1), non-material benefits (1), barter (1), income transfers (1), estimates (1). Any 2 points

- (ii) **Explain the problems faced by the agricultural sector in Timor-Leste.** [3]

Low productivity, underemployment with zero MPP, low incomes, low, volatile prices, lack of trading surplus, natural hazards, replacement of livestock, over-reliance on coffee, inefficient barter, Credit sensible assumptions eg loss of workers, poor communications and infrastructure. Unexplained list max 1 mark.

- (c) **Using Fig.1 and the text, comment on the extent to which Timor-Leste developed between 1999 and 2004.** [5]

Some improvement in GDP per head, literacy, education, water supply, and weights + oil extraction
 Worse shown by lower life expectancy, lower HDI + extensive poverty, little industry, infrastructure and modern methods.
 Up to 3 marks max for improvements or deterioration. (1) per side for identification of relevant data + 2 marks for comment on significance of data for development. Credit overall comment (1). Max of 5 marks available from combination of identification and comment on indicators that are used to judge development, 4 marks max if fig or text source omitted.

- (d) **Discuss the extent to which encouraging tourism and oil and gas extraction are appropriate ways to promote development.** [6]

Both make use of natural resources and reflect comparative advantage and unbalanced growth. Both have the potential for high earnings. One is more labour intensive but may offer mainly unskilled work, while the other is capital-intensive. One may offer more equality in benefit. One is seasonal while the other has been associated with corruption. There is the possibility of externalities, lack of sustainability and cultural impacts associated with both. Both require major funds and the support of international finance There may be problems with the role of MNCs and increased dependence.

Analysis of the two industries positive or negative contribution in terms of, for example, employment, trade, the role of MNC's and externalities, up to (2) marks, evaluation of the extent to which each industry has an advantage over the other or is appropriate in its own right, in terms of its effect on development, for example the

level or degree of skill of the employment or the scale or seriousness of the externalities, up to (4) marks. One industry only, (4) marks max.

- 2 (a) Explain why some economists believe that the term 'developing country' is an unhelpful one. [10]

The term 'developing country' covers a wide range of economies which are not considered 'developed' and are not uniform. They have relatively low levels of HDI and low living standards. This is a wide spectrum covering low income economies, newly industrialised countries, highly indebted countries etc. Within the group, countries are very different, ranging from Sub-Saharan countries with manifold problems to successful Asian economies fast approaching being developed. Judging their performance as though they were a uniform group is, misleading and might lead to policy mistakes. Countries need to be considered on an individual basis.

L3 For an explanation of the unhelpfulness of the term developing country **7-10**

L2 For an application of knowledge and critical understanding of the term 'developing country' **4-6**

L1 For knowledge and understanding of the term 'developing country' **1-3**

- (b) Discuss whether governments of low income economies should concentrate on promoting economic growth or economic development. [15]

Economic growth concerns increases in productive potential and is usually measured by growth in real GDP per head. Development is a wider concept and relates to improvements in material and non-material welfare, it is usually measured by the HDI or a variation. Growth is usually a necessary condition for development but does not guarantee it. Raising output generates higher incomes and higher living standards. It allows governments more opportunity to provide non-market goods and services and to effect redistribution. However growth can cause externalities and increased inequality. The ultimate aim is to increase development but for many low income countries growth will be required before development can occur. Growth of the wrong sort however may hamper development. A higher Level four answer will distinguish between short-term and long-term aims.

L4 For a discussion of the relative desirability of growth and development. **9-15**

L3 For an analysis of the link between growth and development. **6-8**

L2 For an application of knowledge and critical understanding of growth and development. **3-5**

L1 For knowledge and understanding of growth and development. **1-2**

- 3 (a) Explain why many of the world's poorer countries face both savings gaps and foreign exchange gaps. [10]**

Poor countries are faced with a dual financial problem, they lack savings to finance investment and foreign exchange to finance trade and settle international debts. Both of these will restrict growth. The savings gap results from the inability of consumers, firms and government to consume less than income. Low incomes (high MPCs), low profits and low tax revenue contribute to this as do limited financial institutions. The foreign exchange gap is the result of a lack of international competitiveness, a high MPM, balance of payments outflows and prior claims on the foreign exchange which is earned.

L3 For an explanation of the existence of savings and foreign exchange gaps. **7-10**

L2 For an application of knowledge and critical understanding of the nature of savings and foreign exchange gaps. **4-6**

L1 For knowledge and understanding of savings and foreign exchange gaps. **1-3**

- (b) Discuss whether the involvement of multinational companies (MNCs) is a good way to close these gaps. [15]**

Multinational companies produce outside of their country of origin. If they create employment, this will raise incomes and the ability to save. If they use profits to reinvest, this will raise corporate saving. Their activities should raise government tax revenue from income and expenditure. Inflows of investment funds, their ability to export and to reduce imports should reduce the foreign exchange gap. They are able to provide significant sums of finance and introduce new technology. Against this they may require imports of capital equipment, may move profits out of the country, require higher government expenditure and arrange financial flows to avoid tax. It may suit their objectives for some of their operations to be net importers rather than exporters. The overall position may depend upon how ethical their approach is. A higher Level four answer will attempt a judgment based on examples.

L4 For a discussion of desirability of multinational companies' involvement in closing savings and foreign exchange gaps. **9-15**

L3 For an analysis of the ability of multinational companies to close savings and foreign exchange gaps. **6-8**

L2 For an application of knowledge and critical understanding of the operations multinational companies. **3-5**

L1 For knowledge and understanding of multinational companies. **1-2**

- 4 (a) Explain the causes of the population problems found in many low income countries. [10]

The main problems are rapid population growth (falling living standards), rise in proportion of young people (higher dependency ratio), rising death rate from Aids (loss of adults), emigration (loss of skilled workers) and population relocation (environmental impact). Influences at work are birth rates and death rates, children as investments, health facilities and motivation and aspirations. These can be applied to explain different elements of the population problems.

L3 For an explanation of causes of population problems. 7-10

L2 For an application of knowledge and critical understanding of population problems. 4-6

L1 For knowledge and understanding of population problems. 1-3

- (b) Discuss whether encouraging international migration is a desirable way to promote development. [15]

If the movement is from developing to developed, the developing economy's viewpoint may be that there will be the loss of skilled workers, waste of the investment in their training, the loss of potential entrepreneurs/leaders and the break up of families. These can be offset against possible remittance of earnings and later return with enhanced skills and contacts. In the short-run there may be disadvantages which reduce in the long-run. The developed economy may fill skill shortages and raise production making better use of world resources but may be concerned about strain on resources and infrastructure. The balance of benefit will depend on individual cases. An alternative might be the movement from developed (MNC staff and volunteers) to developing. This would bring skills and knowledge which would have the potential to raise development and benefit both parties. A higher Level four answer will show awareness of both directions.

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

L3 For an analysis of the impact of international migration on development. 6-8

L2 For an application of knowledge and critical understanding of the nature of international migration. 3-5

L1 For knowledge and understanding of international migration. 1-2

2887 The UK Economy

Question		Expected Answer	Grade
1	(a)	Define the term 'rate of interest.'	[2]
		The price of money. (2) The reward paid to savers on their deposits. (2) The amount paid by borrowers on top of the initial loan, usually expressed as an annual percentage. (2) 1 mark for something more vague, eg. the cost of a loan, a payment made by a bank to its customers.	
	(b)	With reference to Fig. 1:	
	(i)	state what is meant by net external demand; 2 marks for the x-m element of the AD function. 1 mark for something less precise, eg. the balance of payments account. Reference to only one element, exports or imports. 1 mark	[2]
	(ii)	explain how import prices can affect inflation. A rise in import prices in general will have an important influence on the consumer price index as the UK economy is such an open economy. This would provide a source of cost push inflation that could be detrimental to the maintenance of the inflation target. (2) 1 mark for a less precise account, eg. rising import prices cause inflation. If the link is clearly made that increased import prices feed through to increased input costs passed on to consumers. (2) Imports are part of the basket of goods in the CPI therefore higher import prices put upward pressure on inflation. (2) Import prices fall leading to an increase in demand for imports, the consequent fall in AD leads to less demand pull pressure. (2)	[2]
	(c) (i)	Explain how an increase in the base rate would, in theory, influence the sterling exchange rate.	[4]
		Higher interest rates on offer in London make short term deposits more attractive than elsewhere in the world. (1 mark) This leads to inward hot money flows. (1 mark) Euros and Dollars sold to buy £ to deposit. Increase in demand for £ on for/ex market, ceteris paribus, (1) leads to increase in value. (1) Idea of short term deposits increasing from abroad is enough for hot money.	

Question			Expected Answer	Grade
		(ii)	Comment on the statement that ‘the impact of interest rates on the exchange rate can be uncertain (lines 16-17).’	[4]
			<p>2 marks for an explanation/analysis of why the statement may be true, eg. Over riding influences such as trade movements or speculative flows. Only a small change in rates may be ignored.</p> <p>If others simultaneously change rates in same direction, this may make no difference.</p> <p>For something less precise eg exchange rate values are subject to many influences. (1 mark)</p> <p>2 marks for any qualification, such as on the contrary the reaction may be as expected or an exaggeration of such.</p> <p>For something less precise eg higher interest rates attract savings from abroad. (1 mark)</p> <p>Evidence of evaluation following a one sided answer. 3 marks max.</p>	
		(d)	Discuss whether the MPC has been the most significant influence on the UK’s inflation rate in recent years.	[6]
			The MPC has had a fairly good track record in keeping the rate of inflation on target for the first ten years or so of its existence. More recently inflation has moved above target, and the reasons for this are complex, and to a considerable degree beyond the influence of the MPC. This then begs the question, was it the MPC that kept inflation in check for so long, or was it more the consequence of favourable external influences?	
L3			If L1 + L2 are covered and there is some judgement offered as to the significance of the MPC policy in comparison to other influencing factors.	5-6
L2			If L1 is covered, plus some reference to other potential influences on inflation, eg low commodity prices .Or an account of the success of MPC policy.	3-4
L1			<p>For an account of how the MPC has performed in keeping inflation on target. Or an account of other influences.</p> <p>Maximum 1 mark for an explanation of how MPC policy works.</p>	1-2

Question			Expected Answer	Grade
2	(a)		Explain how economists demonstrate the gains from free trade between nations.	[10]
			It is expected that candidates will attempt to make the classic case for free trade between nations, ideally using the Ricardo comparative advantage approach rather than the Smith absolute advantage explanation. The simple approach would be to demonstrate the advantage of trade using the absolute advantage case, for which we should award a maximum top L2 mark. For L3, candidates should use the comparative advantage model. L1 for general comments on the advantages of trade.	
L3			For an explanation of how economists demonstrate the advantage(s) of free trade via the comparative advantage model.	7-10
L2			For an application of knowledge and critical understanding of the advantage(s) of free trade using the absolute advantage model.	4-6
L1			For a knowledge of the advantage(s) of free trade.	1-3
	(b)		Discuss whether there is any justification for the UK to use protectionist policies in the global economy of the 21st century.	[15]
			The most likely justification for the UK to use protectionist policies would be the anti-dumping case. The infant industry argument would be a harder case to support, but we may even be offered the strategic industry debate. Balance of Payments difficulties may be a further case that could be applied to the UK. However, all this must be counterbalanced by a pro free trade argument and ideally summarised with an evaluated conclusion. At best any use of protectionist policy should be a short term solution to an unusual problem.	
L4			For a discussion of the extent to which protectionist policies by the UK are justified in the 21 st century global economy. 9-12 marks for candidates who just discuss pros and cons of using protectionist policies. 13-15 marks for the above plus an overall judgement re justification for policy use.	9-15
L3			For analysis of protectionist policies used by the UK in the 21 st century global economy.	6-8
L2			For application of knowledge and critical understanding of the protectionist policies used in the 21 st century global economy.	3-5
L1			For descriptive knowledge of relevant issues or relevant assertions about protectionist policies.	1-2

Question		Expected Answer	Grade
3	(a)	<p>Explain how fiscal policy can be used to reduce the level of unemployment in the UK economy.</p> <p>A L3 answer would contain a clear understanding of fiscal policy, an application of a budget deficit approach and an analysis using a diagram and/or reference to the multiplier effect of such a policy. Lesser quality L2 answers would mention the budget deficit approach to solving deficient demand unemployment, but would fail to elaborate the explanation using tools of economic analysis. A L1 for merely displaying knowledge of fiscal policy.</p> <p>Although less likely, candidates may approach the question from a supply-side perspective and explain how fiscal policy can be used to try and reduce the effects on the economy of structural and frictional unemployment problems.</p>	[10]
L3		For an explanation of how fiscal policy can be used to reduce the level of unemployment.	7-10
L2		For an application of knowledge and critical understanding of how fiscal policy can be used to reduce the level of unemployment.	4-6
L1		For a knowledge of fiscal policy.	1-3
	(b)	<p>Discuss the extent to which fiscal policy alone can be used to solve the unemployment problems of the UK economy.</p> <p>For a L4 answer candidates would be expected to analyse the deficiencies of fiscal policy, the alternative monetary demand management approach and the case for supply-side tactics in the face of unemployment caused by structural and frictional difficulties. The better candidates are likely to arrive at a conclusion which clearly suggests the degree to which they feel fiscal policy alone may be useful.</p>	[15]
L4		<p>For a discussion of the extent to which fiscal policy alone can be used to solve the unemployment of the UK economy</p> <p>9-12 marks for an answers that discuss both benefits and deficiencies of using fiscal policies to solve unemployment problems.</p> <p>13-15 marks for the above plus a summary conclusion explicitly evaluating the extent to which FP alone will work.</p>	9-15
L3		For analysis of policy that can be used to solve the unemployment of the UK economy.	6-8
L2		For application of knowledge and critical understanding of policy that can be used to solve unemployment problems.	3-5
L1		For descriptive knowledge of relevant issue(s) or relevant assertion(s) about fiscal policy/ unemployment problems	1-2

Question			Expected Answer	Grade
4	(a)		<p>Explain ONE macro-economic policy conflict that could arise in the UK economy.</p> <p>Possible policy conflicts include reducing unemployment and a widening trade gap. Depreciation of the currency and the potential for this to lead to import cost-push inflation. Policies aimed at stimulating economic growth which simultaneously builds up inflationary pressures. However, the most likely approach would be the Phillips Curve unemployment/inflation case. Which ever conflict is chosen, candidates must offer some clear analysis of the problem in order to achieve a L3 mark.</p>	[10]
L3			For an explanation of one conflict that could arise in the UK economy	7-10
L2			For an application of knowledge and critical understanding of one conflict that could arise.	4-6
L1			For a knowledge of one possible conflict.	1-3
4	(b)		<p>Discuss the extent to which government economic policy can achieve a successful balance between its macro-economic objectives.</p>	[15]
			<p>The anticipated answer would be one where candidates offer an applied essay in the context of the UK economy over the last ten (or so) years. An analysis/discussion of the success with regard to low inflation, high employment and sustained growth, but the growing spectre of the increasing balance of trade deficit.</p>	
L4			<p>For a discussion of the extent to which macroeconomic policy can achieve a successful balance between these variables.</p> <p>9-12 marks For an account that considers the difficulty of achieving all macro goals simultaneously.</p> <p>13-15 marks for the above plus a conclusion re the extent to which government policy can achieve this goal.</p> <p>For a candidate who only addresses one conflict, max 12 marks</p>	9-15
L3			For analysis of the macroeconomic policy used in the attempt to achieve a successful balance between these variables.	6-8
L2			For application of knowledge and critical understanding of macroeconomic policy used in the attempt to achieve a successful balance between these variables.	3-5
L1			For descriptive knowledge of government policy and/or macro-economic objectives.	1-2

2888 Economics in a European Context

- 1 (a) Using Figs. 1.1 – 1.3 of Extract 1, summarise the performance of the euro area economy since January 1999. [6]

Synoptic knowledge

Module 2883 – Section 5.3.1 Indicators of national economic performance.
(The use of data to measure economic performance)

Module 2888 – Section 5.8.2 Economic and Monetary Union (EMU).
(The performance of the eurozone economy)

Outline of content

In each case:

- 1 Mark is available for the identification of the overall trend of each indicator**
- 1 Mark is available for the identification of an exception to this trend**
- 1 Mark is available for the identification of highest and lowest**
- 1 Mark is available for the variability and quantification**
- 1 Mark is available for an overall judgement of performance e.g. improved**

For example:

Inflation

- Euro area inflation has increased over the whole period
- Most of this increase occurred from 1999 – 2001
- Since 2001 euro area inflation has fluctuated around 1.75%
- Euro area inflation was at its highest rate during 2001 and at its lowest rate in January 1999

Unemployment

- The rate of unemployment in the euro area has fallen (by 23% or 2.2 percentage points) over the whole period
- However, the rate of unemployment rose from 2001 – 2005
- The rate of unemployment was at its highest in January 1999 and at its lowest in mid 2007
- The rate of unemployment shows a cyclical pattern

Economic growth

- Euro area economic growth is marginally higher in mid 2007 than in January 1999
- Euro area economic growth fell 2000 – 2002
- Euro area economic growth has increased since 2002
- The highest rate of growth was recorded in the first quarter of 2000 and the lowest growth was in January 2002

Overall

- Overall performance has been good, evidenced by falling unemployment, inflation rarely above the target rate and growth recovering since 2002

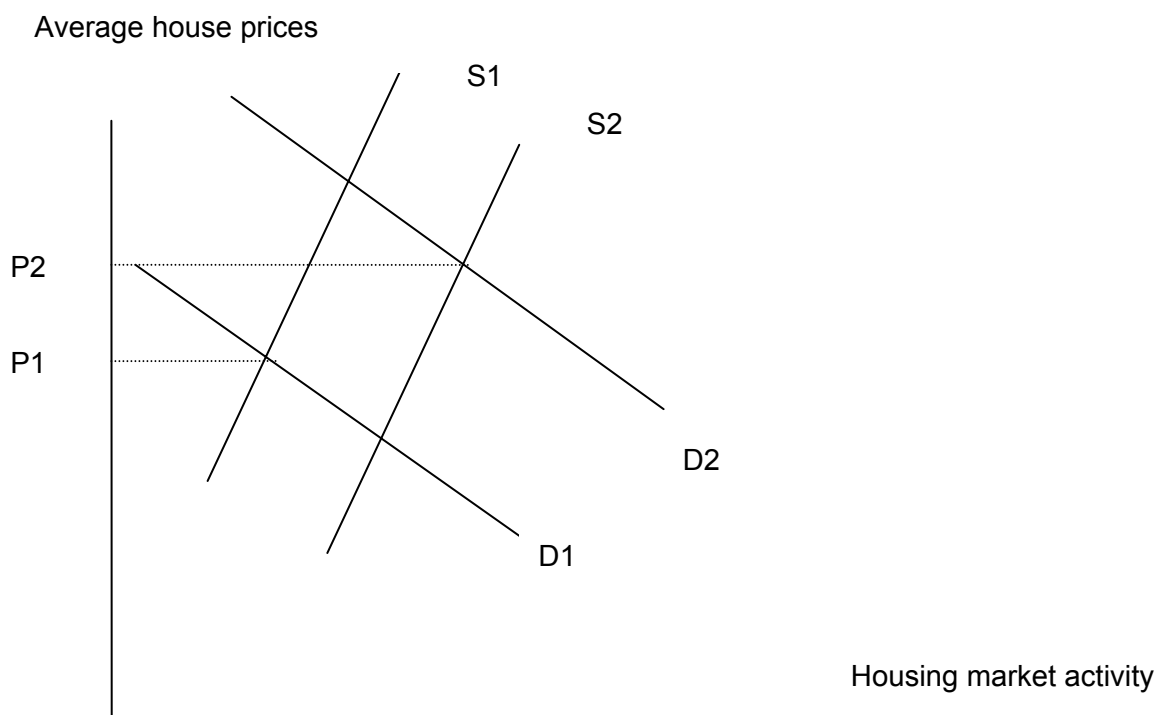
Maximum of 2 marks per indicator

(b) Using a demand and supply diagram, analyse the likely reasons for the rapid increase in house prices experienced in Ireland and Spain since 1999. [9]

Synoptic knowledge

Module 2881 –	Section 5.1.2	Competitive markets and how they work.
	(demand, determinants of demand, supply, determinants of supply, price elasticity of supply, market equilibrium, changes in demand and supply, effects of changes on equilibrium price and quantity)	

Outline of content



The supply of housing is likely to be price inelastic in the short run due to a range of factors related to new house building, such as availability of land, planning. The rapid increase in house prices is likely to be the result of this feature of supply and increasing demand. Increasing demand could be caused by demographic factors, the availability of credit, rising incomes, etc. Despite increase in supply, the price of houses has risen.

Knowledge marks

- 1 for correct labelling of axes (price and quantity is fine as is P and Q. £ is not acceptable)
- 1 for drawing and labelling downward sloping demand curve and upward sloping supply curve
- 1 for identifying and labelling original equilibrium price

Application marks

1 for rightward shift of D

1 for rightward shift of supply OR use of SR/LR supply in the diagram

1 for identifying and labelling new equilibrium price

Application marks can be awarded for diagrams which show shifts of AD and AS i.e. no double penalty

Analysis marks

Up to 3 marks for analysis of reasons for the rapid increase in house prices.

Maximum of 1 mark for simple statement about the diagram

For full marks there must be an explanation of the determinants of the demand for housing and the relative shifts in demand and supply OR developed explanation of price inelasticity of supply or SR/LR supply

Max 2 marks for analysis where no reference to both demand and supply side factors

2 Comment on the benefits of price stability for the euro area.**[10]****Synoptic knowledge**

Module 2883 –	Section 5.3.1	Government macro-economic policy objectives.
	(consequences of inflation)	

Outline of content

The synoptic requirement here is for candidates to recognise that price stability avoids the costs of inflation studied at AS and to set them in the context of monetary union. The benefits of price stability are generally recognised to include:

- **resource allocation** – price stability allows the market to efficiently allocate resources through signalling changes in relative prices. This is important as it contributes to raising the productive potential of the economy. This is particularly important for the euro area as it maximises the benefits from Europe's single market.
- **investment incentives** – if there is uncertainty about the price level, investors will demand higher rates of return on investment projects. Price stability, therefore, delivers lower real rates of interest and stimulates investment. This is particularly important for the euro area in raising long run economic growth.
- **income and wealth distribution** – inflation redistributes income and wealth (disadvantaging savers, those on fixed incomes or those with weak bargaining power). Price stability avoids this problem. It is particularly important for the euro area in promoting social and political stability.
- **competitiveness** – inflation above that of the euro area's major trading partners will erode its competitiveness over time. Price stability plays a part in the avoidance of balance of payments problems.

Commentary on the benefits of price stability will seek to set them clearly in the context of the euro area, justify which of the benefits is most important to the euro area or establish the significance of the benefits (for example by linking them to growth and employment). Some candidates might approach commentary through considering the importance of the way in which price stability is defined as part of monetary policy or the problems of measuring inflation. For example, if price stability is defined as a very low rate of inflation there may be costs of pursuing it in terms of growth and employment – the dangers of deflation.

- Level 4** For a commentary on the benefits of price stability. At the top end it is expected that the benefits of price stability or the problems of pursuing it are set in the context of the euro area.
No mention of euro area = 8 marks
Evaluation in context of euro area = 9-10 marks **8-10**
- Level 3** For an analysis of the benefits of price stability which could be in terms of the costs of inflation or the costs of deflation. **5-7**
- Level 2** For an application and critical understanding of the benefits of price stability. **3-4**
- Level 1** For knowledge and understanding of price stability or inflation only. **1-2**

3 Comment on the impact on firms in the euro area of a significant rise in the foreign exchange value of the euro. [15]

Synoptic knowledge

Module 2883 –	Section 5.3.1	Government macro-economic policy objectives and indicators of national economic performance
	(Consequences of instability of exchange rates)	
Module 2881 –	Section 5.1.3	Firms and how they operate
	(Cost of firms, revenues of firms, profit maximisation as the firm's objective)	
	Section 5.1.2	Competitive markets and how they work
	(Determinants of demand in product markets, relationship between price and quantity demanded, price elasticity of demand)	

Outline of content

Analysis of the impact could take one of two approaches or both:

- a significant rise in the foreign exchange value of the euro will impact negatively on exporters based in the euro area. The appreciation of the euro will increase the price of exports in export markets. Ceteris paribus, this will reduce both the volume and euro value of exports. The reduction in export revenue will cause profits to fall. Firms may respond by reducing investment and/or employment or relocating production outside the euro area.
- the impact on importers based in the euro area will be positive. Imports to the euro area will fall in price as a result of the rise in the foreign exchange value of the currency. This will reduce costs, raising profitability and possibly increasing investment and employment.

Commentary on the impact could include one or more of the following (the list is not meant to be exhaustive and candidates may opt to display depth in evaluation rather than breadth):

- size of effects will be determined by the extent of the appreciation (the question signals a significant rise in the foreign exchange value of the euro)
- the impact on exporters will be more pronounced the higher the value of the PED in export markets, and is, therefore, dependent on the nature of exports
- where imported components, raw materials, etc. make up a large % of total costs, the beneficial impact will be more significant
- there will be no impact on euro area firms which do not trade internationally or which do not trade outside the euro area
- the impacts are dependent on whether the appreciation of the euro is against one currency (such as the dollar) or against all currencies – nominal vs effective exchange rate movements
- the impact on exporters may be offset by reductions in costs of production (eg. wages) or rises in productivity
- demand for exports may be determined by other factors, such as non-price factors and rising incomes/economic growth, so price increases may not cause a reduction in demand.

- exporters may reduce prices in euros in order to offset the increase in prices in export markets caused by the rise in the foreign exchange value of the euro;
- the net effect may be difficult to determine if euro area firms are both exporters and importers;
- the impact depends on the time period over which the euro appreciates.

Level 4	For a commentary on the impact on firms in the euro area of a significant rise in foreign exchange value of the euro.	0-15
Level 3	For an analysis of the impact on firms in the euro area of a significant rise in foreign exchange value of the euro.	5-9
Level 2	For an application and critical understanding of the impact on firms in the euro area of a significant rise in foreign exchange value of the euro.	3-4
Level	For knowledge and understanding of exchange rates and/or appreciation of a currency's foreign exchange value only.	1-2

Examples of typical content by level

Level 1 = ER= Price of one currency in terms of another

Level 2 = Appreciation = increase in price of exports and a decrease in the price of imports

Level 3 = Decrease in demand for exports, increase in demand for imports – revenue, profit, costs

Level 4 = Extent of the impact = Level 4 answers must explain the impact of higher export prices/ lower import prices on firms in euro area and then comment.

Where a candidates response is **SOLELY** focused on countries/ economics maximum Level 2.

- 4 Discuss the extent to which membership of the euro area benefits individual economies in the long run. [20]

Synoptic knowledge

Module 2883 – Section 5.8.2 Economic and Monetary Union (EMU)
(The benefits and costs of European monetary union. The microeconomic pros and cons of the euro. The macroeconomic pros and cons of the euro The performance of the eurozone economy, including the performance of national economies within the eurozone)

Outline of content

The benefits of membership of the euro area include:

- **elimination of transaction costs** – membership eliminates the costs of exchanging currencies in trade with the rest of the euro area. These are ongoing benefits in the long run and reduce the costs of trade, reducing prices, reducing the scope for price discrimination.
- **reduced exchange rate uncertainty** – the exchange rate risk in trade with other members of the euro area is eliminated. Lower real rates of interest are likely. This is likely to lead to greater consumption and investment and, therefore, economic growth as it creates certainty in trade. Again, this is an on-going benefit.
- **greater price transparency** – prices in a single currency are more easily comparable leading to greater competition and trade amongst members of the euro area. This promotes economic growth and employment. The benefit is on-going.

There are costs of membership of the euro area, including:

- **loss of monetary policy sovereignty** – the ability to determine interest rates to suit the individual circumstances of the economy may lead to problems (for some economies may be high inflation, for others low growth).
- **restriction on the use of fiscal policy** – the Stability and Growth Pact constrains an economy's ability to use deficit financing to cushion the impact of recession.
- **lack of real convergence** – an extension of the above two points.
- **price increases** – conversion to the euro may result in one-off hikes in prices as firms take advantage of the uncertainty created in the switch from one currency to another.

Analysis of the benefits requires more than just explanation of each benefit. There should be an attempt to explain how they will impact on economic growth, inflation and unemployment.

Commentary on the extent of the benefits clearly requires recognition that there may be costs of membership as well as benefits. Higher level evaluation will focus or prompt to consider the long run impact of membership. This will require a discussion of the significance of the costs of membership relative to the benefits. Extract 5 provides some of the context for this discussion. Membership of the euro area in the long run requires supply-side improvements to raise productivity. The extent of the benefits and costs depends on the degree of real convergence and integration with the euro area.

Level 4	For a discussion of the extent to which membership of the euro benefits individual economies in the long run.	12-20
	Band 2 – in this band discussion will focus on the long run aspect of the question and be developed beyond simple points or statements and include explanation, justification and judgement.	17-20
	Band 1 – answers in this Band will consider the benefits and costs of membership of the euro area but will not address the long run aspect and the balance between the two.	12-16
Level 3	For an analysis of either the benefits of membership of the euro area or the costs but not both.	5-9
Level 2	For an application and critical understanding of the benefits and/or costs of membership of the euro area, but containing no economic analysis.	3-4
Level 1	For knowledge and understanding of the euro area only.	1-2

Grade Thresholds

Advanced GCE Economics (3812/7812))
January 2009 Examination Series

Unit Threshold Marks

Unit		Maximum Mark	A	B	C	D	E	U
2881	Raw	45	34	31	28	25	22	0
	UMS	90	72	63	54	45	36	0
2882	Raw	45	32	28	24	21	18	0
	UMS	90	72	63	54	45	36	0
2883	Raw	45	36	32	28	25	22	0
	UMS	120	96	84	72	60	48	0
2884	Raw	45	31	28	25	22	20	0
	UMS	90	72	63	54	45	36	0
2885	Raw	45	32	29	27	25	23	0
	UMS	90	72	63	54	45	36	0
2886	Raw	45	33	30	27	24	22	0
	UMS	90	72	63	54	45	36	0
2887	Raw	45	32	28	24	20	17	0
	UMS	90	72	63	54	45	36	0
2888	Raw	60	45	39	34	29	24	0
	UMS	120	896	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	16.9	44.3	73.8	90.4	97.4	100	497
7812	24	60.8	85.6	96	100	100	135

632 candidates aggregated this series

For a description of how UMS marks are calculated see:

http://www.ocr.org.uk/learners/ums_results.html

Statistics are correct at the time of publication.

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