AQA A-LEVEL ECONOMICS

ECONOMICS



EXAM QUESTION PACK

UNIT 3 OLD SPECIFICATION PAPERS

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General Certificate of Education
Advanced Level Examination
June 2013

Economics ECON3

Unit 3 Business Economics and the Distribution of Income

Tuesday 4 June 2013 1.30 pm to 3.30 pm

For this paper you must have:
- an AQA 12-page answer book
- a calculator.

Time allowed
- 2 hours

Instructions
- Use black ink or black ball-point pen. Pencil should only be used for drawing.
- Write the information required on the front of your answer book. The **Examining Body** for this paper is AQA. The **Paper Reference** is ECON3.
- In **Section A**, answer **EITHER** Context 1 **OR** Context 2.
- In **Section B**, answer **one** essay.

Information
- The marks for questions are shown in brackets.
- The maximum mark for this paper is 80.
- There are 40 marks for **Section A** and 40 marks for **Section B**.
- This paper is synoptic. It assesses your understanding of the relationship between the different aspects of Economics.
- You will be marked on your ability to:
  – use good English
  – organise information clearly
  – use specialist vocabulary where appropriate.

Advice
- You are advised to spend 1 hour on **Section A** and 1 hour on **Section B**.

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Section A

Answer **EITHER** Context 1 **OR** Context 2.

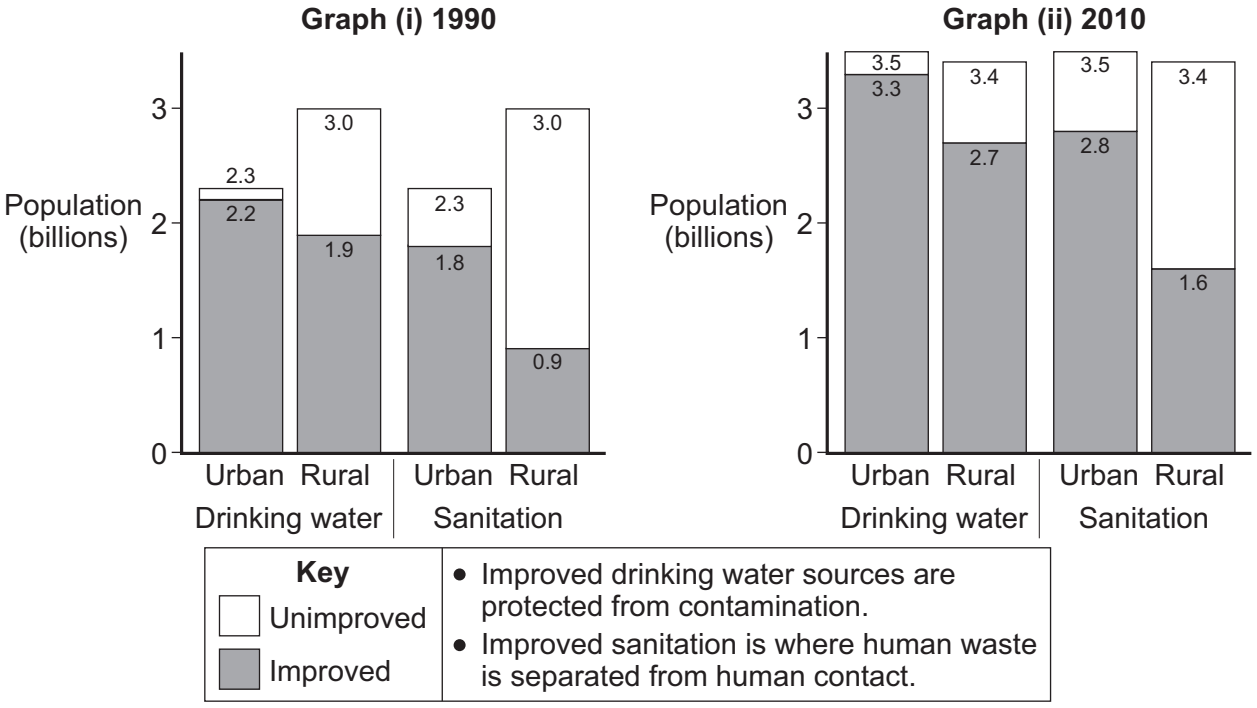
EITHER **Total for this Context: 40 marks**

Context 1

THE GLOBAL CONTEXT

Study **Extracts A**, **B and C**, and then answer **all** parts of Context 1 which follow.

Extract A: World population access to drinking water and sanitation



Source: Unicef and World Health Organisation, www.unicef.org/media/files/JMPreport2012.pdf accessed 25 November 2012.

Extract B: Water, water everywhere

Access to clean water is closely linked to production, income and wealth, both within and between countries. This planet is mainly covered in water, and water might appear to be a free good. However, only a small proportion can be used to support human life and even this is not freely available to all.

As underground water levels drop in industrialised countries, and as waterways become polluted, some places, like southern Spain, are desperately short of water. Meanwhile, poorer countries, such as Bangladesh, sometimes suffer from too much water, with sudden disastrous floods. Unlike developed countries, such as the Netherlands, they cannot afford flood defence infrastructure. In Kenya, people living in villages without drinkable water can see irrigation systems in nearby fields spraying water over vegetables and flowers being grown for export to Europe.

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There are problems with property rights to water. Indeed, some experts have predicted that, during the twenty-first century, countries controlling the world's fresh water supplies will be in a similarly powerful position to that of the twentieth century's oil producers, and that wars might even take place because of disputes over water.

The supply and use of water result in many externalities, both positive and negative. One-third of the water used by UK households is flushed down the toilet. The water used to carry human waste through sewers has to be kept separate from drinking water. When the water industry was privatised by the UK Government, shares were sold in 'water and sewerage businesses', and these companies were regulated by OFWAT (The Water Services Regulation Authority) for their commercial activities as regional monopolies, and by the Environment Agency for their wider impact such as the extraction of water from rivers.

In recent years, several regions of the UK have repeatedly been declared to be suffering from 'drought', and there has been some debate over which policy responses are appropriate. These include hosepipe bans, metering of water supplies, a national 'grid' for transporting water around rivers and canals, and more reservoirs. The privatised companies have made massive investment in infrastructure which has transformed polluted rivers such as the Wandle, near London, from open sewers into trout streams, but further measures are necessary to prevent annual droughts.

Extract C: A lot of bottle

The global market for bottled water is dominated by a small number of large firms, and demonstrates another of the curiosities of globalisation. A plastic bottle of water contains two of the world's most precious commodities: oil and water. Many millions of people, living in absolute poverty, are in need of clean water, and yet the water bottling industry in the more developed countries transports water from people who have water to other people who already have water. Critics say that, in terms of productive resources, it takes three litres of water and one-fifth of a litre of oil to manufacture one litre of bottled water and transport it to a shop shelf.

In the UK, drinking water is cheap, and if unmetered it is even 'free' in terms of marginal cost to the user. Safe drinking water is available on tap through water mains almost anywhere. Thames Water estimates that a litre of mains water creates 600 times less carbon dioxide than a litre of bottled water. Yet the British public spends over £2 billion each year on bottled water, relying mainly on local councils to dispose of the resulting 3 billion plastic bottles.

0 1 Using **Extract A**, identify **two** significant points of comparison between 1990 and 2010 for the data shown in **Graphs (i)** and **(ii)**. *(5 marks)*

0 2 Explain what is meant by 'absolute poverty' **(Extract C**, line 4) **and** analyse how access to clean water is 'closely linked to production, income and wealth, both within and between countries' (**Extract B**, lines 1 and 2). *(10 marks)*

0 3 'The supply and use of water result in many externalities, both positive and negative' (**Extract B**, line 16).

Using the data and your economic knowledge, evaluate UK government policies that could be used to deal with problems associated with the supply and use of water. *(25 marks)*

Turn over ▶

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Do **not** answer Context 2 if you have answered Context 1.

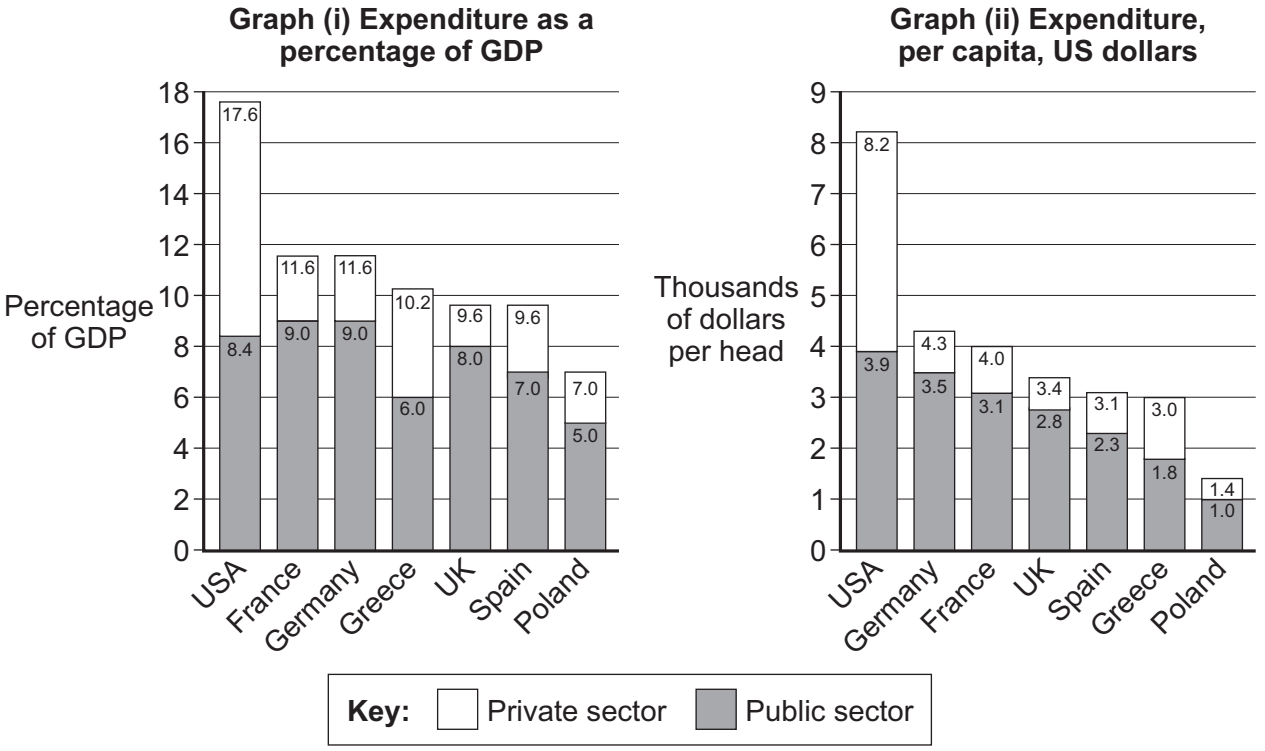
OR **Total for this Context: 40 marks**

Context 2

THE EUROPEAN UNION CONTEXT

Study **Extracts D**, **E and F**, and then answer **all** parts of Context 2 which follow.

Extract D: Health expenditure in the USA and selected EU countries, 2010



Source: OECD, www.oecd.org/united states/BriefingNoteUSA2012.pdf accessed 7 January 2012.

Extract E: The price of health

The European Health Insurance Card (EHIC) is issued free to EU citizens via national governments. It allows anyone entitled to state health care in their home country to receive basic medical treatment in another member state for free or at a reduced cost. While there is no charge for the EHIC, insurance-based health care systems generally involve the purchase of a policy from a company which then pays for treatment for people whose medical conditions are covered.

The UK's National Health Service (NHS) is predominantly in the public sector and is mostly paid for out of taxation. Treatment is 'universal', available to all UK citizens, and usually to visitors as well. While there are some treatments for which charges might be made, for example, for some dental work and spectacles, a guiding principle of the founders of the NHS was that treatment should be based on 'need' rather than 'ability to pay', and provided 'free at the point of use'. In the UK there is also a private sector consisting of hospitals and other facilities. They mostly work with commercial health insurance companies, but they can undertake some work on contract for the NHS.

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In Germany, private health care is used approximately twice as much by patients as it is in the UK, but this does not necessarily mean that patients pay directly for their treatment. Roughly one-third of German hospitals are owned by the state, another third are not-for-profit organisations and the remaining third are in the private sector. German citizens can use any hospital in the system.

The founders of the NHS thought that its costs would fall as living standards rose and the population became healthier. However, when the state or an insurance company acts between the patient and the health provider, the patient's price elasticity of demand for medical treatment is likely to be very low, while income elasticity of demand is likely to be high. Costs have increased due to these unusual elasticities, together with new drugs, more sophisticated medical technology, a wider range of treatments, more complex procedures and increased life expectancy.

Extract F: UK health reforms

Many ideas in the UK for coping with rising health care costs are imported from other EU countries. For example, in 2002, the Labour Government introduced the idea of 'Foundation Trust Hospitals', which had been tried in Spain. These not-for-profit organisations are able to set their own clinical and financial priorities and have greater freedom to borrow money, invest their surpluses, and form public-private partnerships. Meanwhile, in Spain, some doctors were complaining that their newly formed Foundation Hospitals had fewer beds, fewer staff and more complaints from patients than before. Some hospitals were returned to their former status because they were said to be bureaucratic, inefficient and 'cherry-picking', that is choosing the easiest patients to treat.

During 2011 and 2012, the UK Coalition Government legislated for NHS reforms, promoting the idea of an 'internal market' in health provision, with local doctors working in groups to buy hospital services on behalf of their patients. In February 2012, a hospital in East Anglia was the first in the NHS to be taken over by a private company, which hoped to clear the hospital's £45m debts and make it 'profitable' by 'competing' for patients with neighbouring hospitals.

0 4 Using **Extract D**, calculate to one decimal place the percentage of total per capita health expenditure that takes place in the public sector in the UK, **and** identify **one** significant point of comparison between countries for the data shown. *(5 marks)*

0 5 Distinguish between price elasticity of demand and income elasticity of demand, **and** analyse why, when people have medical insurance, the price elasticity of demand for medical treatment might be 'very low' while the income elasticity of demand is 'likely to be high' (**Extract E**, lines 22 to 24). *(10 marks)*

0 6 'Many ideas in the UK for coping with rising health care costs are imported from other EU countries' (**Extract F**, lines 1 and 2).

Using the data and your economic knowledge, assess whether the UK Government should encourage greater use of market forces in the provision of health care. *(25 marks)*

Turn over for the next section

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Section B

Answer **one** essay from this section.

Each essay carries 40 marks.

EITHER

Essay 1

0 7 Explain why the average and marginal revenue curves of a perfectly competitive firm are horizontal, while those of a monopoly slope downwards. *(15 marks)*

0 8 'Most people would say that the ending of the BT telephone monopoly, and competition in the telecommunications market, have been beneficial. However, Britain's railways show why some monopolies should not be replaced by a number of competing firms.'

Evaluate the view that consumers are always better off and producers are always worse off if monopolies are broken up to encourage as much competition as possible. *(25 marks)*

OR

Essay 2

0 9 In January 2012, a BBC consumer programme reported that British nationals living in Florida were paying £3000 for a return flight to London, while the same airline was charging British tourists flying from London £300 for a return flight to Florida.

Explain the market conditions that enable firms to charge different customers different prices for a product. *(15 marks)*

1 0 Assess whether price discrimination is always undesirable. *(25 marks)*

OR

Essay 3

1 1 'Although the wage differential has increased between top executives and other employees, the government cannot tell people what they should be paid. However, it should act where there has been market failure, because labour markets are not perfect.'

Explain **three** reasons why labour markets may be imperfectly competitive. *(15 marks)*

1 2 Assess the view that wide wage differentials are good for the economy and that governments should therefore play no part in deciding wage rates. *(25 marks)*

END OF QUESTIONS

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General Certificate of Education (A-level)
June 2013

Economics ECON3

(Specification 2140)

Unit 3: Business Economics and the Distribution of Income

Final

Mark Scheme

Mark schemes are prepared by the Principal Examiner and considered, together with the relevant questions, by a panel of subject teachers. This mark scheme includes any amendments made at the standardisation events which all examiners participate in and is the scheme which was used by them in this examination. The standardisation process ensures that the mark scheme covers the students' responses to questions and that every examiner understands and applies it in the same correct way. As preparation for standardisation each examiner analyses a number of students' scripts: alternative answers not already covered by the mark scheme are discussed and legislated for. If, after the standardisation process, examiners encounter unusual answers which have not been raised they are required to refer these to the Principal Examiner.

It must be stressed that a mark scheme is a working document, in many cases further developed and expanded on the basis of students' reactions to a particular paper. Assumptions about future mark schemes on the basis of one year's document should be avoided; whilst the guiding principles of assessment remain constant, details will change, depending on the content of a particular examination paper.

Further copies of this Mark Scheme are available from: aqa.org.uk

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June 2013 **ECON3**

Advanced Level Economics Unit 3

General Instructions

Marks awarded to students should be in accordance with the following mark scheme and examiners should be prepared to use the full range of marks available. The mark scheme for most questions is flexible, permitting the candidate to score full marks in a variety of ways. Where the candidate's response to a question is such that the mark scheme permits full marks to be awarded, full marks **MUST** be given. A perfect answer is not necessarily required for full marks. But conversely, if the candidate's answer does not deserve credit, then no marks should be given.

Occasionally, a candidate may respond to a question in a reasonable way, but the answer may not have been anticipated when the mark scheme was devised. In this situation, **OR WHENEVER YOU HAVE ANY DOUBT ABOUT THE INTERPRETATION OF THE MARK SCHEME**, you must in the first instance telephone your team leader to discuss how to proceed.

Two approaches have been used in the construction of the mark scheme.

(i) **An issue based approach.** The mark scheme for parts **01**, **02**, **04** and **05** of the data response questions and the first part of each essay question adopts this approach. The mark scheme lists the marks that can be awarded for particular issues (and associated development) that the candidate might include in the answer.

(ii) **A levels approach.** This approach is used for parts **03** and **06** of the data response questions and the second part of each essay question. The Levels Mark Scheme on the next page identifies five levels representing differences in the quality of work. A range of marks is allocated to each level. First decide the level into which an answer falls. The level chosen should be the one which **best fits** the answer provided by the candidate. It is **not** intended that the answer should satisfy every statement in the level description. Then think in terms of awarding the mid-point mark which has been identified for that level (eg 13 marks for Level 3). Move up or down from this notional mark by considering the extent to which the answer meets the level description overall. Strength in one skill can outweigh weakness in another. When using the Levels Mark Scheme the marker **must** identify where a particular skill is being demonstrated. The **key** to be used to identify the skill is given after the level descriptions. The question-specific mark scheme summarises the information which could be used to answer the question, but without attaching marks to particular issues.

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AQA ADVANCED LEVEL (A2) ECONOMICS
LEVELS OF RESPONSE MARK SCHEME

FOR USE WITH QUESTIONS 03, 06, 08, 10 AND 12 ONLY

A2 **LEVELS OF RESPONSE**	**AO1** **KNOWLEDGE and UNDERSTANDING of theories, concepts and terminology**	**AO2** **APPLICATION of theories, concepts and terminology**	**AO3** **ANALYSIS of economic problems and issues**	**AO4** **EVALUATION of economic arguments and evidence, making informed judgements**
Level 5 22-25 marks (mid-point 24) **Good analysis and good evaluation**	Good throughout the answer with few errors and weaknesses	Good application to issues Where appropriate, good use of data to support answer	Relevant and precise with a clear and logical chain of reasoning Good awareness of the inter-relatedness of economic issues	Good with a clear final judgement
Level 4 17-21 marks (mid-point 19) **Good analysis but limited evaluation** **OR** **Reasonable analysis and reasonable evaluation**	Good throughout the answer with few errors and weaknesses Good throughout much of the answer with few errors and weaknesses	Good application to issues Where appropriate, good use of data to support answer Some good application to issues Where appropriate, some good use of data to support answer	Relevant and precise with a clear and logical chain of reasoning Good awareness of the inter-relatedness of economic issues Largely relevant and well organised with reasonable logic and coherence Some awareness of the inter-relatedness of economic issues	Limited but showing some appreciation of alternative points of view Reasonable, showing an appreciation of alternative points of view
Level 3 10-16 marks (mid-point 13) **Reasonable answer, including some correct analysis but very limited evaluation**	Satisfactory but some weaknesses shown	Reasonable application to issues Where appropriate, reasonable use of data to support answer	Reasonably clear but may not be fully developed and is perhaps confused in places with a few errors present Quite well organised with some logical development	Superficial, perhaps with some attempt to consider both sides of the issue(s)
Level 2 4-9 marks (mid-point 7) **Weak with some understanding**	Limited and some errors are made	Partial application to issues with some errors Where appropriate, limited use of data to support answer	Partial but confused at times, lacking focus and development Limited logic and coherence	A very basic and simplistic attempt is made which is unsupported by analysis
Level 1 0-3 marks (mid-point 2) **Very weak**	Weak with a number of errors	Little, if any, application to issues Where appropriate, no use of data to support answer	Poor and lacking clarity and focus	No relevant evaluation

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THE KEY TO BE USED WHEN USING THE LEVELS MARK SCHEME

D Where a particular economic term is correctly **DEFINED** in order to help the candidate to answer the question properly.

I Where a relevant **ISSUE** is raised by the candidate.

K Where the candidate demonstrates **KNOWLEDGE** of recent developments or features of the economy which help enhance the candidate's response to the question. This should also be used where the candidate quotes relevant examples.

Ap Where the candidate demonstrates the ability to **APPLY** knowledge and **CRITICAL UNDERSTANDING** to problems and issues.

An Where the candidate demonstrates the ability to **ANALYSE** the problem using appropriate economic ideas.

E Where the candidate **EVALUATES** and makes judgements about the significance of various issues and arguments.

Synoptic Assessment
All questions in this unit are synoptic. Therefore, students will need to demonstrate that they are able to think as an economist and to use effectively the economist's 'tool kit' of concepts, theories and techniques.

Students should demonstrate that they:
- understand the inter-relatedness of many economic issues, problems and institutions;
- understand how certain economic concepts, theories and techniques may be relevant to a range of different contexts;
- can apply concepts, theories and techniques in analysing economic issues and problems and in evaluating arguments and evidence.

QUALITY OF WRITTEN COMMUNICATION

Quality of Written Communication (QWC) will be assessed in Questions 03, 06, 08, 10 and 12 only.

Students will be assessed according to their ability to:

- ensure that text is legible, and that spelling, grammar and punctuation are accurate, so that meaning is clear
- select and use a form and style of writing appropriate to purpose and complex subject matter
- organise information clearly and coherently, using specialist vocabulary when appropriate.

No specific marks are awarded for QWC.

However, examiners should take into account QWC when determining the mark to be awarded for an answer. This means an answer could be taken either up (for exceptional QWC) or down (for very poor QWC) by 1 mark (and no more).

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1 THE GLOBAL CONTEXT — Total for this Context: 40 marks

01	Using **Extract A**, identify **two** significant points of comparison between 1990 and 2010 for the data shown in **Graphs (i)** and **(ii)**. *(5 marks)*

Identifying two significant points of comparison between years.

For each point:

For identifying a significant point of comparison **(1 mark)** and providing relevant supporting data **(2 marks)**. Without units, **max 2 marks**.	**Up to 3 marks**
For identifying a feature, with units, but no comparison.	**1 mark**
For a 'trawl' through the numbers with no significant point of comparison identified or for simply providing an item of data.	**0 marks**

Significant points of comparison between years include

- for urban population the gap between improved and unimproved drinking water increases from 0.1 bn to 0.2 bn
- total rural population increases from 3.0 to 3.4 billion, while improved sanitation increases slightly more, from 0.9 billion to 1.6 billion
- unimproved drinking water for the rural population reduces from 1.1 billion in 1990 to 0.7 billion in 2010
- improved sanitation for urban population increases from 1.8 billion in 1990 to 2.8 billion in 2010.

MAXIMUM FOR PART 01: 5 MARKS

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02	Explain what is meant by 'absolute poverty' (**Extract C**, line 4) **and** analyse how access to clean water is 'closely linked to production, income and wealth, both within and between countries' (**Extract B**, lines 1and 2). *(10 marks)*

Explanation:	
For a relevant explanation or definition of absolute poverty, eg in terms of a lack of access **(2 marks)** to a recognised minimum amount of resources **(2 marks)**. An example of a criterion, eg 'living on a dollar a day' **(2 marks)**. For contrasting 'absolute' with relative **(2 marks)**.	**Up to 4 marks**

Maximum 4 marks for the explanation

Analysis of the links: Award 1 mark for each step in a logical chain of reasoning.

For example:

- ownership of water resources gives a source of income and wealth **(1 mark)** to those with the property rights **(1 mark)** since the water can be traded **(1 mark)** or used in production **(1 mark)** eg in agriculture or industry **(1 mark)**
- in turn, people with more income and/or wealth are more likely to have access **(1 mark)** to water than poorer people because they have a greater ability to pay **(1 mark)**
- richer countries can afford to invest in the necessary infrastructure **(1 mark)** such as reservoirs, pipelines **(1 mark)**
- irrigation **(1 mark)** improves the land and enables countries to lift themselves out of subsistence agriculture **(1 mark)**
- access to cheap clean water reduces the cost of living **(1 mark)** and boosts real income **(1 mark)**.

Up to 8 marks for the analysis

For making appropriate use of diagrams, eg supply of and demand for water.	**Up to 2 marks per diagram (1 mark for labelling, 1 mark for correct information shown) to a maximum of 3 marks**

A candidate can be awarded a maximum of **6 marks** for the analysis if the explanation has not been attempted.

MAXIMUM FOR PART 02: 10 MARKS

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03	'The supply and use of water results in many externalities, both positive and negative' (**Extract B,** line 16). Using the data and your economic knowledge, evaluate UK government policies that could be used to deal with problems associated with the supply and use of water. *(25 marks)*

In this part of the question, candidates will need to demonstrate that they are able to evaluate issues and arguments to support a conclusion if they are to be awarded **more than 15 marks**.

Where there is no **explicit** reference to the data, award a maximum of **21 marks**.

Level 5	**Good analysis <u>and</u> good evaluation**	**22-25 marks** *Mid-point 24*
Level 4	**Good analysis <u>but</u> limited evaluation** **OR** **Reasonable analysis <u>and</u> reasonable evaluation**	**17-21 marks** *Mid-point 19*
Level 3	**Reasonable answer, including some correct analysis but very limited evaluation**	**10-16 marks** *Mid-point 13*
Level 2	**Weak with some understanding**	**4-9 marks** *Mid-point 7*
Level 1	**Very weak**	**0-3 marks** *Mid-point 2*

Candidates can approach the question with a focus on the UK government or government in general. Either approach can gain full marks. Also, they can focus on 'externalities' or wider 'problems' of market failure.

Issues and areas for discussion include:

Introduction	• definitions/descriptions of, eg o externalities o positive and negative • clean water as a merit good • polluted water as a demerit good.
Developing the response to the question (Application)	• relevant use of theory, eg private costs, benefits, social costs, benefits • evidence from the data, eg reference to • pressures on drinking water • lowering of water tables • floods • polluted wells, sanitation • unnecessary waste (bottled water) • costs in terms of oil • private (personal) health benefits of clean water • external health benefits of clean water (avoidance of contagious disease) • environmental issues arising from above points

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Developing the response to the question (analysis)	• wider environmental issues, and international comparisons, eg o floods in Bangladesh, drought in southern Spain; o Britain's case of universal drinking water (a result of infrastructure investment over generations). • discussion of water as a private/public/merit good • consequences of different views of the economic nature of water, in terms of government policy, eg • a private good implies privatisation and marginal cost pricing; a public good implies nationalisation and payment out of taxation • a merit good (clean water, good sanitation) implies social benefits exceeding private benefits and under supply/ under consumption, and an argument for direct government provision or subsidy • a de-merit good (unfit water, poor sanitation) implies social costs exceeding private costs and over supply/over consumption, and an argument for government action to remove the negative externalities (eg making the polluter pay) • regulation versus de-regulation • policies for supply • policies for use.
Evaluation	• reasons why market failure/externalities/environmental grounds might be a reason for having a special view of the economics of water; eg water is ubiquitous and a fundamental part of the environment; a basic of life • use of markets to distribute water (eg trade in licences to abstract water) • inequality in buying power, eg utilities can pass costs of buying water along their supply chain to customers; smaller firms, eg farmers, cannot • providing sanitation and clean drinking water cost money, and there is a role for commercialisation (eg there is a debate in the UK about how water should be priced; there is clearly a consumer demand for water in plastic bottles) • balance of advantages and disadvantages of governments regarding water as a merit good • consideration of costs and benefits of, eg o government action o the bottled water industry o alternative uses for water • role of government in general in water-related matters • role of UK government in particular • discussion of whether the UK has consistently regarded water as a 'merit good' ('water and sewerage' businesses have been privatised; however, they have also been strongly regulated) • market failure versus government failure *Examiners should note that, for some of the weaker or average candidates, parts of the above represent quite sophisticated evaluation and so it is important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.*
Also give credit for	• relevant diagrams • an overall judgement on the issues raised.

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It will only be possible for students to consider a few of the above. They may also discuss issues not discussed above.

USE THE DETAILED LEVELS MARK SCHEME ON PAGES 4 AND 5 FOR FURTHER CLARIFICATION

MAXIMUM FOR PART 03: 25 MARKS

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2 THE EUROPEAN UNION CONTEXT — Total for this Context: 40 marks

04 Using **Extract D**, calculate to one decimal place the percentage of total per capita health expenditure that takes place in the public sector in the UK, **and** identify **one** significant point of comparison between countries for the data shown.

(5 marks)

The calculation

The correct answer is 82.4% (max **2 marks** without 'per cent' or %)	**3 marks**
Another answer between 82 and 83 inclusive, irrespective of decimal places.	**2 marks**
For showing a correct method but arriving at a wrong number, ie $\frac{\text{any number}}{\text{any number}} \times 100 = \text{wrong number}$	**1 mark**

Identifying one significant point of comparison	
For identifying a significant point of comparison (**1 mark**) and providing relevant supporting data (**2 marks**). Max **2 marks** without units (% or thousands of dollars).	**Up to 3 marks**
For identifying a feature, with units, but no comparison.	**1 mark**
For a 'trawl' through the numbers with no significant point of comparison identified or for simply providing an item of data.	**0 marks**

Significant points of comparison between countries include:

- The USA has a higher expenditure on health as a percentage of GDP (17.6%) than the UK (9.6%)
- France has a larger gap between private and public expenditure in terms of percentage of GDP than UK (2.6% compared with 1.6%)
- Germany has a larger gap between private and public in terms of dollars per head than UK ($800 compared with $600)
- Greece and Spain (totals 10.2% and 9.6%) in Graph (iii) exchange rank order places in Graph (iv) with expenditures of $3100 and $3000 per head
- The USA has a significantly higher expenditure in both percentage terms (17.6%) and spending per head ($8200) compared with any of the EU countries shown (appropriate figures quoted).

MAXIMUM FOR PART 04: 5 MARKS

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05	Distinguish between price elasticity of demand and income elasticity of demand, **and** analyse why, when people have medical insurance, the price elasticity of demand for medical treatment might be 'very low' while the income elasticity of demand is 'likely to be high' (**Extract E**, lines 22 to 24). *(10 marks)*

Explanation	
For defining/distinguishing between price elasticity (responsiveness of the quantity demanded to a change in price) **(2 marks**) and income elasticity of demand (responsiveness of quantity demanded to a change in income) **(2 marks).** Formulae **(2 marks)**.	**Up to 4 marks**

Maximum 4 marks for the explanation

Analysis of the reason: Award 1 mark for each step in a logical chain of reasoning. For example:	
• (PED) The link between the consumer and price **(1 mark)** is broken by insurance **(1 mark**) and the purchasing decision is now taken by the insurance company **(1 mark)** or by the state **(1 mark)** or its agent (eg the GP **(1 mark)**. The patient will want life saving treatment whatever the price **(1 mark)**. However some people are not members of insurance schemes **(1 mark)** or might not qualify for state provision **(1 mark)**. • assymetric information; unpredictability of medical need • universal state provision replaces price rationing with the queue (or waiting list) insurance enables people to jump the queue • (YED) Higher incomes make insurance more affordable • arguable that people on higher incomes will be more aware of treatments available • possibility of unnecessary treatments and procedures, eg cosmetic surgery for vanity reasons • meaning of high/low/price/income elasticity.	
Up to 8 marks for the analysis **Maximum of 6 marks for the analysis if either YED or PED is not addressed here**	
Make appropriate use of diagrams, eg demand curves related to PED and YED.	**Up to 2 marks per diagram (1 mark for labelling, 1 mark for correct information shown) to a maximum of 3 marks**

A candidate can be awarded a maximum of **6 marks** for the analysis if the explanation has not been attempted.

MAXIMUM FOR PART 05: 10 MARKS

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06	**'**Many ideas in the UK for coping with rising health care costs are imported from other EU countries.' (**Extract F**, lines 1 and 2). Using the data and your economic knowledge, assess whether the UK Government should encourage greater use of market forces in the provision of health care. *(25 marks)*

In this part of the question, candidates will need to demonstrate that they are able to evaluate issues and arguments to support a conclusion if they are to be awarded **more than 15 marks**.

Where there is no **explicit** reference to the data, award a maximum of **21 marks**.

Level 5	**Good analysis <u>and</u> good evaluation**	**22-25 marks** *Mid-point 24*
Level 4	**Good analysis <u>but</u> limited evaluation** **OR** **Reasonable analysis <u>and</u> reasonable evaluation**	**17-21 marks** *Mid-point 19*
Level 3	**Reasonable answer, including some correct analysis but very limited evaluation**	**10-16 marks** *Mid-point 13*
Level 2	**Weak with some understanding**	**4-9 marks** *Mid-point 7*
Level 1	**Very weak**	**0-3 marks** *Mid-point 2*

Issues and areas for discussion include

Introduction	• definition of market forces • distinction between insurance-based and tax-base systems • importance of the NHS 'free at the point of use' principle.
Developing the response to the question (Application)	• use of theory (monopoly, competition, efficiency) • discussion based on information from the data related to eg • practice in France • practice in Germany • practice in Spain • coordination across the EU (The EHIC) • US views of the 'European Model' • charging • internal markets • public-private partnerships.
Developing the response to the question (Analysis)	• the nature of health services o degree of monopoly; contestable markets o imperfect/asymmetric information o externalities

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	• arguments for markets, eg o rationing/signalling o choice o de-centralisation o opportunity costs o efficiency. • arguments against, eg o market failure, externalities o merit good o income distribution o imperfect information o needs and wants o economies of scale.
Evaluation	• efficacy of privatisation • critique of idea of increased choice for patients/competition between providers • bureaucracy of health reforms, eg doctors having to spend time commissioning services • comments on alternative arrangements, eg the German split between public, private, not-for-profit • possibility of 'cherry picking' by the private sector • NHS having to underwrite the private sector's errors, eg recent cases of implants • possibility that insurance leads to unnecessary procedures • economies/diseconomies of scale in the NHS • outcomes and results of PPPs • does the 'ownership' of assets and resources matter more than outcomes? • market failure versus government failure • possibility that innovation in health care comes from government funded investment rather than private sector investment. *Examiners should note that, for some of the weaker or average students, parts of the above represent quite sophisticated evaluation and so it is important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.*
Also give credit for	• diagrams • an overall judgement on the issues raised.

It will only be possible for candidates to consider a few of the above. They may also discuss issues not discussed above.

USE THE DETAILED LEVELS MARK SCHEME ON PAGES 4 AND 5 FOR FURTHER CLARIFICATION

MAXIMUM FOR PART 06: 25 MARKS

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SECTION B

Essay 1 **Total for this Essay: 40 marks**

07	Explain why the average and marginal revenue curves of a perfectly competitive firm are horizontal, while those of a monopoly slope downwards. *(15 marks)*

For relevant definitions, eg average revenue, marginal revenue, perfect competition (eg large number of buyers and sellers), monopoly (single/dominant firm).	**Up to 2 marks per point defined or explained to a maximum of 4 marks**

For explanation of the shape of average and marginal revenue curves under perfect competition (up to 10 marks) and monopoly (up to 10 marks). Award 1 mark for each step in a logical chain of reasoning.	
For example:	
• Perfect competition: the firm is small compared to the industry **(1 mark)** with no entry/exit barriers (**1 mark**) and is therefore a price taker **(1 mark)** it can clear its production lines if it sells at the current market price **(1 mark)**. Since it can clear production lines at the current market price it would be irrational (assuming profit maximisation) to sell below that price **(1 mark)**. If the seller tries to sell above the market price, demand will disappear (or price elasticity of demand is infinity) **(1 mark)**, because of perfect knowledge **(1 mark)** and homogeneous products (or products being perfect substitutes **(1 mark)**. While the market demand curve is downward sloping **(1 mark)** the seller-perceived demand curve (demand curve for the output of the firm) is horizontal **(1 mark)** and therefore AR = MR **(1 mark)**. • Monopoly: the firm is the industry and the firm has some control over price; the downward sloping market demand curve is the firm's average revenue line. Because the firm reduces price to increase quantity demanded or increases price to reduce quantity demanded MR also slopes downwards and MR is less than AR at each level of quantity. • Geometrical relationships.	
Use of diagrams to support the explanation, eg AR and MR for perfect competition and monopoly.	**Up to 2 marks per diagram (1 mark for labelling, 1 mark for information shown) to a total of 4 marks**. **A complex diagram, eg showing perfect competition and monopoly together, can be awarded up to 4 marks**

MAXIMUM OF 10 MARKS for the answer if only average or marginal revenue is addressed.

MAXIMUM FOR PART 07: 15 MARKS

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08 'Most people would say that the ending of the BT telephone monopoly, and competition in the telecommunications market, have been beneficial. However, Britain's railways show why some monopolies should not be replaced by a number of competing firms.'

Evaluate the view that consumers are always better off and producers are always worse off if monopolies are broken up to encourage as much competition as possible. *(25 marks)*

In this part of the question, candidates will need to demonstrate that they are able to evaluate issues and arguments to support a conclusion if they are to be awarded **more than 15 marks**.

Level 5	**Good analysis <u>and</u> good evaluation**	**22-25 marks** *Mid-point 24*
Level 4	**Good analysis <u>but</u> limited evaluation** **OR** **Reasonable analysis <u>and</u> reasonable evaluation**	**17-21 marks** *Mid-point 19*
Level 3	**Reasonable answer, including some correct analysis but very limited evaluation**	**10-16 marks** *Mid-point 13*
Level 2	**Weak with some understanding**	**4-9 marks** *Mid-point 7*
Level 1	**Very weak**	**0-3 marks** *Mid-point 2*

Issues and areas for discussion include:

Introduction	• definitions of monopoly, competition. Examples.
Developing the response to the question **Application/ Analysis**	**Application** • candidates might use some pre-existing knowledge of telecommunications and/or the UK railway system. They might mention Network Rail, the train operating companies (TOCs) and the rolling stock companies (Roscos) • equally, they might have a general appreciation that some organisations require central direction and coordination, and benefit from having a 'general' at the apex of a decision making pyramid. They can argue that railways are in that category, due to the need for coordination in terms of ticketing, timetabling. Long term investment, etc • the question is worded so that candidates can achieve full marks without reference to telecoms or railways, but can cite other examples.

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	Analysis • basic concepts, producer surplus, consumer surplus • basic idea that monopolists reduce output to push up price consumer surplus becomes producer surplus • there is also a deadweight loss • welfare transfers and welfare losses between producers and consumers when monopolies are broken up o without consideration of scale economies o with consideration of scale economies • effects of wider considerations, eg technological change employment, international competition • natural monopoly • efficiency concepts: productive, allocative.
Evaluation	• consideration of the word 'always' contained in the question • question of whether breaking up a monopoly leads to 'perfect' competition, or merely replaces a monopoly with an oligopoly • public versus private sector • the role of government, regulators • occasions where monopoly is arguably in the consumer interest, eg when copyrights, designs, patents, grant a limited monopoly in order to encourage innovators to share their ideas • occasions when patents etc are used to restrict competition and work against the consumer interest, eg when biotech companies attempt to 'patent' genetic information or types of seed • efficiency econs of scale, natural monopoly • market failure/resource allocation. *Examiners should note that, for some of the weaker or average students, parts of the above represent quite sophisticated evaluation and so it is important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.*
Also give credit for	• diagrams • an overall judgement on the issues raised • examples.

It will only be possible for students to consider a few of the above. They may also discuss issues not discussed above.

USE THE DETAILED LEVELS MARK SCHEME ON PAGES 4 AND 5 FOR FURTHER CLARIFICATION

MAXIMUM FOR PART 08: 25 MARKS

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Essay 2 **Total for this Essay: 40 marks**

09	In January 2012, a BBC consumer programme reported that British nationals living in Florida were paying £3000 for a return flight to London, while the same airline was charging British tourists flying from London £300 for a return flight to Florida. Explain the market conditions that enable firms to charge different customers different prices for a product. *(15 marks)*

For relevant definitions, eg price discrimination, market conditions, monopoly Reward a definition of price discrimination as follows: "different prices to different customers" = 2 marks **and** **either** "for same product" = 2 marks **or** "without cost differences" = 2 marks **Overall max 4 marks**	**Up to 2 marks per point defined or explained to a maximum of 4 marks**

For explanation of conditions for price discrimination. Award 1 mark for each link in a logical chain of reasoning.

- Some extent of **monopoly power (1 mark)** or other market imperfections **(1 mark)** such as barriers to entry **(1 mark)** or a lack of consumer information **(1 mark)** or a break in the chain of substitutes **(1 mark)** so that firms are not price-takers **(1 mark)** instead they can set prices **(1 mark)** and/or operate opaque or complex pricing **(1 mark)**.
- Consumers with identifiable **characteristics**, such as age, location, club membership, separable into different markets with no arbitrage/transfer/seepage between markets; costs of separating markets and/or keeping them separate must not exceed the potential gains to the producer.
- Different price **elasticities** of demand; possible reasons for these differences.
- Different **degrees** of price discrimination.
  - First: each individual pays their maximum price
  - Second: price varies with quantity demanded
  - Third: consumers are segmented in to groups

Use of diagrams to support explanations	**Up to 2 marks per diagram (1 mark for labelling, 1 mark for information shown) to a total of 4 marks**. **A complex diagram can receive 4 marks**.

MAXIMUM FOR PART 09: 15 MARKS

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10	Assess whether price discrimination is always undesirable.	*(25 marks)*

In this part of the question, candidates will need to demonstrate that they are able to evaluate issues and arguments to support a conclusion if they are to be awarded **more than 15 marks**.

Level 5	**Good analysis <u>and</u> good evaluation**	**22-25 marks** *Mid-point 24*
Level 4	**Good analysis <u>but</u> limited evaluation** **OR** **Reasonable analysis <u>and</u> reasonable evaluation**	**17-21 marks** *Mid-point 19*
Level 3	**Reasonable answer, including some correct analysis but very limited evaluation**	**10-16 marks** *Mid-point 13*
Level 2	**Weak with some understanding**	**4-9 marks** *Mid-point 7*
Level 1	**Very weak**	**0-3 marks** *Mid-point 2*

Issues and areas for discussion include:

Introduction	• further discussion of the meaning of price discrimination eg reference to the importance of costs.
Developing the response to the question **Application/ Analysis**	**Application** • further examples of p.d. for instance o adult and child fares • examples which are not p.d, for instance o first class and second class train fares (cost differences, not quite the same product) • price discrimination and revenue maximisation or 'yield management' (this phrase is not in the specification) • business models using price discrimination to manage their revenues, eg the low-cost airlines, budget hotels. **Analysis** • reasons for p.d, eg o to increase profits o to turn a loss-making product into a profitable one o to cross subsidise, so that a good or service is provided which would otherwise be unprofitable o spread fixed costs o gain economies of scale. • effects of p.d, eg o loss of consumer surplus o consumer surplus becomes producer surplus.

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	• advantages to the consumer, eg o can make some products more affordable (eg budget airlines o can provide a good or service where none was available before p.d. • disadvantages, eg o consumers forced to pay the maximum they are willing to pay; loss of real income, possible elimination of consumer surplus.
Evaluation	• discussion of advantages versus disadvantages • who gains/who loses • instances where price discrimination is linked to social discrimination (different groups in society discriminated against through higher prices) • the link with monopoly • question of possible government intervention • short run versus long run • use of word 'always.' *Examiners should note that, for some of the weaker or average candidates, parts of the above represent quite sophisticated evaluation and so it is important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.*
Also give credit for	• diagrams • an overall judgement on the issues raised • examples.

It will only be possible for students to consider a few of the above. They may also discuss issues not discussed above.

USE THE DETAILED LEVELS MARK SCHEME ON PAGES 4 AND 5 FOR FURTHER CLARIFICATION

MAXIMUM FOR PART 10: 25 MARKS

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Essay 3 **Total for this Essay: 40 marks**

11	'Although the wage differential has increased between top executives and other employees, the government cannot tell people what they should be paid. However, it should act where there has been market failure, because labour markets are not perfect.' Explain **three** reasons why labour markets may be imperfectly competitive. *(15 marks)*

For relevant definitions eg differentials, market failure, labour market.	**Up to 2 marks per point defined or explained to a maximum of 4 marks**
For explanation of reasons why a labour market may be imperfect (or may not be a "perfect" market) **For example**:	
• **Labour is not homogeneous (1 mark)** people have different abilities **(1 mark)** and qualifications **(1 mark)** there are different attitudes to work (1) some people are hard-working, others lazy **(1 mark)** some are more skilled **(1 mark)** eg at using technology and therefore more productive than others **(1 mark)** • **Collective bargaining** as opposed to individual bargaining, membership of trade unions, professional associations; monopolistic supply of labour; monopsonistic demand for labour; collusion among employers • **Role of government;** employment law, wage legislation • **Mobility/immobility of labour**; geographical, occupational; imperfect information.	**Award 1 mark for each link in a logical chain of reasoning, up to 7 marks per distinct reason**
Use of diagrams to help support explanations, eg supply of and demand for labour.	**Up to 2 marks per diagram (1 mark for labelling, 1 mark for information shown) to a total of 4 marks.** **A complex diagram, eg, comparing a monopsonistic market with a perfect one, can receive 4 marks.**

Notes

- If any two reasons offered are not actually distinct, mark them together with a max, of **7 marks.**
- If three distinct reasons are not actually presented, cap the whole question at **10** out of **15 marks.**
- If more than three distinct reasons are presented, reward the best three.

MAXIMUM FOR PART 11: 15 MARKS

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12	Assess the view that wide wage differentials are good for the economy and that governments should therefore play no part in deciding wage rates. *(25 marks)*

In this part of the question, candidates will need to demonstrate that they are able to evaluate issues and arguments to support a conclusion if they are to be awarded **more than 15 marks**.

Level 5	**Good analysis <u>and</u> good evaluation**	**22-25 marks** *(mid-point 24)*
Level 4	**Good analysis <u>but</u> limited evaluation** **OR** **Reasonable analysis <u>and</u> reasonable evaluation**	**17-21 marks** *(mid-point 19)*
Level 3	**Reasonable answer, including some correct analysis but very limited evaluation**	**10-16 marks** *(mid-point 13)*
Level 2	**Weak with some understanding**	**4-9 marks** *(mid-point 7)*
Level 1	**Very weak**	**0-3 marks** *(mid-point 2)*

Issues and areas for discussion include:

Introduction	• meaning of 'differentials' • measurement of inequality • types of intervention (eg min/ max wage).
Developing the response to the question **Application/Analysis**	**Application** • candidate knowledge of, eg • inequality in the UK • recent issues, eg 'bonus culture' • the argument that inequality is economically dysfunctional. **Analysis** • arguments in favour of differentials, eg o incentive arguments o trickle-down o encouraging enterprise o encouraging work rather than welfare o promoting efficient resource allocation • arguments for government action o market failure o counter-arguments to trickle-down o general disadvantages of inequality (micro/macro).

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	• examples of government action affecting equality, eg o income/wealth taxes o encouraging/discouraging a bonus culture o minimum/ maximum wages/ratios between top and medium pay ▪ effects of government action, eg on patterns of spending (synoptic macro point: mpc and mps of low/high income groups) • the role of the government as an employer.
Evaluation	• overall assessment of whether inequality is 'good' for the economy • possible economic disfunctions of inequality (eg negative externalities, social costs, inflationary pressures, recession) • costs versus benefits of government action/inaction • equality of opportunity versus equality of outcome • equity, efficiency • market failure versus government failure • long run versus short run. *Examiners should note that, for some of the weaker or average students, parts of the above represent quite sophisticated evaluation and so it is important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.*
Also give credit for	• diagrams • an overall judgement on the issues raised • examples.

It will only be possible for students to consider a few of the above. They may also discuss issues not discussed above.

USE THE DETAILED LEVELS MARK SCHEME ON PAGES 4 AND 5 FOR FURTHER CLARIFICATION

MAXIMUM FOR PART 12: 25 MARKS

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General Certificate of Education
Advanced Level Examination
January 2013

Economics ECON3

Unit 3 Business Economics and the Distribution of Income

Tuesday 22 January 2013 9.00 am to 11.00 am

For this paper you must have:
- an AQA 12-page answer book
- a calculator.

Time allowed
- 2 hours

Instructions
- Use black ink or black ball-point pen. Pencil should only be used for drawing.
- Write the information required on the front of your answer book. The **Examining Body** for this paper is AQA. The **Paper Reference** is ECON3.
- In **Section A**, answer **EITHER** Context 1 **OR** Context 2.
- In **Section B**, answer **one** essay.

Information
- The marks for questions are shown in brackets.
- The maximum mark for this paper is 80.
- There are 40 marks for **Section A** and 40 marks for **Section B**.
- This paper is synoptic. It assesses your understanding of the relationship between the different aspects of Economics.
- You will be marked on your ability to:
  – use good English
  – organise information clearly
  – use specialist vocabulary where appropriate.

Advice
- You are advised to spend 1 hour on **Section A** and 1 hour on **Section B**.

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Section A

Answer **EITHER** Context 1 **OR** Context 2.

EITHER **Total for this Context: 40 marks**

Context 1

THE GLOBAL CONTEXT

Study **Extracts A, B and C**, and then answer **all** parts of Context 1 which follow.

Extract A: Trade union membership and density, UK, selected years 1995–2010

	1995	2000	2002	2004	2006	2008	2010
Membership (number of employees, millions)	7.1	7.1	7.0	7.1	7.0	6.9	6.5
Density (total UK trade union membership as a % of all UK employees)	32.4	29.8	28.8	28.8	28.3	27.4	26.6

Source: official statistics, 2011

Extract B: Workers united?

In 1776, Adam Smith argued that business people often 'combined' (today we would say 'colluded') in order to fix prices and wages, while 'combinations' of workers were illegal. In his opinion there was an imbalance between the actions of employers and the rights of employees. In 1948, all members of the United Nations signed up to the Universal Declaration of Human Rights. Article 23 states: "Everyone has the right to form and to join trade unions for the protection of their interests." The Declaration also states that union membership cannot be made compulsory.

In the UK and in other modern democracies, most people would probably agree with the Australian Bureau of Statistics that a trade union is 'an organisation consisting predominantly of employees, the principal activities of which include the negotiation of rates of pay and conditions of employment for its members'. To an economist, a trade union replaces 'individual bargaining' with 'collective bargaining', which may enable workers to create a monopolistic supply of labour to counteract the monopsonistic demand for labour from powerful employers.

A prominent British trade union leader claimed recently that union membership was holding steady despite major economic difficulties, and advised workers worried about further shocks to the economy to join a union. He claimed that union members tended to be better paid than workers who are not part of a trade union but who do the same job. Union members earn on average nearly 17%, or £2 an hour, more than other workers.

Source: news reports, 2011

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Extract C: *Walmart* and China

Some global companies are willing to negotiate with trade unions, whilst others try to avoid them. US company *Walmart*, the world's largest retailer and owners of *Asda* in the UK, has been known to stop operating in some countries rather than have to recognise unions.

With over a billion people and rising prosperity, China is an irresistible market for the world's largest manufacturers, distributors and retailers. Some of these large companies, such as *Walmart*, *McDonald's* and *FedEx*, have adopted an anti-union stance in the countries in which they operate.

In China, however, *Walmart* has signed 'collective bargaining' agreements with the *All-China Federation of Trade Unions* (ACFTU). The Federation has 193 million members and is a monopoly, given that no other trade unions are allowed to operate in China. Officially, signing the agreement was a voluntary action on *Walmart*'s part. However, firms which refuse to sign such agreements are likely to face many difficulties in gaining access to Chinese markets. *Walmart* gets a say in the appointment of the trade union Chairman at its workplaces. This official invariably has close links with the Chinese government. So now, if *Walmart*'s management in China wants to close stores, lay off employees, change workloads or amend working hours, it must consult ACFTU. In effect, this gives the Chinese government a say in the running of the business.

ACFTU discourages strikes at a time when working conditions in China have come in for international criticism. ACFTU has also been accused of failing to represent its members properly because the Chinese government prefers to promote business investment and business growth at the expense of workers' rights. However, there is a view that any negative economic effects of trade unions are outweighed by the positive effects of trade union activities on wages, discrimination and exploitation. For this reason, it is argued, the UK government should encourage businesses, wherever they operate in the world, to engage fully with trade unions.

Source: news reports, 2011

0 1 Using **Extract A**, calculate to one decimal place the percentage decrease in the number of employees who were union members in 2010 compared with 1995 **and** identify **one other** significant feature of the data shown. *(5 marks)*

0 2 Explain what is meant by 'monopsonistic demand for labour' (**Extract B**, lines 13–14) **and** analyse how a trade union can influence wages **and** employment levels in an imperfectly competitive labour market. *(10 marks)*

0 3 '…any negative economic effects of trade unions are outweighed by the positive effects of trade union activities on wages, discrimination and exploitation' (**Extract C**, lines 21–23).

Using the data and your economic knowledge, evaluate whether governments, such as those of the UK or China, should intervene in labour markets to increase trade union membership. *(25 marks)*

Turn over ▶

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Do **not** answer Context 2 if you have answered Context 1.

OR **Total for this Context: 40 marks**

Context 2

THE EUROPEAN UNION CONTEXT

Study **Extracts D, E and F**, and then answer **all** parts of Context 2 which follow.

Extract D: Average annual household gas bills, England and Wales, selected years 1998 – 2010

	1998	2000	2002	2004	2005	2006	2008	2010
Cash terms (£)	277	264	281	309	353	425	582	640
Real terms, 2005 prices (£)	325	300	303	315	353	412	532	560

Source: official statistics, 2011

Extract E: Getting gas to market

In the EU as a whole, there are over 72 million domestic consumers of piped natural gas. The largest consumers of piped gas are Belgium, France, Germany, Italy, the Netherlands and the UK. In the UK, six energy companies control 99% of the market for natural gas. *British Gas*, the privatised utility, dominates the market with over 50% market share. There are no signs, at present, of any significant new entrants to the market.

The EU Commissioner for Energy has called for the 'Europeanisation' of energy policy. The Commissioner argues that it is necessary to assure all EU consumers that their energy sources are safe, competitive, efficient and sustainable. To help achieve this, the *Agency for the Cooperation of Energy Regulators* (ACER) was launched in 2011 as an agency of the EU. At present, it has an advisory and coordinating role across the EU, rather than a regulatory one. In the UK, The *Office for Gas and Electricity Markets* (OFGEM) is the main regulator for piped natural gas.

Consumers might have doubts about the effectiveness of regulators such as OFGEM. In August 2011, price increases averaging 18% were announced for piped natural gas, while general inflation was 4.5%. Observers noted that, while wholesale prices were volatile, domestic retail prices tended to follow them upwards and then became 'sticky' and unlikely to follow them downwards. One problem is that there is very little storage capacity in the UK. OFGEM does not directly regulate prices, and is far more concerned with the ease with which consumers can switch between suppliers.

Source: news reports, 2011

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Extract F: The 'Butane Man'

One reason why it is difficult to regulate gas in the same way across all 27 member states of the Single European Market is that most EU states do not have well-developed pipeline distribution networks. Spain, Portugal, Greece and Ireland are leading the way in the process of catching up. In Spain, for example, where most of the population live near town centres in apartments that were built some time ago, there has been a strong tradition of using liquid petroleum gas (LPG). The 'Butane Man', who regularly delivers gas cylinders to households, has much the same standing in popular culture as the traditional 'milkman' in the UK. A recent proposed strike by butane delivery workers was regarded as a very serious threat by Spanish media, government and consumers.

Putting homes onto the gas mains is least costly when new housing estates are being built, meaning that such houses can all be connected at the same time. It is often forgotten that there are over 4 million homes in the UK not connected to gas mains and which therefore rely on deliveries of LPG. It would also appear that the market for LPG is a highly concentrated oligopolistic market, with just four main suppliers: Shell, BP, Calor and FloGas. However, the market is unregulated and, according to OFGEM, this is because it is not dependent on a pipeline and therefore is 'not a natural monopoly'.

However, in 2011, a BBC consumer affairs programme alleged that these companies were carrying out anti-competitive practices, such as locking consumers into long-term contracts, and that a smaller new entrant, Extra Gas, was the only company with transparent prices on its website. The programme found 30 houses in one neighbourhood all paying different prices, ranging from 35p to 52p per litre, with companies apparently charging the highest prices to customers using the least gas. While their MP called for OFGEM to get involved, one group of 51 households in a village in Devon saved £14 000 a year between them by forming a buying group and negotiating a single contract with a petroleum gas supplier.

Sources: news reports, 2011

0 4 Using **Extract D**, calculate to one decimal place the percentage increase in gas bills in real terms in 2010 compared with 1998 **and** identify **one other** significant feature of the data. *(5 marks)*

0 5 Explain what is meant by an 'oligopolistic market' (**Extract F**, line 14) **and** analyse why such a market might lead to 'sticky' gas prices (**Extract E**, line 16). *(10 marks)*

0 6 'Consumers might have doubts about the effectiveness of regulators such as OFGEM' (**Extract E**, line 13).

Using the data and your economic knowledge, assess methods that could be used by the UK government and the EU to promote competition in the supply of domestic gas. *(25 marks)*

Turn over for Section B

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Section B

Answer **one** essay from this section.

Each essay carries 40 marks.

EITHER

Essay 1

0 7 Explain why a perfectly competitive firm might be regarded as statically efficient while a monopoly might be regarded as dynamically efficient. *(15 marks)*

0 8 'While some economic theories become dated, the theory of perfect competition has become more realistic over time.'

Discuss whether technological developments, such as the internet, are making markets more competitive and making perfect competition theory more realistic. *(25 marks)*

OR

Essay 2

In August 2011, the UK Secretary of State for Culture said that while there were many local television stations broadcasting in the USA, they did not exist in the UK due to 'market failure'. He proposed a subsidy of £40m from public funds to help create stations which would then be financed by advertising.

0 9 Explain why TV broadcasting might be classified as a public good **and** explain why TV broadcasting can also have some characteristics of a private good. *(15 marks)*

1 0 Evaluate the view that attempts by governments to eliminate market failure by intervening in markets for public goods and merit goods will inevitably lead to government failure. *(25 marks)*

OR

Essay 3

1 1 A government has a policy of reducing taxes on income while increasing taxes on spending, such as Value Added Tax (VAT).

Distinguish between equity and equality **and** explain the effects of this government policy on both equity **and** equality. *(15 marks)*

1 2 Assess the economic costs **and** benefits of government action which results in the UK becoming a less equal society. *(25 marks)*

END OF QUESTIONS

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Version 1



General Certificate of Education (A-level)
January 2013

Economics ECON3

(Specification 2140)

Unit 3: Business Economics and the Distribution of Income

Final

Mark Scheme

Mark schemes are prepared by the Principal Examiner and considered, together with the relevant questions, by a panel of subject teachers. This mark scheme includes any amendments made at the standardisation events which all examiners participate in and is the scheme which was used by them in this examination. The standardisation process ensures that the mark scheme covers the students' responses to questions and that every examiner understands and applies it in the same correct way. As preparation for standardisation each examiner analyses a number of students' scripts: alternative answers not already covered by the mark scheme are discussed and legislated for. If, after the standardisation process, examiners encounter unusual answers which have not been raised they are required to refer these to the Principal Examiner.

It must be stressed that a mark scheme is a working document, in many cases further developed and expanded on the basis of students' reactions to a particular paper. Assumptions about future mark schemes on the basis of one year's document should be avoided; whilst the guiding principles of assessment remain constant, details will change, depending on the content of a particular examination paper.

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Advanced Level Economics Unit 3

General Instructions

Marks awarded to students should be in accordance with the following mark scheme and examiners should be prepared to use the full range of marks available. The mark scheme for most questions is flexible, permitting the candidate to score full marks in a variety of ways. Where the candidate's response to a question is such that the mark scheme permits full marks to be awarded, full marks **MUST** be given. A perfect answer is not necessarily required for full marks. But conversely, if the candidate's answer does not deserve credit, then no marks should be given.

Occasionally, a candidate may respond to a question in a reasonable way, but the answer may not have been anticipated when the mark scheme was devised. In this situation, **OR WHENEVER YOU HAVE ANY DOUBT ABOUT THE INTERPRETATION OF THE MARK SCHEME**, you must in the first instance telephone your team leader to discuss how to proceed.

Two approaches have been used in the construction of the mark scheme.

(i) **An issue based approach.** The mark scheme for parts **01**, **02**, **04** and **05** of the data response questions and the first part of each essay question adopts this approach. The mark scheme lists the marks that can be awarded for particular issues (and associated development) that the candidate might include in the answer.

(ii) **A levels approach.** This approach is used for parts **03** and **06** of the data response questions and the second part of each essay question. The Levels Mark Scheme on the next page identifies five levels representing differences in the quality of work. A range of marks is allocated to each level. First decide the level into which an answer falls. The level chosen should be the one which **best fits** the answer provided by the candidate. It is **not** intended that the answer should satisfy every statement in the level description. Then think in terms of awarding the mid-point mark which has been identified for that level (eg 13 marks for Level 3). Move up or down from this notional mark by considering the extent to which the answer meets the level description overall. Strength in one skill can outweigh weakness in another. When using the Levels Mark Scheme the marker **must** identify where a particular skill is being demonstrated. The **key** to be used to identify the skill is given after the level descriptions. The question-specific mark scheme summarises the information which could be used to answer the question, but without attaching marks to particular issues.

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FOR USE WITH QUESTIONS 03, 06, 08, 10 AND 12 ONLY

AQA ADVANCED LEVEL (A2) ECONOMICS
LEVELS OF RESPONSE MARK SCHEME

A2 **LEVELS OF RESPONSE**	**AO1** **KNOWLEDGE and UNDERSTANDING of theories, concepts and terminology**	**AO2** **APPLICATION of theories, concepts and terminology**	**AO3** **ANALYSIS of economic problems and issues**	**AO4** **EVALUATION of economic arguments and evidence, making informed judgements**
Level 5 22-25 marks (mid-point 24) **Good analysis and good evaluation**	Good throughout the answer with few errors and weaknesses	Good application to issues Where appropriate, good use of data to support answer	Relevant and precise with a clear and logical chain of reasoning Good awareness of the inter-relatedness of economic issues	Good with a clear final judgement
Level 4 17-21 marks (mid-point 19) **Good analysis but limited evaluation** **OR** **Reasonable analysis and reasonable evaluation**	Good throughout the answer with few errors and weaknesses Good throughout much of the answer with few errors and weaknesses	Good application to issues Where appropriate, good use of data to support answer Some good application to issues Where appropriate, some good use of data to support answer	Relevant and precise with a clear and logical chain of reasoning Good awareness of the inter-relatedness of economic issues Largely relevant and well organised with reasonable logic and coherence Some awareness of the inter-relatedness of economic issues	Limited but showing some appreciation of alternative points of view Reasonable, showing an appreciation of alternative points of view
Level 3 10-16 marks (mid-point 13) **Reasonable answer, including some correct analysis but very limited evaluation**	Satisfactory but some weaknesses shown	Reasonable application to issues Where appropriate, reasonable use of data to support answer	Reasonably clear but may not be fully developed and is perhaps confused in places with a few errors present Quite well organised with some logical development	Superficial, perhaps with some attempt to consider both sides of the issue(s)
Level 2 4-9 marks (mid-point 7) **Weak with some understanding**	Limited and some errors are made	Partial application to issues with some errors Where appropriate, limited use of data to support answer	Partial but confused at times, lacking focus and development Limited logic and coherence	A very basic and simplistic attempt is made which is unsupported by analysis
Level 1 0-3 marks (mid-point 2) **Very weak**	Weak with a number of errors	Little, if any, application to issues Where appropriate, no use of data to support answer	Poor and lacking clarity and focus	No relevant evaluation

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THE KEY TO BE USED WHEN USING THE LEVELS MARK SCHEME

D Where a particular economic term is correctly **DEFINED** in order to help the candidate to answer the question properly.

I Where a relevant **ISSUE** is raised by the candidate.

K Where the candidate demonstrates **KNOWLEDGE** of recent developments or features of the economy which help enhance the candidate's response to the question. This should also be used where the candidate quotes relevant examples.

Ap Where the candidate demonstrates the ability to **APPLY** knowledge and **CRITICAL UNDERSTANDING** to problems and issues.

An Where the candidate demonstrates the ability to **ANALYSE** the problem using appropriate economic ideas.

E Where the candidate **EVALUATES** and makes judgements about the significance of various issues and arguments.

Synoptic Assessment
All questions in this unit are synoptic. Therefore, students will need to demonstrate that they are able to think as an economist and to use effectively the economist's 'tool kit' of concepts, theories and techniques.

Students should demonstrate that they:
- understand the inter-relatedness of many economic issues, problems and institutions;
- understand how certain economic concepts, theories and techniques may be relevant to a range of different contexts;
- can apply concepts, theories and techniques in analysing economic issues and problems and in evaluating arguments and evidence.

QUALITY OF WRITTEN COMMUNICATION

Quality of Written Communication (QWC) will be assessed in Questions 03, 06, 08, 10 and 12 only.

Students will be assessed according to their ability to:

- ensure that text is legible, and that spelling, grammar and punctuation are accurate, so that meaning is clear
- select and use a form and style of writing appropriate to purpose and complex subject matter
- organise information clearly and coherently, using specialist vocabulary when appropriate.

No specific marks are awarded for QWC.

However, examiners should take into account QWC when determining the mark to be awarded for an answer. This means an answer could be taken either up (for exceptional QWC) or down (for very poor QWC) by 1 mark (and no more).

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1 THE GLOBAL CONTEXT — Total for this Context: 40 marks

01 Using **Extract A,** calculate to one decimal place the percentage decrease in the number of employees who were union members in 2010 compared with 1995 **and** identify **one other** significant feature of the data shown. *(5 marks)*

The calculation:

Acceptable answer is 8.4 or 8.5	**3 marks**
Another answer between 8 and 9 (inclusive) irrespective of decimal places.	**2 marks**
For showing a correct method but arriving at a wrong number i.e $\frac{\text{any number}}{\text{any number}} \times 100 = \text{wrong number}$	**1 mark**

Maximum 3 marks for the calculation

Identifying one other significant feature

For identifying a significant feature	**1 mark**
For providing a piece of supporting data	**Up to 2 marks**

Other significant features include:

- membership trend is downwards (7.1 to 6.5 million) over the period shown.
- membership rises between 2002 and 2004 (7.0 to 7.1 million) before falling again
- density trend is downwards over the period shown (32.4% to 26.6%) with no upward blip
- density is highest in 1995 (32.4%)
- density is level, at 28.8%, between 2002 and 2004 while membership is rising, from 7.0 to 7.1 million (either membership or density figures sufficient for the data mark)

No marks for a year-by-year 'trawl' through the numbers with no significant feature identified

Maximum 3 marks for the significant feature

MAXIMUM FOR PART 01: 5 MARKS

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02	Explain what is meant by 'monopsonistic demand for labour' (**Extract B**, lines 13-14) **and** analyse how a trade union can influence wages **and** employment levels in an imperfectly competitive labour market. *(10 marks)*

Explanation	
For a relevant definition/explanation of eg a trade union, monopsonistic demand for labour, eg a labour market in which there is only one 'buyer', in terms of a single firm or group of employers of people with particular skills or qualifications, or in a particular locality.	**Up to 2 marks per point defined or explained to a maximum of 4 marks**

Maximum of 4 marks for the explanation

Analysis	
Analysis of trade union influence, for example: The trade union could shift the supply curve of labour to the left **(1 mark)** by restricting the supply of labour **(1 mark)**, eg by insisting on a barrier to entry **(1 mark)** such as minimum qualifications **(1 mark)**. Supply elasticity also reduced **(1 mark)**. This will raise the price of labour (the wage rate) **(1 mark)** above the market equilibrium **(1 mark)** but could reduce the number employed **(1 mark)**. • the union could turn a monopsonistic labour market into a bilateral monopoly • a union-negotiated wage above the market equilibrium • single-union agreements • no-strike deals • 'closed shop' • strikes.	**Award 1 mark for each link in a logical chain of reasoning**
	Up to 8 marks for the analysis
For making appropriate use of diagrams, eg labour market S & D; diagram with the wage rate above the market equilibrium, bilateral monopoly diagram.	**Up to 2 marks per diagram (1 mark for labelling, 1 mark for correct information shown) to a maximum of 3 marks**

A maximum of 8 marks overall for the question if there is not a reference to both wages and employment levels

MAXIMUM FOR PART 02: 10 MARKS

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03 '…any negative economic effects of trade unions are outweighed by the positive effects of trade union activities on wages, discrimination and exploitation' (**Extract C**, lines 21-23).

Using the data and your economic knowledge, evaluate whether governments, such as those of the UK and China, should intervene in labour markets to increase trade union membership. *(25 marks)*

In this part of the question, students will need to demonstrate that they are able to evaluate issues and arguments to support a conclusion if they are to be awarded **more than 15 marks.**

Where there is no **explicit** reference to the data, award a maximum of **21 marks**.

Level 5	**Good analysis <u>and</u> good evaluation**	**22-25 marks** *Mid-point 24*
Level 4	**Good analysis <u>but</u> limited evaluation** **OR** **Reasonable analysis <u>and</u> reasonable evaluation**	**17-21 marks** *Mid-point 19*
Level 3	**Reasonable answer, including some correct analysis but very limited evaluation**	**10-16 marks** *Mid-point 13*
Level 2	**Weak with some understanding**	**4-9 marks** *Mid-point 7*
Level 1	**Very weak**	**0-3 marks** *Mid-point 2*

Issues and areas for discussion include:

Introduction	• Definitions/descriptions of eg o trade union o collective bargaining.
Developing the response to the question (application)	• Relevant use of theory, eg effects of collective bargaining • Evidence from the data, eg reference to o British trade unions **(Extracts A, B)** o Chinese experience **(Extract C)** o multinational behaviour, eg Walmart **(Extract C)** o candidate's own knowledge, eg relevant application of 'minimum wage' concepts to this particular context.
Developing the response to the question (analysis)	• Possible 'negative' effects of trade unions, eg o slow down productivity gains o reduce competitiveness, by, eg ▪ increasing costs of production ▪ reducing flexibility ▪ creating barriers to exit from a market • Possible positive effects, eg o protect members' earning power o fight discrimination in the workplace o improve working conditions, eg ▪ health and safety of employees ▪ working hours and holiday entitlement o may <u>reduce</u> costs (easier to negotiate with a single entity) • Use of the perfect competition model in the labour market • Use of the imperfect competition model in the labour market.

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Evaluation	• positive versus negative aspects • consideration of the value-laden word 'exploitation' in the question • challenging basic assumptions, e.g. that employers do not want to be part of a high wage industry, or that unions are not interested in flexibility or efficiency, e.g. through multi-skilling or training • consideration of when is a union not a union (critical view of the Chinese model) • role of government in general in trade union matters • role of UK government in particular • question the implication contained in the data **(Extract C)**, that workers rights are incompatible with investment in and growth of businesses. *Examiners should note that, for some of the weaker or average students, parts of the above represent quite sophisticated evaluation and so it is important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.*
Also give credit for	• relevant diagrams • an overall judgement on the issues raised.

It will only be possible for students to consider a few of the above. They may also discuss issues not discussed above.

USE THE DETAILED LEVELS MARK SCHEME ON PAGES 3 AND 4 FOR FURTHER CLARIFICATION

MAXIMUM FOR PART 03: 25 MARKS

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2 THE EUROPEAN UNION CONTEXT — Total for this Context: 40 marks

04 Using **Extract D**, calculate to one decimal place the percentage increase in gas bills in real terms in 2010 compared with 1998 **and** identify **one other** significant feature of the data. *(5 marks)*

The calculation

Acceptable answer is 72.3 or 72.4	**3 marks**
Another answer between 72 and 73 (inclusive) irrespective of decimal places.	**2 marks**
For showing a correct method but arriving at a wrong number ie $\frac{\text{any number}}{\text{any number}} \times 100 = \text{wrong number}$	**1 mark**
	Maximum 3 marks for calculation

Identifying one other significant feature	
For identifying a significant feature.	**1 mark**
For providing a piece of supporting data.	**Up to 2 marks**

Other significant features include:

- cash terms' prices fall from £277 to £264 between 1998 and 2000, then the trend is upwards to £640 in 2010
- real terms' prices fall from £325 to £300 between 1998 and 2000, then the trend is upwards to £560 in 2010
- the lowest prices are in 2000 (£264 cash terms, or £300 real terms)
- price in cash terms more than doubles, from £227 to £640 over the period shown, while price in real terms less than doubles, from £325 to £560 (NB either cash or real terms figures sufficient for the data mark).

No marks for a year-by-year 'trawl' through the numbers with no significant feature identified.

Maximum of 3 marks for the significant feature

MAXIMUM FOR PART 04: 5 MARKS

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05	Explain what is meant by an 'oligopolistic market' (**Extract F**, line 14) **and** analyse why such a market might lead to 'sticky' gas prices (**Extract E**, line 16). *(10 marks)*

Explanation	
For a relevant definition/explanation, eg a market where a small number of firms account for a high proportion of sales or another dimension of economic importance in an industry. Reference to concentration ratios.	**Up to 2 marks per point defined or explained to a maximum of 4 marks**

Maximum of 4 marks for the explanation

Analysis	
Analysis of reasons for price stickiness, for example: The suppliers are an oligopoly **(1 mark)** and adopt the oligopolist's price seeking behaviour **(1 mark)**, having to judge not only consumer reactions to a price change **(1 mark)**, but also competitor reactions **(1 mark)**, fearing that they face elastic **(1 mark)** demand for a price increase **(1 mark)**, and inelastic **(1 mark)** demand for a price decrease **(1 mark)**, either way losing total revenue **(1 mark)**. • price leadership; • cartels/collusion/other relevant monopoly points • admin costs • implications of lack of storage capacity (mentioned in the data) • although this is not required by the question for full marks, it is mentioned in the data, so amply reward any explanation of 'asymmetric' stickiness (prices rising more readily than they fall) as this is likely to be quite sophisticated, eg asymmetric barriers to entry and exit causing asymmetric competitive pressure (it's easier to leave the market than enter it, so existing firms are more likely to leave when costs and prices are rising than new firms are likely to enter when costs and prices are falling).	**Award 1 mark for each link in a logical chain of reasoning**

Up to 8 marks for the analysis

Make appropriate use of diagrams, eg kinked demand curve; game theory matrix.	**Up to 2 marks per diagram (1 mark for labelling, 1 mark for correct information shown) to a maximum of 3 marks**

MAXIMUM FOR PART 05: 10 MARKS

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06	'Consumers might have doubts about the effectiveness of regulators such as OFGEM' (**Extract E**, line 13). Using the data and your economic knowledge, assess methods that could be used by the UK government and the EU to promote competition in the supply of domestic gas. *(25 marks)*

In this part of the question, students will need to demonstrate that they are able to evaluate issues and arguments to support a conclusion if they are to be awarded **more than 15 marks**.

Where there is no **explicit** reference to the data, award a maximum of **21 marks**.

Level 5	**Good analysis <u>and</u> good evaluation**	**22-25 marks** *Mid-point 24*
Level 4	**Good analysis <u>but</u> limited evaluation** **OR** **Reasonable analysis <u>and</u> reasonable evaluation**	**17-21 marks** *Mid-point 19*
Level 3	**Reasonable answer, including some correct analysis but very limited evaluation**	**10-16 marks** *Mid-point 13*
Level 2	**Weak with some understanding**	**4-9 marks** *Mid-point 7*
Level 1	**Very weak**	**0-3 marks** *Mid-point 2*

Issues and areas for discussion include:

Introduction	• definition of 'competition' • differences between gas and other commodities • regulation explained/defined.
Developing the response to the question (Application)	• use of theory (monopoly) • discussion based on information from the data related to market conditions, eg price changes **(Extract D)** o market share **(Extract E)** o piped gas and LPG/natural monopoly **(Extract F)** o candidate's own knowledge of relevant issues.
Developing the response to the question (Analysis)	Policies aimed at increasing competition, examples, effects eg • competition policy • privatisation • deregulation vs regulation • removing entry barriers • public/private partnerships • contestable markets • increase the scope of OFGEM, eg to cover LPG supplies • direct price controls • simpler/more transparent price tariffs.

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Evaluation	• efficacy of OFGEM • question its focus on 'natural monopoly' • what use is 'switching' if tariffs are complicated? (price transparency) • infrastructure investment (data mentions lack of storage. Gas-holders would help reduce price volatility) • should regulators directly regulate price? • should regulation operate at a national or EU level? • advantages/disadvantages of each method, eg 'regulatory capture'. *Examiners should note that, for some of the weaker or average students, parts of the above represent quite sophisticated evaluation and so it is important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.*
Also give credit for	• diagrams • an overall judgement on the issues raised.

It will only be possible for students to consider a few of the above. They may also discuss issues not discussed above.

USE THE DETAILED LEVELS MARK SCHEME ON PAGES 3 AND 4 FOR FURTHER CLARIFICATION

MAXIMUM FOR PART 06: 25 MARKS

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SECTION B

Essay 1 **Total for this Essay: 40 marks**

07	Explain why a perfectly competitive firm might be regarded as statically efficient while a monopoly might be regarded as dynamically efficient. *(15 marks)*

For relevant definitions, eg perfect competition, static efficiency, monopoly, dynamic efficiency.	**Up to 2 marks per point defined or explained to a maximum of 4 marks**

For explanation of the relationship between perfect competition, static efficiency, monopoly, dynamic efficiency; **for example:**	
• Perfect competition and static efficiency, eg because perfect competition involves price taking **(1 mark**), the seller-perceived demand curve is horizontal **(1 mark),** so that when the industry is in equilibrium P=MC **(1 mark)** giving allocative efficiency **(1 mark)**, and P=MC **(1 mark)** where AC is minimised **(1 mark**), giving productive efficiency **(1 mark).** The structure of the industry gives static efficiency due to price seeking behaviour **(1 mark**) which drives down costs **(1 mark)** by eliminating inefficient firms **(1 mark)**.	**Award 1 mark for each link in a logical chain of reasoning** **Up to 10 marks**
• Monopoly and dynamic efficiency, eg an argument that monopolies tend to be large, and achieve economies of scale; over time, large firms can devote more resources to research & development and so achieve dynamic efficiency.	**Award 1 mark for each link in a logical chain of reasoning** **Up to 10 marks**
ALTERNATIVELY • perfect competition and monopoly discussed together in a comparative way • other relevant arguments, eg the possibility of a 'trade-off' between static and dynamic efficiency • why monopolies may not be dynamically efficient/ perfect competition may not be statically efficient.	**Award each link in a logical chain of reasoning** **Up to 15 marks**
Use of diagrams to support the explanation	Up to **2 marks** per diagram (**1 mark** for labelling, **1 mark** for information shown) to a total of **6 marks**. A complex diagram, eg showing perfect competition and monopoly together, can be awarded up to **4 marks**

Maximum of 10 marks if only static or dynamic efficiency is discussed

MAXIMUM FOR PART 07: 15 MARKS

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08	**'**While some economic theories become dated, the theory of perfect competition has become more realistic over time.' Discuss whether technological developments, such as the internet, are making markets more competitive and making perfect competition theory more realistic. *(25 marks)*

In this part of the question, students will need to demonstrate that they are able to evaluate issues and arguments to support a conclusion if they are to be awarded **more than 15 marks**.

Level 5	**Good analysis <u>and</u> good evaluation**	**22-25 marks** *Mid-point 24*
Level 4	**Good analysis <u>but</u> limited evaluation** **OR** **Reasonable analysis <u>and</u> reasonable evaluation**	**17-21 marks** *Mid-point 19*
Level 3	**Reasonable answer, including some correct analysis but very limited evaluation**	**10-16 marks** *Mid-point 13*
Level 2	**Weak with some understanding**	**4-9 marks** *Mid-point 7*
Level 1	**Very weak**	**0-3 marks** *Mid-point 2*

Issues and areas for discussion include

Introduction	• basic assumptions of perfect competition theory, eg perfect knowledge, homogenous products, entry barriers, no. of buyers and sellers. • basic assumptions common to other theory, eg rational behaviour, profit maximisation.
Developing the response to the question **Application/ Analysis**	• Reasons why some assumptions may be unrealistic eg o highly technical products (imperfect knowledge); o product differentiation/ branding/ persuasive advertising • Reasons why theory can go out of date, eg o large numbers of small firms being merged, becoming more monopolistic • Possible effects of technology such as the internet, supporting competition e.g. o Improving information flows o Removing barriers to entry o Reducing advantages of scale economies (small firms on eBay, Amazon small bookshop partners) • Technology supporting theory in a practical sense, eg o Computers helping firms to track marginal costs and revenues, therefore supporting the MC=MR assumption.

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Evaluation	• internet may support price discrimination eg budget airlines • the internet allows some monopolies to emerge and grow, eg Google, Microsoft • however, some dominant firms on the internet challenge traditional monopolies (half of Amazon profits come from books whose sales are too low for Waterstones, Smiths, Tesco etc to handle) • contestability • relevance of legal restrictions (copyright, designs, patents). *Examiners should note that, for some of the weaker or average students, parts of the above represent quite sophisticated evaluation and so it is important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.*

Also give credit for	• diagrams • an overall judgement on the issues raised • examples.

It will only be possible for students to consider a few of the above. They may also discuss issues not discussed above.

USE THE DETAILED LEVELS MARK SCHEME ON PAGES 3 AND 4 FOR FURTHER CLARIFICATION

MAXIMUM FOR PART 08: 25 MARKS

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Essay 2 **Total for this Essay: 40 marks**

In August 2011, the UK Secretary of State for Culture said that while there were many local television stations broadcasting in the USA, they did not exist in the UK due to 'market failure'. He proposed a subsidy of £40m from public funds to help create stations which would then be financed by advertising.

09 Explain why TV broadcasting might be classified as a public good **and** explain why TV broadcasting can also have some characteristics of a private good. *(15 marks)*

• **For relevant definitions**, eg public good, private good, externalities, excludability, non-diminishability, free-rider.	**Up to 2 marks per point defined or explained to a maximum of 4 marks**
For explanation of reasons for classifying broadcasts as a public good or private good.	
Public good arguments, eg Broadcasts are non-diminishable **(1 mark)**, one person's use does not deny another person access **(1 mark)**, the benefits of broadcasting are communal as well as individual **(1 mark)** broadcasting is high in positive externalities **(1 mark)** it is difficult to attribute benefits to individuals **(1 mark)** and it is therefore fairer to finance by methods other than charging individuals **(1 mark)**. Provision at all means provision for all **(1 mark)**, so broadcasts are, at least to some extent, non-excludable **(1 mark)**. The minister appears to be claiming a 'missing market' **(1 mark)**, or might be mis-interpreting the economist's idea of 'market failure **(1 mark).**	**Award 1 mark for each link in a logical chain of reasoning** **Up to 10 marks**
Private good arguments, eg • challenging 'non-excludability' (evidenced by licence fee enforcement, encryption, pay-tv) • arguments for a 'mixed' type of good, eg some characteristics of a merit/demerit good, arguing that benefits/costs do not end with final consumer (positive/ negative externalities) and the market under-provides/ over-provides.	**Award 1 mark for each link in a logical chain of reasoning** **Up to 10 marks**
Use of diagrams to support explanations.	**Up to 2 marks per diagram (1 mark for labelling, 1 mark for information shown) to a total of 4 marks.**

Maximum 10 marks if either public goods or private goods not considered

MAXIMUM FOR PART 09: 15 MARKS

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10 Evaluate the view that attempts by governments to eliminate market failure by intervening in markets for public goods and merit goods will inevitably lead to government failure. *(25 marks)*

In this part of the question, students will need to demonstrate that they are able to evaluate issues and arguments to support a conclusion if they are to be awarded **more than 15 marks**.

Level 5	**Good analysis <u>and</u> good evaluation**	**22-25 marks** *Mid-point 24*
Level 4	**Good analysis <u>but</u> limited evaluation** **OR** **Reasonable analysis <u>and</u> reasonable evaluation**	**17-21 marks** *Mid-point 19*
Level 3	**Reasonable answer, including some correct analysis but very limited evaluation**.	**10-16 marks** *Mid-point 13*
Level 2	**Weak with some understanding**	**4-9 marks** *Mid-point 7*
Level 1	**Very weak**	**0-3 marks** *Mid-point 2*

Issues and areas for discussion include:

Introduction	• Meaning of market failure • Reasons for and examples of market failure, eg o distinction between public and merit goods o positive and negative externalities o public goods, merit goods • Reasons for and examples of government failure.
Developing the response to the question **Application/ Analysis**	• Policy options for public/merit goods o taxation (the ability to pay principle) o charging (the beneficial principle) o subsidies o direct government provision o public/private partnerships • Opportunity cost • Efficiency arguments • Rationale for govt. intervention in providing MSC=MSB, therefore providing a socially optimum level • Consequences of policy options, eg o consumer welfare and producer surplus o national/ international competitiveness o prices, employment • Reasons for and examples of government failure • Discussion specific to the local TV station example

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Evaluation	• effectiveness of different types of policy • intended and unintended consequences • the option of allowing market forces to work without government intervention (in the local TV case, challenging the apparent view of the minister that there is a 'missing market'); consumer sovereignty arguments) • problems of determining social optimum • market vs govt failure. *Examiners should note that, for some of the weaker or average students, parts of the above represent quite sophisticated evaluation and so it is important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.*
Also give credit for	• diagrams • an overall judgement on the issues raised • examples.

It will only be possible for students to consider a few of the above. They may also discuss issues not discussed above.

USE THE DETAILED LEVELS MARK SCHEME ON PAGES 3 AND 4 FOR FURTHER CLARIFICATION

MAXIMUM FOR PART 10: 25 MARKS

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Essay 3 **Total for this Essay: 40 marks**

11 A government has a policy of reducing taxes on income while increasing taxes on spending, such as Value Added Tax (VAT).

Distinguish between equity and equality **and** explain the effects of this government policy on both equity **and** equality. *(15 marks)*

For distinguishing between equity and equality, eg basic definitions of equity (to do with 'fairness), equality (to do with reducing 'differentials'/increasing opportunities/affecting outcomes).	**Up to 2 marks per point defined or explained to a maximum of 4 marks**
For explanation of effects of a switch from direct to indirect taxation; for example:	
• **Vertical equity**: The treatment of people in different income **(1 mark)** and wealth positions (**1 mark)**. Taxes can be progressive **(1 mark)** proportional **(1 mark)** or regressive **(1 mark)**. Switch to VAT is likely to be regressive **(1 mark)** because, assuming a wide range of goods and services are taxed **(1 mark)**, and as a general rule consumption expenditure represents a decreasing proportion of income **(1 mark)** the actual **(1mark)** amount of tax paid will increase with expenditure **(1 mark)** but fall as a percentage of income **(1 mark)**. • **Horizontal equity:** The treatment of people in similar earning positions. Policy effects depend on, eg the 'universality' or otherwise of the VAT, and whether, say, 'luxury' items can be identified and taxed at higher rates. • **Equality**, eg it could be argued that the switch will affect life chances of both the better off and less well off by increasing 'incentives', and hence affect equality through trickle-down; or that the regressive nature of the switch and the resulting inequality is economically dysfunctional and will cause further inequality; or that the effects are neutral, and wealth taxes would have greater effects on equality than tinkering with income and expenditure taxes.	**Award 1 mark for each link in a logical chain of reasoning** **Up to 10 marks for each of equity and equality**
Use of diagrams to help support explanations	**Up to 2 marks per diagram (1 mark for labelling, 1 mark for information shown) to a total of 4 marks.**

Maximum of 10 marks if only equity or equality discussed

MAXIMUM FOR PART 11: 15 MARKS

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12	Assess the economic costs **and** benefits of government action which results in the UK becoming a less equal society.	*(25 marks)*

In this part of the question, students will need to demonstrate that they are able to evaluate issues and arguments to support a conclusion if they are to be awarded **more than 15 marks**.

Level 5	**Good analysis <u>and</u> good evaluation**	**22-25 marks** *Mid-point 24*
Level 4	**Good analysis <u>but</u> limited evaluation** **OR** **Reasonable analysis <u>and</u> reasonable evaluation**	**17-21 marks** *Mid-point 19*
Level 3	**Reasonable answer, including some correct analysis but very limited evaluation**	**10-16 marks** *Mid-point 13*
Level 2	**Weak with some understanding**	**4-9 marks** *Mid-point 7*
Level 1	**Very weak**	**0-3 marks** *Mid-point 2*

Issues and areas for discussion include:

Introduction	• Meaning of a 'less equal society' • Measurement of inequality • Examples of government action resulting in inequality, eg o regressive taxes o reducing inheritance taxes o encouraging a bonus culture o removal of universal benefits o raising entry barriers (eg. tuition fees) o reducing the 'social wage' (reducing or slowing down increases in spending on public and merit goods) o equality of opportunity/equality of outcome.
Developing the response to the question **Application/Analysis**	• Benefits of inequality, eg o incentive arguments o trickle-down o encouraging enterprise o encouraging work rather than welfare o impact on saving and investment • Costs of inequality, eg o social cost, unrest, riots o waste of talent o lack of safety nets o wider costs, correlations between inequality and wider economic and social issues o macro effects of inequality and insecurity (synoptic points), eg ▪ downward multiplier ▪ boom and bust ▪ national income and welfare ▪ impact on output of policies to promote equality/ inequality.

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Evaluation	• questioning of individual alleged benefits, eg do managers receiving annual 'compensation' measured in millions really have an 'incentive' to improve efficiency? • questioning of individual alleged costs, eg is social unrest caused by inequality as such, or by unreal expectations or simple greed? • overall assessment of costs versus benefits • question of whether 'inequality' is an actual 'aim' of policy • for and against 'trickle down' ideas • impacts depend on the extent of inequality, time periods. *Examiners should note that, for some of the weaker or average students, parts of the above represent quite sophisticated evaluation and so it is important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.*
Also give credit for	• diagrams • an overall judgement on the issues raised • examples.

It will only be possible for students to consider a few of the above. They may also discuss issues not discussed above.

USE THE DETAILED LEVELS MARK SCHEME ON PAGES 3 AND 4 FOR FURTHER CLARIFICATION

MAXIMUM FOR PART 12: 25 MARKS

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General Certificate of Education
Advanced Level Examination
June 2012

Economics ECON3

Unit 3 Business Economics and the Distribution of Income

Tuesday 12 June 2012 1.30 pm to 3.30 pm

For this paper you must have:
- an AQA 12-page answer book
- a calculator.

Time allowed
- 2 hours

Instructions
- Use black ink or black ball-point pen. Pencil should only be used for drawing.
- Write the information required on the front of your answer book. The **Examining Body** for this paper is AQA. The **Paper Reference** is ECON3.
- In **Section A**, answer **EITHER** Context 1 **OR** Context 2.
- In **Section B**, answer **one** essay.

Information
- The marks for questions are shown in brackets.
- The maximum mark for this paper is 80.
- There are 40 marks for **Section A** and 40 marks for **Section B**.
- This paper is synoptic. It assesses your understanding of the relationship between the different aspects of Economics.
- You will be marked on your ability to:
  – use good English
  – organise information clearly
  – use specialist vocabulary where appropriate.

Advice
- You are advised to spend 1 hour on **Section A** and 1 hour on **Section B**.

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Section A

Answer **EITHER** Context 1 **OR** Context 2.

EITHER **Total for this Context: 40 marks**

Context 1

THE GLOBAL CONTEXT

Study **Extracts A and B**, and then answer **all** parts of Context 1 which follow.

Extract A: Carbon emissions from fossil fuels, world and selected countries, 2007

(i) Total CO_2 emissions

	Millions of tonnes
China	6 500
USA	6 000
Russia	1 500
UK	500
Brazil	400
Nigeria	95
Qatar	60
Morocco	45
World	29 300

(ii) Per capita CO_2 emissions

	Tonnes per head
Qatar	55.5
USA	19.0
Russia	11.0
UK	9.0
China	5.0
Brazil	2.0
Morocco	1.5
Nigeria	0.5
World	4.5

Note: Figures are rounded

Source: official statistics

Extract B: Climate change

In 2004, Russia signed up to the Kyoto Protocol, an international agreement on policies to manage climate change. This committed Russia to a United Nations programme to reduce emissions of greenhouse gases. In 2010, Russia's emissions were as low as their 1990 levels, but this was less to do with environmental policy and more to do with the collapse of heavy industry following the fall of the Soviet Union. A large contribution towards the UK's Kyoto targets also came from deindustrialisation. However, China, like the USA, did not sign up to the Kyoto Protocol.

International action to control carbon emissions is necessary. One policy is known as 'carbon trading'. Countries agree overall emissions limits and try to create an international market for permits to pollute. The idea is to put a money value on emissions and, over time, to create incentives for businesses to invest in less-polluting technology. As well as the large compulsory 'compliance' market for carbon credits, there is also a smaller voluntary market for 'carbon offsets'.

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For example, an organisation can be paid to plant trees to allegedly offset the damage that an airline journey does to the ozone layer. Some companies are using these offsets, together with greater energy efficiency and reduced polluting activities, to claim to be 'carbon neutral'. Some environmentalists are suspicious of offset schemes and claim, for instance, that offset schemes have hidden environmental costs.

Some economists argue that the pollution and depletion of communal resources such as clean air, water reserves and fish stocks are made worse by a lack of property rights. Critics say that carbon trading amounts to 'privatisation of the atmosphere', with property rights in this vast new market being grabbed by speculators or by those who already pollute the most. They also claim that activities such as buying credits from Russia are an 'accounting fraud' because they do not necessarily arise from energy efficiency but from the collapse of heavy industry. There is concern that carbon trading is a further blow to manufacturing and that service industries are treated more leniently. If the UK relies on manufactured imports, it can be argued that factories located in China are actually creating UK emissions.

Some major UK businesses appear happier with permit trading than with alternative policies such as quotas on emissions or the taxation of fuel. There is a suspicion that carbon trading might mislead the public into believing that pollution from airlines and other industries is no longer damaging. Governments are accused of being overgenerous in allotting permits to industries that they see as nationally important, such as car manufacturing and electricity generation. While the UK might reduce its domestic demand for carbon, it continues to contribute to the world supply of fossil fuels through activities such as oil prospecting and opencast mining. Russia, China and less-developed countries with coal reserves show few signs of reducing their output of this form of carbon.

Source: news reports, 2010

0 1 Using **Extract A**, calculate to one decimal place the percentage of world CO_2 emissions generated by the UK **and** identify **one other** significant feature of the data shown. *(5 marks)*

0 2 Explain what is meant by 'property rights' (**Extract B**, line 20) **and** analyse how an absence of property rights can worsen the environmental market failures of **both** pollution **and** the rapid depletion of natural resources. *(10 marks)*

0 3 'Some major UK businesses appear happier with permit trading than with alternative policies such as quotas on emissions or the taxation of fuel' (**Extract B**, lines 29–30).

Using the data and your economic knowledge, evaluate the possible impact on UK businesses of policies to reduce pollution and climate change. *(25 marks)*

Turn over ▶

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Do **not** answer Context 2 if you have answered Context 1.

OR **Total for this Context: 40 marks**

Context 2

THE EUROPEAN UNION CONTEXT

Study **Extracts C and D**, and then answer **all** parts of Context 2 which follow.

Extract C: Some comparisons of pay in the EU and UK

(i) Estimated monthly minimum wage, selected EU countries, 2007

	€ (euros)
Luxembourg	1570
Ireland	1400
UK	1360
France	1250
Spain	670
Portugal	470
Poland	250
Bulgaria	90

Note: Figures are rounded

(ii) Comparative pay over time, selected UK occupations

	Year	
Typical annual pay of:	**1980 (£)**	**2009 (£)**
Office cleaner	4 500	14 000
Nurse	5 000	29 500
Teacher	6 500	35 000
Doctor	12 500	78 500
Chief Executive of a FTSE 100 company	85 000	4 900 000

Source: official statistics

Extract D: Policies for fairness

The European Union is one of the richest areas in the world but both absolute poverty and relative poverty exist within the EU. Although unemployment is a major cause of poverty, the working poor, whose wages are at or below the 'poverty line', are estimated to number 20 million across the EU.

The EU named 2010 as the 'European Year for Combating Poverty and Social Exclusion', but this hardly featured at all in the UK media. However, the concept of fairness is very much on the national agenda. For example, the UK Prime Minister, David Cameron, did at one stage suggest that the earnings of the highest paid public servant should be no more than 20 times that of the lowest. Furthermore, many commentators have suggested that, if such a formula were introduced, the idea could spread to the private sector. The UK is one of 20 out of 27 EU member states with a minimum wage. Across those 20 countries, minimum wages are between 30% and 50% of average earnings. The European Parliament has floated the idea of an all-EU 'minimum income' but this is not expected to be taken up by governments just yet. And how long before there are also serious proposals for a national, or even an all-EU, maximum wage?

Between 1980 and 2005, the distribution of income in the UK became less equal. In 1980, the top 1% of earners received 12% of all income. However, by 2005 the top 1% of earners received 16% of all income, with bonuses in the financial sector pushing this figure nearer

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to 18%. The trend towards greater income inequality in the UK in recent years has largely been justified by the idea that market forces provide 'incentives' for successful businesses and that the spending power of high earners 'trickles down' to the rest of society.

Fairness is difficult to define. One view, suggested by the UK's *Institute for Public Policy Research*, is that fairness involves basic minimum entitlements and equal opportunities, plus an absence of obstacles created by factors such as where an individual is born or where they happen to live. Addressing unfairness in the UK tends to focus on policies to redistribute income after it has been earned: for example, through the tax and benefits system. On the other hand, much EU policy is aimed at reducing the unequal distribution of income at source, through what are called cohesion policies to target supply-side obstacles.

EU policies are, to a large extent, aimed at boosting the employability and earning potential of workers through measures such as skills training and business advice. They work on the 'supply side' of the labour market but the demand for labour cannot be ignored. For example, despite receiving significant levels of EU funding, recently Wales lost 900 well-paid, skilled jobs when the German company *Robert Bosch* moved its factory to Hungary, where wages are much lower. Perhaps an all-EU minimum wage would have helped to prevent this.

Source: news reports, 2010

0 4 Using **Extract C**, calculate to one decimal place the typical annual pay of a teacher in 1980 as a percentage of the typical annual pay of a teacher in 2009 **and** identify **one other** significant feature of the data. *(5 marks)*

0 5 Explain the distinction between absolute poverty and relative poverty (**Extract D**, lines 1–2) **and** analyse **two** causes of poverty. *(10 marks)*

0 6 'Addressing unfairness in the UK tends to focus on policies to redistribute income after it has been earned… On the other hand, much EU policy is aimed at reducing the unequal distribution of income at source…' (**Extract D**, lines 25–28).

Using the data and your economic knowledge, evaluate the view that a fair distribution of income can better be achieved by policies which aim to redistribute income after it is earned rather than by policies which tackle supply-side obstacles in the economy. *(25 marks)*

Turn over for the next question

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Section B

Answer **one** essay from this section.

Each essay carries 40 marks.

EITHER

Essay 1

'Bigger is better.... Small is beautiful.... Size does not matter.'

0 7 Explain how a firm can experience diminishing returns in the short run **and** economies of scale in the long run. *(15 marks)*

0 8 Discuss whether large firms in the UK today are necessarily more efficient than small firms. *(25 marks)*

OR

Essay 2

An oligopolistic firm is trying to decide on the selling price and output of its product, and is also considering colluding with other firms in the industry.

0 9 Explain why oligopolistic firms are affected by both interdependence and uncertainty when selling their product. *(15 marks)*

1 0 Evaluate policies which a UK government could use to control the activities of oligopolists. *(25 marks)*

OR

Essay 3

1 1 Explain the main principles that would be involved in a cost-benefit analysis (CBA). *(15 marks)*

1 2 In December 2010, the *Federation of Small Businesses* estimated that UK industry had lost at least £1 billion due to the disruption caused by one week's heavy snow. It was suggested that both product markets and labour markets would benefit from investment in snow-clearing equipment.

Evaluate the advantages **and** disadvantages of using CBA when deciding whether or not to invest in snow-clearing equipment. *(25 marks)*

END OF QUESTIONS

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Version 1



General Certificate of Education (A-level)
June 2012

Economics ECON3

(Specification 2140)

Unit 3: Business Economics and the Distribution of Income

Final

Mark Scheme

Mark schemes are prepared by the Principal Examiner and considered, together with the relevant questions, by a panel of subject teachers. This mark scheme includes any amendments made at the standardisation events which all examiners participate in and is the scheme which was used by them in this examination. The standardisation process ensures that the mark scheme covers the students' responses to questions and that every examiner understands and applies it in the same correct way. As preparation for standardisation each examiner analyses a number of students' scripts: alternative answers not already covered by the mark scheme are discussed and legislated for. If, after the standardisation process, examiners encounter unusual answers which have not been raised they are required to refer these to the Principal Examiner.

It must be stressed that a mark scheme is a working document, in many cases further developed and expanded on the basis of students' reactions to a particular paper. Assumptions about future mark schemes on the basis of one year's document should be avoided; whilst the guiding principles of assessment remain constant, details will change, depending on the content of a particular examination paper.

Further copies of this Mark Scheme are available from: aqa.org.uk

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Advanced Level Economics Unit 3

June 2012 **ECON3**

Mark Scheme

General Instructions

Marks awarded to students should be in accordance with the following mark scheme and examiners should be prepared to use the full range of marks available. The mark scheme for most questions is flexible, permitting the student to score full marks in a variety of ways. Where the student's response to a question is such that the mark scheme permits full marks to be awarded, full marks **MUST** be given. A perfect answer is not necessarily required for full marks. But conversely, if the student's answer does not deserve credit, then no marks should be given.

Occasionally, a student may respond to a question in a reasonable way, but the answer may not have been anticipated when the mark scheme was devised. In this situation, **OR WHENEVER YOU HAVE ANY DOUBT ABOUT THE INTERPRETATION OF THE MARK SCHEME**, you must in the first instance telephone your team leader to discuss how to proceed.

Two approaches have been used in the construction of the mark scheme.

(i) **An issue based approach.** The mark scheme for parts **01**, **02**, **04** and **05** of the data response questions and the first part of each essay question adopts this approach. The mark scheme lists the marks that can be awarded for particular issues (and associated development) that the student might include in the answer.

(ii) **A levels approach.** This approach is used for parts **03** and **06** of the data response questions and the second part of each essay question. The Levels Mark Scheme on the next page identifies five levels representing differences in the quality of work. A range of marks is allocated to each level. First decide the level into which an answer falls. The level chosen should be the one which **best fits** the answer provided by the student. It is **not** intended that the answer should satisfy every statement in the level description. Then think in terms of awarding the mid-point mark which has been identified for that level (eg 13 marks for Level 3). Move up or down from this notional mark by considering the extent to which the answer meets the level description overall. Strength in one skill can outweigh weakness in another. When using the Levels Mark Scheme the marker **must** identify where a particular skill is being demonstrated. The **key** to be used to identify the skill is given after the level descriptions. The question-specific mark scheme summarises the information which could be used to answer the question, but without attaching marks to particular issues.

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FOR USE WITH QUESTIONS 03, 06, 08, 10 AND 12 ONLY

AQA ADVANCED LEVEL (A2) ECONOMICS
LEVELS OF RESPONSE MARK SCHEME

A2 **LEVELS OF RESPONSE**	**AO1** **KNOWLEDGE and UNDERSTANDING of theories, concepts and terminology**	**AO2** **APPLICATION of theories, concepts and terminology**	**AO3** **ANALYSIS of economic problems and issues**	**AO4** **EVALUATION of economic arguments and evidence, making informed judgments**
Level 5 22-25 marks (mid-point 24) **Good analysis and good evaluation**	Good throughout the answer with few errors and weaknesses	Good application to issues Where appropriate, good use of data to support answer	Relevant and precise with a clear and logical chain of reasoning Good awareness of the inter-relatedness of economic issues	Good with a clear final judgement
Level 4 17-21 marks (mid-point 19) **Good analysis but limited evaluation** **OR** **Reasonable analysis and reasonable evaluation**	Good throughout the answer with few errors and weaknesses Good throughout much of the answer with few errors and weaknesses	Good application to issues Where appropriate, good use of data to support answer Some good application to issues Where appropriate, some good use of data to support answer	Relevant and precise with a clear and logical chain of reasoning Good awareness of the inter-relatedness of economic issues Largely relevant and well organised with reasonable logic and coherence Some awareness of the inter-relatedness of economic issues	Limited but showing some appreciation of alternative points of view Reasonable, showing an appreciation of alternative points of view
Level 3 10-16 marks (mid-point 13) **Reasonable answer, including some correct analysis but very limited evaluation**	Satisfactory but some weaknesses shown	Reasonable application to issues Where appropriate, reasonable use of data to support answer	Reasonably clear but may not be fully developed and is perhaps confused in places with a few errors present Quite well organised with some logical development	Superficial, perhaps with some attempt to consider both sides of the issue(s)
Level 2 4-9 marks (mid-point 7) **Weak with some understanding**	Limited and some errors are made	Partial application to issues with some errors Where appropriate, limited use of data to support answer	Partial but confused at times, lacking focus and development Limited logic and coherence	A very basic and simplistic attempt is made which is unsupported by analysis
Level 1 0-3 marks (mid-point 2) **Very weak**	Weak with a number of errors	Little, if any, application to issues Where appropriate, no use of data to support answer	Poor and lacking clarity and focus	No relevant evaluation

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THE KEY TO BE USED WHEN USING THE LEVELS MARK SCHEME

D Where a particular economic term is correctly **DEFINED** in order to help the student to answer the question properly.

I Where a relevant **ISSUE** is raised by the student.

K Where the student demonstrates **KNOWLEDGE** of recent developments or features of the economy which help enhance the student's response to the question. This should also be used where the student quotes relevant examples.

Ap Where the student demonstrates the ability to **APPLY** knowledge and **CRITICAL UNDERSTANDING** to problems and issues.

An Where the student demonstrates the ability to **ANALYSE** the problem using appropriate economic ideas.

E Where the student **EVALUATES** and makes judgements about the significance of various issues and arguments.

Synoptic Assessment
All questions in this unit are synoptic. Therefore, students will need to demonstrate that they are able to think as an economist and to use effectively the economist's 'tool kit' of concepts, theories and techniques.

Students should demonstrate that they:
- understand the inter-relatedness of many economic issues, problems and institutions;
- understand how certain economic concepts, theories and techniques may be relevant to a range of different contexts;
- can apply concepts, theories and techniques in analysing economic issues and problems and in evaluating arguments and evidence.

QUALITY OF WRITTEN COMMUNICATION

Quality of Written Communication (QWC) will be assessed in Questions 03, 06, 08, 10 and 12 only.

Students will be assessed according to their ability to:

- ensure that text is legible, and that spelling, grammar and punctuation are accurate, so that meaning is clear
- select and use a form and style of writing appropriate to purpose and complex subject matter
- organise information clearly and coherently, using specialist vocabulary when appropriate.

No specific marks are awarded for **QWC**.

However, examiners should take into account **QWC** when determining the mark to be awarded for an answer. This means an answer could be taken either up (for exceptional **QWC**) or down (for very poor **QWC**) by 1 mark (and no more).

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1 THE GLOBAL CONTEXT — Total for this Context: 40 marks

01	Using **Extract A**, calculate to one decimal place the percentage of world CO_2 emissions generated by the UK **and** identify **one other** significant feature of the data shown. *(5 marks)*

The calculation:

Correct answer is **1.7 (or 1.706485)**

For a correct answer (working need not be shown). Do **not** penalise a candidate who answers to two or more correct decimal places.	**3 marks**
Any answer between 1.0 and 2.0 inclusive, irrespective of decimal places.	**1 mark**
For showing a correct method but arriving at a wrong answer ie $\frac{\text{any number}}{\text{any number}} \times 100 = \text{wrong answer}$	**1 mark**

Identifying one significant feature

For identifying a significant feature and providing one piece of supporting data **with** the unit of measurement correctly shown.	**3 marks (1+2)**
For identifying a significant feature but using data **without** the appropriate unit of measurement shown.	**2 marks**
For identifying a significant feature without supporting data.	**1 mark**
For simply providing one item of data with or without the unit shown.	**0 marks**

Significant features include:

- China is top of total emissions table (6500 million tonnes)
- measuring 'per head' instead of 'total' emissions moves Qatar to the top of the table (at 55.5. tonnes per head)
- in either table the rank order of USA, Russia, UK does not alter (2nd, 3rd, 4th)
- US per capita emissions (19 tonnes per head) are over twice those of the UK (9 tonnes per head).

MAXIMUM FOR PART 01: 5 MARKS

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02	Explain what is meant by 'property rights' (**Extract B**, line 20) **and** analyse how an absence of property rights can worsen the environmental market failures of **both** pollution **and** the rapid depletion of natural resources. *(10 marks)*

Explanation	
For a relevant definition/description of property rights, eg a legally recognised right of ownership over a resource; or a definition of market failure.	**Up to 2 marks**
For explaining how property rights can be lacking, eg on common land, on the high seas, in the atmosphere.	**Up to 2 marks**

Maximum of 4 marks for the explanation

Analysis

Award up to 5 marks for each of the two 'market failures'.

Award 1 mark for each logical link in the chain of reasoning.

Examples include:

Pollution is an example of a negative externality **(1 mark).** One failure is the pollution of a communal resource such as a piece of land, a lake or the atmosphere (**1 mark)** for any one example). Fresh air is a resource essential to life (**1 mark**) however the atmosphere can also be polluted by human activity (**1 mark**). Because nobody owns the atmosphere (**1 mark**) the costs of pollution are external to the polluter (**1 mark**) and it is possible for an economic agent to pass these costs on to the wider community (**1 mark**).	**Up to 5 marks**
Another failure is the **depletion** of a communal resource, eg water reserves, fish stocks, wildlife, open spaces, and property rights incentivise conservation.	**Up to 5 marks**
Make appropriate use of diagrams, eg an externality diagram.	**Up to 2 marks per diagram (1 mark for labelling, 1 mark for correct information shown) to a maximum of 3 marks**

Maximum of 6 marks if only the analysis attempted.

Maximum of 8 marks if only the explanation and one of the two market failures (pollution, depletion) analysed.

MAXIMUM FOR PART 02: 10 MARKS

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03 'Some major UK businesses appear happier with permit trading than with alternative policies such as quotas on emissions or the taxation of fuel' (**Extract B**, lines 29-30).

Using the data and your economic knowledge, evaluate the possible impact on UK businesses of policies to reduce pollution and climate change. *(25 marks)*

In this part of the question, students will need to demonstrate that they are able to evaluate issues and arguments to support a conclusion if they are to be awarded **more than 15 marks**.

Where there is no **explicit** reference to the data, award a maximum of **21 marks**.

To reach **Level 4**, the answer must evaluate the impact of policies on firms.

Level 5	**Good analysis and good evaluation**	**22-25 marks (mid-point 24)**
Level 4	**Good analysis but limited evaluation OR Reasonable analysis and reasonable evaluation**	**17-21 marks (mid-point 19)**
Level 3	**Reasonable answer, including some correct analysis but very limited evaluation**	**10-16 marks (mid-point 13)**
Level 2	**Weak with some understanding**	**4-9 marks (mid-point 7)**
Level 1	**Very weak**	**0-3 marks (mid-point 2)**

Issues and areas for discussion include:

Introduction	• definitions/descriptions of o permit trading, quotas, environmental taxes.
Developing the response to the question **Application**	• relevant use of theory • evidence from the data, eg reference to o Russian experience (**Extract B**, lines 1-5) o British policy (**Extract B**, lines 29-32)
Developing the response to the question **Analysis**	• effects of emissions trading and alternatives, specifically on UK businesses (firms) in terms of: • costs • revenues • profits • being 'carbon neutral' as a business objective • rationale for government intervention • internalising externalities • command-and-control versus market-based solutions • "polluter pays" ideas • the need for international action • permit trading in theory and practice • alternatives and their implications, eg o physical quotas on emissions o environmental taxes • the demand for carbon and the supply of carbon.

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Evaluation	• weaknesses of carbon trading • efficacy/appropriateness of 'offsets' • the 'smokescreen' argument (mentioned in data) • lack of political will • distortions, eg lenient treatment of favoured businesses/industries (mentioned in data) • pollution permits and alternatives compared and contrasted • possible conflicts between policies, eg environmental improvement versus growth and employment • other alternative policies, eg use of green technology *Examiners should note that, for some of the weaker or average students, parts of the above represent quite sophisticated evaluation and so it is important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.*
Also give credit for	• relevant use of evidence and examples not contained in the data • relevant diagrams • an overall judgement on the issues raised.

It will only be possible for students to consider a few of the above. They may also discuss issues not discussed above.

No penalty for not discussing both pollution and climate change.

USE THE DETAILED LEVELS MARK SCHEME ON PAGES 4 & 5 FOR FURTHER CLARIFICATION

MAXIMUM FOR PART 03: 25 MARKS

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2 THE EUROPEAN UNION CONTEXT — Total for this Context: 40 marks

04 Using **Extract C**, calculate to one decimal place the typical annual pay of a teacher in 1980 as a percentage of the typical annual pay of a teacher in 2009 **and** identify **one other** significant feature of the data. *(5 marks)*

The calculation

Correct answer is **18.6 (or 18.571429)**

For a correct answer (working need not be shown). Do **not** penalise a candidate who answers to two or more correct decimal places.	**3 marks**
Any answer between 18.0 and 19.0 inclusive, irrespective of decimal places	**1 mark**
For showing a correct method but arriving at a wrong answer i.e $\frac{\text{any number}}{\text{any number}} \times 100 = \text{wrong answer}$	**1 mark**

Identifying one significant feature

For identifying a significant feature and providing one piece of supporting data **with** the unit of measurement correctly shown.	**3 marks (1+2)**
For identifying a significant feature but using data **without** the appropriate unit of measurement shown.	**2 marks**
For identifying a significant feature without supporting data.	**1 mark**
For simply providing one item of data with or without the unit shown.	**1 mark**

Significant features include:

- there is a wide range of minimum wage payments, eg €1360 in the UK and €250 in Poland
- some small countries (eg Luxembourg, Ireland) come higher in the minimum wage table than large countries (UK, France, Spain). (Data: name the countries which are higher/lower.)
- the wages of an office cleaner have increased x3 over the period shown, while those of a CEO have increased x 58
- in 2009 the country could employ 140 teachers for the price of a CEO.

MAXIMUM FOR PART 04: 5 MARKS

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05	Explain the distinction between absolute poverty and relative poverty (**Extract D**, lines 1-2) **and** analyse **two** causes of poverty. *(10 marks)*

Explanation	
For a relevant distinction eg absolute: in terms of a lack of access to basics/or in terms of an absolute poverty line (eg dollar a day); relative: lack of life chances or income in terms of a national average, or a percentage based poverty line.	**Up to 4 marks**

Maximum of 4 marks for the explanation

Analysis **Award up to 5 marks for each of two causes.** **Award 1 mark for each logical link in the chain of reasoning.** **Examples of causes include**:	
Significant shortages of <u>education and training</u> **(1 mark)** because of a lack of teachers/schools **(1 mark)** will reduce life chances **(1 mark)** and provide a 'vicious circle' of low wages **(1 mark)** leading to low taxation receipts **(1 mark)** and low investment in education **(1 mark)** leading to a less-qualified population **(1 mark)**.	
Other possible causes, eg ownership of land and/or other assets, eg housing; imperfect factor mobility; social structure/discrimination; ineffective use of taxes/transfer payments; government pricing policies, subsidies, taxes, population growth, age distribution, etc unemployment, number of adults/children in household, low wages.	
Make appropriate use of diagrams, eg supply of and demand for labour.	**Up to 2 marks per diagram (1 mark for labelling, 1 mark for correct information shown) to a maximum of 3 marks**

Maximum of 6 marks if only the analysis is attempted.

Maximum of 8 marks if only the explanation and one cause is analysed.

If more than two distinct causes are explained, award marks for the best two.

MAXIMUM FOR PART 05: 10 MARKS

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06	'Addressing unfairness in the UK tends to focus on policies to redistribute income after it has been earned….On the other hand, much EU policy is aimed at reducing the unequal distribution of income at source….' (**Extract D**, lines 25-28). Using the data and your economic knowledge, evaluate the view that a fair distribution of income can better be achieved by policies which aim to redistribute income after it is earned rather than by policies which tackle supply-side obstacles in the economy. *(25 marks)*

In this part of the question, students will need to demonstrate that they are able to evaluate issues and arguments to support a conclusion if they are to be awarded more **than 15 marks**.

Where there is no **explicit** reference to the data, award a maximum of **21 marks**.

Level 5	**Good analysis <u>and</u> good evaluation**	**22-25 marks (mid-point 24)**
Level 4	**Good analysis <u>but</u> limited evaluation** **OR** **Reasonable analysis <u>and</u> reasonable evaluation**	**17-21 marks (mid-point 19)**
Level 3	**Reasonable answer, including some correct analysis but very limited evaluation**	**10-16 marks (mid-point 13)**
Level 2	**Weak with some understanding**	**4-9 marks (mid-point 7)**
Level 1	**Very weak**	**0-3 marks (mid-point 2)**

Issues and areas for discussion include:

Introduction	• definition of income • examples of minimum entitlements (eg minimum wage, universal benefits) • examples of 'hindrances', eg poor education, health, life chances; 'postcode lotteries.'
Developing the response to the question **Application**	• use of theory • discussion based on information from the data related to fairness, eg distribution facts and figures (Extract D, lines 7-12)
Developing the response to the question **Analysis**	• policies aimed at re-distribution, examples, effects, eg o progressive/ proportional/ regressive taxes o universal benefits o EU social policies. • role of other policies, examples, effects, eg o minimum wage o anti-discrimination laws. • policies aimed at 'obstacles', examples, effects eg o access to education/training o social housing o health care o EU cohesion policies, eg skills training, business advice

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Evaluation	• what is fairness? • conflict between policies, eg o income tax: redistributive or disincentive? o supply side/demand side • 'trickle down' arguments • idea of 'multiples' in public sector; appropriateness for private sector? • maximum wage idea • difficulty of defining 'fairness' • is it a question of either/or? Can different types of policies complement each other? *Examiners should note that, for some of the weaker or average students, parts of the above represent quite sophisticated evaluation and so it is important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.*
Also give credit for	• relevant use of evidence and examples not contained in the data • diagrams • an overall judgement on the issues raised.

It will only be possible for students to consider a few of the above. They may also discuss issues not discussed above.

USE THE DETAILED LEVELS MARK SCHEME ON PAGES 4 & 5 FOR FURTHER CLARIFICATION

MAXIMUM FOR PART 06: 25 MARKS

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SECTION B

Essay 1 **Total for this Essay: 40 marks**

‘Bigger is better....Small is beautiful.....Size does not matter’.

07 Explain how a firm can experience diminishing returns in the short run **and** economies of scale in the long run. *(15 marks)*

For relevant definitions/descriptions/distinctions, eg • short run/long run • examples of fixed/variable factors • economies of scale.	**Up to 2 marks per point defined or explained** **to a maximum of 4 marks**

Award up to 8 marks for each reason identified and explained. **Award 1 mark for each logical link in the chain of reasoning**. **Examples include:**	
Short run, for example, successive units of a variable factor **(1 mark)** are applied to a fixed factor **(1 mark)** as optimum capacity limits **(1 mark)** are approached first marginal returns **(1 mark)** then average returns diminish **(1 mark)**. Eventually total returns diminish **(1 mark)**. Returns are related to costs **(1 mark)**. Productive efficiency maximised at the point of maximum average physical product **(1 mark)** or minimum average cost **(1 mark)**.	**Up to 8 marks**
Long run, explanation of long run returns/relationship to internal economies of scale. Relationship between long run and short run.	**Up to 8 marks** **but award a maximum of 5 marks if this part of the answer is a confined to a description of types of economies of scale.**
Use of diagrams to help support explanations.	**Up to 2 marks per diagram (1 mark for labelling, 1 mark for information shown) to a total of 4 marks** **This question lends itself to a complex diagram, for which 4 marks may be awarded. For example, one ‘envelope curve’ diagram might show both SR and LR**

Maximum of 10 marks if ONLY short run (diminishing returns) OR long run (economies of scale) is discussed.

MAXIMUM FOR PART 07: 15 MARKS

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08	Discuss whether large firms in the UK today are necessarily more efficient than small firms.	*(25 marks)*

In this part of the question, students will need to demonstrate that they are able to evaluate issues and arguments to support a conclusion if they are to be awarded **more than 15 marks**.

Level 5	**Good analysis and good evaluation**	**22-25 marks (mid-point 24)**
Level 4	**Good analysis but limited evaluation** **OR** **Reasonable analysis and reasonable evaluation**	**17-21 marks (mid-point 19)**
Level 3	**Reasonable answer, including some correct analysis but very limited evaluation**	**10-16 marks (mid-point 13)**
Level 2	**Weak with some understanding**	**4-9 marks (mid-point 7)**
Level 1	**Very weak**	**0-3 marks (mid-point 2)**

Issues and areas for discussion include

Introduction	• definitions of 'large' and 'small' firms • problems of comparison, eg capital intensive and labour intensive firms • definitions of efficiency.
Developing the response to the question **Application/ Analysis**	• discussion of efficiency • advantages of large firms o internal economies of scale ▪ types ▪ effects on costs • external economies o effects on large and small firms • disadvantages of large firms o diseconomies of scale o X inefficiency (note, this is not actually in the specification) o divorce of ownership and control ▪ less clear objectives • size and market structure • advantages of small firms o impact of technology o divisibilities of capital.
Evaluation	• significance of large firms, eg o output o market share o efficiency, dynamic, static • significance of small firms, eg o employment o entrepreneurship and innovation o niche markets o personal service

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	• effects of changes in markets and technology, eg o divisibilities o internet trading o mass production versus mass customisation; dozens of markets of millions versus millions of markets of dozens. *Examiners should note that, for some of the weaker or average students, parts of the above represent quite sophisticated evaluation and so it is important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.*
Also give credit for	• diagrams • an overall judgement on the issues raised

It will only be possible for students to consider a few of the above. They may also discuss issues not discussed above.

USE THE DETAILED LEVELS MARK SCHEME ON PAGES 4 & 5 FOR FURTHER CLARIFICATION

MAXIMUM FOR PART 08: 25 MARKS

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Essay 2 **Total for this Essay: 40 marks**

An oligopolistic firm is trying to decide on the selling price and output of its product, and is also considering colluding with other firms in the industry.

09 Explain why oligopolistic firms are affected by both interdependence and uncertainty when selling their product. *(15 marks)*

For relevant definitions/descriptions, eg: • oligopoly • cartel • collusion.	**Up to 2 marks per point defined or explained** **to a maximum of 4 marks**

Award up to 8 marks for each of two reasons identified and explained. **Award 1 mark for each logical link in the chain of reasoning.** **Examples include:**	
Interdependence refers to the idea that when making price and output decisions oligopolists have to consider not only how customers might react **(1 mark)** but also how rival companies might react **(1 mark)**; if a firm raises price, other firms might not follow suit **(1 mark)**; if it reduces price it might spark a price-cutting war **(1 mark)** this interdependence gives an elastic demand curve (**1 mark)** for price increases **(1 mark)** and an inelastic curve for price reductions **(1 mark)** and can lead to price stickiness **(1 mark)** and a kinked demand curve **(1 mark)**.	**Up to 8 marks**
Uncertainty identified and explained, effects on total revenue; price seeking behaviour; price leadership, game theory, collusion.	**Up to 8 marks**
Any other relevant issue, eg the presence of externalities which might result in an inefficient equilibrium.	**Up to 8 marks**
Use of diagrams to help support explanations. (Game theory matrix counts as a diagram for **2 marks**)	**Up to 2 marks per diagram (1 mark for labelling, 1 mark for information shown) eg a kinked demand diagram with just an AR curve on it to a total of 4 marks** **This question lends itself to a complex diagram for which up to 4 marks can be awarded, eg a kinked demand curve (including cost curves and a discontinuous MR curve)**

Maximum of 10 marks if either interdependence or uncertainty is not discussed.

MAXIMUM FOR PART 09: 15 MARKS

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10	Evaluate policies which a UK government could use to control the activities of oligopolists. *(25 marks)*

In this part of the question, students will need to demonstrate that they are able to evaluate issues and arguments to support a conclusion if they are to be awarded **more than 15 marks**.

Level 5	**Good analysis <u>and</u> good evaluation**	**22-25 marks (mid-point 24)**
Level 4	**Good analysis <u>but</u> limited evaluation** **OR** **Reasonable analysis <u>and</u> reasonable evaluation**	**17-21 marks (mid-point 19)**
Level 3	**Reasonable answer, including some correct analysis but very limited evaluation**	**10-16 marks (mid-point 13)**
Level 2	**Weak with some understanding**	**4-9 marks (mid-point 7)**
Level 1	**Very weak**	**0-3 marks (mid-point 2)**

Issues and areas for discussion include:

Introduction	• reasons why oligopolists might be considered to need regulation, eg o complex monopoly o anti-competitive practices o allocative inefficiency.
Developing the response to the question **Application / Analysis**	• policy options, advantages and disadvantages, eg o ending oligopoly, breaking up larger firms into smaller ones o amending oligopoly ▪ policing collusive activities, fining colluding companies (the EU approach) ▪ use of criminal law (the US approach) ▪ administrative means for investigating monopolies and mergers (the traditional UK approach) ▪ preventing potential monopolies becoming actual monopolies by restricting merger activity among oligopolies ▪ regulation ▪ privatisation/nationalisation ▪ removal of barriers • consequences of policy options, eg for o research and development o consumer and producer surplus o productive and allocative efficiency o dynamic, static efficiency

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	o barriers to entry o scale economies o national/international competitiveness o employment.
Evaluation	Consideration of o effectiveness of different types of policy o effectiveness of individual policies o intended and unintended consequences o the option of allowing market forces to work without government intervention (the IBM/Microsoft argument). o market vs govt failure o contestability of market. *Examiners should note that, for some of the weaker or average students, parts of the above represent quite sophisticated evaluation and so it is important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.*
Also give credit for	• diagrams • an overall judgement on the issues raised.

It will only be possible for students to consider a few of the above. They may also discuss issues not discussed above.

USE THE DETAILED LEVELS MARK SCHEME ON PAGES 4 & 5 FOR FURTHER CLARIFICATION

MAXIMUM FOR PART 10: 25 MARKS

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Essay 3 **Total for this Essay: 40 marks**

11	Explain the main principles that would be involved in a cost-benefit analysis (CBA). *(15 marks)*

General definition/description of costs, benefits (internal, external); idea of net social product (the difference between social benefits and social costs).	**Up to 2 marks per point defined or explained** **to a maximum of 4 marks**

Award 1 mark for each logical link in the chain of reasoning, up to 15 marks. **Examples include:**	
It is necessary to identify **(1 mark)** and assign monetary values **(1 mark)** to all costs and benefits **(1 mark)**. CBA puts monetary values on costs and benefits which are not always easy to identify **(1 mark)** and not usually monetised in the case of externalities **(1 mark)**. An example such as time lost when traffic is held up **(1 mark)**. Techniques include shadow pricing **(1 mark)**.	
Other principles, eg assigning a present value to future cost/ benefit flows; calculating the likelihood of various risks; assessing distribution of costs and benefits. A full explanation of **shadow pricing** can be rewarded as a distinct 'principle'.	
Use of diagrams to help support explanations.	**Up to 2 marks per diagram (1 mark for labelling, 1 mark for information shown) to a total of 4 marks**

MAXIMUM FOR PART 11: 15 MARKS

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12 In December 2010, the *Federation of Small Businesses* estimated that UK industry had lost at least £1 billion due to the disruption caused by one week's heavy snow. It was suggested that both product markets and labour markets would benefit from investment in snow-clearing equipment.

Evaluate the advantages **and** disadvantages of using CBA when deciding whether or not to invest in snow-clearing equipment. *(25 marks)*

In this part of the question, students will need to demonstrate that they are able to evaluate issues and arguments to support a conclusion if they are to be awarded **more than 15 marks**.

To reach Level 4, the answer must be in the context of the snow-clearing scenario.

Level 5	**Good analysis <u>and</u> good evaluation**	**22-25 marks (mid-point 24)**
Level 4	**Good analysis <u>but</u> limited evaluation** **OR** **Reasonable analysis <u>and</u> reasonable evaluation**	**17-21 marks (mid-point 19)**
Level 3	**Reasonable answer, including some correct analysis but very limited evaluation**	**10-16 marks (mid-point 13)**
Level 2	**Weak with some understanding**	**4-9 marks (mid-point 7)**
Level 1	**Very weak**	**0-3 marks (mid-point 2)**

Issues and areas for discussion include:

Introduction	• identifying general ways in which such CBA provides useful information, eg in terms of product markets, labour markets.
Developing the response to the question **Application/ Analysis**	• general advantages of using CBA, eg o puts more information in front of decision makers o encourages transparency about the claims that are made and the basis upon which they are made • general disadvantages of using CBA, eg o collects too much information o clouds the issue o 'false objectivity.' • suggestions of possible specific arguments that a CBA could reveal in favour of the investment, eg in terms of o prices o output o profits o earnings o employment. • Suggestions of possible specific arguments against that a CBA could reveal, eg in terms of o costs o taxes o government budgets/priorities o possible waste of resources (unpredictability of the weather).

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	• possible specific effects that CBA could reveal in terms of o product markets o internal costs and benefits of the investment o external costs and benefits o labour markets • possible criticisms of such findings: o 'interventionist' view, eg the process of discounting makes environmental costs look smaller than they actually are o 'free market' view, eg CBA is 'wishy-washy' and can be used in an anti-business way or to prevent progress o it is necessary to look at distribution effects, eg costs and benefits might balance; but one group in society might be paying all the costs, and another receiving all the benefits o difficulties of assigning money values to non-monetary items o difficulties of setting appropriate discount rate.
Evaluation	• problems that would still remain after CBA, eg who pays for the investment? Taxpayer? Companies? Consumers? • assessment of the risks in making long-term predictions • possibility of bias, eg depending on who commissions the CBA • argument along the lines that CBA does not necessarily make a decision (this is not the job of the economist) it merely puts more information on the table for the use of the decision-maker (e.g. the responsible politician). Hopefully this makes decisions more transparent and decision-makers more accountable • overall assessment of whether the advantages of using CBA outweigh the disadvantages. *Examiners should note that, for some of the weaker or average students, parts of the above represent quite sophisticated evaluation and so it is important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.*
Also give credit for	• diagrams • an overall judgement on the issues raised

It will only be possible for students to consider a few of the above. They may also discuss issues not discussed above.

USE THE DETAILED LEVELS MARK SCHEME ON PAGES 4 & 5 FOR FURTHER CLARIFICATION

MAXIMUM FOR PART 12: 25 MARKS

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General Certificate of Education
Advanced Level Examination
January 2012

Economics ECON3

Unit 3 Business Economics and the Distribution of Income

Monday 23 January 2012 1.30 pm to 3.30 pm

For this paper you must have:
- an AQA 12-page answer book
- a calculator.

Time allowed
- 2 hours

Instructions
- Use black ink or black ball-point pen. Pencil should only be used for drawing.
- Write the information required on the front of your answer book. The **Examining Body** for this paper is AQA. The **Paper Reference** is ECON3.
- In **Section A**, answer **EITHER** Context 1 **OR** Context 2.
- In **Section B**, answer **one** essay.

Information
- The marks for questions are shown in brackets.
- The maximum mark for this paper is 80.
- There are 40 marks for **Section A** and 40 marks for **Section B**.
- This paper is synoptic. It assesses your understanding of the relationship between the different aspects of Economics.
- You will be marked on your ability to:
  – use good English
  – organise information clearly
  – use specialist vocabulary where appropriate.

Advice
- You are advised to spend 1 hour on **Section A** and 1 hour on **Section B**.

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Section A

Answer **EITHER** Context 1 **OR** Context 2.

EITHER **Total for this Context: 40 marks**

Context 1

THE GLOBAL CONTEXT

Study **Extracts A and B**, and then answer **all** parts of Context 1 which follow.

Extract A: UK production and imports of natural gas

	2007	2008	2009	Year X (forecast)
UK production of natural gas (GWh)	840 000	810 000	700 000	560 000
Index of UK production of natural gas	120	116	100	?
UK imports of natural gas (GWh)	340 000	410 000	460 000	540 000
Index of UK imports of natural gas	74	89	100	117

Note: A gigawatt hour (GWh) is a measure of the energy content of gas.

Sources: industry information, 2010, and independent forecast

Extract B: Supplying the energy market: the case of Milford Haven

For hundreds of years, the harbour of Milford Haven in West Wales has responded to changes in the global economy. It has accommodated many global activities, including trade, defence, transport and tourism. These activities are often in potential conflict with the environment. Although it is surrounded by the Wales coastal footpath and the *Pembrokeshire National Park*, Milford Haven contains two massive oil refineries, several leisure marinas, an international car ferry port and quays for what little remains of the West Wales fishing industry.

Milford Haven Port Authority (MHPA) is a nationalised enterprise, accountable to the *Department of Trade and Industry* in London. Ports have often developed historically as 'public works' due to their strategic importance and because of the large amount of investment needed to build port installations. Governments are trying to reduce the size of the public sector in order to improve efficiency and competition. However, given the activities with which it is involved, there are commercial and wider economic and social arguments against a body such as the MHPA being privatised. For example, the MHPA has argued that privatisation would reduce its ability to take part in infrastructure projects in public–private partnerships. These partnerships involve a variety of companies and government bodies at local, regional, national and international levels.

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A major strategy adopted by the MHPA involves anticipating and reacting to changes in the global energy market. The boom years of North Sea oil and gas, which created high wages in skilled jobs for northern ports such as Aberdeen, are drawing to a close. Global oil and gas markets are often concentrated markets. For this reason, as well as for reasons of ensuring security of supply, new sources such as biofuels and other diverse forms of energy are being sought.

The MHPA, together with the UK government, has negotiated a long-term deal with the government of Qatar in the Arabian Gulf for the supply of liquefied natural gas (LNG). This is sent to Milford Haven in refrigerated container ships and then stored in huge tanks at the port. When the gas is warmed up, it expands to 600 times its liquefied volume. The gas is sent through a new pipeline to a pumping station 150 miles away in Gloucestershire. It is then distributed into the UK national grid for industrial and domestic use. This is an example of a public–private partnership in action.

The distribution of fuels such as gas and oil involves some negative externalities. There was controversy when the new pipeline was laid through attractive Welsh countryside, including the *Brecon Beacons National Park*. Some 15 years ago, the oil tanker *Sea Empress* sank near the entrance to Milford Haven and it took the local economy several years to recover from the environmental impact of the resulting pollution. Given the recent environmental experiences of BP in the Gulf of Mexico, environmentalists are concerned about the possibility of some sort of disaster arising from the storage or movement of LNG.

There are also concerns about the UK's possible over-reliance on a single product (LNG) from a monopoly source (the state of Qatar) and a single distribution channel (the Pembroke–Gloucester pipeline). Supporters of the MHPA strategy claim that the LNG business actually aids consumer choice and competition through diversification, adding gas installations to the existing oil and renewable energy installations in and around the port. The MHPA states that safety and the prevention of environmental incidents are the 'most important priorities' of their business.

Sources: news reports and industry information, 2010

0 1 Using **Extract A**, calculate the index of UK production of natural gas for **Year X and** identify **one** significant feature of the data for the years 2007 to 2009. *(5 marks)*

0 2 Explain what is meant by 'concentrated markets' (**Extract B**, line 21) **and** analyse **two** possible consequences of energy being supplied through concentrated markets. *(10 marks)*

0 3 '…given the activities with which it is involved, there are commercial and wider economic and social arguments against a body such as the MHPA being privatised' (**Extract B**, lines 12–14).

Using the data and your economic knowledge, do you agree with the view that enterprises such as the MHPA should be privatised? Justify your answer. *(25 marks)*

Turn over ▶

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Do **not** answer Context 2 if you have answered Context 1.

OR **Total for this Context: 40 marks**

Context 2

THE EUROPEAN UNION CONTEXT

Study **Extracts C and D**, and then answer **all** parts of Context 2 which follow.

Extract C: Quantity and value of fish landed in UK ports, all species

	2003	2006	2009	Year Y (forecast)
Quantity of fish (tonnes)	700 000	530 000	500 000	400 000
Index of quantity of fish	140	106	100	?
Value (£ million)	475	590	611	620
Index of value of fish	78	97	100	101

Sources: official statistics and industry information, 2010

Extract D: Changing markets and EU policy: the case of Grimsby

Deep sea fishermen have been called the last of the hunter-gatherers. They chase a scarce natural resource which is not farmed or domesticated. While there is pressure to achieve economies of scale, large super-efficient factory ships are in danger of eradicating the very raw material upon which they rely. The market for fish operates efficiently in many ways, with buyers and sellers who have good knowledge of the product and of prices. However, at the European Union level, a great deal of time and money is spent on trying to reduce failures in this market for fish.

Marine scientists have said that, without government intervention, fish stocks will collapse completely by 2050 and that intervention is necessary to prevent various market failures. Sea fish are not a public good, although they tend to be treated as one largely due to a lack of property rights. For the past 30 years, the national fisheries of EU member states within Community waters have been governed by the Common Fisheries Policy (CFP). The CFP includes measures which are aimed at conservation by regulating the amount of fish taken from the sea, controlling the fishing methods that are used, and policies for matching supply and demand. Policies include quotas and restrictions on the times that boats can spend at sea. Trawler captains usually operate as small business entrepreneurs, often with expensive loans, and have costs to pay even when a boat is laid up in harbour. New boats cost about £25 million and EU licences can insist that, when taken out of service, the boats are destroyed. Ultimately, these boats have to be efficient enough to catch sufficient fish to earn a profit during the equivalent of only two months at sea each year.

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The CFP has been widely criticised. For example, critics claim that quotas are wasteful since, if too many fish are caught, perfectly edible fish have to be dumped at sea rather than brought ashore. On the other hand, supporters of the CFP would argue that it gives hope of avoiding the collapse of stocks or even the complete extinction of some species.

In the 1950s, deep sea fishing was a multi-million pound business and Grimsby in North Lincolnshire was the largest fishing port in the world. Generations of families found employment in fishing and its related industries, such as food manufacture. The UK's first frozen 'fish finger' was produced in Grimsby in 1955. Demand in product markets leads directly to a derived demand in labour markets and the CFP has had a massive impact on towns such as Grimsby.

Nationally, fisheries represent well under one per cent of the UK economy. However, their effects on local and regional labour markets are much greater than this figure would suggest. Workers in the fishing industry tend to be immobile occupationally, in terms of their experience and skills, and geographically, in terms of where they are prepared to live and work.

In 1964, 22 000 fishermen were employed in the UK. This fell slowly to 21 000 in 1994 and then more rapidly to 12 000 by 2009. While fishing has been in decline for many years, Grimsby retains several major companies which produce some of the best known brands of fish and other frozen food products in the UK. Also, Grimsby still has the largest fish market in the UK, although most of what is sold is now transported to Grimsby by road from other ports or imported in container ships. New industries such as light engineering, chemicals and plastics have become important employers. Grimsby, like many other towns, relies heavily on retailing as a source of employment, together with tourism in the nearby resort of Cleethorpes.

Sources: news reports and industry information, 2010

0 4 Using **Extract C**, calculate the index of quantity of fish for **Year Y and** identify **one** significant feature of the data for the period 2003 to 2009. *(5 marks)*

0 5 Explain what is meant by 'economies of scale' (**Extract D**, line 3) **and** analyse how **two** types of economy of scale could affect the fishing industry. *(10 marks)*

0 6 Using the data and your economic knowledge, evaluate the view that intervention in the fishing industry by the EU is unlikely to correct market failure but is likely to result in government failure in **both** UK product markets **and** UK labour markets. *(25 marks)*

Turn over for the next question

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Section B

Answer **one** essay from this section.

Each essay carries 40 marks.

EITHER

Essay 1

0 7 'A pharmaceutical company can expect to make supernormal profits on a new drug or medicine in the short run.'

Explain why some firms might be able to **continue** to make supernormal profits in the **long run**. *(15 marks)*

0 8 Evaluate whether profit maximisation is always the most important objective of firms. *(25 marks)*

OR

Essay 2

0 9 Explain why competition might lead to **both** productive efficiency **and** allocative efficiency. *(15 marks)*

1 0 Evaluate the view that, providing there is market contestability, government intervention to ensure competition is unnecessary. *(25 marks)*

OR

Essay 3

1 1 Explain how marginal revenue product can help to determine **both** wage rates **and** employment in particular occupations. *(15 marks)*

1 2 A government wishes to make the distribution of **both** income **and** wealth more equal.

Discuss whether the most effective way to achieve these aims is to tax income more progressively. *(25 marks)*

END OF QUESTIONS

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Version 1



General Certificate of Education (A-level)
January 2012

Economics ECON3

(Specification 2140)

Unit 3: Business Economics and the Distribution of Income

Final

Mark Scheme

Mark schemes are prepared by the Principal Examiner and considered, together with the relevant questions, by a panel of subject teachers. This mark scheme includes any amendments made at the standardisation events which all examiners participate in and is the scheme which was used by them in this examination. The standardisation process ensures that the mark scheme covers the students' responses to questions and that every examiner understands and applies it in the same correct way. As preparation for standardisation each examiner analyses a number of students' scripts: alternative answers not already covered by the mark scheme are discussed and legislated for. If, after the standardisation process, examiners encounter unusual answers which have not been raised they are required to refer these to the Principal Examiner.

It must be stressed that a mark scheme is a working document, in many cases further developed and expanded on the basis of students' reactions to a particular paper. Assumptions about future mark schemes on the basis of one year's document should be avoided; whilst the guiding principles of assessment remain constant, details will change, depending on the content of a particular examination paper.

Further copies of this Mark Scheme are available from: aqa.org.uk

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Advanced Level Economics Unit 3

General Instructions

Marks awarded to students should be in accordance with the following mark scheme and examiners should be prepared to use the full range of marks available. The mark scheme for most questions is flexible, permitting the student to score full marks in a variety of ways. Where the student's response to a question is such that the mark scheme permits full marks to be awarded, full marks **MUST** be given. A perfect answer is not necessarily required for full marks. But conversely, if the student's answer does not deserve credit, then no marks should be given.

Occasionally, a student may respond to a question in a reasonable way, but the answer may not have been anticipated when the mark scheme was devised. In this situation, **OR WHENEVER YOU HAVE ANY DOUBT ABOUT THE INTERPRETATION OF THE MARK SCHEME**, you must in the first instance telephone your team leader to discuss how to proceed.

Two approaches have been used in the construction of the mark scheme.

(i) **An issue based approach.** The mark scheme for parts **01**, **02**, **04** and **05** of the data response questions (**Section A**) and the first part of each essay question (**Section B**) adopts this approach. The mark scheme lists the marks that can be awarded for particular issues (and associated development) that the student might include in the answer.

(ii) **A levels approach.** This approach is used for parts **03** and **06** of the data response questions (**Section A**) and the second part of each essay question (**Section B**). The Levels Mark Scheme on the next page identifies five levels representing differences in the quality of work. A range of marks is allocated to each level. First decide the level into which an answer falls. The level chosen should be the one which **best fits** the answer provided by the student. It is **not** intended that the answer should satisfy every statement in the level description. Then think in terms of awarding the mid-point mark which has been identified for that level (eg 13 marks for Level 3). Move up or down from this notional mark by considering the extent to which the answer meets the level description overall. Strength in one skill can outweigh weakness in another. When using the Levels Mark Scheme the marker **must** identify where a particular skill is being demonstrated. The **key** to be used to identify the skill is given after the level descriptions. The question-specific mark scheme summarises the information which could be used to answer the question, but without attaching marks to particular issues.

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AQA ADVANCED LEVEL (A2) ECONOMICS

LEVELS OF RESPONSE MARK SCHEME

FOR USE WITH QUESTIONS 03, 06, 08, 10 AND 12 ONLY

A2 **LEVELS OF RESPONSE**	**AO1** **KNOWLEDGE and UNDERSTANDING of theories, concepts and terminology**	**AO2** **APPLICATION of theories, concepts and terminology**	**AO3** **ANALYSIS of economic problems and issues**	**AO4** **EVALUATION of economic arguments and evidence, making informed judgements**
Level 5 22-25 marks (mid-point 24) **Good analysis and good evaluation**	Good throughout the answer with few errors and weaknesses	Good application to issues Where appropriate, good use of data to support answer	Relevant and precise with a clear and logical chain of reasoning Good awareness of the inter-relatedness of economic issues	Good with a clear final judgement
Level 4 17-21 marks (mid-point 19) **Good analysis but limited evaluation** **OR** **Reasonable analysis and reasonable evaluation**	Good throughout the answer with few errors and weaknesses Good throughout much of the answer with few errors and weaknesses	Good application to issues Where appropriate, good use of data to support answer Some good application to issues Where appropriate, some good use of data to support answer	Relevant and precise with a clear and logical chain of reasoning Good awareness of the inter-relatedness of economic issues Largely relevant and well organised with reasonable logic and coherence Some awareness of the inter-relatedness of economic issues	Limited but showing some appreciation of alternative points of view Reasonable, showing an appreciation of alternative points of view
Level 3 10-16 marks (mid-point 13) **Reasonable answer, including some correct analysis but very limited evaluation**	Satisfactory but some weaknesses shown	Reasonable application to issues Where appropriate, reasonable use of data to support answer	Reasonably clear but may not be fully developed and is perhaps confused in places with a few errors present Quite well organised with some logical development	Superficial, perhaps with some attempt to consider both sides of the issue(s)
Level 2 4-9 marks (mid-point 7) **Weak with some understanding**	Limited and some errors are made	Partial application to issues with some errors Where appropriate, limited use of data to support answer	Partial but confused at times, lacking focus and development Limited logic and coherence	A very basic and simplistic attempt is made which is unsupported by analysis
Level 1 0-3 marks (mid-point 2) **Very weak**	Weak with a number of errors	Little, if any, application to issues Where appropriate, no use of data to support answer	Poor and lacking clarity and focus	No relevant evaluation

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THE KEY TO BE USED WHEN USING THE LEVELS MARK SCHEME

D Where a particular economic term is correctly **DEFINED** in order to help the student to answer the question properly.

I Where a relevant **ISSUE** is raised by the student.

K Where the student demonstrates **KNOWLEDGE** of recent developments or features of the economy which help enhance the student's response to the question. This should also be used where the student quotes relevant examples.

Ap Where the student demonstrates the ability to **APPLY** knowledge and **CRITICAL UNDERSTANDING** to problems and issues.

An Where the student demonstrates the ability to **ANALYSE** the problem using appropriate economic ideas.

E Where the student **EVALUATES** and makes judgements about the significance of various issues and arguments.

Synoptic Assessment

All questions in this unit are synoptic. Therefore, students will need to demonstrate that they are able to think as an economist and to use effectively the economist's 'tool kit' of concepts, theories and techniques.

Students should demonstrate that they:
- understand the inter-relatedness of many economic issues, problems and institutions;
- understand how certain economic concepts, theories and techniques may be relevant to a range of different contexts;
- can apply concepts, theories and techniques in analysing economic issues and problems and in evaluating arguments and evidence.

QUALITY OF WRITTEN COMMUNICATION

Quality of Written Communication (QWC) will be assessed in Questions 03, 06, 08, 10 and 12 only.

Students will be assessed according to their ability to:

- ensure that text is legible, and that spelling, grammar and punctuation are accurate, so that meaning is clear
- select and use a form and style of writing appropriate to purpose and complex subject matter
- organise information clearly and coherently, using specialist vocabulary when appropriate.

No specific marks are awarded for QWC.

However, examiners should take into account QWC when determining the mark to be awarded for an answer. This means an answer could be taken either up (for exceptional QWC) or down (for very poor QWC) by 1 mark (and no more).

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1 THE GLOBAL CONTEXT — Total for this context: 40 marks

01 Using **Extract A**, calculate the index of UK production of natural gas for **Year X and** identify **one** significant feature of the data shown for the years 2007 to 2009.*(5 marks)*

The calculation:

For a correct answer (80). Working out need not be shown. No units necessary here.	**3 marks**
For showing a correct method but arriving at a wrong answer, eg $\frac{\text{Any number}}{\text{Any number}}$ x 100 = wrong answer	**1 mark**

Identifying one significant feature:

For identifying a significant feature	**1 mark**
For providing accurate supporting data with appropriate unit of measurement (GWh or mention of index)	**1 mark for appropriate data** **+** **1 mark for GWh or mention of index**

Significant features from 2007 to 2009 include:

- UK production falls continuously from 840 000 to 700 000 GWh (or from index 120 to 100)
- imports rise from 340 000 to 460 000 GWh (or index 74 to 100)
- the imports do not entirely replace lost production (with relevant figures to support this)
- production was highest in 2007 at 840 000 GWh (or an index of 120)
- production was lowest in 2009 at 700 000 (or an index of 100)
- imports were highest in 2009 at 460 000 GWh (or an index of 100)
- imports were lowest in 2007 at 340 000 GWh (or an index of 74).

Do not credit a feature which relates to the forecast Year X.

MAXIMUM FOR PART 01: 5 MARKS

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02 Explain what is meant by 'concentrated markets' (**Extract B**, line 21) **and** analyse **two** possible consequences of energy being supplied through concentrated markets. *(10 marks)*

Explanation:

For a relevant definition/explanation of concentrated market, eg • a small number of firms (2) • high market share (2) • brief explanation of market structure (2) • concentration ratio (2).	**Up to 4 marks**

Maximum of 4 marks for the explanation

Analysis:

Award up to 6 marks for each of two consequences. 1 mark should be awarded for identifying the consequence and up to a further 5 marks for elaboration. Award one mark for each step in a logical chain of argument. Examples include:	
Concentration reduces consumer choice (**1 mark**), because there are few alternatives (**1 mark**), firms have some ability to fix prices (**1 mark**), and part of the consumer price becomes supernormal profit (**1 mark**), so there is a loss of consumer surplus (**1 mark**) and a gain in producer surplus (**1 mark**).	**Up to 6 marks**
Other examples, eg possible benefits of concentration, eg. research and development; problems arising due to supply from limited sources	**Up to 6 marks**

Make appropriate use of diagrams to support the explanation and/or analysis, eg monopoly / oligopoly / kinked demand curve	**Up to 2 marks per diagram (1 mark for labelling, 1 mark for correct information shown) to a maximum of 3 marks**

Maximum of 6 marks if one of only the explanation OR the analysis is attempted.

Maximum of 8 marks if only one consequence is analysed.

Maximum of 8 marks if there is no explicit reference to energy market.

MAXIMUM FOR PART 02: 10 MARKS

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03 '…given the activities with which it is involved, there are commercial and wider economic and social arguments against a body such as the MHPA being privatised' (**Extract B**, line 12-14).

Using the data and your economic knowledge, do you agree with the view that enterprises such as the MHPA should be privatised? Justify your answer.

(25 marks)

In this part of the question, candidates will need to demonstrate that they are able to evaluate issues and arguments to support a conclusion if they are to be awarded **more than 15 marks**.

A maximum of **21 marks** if there is no explicit use of the data.

Level 5	**Good analysis and good evaluation**	**22-25 marks (mid-point 24)**
Level 4	**Good analysis but limited evaluation OR Reasonable analysis and reasonable evaluation**	**17-21 marks (mid-point 19)**
Level 3	**Reasonable answer, including some correct analysis but very limited evaluation**	**10-16 marks (mid-point 13)**
Level 2	**Weak with some understanding**	**4-9 marks (mid-point 7)**
Level 1	**Very weak**	**0-3 marks (mid-point 2)**

Issues and areas for discussion include:

Introduction	• definitions/descriptions of o privatisation o public-private partnership (PPP).
Developing the response to the question (application)	• Evidence from the data used to support arguments for or against privatisation, eg references to o competition o concentration o strategic industry o public/private partnerships o need for coordination across government levels o environmental considerations. o employment

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Developing the response to the question (analysis)	• general arguments **FOR** privatisation, eg privatisation increases efficiency because the organisation becomes accountable to shareholders instead of politicians/ taxpayers and therefore has to focus on profits. • general arguments **AGAINST**, eg an organisation of this type needs to have wider social objectives as well as narrow commercial objectives; the large capital costs and the strategic nature of LNG make it appropriate for the state to intervene. • reasons for the PPP format, eg to supply funds in the national interest; to negotiate enforceable contracts with foreign governments • reasons why the MHPA's activities might create negative externalities and impact of state versus private control.
Evaluation	• effects on competition and consumer choice can go either way; could possibly reduce competition and choice • spill-over effects from LNG industry creating costs for others in the area, eg tourism • possibility of market failure • possibility of government failure, eg wrongly predicting the market for energy • knock-on effects on the labour market • conflict of policies, eg with renewable energy • critique of the PPP format, eg may lead to o inefficiency o monopoly • impact of regulation *Examiners should note that, for some of the weaker or average candidates, parts of the above represent quite sophisticated evaluation and so it is important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.*
Also give credit for	• relevant use of evidence and examples not contained in the data • relevant diagrams • an overall judgement on the issues raised.

USE THE DETAILED LEVELS MARK SCHEME ON PAGES 4 AND 5 FOR FURTHER CLARIFICATION

MAXIMUM FOR PART 03: 25 MARKS

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2 THE EUROPEAN UNION CONTEXT

Total for this Context: 40 marks

04 Using **Extract C**, calculate the index of quantity of fish for **Year Y and** identify **one** significant feature of the data for the period 2003 – 2009. *(5 marks)*

The calculation:

For a correct answer (80). Working out need not be shown. No units necessary here.	**3 marks**
For showing a correct method but arriving at a wrong answer, eg $\frac{\text{Any number}}{\text{Any number}}$ x 100 = wrong number	**1 mark**

Identifying one significant feature:

For identifying a significant feature	**1 mark**
For providing accurate supporting data with appropriate unit of measurement (tonnes or £million or mention of index)	**1 mark for appropriate data** **+** **1 mark for tonnes or £million or mention of index**

Significant features for the years 2003 to 2009 include:

- quantity falls continuously from 700 000 to 500 000 tonnes (or from index 140 to 100)
- value rises from £475m to £611m (or index 78 to 100)
- the price of fish must be increasing, since fewer landings have a higher value (with relevant figures to support this).
- quantity was highest in 2003 at 700 000 tonnes
- quantity was lowest in 2009 at 500 000 tonnes
- value was highest in 2009 at £611m
- value was highest in 2003 at £475m

Do not credit a feature which relates to the forecast Year Y.

MAXIMUM FOR PART 04: 5 MARKS

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05	Explain what is meant by 'economies of scale' (**Extract D,** line 3) **and** analyse how **two** types of economy of scale could affect the fishing industry. *(10 marks)*

Explanation:

For a relevant definition/explanation of economies of scale, eg a reduction in long-run average costs (**2**) due to the growth of the firm or industry (**2**), internal economies, external economies.	**Up to 4 marks**

Maximum of 4 marks for the explanation

Analysis:

Award up to 6 marks for each of two types. 1 mark should be awarded for identifying the type and up to a further 5 marks for elaboration. Award one mark for each step in a logical chain of argument. Examples include:	
Technical economies (**1 mark**), related to the use of large scale machinery (**1 mark**), reference to factory ships (**1 mark**), more capital intensive (**1 mark**), less labour employed (**1 mark**) problems such as 'hoovering up' the seas (**1 mark**).	**Up to 6 marks**
Other economies, eg financial, managerial, risk bearing/marketing etc (note: fishing industry can be interpreted to include markets and processing). Reward EXTERNAL as well as INTERNAL economies.	**Up to 6 marks**
Make appropriate use of diagrams to support the analysis, eg LRAC, minimum efficient scale	**Up to 2 marks per diagram (1 mark for labelling, 1 mark for correct information shown)** **To a maximum of 3 marks**

Maximum of 6 marks if one of only the explanation OR the analysis is attempted.

Maximum of 8 marks if only one type of economy of scale is analysed.

Maximum of 8 marks if there is no explicit reference to the fishing industry.

MAXIMUM FOR PART 02: 10 MARKS

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06	Using the data and your economic knowledge, evaluate the view that intervention in the fishing industry by the EU is unlikely to correct market failure but is likely to result in government failure in **both** UK product markets **and** UK labour markets. *(25 marks)*

In this part of the question, candidates will need to demonstrate that they are able to evaluate issues and arguments to support a conclusion if they are to be awarded **more than 15 marks**.

Award a maximum of **21 marks** if either UK product or UK labour markets are **not** included in answer.

A maximum of **21 marks** if there is no explicit use of data.

Level 5	**Good analysis <u>and</u> good evaluation**	**22-25 marks (mid-point 24)**
Level 4	**Good analysis <u>but</u> limited evaluation** **OR** **Reasonable analysis <u>and</u> reasonable evaluation**	**17-21 marks (mid-point 19)**
Level 3	**Reasonable answer, including some correct analysis but very limited evaluation**	**10-16 marks (mid-point 13)**
Level 2	**Weak with some understanding**	**4-9 marks (mid-point 7)**
Level 1	**Very weak**	**0-3 marks (mid-point 2)**

Issues and areas for discussion include:

Introduction	• the characteristics of government intervention • distinction between product and labour markets • meaning of market failure, government failure • meaning of market failure in the fishing industry
Developing the response to the question (application)	Discussion based on information from the data related to, for example, • product market, eg price and quantity of fish, effects of quotas • labour market, eg collapse of employment in the trawler industry • wider fishing industry, eg processing.
Developing the response to the question (analysis)	• marginal cost and marginal private benefit of fishing: an overfishing equilibrium • types of government intervention, eg taxes, subsidies, quotas • effects of government intervention on prices and quantities • the possibility that the CFP actually encourages large–scale fishing and therefore defeats the conservation objective (there are strong hints in the data pointing to this conclusion) • links between product markets and labour markets, eg. the concept of derived demand • market failures in the fish product market, eg lack of information, externalities

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	• higher fish prices do not incentivise further supply from 'producer', as the producer is nature not man • higher prices incentivise even more over-fishing for the profits available • market failures in the fishing labour market, eg occupational immobility, geographical immobility • the inefficiency of EU bureaucracy • government failure in the fishing market, eg bureaucracy, irrational policies (waste of dumping the 'wrong' fish), information failure • regional downward multiplier effects.
Evaluation	• need for international action • rationale for EU intervention • possibility that EU and national governments act out of step, or even in conflict with each other • possibility that a policy can benefit a product market while harming a labour market, or vice versa • the option of non-intervention; argument that product markets work • arguments that labour markets work, eg the data mentions diversification in the Grimsby area • depends on what is done over what time period, to what extent, and state of the UK economy. *Examiners should note that, for some of the weaker or average candidates, parts of the above represent quite sophisticated evaluation and so it is important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.*
Also give credit for	• relevant use of evidence and examples not contained in the data • diagrams • an overall judgement on the issues raised.

USE THE DETAILED LEVELS MARK SCHEME ON PAGES 4 AND 5 FOR FURTHER CLARIFICATION

MAXIMUM FOR QUESTION 06: 25 MARKS

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SECTION B

Essay 1 **Total for this Essay: 40 marks**

07	'A pharmaceutical company can expect to make supernormal profits on a new drug or medicine in the short run.' Explain why some firms might be able to **continue** to make supernormal profits in the **long run**. *(15 marks)*

For relevant definitions, eg • normal/supernormal profits • short run/long run	**Up to 2 marks for each to a maximum of 4 marks**

Award one mark for each step in a logical chain of argument up to 15 marks, for example	
• Barriers to entry are a reason (**1 mark**). These can include patents (**1 mark**) which are relevant to pharmaceuticals (**1 mark**); they reduce competition (**1 mark**) and allow a degree of monopoly (**1 mark**) preventing prices from falling in the long run (**1 mark**) and thus maintaining supernormal profits (**1 mark**). • Structure of the industry, product differentiation, imperfect knowledge, technological change collusion, limit pricing etc.	
Use of appropriate diagrams to help support explanations, eg monopoly and/or perfect competition diagram accompanied by analysis of the effects of entry barriers	**Up to 2 marks per diagram (1 mark for labelling, 1 mark for information shown) to a total of 4 marks.**

MAXIMUM FOR PART 07: 15 MARKS

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08	Evaluate whether profit maximisation is always the most important objective of firms. *(25 marks)*

In this part of the question, candidates will need to demonstrate that they are able to evaluate issues and arguments to support a conclusion if they are to be awarded **more than 15 marks**.

Level 5	**Good analysis <u>and</u> good evaluation**	**22-25 marks (mid-point 24)**
Level 4	**Good analysis <u>but</u> limited evaluation** **OR** **Reasonable analysis <u>and</u> reasonable evaluation**	**17-21 marks (mid-point 19)**
Level 3	**Reasonable answer, including some correct analysis but very limited evaluation**	**10-16 marks (mid-point 13)**
Level 2	**Weak with some understanding**	**4-9 marks (mid-point 7)**
Level 1	**Very weak**	**0-3 marks (mid-point 2)**

Issues and areas for discussion include:

Introduction	• profit as a factor reward • rationale for profit maximisation • explanation of profit maximisation.
Developing the response to the question **(application/ analysis)**	• influence of the ownership/control 'divorce' • size/complexity of firms • alternative objectives, eg o maximisation of ▪ sales ▪ output/production ▪ revenue ▪ social welfare o minimisation of ▪ money costs ▪ social costs o satisficing behaviour • circumstances when different objectives might be appropriate • consequences of different objectives.

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Evaluation	• feasibility of some or all of the possible objectives, (eg are firms able to track their marginal costs and revenues as accurately as theory suggests?) • inter-industry differences, eg manufacturing versus services; private versus public sector • are objectives exclusive?, or o can several objectives be followed at once? o are any objectives possible without profits being made? • short/long run objectives. *Examiners should note that, for some of the weaker or average candidates, parts of the above represent quite sophisticated evaluation and so it is important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.*
Also give credit for	• relevant use of examples • diagrams • an overall judgement on the issues raised.

USE THE DETAILED LEVELS MARK SCHEME ON PAGES 4 AND 5 FOR FURTHER CLARIFICATION

MAXIMUM FOR PART 08: 25 MARKS

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Essay 2 **Total for this Essay: 40 marks**

09	Explain why competition might lead to **both** productive efficiency **and** allocative efficiency. *(15 marks)*

For relevant definitions, eg competition, efficiency	**Up to 2 marks for each to a maximum of 4 marks**

Award one mark for each step in a logical chain of argument up to 15 marks, for example	
• Allocative: Perfect competition leads to an efficient allocation of resources (**1 mark)**. Price = marginal cost (**1 mark**) so that producers are compensated for the effort of production (**1 mark**) and consumers receive benefit (**1 mark**) both of which are reflected in the price (**1 mark**). Movement away from this equilibrium rewards one group at the expense of the other (**1 mark**). • Productive efficiency arising out of competition, marginal cost = average cost, average cost minimised	
Use of appropriate diagrams to help support explanations, eg LR equilibrium under perfect competition, monopoly equilibrium	**Up to 2 marks per diagram (1 mark for labelling, 1 mark for information shown) to a total of 4 marks.**

Maximum of 10 marks if only one of the types of efficiency in the question is considered.

MAXIMUM FOR PART 09: 15 MARKS

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10	Evaluate the view that, providing there is market contestability, government intervention to ensure competition is unnecessary.	*(25 marks)*

In this part of the question, candidates will need to demonstrate that they are able to evaluate issues and arguments to support a conclusion if they are to be awarded **more than 15 marks**.

Level 5	**Good analysis and good evaluation**	**22-25 marks (mid-point 24)**
Level 4	**Good analysis but limited evaluation** **OR** **Reasonable analysis and reasonable evaluation**	**17-21 marks (mid-point 19)**
Level 3	**Reasonable answer, including some correct analysis but very limited evaluation**	**10-16 marks (mid-point 13)**
Level 2	**Weak with some understanding**	**4-9 marks (mid-point 7)**
Level 1	**Very weak**	**0-3 marks (mid-point 2)**

Issues and areas for discussion include:

Introduction	• the characteristics of a market • the meaning of 'contestability', eg a market where firms can enter or leave easily so that firms face competition from potential entrants • types of government intervention • types of competition.
Developing the response to the question(application/ analysis)	• examples of markets that are non-contestable and contestable o non-contestable: domestic piped water (natural monopoly) o contestable: bottled mineral water; • contestable markets in terms of o structure o performance o conduct. • could be argued that budget air travel is more contestable than full-service air travel • strategies for firms in contestable markets, o legitimate/legal strategies ▪ eg limit pricing o illegitimate/illegal strategies ▪ eg collusion • contestable markets and oligopoly o cartels o 'gaming behaviour • government influence on contestability, eg o competition policy o franchising, eg ensuring a new operator for the National Lottery could enter with minimum cost, and an existing one leave without penalty o use of law, regulation.

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Evaluation	• government intervention might still be necessary due to abuse of monopoly power, even if the market is contestable • the possibility that an industry that looks monopolistic or oligopolistic in terms of scale or structure might actually behave very competitively in certain aspects, eg the car industry supplying the global market for family cars • the effects on conduct (eg persuasive/ informative advertising, product differentiation) and performance (costs, efficiency, externalities) • the issue of whether small firms are necessarily more competitive than large firms • government/market failure issues. *Examiners should note that, for some of the weaker or average candidates, parts of the above represent quite sophisticated evaluation and so it is important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.*
Also give credit for	• relevant use of examples • diagrams • an overall judgement on the issues raised.

USE THE DETAILED LEVELS MARK SCHEME ON PAGES 4 AND 5 FOR FURTHER CLARIFICATION

MAXIMUM FOR PART 10: 25 MARKS

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Essay 3 **Total for this Essay: 40 marks**

11	Explain how marginal revenue product can help to determine **both** wage rates **and** employment in particular occupations. *(15 marks)*

For relevant definitions, eg • marginal product • marginal revenue product • wage rates.	**Up to 2 marks for each to a maximum of 4 marks**

Award one mark for each step in a logical chain of argument up to 15 marks, for example	
• Employment: In a perfectly competitive labour market (**1 mark**) the wage rate is the price of labour (**1 mark**) and the employer is a price taker (**1 mark**) MRP falls as a firm takes on more employees (**1 mark**); as long as wage rate < MRP it is worth taking on more staff (**1 mark**); where WR = MRP the employer stops taking on more employees (**1 mark**). • Wage rates: determined on the labour market; within a firm the above theory suggest that each worker receives MRP; conditions for a perfect labour market. • Wider arguments: elasticity of demand for labour, MRP considers demand side; must also consider supply side of labour; can argue that MRP is of limited use, due to market 'imperfections', bilateral monopoly, collective bargaining etc.	
Use of appropriate diagrams to help support explanations, eg supply and demand for labour, MRP	**Up to 2 marks per diagram (1 mark for labelling, 1 mark for information shown) to a total of 4 marks.** **This question lends itself to an over-arching diagram, eg perfect/imperfect competition in the labour market, for which 4 marks may be awarded.**

Maximum of 10 marks if either wage rates or employment not considered.

MAXIMUM FOR PART 11: 15 MARKS

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12 A government wishes to make the distribution of **both** income **and** wealth more equal.

Discuss whether the most effective way to achieve these aims is to tax income more progressively. *(25 marks)*

In this part of the question, candidates will need to demonstrate that they are able to evaluate issues and arguments to support a conclusion if they are to be awarded **more than 15 marks.**

Level 5	**Good analysis <u>and</u> good evaluation**	**22-25 marks (mid-point 24)**
Level 4	**Good analysis <u>but</u> limited evaluation** **OR** **Reasonable analysis <u>and</u> reasonable evaluation**	**17-21 marks (mid-point 19)**
Level 3	**Reasonable answer, including some correct analysis but very limited evaluation**	**10-16 marks (mid-point 13)**
Level 2	**Weak with some understanding**	**4-9 marks (mid-point 7)**
Level 1	**Very weak**	**0-3 marks (mid-point 2)**

Issues and areas for discussion include

Introduction	• details of inequalities • the distinction between income and wealth • progressive, proportional and regressive taxation.
Developing the response to the question(application/ analysis)	• the relationships between income and wealth • examples of taxes on income and wealth • ways in which income affects wealth and wealth affects income • horizontal and vertical equity in the taxation of income and wealth • the use of taxes for re-distribution purposes • the effects of various taxes on income and wealth distribution • influences other than taxes, eg the provision of public services free at the point of use • ways in which taxing income affects income • ways in which taxing income might affect wealth • the concept of 'ability to pay' • the idea that progressive income taxes reduce incentives • demand side effects, supply–side effects.

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Evaluation	• market forces versus government intervention • different treatment of income and wealth • income is not just wages: also rent, interest, profit • consideration of the claim for progressive income taxation made in the question • critique of various 'theories' such as 'trickle down' • reference to claims about relative success of more equal societies • strengths and weaknesses of alternative methods of redistribution, eg education and training, min wage. *Examiners should note that, for some of the weaker or average candidates, parts of the above represent quite sophisticated evaluation and so it is important to ensure that more basic evaluation is adequately rewarded where a genuine effort has been made to display that skill.*
Also give credit for	• relevant use of examples • diagrams • an overall judgement on the issues raised

USE THE DETAILED LEVELS MARK SCHEME ON PAGES 4 AND 5 FOR FURTHER CLARIFICATION

MAXIMUM FOR PART 10: 25 MARKS

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General Certificate of Education
Advanced Level Examination
June 2011

Economics ECON3

Unit 3 Business Economics and the Distribution of Income

Friday 17 June 2011 1.30 pm to 3.30 pm

For this paper you must have:
- an AQA 12-page answer book.

You may use a calculator.

Time allowed
- 2 hours

Instructions
- Use black ink or black ball-point pen. Pencil should only be used for drawing.
- Write the information required on the front of your answer book. The **Examining Body** for this paper is AQA. The **Paper Reference** is ECON3.
- In **Section A**, answer **EITHER** Context 1 **OR** Context 2.
- In **Section B**, answer **one** essay.

Information
- The marks for questions are shown in brackets.
- The maximum mark for this paper is 80.
- There are 40 marks for **Section A** and 40 marks for **Section B**.
- This paper is synoptic. It assesses your understanding of the relationship between the different aspects of Economics.
- You will be marked on your ability to:
  – use good English
  – organise information clearly
  – use specialist vocabulary where appropriate.

Advice
- You are advised to spend 1 hour on **Section A** and 1 hour on **Section B**.

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Section A

Answer **EITHER** Context 1 **OR** Context 2.

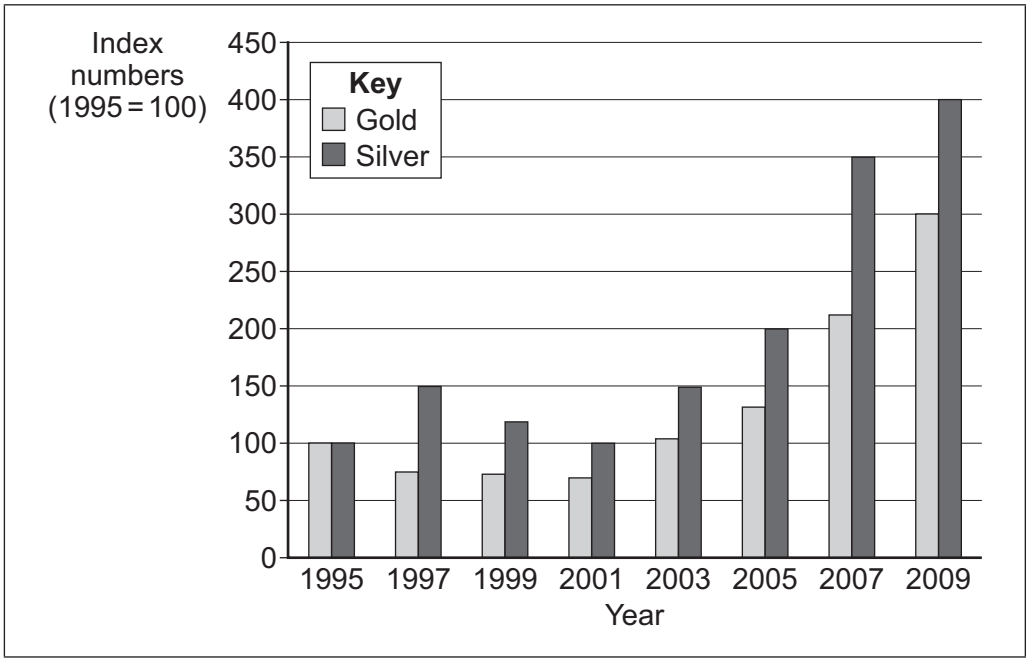
EITHER **Total for this context: 40 marks**

Context 1

THE GLOBAL CONTEXT

Study **Extracts A and B**, and then answer **all** parts of Context 1 which follow.

Extract A: Gold and silver, world price indices



Source: industry statistics, accessed 2010

Extract B: The recycling market

Scrap metal dealers are once again touring housing estates in their pick-up trucks obtaining steel and other metals from householders. Increased demand for steel and other metals on world markets has led to a change in the fortunes of these dealers, who are price takers.

Recycling has become a global activity. In 2009, with gold selling internationally at well over $1000 an ounce, there were TV adverts from companies wanting to buy unwanted jewellery. A mobile phone also contains tiny traces of precious metals which can be extracted profitably from the millions of phones discarded each year. This is done at large processing centres, usually near sea ports, and much of the recovered material is exported to factories in China. The Olympic stadium in Beijing, China, was built almost entirely using recycled steel.

Germans, Scandinavians and Canadians are used to sorting their rubbish into different coloured bins. But instead of matching the recycling rates achieved in some countries, the UK still dumps many potentially useful materials. These include plastics, glass, paper

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and metals, which are buried in landfill sites partly because there are insufficient market incentives for recycling. The UK's strong reliance on landfill indicates the existence of widespread environmental market failure. Landfill creates greenhouse gases, threatens to pollute water sources and wastes scarce resources.

Some critics suggest that it would be better for the UK to aim at waste reduction, eliminating unnecessary packaging and other 'bads' at the production and retail stages. The UK pressure group *Waste Watch* also suggests more reuse, for example encouraging people to buy second-hand clothes from charity shops. However, other methods, such as returnable milk bottles, are in sharp decline.

There are now landfill taxes and regulations which provide incentives for recycling. Households could face the prospect of fines for breaking 'bin-bag rules'. However, this may lead to unintended consequences such as illegal dumping of waste. *Waste Watch* wants national targets and other policies to promote composting because, by weight, garden and kitchen waste make up the majority of material sent to landfill. *Waste Watch* also suggests increasing the landfill tax each year and extending it to cover incineration and other waste-disposal methods.

Recovery is a further option. In less developed countries, some homeless people live on city rubbish dumps making a living from what they can find and sell. In the UK, market conditions are such that the metal in a 2p coin is now actually worth 3p. Some experts even predict that within ten years it will be economic to excavate landfill sites to 'mine' the tin cans and other scrap materials that have been buried there.

Source: news reports, 2009–10

0 1 Using **Extract A**, identify **two** significant points of comparison between the world price index for gold and the world price index for silver over the period shown. *(5 marks)*

0 2 Explain the term 'price taker' **and** analyse the likely effects of an increase in the world demand for scrap metals on the output **and** profits of a scrap metal dealer (**Extract B**, lines 1–4). *(10 marks)*

0 3 'The UK's strong reliance on landfill indicates the existence of widespread environmental market failure' (**Extract B**, lines 16–17).

Using the data and your economic knowledge, evaluate alternative methods of correcting market failure arising from waste disposal. *(25 marks)*

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Do **not** answer Context 2 if you have answered Context 1.

OR **Total for this context: 40 marks**

Context 2

THE EUROPEAN UNION CONTEXT

Study **Extracts C and D**, and then answer **all** parts of Context 2 which follow.

Extract C: Air traffic between the UK and abroad: indices of flight and passenger numbers, 2001–2008 (2001=100)

Year	Index of number of flights	Index of passenger numbers
2001	100	100
2002	100	100
2003	96	101
2004	104	109
2005	108	119
2006	112	122
2007	115	129
2008	115	126

Source: official statistics, 2009

Extract D: *British Airways* and *Iberia Airlines*

Until about twenty years ago, most European countries had at least one large 'national carrier' airline which was in public ownership. When airlines were privatised, there were fears that a state-owned monopoly would simply become a private monopoly. On some routes, de-regulation took some time and it was not until 2008 that the 'Open Skies' agreement sought to eliminate anti-competitive practices among airlines flying from Europe to North America. These anti-competitive practices included denying smaller airlines the opportunity to rent landing slots (landing spaces) at major airports.

In the face of greater competition from smaller, more innovative airlines such as *Virgin Atlantic* and the low-cost carriers such as *easyJet*, there has been increasing collaboration between some of the larger, traditional companies. *British Airways* (*BA*), *Iberia Airlines* (Spain) and *American Airlines* (*AA*), together with five other airlines, belong to *One World Alliance*, an arrangement which enables member airlines to sell seats on each other's flights.

With *BA* reporting a pre-tax loss of £401m in May 2009, its Chief Executive proposed a 'tie-up' with *Iberia* and *AA* which would come closer to a full-blown horizontal merger, enabling not only the marketing of flights but also joint pricing and a sharing of revenues. The proposal needed to be cleared by both EU and US anti-monopoly authorities, but it quickly failed when the European Union's Competition Commissioner objected, mainly on the grounds that it would raise prices and reduce consumer choice.

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In October 2009, two European members of *One World Alliance*, *BA* and *Iberia*, tried again to reach a preliminary agreement for a full merger which they aimed to complete in late 2010. They claimed that a merger would be good for consumers as well as for the companies involved because duplicated European routes could be rationalised, while the routes operated in North America by *BA* and in South America by *Iberia* were complementary rather than competitive. The merger would need to be approved by the European Commission but there was a precedent because, in 2004, *Air France* was allowed to merge with Dutch airline *KLM*.

The merger between *BA* and *Iberia* would create Europe's biggest airline. Critics raised concerns about the new company's market share and claimed that *BA*'s dominance at Heathrow Airport would increase to even more than its existing 44% of landing slots. Meanwhile, both *BA* and *Iberia* workers were planning strikes over cost-cutting proposals and pay offers.

Source: news reports, 2009

0 4 Using **Extract C**, identify **two** significant points of comparison between the index of number of flights and the index of passenger numbers over the period shown. *(5 marks)*

0 5 Explain the term 'public ownership' (**Extract D**, line 2) **and** analyse **two** economic reasons that could be used to support public ownership of industries such as airlines. *(10 marks)*

0 6 Using the data and your economic knowledge, evaluate the view that mergers, such as the one proposed between *British Airways* and *Iberia Airlines*, are usually 'good for consumers as well as for the companies involved' (**Extract D**, lines 22–23). *(25 marks)*

Turn over for the next question

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Section B

Answer **one** essay from this section.

Each essay carries 40 marks.

EITHER

Essay 1

'The law of diminishing returns is an economic principle which will definitely operate at some point, whereas economies of scale are less certain.'

0 7 Explain how a firm's costs of production may be affected by diminishing returns in the short run and economies of scale in the long run. *(15 marks)*

0 8 Evaluate the view that firms will always try to minimise their costs and maximise their revenues. *(25 marks)*

OR

Essay 2

0 9 'On a typical train journey, there could be as many as twenty different fares being paid by passengers travelling between the same two stations.'

Using the concept of price discrimination to help you, explain how and why this might happen. *(15 marks)*

1 0 Is price discrimination always good for producers and bad for consumers? Justify your answer. *(25 marks)*

OR

Essay 3

'*The Spirit Level*, a book by Richard Wilkinson and Kate Pickett published in 2009, is subtitled: *Why More Equal Societies Almost Always Do Better*.'

1 1 Explain the causes of inequality in the distribution of income and wealth in the UK. *(15 marks)*

1 2 Evaluate the view that the government should rely less on market forces to determine the distribution of income and wealth in the UK and should increase its intervention to make the UK more equal. *(25 marks)*

END OF QUESTIONS

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Version 1.0



General Certificate of Education
June 2011

ECONOMICS ECON3

Unit 3: Business Economics and the Distribution of Income

Final

Mark Scheme

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Mark schemes are prepared by the Principal Examiner and considered, together with the relevant questions, by a panel of subject teachers. This mark scheme includes any amendments made at the standardisation meeting attended by all examiners and is the scheme which was used by them in this examination. The standardisation meeting ensures that the mark scheme covers the candidates' responses to questions and that every examiner understands and applies it in the same correct way. As preparation for the standardisation meeting each examiner analyses a number of candidates' scripts: alternative answers not already covered by the mark scheme are discussed at the meeting and legislated for. If, after this meeting, examiners encounter unusual answers which have not been discussed at the meeting they are required to refer these to the Principal Examiner.

It must be stressed that a mark scheme is a working document, in many cases further developed and expanded on the basis of candidates' reactions to a particular paper. Assumptions about future mark schemes on the basis of one year's document should be avoided; whilst the guiding principles of assessment remain constant, details will change, depending on the content of a particular examination paper.

Further copies of this Mark Scheme are available to download from the AQA Website: www.aqa.org.uk

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Advanced Level Economics Unit 3

General Instructions

Marks awarded to candidates should be in accordance with the following mark scheme and examiners should be prepared to use the full range of marks available. The mark scheme for most questions is flexible, permitting the candidate to score full marks in a variety of ways. Where the candidate's response to a question is such that the mark scheme permits full marks to be awarded, full marks **MUST** be given. A perfect answer is not necessarily required for full marks. But conversely, if the candidate's answer does not deserve credit, then no marks should be given.

Occasionally, a candidate may respond to a question in a reasonable way, but the answer may not have been anticipated when the mark scheme was devised. In this situation, **OR WHENEVER YOU HAVE ANY DOUBT ABOUT THE INTERPRETATION OF THE MARK SCHEME**, you must in the first instance telephone your team leader to discuss how to proceed.

Two approaches have been used in the construction of the mark scheme.

(i) **An issue based approach.** The mark scheme for parts **01**, **02**, **04** and **05** of the data-response questions (**Section A**) and the first part of each essay question (**Section B**) adopts this approach. The mark scheme lists the marks that can be awarded for particular issues (and associated development) that the candidate might include in the answer.

(ii) **A levels approach.** This approach is used for parts **03** and **06** of the data-response questions (**Section A**) and the second part of each essay question (**Section B**). The Levels Mark Scheme on the next page identifies five levels representing differences in the quality of work. A range of marks is allocated to each level. First decide the level into which an answer falls. The level chosen should be the one which **best fits** the answer provided by the candidate. It is **not** intended that the answer should satisfy every statement in the level description. Then think in terms of awarding the mid-point mark which has been identified for that level (eg 13 marks for Level 3). Move up or down from this notional mark by considering the extent to which the answer meets the level description overall. Strength in one skill can outweigh weakness in another. When using the Levels Mark Scheme the marker **must** identify where a particular skill is being demonstrated. The **key** to be used to identify the skill is given after the level descriptions. The question-specific mark scheme summarises the information which could be used to answer the question, but without attaching marks to particular issues.

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THE LEVELS MARK SCHEME FOR A2

LEVELS OF RESPONSE MARK SCHEME FOR USE WITH QUESTIONS 03, 06, 08, 10 AND 12 ONLY

A2 LEVELS OF RESPONSE	AO1 KNOWLEDGE and UNDERSTANDING of theories, concepts and terminology	AO2 APPLICATION of theories, concepts and terminology	AO3 ANALYSIS of economic problems and issues	AO4 EVALUATION of economic arguments and evidence, making informed judgments
Level 5 22-25 marks (mid-point 24) **Good analysis and good evaluation**	Good throughout the answer with few errors and weaknesses	Good application to issues Where appropriate, good use of data to support answer	Relevant and precise with a clear and logical chain of reasoning Good awareness of the inter-relatedness of economic issues	Good with a clear final judgement
Level 4 17-21 marks (mid-point 19) **Good analysis but limited evaluation** **OR** **Reasonable analysis and reasonable evaluation**	Good throughout the answer with few errors and weaknesses Good throughout much of the answer with few errors and weaknesses	Good application to issues Where appropriate, good use of data to support answer Some good application to issues Where appropriate, some good use of data to support answer	Relevant and precise with a clear and logical chain of reasoning Good awareness of the inter-relatedness of economic issues Largely relevant and well organised with reasonable logic and coherence Some awareness of the inter-relatedness of economic issues	Limited but showing some appreciation of alternative points of view Reasonable, showing an appreciation of alternative points of view
Level 3 10-16 marks (mid-point 13) **Reasonable answer, including some correct analysis but very limited evaluation**	Satisfactory but some weaknesses shown	Reasonable application to issues Where appropriate, reasonable use of data to support answer	Reasonably clear but may not be fully developed and is perhaps confused in places with a few errors present Quite well organised with some logical development	Superficial, perhaps with some attempt to consider both sides of the issue(s)
Level 2 4-9 marks (mid-point 7) **Weak with some understanding**	Limited and some errors are made	Partial application to issues with some errors Where appropriate, limited use of data to support answer	Partial but confused at times, lacking focus and development Limited logic and coherence	A very basic and simplistic attempt is made which is unsupported by analysis
Level 1 0-3 marks (mid-point 2) **Very weak**	Weak with a number of errors	Little, if any, application to issues Where appropriate, no use of data to support answer	Poor and lacking clarity and focus	No relevant evaluation

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THE KEY TO BE USED WHEN USING THE LEVELS MARK SCHEME

D Where a particular economic term is correctly **DEFINED** in order to help the candidate to answer the question properly.

I Where a relevant **ISSUE** is raised by the candidate.

K Where the candidate demonstrates **KNOWLEDGE** of recent developments or features of the economy which help enhance the candidate's response to the question. This should also be used where the candidate quotes relevant examples.

Ap Where the candidate demonstrates the ability to **APPLY** knowledge and **CRITICAL UNDERSTANDING** to problems and issues.

An Where the candidate demonstrates the ability to **ANALYSE** the problem using appropriate economic ideas.

E Where the candidate **EVALUATES** and makes judgements about the significance of various issues and arguments.

Synoptic Assessment

All questions in this unit are synoptic. Therefore, candidates will need to demonstrate that they are able to think as an economist and to use effectively the economist's 'tool kit' of concepts, theories and techniques.

Candidates should demonstrate that they:

- understand the inter-relatedness of many economic issues, problems and institutions;
- understand how certain economic concepts, theories and techniques may be relevant to a range of different contexts;
- can apply concepts, theories and techniques in analysing economic issues and problems and in evaluating arguments and evidence.

QUALITY OF WRITTEN COMMUNICATION

Quality of Written Communication (QWC) will be assessed in Questions 03, 06, 08, 10 and 12 only.

Candidates will be assessed according to their ability to:

- ensure that text is legible, and that spelling, grammar and punctuation are accurate, so that meaning is clear
- select and use a form and style of writing appropriate to purpose and complex subject matter
- organise information clearly and coherently, using specialist vocabulary when appropriate.

No specific marks are awarded for QWC.

However, examiners should take into account QWC when determining the mark to be awarded for an answer. This means an answer could be taken either up (for exceptional QWC) or down (for very poor QWC) by 1 mark (and no more).

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CONTEXT 1 **Total for this Context: 40 marks**

01 Using **Extract A**, identify **two** significant points of comparison between the world price index for gold and the world price index for silver over the period shown. *(5 marks)*

Award 1 mark for each significant point of comparison made and up to 2 marks for the supporting reference to the data ('significant' such as peaks/troughs, major changes/trends over a period of time).

Significant points of comparison might include:

- gold index has increased (100 to 300); the silver index has increased more than gold (100 to 400)
- from 2001 onwards silver index rises faster than gold index (the columns diverge, gold index 70 to 300; silver index 100 to 400)
- from 1995 silver index rises then falls, reaching 100 again in 2001; gold index falls then rises, reaching 100 again in between 2001 and 2003
- the silver index never drops below the base; gold index falls to approx. 70.

A maximum of **2 marks** may be awarded if the candidate simply trawls through the data with no attempt at identifying two significant features.

A maximum of **2 marks** may be awarded if there is no use of statistics which support the point(s) being made.

A maximum of **4 marks** may be awarded where there is evidence of one significant point (one good point is included with data) together with the other part of the answer giving the impression of a few statistics chosen at random.

No marks for a comment to the effect that silver has a higher price than gold (these are index numbers not actual prices).

A maximum of **4 marks** if nowhere in the answer does the candidate make it clear that they are dealing with index numbers as opposed to actual prices. This cap is removed if, for example, any one of the supporting references to the data mentions the word 'index' (even if an error or omission is made elsewhere – using 'positive' marking).

MAXIMUM FOR QUESTION 01: 5 MARKS

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02 Explain the term 'price taker' **and** analyse the likely effects of an increase in the world demand for scrap metals on the output **and** profits of a scrap metal dealer (**Extract B**, lines 1–4). *(10 marks)*

For candidates who:

Explain 'price taker', eg

- in terms of a firm which is small in relation to the industry (**1 mark**) so by its own actions cannot affect market price (**1 mark**) and from its point of view faces a horizontal (perfectly elastic) (**1 mark**) demand curve (**1 mark**). **Up to 4 marks**

For a horizontal demand curve diagram **Up to 2 marks**

Analyse the effects as required, for example:

- an argument to the effect that because of, for example, Chinese manufacturing development, the world demand for steel has risen, increasing the world price of steel (**1 mark**) and hence the world price of scrap iron and steel (**1 mark**) enabling the firm to increase its output (**1 mark**) and make a supernormal profit (**1 mark**).
- more firms enter the market shifting the world supply of scrap steel to the right and reducing the world price
- eventually the world market is in long-run equilibrium with firms earning normal profits on their individual outputs and world output at a higher level than before
- the increased entry tending to lower price, might be counteracted by continuing increases in world demand (eg due to demand from China).

Reward each step in a logical chain of reasoning up to 8 marks

Maximum 8 marks for analysis

A maximum of **6 marks** for the analysis if there is not a reference to **both** output **and** profits.

Make use of a suitable diagram or diagrams in the analysis, eg a perfect competition SR/LR equilibrium diagram **Up to 2 marks for a diagram**
(1 mark for labelling, 1 mark for correct information shown)
to a maximum of 4 marks for diagrams

MAXIMUM FOR QUESTION 02: 10 MARKS

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03 'The UK's strong reliance on landfill indicates the existence of widespread environmental market failure' (**Extract B**, lines 16-17).

Using the data and your economic knowledge, evaluate alternative methods of correcting market failure arising from waste disposal. *(25 marks)*

There must be evidence of evaluation to score more than 15 marks.

A maximum of **21 marks** if there is no explicit use of the data.

Level 5	**Good analysis <u>and</u> good evaluation**	**22-25 marks (mid-point 24)**
Level 4	**Good analysis <u>but</u> limited evaluation** **OR** **Reasonable analysis <u>and</u> reasonable evaluation**	**17-21 marks (mid-point 19)**
Level 3	**Reasonable answer, including some correct analysis but very limited evaluation**	**10-16 marks (mid-point 13)**
Level 2	**Weak with some understanding**	**4-9 marks (mid-point 7)**
Level 1	**Very weak**	**0-3 marks (mid-point 2)**

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these and/or other issues in the time available.

Issues and areas for discussion include:

Introductory:

- meaning of environmental market failure
- reasons why landfill exemplifies market failure, eg missing markets for recycled products, negative externalities, local/national decisions favouring landfill over its alternatives

Developing a response to the question:

- general policies, eg:
  - market-based policies
  - command-and-control policies
- specific methods/ strategies, eg reduction, re-use, recovery, recycling, disposal (alternative methods of, eg landfill, incineration)
- specific policies (some but not all mentioned in the data) aimed at supporting these methods/ strategies, eg:
  - landfill tax (polluter pays/market based)
  - fines for dumping (command-and-control)
  - subsidies for favoured recycling schemes
  - targets for re-cycling
  - subsidies/ carrot and stick approaches

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- the alternative of non-intervention/allowing markets to work (the extract mentions market forces and price signals in scrap metals and suggests that a market for 'mined' recyclables from landfill could emerge in due course).

Evaluation:

- comment on scarce/ finite resources and the possibility of re-cycling in the case of metals, so that they become, in a sense, 'renewable'
- role of government/ legal sanctions
- market failure versus government failure
- the need for international/global action
- pros and cons of particular policies, eg composting, incineration.

Examiners should note that it may be possible to award some marks for basic evaluation such as consideration of a number of pros and cons. However, this must be considered as low-level evaluation and rewarded accordingly. Stronger evaluation would prioritise the arguments for and against, and/or give economic reasons for justifying a particular course of action.

Also give credit for:

- relevant use of evidence and examples not contained in the data
- diagrams
- an overall judgement on the issues raised

USE THE LEVELS MARK SCHEME ON PAGES 4 AND 5 FOR FURTHER CLARIFICATION

MAXIMUM FOR QUESTION 03: 25 MARKS

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CONTEXT 2 **Total for this Context: 40 marks**

04	Using **Extract C**, identify **two** significant points of comparison between the index of number of flights and the index of passenger numbers over the period shown. *(5 marks)*

Award 1 mark for each significant point of comparison made and up to 2 marks for the supporting reference to the data ('significant' such as highs/lows, major changes/trends over a period of time).

Significant points of comparison might include:

- both flights (index 100 to 115) and passengers (index 100 to 126) are higher in 2008 than they were in 2001
- flights take a dip in 2003 (index 100 to 96) while passengers remain approximately level (at 100 and 101)
- flights remain level (at index 115) in the final year while passengers reduce (from 129 to 126)
- steady growth in both flights (index 96 to 115 and passengers (101 to 129) between 2003 and 2007

A maximum of **2 marks** may be awarded if the candidate simply trawls through the data with no attempt at identifying two significant points of comparison.

A maximum of **2 marks** may be awarded if there is no use of statistics which support the point(s) being made.

A maximum of **4 marks** may be awarded where there is evidence of one significant point (one good point is included with data) together with the other part of the answer giving the impression of a few statistics chosen at random.

A maximum of **4 marks** if nowhere in the answer does the candidate make it clear that they are dealing with index numbers as opposed to actual quantities. This cap is removed if, for example, any one of the supporting references to the data mentions the word 'index' (even if an error or omission is made elsewhere – using 'positive' marking).

MAXIMUM FOR QUESTION 04: 5 MARKS

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05 Explain the term 'public ownership' (**Extract D**, line 2) **and** analyse **two** economic reasons that could be used to support public ownership of industries such as airlines. *(10 marks)*

For candidates who:

Explain 'public ownership', eg:

- in terms of a business or organisation that is owned by the state/taxpayer/the community (**up to 2 marks**).
- and might take the form of eg a nationalised industry, government department, majority shareholding, public corporation, public/private partnership (**up to 2 marks**).
- examples: BBC, Royal Mail, etc. (**2 x 1 mark = 2 marks**). **up to 4 marks**

Analyse **two** reasons, in terms of airline or another appropriate example, eg:

- airlines tend to be monopolistic (**1 mark**) and could therefore exploit monopoly power with lower output (**1 mark**) and raised prices (**1 mark**) and public ownership is one way of dealing with monopoly (**1 mark**).
- air travel underpins other aspects of a modern economy (transport, aerospace etc) and is therefore too important for strategic economic reasons to be left to the private sector
- 'commanding heights arguments' or their modern variant : 'too big to fail'
- airlines are 'flag carriers' and important businesses in terms of national prestige/ image building; they support a great deal of employment, both directly and indirectly.
- aircraft pass over sovereign territories so there are issues of international coordination and security matters, and these are better dealt with by government than by the private sector
- efficiency, including allocative, productive, dynamic. **However, do not treat each type of efficiency as a separate reason.**

Reward each step in a logical chain of reasoning
Up to 4 marks per reason analysed
(1 mark for identification and up to 3 marks for analysis)

Maximum for analysis 8 marks

Note: if the candidate identifies more than two reasons, award the marks based upon the best two explanations.

Make use of a suitable diagram in the analysis **Up to 2 marks for a diagram**
(1 mark for labelling, 1 mark for correct information shown)
to a maximum of 4 marks for diagrams

MAXIMUM FOR QUESTION 05: 10 MARKS

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06	Using the data and your economic knowledge, evaluate the view that mergers, such as the one proposed between *British Airways* and *Iberia Airlines*, are usually 'good for consumers as well as the companies involved' (**Extract D**, lines 22-23). *(25 marks)*

There must be evidence of evaluation to score more than 15 marks.

A maximum of **21 marks** if there is no explicit use of the data

Level 5	**Good analysis <u>and</u> good evaluation**	**22-25 marks (mid-point 24)**
Level 4	**Good analysis <u>but</u> limited evaluation** **OR** **Reasonable analysis <u>and</u> reasonable evaluation**	**17-21 marks (mid-point 19)**
Level 3	**Reasonable answer, including some correct analysis but very limited evaluation**	**10-16 marks (mid-point 13)**
Level 2	**Weak with some understanding**	**4-9 marks (mid-point 7)**
Level 1	**Very weak**	**0-3 marks (mid-point 2)**

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these and/or other issues in the time available.

Issues and areas for discussion include:

Introductory:

- basic meaning of merger
- different types of merger (data refers to 'horizontal')
- possible motives for merger: market share, growth, economies of scale, efficiency gains, monopoly power

Developing a response to the question:

- Reasons why mergers might be good for customers/ passengers, eg:
  - Lower prices, due to eg economies of scale, aircraft working closer to capacity
  - Wider range of product/ services
  - Synergies, more integrated services (data refers to intra-EU, and EU-America services)
- Reasons why they might be bad
  - Higher prices, due to eg reduced competition
  - Less choice
  - Loss of consumer surplus
- Reasons why mergers might be good for producers/ airlines, eg:
  - Economies of scale, lower costs, greater efficiency
  - Rationalisation
  - Less competition, higher profits
  - Long run, dynamic efficiency, greater market power

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- Reasons why they might be bad, eg:
    - Might attract attention of regulators (EU Commission mentioned in data)
    - Monopoly, inertia, loss of efficiency

Evaluation:

- costs versus benefits of merger
- discussion of government role in regulating mergers
- complications arising from transnational conglomerates, eg difficulties of communication, diseconomies of management.
- short-run versus long-run perspectives.

Examiners should note that it may be possible to award some marks for basic evaluation such as consideration of a number of pros and cons. However, this must be considered as low-level evaluation and rewarded accordingly. Stronger evaluation would prioritise the benefits and costs, and/or give economic reasons for justifying a judgement on, for example whether benefits generally outweigh costs.

Also give credit for

- relevant use of evidence and examples not contained in the data
- diagrams
- an overall judgement on the issues raised.

USE THE LEVELS MARK SCHEME ON PAGES 4 AND 5 FOR FURTHER CLARIFICATION

MAXIMUM FOR QUESTION 06: 25 MARKS

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SECTION B

ESSAY 1 **Total for this Essay: 40 marks**

07	Explain how a firm's costs of production may be affected by diminishing returns in the short run and economies of scale in the long run. *(15 marks)*

For candidates who:

Explain the difference between the short run and long run, eg in terms of a fixed factor of production in the short run (**up to 2 marks**) and variable productive capacity in the long run (**up to 2 marks**); **or** define terms: diminishing returns (**up to 2 marks**), economies of scale (**up to 2 marks**). **Up to 4 marks**

Explain the relationship between diminishing returns and short run costs, and returns to scale and long run costs (explanation can refer to marginal or average values) eg:

- diminishing returns operate in the short run as successive units of a variable factor (**1 mark**) are combined with a fixed factor (**1 mark**); example given of a fixed factor (**1 mark**) and variable factor (**1 mark**); eventually average/marginal physical output falls (**1 mark**) and average/marginal costs rise (**1 mark**).

- if a production unit operates at a level of output well below capacity then efficiency is low, average costs will be high; as more units of variable factors are used average costs will fall as productive capacity is approached.

- in the long run all factors are variable and the LRAC curve can be falling, horizontal or rising, depending on increasing returns to scale, constant returns to scale, or decreasing returns to scale

- types of scale economies/diseconomies/indivisibilities etc.

- reward a direct discussion of the quote, regarding certainty. For example, if diminishing returns never set in, we could feed the world out of one farmer's field (factors are not perfectly substitutable); in the long run we are looking into the future, which is inherently unpredictable, so scale economies are less certain.

Reward each step in a logical chain of reasoning up to 15 marks

A maximum of **10 marks** for explaining the relationship if reference to either the diminishing returns (short run) or returns to scale (long run) is omitted from this explanation.

Make relevant use of supporting diagram(s) **Up to 2 marks per diagram**
(1 mark for labelling, 1 mark for correct information shown)

A more complex diagram, eg showing short- and long-run together, can be awarded up to 3 marks

Maximum of 6 marks for diagrams

MAXIMUM FOR QUESTION 07: 15 MARKS

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08	Evaluate the view that firms will always try to minimise their costs and maximise their revenues *(25 marks)*

There must be evidence of evaluation to score more than 15 marks.

Level 5	**Good analysis and good evaluation**	**22-25 marks (mid-point 24)**
Level 4	**Good analysis but limited evaluation** **OR** **Reasonable analysis and reasonable evaluation**	**17-21 marks (mid-point 19)**
Level 3	**Reasonable answer, including some correct analysis but very limited evaluation**	**10-16 marks (mid-point 13)**
Level 2	**Weak with some understanding**	**4-9 marks (mid-point 7)**
Level 1	**Very weak**	**0-3 marks (mid-point 2)**

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these and/or other issues in the time available.

Answers which overwhelmingly discuss the objectives of firms as opposed to costs and revenues would not normally get beyond Level 3.

Issues and areas for discussion include:

Introductory:

- the meaning of cost minimisation
- the meaning of revenue maximisation.

Developing a response to the question:

- methods of reducing/ minimising costs
- implications of cost minimisation
- methods of increasing/ maximising revenues
- implications of revenue maximisation
- discussion of whether both can be pursued at once
- profit maximisation/ satisficing
- other possible objectives; the importance of the type of firm, eg small, large
- issues to do with the divorce of ownership and control; different sections/interests within a single firm might have different objectives, eg production process (minimise costs) sales/marketing (maximise total revenue) managers (utility/status/bonuses linked to profits/sales/other indices), shareholders (long-run, short-run perspectives on share prices and dividends).

Evaluation:

- consequences of different types of conduct/ market structure
- explanation that while Total Profit = TR –TC, maximum profit is at MC = MR and can occur in the short run when revenues are not maximised and costs are not minimised
- consideration of short-run and long-run equilibrium

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- possibility of satisficing and other types of behaviour
- picking up on the word 'always' in the question.

Examiners should note that it may be possible to award some marks for basic evaluation such as consideration of a number of pros and cons. However, this must be considered as low-level evaluation and rewarded accordingly. Stronger evaluation would prioritise the arguments for and against, and/or give economic reasons for justifying a judgement.

Also give credit for

- relevant use of evidence and examples
- diagrams
- an overall judgement on the issues raised.

USE THE LEVELS MARK SCHEME ON PAGES 4 AND 5 FOR FURTHER CLARIFICATION

MAXIMUM FOR QUESTION 08: 25 MARKS

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ESSAY 2 **Total for this essay: 40 marks**

09 'On a typical train journey, there could be as many as twenty different fares being paid by passengers travelling between the same two stations.'

Using the concept of price discrimination to help you, explain how and why this might happen. *(15 marks)*

For candidates who:

Define/explain 'price discrimination' in general terms, eg a producer charging different customers different prices (**up to 2 marks**) which are not fully justified by cost differences (**up to 2 marks**) for the same good or service (**up to 2 marks**). **Up to 4 marks**

Connecting price discrimination to this example (a train journey), with reference to competition/revenues/costs, eg:

- PD involves at least some customers paying more than they would under perfect competition (**1 mark**) and for PD to work the firm needs some degree of control over price (**1 mark**) a means of separating markets (**1 mark**) eg by characteristics of customers (**1 mark**) avoiding arbitrage/seepage (**1 mark**)
- consideration of the different characteristics/elasticities of different rail passengers (e.g. commuters, off peak). Those with lower PED pay higher prices.
- considerations of different costs created by different passengers (eg 1st Class vs. Standard, commuters vs. leisure travellers)
- PD is closely related to yield management/ relationship between total revenue and price elasticity of demand, with separate elasticities in each market.
- outline of different 'degrees' of PD
- profit maximisation as a motive for PD
- fully reward discussion of reasons other than PD

Reward each step in a logical chain of reasoning up to 15 marks

Make relevant use of supporting diagram(s) **Up to 2 marks per diagram**
(1 mark for labelling, 1 mark for correct information shown)

A more complex diagram, eg showing industry and firm, can be awarded up to 3 marks in total

Maximum of 6 marks for diagrams

MAXIMUM FOR QUESTION 09: 15 MARKS

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10	Is price discrimination always good for producers and bad for consumers? Justify your answer. *(25 marks)*

There must be evidence of evaluation to score more than 15 marks.

Level 5	**Good analysis <u>and</u> good evaluation**	**22-25 marks (mid-point 24)**
Level 4	**Good analysis <u>but</u> limited evaluation** **OR** **Reasonable analysis <u>and</u> reasonable evaluation**	**17-21 marks (mid-point 19)**
Level 3	**Reasonable answer, including some correct analysis but very limited evaluation**	**10-16 marks (mid-point 13)**
Level 2	**Weak with some understanding**	**4-9 marks (mid-point 7)**
Level 1	**Very weak**	**0-3 marks (mid-point 2)**

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these and/or other issues in the time available.

Issues and areas for discussion include:

Introductory

- further consideration of the 'degrees' of PD, relating to consumer and producer surplus
- discussion of the significance of relatively high fixed costs and peak demand
- examples of PD.

Developing a response to the question

- Reasons why PD may be good for the producer, eg helps the producer to increase
  - total revenue
  - profit/ producer surplus
  - output/ market share
  - protection of a monopoly.

- Reasons why PD may be bad for consumers, eg
  - reduces welfare (transfers consumer surplus to producer)
  - reduces equity: some consumers might feel it unfair that others get cheaper prices
  - 'first degree' (precise phrase need not be used) PD would remove all consumer surplus, therefore increase the cost of living for individuals
  - low prices could be a barrier to entry, or used to eliminate competition.

Evaluation

- However
  - PD might secure a loss-making good or service if high price consumers in effect cross-subsidise others
  - less well-off customers might get access to a product for the first time (eg budget air travel)

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    - if profits are re-invested consumers might benefit in the long run
    - a larger market leads to economies of scale with lower prices than otherwise
- Consideration of word 'always'
- General consideration of costs versus benefits.

Examiners should note that it may be possible to award some marks for basic evaluation such as consideration of a number of pros and cons. However, this must be considered as low-level evaluation and rewarded accordingly. Stronger evaluation would prioritise the arguments for and against, and/or give economic reasons for justifying a judgement.

Also give credit for

- reference to the UK and/ or other economies
- diagrams
- an overall judgement of the issues raised.

USE THE LEVELS MARK SCHEME ON PAGES 4 AND 5 FOR FURTHER CLARIFICATION

MAXIMUM FOR QUESTION 10: 25 MARKS

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ESSAY 3 **Total for this Essay: 40 marks**

11 Explain the causes of inequality in the distribution of income and wealth in the UK. *(15 marks)*

For candidates who:

Define or explain inequality, eg in terms of unequal absolute/relative distribution of income (**up to 2 marks**) and wealth (**up to 2 marks**) and/or distinguish between income as a flow concept/reward to a factor (**up to 2 marks**) and wealth as a stock concept/ an accumulation of past savings out of income (**up to 2 marks**). **Up to 4 marks**

Explain causes, eg

- (Income) differences in earnings between households (**1 mark**) can arise due to eg full-time/part-time work (**1 mark**), male/female earnings (**1 mark**) qualifications and skills required (**1 mark**), the economic significance of the industry (**1 mark**).
- (Income) marginal revenue product and/or labour supply and demand
- (Wealth) differences in wealth between households, eg due to inheritance
- (Income/ wealth) regional differences, eg due to industrial history, locational factors
- (Income/ wealth) influences of the state, public services, taxation and benefits
- (Income/ wealth) unemployment, old age, disability, single parenthood, home ownership, discrimination etc. **Each of these could be developed as an issue on their own, up to 5 marks for each.**
- (Income/ wealth) the argument that wealth begets income and vice versa.

Reward each step in a logical chain of reasoning
Up to 5 marks per issue explained
(1 mark for identification and up to 4 marks for the explanation)

Maximum of **10 marks** for causes if there is no reference to **both** income **and** wealth in this explanation.

Make relevant use of supporting diagram(s) **Up to 2 marks per diagram**
(1 mark for labelling, up to 1 mark for correct information shown)

A more complex diagram, eg showing the wages of skilled and unskilled labour, can be awarded up to 3 marks in total

Maximum of 6 marks for diagrams

MAXIMUM FOR QUESTION 11: 15 MARKS

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12 Evaluate the view that the government should rely less on market forces to determine the distribution of income and wealth in the UK and should increase its intervention to make the UK more equal. *(25 marks)*

There must be evidence of evaluation to score more than 15 marks.

Level 5	**Good analysis <u>and</u> good evaluation**	**22-25 marks (mid-point 24)**
Level 4	**Good analysis <u>but</u> limited evaluation** **OR** **Reasonable analysis <u>and</u> reasonable evaluation**	**17-21 marks (mid-point 19)**
Level 3	**Reasonable answer, including some correct analysis but very limited evaluation**	**10-16 marks (mid-point 13)**
Level 2	**Weak with some understanding**	**4-9 marks (mid-point 7)**
Level 1	**Very weak**	**0-3 marks (mid-point 2)**

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these and/or other issues in the time available.

Answers which overwhelmingly discuss policies as opposed to the case for and against government intervention, would not normally get beyond Level 3.

Issues and areas for discussion include:

Introductory

- types of government action, eg:
  - fiscal/ taxes, welfare, payments in kind
  - legislative, eg:
    - NMW, anti age/ sex/racial discrimination
- supply side policies: qualifications/life chances
- ad hoc measures, eg 'supertax' on bank bonuses
- general policy options, eg progressive versus regressive taxation
- definitions of income, wealth, market forces.

Developing a response to the question

- consequences of market forces, eg:
  - positive : efficiency, adjustment between emerging and declining industries; incentives, enterprise
  - negative: inequality, poverty
  - winners and losers
  - trickle down
- arguments for government action, eg:
  - imperfect labour markets
  - efficiency arguments, eg supply-side policy
  - demand side policy
  - the government is itself a major employer

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    - equality and aggregate demand.
- arguments against government action, eg:
    - government failure
    - trade offs between incomes and employment
    - costs of intervention, eg burden on the taxpayer/government debt
    - savings, incentives.

Evaluation

- efficiency versus equity
- the fairness and justice of reliance on markets (eg costs and benefits might accrue to different people/ groups/ firms)
- relationships between equality and wider economic/ social variables (as hinted in the quotation)
- do market forces widen or reduce inequality?
- market failure and government failure
- greater case for targeting income or wealth?

Examiners should note that it may be possible to award some marks for basic evaluation such as consideration of a number of pros and cons. However, this must be considered as low-level evaluation and rewarded accordingly. Stronger evaluation would prioritise the arguments for and against, and/or give economic reasons for justifying a course of action.

Also give credit for

- reference to the UK and/ or other economies
- diagrams
- an overall judgement of the issues raised.

USE THE LEVELS MARK SCHEME ON PAGES 4 AND 5 FOR FURTHER CLARIFICATION

MAXIMUM FOR QUESTION 12: 25 MARKS

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General Certificate of Education
Advanced Level Examination
January 2010

Economics ECON3

Unit 3 Business Economics and the Distribution of Income

Friday 29 January 2010 1.30 pm to 3.30 pm

For this paper you must have:
- a 12-page answer book.

You may use a calculator.

Time allowed
- 2 hours

Instructions
- Use black ink or black ball-point pen. Pencil should only be used for drawing.
- Write the information required on the front of your answer book. The **Examining Body** for this paper is AQA. The **Paper Reference** is ECON3.
- In **Section A**, answer **EITHER** Question 1 **OR** Question 2.
- In **Section B**, answer **one** question.

Information
- The maximum mark for this paper is 80.
- There are 40 marks for **Section A** and 40 marks for **Section B**.
- The marks for questions are shown in brackets.
- This paper is synoptic. It assesses your understanding of the relationship between the different aspects of Economics.
- You will be marked on your ability to:
  – use good English
  – organise information clearly
  – use specialist vocabulary where appropriate.

Advice
- You are advised to spend 1 hour on **Section A** and 1 hour on **Section B**.

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SECTION A

Answer **EITHER** Question 1 **OR** Question 2.

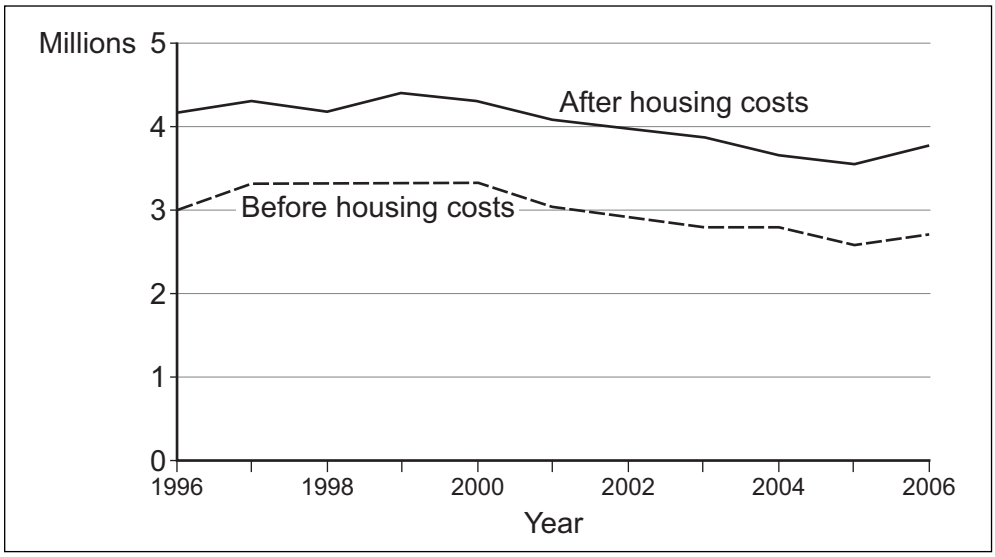
EITHER

1 THE GLOBAL CONTEXT

Total for this question: 40 marks

Study **Extracts A**, **B and C**, and then answer **all** parts of Question 1 which follows.

Extract A: Number of children living in poverty, UK



Source: adapted from official statistics

Extract B: Child poverty in the UK

In the mid to late 1990s, the United Kingdom suffered higher child poverty than nearly any other industrialised nation in the world. Over a period of 20 years, the proportion of children in relatively low-income households had more than doubled, and one in five families had no one in work. When the Labour Party came to power in 1997, it was estimated that more than one British child in four (nearly 5 million children) were living in households where family income was less than 60% of median (average) income after accounting for housing costs. It is considered important to allow for the impact of house rents and mortgage repayments because of the significant impact they have on the remaining disposable income of families, especially those on low incomes. In 1999, the then Prime Minister, Tony Blair, promised to halve child poverty (as measured this way) by 2010, and to eliminate it by 2020.

Children who grow up in relative poverty in the UK have poorer life chances than children from higher-income families. Every area of a child's development is affected: social, educational, personal, economic. There are long-term effects because childhood poverty tends to persist into adulthood. Children from poor families have worse school attendance records and are less likely to do well at school. They have more illnesses and are more likely to die in accidents. As adults, they are more likely to be unemployed, commit crimes, enter into abusive relationships or develop alcohol and/or drug dependencies.

Source: news reports, 2008

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Extract C: Child poverty in less developed countries

Living in absolute poverty is the norm for the majority of people alive today. Almost half the world's population, over 3 billion people, live on less than $2.50 a day. The annual total of Gross Domestic Product (GDP) of the 41 countries described by the United Nations as being 'Heavily Indebted Poor Countries' (HIPCs), which together contain 567 million people, is less than the total personal wealth of the world's seven richest individuals. Every year, the world spends on weapons more than 100 times the amount needed to put every child into school. Meanwhile, nearly a billion people worldwide are unable to read or write. While multinational companies spend millions of pounds every year marketing fizzy drinks to poorer countries, thousands of children in those countries die every day from intestinal diseases linked to a lack of clean drinking water. Meanwhile, the World Bank and International Monetary Fund have pursued policies that controversially encourage governments to privatise water supplies.

Child poverty is a particular problem, and the UN estimates that half the children in the world live in poverty, defined as having 'severe deprivation' in two or more of the following basic needs: shelter, sanitation, information, water, food, health or education. Economists have estimated that, if appropriately measured, the long-run economic rate of return on national investment in basic services such as primary education is greater than would be expected from stocks and shares.

Source: news reports, 2008

Question 1

1 (a) Using **Extract A**, identify **two** significant points of comparison between the number of children living in poverty before and after housing costs over the period shown. *(5 marks)*

(b) Distinguish between absolute and relative poverty **and**, using the data to help you, explain why this distinction is useful when investigating poverty in the UK and in less developed countries. *(10 marks)*

(c) Evaluate whether the UK government should attempt to eliminate poverty, and child poverty in particular, **or** leave the issue to market forces. *(25 marks)*

Turn over for the next question

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Do **not** answer Question 2 if you have answered Question 1.

OR

2 THE EUROPEAN UNION CONTEXT **Total for this question: 40 marks**

Study **Extracts D and E**, and then answer **all** parts of Question 2 which follows.

Extract D: Motor vehicle manufacturers supplying the EU market, 2007

Company	Market share (%)
Volkswagen (Germany)	18.3
Peugeot-Citroën (France)	13.2
Ford (USA)	10.7
General Motors (USA)	9.6
Renault (France)	9.4
Fiat (Italy)	8.8
Mercedes (Germany)	5.9
BMW (Germany)	4.6
Japanese companies	13.8
Korean companies	3.2
Others	2.5

Extract E: Mergers among car producers

In Germany, where it is estimated that one job in seven is dependent on the motor industry, the so-called 'Volkswagen Law' states that any shareholder in Volkswagen (VW) cannot exercise more than 20% of voting rights, even if their stake in the firm is bigger. In 2007, the European Union's highest court ruled that this law, protecting the car-maker VW from takeovers, was illegal.

The German Government resisted demands to scrap the VW law, but in 2008 the family-owned Porsche group took its shareholding in VW above 74%, saying that it wished to protect VW from 'foreign' takeover, anticipating that the German Government would have to back down. VW had itself completed a takeover of Sweden's Scania. The end result is a global giant that makes cars, buses and trucks, and contains not only VW and Porsche, but also Bentley, Audi, Lamborghini, Seat and Skoda.

At one time there were at least 20 car manufacturers in Britain alone; today, there is no single independent British manufacturer, and there are only about 20 major manufacturers in the whole world. Several well-known British brands have merged with each other or become the property of companies based elsewhere in the EU, in the USA, or as far afield as China. However, the employment and skills profiles of many British towns benefit from the fact that overseas manufacturers invest in this country in order to have unhindered access to the Single European Market. For example, since 1983 Ford has been making engines in

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Wales which are then installed in cars at its assembly plants in Spain and other EU countries.

As well as full-blown mergers, there are many instances of cross-industry collaboration, some of which date back several decades. In 1979, for example, the then Rover Group began cooperating with Honda to produce some models using resources in both Britain and Japan. This collaboration was phased out after 1994 when Rover was taken over by BMW. Today, the Ford Galaxy, VW Sharan and Seat Alhambra (seven-seater multi-purpose vehicle models) all look remarkably similar, as they share the same basic body design and some components. The attempt by producers to benefit from economies of scale through collaboration needs to be carefully distinguished from cases of collusion. When oligopolists collude, the results can be anti-competitive and against the consumer interest.

EU Commission estimates of minimum efficient scales (MES) in motor manufacturing (2006)

Product	MES as a % of production in the EU
Cars	20
Lorries	19

The tendency for the car market in Europe to become dominated by fewer, larger firms is at least partly explained by the concept of minimum efficient scale (MES). Where the MES is a large proportion of EU production, the industry will find it difficult to support many firms.

Source: news reports, 2008

Question 2

2 (a) Using **Extract D**, identify **two** main features of the market for motor vehicles in the EU. *(5 marks)*

(b) Explain the concept of 'minimum efficient scale' (**Extract E**, line 30) **and** analyse its implications for the structure of, **and** barriers to entry to, the motor manufacturing industry. *(10 marks)*

(c) 'When oligopolists collude, the results can be anti-competitive and against the consumer interest' (**Extract E**, lines 27–28).

Evaluate policies that could be used to deal with this problem. *(25 marks)*

Turn over for the next question

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SECTION B

Answer **one** question from this section.

Each question carries 40 marks.

3 (a) The *British Airports Authority* (BAA), a private-sector monopolist which operates Heathrow Airport, says it needs to build a third runway. Critics say that this would cause air and noise pollution and add to global warming.

Explain why, even if this runway were profitable, an economist could argue that it would be a case of market failure. *(15 marks)*

(b) A government is considering subsidising a series of high-speed rail lines in order to reduce short-haul air flights.

To what extent might cost benefit analysis be a useful method of evaluating this proposal? *(25 marks)*

4 (a) *Home Farm* is one of many small firms producing lettuces and attempting to maximise profits.

Explain the circumstances in which *Home Farm* might make supernormal profits in the short run, but only normal profits in the long run. *(15 marks)*

(b) Evaluate the argument that managers controlling large companies might follow policies which do **not** necessarily maximise the profits of the owners. *(25 marks)*

5 (a) Explain why a television journalist working on the BBC's *Newsnight* current-affairs programme would usually be paid a much higher wage rate than a reporter on a local newspaper.

(15 marks)

(b) Evaluate the view that the best way to narrow wage differentials is to increase the National Minimum Wage (NMW). *(25 marks)*

END OF QUESTIONS

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Version 1.0 02/10

ASSESSMENT and QUALIFICATIONS ALLIANCE

General Certificate of Education

Economics

ECON3: Business Economics and the Distribution of Income

Mark Scheme

2010 examination - January series

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Mark schemes are prepared by the Principal Examiner and considered, together with the relevant questions, by a panel of subject teachers. This mark scheme includes any amendments made at the standardisation meeting attended by all examiners and is the scheme which was used by them in this examination. The standardisation meeting ensures that the mark scheme covers the candidates' responses to questions and that every examiner understands and applies it in the same correct way. As preparation for the standardisation meeting each examiner analyses a number of candidates' scripts: alternative answers not already covered by the mark scheme are discussed at the meeting and legislated for. If, after this meeting, examiners encounter unusual answers which have not been discussed at the meeting they are required to refer these to the Principal Examiner.

It must be stressed that a mark scheme is a working document, in many cases further developed and expanded on the basis of candidates' reactions to a particular paper. Assumptions about future mark schemes on the basis of one year's document should be avoided; whilst the guiding principles of assessment remain constant, details will change, depending on the content of a particular examination paper.

Further copies of this Mark Scheme are available to download from the AQA Website: www.aqa.org.uk

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Registered address: AQA, Devas Street, Manchester M15 6EX *Dr Michael Cresswell Director General*

Advanced Level Economics Unit 3

General Instructions

Marks awarded to candidates should be in accordance with the following mark scheme and examiners should be prepared to use the full range of marks available. The mark scheme for most questions is flexible, permitting the candidate to score full marks in a variety of ways. Where the candidate's response to a question is such that the mark scheme permits full marks to be awarded, full marks **MUST** be given. A perfect answer is not necessarily required for full marks. But conversely, if the candidate's answer does not deserve credit, then no marks should be given.

Occasionally, a candidate may respond to a question in a reasonable way, but the answer may not have been anticipated when the mark scheme was devised. In this situation, **OR WHENEVER YOU HAVE ANY DOUBT ABOUT THE INTERPRETATION OF THE MARK SCHEME**, you must in the first instance telephone your team leader to discuss how to proceed.

Two approaches have been used in the construction of the mark scheme.

(i) **An issue based approach.** The mark scheme for parts (a) and (b) of the data response questions and part (a) of the essay questions adopts this approach. The mark scheme lists the marks that can be awarded for particular issues (and associated development) that the candidate might include in the answer.

(ii) **A levels approach.** This approach is used for part (c) of the data response questions and part (b) of the essay questions. The Levels Mark Scheme on the next page identifies five levels representing differences in the quality of work. A range of marks is allocated to each level. First decide the level into which an answer falls. The level chosen should be the one which **best fits** the answer provided by the candidate. It is **not** intended that the answer should satisfy every statement in the level description. Then think in terms of awarding the mid-point mark which has been identified for that level (e.g. 14 marks for Level 3). Move up or down from this notional mark by considering the extent to which the answer meets the level description overall. Strength in one skill can outweigh weakness in another. When using the Levels Mark Scheme the marker **must** identify where a particular skill is being demonstrated. The **key** to be used to identify the skill is given after the level descriptions. The question-specific mark scheme summarises the information which could be used to answer the question, but without attaching marks to particular issues.

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THE LEVELS MARK SCHEME FOR A2

Level Descriptions

In part (c) of the data response questions and part (b) of the essay questions, 40% of the marks are available to award to candidates who demonstrate that they can evaluate economic arguments and evidence, and make informed judgements. An answer showing no evidence of evaluation, however good the analysis, should be awarded a maximum of 15 marks (in Level 3). The quality of evaluation should be the sole distinction between a Level 4 and Level 5 answer. As indicated below, the **Quality of Written Communication** used should be taken into account when awarding marks.

Level 1: A very weak answer
Few, if any, relevant issues are recognised. Descriptions and explanations lack clarity. Economic concepts and principles are not adequately understood or applied to the question and its context. No satisfactory analysis or evaluation. Little, if any, appreciation of the inter-relatedness of economic issues, problems and institutions. There might be some evidence of organisation in the answer but generally it fails to answer the question. Spelling, punctuation and grammar may be poor. There is little use of specialist vocabulary. **0 to 6 marks**

Mid-Point 4 marks

Level 2: A poor answer but some understanding is shown
A few issues are recognised but there is only limited evidence of the candidate's ability to apply relevant economic concepts. Descriptions and explanations are sometimes hard to follow. An attempt is made to answer the question but there is little satisfactory analysis or evaluation. There is some very limited appreciation of the inter-relatedness of economic issues, problems and institutions. There is some limited logic and coherence in the organisation of the answer. The candidate demonstrates some ability to spell commonly used words and to follow the standard conventions of punctuation and grammar. Some use of specialist vocabulary is made but this is not always applied appropriately. **7 to 11 marks**

Mid-Point 9 marks

Level 3: An adequate answer with some correct analysis but very limited evaluation
A few issues are recognised. The candidate has attempted to apply relevant economic concepts and ideas to the question and its context. A reasonable understanding of some concepts and theories is demonstrated. However, the evaluation of the issues, arguments and evidence is limited or superficial. There is some understanding of the inter-relatedness of economic issues, problems and institutions. There is some logic and coherence in the organisation of the answer. The candidate is generally able to spell commonly used words and usually follows the standard conventions of punctuation and grammar. Some descriptions and explanations are easy to understand but the answer may not be expressed clearly throughout. There is some use of specialist vocabulary which is applied appropriately. **12 to 16 marks**

Mid-Point 14 marks

Level 4: Good analysis but limited evaluation
Several relevant issues are identified. Good understanding of economic concepts and principles is demonstrated throughout. The candidate is able to apply these concepts and principles to the context to answer the question. A clear understanding of the inter-relatedness of economic issues, problems and institutions is demonstrated. The candidate shows the ability to think as an economist making effective use of the economist's 'tool kit' of concepts, theories and techniques. There is some appreciation of alternative points of view. Satisfactory use is made of evidence and/or theoretical analysis to evaluate the issues/arguments/models identified. The candidate demonstrates some ability to synthesise the arguments presented and come to some relevant conclusions although these might not always be based on evidence presented. Spelling is

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generally accurate and the standard conventions of punctuation and grammar are usually followed. The answer is well organised. Descriptions and explanations are clearly expressed. A wide range of specialist vocabulary is used with facility. **17 to 21 marks**

Mid-Point 19 marks

Level 5: Good analysis and evaluation

Several relevant issues are identified. Good understanding of economic concepts and principles is demonstrated throughout. The candidate is able to apply these concepts and principles to the context to answer the question. A clear understanding of the inter-relatedness of economic issues, problems and institutions is demonstrated. The candidate shows the ability to think as an economist making effective use of the economist's 'tool kit' of concepts, theories and techniques. There is an appreciation of alternative points of view. Good use is made of evidence and/or theoretical analysis to evaluate the issues/arguments/models identified. The candidate demonstrates the ability to synthesise the arguments presented and come to conclusions which are based on the evidence presented. A clear final judgement is made. Spelling is generally accurate and the standard conventions of punctuation and grammar are usually followed. The answer is well organised. Descriptions and explanations are clearly expressed. A wide range of specialist vocabulary is used with facility. **22 to 25 marks**

Mid-Point 24 marks

THE KEY TO BE USED WHEN USING THE LEVELS MARK SCHEME

D Where a particular economic term is correctly **DEFINED** in order to help the candidate to answer the question properly.

I Where a relevant **ISSUE** is raised by the candidate.

K Where the candidate demonstrates **KNOWLEDGE** of recent developments or features of the economy which help enhance the candidate's response to the question. This should also be used where the candidate quotes relevant examples.

Ap Where the candidate demonstrates the ability to **APPLY** knowledge and **CRITICAL UNDERSTANDING** to problems and issues.

A Where the candidate demonstrates the ability to **ANALYSE** the problem using appropriate economic ideas.

E Where the candidate **EVALUATES** and makes judgements about the significance of various issues and arguments.

Synoptic Assessment

All questions in this unit are synoptic. Therefore, candidates will need to demonstrate that they are able to think as an economist and to use effectively the economist's 'tool kit' of concepts, theories and techniques.

They should demonstrate that they:

- understand the inter-relatedness of many economic issues, problems and institutions;
- understand how certain economic concepts, theories and techniques may be relevant to a range of different contexts;
- can apply concepts, theories and techniques in analysing economic issues and problems and in evaluating arguments and evidence.

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1 THE GLOBAL CONTEXT — Total for this question: 40 marks

1 (a) Using **Extract A,** identify **two** significant points of comparison between the number of children living in poverty before and after housing costs over the period shown. *(5 marks)*

Award **1 mark** for each valid point made and **2 marks** for the supporting reference to the data, up to a maximum of **5 marks**. Points might include:

- After housing costs are accounted for, there are more children living in poverty (or housing costs make the child poverty problem worse)
- Generally speaking, the two graphs tend to move together (more or less in parallel)
- Both graphs are rising together at the end of the period
- Between 1996 and 2000 (approximately) the 'after' line fluctuates, while the 'before' line is level
- Both lines show poverty lower at the end than at the start
- The decline mainly happened between 98/99 and 04/05
- The gap narrows over the whole period

Award a maximum of **1 mark** for each supporting reference to the data if the unit (millions) is not used.

A maximum of **2 marks** may be awarded if the candidate simply trawls through the data

A maximum of **2 marks** may be awarded if there is no use of statistics which support the point(s) being made.

A maximum of **4 marks** may be awarded where there is evidence of two points of comparison (one good point is included with data) even though other parts of the answer give the impression of a few statistics chosen at random.

MAXIMUM FOR PART (a): 5 MARKS

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1 (b) Distinguish between absolute and relative poverty **and**, using the data to help you, explain why this distinction is useful when investigating poverty in the UK and in less developed countries. *(10 marks)*

For candidates who:

- define absolute poverty, in terms of some sort of poverty line or threshold (e.g. living on a dollar a day).
- define relative poverty, in terms of comparison to some sort of average
- attempt to 'distinguish', over and above providing two separate definitions, e.g. by saying that relative poverty is an average, and like any average an individual's position can look different depending on the position of others; whereas an absolute measure is the same for the individual whatever the position of others in the group.

Up to 3 marks per definition or overview to a maximum of 6 marks (including diagrams)

Explain different circumstances and the appropriateness of different definitions in different circumstances, e.g. by saying that

- in less developed countries the circumstances are such that survival is an issue in a way in which it is not in richer countries; this makes an absolute measure more relevant than a relative one
- in richer countries unequal 'living standards' might be dysfunctional but are not normally an immediate matter of life or death; however they are a matter of long term 'life chances'
- any definition of 'poverty' (absolute or relative) is bound to be arbitrary, e.g. terms like 'severe deprivation' can mean different things to different people
- absolute poverty indicates a lack of access to basic needs, while relative poverty indicates inequality. It is possible for a country to have no absolute poverty, but there will still be relative poverty if there is inequality
- we would not expect people in more developed countries to be poor enough to be regarded as being in 'absolute' poverty in terms of, say, less than $2.50 a day
- the data indicates that in the UK there is a mixture of measures being used in order to discuss child poverty: relative (the 60% figure), and absolute (school attendance, health)

Up to **4 marks** for each of the points made (**1 mark** for identification and **3 marks** for analysis) up to a maximum of **8 marks.**

Up to **2 marks** per diagram (**1 mark** for labelling, **1 mark** for correct information shown) to a maximum of **3 marks**.

MAXIMUM FOR PART (b): 10 MARKS

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1(c) Evaluate whether the UK government should attempt to eliminate poverty, and child poverty in particular, **or** leave the issue to market forces. *(25 marks)*

There are hints in the data concerning the 'long run', to which candidates can respond, and an argument can be constructed around the long run returns to investment in children in terms of long term negative externalities which are avoided by eradicating child poverty. On the other hand, other groups could make a case for government targeting, e.g. senior citizens could argue that having spent a lifetime paying taxes they are entitled to be the beneficiaries of anti-poverty policies, and could make a case that such expenditure, e.g. on home heating, saves on costs in other parts of the government budget, e.g. the NHS.

The issues identified below are intended to provide an indication of some of the areas that might be discussed. They are not necessarily the only valid approach. Candidates can only be expected to consider a few of these and/or other relevant issues in the time available.

There must be evidence of evaluation to score more than 15 marks.

To achieve **Level 4**, at least **two** issues should be presented and evaluated. (One of these issues could be the actual policies used)

To achieve **Level 5**, there should, in addition, be an attempt to provide a more general evaluation of the arguments referred to in order that a concluding judgement can be made by the candidate.

Issues and areas for discussion include

- Arguments for/ against tackling general poverty, e.g.
  - Families without children are equally deserving
  - There are other groups beside children, e.g. the elderly, the disabled, who could benefit from poverty alleviation

- However
  - Such a wide target might be unachievable
  - Costs and opportunity costs might be too great

- Arguments for / against targeting child poverty, e.g.
  - It provides objectives which are more easily measurable
  - It is less costly than targeting general poverty
  - It gives time for the policies to work instead of looking for quick results (the opposite of short termism)
  - … this also enables governments to work towards a change in culture (e.g. welfare to work)
  - Children are more vulnerable than adults, so spending targeted at, e.g. infant mortality, have larger returns than those aimed at adults
  - There are spin-off benefits in the long run, e.g. a healthier and better educated workforce
  - There are reduced external costs in the long run, e.g. fewer costs associated with unemployment, sickness, crime etc.

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- However
  - It is too narrow a target
  - It could be an 'easier' target for politicians
  - Arguments for/against tackling general poverty, eg other groups (eg older people) are just as 'deserving' as children, general poverty is dysfunctional and undermines the economy for all groups, including children

- Arguments for / against 'market forces', e.g.
  - Government failure
  - 'Trickle-down' ideas

- However
  - Market failure
  - 'Trickle down might not happen'

- Evaluation could come from, for instance:
  - an argument that it is not a simple matter of either / or, and there could be a role for both markets and government in tackling both child poverty and general poverty.
  - the point that in extreme cases of global poverty, individual governments might not have sufficient power to make any difference, and that concerted international action might be required.

Also give credit for:

- Relevant use of evidence and examples not contained in the data
- Diagrams
- An overall judgement on the issues raised

USE THE LEVELS MARK SCHEME ON PAGES 4 AND 5

MAXIMUM FOR PART (c): 25 MARKS

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2 THE EUROPEAN UNION CONTEXT — Total for this question: 40 marks

2 (a) Using **Extract D**, identify **two** main features of the market for motor vehicles in the EU. *(5 marks)*

Award **1 mark** for each valid point made and **2 marks** for the supporting reference to the data, up to a maximum of **5 marks**. Points might include:

- There is a relatively small number of producers supplying the EU market, which implies oligopoly
- We are not told how many manufacturers come from Japan, Korea, and 'Others' (but the market shares probably suggest that they do not have many)
- Major manufacturers are based in a small number of countries
- Several manufacturers have roughly equal market share (9.4 to 13.8 per cent (with VW the largest, at 18.3 per cent))
- The 2/ 3 firm concentration ratio indicates a high degree of concentration

Award a maximum of **1 mark** for each supporting reference to the data if the unit (per cent) is not used.

A maximum of **2 marks** may be awarded if the candidate simply trawls through the data

A maximum of **2 marks** may be awarded if there is no use of statistics which support the point(s) being made.

A maximum of **4 marks** may be awarded where there is evidence of two features (one good point is included with data) even though other parts of the answer give the impression of a few statistics chosen at random.

MAXIMUM FOR PART (a): 5 MARKS

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2 (b) Explain the concept of 'minimum efficient scale' (**Extract E**, line 30) **and** analyse its implications for the structure of, **and** barriers to entry to, the motor-manufacturing industry. *(10 marks)*

For candidates who:

- Explain what happens on the LRAC curve where falling LRAC becomes constant LRAC

- Explain what is meant by 'minimum efficient scale' (e.g. this is the lowest level of output capacity where LRAC is minimised, or where economies of scale are exhausted)

Up to 3 marks per explanation to a maximum of 6 marks (including diagrams)

Analyse implications, e.g. by saying that

- as output is increased through increasing the size of plant or industry, there are economies of scale. These economies are managerial, technical, marketing, etc.
- In the table MES indicates that
  - the UK is too small a market to accommodate a major UK-only manufacturer efficiently
  - 4 or 5 manufacturers could supply the EU market efficiently.
- in effect MES at a high level of output is a barrier to entry (e.g. because of capital set-up costs) – this point is not essential for full marks to be earned
- the higher the level of output where MES kicks in, the less room there is for efficient competition (this is stated in the data, but is worth rewarding if it is used to support the analysis here)
- however, anti competitive practices such as collusion, cartels and a wish for market share, or market dominance, might also help explain the number of firms
- mass production creates indivisibilities which move the MES curve to the right
- unlike, say, computers/ ICT where capital equipment has become more divisible (mainframe to PC to laptop), and smaller firms can compete, in the car industry due to the technological complexity of modern cars and the need to match world standards of technology, the MES point has moved to the right
- car firms need to be large to supply affordable mass production cars to the technical standards that consumers now demand

Up to **4 marks** for each of the points made (**1 mark** for identification and **3 marks** for analysis) up to a maximum of **8 marks**.

Up to **2 marks** per diagram (**1 mark** for labelling, **1 mark** for correct information shown) to a maximum of **3 marks**.

Do not insist on both structure and barriers for full marks. No mark cap in this instance but award appropriately a candidate who makes a clear link with barriers to entry.

MAXIMUM FOR PART (b): 10 MARKS

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2 (c) 'When oligopolists collude, the results can be anti-competitive and against the consumer interest' (**Extract E**, lines 27-28).

Evaluate policies that could be used to deal with this problem. *(25 marks)*

There must be evidence of evaluation to score more than 15 marks.

To achieve **Level 4**, at least **two** issues should be presented and evaluated.

To achieve **Level 5**, there should, in addition, be an attempt to provide a more general evaluation of the arguments referred to in order that a concluding judgement can be made by the candidate.

The issues identified below are intended to provide an indication of some of the areas that might be discussed. They are not necessarily the only valid approach. Candidates can only be expected to consider a few of these and/or other relevant issues in the time available.

Issues and areas for discussion include:

- Definition of 'consumer interest'
- Definitions of 'oligopolists' and 'anti-competitive'
- Collusion
  - can be against the consumer interest, e.g. if it involves secret deals over market share, price fixing, etc.
  - is usually against both UK and EU law, and might result in fines or even imprisonment for the managers of the firms involved.
  - needs to be distinguished from 'collaboration'
- Government/ EU intervention, eg legislation, taxation, commission of enquiry, subsidising new competitors
  - Arguments for intervention, e.g.
    - to reduce barriers to entry, restrictive practices (created by firms)
    - to tackle trade barriers (created by national governments)
  - Arguments against intervention, e.g.
    - 'markets know best',
    - government failure
- Evaluation could come from, for instance:
  - Evaluation of the arguments above
  - assessing the effectiveness of various policies, e.g. comparing the traditional British administrative approach (commissions, enquiries, recommendations) with the newer, European approach (the use of investigators and legal sanctions)
  - suggesting that whether intervention is necessary depends on the behaviour of firms, and that if market forces are automatically creating competition then intervention is unnecessary.
  - arguing that EU intervention is necessary to modify the behaviour of national governments as opposed to firms (as in the case of the VW law)
  - …or that protectionism is not necessarily a bad thing, e.g. if it protects employment).
  - distinction between collaboration and collusion

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Also **give credit for:**

- Relevant use of evidence and examples not contained in the data
- Diagrams
- An overall judgement on the issues raised

USE THE LEVELS MARK SCHEME ON PAGES 4 AND 5

MAXIMUM FOR PART (c): 25 MARKS

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SECTION B

3 **Total for this question: 40 marks**

3 (a) The *British Airports Authority* (BAA), a private-sector monopolist which operates Heathrow Airport, says it needs to build a third runway. Critics say that this would cause air and noise pollution and add to global warming.

Explain why, even if this runway were profitable, an economist could argue that it would be a case of market failure. *(15 marks)*

For candidates who:

Define or explain 'profit' and 'market failure' and make it clear that they realise that commercial success and market failure can co-exist (equally, a commercial failure can show that a market is working successfully, by eliminating firms that are inefficient or outdated).

Up to 4 marks

Explain that profitability can be created by, e.g.

- Use of the runway by customer airlines (paying fees to BAA)
- More passengers passing through Heathrow (using airport shops and services)
- Internal costs being accounted for (but not necessarily external costs)

Explain that market failure can exist in terms of, e.g.

- Negative externalities (external costs) of pollution
- Social costs exceeding social benefits
- Market forces leading to a sub-optimal level of output
- Monopoly forcing up prices **Up to 4 marks per feature explained**

(1 mark for identification and up to 3 marks for the explanation)

Use of supporting diagram(s) showing, e.g.

- externalities (**up to 4 marks**)
- monopoly (**up to 4 marks**) **Up to 8 marks for diagrams**

MAXIMUM FOR PART (a): 15 MARKS

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3 (b) A government is considering subsidising a series of high-speed rail lines in order to reduce short-haul air flights.

To what extent might cost benefit analysis be a useful method of evaluating this proposal? *(25 marks)*

An effective answer to the question requires recognition that the existence of negative externalities means that prices do not fully reflect the costs of production hence the role of taxes and subsidies. The nature of CBA, and an outline of its various elements is a sensible starting point. Better answers will stick to the cases mentioned in the question rather than digressing towards other cases such as Concorde or a Severn barrage.

There must be evidence of evaluation to score more than 15 marks.

To achieve **Level 4**, at least **two** issues should be presented and evaluated.

To achieve **Level 5**, there should, in addition, be an attempt to provide a more general evaluation of the arguments referred to in order that a concluding judgement can be made by the candidate.

The issues identified below are intended to provide an indication of some of the areas that might be discussed. They are not necessarily the only valid approach. Candidates can only be expected to consider a few of these and/or other relevant issues in the time available.

Issues and areas for discussion include:

- Subsidies
  - Definition of subsidy
  - Explanation of effect of subsidy
- Costs and benefits
  - Definitions of costs, benefits,
  - Positive and negative externalities
- CBA
  - Steps involved in CBA
  - Problems with selected aspects of CBA
  - Advantages of CBA as a whole
  - Disadvantages of CBA

- Evaluation could come from, for instance:
  - assessing the usefulness of individual aspects of CBA, e.g.
    - assigning shadow prices,
    - discounting for the time value of money
  - or an overall judgement on CBA as a whole methodology.

Also give credit for

- Reference to the UK and/ or other economies
- Diagrams
- An overall judgement of the issues raised

USE THE LEVELS MARK SCHEME ON PAGES 4 AND 5

MAXIMUM FOR PART (b): 25 MARKS

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4 (a) *Home Farm* is one of many small firms producing lettuces and attempting to maximise profits.

Explain the circumstances in which *Home Farm* might make supernormal profits in the short run, but only normal profits in the long run. *(15 marks)*

For candidates who:

Define or explain normal profit, supernormal profit, and profit maximising behaviour, and who make it clear that they understand the role of profit in the short and long run theory of the perfectly competitive firm. **Up to 4 marks**

Explain the conditions for a 'perfect market' and analyse how the profit maximising level of output can be identified, e.g. by referring to:

- Home Farm being one of many, small firms
- Lettuces possibly being an homogenous product/ having no brand name
- Other conditions that would need to be fulfilled, e.g. freedom of entry and exit, perfect knowledge
- Whether the firm sells to one large customer or to many smaller ones
- Short-run equilibrium
- Long-run equilibrium
- The possibility of a contestable market **Up to 4 marks per feature explained (1 mark for identification and up to 3 marks for the explanation)**

Use of supporting diagram(s) showing, e.g.

- Short run (**up to 4 marks**)
- Long run (**up to 4 marks**) **Up to 8 marks for diagrams**

MAXIMUM FOR PART (a): 15 MARKS

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4 (b) Evaluate the argument that managers controlling large companies might follow policies which do **not** necessarily maximise the profits of the owners. *(25 marks)*

Candidates might trawl through a list of alternative theories of the firm. While this is relevant and should be credited, a more incisive and effective answer to the question is likely to start from a discussion of 'ownership' and 'control', with the traditional idea being that shareholders 'own', 'take risks' and receive 'profits' as their factor reward, while directors, representing shareholders, 'control' and managers may carry out day-to-day decisions, receiving 'wages' (salaries) as their factor reward. This can be developed into an argument that in modern large corporations, managers have usurped directors and become 'divorced' from owners.

There must be evidence of evaluation to score more than 15 marks.

To achieve **Level 4**, at least **two** issues should be presented and evaluated.

To achieve **Level 5**, there should, in addition, be an attempt to provide a more general evaluation of the arguments referred to in order that a concluding judgement can be made by the candidate.

The issues identified below are intended to provide an indication of some of the areas that might be discussed. They are not necessarily the only valid approach. Candidates can only be expected to consider a few of these and/or other relevant issues in the time available.

Issues and areas for discussion include:

- The factor of production 'enterprise' in theory
- Explanation of the role of profit maximisation as an objective
- Enterprise in large companies: the location of risk-taking, ownership, control, decision making
- Lack of information might make it difficult in practice to track marginal values
- The divorce of ownership and control
- Alternatives to profit maximising, e.g.
    - Revenue maximisation (likely to be of interest to the marketing/ sales managers)
    - Output maximisation/ cost minimisation (likely to be of interest to the production management)
    - Maximisation of managerial utility/ power/ status
    - Social/ environmental/ community involvement/ 'ethical' issues (and their contribution to the bottom line)
    - Satisficing behaviour
    - Above alternatives might be short run behaviour, and not inconsistent with profit maximisation in the long run
- Evaluation could come from, for instance:
    - arguing that managers do not necessarily maximise profits all the time
    - but managers who do not provide 'shareholder value' will not survive in the long run
    - neither will firms that do not give due weight to profitability

Also give credit for

- Reference to the UK and/ or other economies
- Diagrams
- An overall judgement of the issues raised.

USE THE LEVELS MARK SCHEME ON PAGES 4 AND 5

MAXIMUM FOR PART (b): 25 MARKS

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5 (a) Explain why a television journalist working on the BBC's *Newsnight* current-affairs programme would usually be paid a much higher wage rate than a reporter on a local newspaper. *(15 marks)*

For candidates who:

Define 'wage rate' in terms of a kind of 'price', mention the relevance of the supply and demand of labour, or refer to the features of a labour market, e.g. derived demand; or refer to the 'marginal revenue product' of a factor in general terms and explain how the MRP of a factor determines the quantity demanded by an employer **Up to 4 marks**

Explain how the potential **supply** of suitable *Newsnight* journalists is less than that of local reporters, due to, for example,

- Natural ability/ suitability
- Training, skills

Explain how the effective **demand** for *Newsnight* journalists is greater/ stronger than that of local reporters due to, for example,

- The BBC is a more specialised labour market
- The BBC has greater resources than the local newspaper industry
- The *Newsnight* presenter is more vital to the programme than the average reporter is to the newspaper (without the presenter there might be no programme; the reporter is more easily replaced);
- In theoretical terms the marginal revenue product of the *Newsnight* journalist is greater than that of the local reporter (marks awarded here for **specific** use of MRP in addition to **general** marks allowed above)

Discuss other possible factors, e.g. mention the relevance of

- price (wage) elasticity of supply and price (wage) elasticity of demand
- non-price or non-market mechanism factors (e.g. the *Newsnight* presenter might be represented by a powerful agent, while the local reporter might be in a relatively weak trade union) **Up to 4 marks per feature explained**
  (1 mark for identification and up to 3 marks for the explanation)

Use of supporting diagram(s) showing, e.g.

- MRP (**up to 4 marks**)
- S & D (**up to 4 marks**) **Up to 8 marks for diagrams**

MAXIMUM FOR PART (a): 15 MARKS

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5 (b) Evaluate the view that the best way to narrow wage differentials is to increase the National Minimum Wage (NMW). *(25 marks)*

There must be evidence of evaluation to score more than 15 marks.

To achieve **Level 4**, at least **two** issues should be presented and evaluated.

To achieve **Level 5**, there should, in addition, be an attempt to provide a more general evaluation of the arguments referred to in order that a concluding judgement can be made by the candidate.

The issues identified below are intended to provide an indication of some of the areas that might be discussed. They are not necessarily the only valid approach. Candidates can only be expected to consider a few of these and/or other relevant issues in the time available.

Issues and areas for discussion include:

- The meaning of 'to narrow wage differentials'
- The nature of labour markets (perfect/ imperfect)
- The nature, impact and success of the national minimum wage
- The capping of wages (market forces versus government failure arguments can be used here)
- The implications of other policies, e.g.
    - Progressive taxation
    - Provision of universal public services
- Specific arguments for and against
    - The narrowing of wage differentials
    - A more equal distribution of income
- General arguments about the role of government/ consequences of leaving wage determination to market forces

- Evaluation could come from, for instance:
    - discussion of progressive versus regressive taxation, the impact of transfer payments (the 'social wage') etc.
    - assessing the success or otherwise of various policies such as the current minimum wage
    - the desirability of alternative policies
    - a more general discussion about income distribution and the issue of equality versus inequality (bonuses paid to senior banking executives, 'rewards for failure' during the credit crunch, and possible government policy responses could feature in the discussion).

Also give credit for

- Reference to the UK and/ or other economies
- Diagrams
- An overall judgement of the issues raised

There must be evidence of evaluation to score more than **15 marks**.

USE THE LEVELS MARK SCHEME ON PAGES 4 AND 5

MAXIMUM FOR PART (b): 25 MARKS

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General Certificate of Education
June 2008
Advanced Level Examination

ECONOMICS **ECN5**
Unit 5 Business Economics and the Distribution of Income

Friday 13 June 2008 9.00 am to 10.30 am

For this paper you must have:
- an 8-page answer book.

You may use a calculator.

Time allowed: 1 hour 30 minutes

Instructions
- Use black ink or black ball-point pen. Pencil should only be used for drawing.
- Write the information required on the front of your answer book. The *Examining Body* for this paper is AQA. The *Paper Reference* is ECN5.
- In **Section A**, answer **all** parts of the question.
- In **Section B**, answer **one** question.

Information
- The maximum mark for this paper is 100.
- The marks for questions are shown in brackets.
- This paper is synoptic. It assesses your understanding of the relationship between the different aspects of Economics.
- You will be marked on your ability to use good English, to organise information clearly and to use specialist vocabulary where appropriate.

Advice
- You are advised to spend approximately 45 minutes on **Section A** and approximately 45 minutes on **Section B**.

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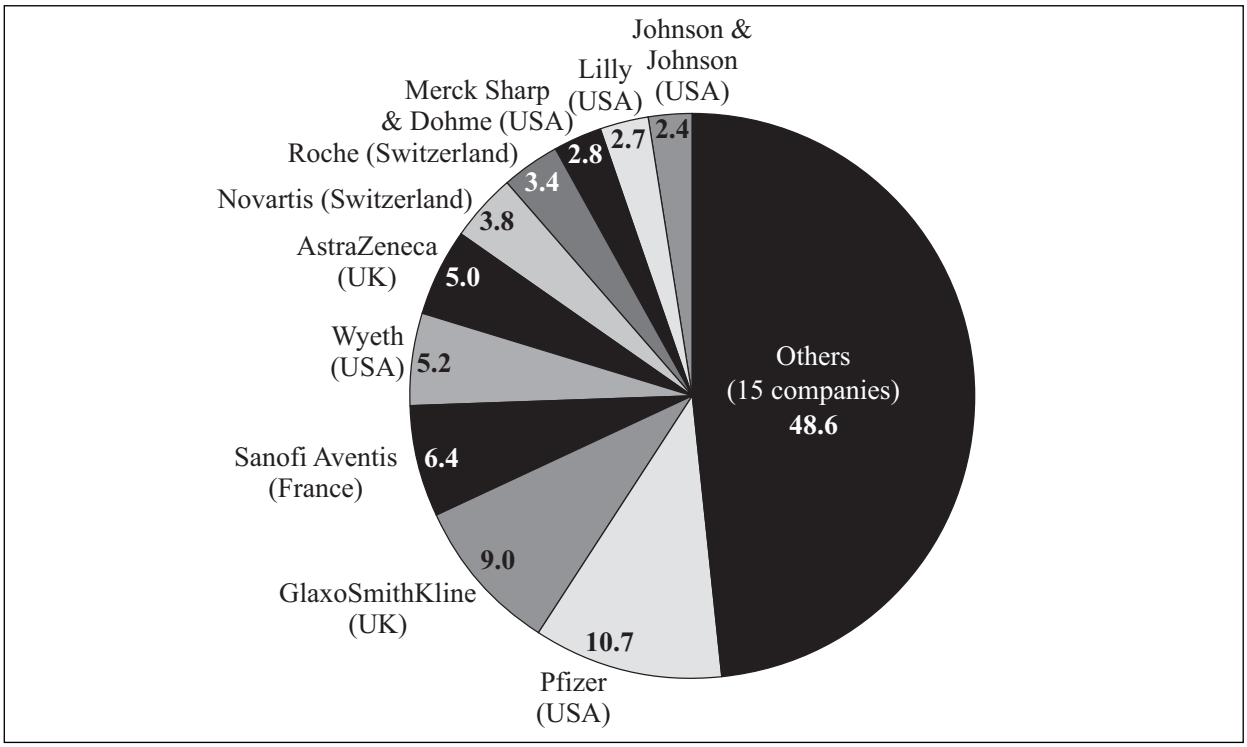
SECTION A

Answer **all** parts of this question.

Total for this question: 50 marks

1 Study **Extracts A**, **B and C**, and then answer **all** parts of Question 1 which follows.

Extract A: **% market shares of manufacturing companies operating in the UK pharmaceutical (drug) market, 2004**



Source: The Association of the British Pharmaceutical Industry (ABPI), accessed on 20 December 2006

Extract B: Rich countries are blocking cheap drugs for poor countries

Extract B has been removed due to third-party copyright constraints.

It was adapted from an article in The Guardian on 14 November 2006.

Source: adapted from an article by SARAH BOSELEY, *The Guardian*, 14 November 2006

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Extract C: Pharmaceutical companies need patents to protect their investments in new drugs, but the investments are not always successful

Drug companies lavish fortunes on research and development (R&D), some spending well above £4 billion a year. Finding a drug takes an average of 12 years and costs £800 million, enough for three jumbo jets. Companies recoup that vast expenditure through the patent system, which allows them to charge high prices for drugs until their monopoly expires.

Without patents, drug companies would be dead. When rivals try to breach those patents, the multinational pharmaceutical companies react ferociously, bringing in lawyers and private detectives. The chairman of a leading British pharmaceutical company has argued: "If someone can come along and free-ride on my company's inventions, then why should I put money into research to improve my company's products?"

But even when protected by patents, investment in new drugs is not always successful. AstraZeneca (AZ), the UK's second-largest pharmaceutical company, has recently spent heavily on investing in an experimental treatment for hardened arteries. If the drug eventually reaches the market, it is likely to generate billions of pounds a year in sales for AZ. But the group's chief executive has sounded a gloomy note on the chances of success for the drug, believing it to be a very high-risk project. And if it fails, the drug will be added to AZ's many other failed investment projects. The drug's failure may lead to a collapse in AZ's share price, which will then increase the possibility of a hostile take-over.

Question 1

1 (a) Using **Extract A**, describe **two** features of the UK pharmaceutical market in 2004. *(4 marks)*

(b) '...large pharmaceutical companies in rich countries successfully restrict output and make supernormal profit' (**Extract B**, lines 8–10).

With the help of a monopoly diagram, explain this statement. *(6 marks)*

(c) **Extract C** (lines 13–14) suggests that the UK's second-largest pharmaceutical company, AstraZeneca, invests heavily in research and development.

Analyse the long-term private benefits **and** costs that may be experienced by a pharmaceutical company when investing in the development of new drugs. *(10 marks)*

(d) Using the data and your economic knowledge, evaluate the view that firms in industries such as pharmaceuticals and recorded music should be able to protect their market power, for example by patenting HIV drugs and through copyright protection. *(30 marks)*

Turn over for the next question

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SECTION B

Answer **one** question from this section.

Each question carries 50 marks.

2 (a) Economists often assume that firms have only one objective, to maximise profit.

Explain other objectives firms may have other than profit maximisation. *(20 marks)*

(b) Evaluate the view that separation of ownership from control has an adverse effect on firms' conduct **and** performance. *(30 marks)*

3 (a) Explain how the supply of labour is determined in a labour market. *(20 marks)*

(b) 'Competitive labour markets lead to an unequal and inequitable distribution of income.'

To what extent does this justify government intervention in labour markets? *(30 marks)*

4 (a) Explain why externalities result in a misallocation of resources. *(20 marks)*

(b) Evaluate the view that the most effective way to reduce environmental externalities is to create markets in permits to pollute. *(30 marks)*

END OF QUESTIONS

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Version: 1.0:07/08

ASSESSMENT and QUALIFICATIONS ALLIANCE

General Certificate of Education

Economics 6141

ECN5: Business Economics and Distribution of Income

Mark Scheme

2008 examination - June series

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Mark schemes are prepared by the Principal Examiner and considered, together with the relevant questions, by a panel of subject teachers. This mark scheme includes any amendments made at the standardisation meeting attended by all examiners and is the scheme which was used by them in this examination. The standardisation meeting ensures that the mark scheme covers the candidates' responses to questions and that every examiner understands and applies it in the same correct way. As preparation for the standardisation meeting each examiner analyses a number of candidates' scripts: alternative answers not already covered by the mark scheme are discussed at the meeting and legislated for. If, after this meeting, examiners encounter unusual answers which have not been discussed at the meeting they are required to refer these to the Principal Examiner.

It must be stressed that a mark scheme is a working document, in many cases further developed and expanded on the basis of candidates' reactions to a particular paper. Assumptions about future mark schemes on the basis of one year's document should be avoided; whilst the guiding principles of assessment remain constant, details will change, depending on the content of a particular examination paper.

Further copies of this Mark Scheme are available to download from the AQA Website: www.aqa.org.uk

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Dr Michael Cresswell Director General

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Advanced Level Economics

June 2008 **ECN5**

MARK SCHEME

General Instructions

Marks awarded to candidates should be in accordance with the following mark scheme and examiners should be prepared to use the full range of marks available. The mark scheme for most questions is flexible, permitting the candidate to score full marks in a variety of ways. Where the candidate's response to a question is such that the mark scheme permits full marks to be awarded, full marks **MUST** be given. A perfect answer is not necessarily required for full marks. But conversely, if the candidate's answer does not deserve credit, then no marks should be given.

Occasionally, a candidate may respond to a question in a reasonable way, but the answer may not have been anticipated when the mark scheme was devised. In this situation, **OR WHENEVER YOU HAVE ANY DOUBT ABOUT THE INTERPRETATION OF THE MARK SCHEME**, you must in the first instance telephone your team leader to discuss how to proceed.

Two approaches have been used in the construction of the mark scheme:

(i) **An 'issue' based approach.** The mark scheme for parts (a) and (b) of the data response question and part (a) of the essay questions adopts this approach. The questions do not generally require that the candidate demonstrates evaluative skills although some explanation and analysis may be expected. The mark scheme lists the marks that can be awarded for particular issues (and associated development) that the candidate might include in the answer. Marks awarded for development should take into account the Quality of Written Communication used by candidates as indicated on page 5 of this mark scheme.

(ii) **A 'levels' approach.** This approach is used for parts (c) and (d) of the data response question and part (b) of the essay questions. The mark scheme summarises the information required to answer the question, but without attaching marks to particular issues. Marks should be awarded according to whether the answer displays the skills indicated by the five Mark Band Descriptors or "Levels of Skill" included in the mark scheme. The Mark Band Descriptors are set out on page 4. When using a 'levels' mark scheme the marker must identify where a particular skill is being demonstrated. The **key** to be used to identify the skill is also shown on page 5. The level chosen should be the one which **best fits** the answer provided by the candidate. It is not intended that the answer should satisfy every statement in the level description.

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APPLYING THE 'LEVELS' MARK SCHEME

Levels of Response Mark Band Descriptors

Level 1:
Few, if any, relevant issues recognised. Economic concepts and principles are not adequately understood or applied to the question and its context. No satisfactory analysis or evaluation. Little, if any, appreciation of the inter-relatedness of economic issues, problems and institutions. A poorly organised response which generally fails to answer the question. Descriptions and explanations lack clarity. Spelling, punctuation and grammar may be poor. There is very little use of specialist vocabulary. **0 to 6 marks** *(Mid-Point: 3 marks)*

Level 2:
A few issues are recognised but there is only limited evidence of the candidate's ability to apply relevant economic concepts. An attempt is made to answer the question but there is little satisfactory analysis or evaluation. Some very limited appreciation of the inter-relatedness of economic issues, problems and institutions. A poorly organised answer which does not have a clear structure. Descriptions and explanations are sometimes hard to follow. The candidate demonstrates some ability to spell commonly used words and to follow the standard conventions of punctuation and grammar. Some use of specialist vocabulary is made but this is not always applied appropriately. **7 to 12 marks** *(Mid-Point: 10 marks)*

Level 3:
A few issues recognised. The candidate has attempted to apply relevant economic concepts and ideas to the question and its context. A reasonable understanding of some concepts and theories is demonstrated. However, the evaluation of issues, arguments and evidence is limited or superficial. Some understanding of the inter-relatedness of economic issues, problems and institutions. There is some logic and coherence in the organisation of the answer. The candidate is generally able to spell commonly used words and usually follows the standard conventions of punctuation and grammar. Some descriptions and explanations are easy to understand but the answer may not be expressed clearly throughout. Some use of specialist vocabulary which is applied appropriately. **13 to 20 marks** *(Mid-Point: 17 marks)*

Level 4:
Several relevant issues identified. Good understanding of some economic concepts and principles is demonstrated. The candidate is able to apply these concepts and principles to the context to help answer the question. There is some appreciation of alternative points of view. Satisfactory use is made of evidence and/or theoretical analysis to evaluate the issues and arguments identified. Good understanding of the inter-relatedness of economic issues, problems and institutions is demonstrated. Shows the ability to think as an economist making effective use of the economist's 'tool kit' of concepts, theories and techniques. Spelling is generally accurate and the standard conventions of punctuation and grammar are usually followed. The answer is well organised. Descriptions and explanations are usually clearly expressed. A wide range of specialist vocabulary is used with facility. **21 to 26 marks** *(Mid-Point: 24 marks)*

Level 5:
Several relevant issues identified. Good understanding of economic concepts and principles is demonstrated throughout. The candidate is able to apply these concepts and principles to the context to help answer the question. There is an appreciation of alternative points of view. Good use is made of evidence and/or theoretical analysis to evaluate the issues and arguments identified. The candidate demonstrates the ability to synthesise the arguments presented and come to a reasonable conclusion albeit tentative. A clear understanding of the inter-relatedness of economic issues, problems and institutions is demonstrated Shows the ability to think as an economist making very effective use of the economist's 'tool kit' of concepts, theories and techniques. Spelling is accurate and the standard conventions of punctuation and grammar are followed. The answer is well organised. Descriptions and explanations are expressed with clarity throughout. Extensive use of specialist vocabulary which is applied adeptly and with precision. **27 to 30 marks** *(Mid-Point: 29 marks)*

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THE KEY TO BE USED WHEN USING THE 'LEVELS' MARK SCHEME

D Where a particular economic term is correctly **DEFINED** in order to help the candidate to answer the question properly.

I Where a relevant **ISSUE** is raised by the candidate.

K Where the candidate demonstrates **KNOWLEDGE** of recent developments or features of the economy which help enhance the candidate's response to the question. This should also be used where the candidate quotes relevant examples.

Ap Where the candidate demonstrates the ability to **APPLY** knowledge and **CRITICAL UNDERSTANDING** to problems and issues.

A Where the candidate demonstrates the ability to **ANALYSE** the problem using appropriate economic ideas.

E Where the candidate **EVALUATES** and makes judgements about the significance of various issues and arguments.

QUALITY OF WRITTEN COMMUNICATION

The Mark Band Descriptors, which are used for assessing Question 1 (d) and part (b) of the essay questions, incorporate statements which relate to the Quality of Written Communication used by the candidates.

However, it is also important to assess Quality of Written Communication whenever candidates produce answers using continuous prose. When applying an issue based mark scheme, examiners must take into account the following when deciding how many marks to award for development:

(i) use of appropriate format and style of writing to organise relevant information clearly and coherently;
(ii) use of specialist vocabulary, where appropriate;
(iii) legibility of handwriting;
(iv) accuracy of spelling, punctuation and grammar.

Synoptic Assessment

All questions in this unit are synoptic. Therefore candidates will need to demonstrate that they are able to think as an economist and to use effectively the economist's 'tool kit' of concepts, theories and techniques.

They should demonstrate that they:

- understand the inter-relatedness of many economic issues, problems and institutions;
- understand how certain economic concepts, theories and techniques may be relevant to a range of different contexts
- can apply concepts, theories and techniques in analysing economic issues and problems and in evaluating arguments and evidence.

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Section A

Total for this question: 50 marks

1 (a) Using **Extract A**, describe **two** features of the UK pharmaceutical market in 2004. *(4 marks)*

It is arguable as to whether the UK pharmaceutical market is an oligopoly. Credit answers that state it is an oligopoly, but also credit answers that state that the market is competitive. Do not credit assertions that the market is perfectly competitive, or a monopoly, but do credit the assertion that the market is an example of monopolistic competition. However, this response is not expected because monopolistic competition is not in the AQA specification.

Award one mark for each valid point made and one mark for the supporting reference to the data. Points might include:

- a statement that there are many firms in the UK pharmaceutical market
- describing the market as an oligopoly, or oligopolistic (10 largest firms sharing over 50% of the market)
- calculation of particular concentration ratios, e.g. the three firm concentration ratio (26.1%)
- noting that the largest company. Pfizer, has a market share of just 10.7%
- noting the importance of 'others'
- noting the importance of foreign-owned companies in the UK pharmaceutical market

A maximum of **1 mark** may be awarded if the candidate simply trawls through the data, with no attempt at overview**.**

A maximum of **2 marks** may be awarded if no use is made of statistics.

A maximum of **3 marks** may be awarded where there is evidence of an overview having been taken, even though parts of the answer give an impression of a trawl through the data.

MAXIMUM FOR PART (a) 4 MARKS

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1 (b) '…large pharmaceutical companies in rich countries successfully restrict output and make supernormal profit' (**Extract B**, lines 8-10).

With the help of a monopoly diagram, explain this statement. *(6 marks)*

For the written answer

For candidates who:

define supernormal profit: **1 mark**

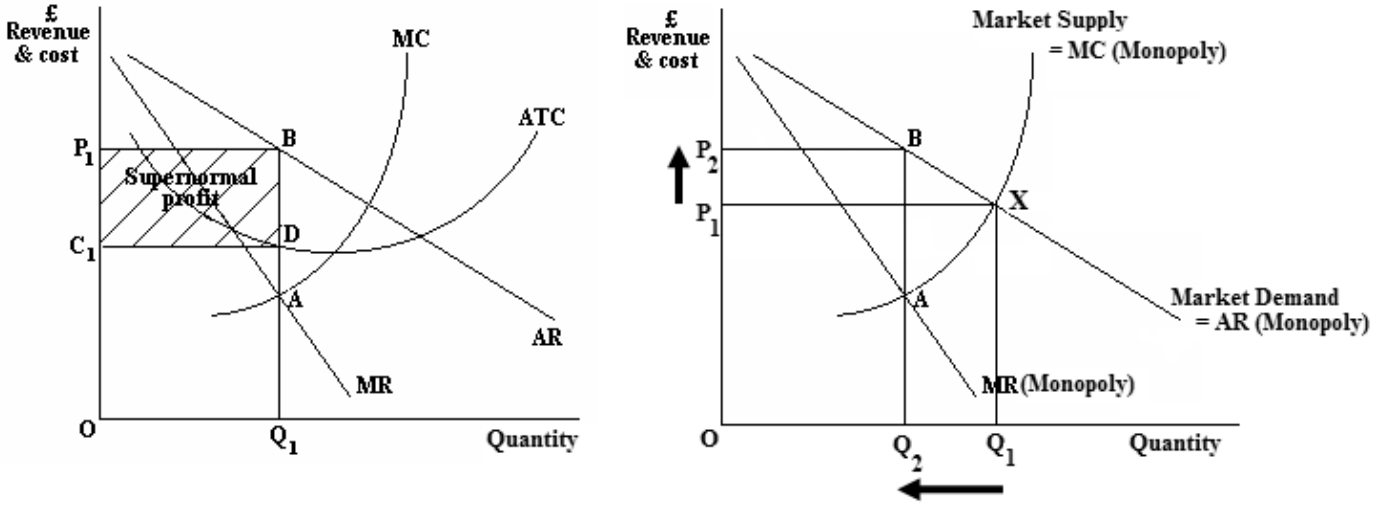
Award up to 2 marks, in each case, for relevant points such as the following:

- stating that the ability to restrict output and/or make supernormal profit requires the exercise of monopoly power
- stating/explaining how entry barriers enable a firm to restrict output and make supernormal profit
- explaining how the MR=MC rule determines the level of output
- explaining how the candidate's diagram shows output being restricted
- explaining how the candidate's diagram shows supernormal profit being made

Maximum of 4 marks for the written answer

For the diagram

Reward any relevant diagram. Two likely diagrams are shown below. The left-hand diagram shows supernormal profit being made, but it does not show explicitly output being restricted. The right-hand diagram shows output being restricted to Q_2, compared to the output in perfect competition of Q_1, but it does not explicitly show supernormal profit.



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Award 1 mark, in each case, for drawing and labelling the following:

- accurate drawing and labelling of axes AND a relevant set of curves relating to monopoly
- illustration of profit-maximising price where MR = MC
- illustration of profit-maximising output where MR = MC
- illustration of perfectly competitive level of output where P = MC
- labelling supernormal profit
- illustration of output being restricted

Maximum of 4 marks for the diagram

Maximum of 3 marks for a written answer with no relevant diagram, or a diagram with no written answer

MAXIMUM FOR PART (b) 6 MARKS

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1 (c) **Extract C** (lines 13-14) suggests that the UK's second-largest pharmaceutical company, AstraZeneca, invests heavily in research and development.

Analyse the long-term private benefits **and** costs that may be experienced by a pharmaceutical company when investing in the development of new drugs. *(10 marks)*

The question mentions benefits and costs (in the plural). Two or more benefits and two or more costs analysed can earn full marks, but an answer that provides a bullet point list without any analysis should be restricted to a maximum at lower Level 2 (4 marks).

An answer that only analyses long-term private benefits (or costs) should be restricted to a maximum of Lower Level 2 (4 marks).

Issues and areas for analysis include:

- Lower costs and higher profit
- Long-term benefits as against long-term costs
- Ability to enjoy monopoly power in the future, via patent protection
- Higher costs because the investment fails
- Securing (or failing to secure) a future product portfolio and income stream

LEVEL 1
At the bottom of the range, a superficial statement without analysis, of just **one** benefit **or** cost. At the top of the range, superficial statements, without analysis, of **one benefit and one cost**. An answer that considers only *short-term* benefits and costs, e.g. the immediate benefit of good publicity or the immediate cost of financing research, and not *long-term* benefits and costs, should be restricted to Level 1. An answer which explains *external* benefits and costs, but not *private* benefits and costs, should also be restricted to Level 1. **1 to 3 marks**

LEVEL 2
At the bottom of the range, *basic* analysis of **one benefit and one cost, or an undeveloped bullet point list**. At the top of the range, *developed* analysis of **one benefit and one cost**.
4 to 7 marks

LEVEL 3
At the bottom of the range, *developed* analysis of **two long-term private benefits and one long-term private cost, or vice versa**. At the top of the range, *full* or *significantly deeper* analysis of **two long-term private benefits and one long-term private cost, or vice versa**. **8 to 10 marks**

MAXIMUM FOR PART (c) 10 MARKS

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1 (d) Using the data and your economic knowledge, evaluate the view that firms in industries such as pharmaceuticals and recorded music should be able to protect their market power, for example by patenting HIV drugs and through copyright protection. *(30 marks)*

Explanation/analysis is needed to reach Level 3, and some evaluation, building on the analysis, is required to score **19 marks or more**.

Where there is no explicit reference to the data, award a maximum of **24 marks.**

Evaluation could be in terms of: relating the abuse of monopoly power with benefits of monopoly power such as cost reduction through economies of scale and improved dynamic efficiency; arguing the case for protecting intellectual property rights against the benefits the general public gain from free-riding; arguing that the long-term benefits for the general public may justify short-term costs incurred.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

Issues and areas for discussion include:

- Explaining the nature of patents and copyright protection
- Relating these to the idea of intellectual property and the theory of property rights
- Patents creating barriers to entry
- Relevant application of market failure theory, e.g. in terms of the effects of free-riding
- Relevant application of government failure theory, e.g. in terms of unintended consequences, promotion of monopoly at the expense of competition
- Use of the examples in the question: pharmaceuticals, recorded music, patents, copyright law
- Use of the examples not in the question, e.g. pirated designer clothing

Other equally valid points may be discussed and should be given due credit

Also give credit for:

- an overall judgement of the issues raised
- use of diagrams
- relevant reference to the real world

USE THE LEVELS MARK SCHEME ON PAGES 4 & 5

MAXIMUM FOR PART (d) 30 MARKS

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Section B

Total for this question: 50 marks

2 (a) Economists often assume that firms have only one objective, to maximise profit.

Explain other objectives firms may have other than profit maximisation. *(20 marks)*

Alternative objectives include:

- maximising growth
- maximising sales revenue
- maximising quantity of sales
- maximising a managerial objective
- survival
- resisting hostile takeover raids
- satisficing rather than maximising
- social objective(s)

For candidates who

define profit: **1 mark**

define any other relevant concept, e.g. revenue; sales **1 mark**

Maximum of 2 marks for definitions

explain the meaning of profit maximisation, e.g. equating MR and MC; maximising the difference between TR and TC: **2 marks**

explain the profit maximising price and level of output in perfect competition, monopoly or oligopoly (award marks for only one of these): **Up to 2 further marks**

identify an alternative objective: **2 marks per objective**

(Maximum of 8 marks for identification)

explain the alternative objective: **Up to 5 further marks**

provide a relevant diagram or diagrams: **Up to 4 marks per diagram**
Maximum of 8 marks for diagrams

Maximum of 4 marks for an answer that includes no relevant points other than an explanation of profit maximisation

MAXIMUM FOR PART (a) 20 MARKS

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2 (b) Evaluate the view that separation of ownership from control has an adverse effect on firms' conduct **and** performance. *(30 marks)*

Explanation/analysis is needed to reach Level 3, and some evaluation, building on the analysis, is required to score **19 marks or more**.

Evaluation could be in terms of: explaining that for many if not most small firms, the divorce between ownership and control is non-existent, so the problem does not arise; discussing whether the owners of a business (the shareholders) have mechanisms for ensuring that managers make decisions that are consistent with profit maximisation; discussing the role of competition (in goods markets and/or the capital market and takeover activity) in resolving the problem.

To reach Level 5, firms' conduct and performance must both be mentioned. Candidates might for example discuss the pursuit of objectives other than profit maximisation as a part of firms' conduct and cost levels and profit levels/rates as a part of firms' performance.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

Issues and areas for discussion include:

- Understanding the meaning of a separation of ownership from control
- Understanding of, and relevant application of, efficiency concepts such as productive efficiency, allocative and dynamic efficiency
- Providing plausible linkage of separation of ownership and control, business objectives, and resulting economic efficiency or inefficiency
- Relevant application of market structure theory, e.g. monopoly, oligopoly
- The principal/agent problem
- Conduct indicators such as creating entry barriers, price discrimination, excessive advertising
- The possible role of the market mechanism (in goods and/or capital markets) for resolving the problem
- The role of takeover activity
- Market failure analysis

Other equally valid points may be discussed and should be given due credit.

Also give credit for:

- an overall judgement of the issues raised
- the use of evidence
- use of diagrams

USE THE LEVELS MARK SCHEME ON PAGES 4 & 5

MAXIMUM FOR PART (b) 30 MARKS

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Total for this question: 50 marks

3 (a) Explain how the supply of labour is determined in a labour market. *(20 marks)*

For candidates who:

define a labour market: **1 mark**

define the supply of labour, or any other relevant definition: **1 mark**

Maximum of 2 marks for definitions

explain the meaning of the supply of labour, e.g. the quantity of labour that a worker (or workers) is/are willing to supply at different hourly wage rates: **up to 3 marks**

provide an example of the supply of labour: **1 mark only**

distinguish between the market supply of labour and an individual's supply of labour: **1 mark**
explaining the link between the two: **2 marks**

distinguish between an upward-sloping and a backward-bending supply curve of labour: **2 marks**

provide an explanation for an upward-sloping supply curve of labour: **up to 8 marks**

provide an explanation for a backward-bending supply curve of labour: **up to 8 marks**

explain the significance of non-monetary considerations, e.g. job satisfaction, non-monetary perks: **up to 6 marks**

explain any other relevant point, e.g. relating to elasticity; required skills for a job: **Up to 4 marks per point**

provide a relevant diagram or diagrams: **Up to 4 marks per diagram**
Maximum of 8 marks for diagrams

MAXIMUM FOR PART (a) 20 MARKS

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3 (b) 'Competitive labour markets lead to an unequal and inequitable distribution of income.'

To what extent does this justify government intervention in labour markets? *(30 marks)*

Explanation/analysis is needed to reach Level 3, and some evaluation, building on the analysis, is required to score **19 marks or more**.

Evaluation could be: interpreting the significance of the difference between 'unequal' and 'inequitable'; discussing whether or not inequality and/or inequity lead to market failure, e.g. by arguing that wage differences are not a market failure because they create incentives in labour markets; debating whether or not government intervention can lead to a better outcome.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

Issues and areas for discussion include:

- The meaning of competitive labour markets
- Understanding of why competitive labour markets may lead to inequality
- Understanding of why competitive labour markets may lead to inequity
- The meaning of market failure in general
- The issue of whether inequality and/or inequity lead to market failure
- Disincentive effects
- Incentive effects
- Linking inequality and/or inequity to a labour market performing better
- Methods of government intervention, e.g. progressive taxation and welfare benefits directed at the poor, national minimum wage
- Government failure issues

Other equally valid points may be discussed and should be given due credit.

Also give credit for:

- an overall judgement of the issues raised
- use of diagrams
- reference to real world examples

USE THE LEVELS MARK SCHEME ON PAGES 4 & 5

MAXIMUM FOR PART (b) 30 MARKS

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Total for this question: 50 marks

4 (a) Explain why externalities result in a misallocation of resources. *(20 marks)*

For candidates who:

define an externality: **1 mark**

define any other relevant concept, e.g. negative externality; positive externality; resource: **1 mark per definition**

Maximum of 2 marks for definitions

explain the meaning of a misallocation of resources: **up to 3 marks**

explain how negative externalities lead to a misallocation of resources through overproduction of a good in a market: **up to 8 marks**

provide examples of negative externalities: **1 mark per example, up to a maximum of 2 marks**

explain how positive externalities lead to a misallocation of resources through underproduction of a good in a market: **up to 8 marks**

provide examples of positive externalities: **1 mark per example, up to a maximum of 2 marks**

provide a relevant diagram or diagrams: **Up to 4 marks per diagram**
Maximum of 8 marks for diagrams

Maximum of 16 marks if the answer explains only how negative (or positive) externalities result in a misallocation of resources

MAXIMUM FOR PART (a) 20 MARKS

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4 (b) Evaluate the view that the most effective way to reduce environmental externalities is to create markets in permits to pollute. *(30 marks)*

Explanation/analysis is needed to reach Level 3, and some evaluation, building on the analysis, is required to score **19 marks or more**.

Evaluation could be in terms of: introducing the idea that different forms of pollution may require different policy approaches; recognising the difference between preventing future pollution and dealing with the effects of pollution that has already occurred; identifying and discussing criteria for evaluating policy effectiveness; discussing the virtues of market-orientated policies versus interventionist policies; discussing long-term versus short-term effects of different approaches; evaluating existing markets in permits to pollute.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

Issues and areas for discussion include:

- The meaning of environmental externalities
- Recognising that pollution is an economic 'bad'
- Recognising that pollution is a negative externality or external cost
- Recognising and explaining that a market in pollution permits creates defined property rights that can be traded in a market
- Recognising and explaining the fact that pollution permits are an example of a market-orientated approach
- Explaining how a market in permits to pollute operates and how it may reduce pollution
- Relating the market to resource allocation and the functions of prices in a market economy
- Recognising and explaining possible disadvantages of a market in pollution permits, e.g. if the upper limit for allowable pollution is set too high, the market may encourage rather than reduce total pollution
- Comparing a market in permits to pollute with alternative policies such as taxation and regulation

Other equally valid points may be discussed and should be given due credit.

Also give credit for:

- an overall judgement of the issues raised
- use of diagrams
- reference to real world examples

Maximum of 20 marks if markets in permits to pollute are not compared with at least one alternative policy.

USE THE LEVELS MARK SCHEME ON PAGES 4 & 5

MAXIMUM FOR PART (b) 30 MARKS

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General Certificate of Education
January 2008
Advanced Level Examination

ECONOMICS **ECN5**
Unit 5 Business Economics and the Distribution of Income

Tuesday 29 January 2008 9.00 am to 10.30 am

For this paper you must have:
- an 8-page answer book.

You may use a calculator.

Time allowed: 1 hour 30 minutes

Instructions
- Use blue or black ink or ball-point pen. Pencil should only be used for drawing.
- Write the information required on the front of your answer book. The *Examining Body* for this paper is AQA. The *Paper Reference* is ECN5.
- In **Section A**, answer **all** parts of the question.
- In **Section B**, answer **one** question.

Information
- The maximum mark for this paper is 100.
- The marks for questions are shown in brackets.
- This paper is synoptic. It assesses your understanding of the relationship between the different aspects of Economics.
- You will be marked on your ability to use good English, to organise information clearly and to use specialist vocabulary where appropriate.

Advice
- You are advised to spend approximately 45 minutes on **Section A** and approximately 45 minutes on **Section B**.

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SECTION A

Answer **all** parts of this question.

Total for this question: 50 marks

1 Study **Extracts A**, **B**, **C**, **and D**, and then answer **all** parts of Question 1 which follows.

Extract A: The UK grocery market: market shares of the four largest UK supermarkets



Source: *The Grocery Market: The OFT's reasons for making a reference to the Competition Commission*, Office of Fair Trading, May 2006

Extract B: How supermarkets are harming communities

Food retailing has undergone a massive shift in the past forty years. The loss of independent butchers, bakers, grocers and pharmacies from the high street has punctured the heart of many local communities, and food retailing is now dominated by the 'big four' supermarket chains. The influential *All Party Parliamentary Shops Report* (2006) says that by 2015 there will be no independent convenience stores, grocers or newsagents left.

Shopping in the high street is much more than a consumer experience; it binds people and communities together. Furthermore, money spent in a supermarket is channelled to directors, shareholders and management staff living in other parts of the country, rather than boosting the local economy. A study by the *New Economics Foundation* found that £10, if spent in a local independent shop, generates £25 for the local economy, compared with only £14 if spent in a supermarket.

Supermarkets argue that they bring jobs to a community. However, a *British Retail Planning Forum* study found that, rather than creating jobs, every time a large supermarket opens, on average 276 jobs are lost within a 15km radius of the new store (through closure of smaller stores and associated services).

Source: adapted from a Corporate Watch Workers' Co-operative briefing, *www.corporatewatch.org.uk*, 30 July 2006

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Extract C: Supermarket pricing policies

Are supermarkets really so cheap? In 2000, the Competition Commission found that supermarkets were putting prices up in areas where there was no strong competition. Key items such as bread and milk are certainly cheaper in supermarkets. But they are sold at prices set below average cost. However, not all products are so cheap. A simple comparison of fresh produce shows you can often get it cheaper at a local independent store.

Source: adapted from *Supermarkets or corporate bullies?*, Friends of the Earth, 2003

Extract D: The competition authorities have been taken over by the superstores

The domination of the UK supermarket industry by companies such as Tesco and Asda results from government and regulatory failure. For many years, competition policy has interpreted the public interest as the 'consumer interest', which it has defined in very narrow terms. Regulators such as the Office of Fair Trading (OFT) look at price, but not at issues such as employment, local investment, diversity, social networks, environmental impact or even competition in the wider sense. As long as the superstores are deemed to be competing among themselves, there is no need for other kinds of shops to survive.

Over the years, the UK competition authorities have decided that the way in which the superstores use market power against their suppliers to extract special concessions is 'beneficial to competition and to the consumer'. The OFT announced, to the amazement of the businesses that supply the big supermarket firms, that it was 'unable to identify any particular case which amounted to an abuse of buying power or other anti-competitive practice'. In the mid-1990s, after discovering that the superstores were engaged in predatory pricing (setting prices at a level to force competitors out of the market), the OFT decided to take no action. The regulators' refusal to acknowledge any wider public interest made thousands of small shops, farmers and food processors go out of business.

Source: adapted from an article by George Monbiot, *The Guardian*, 14 March 2006

Question 1

(a) Using **Extract A**, compare the changes in market shares in the UK grocery market over the period 2002 to 2005. *(4 marks)*

(b) '… £10, if spent in a local independent shop, generates £25 for the local economy, compared with only £14 if spent in a supermarket' (**Extract B**, lines 11–12).

Explain this statement. *(6 marks)*

(c) Analyse possible reasons why items such as bread and milk are often sold at cheaper prices by supermarket chains than by local independent stores (**Extract C**, line 3). *(10 marks)*

(d) In relation to large supermarkets, **Extract D** (lines 12–14) states that the OFT was "unable to identify any particular case which amounted to an abuse of buying power or other anti-competitive practice".

Using the data and your economic knowledge, evaluate the view that the largest supermarket firms in the UK should be free to operate without any government interference. *(30 marks)*

Turn over ▶

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SECTION B

Answer **one** question from this section.

Each question carries 50 marks.

2 (a) Explain how technological change can affect a firm's costs of production **and** its methods of production. *(20 marks)*

(b) Some firms, such as Amazon, Google, Microsoft and Apple, currently operate in markets undergoing rapid technological change.

Evaluate whether technological change leads to more competitive or more monopolistic markets. *(30 marks)*

3 (a) Explain how the wage rate is determined in a competitive labour market. *(20 marks)*

(b) 'The movement of workers from eastern Europe into the UK has plugged gaps in labour markets and improved UK economic performance.'

Assess the effects of such a movement of workers upon wage rates, levels of employment **and** the competitiveness of labour markets. *(30 marks)*

4 In the summer of 2006, several UK water companies imposed hosepipe bans which restricted the amount of water that households could consume.

(a) Explain the costs **and** benefits that might result from new infrastructure projects, such as the building of new reservoirs in areas suffering from water shortages. *(20 marks)*

(b) Evaluate the view that shortages in markets, such as those for water and health care, can best be prevented by the operation of market forces rather than by government intervention in markets. *(30 marks)*

END OF QUESTIONS

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Version 1.0:02/08

ASSESSMENT and QUALIFICATIONS ALLIANCE

General Certificate of Education

Economics 6141

ECN5 Business Economics and the Distribution of Income

Mark Scheme

2008 examination - January series

STEMUP.CO.UK

Mark schemes are prepared by the Principal Examiner and considered, together with the relevant questions, by a panel of subject teachers. This mark scheme includes any amendments made at the standardisation meeting attended by all examiners and is the scheme which was used by them in this examination. The standardisation meeting ensures that the mark scheme covers the candidates' responses to questions and that every examiner understands and applies it in the same correct way. As preparation for the standardisation meeting each examiner analyses a number of candidates' scripts: alternative answers not already covered by the mark scheme are discussed at the meeting and legislated for. If, after this meeting, examiners encounter unusual answers which have not been discussed at the meeting they are required to refer these to the Principal Examiner.

It must be stressed that a mark scheme is a working document, in many cases further developed and expanded on the basis of candidates' reactions to a particular paper. Assumptions about future mark schemes on the basis of one year's document should be avoided; whilst the guiding principles of assessment remain constant, details will change, depending on the content of a particular examination paper.

Further copies of this Mark Scheme are available to download from the AQA Website: www.aqa.org.uk

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Dr Michael Cresswell Director General

Advanced Level Economics

January 2008 **ECN5**

MARK SCHEME

General Instructions

Marks awarded to candidates should be in accordance with the following mark scheme and examiners should be prepared to use the full range of marks available. The mark scheme for most questions is flexible, permitting the candidate to score full marks in a variety of ways. Where the candidate's response to a question is such that the mark scheme permits full marks to be awarded, full marks **MUST** be given. A perfect answer is not necessarily required for full marks. But conversely, if the candidate's answer does not deserve credit, then no marks should be given.

Occasionally, a candidate may respond to a question in a reasonable way, but the answer may not have been anticipated when the mark scheme was devised. In this situation, **OR WHENEVER YOU HAVE ANY DOUBT ABOUT THE INTERPRETATION OF THE MARK SCHEME**, you must in the first instance telephone your team leader to discuss how to proceed.

Two approaches have been used in the construction of the mark scheme:

(i) **An 'issue' based approach.** The mark scheme for parts (a) and (b) of the data response question and part (a) of the essay questions adopts this approach. The questions do not generally require that the candidate demonstrates evaluative skills although some explanation and analysis may be expected. The mark scheme lists the marks that can be awarded for particular issues (and associated development) that the candidate might include in the answer. Marks awarded for development should take into account the Quality of Written Communication used by candidates as indicated on page 5 of this mark scheme.

(ii) **A 'levels' approach.** This approach is used for parts (c) and (d) of the data response question and part (b) of the essay questions. The mark scheme summarises the information required to answer the question, but without attaching marks to particular issues. Marks should be awarded according to whether the answer displays the skills indicated by the five Mark Band Descriptors or "Levels of Skill" included in the mark scheme. The Mark Band Descriptors are set out on page 4. When using a 'levels' mark scheme the marker must identify where a particular skill is being demonstrated. The **key** to be used to identify the skill is also shown on page 5. The level chosen should be the one which **best fits** the answer provided by the candidate. It is not intended that the answer should satisfy every statement in the level description.

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APPLYING THE 'LEVELS' MARK SCHEME

Levels of Response Mark Band Descriptors

Level 1:
Few, if any, relevant issues recognised. Economic concepts and principles are not adequately understood or applied to the question and its context. No satisfactory analysis or evaluation. Little, if any, appreciation of the inter-relatedness of economic issues, problems and institutions. A poorly organised response which generally fails to answer the question. Descriptions and explanations lack clarity. Spelling, punctuation and grammar may be poor. There is very little use of specialist vocabulary.
0 to 6 marks *(Mid-Point: 3 marks)*

Level 2:
A few issues are recognised but there is only limited evidence of the candidate's ability to apply relevant economic concepts. An attempt is made to answer the question but there is little satisfactory analysis or evaluation. Some very limited appreciation of the inter-relatedness of economic issues, problems and institutions. A poorly organised answer which does not have a clear structure. Descriptions and explanations are sometimes hard to follow. The candidate demonstrates some ability to spell commonly used words and to follow the standard conventions of punctuation and grammar. Some use of specialist vocabulary is made but this is not always applied appropriately. **7 to 12 marks** *(Mid-Point: 10 marks)*

Level 3:
A few issues recognised. The candidate has attempted to apply relevant economic concepts and ideas to the question and its context. A reasonable understanding of some concepts and theories is demonstrated. However, the evaluation of issues, arguments and evidence is limited or superficial. Some understanding of the inter-relatedness of economic issues, problems and institutions. There is some logic and coherence in the organisation of the answer. The candidate is generally able to spell commonly used words and usually follows the standard conventions of punctuation and grammar. Some descriptions and explanations are easy to understand but the answer may not be expressed clearly throughout. Some use of specialist vocabulary which is applied appropriately. **13 to 20 marks** *(Mid-Point: 17 marks)*

Level 4:
Several relevant issues identified. Good understanding of some economic concepts and principles is demonstrated. The candidate is able to apply these concepts and principles to the context to help answer the question. There is some appreciation of alternative points of view. Satisfactory use is made of evidence and/or theoretical analysis to evaluate the issues and arguments identified. Good understanding of the inter-relatedness of economic issues, problems and institutions is demonstrated. Shows the ability to think as an economist making effective use of the economist's 'tool kit' of concepts, theories and techniques. Spelling is generally accurate and the standard conventions of punctuation and grammar are usually followed. The answer is well organised. Descriptions and explanations are usually clearly expressed. A wide range of specialist vocabulary is used with facility. **21 to 26 marks** *(Mid-Point: 24 marks)*

Level 5:
Several relevant issues identified. Good understanding of economic concepts and principles is demonstrated throughout. The candidate is able to apply these concepts and principles to the context to help answer the question. There is an appreciation of alternative points of view. Good use is made of evidence and/or theoretical analysis to evaluate the issues and arguments identified. The candidate demonstrates the ability to synthesise the arguments presented and come to a reasonable conclusion albeit tentative. A clear understanding of the inter-relatedness of economic issues, problems and institutions is demonstrated Shows the ability to think as an economist making very effective use of the economist's 'tool kit' of concepts, theories and techniques. Spelling is accurate and the standard conventions of punctuation and grammar are followed. The answer is well organised. Descriptions and explanations are expressed with clarity throughout. Extensive use of specialist vocabulary which is applied adeptly and with precision.
27 to 30 marks *(Mid-Point: 29 marks)*

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THE KEY TO BE USED WHEN USING THE 'LEVELS' MARK SCHEME

D Where a particular economic term is correctly **DEFINED** in order to help the candidate to answer the question properly.

I Where a relevant **ISSUE** is raised by the candidate.

K Where the candidate demonstrates **KNOWLEDGE** of recent developments or features of the economy which help enhance the candidate's response to the question. This should also be used where the candidate quotes relevant examples.

Ap Where the candidate demonstrates the ability to **APPLY** knowledge and **CRITICAL UNDERSTANDING** to problems and issues.

A Where the candidate demonstrates the ability to **ANALYSE** the problem using appropriate economic ideas.

E Where the candidate **EVALUATES** and makes judgements about the significance of various issues and arguments.

QUALITY OF WRITTEN COMMUNICATION

The Mark Band Descriptors, which are used for assessing Question 1 (d) and part (b) of the essay questions, incorporate statements which relate to the Quality of Written Communication used by the candidates.

However, it is also important to assess Quality of Written Communication whenever candidates produce answers using continuous prose. When applying an issue based mark scheme, examiners must take into account the following when deciding how many marks to award for development:

(i) use of appropriate format and style of writing to organise relevant information clearly and coherently;
(ii) use of specialist vocabulary, where appropriate;
(iii) legibility of handwriting;
(iv) accuracy of spelling, punctuation and grammar.

Synoptic Assessment

All questions in this unit are synoptic. Therefore candidates will need to demonstrate that they are able to think as an economist and to use effectively the economist's 'tool kit' of concepts, theories and techniques.

They should demonstrate that they:

- understand the inter-relatedness of many economic issues, problems and institutions;
- understand how certain economic concepts, theories and techniques may be relevant to a range of different contexts
- can apply concepts, theories and techniques in analysing economic issues and problems and in evaluating arguments and evidence.

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Section A

1 **Total for this question: 50 marks**

1 (a) Using **Extract A**, compare the changes in market shares in the UK grocery market over the period 2002 to 2005. *(4 marks)*

The data shows the percentage market shares of the four largest supermarket chains in the UK grocery market over the period 2002 to 2005. However, the data does not show directly the total percentage share of other supermarket chains such as Waitrose and smaller independent shops that are outside the 'Big 4'. Since, at the beginning of 2002, the combined share of the 'Big 4'was approximately 73% (Tesco 25% + Sainsbury 17% + Asda 16% + Morrisons/Safeway 15%), 'others' must therefore at that date have been approximately 27%. At the end of 2006, the market share for the 'big four' was 76%.

Award one mark for each valid point made and one mark for the supporting reference to the data. Points might include:

- comparison of the 2002 and 2005 changes for the 'Big Four' (increased from73% to 76% approx.)
- the percentage share of 'others', at the beginning, or end, or an intermediary point in the data series (decreased from 27% to 24%)
- the market share of Tesco rose (from 25% to 31% approx.)
- the market share of Morrisons fell (from 15% to 12% approx.)
- the market share of Sainsbury and Asda was fairly stable (fluctuated around 15% to 17%)
- Asda had a smaller market share than Sainsbury in 2002 but by 2005 the position was reversed (Asda 16% to 17%, Sainsbury 17% to 16%)
- Tesco had the highest market share throughout the period (8% higher than its nearest rival at the start of 2002 and 14% higher at the end of 2005)

A maximum of **1 mark** may be awarded if the candidate simply trawls through the data, with no attempt at overview, or if only one time period is referred to.

A maximum of **2 marks** may be awarded if no use is made of relevant statistics **and/or no comparison is attempted**

A maximum of **3 marks** may be awarded where there is evidence of an overview having been taken and there is some attempt to compare, even though parts of the answer give an impression of a trawl through the data.

MAXIMUM FOR PART (a) 4 MARKS

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1 (b) '…£10, if spent in a local independent shop, generates £25 for the local economy, compared with only £14 if spent in a supermarket' (**Extract B**, lines 11-12).

Explain this statement. *(6 marks)*

This is a synoptic question, testing knowledge and application of the multiplier concept. The Module 2 specification (which is the only specification mentioning the multiplier), states:

*'Knowledge of the multiplier formulae and calculations also are **not** required, but candidates should understand that an initial change in expenditure may lead to a larger impact upon local or national income.'*

Candidates can earn full marks by explaining how (with reference to the figures in the question, but without a calculation) the initial change in expenditure may lead to a larger impact upon local or national income. Candidates do NOT have to explicitly mention the multiplier to be awarded full marks.

Award 1 mark for relevant points such as the following:

explaining that "£10 spent in a local independent shop increases the income of someone living locally

explaining that the people whose income rises then go on to spend some of the income locally

explaining one or more further stages leading to an eventual increase in local income to £25

explaining that much of the £10 spent in a supermarket increases the income of someone living outside the region:

explaining that this increases incomes outside but not inside the local region

explaining that because some of the £10 is spent locally, there is an eventual increase in local income to £14

Additionally, for candidates who:

mention the multiplier (1) and provide a definition (1) (e.g. an initial increase in spending leads to a larger increase in income **up to 2 marks**

use multiplier analysis relevantly: **up to 4 further marks**

Maximum of 4 marks for an answer that doesn't explain why the local independent shop generates MORE income for the local economy than a supermarket

Maximum of 5 marks for an answer that makes no reference to the statistics in the question

MAXIMUM FOR PART (b) 6 MARKS

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1(c) Analyse possible reasons why items such as bread and milk are often sold at cheaper prices by supermarket chains than by local independent stores (**Extract C**, line 3). *(10 marks)*

The question mentions reasons (in the plural) rather than a single reason, so answers that analyse only one reason should be restricted to a maximum mark at mid-Level 2 (6 marks). Two or more reasons analysed can earn full marks, but an answer that provides a bullet point list without any analysis should be restricted to a maximum at lower Level 2 (4 marks).

Issues and areas for analysis include:

- Supermarkets and independent stores buying goods for sale at different prices
- Supermarkets exploiting farmers etc (the exercise of monopsony power)
- Economy of scale arguments, including the effects of bulk buying
- The better organisation of supermarket chains which reduces average costs
- The exercise of monopoly power to gain control of the market, increasing market share
- Particular pricing policies: loss leaders, limit pricing, predatory pricing etc.
- Consumers using local independent stores as 'convenience' stores for buying bread and milk enables the stores to charge higher prices
- Use of evidence

LEVEL 1

At the bottom of the range, a superficial statement without analysis, of just **one** reason why supermarkets charge lower prices. At the top of the range, superficial statements, without analysis, of **two or more reasons** why supermarkets charge lower prices. **1 to 3 marks**

LEVEL 2

At the bottom of the range, basic analysis of just **one** reason why supermarkets charge lower prices. At the top of the range, basic analysis of **two or more reasons** why supermarkets charge lower prices, or developed analysis of **one reason** why supermarkets charge lower prices. **4 to 7 marks**

LEVEL 3

At the bottom of the range, developed analysis of **two or more reasons** why supermarkets charge lower prices. At the top of the range, developed analysis of **two or more reasons** why supermarkets charge lower prices, **together with** use of relevant examples **or** appreciation of the fact that independent stores sometimes charge prices that are lower than those charged by supermarket chains. **8 to 10 marks**

MAXIMUM FOR PART (c) 10 MARKS

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1(d) In relation to large supermarkets, **Extract D** (lines 12-14) states that the OFT was 'unable to identify any particular case which amounted to an abuse of buying power or other anti-competitive practice'.

Using the data and your economic knowledge, evaluate the view that the largest supermarket firms in the UK should be free to operate without any government interference. *(30 marks)*

Candidates may evaluate each of the issues they identify in turn and/or give some assessment of the arguments in their entirety.

To achieve **Level 4,** at least **three** issues should be presented and evaluated.

To achieve **Level 5,** there should, in addition, be an attempt to provide a more general evaluation of the arguments referred to, in order that a concluding judgement can be made by the candidate.

There must be evidence of evaluation for candidates to score **19 marks** or more.

Extracts B, C, and D refer to a number of disadvantages of supermarkets, but with the exception of the lower prices mentioned in Extract C, the information in the Extracts is biased towards the disadvantages of supermarkets. The possible disadvantages of supermarkets summarised in the Extracts are: the destruction of high-street shopping that binds people and communities together; income and spending power leaving a community; loss of jobs (all Extract B); supermarkets putting prices up in areas where there was no strong competition; adverse effects on the viability of a rural community and the closure of many village shops; unfair competition resulting from price cutting (all in Extract C); unnecessary car travel leading to pollution and congestion; unnecessary transport costs of food; lack of use of local produce; supermarkets playing farmers around the world off against each other so that they can get the lowest price (all in Extract D). Discussion of disadvantages may also pick up on the prompt in the question about abuse of buying power and anti-competitive practices.

Besides lower prices that might benefit consumers, the advantages of supermarkets include: convenience; possibly wider choice; possibly better quality; ease of car parking; uniform standards; provision of other services such as online buying and home delivery, and financial services.

Evaluation could be in terms of: assessing the benefits and costs of free market forces in the case of the supermarket industry; discussing the benefits and costs of government intervention; discussing the costs and benefits of different forms of government intervention; assessing the advantages and disadvantages of supermarkets compared to alternative methods of providing groceries etc.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

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Issues and areas for discussion include:

- Identifying and explaining the advantages and disadvantages of supermarkets
- Application of relevant economic theories, e.g. relating to cost curves, market structures, pricing policy
- the benefits of market forces and the application of these benefits to the supermarket industry
- sources of market failure relevant to the supermarket industry e.g. monopoly power, externalities, short-termism
- Considering the method(s) of government intervention
- Considering the effects of government intervention
- Government failure in relation to the methods of regulation that might be applied to the supermarket industry

Other equally valid points may be discussed and should be given due credit

Also give credit for:

- an overall judgement of the issues raised
- use of diagrams
- relevant reference to the real world

Where there is no explicit reference to the data, award a maximum of **24 marks.**

USE THE LEVELS MARK SCHEME ON PAGES 4 & 5

MAXIMUM FOR PART (d) 30 MARKS

TOTAL FOR THIS QUESTION: 50 MARKS

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Section B

Total for this question: 50 marks

2 (a) Explain how technological change can affect a firm's costs of production **and** its methods of production. *(20 marks)*

For candidates who:
define technological change, e.g. in terms of invention and/or innovation: **Up to 2 marks**

explain how investment in R&D can lead to technological change **Up to 2 marks**

explain that technical change can lead to completely new products (or goods and/or services) and that this may affect methods of production **Up to 4 marks**

With regard to costs of production, for candidates who:

define costs of production (e.g. payments made for factors of production): **Up to 2 marks**

simply state that technological change is likely to reduce costs **1 mark**

define/distinguish between different types of production cost (short-run costs, long-run costs, fixed, variable, total, marginal, average variable, average fixed and average total costs):
Up to 2 marks per definition, to a maximum of 4 marks

explain how technical change may affect a particular type of production cost
Up to 4 marks for each type of cost

use examples to illustrate how technological change has affected production costs
Up to 4 mark per example, to a maximum of 8 marks

use a relevant diagram (e.g. a downward movement in a firm's average cost curve (in either the short run or the long run), a rightward shift in the supply curve):

for each diagram, **1 mark** for correct labelling of axes, **1 mark** for correct labelling of information provided, eg cost curve(s), **1 mark** for correct representation of information, eg downward movement of cost curve, **1 mark** for accurate drawing and labelling of relevant coordinates.

A **diagram that is of limited value** in the context of the question **should be awarded less than 4 marks** even if labelling etc. is correct
up to 4 marks per relevant diagram, to a maximum of 6 marks

Maximum of 14 marks for explaining how technological change can affect costs of production

With regard to methods of production, for candidates who:

state that technological change is often embodied in capital equipment and hence involves investment **2 marks**

explain how technological change might result in more capital intensive methods of production **Up to 4 marks**

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explain how technical change might result in more knowledge intensive methods of production and require the employment of highly trained, skilled labour **Up to 4 marks**

explain any other relevant point relating to the effect on factor combinations **Up to 4 marks**

explain how technological change affects productivity **Up to 4 marks**

explain how technological change may affect the scale of production **Up to 4 marks**

use examples to illustrate how technological change has affected production methods **Up to 4 marks per example, to a maximum of 8 marks**

Maximum of 14 marks for explaining how technological change can affect methods of production

Maximum of 12 marks for a candidate who explains only the effects on methods of production OR the effects on costs of production

MAXIMUM FOR PART (a) 20 MARKS

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2 (b) Some firms, such as Amazon, Google, Microsoft and Apple, currently operate in markets undergoing rapid technological change.

Evaluate whether technological change leads to more competitive or more monopolistic markets. *(30 marks)*

To achieve **Level 4,** at least three issues should be presented and evaluated.

To achieve **Level 5,** there should, in addition, be an attempt to provide a more general evaluation of the arguments referred to, in order that a concluding judgement can be made by the candidate.

There must be evidence of evaluation for candidates to score **19 marks** or more.

Evaluation could be in terms of: discussing the extent to which technological change is leading to more or less monopoly power in the markets identified in the question or in other markets. Examples of issues might include: (i) promoting competition, e.g. by reducing entry barriers, and (ii) promoting monopoly, e.g. through firms patenting their innovations; (iii) discussion of how technical change reduces the power of established monopolies by creating new and competing products, e.g. digital photography reducing the monopoly power of Kodak (iv) the internet providing better information to consumers and producers. It might also be in terms of the short run versus long run effects on a market.

Some credit can be given for implicit evaluation provided the candidate discusses reasons why technological change can lead to a more competitive market **AND** why it may increase monopoly power. If the candidate also attempts to assess the likelihood of technological change leading to more competitive or monopolistic market there is scope to reward the candidate well for evaluation.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

Issues and areas for discussion include:

- The general features of competitive and monopolistic markets (e.g. nature of the product, number of firms, barriers to entry, knowledge..…….)
- Relevant application of knowledge of particular market structures: perfect competition, monopoly and oligopoly
- Examples of technical progress affecting market structures
- How technical progress has affected the companies stated in the question
- How technical progress has affected companies other than those stated in the question
- How technical progress has affected/may affect entry barriers
- How technical progress can affect the number of competitors/concentration
- Technological progress, patents and the implications for competition
- Creative destruction and competition
- Application of contestable market theory

Other equally valid points may be discussed and should be given due credit.

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Also give credit for:

- an overall judgement of the issues raised
- use of diagrams

USE THE LEVELS MARK SCHEME ON PAGES 4 & 5

MAXIMUM FOR PART (b) 30 MARKS

TOTAL FOR THIS QUESTION: 50 MARKS

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Total for this question: 50 marks

3 (a) Explain how the wage rate is determined in a competitive labour market. *(20 marks)*

The Module 5 specification mentions competitive labour markets, without explicit reference to perfect competition. Most candidates will write about perfectly competitive labour markets, though it is equally valid to write about labour markets at the competitive end of the spectrum of imperfectly competitive labour markets. Full marks can be earned by an answer that focuses on the whole labour market (and not on the firms within the labour market), provided relevant reference is made to the factors affecting the demand for, and the supply of, labour.

For candidates who:

explain the meaning of the term 'wage rate': **2 marks**

explain the meaning of a competitive labour market: **2 marks**

state that in a competitive market the wage rate is determined by market forces, or by demand and supply: **2 marks**

explain the determinants of the demand for labour in a competitive labour market, e.g. market demand is the sum of the MRP curves facing each employer; the determinants of the MRP curve; derived demand; elasticity of demand for labour: **up to 4 marks per point, up to a maximum of 12 marks for demand**

explain the determinants of the supply of labour in a competitive labour market, e.g. market supply is the sum of individual supply curves of labour; the determinants of individual supply curves; skills; training; non-monetary factors; elasticity of supply of labour: **up to 4 marks per point, up to a maximum of 12 marks for supply**

explain how the equilibrium wage rate is determined through the elimination of excess demand for labour: **2 marks**

explain how the equilibrium wage rate is determined through the elimination of excess supply of labour: **2 marks**

make any other relevant point in relation to effects on labour markets, e.g. that firms are passive wage takers at the ruling market wage rate: **up to 2 marks per point**

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use a relevant diagram or diagrams (e.g. showing elimination of excess demand for labour and determination of the equilibrium market wage rate):

for each diagram, **1 mark** for correct labelling of axes, **1 mark** for correct labelling of information provided, eg demand and supply curves, **1 mark** for correct representation of information, eg excess demand at a wage rate below the equilibrium wage rate, **1 mark** for accurate drawing and labelling of relevant coordinates.

A **diagram that is of limited value** in the context of the question **should be awarded less than 4 marks** even if labelling etc. is correct e.g. a diagram that just includes a supply or demand curve might be awarded 1 mark depending on how it is used

up to 4 marks per relevant diagram, to a maximum of 6 marks

Maximum of 8 marks for a candidate who explains the determination of levels of employment rather than the wage rate.

MAXIMUM FOR PART (a) 20 MARKS

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3 (b) 'The movement of workers from eastern Europe into the UK has plugged gaps in labour markets and improved UK economic performance.'

Assess the effects of such a movement of workers upon wage rates, levels of employment **and** the competitiveness of labour markets. *(30 marks)*

To achieve **Level 4,** at least three issues should be presented and evaluated.

To achieve **Level 5,** there should, in addition, be an attempt to provide a more general evaluation of the arguments referred to, in order that a concluding judgement can be made by the candidate.

There must be evidence of evaluation for candidates to score **19 marks** or more.

Evaluation could be in terms of: comparison of effects (on wage rates, levels of employment, labour market competitiveness) in the UK and the countries the migrants have left; recognition that employment may have risen as a result of lower wage rates; arguing that the effects may differ for workers of different skills, education and ability to speak English; arguing that the effects may differ for workers of different countries of origin.

If a candidate includes valid reasons why wages and employment (and/or unemployment) may both rise or fall in the UK, they should be given credit for evaluation.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

Issues and areas for discussion include:

- 'Push' factors causing the movement of labour into the UK, e.g. low wage rates and high unemployment in eastern Europe
- 'Pull' factors causing the movement of labour into the UK, e.g. high wage rates and low unemployment in the UK
- The effect of creating a single labour market in the EU
- International labour mobility affecting resource allocation within the UK, European and world economies
- The depressing of UK wage rates because migration increases the supply of labour and immigrant labour is often prepared to work at lower wage rates
- The creation of unemployment among indigenous workers
- The negation of these effects because of more rapid economic growth in the UK
- Greater competition in UK labour markets
- The impact on employment e.g. overall levels of employment may increase as migrant workers may fill vacancies that were not being filled by people in the UK
- The impact on different labour markets e.g. skilled versus unskilled workers
- The effect of labour mobility (migration) on growth, inflation and the balance of payments

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Other equally valid points may be discussed and should be given due credit, e.g. labour immigration may reduce UK inflation and boost employment through export markets and import saving.

Also give credit for:

- an overall judgement of the issues raised
- use of diagrams
- reference to real world examples

Answers should consider all three aspects of the question i.e. wage rates, levels of employment and competitiveness (be flexible when interpreting what is meant by the competitiveness of a labour market). Answers that only consider one aspect should be awarded up to a maximum of 20 marks. Answers that consider two aspects can be awarded up to a maximum of 25 marks.

USE THE LEVELS MARK SCHEME ON PAGES 4 & 5

MAXIMUM FOR PART (b) 30 MARKS

TOTAL FOR THIS QUESTION: 50 MARKS

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Total for this question: 50 marks

4 (a) Explain the costs **and** benefits that might result from new infrastructure projects, such as the building of new reservoirs in areas suffering from water shortages. *(20 marks)*

The question does not ask for a distinction between private and social costs and benefits, or between private and external costs and benefits, but better answers are likely to make one or both of these distinctions. The specifications state that social cost = private cost + external cost and that social benefit = private benefit + external benefit.

For candidates who:

define an infrastructure project: **1 mark**

explain the meaning of cost benefit analysis, including problems of valuing external costs and benefits: **Up to 6 marks**

explain the meaning of "costs", e.g. payments to factors of production, opportunity costs, fixed and variable costs: **up to 4 marks**

distinguish between private and external (or private and social) costs: **2 marks**

provide examples of costs incurred when building an infrastructure project, eg wages, raw materials, visual pollution, noise pollution:
1 mark per example, up to a maximum of 4 marks

explain the meaning of "benefits": **2 marks**

distinguish between private and external (or private and social) benefits: **2 marks**

provide examples of benefits received or generated when building an infrastructure project, eg external economies provided for businesses, ensuring continuous supply of a useful service; in the case of reservoirs, ensuring water supplies, facilitating population growth in southern England, reducing the need to shift water from and to different parts of the country, creating nature reserves and leisure facilities:
1 mark per example, up to a maximum of 4 marks

use a relevant diagram or diagrams (eg showing the marginal private, external and social costs and benefits of building or using an infrastructure project such as a reservoir):

for each diagram, **1 mark** for correct labelling of axes, **1 mark** for correct labelling of information provided, eg cost and benefit curves, **1 mark** for correct representation of information, eg in the case of water, the distinction between private and social optimal quantity or use of reservoirs), **1 mark** for accurate drawing and labelling of relevant coordinates.

A **diagram that is of limited value** in the context of the question **should be awarded less than 4 marks** even if labelling etc. is correct
up to 4 marks per relevant diagram, to a maximum of 6 marks

Maximum of 14 marks for a candidate who only explains the costs or benefits of a project or projects.

MAXIMUM FOR PART (a) 20 MARKS

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4 (b) Evaluate the view that shortages in markets, such as those for water and health care, can best be prevented by the operation of market forces rather than by government intervention in markets. *(30 marks)*

To achieve **Level 4,** at least three issues should be presented and evaluated.

To achieve **Level 5,** there should, in addition, be an attempt to provide a more general evaluation of the arguments referred to, in order that a concluding judgement can be made by the candidate.

There must be evidence of evaluation for candidates to score **19 marks** or more.

Evaluation could be in terms of: a discussion of the pros and cons of allowing markets to eliminate shortages; considering the extent to which government intervention in a market subject to market failure can correct or eliminate the market failure, or promote forms of government failure; distinguishing between significant and relatively trivial cases of market failure.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

Issues and areas for discussion include:

- How market forces may deal with a shortage, e.g. through pricing and metering
- The rationing, incentive and signalling functions of the price mechanism
- The advantages and disadvantages of using prices to eliminate shortages
- How market forces may prevent future shortages, e.g. through encouraging investment in additional capacity and appropriate infrastructure
- How market forces may fail to deal with a shortages, e.g. in the case of water, through failing to deal with leakages
- How market forces may fail to prevent future shortages, e.g. through failure to undertake sufficient investment
- Market failure considerations e.g. health care as a merit good, natural monopoly issues in water supply
- How government may intervene
- The costs and benefits of government intervention, including the possibility of government failure
- Use of cost benefit analysis

Other equally valid points may be discussed and should be given due credit.

Also give credit for:

- an overall judgement of the issues raised
- use of diagrams
- reference to real world examples

USE THE LEVELS MARK SCHEME ON PAGES 4 & 5

MAXIMUM FOR PART (b) 30 MARKS

TOTAL FOR THIS QUESTION: 50 MARKS

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General Certificate of Education
June 2007
Advanced Level Examination

ASSESSMENT and QUALIFICATIONS ALLIANCE

ECONOMICS **ECN5**
Unit 5 Business Economics and the Distribution of Income

Tuesday 19 June 2007 1.30 pm to 3.00 pm

For this paper you must have:
- an 8-page answer book.

You may use a calculator.

Time allowed: 1 hour 30 minutes

Instructions
- Use blue or black ink or ball-point pen. Pencil should only be used for drawing.
- Write the information required on the front of your answer book. The *Examining Body* for this paper is AQA. The *Paper Reference* is ECN5.
- In **Section A**, answer **all** parts of the question.
- In **Section B**, answer **one** question.

Information
- The maximum mark for this paper is 100.
- The marks for questions are shown in brackets.
- This paper is synoptic. It assesses your understanding of the relationship between the different aspects of Economics.
- You will be marked on your ability to use good English, to organise information clearly and to use specialist vocabulary where appropriate.

Advice
- You are advised to spend approximately 45 minutes on **Section A** and approximately 45 minutes on **Section B**.

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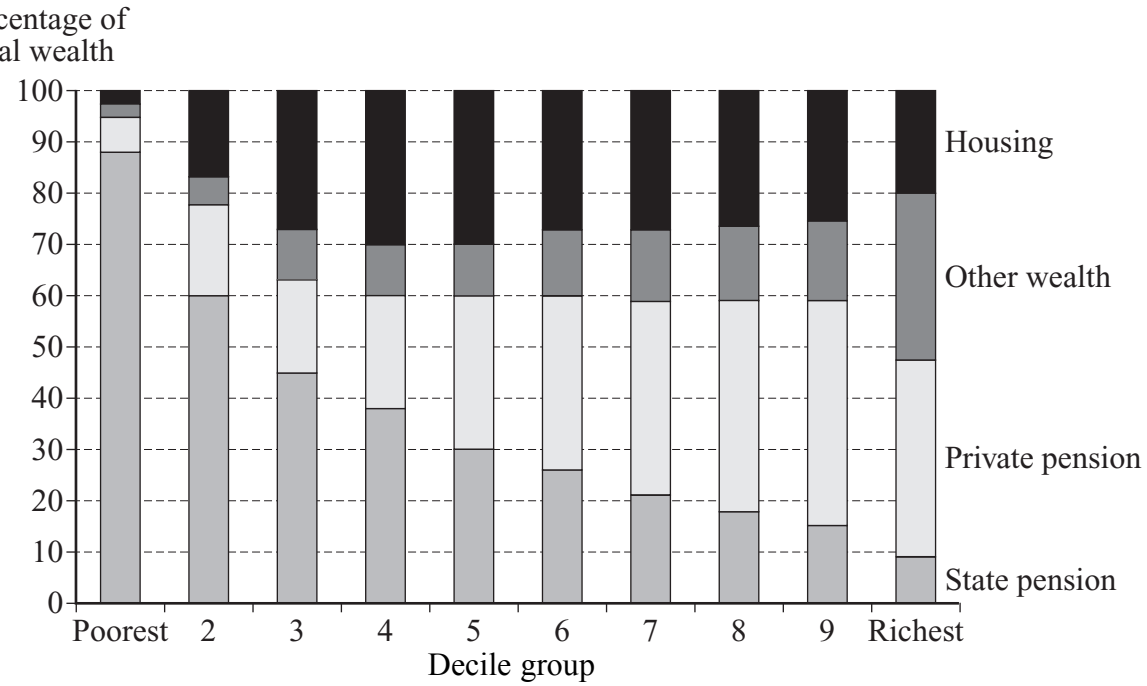
SECTION A

Answer **all** parts of this question.

Total for this question: 50 marks

1 Study **Extracts A**, **B**, **C and D**, and then answer **all** parts of Question 1 which follows.

Extract A: Composition of the wealth of UK residents aged 50 to 65 by decile group, 2005



Note: (i) Each decile group represents 10% of the total population aged between 50 and 65, ranked by wealth.
(ii) The table estimates the future value of state and private pensions which will be received after retirement.

Source: *A New Pension Settlement for the Twenty-First Century,* The Second Report of the Pensions Commission, 2005

Extract B: Causes of wealth inequality

Two factors that promote wealth inequality:

- People save as they age, which affects the distribution of wealth between young and old age-groups.
- Home-ownership is a very important determinant of overall wealth levels and inequalities.

Source: adapted from *The long-term relationship between poverty and debt,* The Joseph Rowntree Foundation, November 2005

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Extract C: Market failure and income and wealth inequality

Extract C is an extract of text.

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Extract D: Young people face 'pensions time bomb'

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Question 1

(a) Using **Extract A**, compare **two** ways in which the composition of the wealth of UK residents aged 50 to 65 changes as their wealth increases. *(4 marks)*

(b) **Extract B** identifies two factors that promote wealth inequality.

Explain the difference between wealth and income **and** explain **one** factor which causes wealth inequality. *(6 marks)*

(c) 'Society may come to the view that too much inequality is unacceptable or undesirable' (**Extract C**, lines 3-4).

Analyse how the existence of inequality can cause economic problems, such as market failure. *(10 marks)*

(d) Using the data and your economic knowledge, evaluate the view that the most effective way to reduce poverty is to increase significantly the state pension. *(30 marks)*

Turn over ▶

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SECTION B

Answer **one** question from this section.

Each question carries 50 marks.

2 (a) Explain how the equilibrium level of output is determined in perfect competition, **both** for the whole market **and** for **one** firm within the market. *(20 marks)*

(b) In recent years, British Telecom, the supermarket industry and 50 private schools have been investigated by the competition authorities for limiting competition.

Evaluate different ways in which governments could make markets more competitive. *(30 marks)*

3 (a) Explain how interdependence **and** uncertainty affect the behaviour of firms in oligopolistic markets. *(20 marks)*

(b) Evaluate the view that **only** producers, and **not** consumers, benefit when oligopolistic firms collude to try to reduce the uncertainty they experience. *(30 marks)*

4 (a) Explain how the equilibrium wage rate in a labour market is determined **both** by the marginal productivity of labour **and** by influences upon the supply of labour. *(20 marks)*

(b) Do you agree that if a trade union persuades employers to increase wage rates in a labour market, employment must inevitably fall in that labour market? Justify your answer. *(30 marks)*

END OF QUESTIONS

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Version 1.0: 0607

ASSESSMENT and QUALIFICATIONS ALLIANCE

General Certificate of Education

Economics

ECN5: Business Economics and Distribution of Income

Mark Scheme

2007 examination - June series

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Mark schemes are prepared by the Principal Examiner and considered, together with the relevant questions, by a panel of subject teachers. This mark scheme includes any amendments made at the standardisation meeting attended by all examiners and is the scheme which was used by them in this examination. The standardisation meeting ensures that the mark scheme covers the candidates' responses to questions and that every examiner understands and applies it in the same correct way. As preparation for the standardisation meeting each examiner analyses a number of candidates' scripts: alternative answers not already covered by the mark scheme are discussed at the meeting and legislated for. If, after this meeting, examiners encounter unusual answers which have not been discussed at the meeting they are required to refer these to the Principal Examiner.

It must be stressed that a mark scheme is a working document, in many cases further developed and expanded on the basis of candidates' reactions to a particular paper. Assumptions about future mark schemes on the basis of one year's document should be avoided; whilst the guiding principles of assessment remain constant, details will change, depending on the content of a particular examination paper.

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Dr Michael Cresswell Director General

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Advanced Level Economics

June 2007 **ECN5**

MARK SCHEME

General Instructions

Marks awarded to candidates should be in accordance with the following mark scheme and examiners should be prepared to use the full range of marks available. The mark scheme for most questions is flexible, permitting the candidate to score full marks in a variety of ways. Where the candidate's response to a question is such that the mark scheme permits full marks to be awarded, full marks **MUST** be given. A perfect answer is not necessarily required for full marks. But conversely, if the candidate's answer does not deserve credit, then no marks should be given.

Occasionally, a candidate may respond to a question in a reasonable way, but the answer may not have been anticipated when the mark scheme was devised. In this situation, **OR WHENEVER YOU HAVE ANY DOUBT ABOUT THE INTERPRETATION OF THE MARK SCHEME**, you must in the first instance telephone your team leader to discuss how to proceed.

Two approaches have been used in the construction of the mark scheme:

(i) **An 'issue' based approach.** The mark scheme for parts (a) and (b) of the data response question and part (a) of the essay questions adopts this approach. The questions do not generally require that the candidate demonstrates evaluative skills although some explanation and analysis may be expected. The mark scheme lists the marks that can be awarded for particular issues (and associated development) that the candidate might include in the answer. Marks awarded for development should take into account the Quality of Written Communication used by candidates as indicated on page 5 of this mark scheme.

(ii) **A 'levels' approach.** This approach is used for parts (c) and (d) of the data response question and part (b) of the essay questions. The mark scheme summarises the information required to answer the question, but without attaching marks to particular issues. Marks should be awarded according to whether the answer displays the skills indicated by the five Mark Band Descriptors or "Levels of Skill" included in the mark scheme. The Mark Band Descriptors are set out on page 4. When using a 'levels' mark scheme the marker must identify where a particular skill is being demonstrated. The **key** to be used to identify the skill is also shown on page 5. The level chosen should be the one which **best fits** the answer provided by the candidate. It is not intended that the answer should satisfy every statement in the level description.

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APPLYING THE 'LEVELS' MARK SCHEME
Levels of Response Mark Band Descriptors

Level 1:
Few, if any, relevant issues recognised. Economic concepts and principles are not adequately understood or applied to the question and its context. No satisfactory analysis or evaluation. Little, if any, appreciation of the inter-relatedness of economic issues, problems and institutions. A poorly organised response which generally fails to answer the question. Descriptions and explanations lack clarity. Spelling, punctuation and grammar are likely to be poor. There is very little use of specialist vocabulary. **0 to 6 marks** *(Mid-Point: 3 marks)*

Level 2:
A few issues are recognised but there is only limited evidence of the candidate's ability to apply relevant economic concepts. An attempt is made to answer the question but there is little satisfactory analysis or evaluation. Some very limited appreciation of the inter-relatedness of economic issues, problems and institutions. A poorly organised answer which does not have a clear structure. Descriptions and explanations are sometimes hard to follow. The candidate demonstrates some ability to spell commonly used words and to follow the standard conventions of punctuation and grammar. Some use of specialist vocabulary is made but this is not always applied appropriately.
7 to 12 marks *(Mid-Point: 10 marks)*

Level 3:
A few issues recognised. The candidate has attempted to apply relevant economic concepts and ideas to the question and its context. A reasonable understanding of some concepts and theories is demonstrated. However, the evaluation of issues, arguments and evidence is limited and superficial. Some understanding of the inter-relatedness of economic issues, problems and institutions. There is some logic and coherence in the organisation of the answer. The candidate is generally able to spell commonly used words and usually follows the standard conventions of punctuation and grammar. Some descriptions and explanations are easy to understand but the answer may not be expressed clearly throughout. Some use of specialist vocabulary which is applied appropriately.
13 to 20 marks *(Mid-Point: 17 marks)*

Level 4:
Several relevant issues identified. Good understanding of some economic concepts and principles is demonstrated. The candidate is able to apply these concepts and principles to the context to help answer the question. There is some appreciation of alternative points of view. Satisfactory use is made of evidence and/or theoretical analysis to evaluate the issues and arguments identified. Good understanding of the inter-relatedness of economic issues, problems and institutions is demonstrated Shows the ability to think as an economist making effective use of the economist's 'tool kit' of concepts, theories and techniques. Spelling is generally accurate and the standard conventions of punctuation and grammar are usually followed. The answer is well organised. Descriptions and explanations are usually clearly expressed. A wide range of specialist vocabulary which is used with facility. **21 to 26 marks** *(Mid-Point: 24 marks)*

Level 5:
Several relevant issues identified. Good understanding of economic concepts and principles demonstrated throughout. The candidate is able to apply these concepts and principles to the context to help answer the question. There is an appreciation of alternative points of view. Good use is made of evidence and/or theoretical analysis to evaluate the issues and arguments identified. The candidate demonstrates the ability to synthesise the arguments presented and come to a reasonable conclusion albeit tentative. A clear understanding of the inter-relatedness of economic issues, problems and institutions is demonstrated Shows the ability to think as an economist making very effective use of the economist's 'tool kit' of concepts, theories and techniques. Spelling is accurate and the standard conventions of punctuation and grammar are followed. The answer is well organised. Descriptions and explanations are expressed with clarity throughout. Extensive use of specialist vocabulary which is applied adeptly and with precision.
27 to 30 marks *(Mid-Point: 29 marks)*

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THE KEY TO BE USED WHEN USING THE 'LEVELS' MARK SCHEME

D Where a particular economic term is correctly **DEFINED** in order to help the candidate to answer the question properly.

I Where a relevant **ISSUE** is raised by the candidate.

K Where the candidate demonstrates **KNOWLEDGE** of recent developments or features of the economy which help enhance the candidate's response to the question. This should also be used where the candidate quotes relevant examples.

Ap Where the candidate demonstrates the ability to **APPLY** knowledge and **CRITICAL UNDERSTANDING** to problems and issues.

A Where the candidate demonstrates the ability to **ANALYSE** the problem using appropriate economic ideas.

E Where the candidate **EVALUATES** and makes judgements about the significance of various issues and arguments.

QUALITY OF WRITTEN COMMUNICATION

The Mark Band Descriptors, which are used for assessing Question 1 (d) and part (b) of the essay questions, incorporate statements which relate to the Quality of Written Communication used by the candidates.

However, it is also important to assess Quality of Written Communication whenever candidates produce answers using continuous prose. When applying an issue based mark scheme, examiners must take into account the following when deciding how many marks to award for development:

(i) use of appropriate format and style of writing to organise relevant information clearly and coherently;
(ii) use of specialist vocabulary, where appropriate;
(iii) legibility of handwriting;
(iv) accuracy of spelling, punctuation and grammar.

Synoptic Assessment

All questions in this unit are synoptic. Therefore candidates will need to demonstrate that they are able to think as an economist and to use effectively the economist's 'tool kit' of concepts, theories and techniques.

They should demonstrate that they:

- understand the inter-relatedness of many economic issues, problems and institutions;
- understand how certain economic concepts, theories and techniques may be relevant to a range of different contexts
- can apply concepts, theories and techniques in analysing economic issues and problems and in evaluating arguments and evidence.

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Section A

Total for this question: 50 marks

1(a) Using **Extract A**, compare **two** ways in which the composition of the wealth of UK residents aged 50 to 65 changes as their wealth increases. *(4 marks)*

Award up to 2 marks for each valid point made (one mark for identification and one mark for supporting reference(s) to the data). The valid points include:

- The state pension, which accounted for nearly 90% of the wealth of the poorest decile group, continuously falls to less than 10% of wealth of the richest decile group
- Private pensions, which accounted for less than 10% of the wealth of the poorest decile group, rises to between 30% and 40% of wealth of the richest decile group
- But private pensions fell as a proportion of total wealth for the richest decile group, compared to at least two of the decile groups immediately below the richest decile group
- Housing, which accounted for less than 5% of the wealth of the poorest decile group, rose to peak at about 30% of the wealth of the fourth and fifth decile groups
- But housing then fell in the higher income decile groups, to around 20% of wealth for the richest decile group
- Any other valid point, e.g. comparisons of two of the types of wealth

A maximum of **1 mark** may be awarded if the candidate simply trawls through the data, with no attempt at comparison, or if only one point of comparison is made.

A maximum of **2 marks** may be awarded if no use is made of statistics.

A maximum of **3 marks** may be awarded where there is evidence of an overview being taken, even though part of the answer gives an impression of a trawl through the data.

MAXIMUM FOR PART (a) 4 MARKS

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1(b) **Extract B** identifies two factors that promote wealth inequality.

Explain the difference between wealth and income **and** explain **one** factor which causes wealth inequality. *(6 marks)*

For answers to the first part of the question, award the following marks to candidates who:

provide an acceptable definition of wealth, e.g. wealth as a *stock* of accumulated assets: **1 mark**

provide an acceptable definition of income, e.g. income as a *flow* of output or wealth, or as money received over a period: **1 mark**

(**1 mark** for solely stating that wealth is a stock and income is a flow, though a **further mark** can be earned for providing accurate examples of **both** wealth and income.)

Maximum of 2 marks for explaining the difference between wealth and income

For answers to the second part of the question:

Up to 5 marks are available for explanation of the role of saving OR the role of home ownership. (No marks for simply stating the role of saving or home ownership.) In a similar way, **up to 5 marks** are available for explanation of a factor not mentioned in the preamble of the question. e.g. the role of inheritance. (In this case, 1 mark is available for identification of the factor.) If more than one factor is explained, award marks only for the best explanation.

For the role of saving, award up to 3 marks for each of the following:

- an explanation how saving adds to the wealth of older age groups
- an explanation how old people's wealth may fall compared to relatively younger people, as they run down stocks of previously accumulated wealth to finance old age

For the role of housing, **award up to 3 marks for each of the following:**

- an explanation of how home ownership or lack of ownership affects the distribution of wealth between rich and poor
- an explanation of why the value of the property owned by the better off has generally risen faster than the value of other forms of wealth which form a larger fraction of the assets owned by the poor, e.g. claims on the state pension (which are a form of non-marketable wealth).

Reward any other valid explanation with respect to the chosen factor

MAXIMUM FOR PART (b) 6 MARKS

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1(c) 'Society may come to the view that too much inequality is unacceptable or undesirable' (**Extract C**, lines 3-4).

Analyse how the existence of inequality can cause economic problems, such as market failure. *(10 marks)*

Most candidates will probably accept without question that income and/or wealth inequalities are a form of market failure. However, some centres teach their students that market failure should be defined in a narrower way, i.e. solely in terms of market inefficiency and not in terms of alleged inequity resulting from the operation of markets. If this is the only argument the candidate makes, a good statement of the argument can reach Level 2. However, this argument on its own is not sufficient to reach Level 3. This is because inequalities in the distribution of income and wealth are clearly a part of the market failures listed in the Module 1 specification, and the Module 5 specification then states that, for the Unit 5 examination, candidates are clearly expected to extend and develop the models of market failure introduced in Module 1. The words *such as* in the question may be significant: award marks for relevant analysis of economic problems *other than* market failure.

Issues and areas for analysis include:

- The meaning of market failure
- The links between inequality and inequity
- How market forces operating in labour markets may lead to inequality
- Relevant use of the concepts of vertical and horizontal equity
- Linking an unequal distribution of income to under-consumption of merit goods such as education
- Linking an unequal distribution of income to over-consumption of demerit goods such as tobacco
- Linking an unequal distribution of income to inequitable consumption externalities, e.g. the poor living in polluted neighbourhoods
- Inequality linked to poverty, eg its effect on poverty

LEVEL 1
At the bottom of the range, the candidate does not attempt any analysis, and goes no further than providing a general purpose definition of market failure. At the top of the range, the candidate goes further by linking income inequality to an economic problem such as market failure, but without any analysis. **1 to 3 marks**

LEVEL 2
At the bottom of the range, the candidate provides a basic analysis of how inequality may lead to an economic problem. At the top of the range, **one** problem is analysed **and a second** economic problem is identified. **4 to 7 marks**

LEVEL 3
At the bottom of the range, the candidate analyses **two** economic problems. At the top of the range, very good analysis is provided of **at least two** economic problems. **8 to 10 marks**

MAXIMUM FOR PART (c) 10 MARKS

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1(d) Using the data and your economic knowledge, evaluate the view that the most effective way to reduce poverty is to increase significantly the state pension. *(30 marks)*

It is expected that candidates will provide a definition of poverty, before explaining how increasing the state old age pension can reduce poverty. There must be evidence of evaluation for candidates to score **19 marks** or above, and evaluation requires reference to methods of reducing poverty other than by raising the state pension. Each argument introduced into the answer may be evaluated in turn, and/or the candidate may give some overall assessment of the issues.

To score **24 marks** or more, candidates must make reference to the data. References to Extract B should be most useful. Evaluation could include commenting on the relative merits of increasing private and state pensions, and arguing that increasing pensions has no effect on the poverty of the unemployed or low-paid families where parents are of working age. Candidates may also argue that effective policies to reduce absolute and relative poverty are not necessarily the same.

For sound analysis of methods of reducing poverty, without a mention of state pensions, award a **maximum of 17 marks**

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

Issues and areas for discussion include:

- Different types of poverty (e.g. absolute and relative) and their causes
- How raising state pensions can reduce poverty suffered by old people
- How raising private pensions can reduce poverty suffered by old people
- Comparison of the relative merits of using state and private pensions to reduce poverty
- Discussion of the effect of paying for higher pensions through taxation
- Discussion of the effect of paying for higher pensions through funded contributions during people's working lives
- Other relevant policies to reduce the poverty suffered by old people, e.g. raising retirement age while enforcing policies to discourage ageist employment policies; policies to promote economic growth
- Recognising and explaining that raising pensions has little or no effect on reducing poverty that is caused by factors unrelated to age
- Who pays for the state pension

Other equally valid points may be discussed and should be given due credit.

Also give credit for:

- an overall judgement of the issues raised
- use of diagrams
- relevant reference to the real world

USE THE LEVELS MARK SCHEME ON PAGES 4 & 5

MAXIMUM FOR PART (d) 30 MARKS
TOTAL FOR THIS QUESTION: 50 MARKS

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Section B

Total for this question: 50 marks

2 (a) Explain how the equilibrium level of output is determined in perfect competition, **both** for the whole market **and** for **one** firm within the market. *(20 marks)*

For candidates who:

explain the meaning of perfect competition:
1 mark per condition or characteristic, up to a maximum of 3 marks

state the equilibrium output for the whole market (equating supply and demand): **1 mark**

state the equilibrium output for a firm in terms of profit-maximisation and/or equating MR and MC: **1 mark**

explain how for the whole market, the equilibrium level of output is determined: **up to 6 marks**

explain how for one firm, the short-run equilibrium level of output is determined: **up to 6 marks**

explain how for one firm, the long-run equilibrium level of output is determined: **up to 6 marks**

The conditions of perfect competition are:

- a large number of buyers and sellers
- each with perfect information
- each able to buy/sell as much as it wishes at the ruling price
- but each unable to influence the ruling price
- homogeneous product
- no entry or exit barriers in the long run

Diagrams are not required but good answers are likely to include relevant diagrams.
Up to 3 marks per diagram, up to a maximum of 9 marks for diagrams

Maximum of 12 marks for a candidate who explains the determination of equilibrium output *only* for the whole market *or* for one firm within the market

MAXIMUM FOR PART (a) 20 MARKS

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2 (b) In recent years, British Telecom, the supermarket industry and 50 private schools have been investigated by the competition authorities for limiting competition.

Evaluate different ways in which governments could make markets more competitive.

(30 marks)

There needs to be evidence of evaluation if a candidate is to be awarded **19 marks** or more. Since the question assumes that making markets more competitive is desirable, most of or all the marks awarded for evaluation should be for comparing the advantages and disadvantages of different ways of making markets more competitive. Two ways explained and then evaluated in depth, or three or more ways explained and evaluated in less depth can reach Level 5. However, an answer restricted to a list of ways with no accompanying explanation and evaluation, should be restricted to low Level 2. An answer that is strong on explanation but in which evaluation is thin or unconvincing, should be placed in Level 3. Rather better evaluation should reach Level 4, while good evaluation should reach Level 5, subject to the advice already given.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

Issues and areas for discussion include:

- Explanation of the meaning of competitive markets
- Ways to make markets more price competitive e.g. through removing or reducing entry barriers
- Ways to make markets more quality competitive, by promoting R&D and design
- The role of competition policy in making markets more competitive
- The impact of different forms of competition policy e.g. breaking up monopolies versus promoting market contestability
- Ways other than through the use of competition policy (e.g. privatisation) for improving competitiveness
- Ways of improving different forms of economic efficiency

Other equally valid points may be discussed and should be given due credit.

Also give credit for:

- an overall judgement of the issues raised
- use of diagrams
- reference to real world markets and use of evidence

USE THE LEVELS MARK SCHEME ON PAGES 4 & 5

MAXIMUM FOR PART (b) 30 MARKS

TOTAL FOR THIS QUESTION: 50 MARKS

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Total for this question: 50 marks

3 (a) Explain how interdependence **and** uncertainty affect the behaviour of firms in oligopolistic markets. *(20 marks)*

The question does not distinguish between *competitive* oligopolistic markets, i.e. markets dominated by relatively few firms in which the firms do not collude, and *collusive* oligopolists, e.g. members of a cartel. While it is possible to earn full marks solely by explaining features of competitive oligopolistic markets, the best answers may explain collusion, for example by explaining that competitive oligopolists may respond to interdependence and uncertainty by colluding. Marks can also be awarded, as per the mark scheme, if candidates assume that the firms have already formed a cartel. Marks should be awarded for the relevant use of:

(i) the theory of the kinked demand curve to explain how oligopolists are affected by interdependence;

(ii) the theory of the kinked demand curve to explain how oligopolists are affected by uncertainty;

(iii) game theory to explain how oligopolists are affected by interdependence;

(iv) game theory to explain how oligopolists are affected by uncertainty;

For candidates who:

define an oligopoly in terms of market structure e.g. using a concentration ratio: **2 marks**

define an oligopoly in terms of market conduct or behaviour (such a definition will probably mention interdependence): **up to 4 marks**

distinguish between competitive and collusive oligopoly **up to 3 marks**

provide a very basic explanation of one of points (i) to (iv): **2 marks per point**

OR

provide a developed explanation of one of points (i) to (iv): **up to 6 marks per point**

Reward in a similar way, explanation of any other relevant point or argument, e.g. relating to pricing policies, price leadership, predatory pricing, market contestability

Candidates who explain the kinked demand theory without explicitly distinguishing between interdependence and uncertainty can earn **up to 6 marks** for the explanation.

Likewise, candidates who explain game theory without explicitly distinguishing between interdependence and uncertainty can earn **up to 6 marks** for the explanation.

Diagrams are not required but good answers are likely to include relevant diagrams.
Up to 3 marks per diagram, up to a maximum of 9 marks for diagrams

Maximum of 6 marks for a candidate who explains only *causes* rather than *effects*

MAXIMUM FOR PART (a) 20 MARKS

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3 (b) Evaluate the view that **only** producers, and **not** consumers, benefit when oligopolistic firms collude to try to reduce the uncertainty they experience. *(30 marks)*

There needs to be evidence of evaluation if a candidate is to be awarded **19 marks** or more. For this question, evaluation could be in terms of arguing that different forms of collusion have different outcomes. For example, colluding to rig the market, to restrict choice and to increase the price to a monopoly level are in the producers' interest but against the consumers' interest. However, if collusion involves setting industry-wide product standards (e.g. firms such as Sony and Toshiba agreeing a single standard for DVD recording technology), consumers as well as producers can benefit.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

Issues and areas for discussion include:

- how collusion reduces uncertainty (avoid double marking, if this has already been fully discussed and credited in the answer to part (a)
- how cartels restrict output and raise prices charged
- any other relevant way in which producers benefit
- the theory of joint profit maximisation
- how consumers suffer from the high prices charged by the colluding producers
- how consumers suffer if collusion leads to productive and/or dynamic inefficiency
- how consumers may also benefit if some of the benefits producers enjoy are passed on to consumers, e.g. collusion *may* lead to greater dynamic efficiency
- how consumers as well as producers may benefit from collusion that sets agreed standards, or prevents the firms poaching workers from each other
- how because of cheating and/or the fear of government intervention, collusion is unlikely completely to eradicate uncertainty
- consumers may sometimes benefit from the results of collusion

Other equally valid points may be discussed and should be given due credit.

Also give credit for:

- an overall judgement of the issues raised
- use of diagrams
- reference to real world examples of collusion

USE THE LEVELS MARK SCHEME ON PAGES 4 & 5

MAXIMUM FOR PART (b) 30 MARKS
TOTAL FOR THIS QUESTION: 50 MARKS

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Total for this question: 50 marks

4 (a) Explain how the equilibrium wage rate in a labour market is determined **both** by the marginal productivity of labour **and** by influences upon the supply of labour. *(20 marks)*

For candidates who:

define the equilibrium wage rate in a labour market: **2 marks**

For candidates who for the demand for labour:

explain the meaning of the marginal physical product or productivity of labour: **up to 2 marks**

OR

explain the meaning of the marginal revenue product or productivity of labour (including explanation of the physical productivity of labour): **up to 4 marks in total**

explain marginal productivity in terms of the law of diminishing returns (also known as the law of diminishing marginal productivity and the law of variable proportions): **up to 4 marks**

go on to explain how the marginal productivity of labour affects the demand for labour: **up to 4 further marks**

Maximum of 12 marks for the demand for labour

For candidates who for the supply of labour:

define the supply of labour **2 marks**

identify an influence upon the supply of labour: **1 mark (up to a maximum of 6 marks)**

explain an identified influence: up to a further **3 marks** per influence

Maximum of 12 marks for the supply of labour

For candidates who:

bring demand and supply conditions together to explain the equilibrium wage rate: **up to 6 marks**

explain how demand and/or supply conditions are different in perfectly competitive and monopsony labour markets: **up to 6 marks**

Diagrams are not required but good answers are likely to include relevant diagrams. **Up to 3 marks per diagram, up to a maximum of 9 marks for diagrams**

Maximum of 12 marks for a candidate who explains *only* the influence of demand *or* supply

Maximum of 14 marks for a candidate who does not bring demand and supply together to explain the equilibrium wage rate

MAXIMUM FOR PART (a) 20 MARKS

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4 (b) Do you agree that if a trade union persuades employers to increase wage rates in a labour market, employment must inevitably fall in that labour market? Justify your answer.
(30 marks)

There needs to be evidence of evaluation if a candidate is to be awarded **19 marks** or more. For this question, evaluation could be in terms of considering that the effect on employment depends on the competitiveness of the labour market. Good answers may compare the outcomes in perfectly competitive and monopsony labour markets. Evaluation can also centre on discussing the implications of the word *inevitably* in the question.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

Issues and areas for discussion include:

- how trade unions my force employers to pay higher wage rates
- the effect(s) of paying a higher wage rate may depend on the rate at which it is set
- the effect(s) depend on the wage elasticity of demand for labour and the wage elasticity of supply of labour
- the effect of the higher wage in a previously perfectly competitive labour market
- the effect of the higher wage in a monopsony labour market
- relevant comparison of different market conditions

Other equally valid points may be discussed and should be given due credit.

Also give credit for:

- an overall judgement of the issues raised
- use of diagrams
- reference to real world labour markets

USE THE LEVELS MARK SCHEME ON PAGES 4 & 5

MAXIMUM FOR PART (b) 30 MARKS

TOTAL FOR THIS QUESTION: 50 MARKS

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General Certificate of Education
January 2007
Advanced Level Examination

ASSESSMENT and QUALIFICATIONS ALLIANCE

ECONOMICS **ECN5**
Unit 5 Business Economics and the Distribution of Income

Tuesday 30 January 2007 9.00 am to 10.30 am

For this paper you must have:
- an 8-page answer book.

You may use a calculator.

Time allowed: 1 hour 30 minutes

Instructions
- Use blue or black ink or ball-point pen. Pencil should only be used for drawing.
- Write the information required on the front of your answer book. The *Examining Body* for this paper is AQA. The *Paper Reference* is ECN5.
- In **Section A**, answer **all** parts of the question.
- In **Section B**, answer **one** question.

Information
- The maximum mark for this paper is 100.
- The marks for questions are shown in brackets.
- This paper is synoptic. It assesses your understanding of the relationship between the different aspects of Economics.
- You will be marked on your ability to use good English, to organise relevant information clearly and to use specialist vocabulary where appropriate.

Advice
- You are advised to spend approximately 45 minutes on **Section A** and approximately 45 minutes on **Section B**.

SECTION A

Answer **all** parts of this question.

Total for this question: 50 marks

1 THE COMPUTER GAME MARKET

Study **Extracts A, B and C**, and then answer **all** parts of Question 1 which follows.

The computer game (or video game) market includes two main sub-markets: for hardware and for software. Sony, Nintendo and Microsoft manufacture most of the hardware, namely the machines or consoles that run the computer games. By contrast, a large number of much smaller companies (the developers) design and sometimes manufacture the software, namely the computer games that are played on the hardware. Firms in the computer game market are facing increasing competition from mobile phone games and online internet games.

Extract A: Actual and forecast worldwide sales in the computer game market, 2001-06

Extract A was a graph.
It has not been reproduced electronically due to third-party copyright constraints.

Extract B: The computer game cycle

Extract B was an extract of text.
It has not been reproduced electronically due to third-party copyright constraints.

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Extract C: Competition in the computer game market

In the boom phase of each computer game cycle, dominant firms release game systems that are incompatible with those of their rivals. At any one time, there is only room in the market for two or three successful systems.

Each manufacturer then tries to maximise its market share, hoping to reach the 'tipping point' at which its system dominates the market and forces others out. Because games developed for one system cannot be played on rival consoles, the consumer is forced into an 'all-or-nothing' decision when purchasing a new game system.

Hardware prices are deliberately kept low in order to maximise sales of consoles, so as to generate game sales. But hardware manufacturers make much of their profit from the royalties paid to them by software firms.

The only common interest that hardware manufacturers have is in the health of the whole industry, and not in each other. They have no incentive to work together because they are all fighting over the same potential user-base. One firm's gain is another firm's loss, so the drive to acquire those consumers first is all-consuming. Cartel-like behaviour is unlikely in this market structure.

Source: adapted from an article by DMITRI WILLIAMS in *The International Journal on Media Management*, Vol 4, No 1, 2002, pages 41-52

Question 1

(a) For the period 2001-06, compare the actual and forecast changes in the worldwide sales of console software and mobile phone games that are shown in **Extract A**. *(4 marks)*

(b) Explain why sales of computer game hardware and software may **not** be affected by recessions (**Extract B,** line 1). *(6 marks)*

(c) Using **Extract C,** analyse the ways in which firms compete in the market for computer game hardware. *(10 marks)*

(d) Assess whether a market where there are many manufacturers of computer game hardware would give greater benefits to consumers than the existing market where there are only three dominant producers. *(30 marks)*

Turn over for the next question

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SECTION B

Answer **one** question from this section.

Each question carries 50 marks.

2 (a) Explain the possible advantages of privatisation. *(20 marks)*

(b) In the 1990s, the UK railway industry was privatised and split into a company owning the rail track and a number of companies providing train services in different parts of the country.

Evaluate the economic case for taking privatised industries, such as the railways, back into public ownership. *(30 marks)*

3 (a) Using appropriate diagrams, explain how positive **and** negative externalities may result in market failure. *(20 marks)*

(b) Evaluate the view that government intervention to correct market failure inevitably results in government failure. *(30 marks)*

4 (a) Explain the causes of absolute **and** relative poverty in the United Kingdom. *(20 marks)*

(b) Evaluate the view that the most effective way to reduce poverty is to redistribute **both** income **and** wealth from the rich to the poor. *(30 marks)*

END OF QUESTIONS

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ASSESSMENT and QUALIFICATIONS ALLIANCE

General Certificate of Education

Economics ECN5

Unit 5 Business Economics and the Distribution of Income

Mark Scheme

2007 examination - January series

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Mark schemes are prepared by the Principal Examiner and considered, together with the relevant questions, by a panel of subject teachers. This mark scheme includes any amendments made at the standardisation meeting attended by all examiners and is the scheme which was used by them in this examination. The standardisation meeting ensures that the mark scheme covers the candidates' responses to questions and that every examiner understands and applies it in the same correct way. As preparation for the standardisation meeting each examiner analyses a number of candidates' scripts: alternative answers not already covered by the mark scheme are discussed at the meeting and legislated for. If, after this meeting, examiners encounter unusual answers which have not been discussed at the meeting they are required to refer these to the Principal Examiner.

It must be stressed that a mark scheme is a working document, in many cases further developed and expanded on the basis of candidates' reactions to a particular paper. Assumptions about future mark schemes on the basis of one year's document should be avoided; whilst the guiding principles of assessment remain constant, details will change, depending on the content of a particular examination paper.

Further copies of this Mark Scheme are available to download from the AQA Website: www.aqa.org.uk

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Dr Michael Cresswell Director General

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Advanced Level Economics

January 2007 **ECN5**

MARK SCHEME

General Instructions

Marks awarded to candidates should be in accordance with the following mark scheme and examiners should be prepared to use the full range of marks available. The mark scheme for most questions is flexible, permitting the candidate to score full marks in a variety of ways. Where the candidate's response to a question is such that the mark scheme permits full marks to be awarded, full marks **MUST** be given. A perfect answer is not necessarily required for full marks. But conversely, if the candidate's answer does not deserve credit, then no marks should be given.

Occasionally, a candidate may respond to a question in a reasonable way, but the answer may not have been anticipated when the mark scheme was devised. In this situation, **OR WHENEVER YOU HAVE ANY DOUBT ABOUT THE INTERPRETATION OF THE MARK SCHEME**, you must in the first instance telephone your team leader to discuss how to proceed.

Two approaches have been used in the construction of the mark scheme:

(i) **An 'issue' based approach.** The mark scheme for parts (a) and (b) of the data response question and part (a) of the essay questions adopts this approach. The questions do not generally require that the candidate demonstrates evaluative skills although some explanation and analysis may be expected. The mark scheme lists the marks that can be awarded for particular issues (and associated development) that the candidate might include in the answer. Marks awarded for development should take into account the Quality of Written Communication used by candidates as indicated on page 5 of this mark scheme.

(ii) **A 'levels' approach.** This approach is used for parts (c) and (d) of the data response question and part (b) of the essay questions. The mark scheme summarises the information required to answer the question, but without attaching marks to particular issues. Marks should be awarded according to whether the answer displays the skills indicated by the five Mark Band Descriptors or "Levels of Skill" included in the mark scheme. The Mark Band Descriptors are set out on page 4. When using a 'levels' mark scheme the marker must identify where a particular skill is being demonstrated. The **key** to be used to identify the skill is also shown on page 5. The level chosen should be the one which **best fits** the answer provided by the candidate. It is not intended that the answer should satisfy every statement in the level description.

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APPLYING THE 'LEVELS' MARK SCHEME
Levels of Response Mark Band Descriptors

Level 1:
Few, if any, relevant issues recognised. Economic concepts and principles are not adequately understood or applied to the question and its context. No satisfactory analysis or evaluation. Little, if any, appreciation of the inter-relatedness of economic issues, problems and institutions. A poorly organised response which generally fails to answer the question. Descriptions and explanations lack clarity. Spelling, punctuation and grammar are likely to be poor. There is very little use of specialist vocabulary. **0 to 6 marks** *(Mid-Point: 3 marks)*

Level 2:
A few issues are recognised but there is only limited evidence of the candidate's ability to apply relevant economic concepts. An attempt is made to answer the question but there is little satisfactory analysis or evaluation. Some very limited appreciation of the inter-relatedness of economic issues, problems and institutions. A poorly organised answer which does not have a clear structure. Descriptions and explanations are sometimes hard to follow. The candidate demonstrates some ability to spell commonly used words and to follow the standard conventions of punctuation and grammar. Some use of specialist vocabulary is made but this is not always applied appropriately.**7 to 12 marks** *(Mid-Point: 10 marks)*

Level 3:
A few issues recognised. The candidate has attempted to apply relevant economic concepts and ideas to the question and its context. A reasonable understanding of some concepts and theories is demonstrated. However, the evaluation of issues, arguments and evidence is limited and superficial. Some understanding of the inter-relatedness of economic issues, problems and institutions. There is some logic and coherence in the organisation of the answer. The candidate is generally able to spell commonly used words usually follows the standard conventions of punctuation and grammar. Some descriptions and explanations are easy to understand but the answer may not be expressed clearly throughout. Some use of specialist vocabulary which is applied appropriately.**13 to 20 marks** *(Mid-Point: 17 marks)*

Level 4:
Several relevant issues identified. Good understanding of some economic concepts and principles is demonstrated. The candidate is able to apply these concepts and principles to the context to help answer the question. There is some appreciation of alternative points of view. Satisfactory use is made of evidence and/or theoretical analysis to evaluate the issues and arguments identified. Good understanding of the inter-relatedness of economic issues, problems and institutions is demonstrated Shows the ability to think as an economist making effective use of the economist's 'tool kit' of concepts, theories and techniques. Spelling is generally accurate and the standard conventions of punctuation and grammar are usually followed. The answer is well organised. Descriptions and explanations are usually clearly expressed. A wide range of specialist vocabulary which is used with facility. **21 to 26 marks** *(Mid-Point: 24 marks)*

Level 5:
Several relevant issues identified. Good understanding of economic concepts and principles demonstrated throughout. The candidate is able to apply these concepts and principles to the context to help answer the question. There is an appreciation of alternative points of view. Good use is made of evidence and/or theoretical analysis to evaluate the issues and arguments identified. The candidate demonstrates the ability to synthesise the arguments presented and come to a reasonable conclusion albeit tentative. A clear understanding of the inter-relatedness of economic issues, problems and institutions is demonstrated Shows the ability to think as an economist making very effective use of the economist's 'tool kit' of concepts, theories and techniques. Spelling is accurate and the standard conventions of punctuation and grammar are followed. The answer is well organised. Descriptions and explanations are expressed with clarity throughout. Extensive use of specialist vocabulary which is applied adeptly and with precision. **27 to 30 marks** *(Mid-Point: 29 marks)*

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THE KEY TO BE USED WHEN USING THE 'LEVELS' MARK SCHEME

D Where a particular economic term is correctly **DEFINED** in order to help the candidate to answer the question properly.

I Where a relevant **ISSUE** is raised by the candidate.

K Where the candidate demonstrates **KNOWLEDGE** of recent developments or features of the economy which help enhance the candidate's response to the question. This should also be used where the candidate quotes relevant examples.

Ap Where the candidate demonstrates the ability to **APPLY** knowledge and **CRITICAL UNDERSTANDING** to problems and issues.

A Where the candidate demonstrates the ability to **ANALYSE** the problem using appropriate economic ideas.

E Where the candidate **EVALUATES** and makes judgements about the significance of various issues and arguments.

QUALITY OF WRITTEN COMMUNICATION

The Mark Band Descriptors, which are used for assessing Question 1 (d) and part (b) of the essay questions, incorporate statements which relate to the Quality of Written Communication used by the candidates.

However, it is also important to assess Quality of Written Communication whenever candidates produce answers using continuous prose. When applying an issue based mark scheme, examiners must take into account the following when deciding how many marks to award for development:

(i) use of appropriate format and style of writing to organise relevant information clearly and coherently;
(ii) use of specialist vocabulary, where appropriate;
(iii) legibility of handwriting;
(iv) accuracy of spelling, punctuation and grammar.

Synoptic Assessment

All questions in this unit are synoptic. Therefore candidates will need to demonstrate that they are able to think as an economist and to use effectively the economist's 'tool kit' of concepts, theories and techniques.

They should demonstrate that they:

- understand the inter-relatedness of many economic issues, problems and institutions;
- understand how certain economic concepts, theories and techniques may be relevant to a range of different contexts
- can apply concepts, theories and techniques in analysing economic issues and problems and in evaluating arguments and evidence.

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Section A

1 **Total for this question: 50 marks**

1(a) For the period 2001- 06, compare the actual and forecast changes in the worldwide sales of console software and mobile phone games that are shown in **Extract A**. *(4 marks)*

The expected answer is a comparison of sales of console software and mobile phone games over the whole period 2001-2006, or over selected years in the period. However some candidates may interpret the question slightly differently, as asking for a comparison of actual sales (in 2001) with forecast sales (2002-2006) for both goods. Both approaches can earn full marks, provided both goods are compared, and there is sufficient development of points of comparison.

Award up to 2 marks each for each valid point made (one mark for identification and one mark for supporting reference(s) to the data):

The changes include:

- Actual sales of mobile phone games were zero in 2001 whilst console software sales were just under $10 billion
- Console software sales were forecast to fall over the period whilst mobile phone games were forecast to rise over the period
- Despite the overall forecast fall, console software sales were forecast to rise in 2002 (i.e. there was expected to be some volatility in sales, but there was a forecast continuous rise in sales of mobile phone games (i.e. no volatility)
- Actual and forecast sales of mobile phone games were below those of console software throughout the period
- The forecasted gap narrowed over the period between sales of the two goods

A maximum of **2 marks** if there is no use of statistics or if a candidate confines the comparison to just one indicator.

If the candidate simply trawls through the data, award a maximum of **2 marks**.

A maximum of **3 marks** may be awarded where there is evidence of an overview having been taken, even though parts of the answer give an impression of a trawl through the data.

MAXIMUM FOR PART (a) 4 MARKS

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1 (b) Explain why sales of computer game hardware and software may **not** be affected by recessions (**Extract B**, line 1). *(6 marks)*

Possible reasons include:

- The power of a new product cycle;
- There have been no recessions in recent years, merely a slow down in rates of growth;
- Recent recessions have been short and mild;
- Recession in particular activities or regions have been offset by growth elsewhere in the economy;
- Computer games may have zero or negative income elasticities of demand, in the latter case being an inferior good;
- Income elasticity of demand may be close to zero because computer games are addictive;
- The effect of children joining the market at the same time that a generation of adult game players emerges;
- Children may not be affected by recessions;
- Unemployment increases the quantity of leisure time available for playing games.

For candidates who:

- define a recession **1 mark**
- state a reason why sales of computer game hardware and/or software may not be affected by recessions: **1 mark**
- explain the reason: **Up to a further 4 marks**

Two possible reasons must be stated/explained for full marks, unless the candidate takes issue with the question and argues plausibly that sales may be affected by recession, for which point up to 2 marks can be awarded.

MAXIMUM FOR PART (b) 6 MARKS

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1 (c) Using **Extract C**, analyse the ways in which firms compete in the market for computer game hardware. *(10 marks)*

Extract C mentions or implies a number of different forms of "competition". Some of these are actually anti-competitive in the sense that they actually reduce competition, though candidates should not be penalised for failing to recognise this. Candidates may also analyse methods of competition (such as advertising and through establishing a brand image) that are not mentioned in Extract C. However, if the answer lacks any implicit or explicit reference to Extract C, Levels 2 and 3 cannot be reached. The Extract mentions the concept of a "tipping point". Although good answers may show an understanding of tipping points, the concept is not in the specification, so full marks can be earned without this technical term. An answer that analyses competition in the computer game *software* market (rather than the *hardware* market) should be restricted to a maximum of 7 marks. The use of relevant and accurate diagrams should be rewarded.

Issues and areas for analysis include:

- Ways (or methods) in which firms may compete
- Price competition
- Non-price competition
- Establishing barriers to entry.
- Relevant use of game theory or a theoretical model of oligopoly
- The impact of the development of new technology
- Particular games can only be played on one make of console
- Exploiting the complementary good (joint demand) relationship
- Relating competition to firms' objectives such as maximising profit or market share

LEVEL 1
At the bottom of the range, the candidate who does not attempt any analysis. At the top of the range, the candidate who makes a very basic analysis of one method of competition, whether or not there is any reference to Extract C. **1 to 3 marks**

LEVEL 2
At the bottom of the range, the candidate who develops the analysis of one method of competition, or who makes a very basic analysis of two or more methods of competition, and makes some use of the Extract. At the top of the range, the candidate analyses in some depth two or more reasons, with few mistakes. **4 to 7 marks**

LEVEL 3
At the bottom of the range, the candidate who provides good analysis of two or more forms of competition, but the answer is somewhat narrow and is not fully related to the computer game market. At the top of the range, the candidate provides a confident and full analysis of two or more forms of competition, with good use of the information in the Extract. The answer shows a very sound understanding of forms of competition in the computer game market. **8 to 10 marks**

MAXIMUM FOR PART (c) 10 MARKS

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1 (d) Assess whether a market where there are many manufacturers of computer game hardware would give greater benefits to consumers than the existing market where there are only three dominant producers. *(30 marks)*

Extracts B and C indicate that the computer game *hardware* market is a competitive oligopoly, dominated by 3 or 4 firms. The preamble to the Extracts states that a large number of small firms already design and develop the software (computer games). In this part of the market, the issue is not the number of firms, but their relationship with the console manufacturers who might be exercising market power at the expense of the developers. Discussion of this issue should be rewarded, but since the question refers only to *hardware* manufacturers, full marks can be earned by answers which don't address this issue.

Explanation/analysis is needed to reach Level 3, and some evaluation, building on the analysis, is required to score **19 marks or more**.

Candidates may evaluate by: arguing that a larger number of firms could lead to more choice and lower prices, but this could be countered by losing the benefits of economies of scale and dynamic efficiency; by considering whether, in this market, efficiency and welfare gains resulting from greater competition justify reduced concentration and/or break up of monopoly power.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

Issues and areas for discussion include:

- The computer game *hardware* market as a competitive oligopoly
- Relevant application of oligopoly and/or monopoly theory
- Different possible approaches to the problem of monopoly and monopoly power
- Justifications of large size and lack of competition, such as economies of scale and dynamic efficiency arguments
- The benefits of competition
- Producer sovereignty versus consumer sovereignty arguments
- Relevant use of other efficiency concepts e.g. productive and allocative efficiency
- Policy ineffectiveness resulting from the fact that the hardware manufacturers are overseas companies

Also give credit for:

- relevant use of data and/or candidate's knowledge
- relevant use of evidence
- overall assessment

USE THE LEVELS MARK SCHEME ON PAGES 4 & 5

MAXIMUM FOR PART (d) 30 MARKS

TOTAL FOR THIS QUESTION: 50 MARKS

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Section B

2 **Total for this question: 50 marks**

2 (a) Explain the possible advantages of privatisation. *(20 marks)*

The advantages of privatisation include:

- revenue raising;
- reducing government borrowing;
- promoting competition;
- reducing monopoly abuse;
- promoting efficiency;
- creating an enterprise culture;.

For candidates who:

provide a basic definition of privatisation: **1 mark**

develop the definition e.g. in terms of sale of assets, contractualisation etc.: **Up to 3 further marks**

provide an example of privatisation (excluding rail privatisation):
1 mark for each example, up to a maximum of two marks

Maximum of 4 marks for definition and a maximum of 2 marks for examples

identify an advantage of privatisation: **1 mark**
explain the advantage: **Up to a further 4 marks**

provide relevant examples of the advantage: **1 mark per example, up to a maximum of 2 marks**

MAXIMUM FOR PART (a) 20 MARKS

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2 (b) In the 1990s, the UK railway industry was privatised and split into a company owning the rail track and a number of companies providing train services in different parts of the country.

Evaluate the economic case for taking privatised industries, such as the railways, back into public ownership. *(30 marks)*

Explanation/analysis is needed to reach Level 3, and some evaluation, building on the analysis, is required to score **19 marks or more**. The privatisation of the UK railway industry acts as a prompt for candidates, but the words *'such as'* in the question mean that candidates can discuss conditions in other previously state-owned, and later privatised, industries and then earn high marks provided they evaluate the issues that focus on whether the industries should revert to public ownership.

The candidate could evaluate by: arguing, with evidence, that some privatisations have been successful but others have been unsuccessful; by considering the extent to which state-owned industries are efficient and promote the public interest in other countries e.g. French railways; by arguing that even if there is a case for renationalisation, it might be too costly and difficult to organise.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

Issues and areas for discussion include:

- The advantages of privatisation (perhaps drawing on the earlier answer to part (a))
- The disadvantages of privatisation
- Arguments in favour of public ownership (e.g. controlling the commanding heights of the economy, long-termism rather than short-termism etc.)
- Ways in which the performance of industries or firms improved following privatisation
- Ways in which the performance of industries or firms deteriorated following privatisation
- Economic efficiency arguments
- Economic welfare arguments
- Distribution arguments
- Government failure and market failure issues

Also give credit for:

- relevant use of the candidate's knowledge
- relevant use of evidence
- overall assessment

USE THE LEVELS MARK SCHEME ON PAGES 4 & 5

MAXIMUM FOR PART (b) 30 MARKS

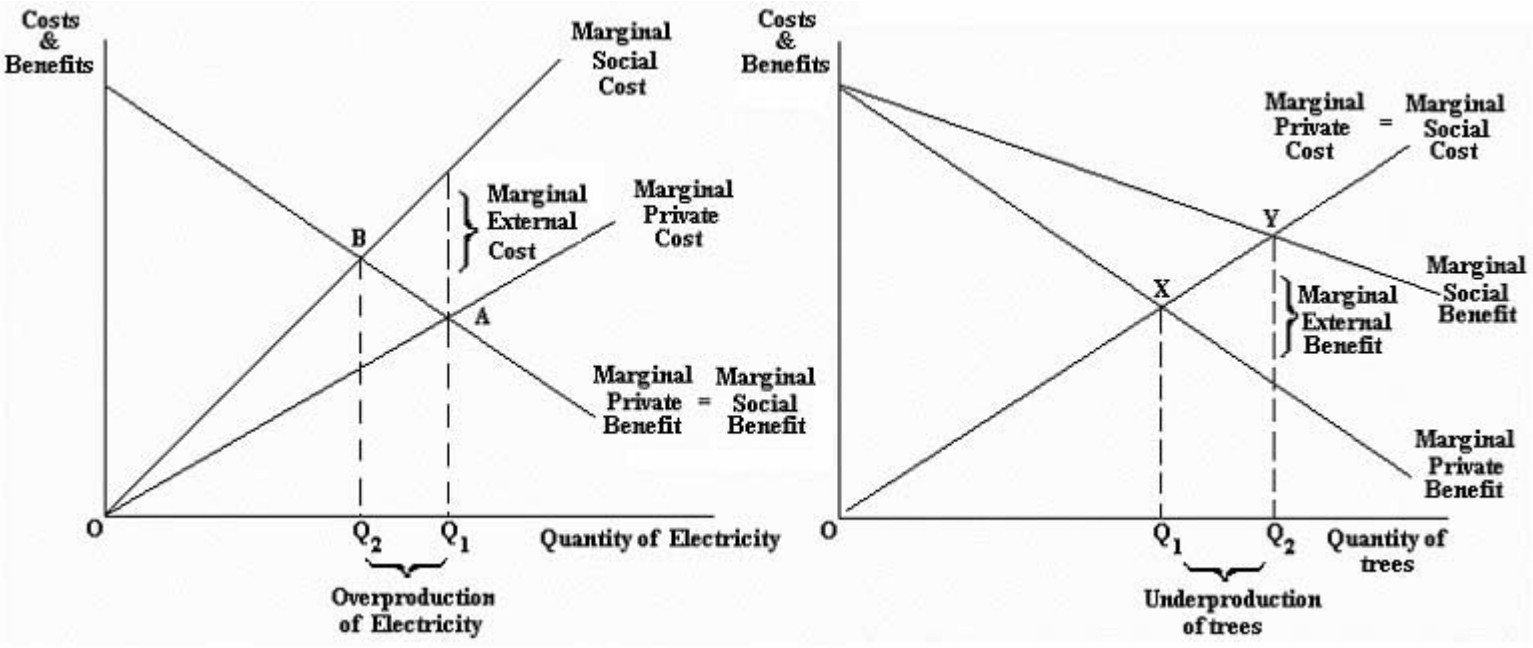
TOTAL FOR THIS QUESTION: 50 MARKS

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3 **Total for this question: 50 marks**

3 (a)	Using appropriate diagrams, explain how positive **and** negative externalities may result in market failure. *(20 marks)*

The most likely diagrams candidates will use are variations of:



(i) The generation of negative externalities **(ii) The generation of external benefits**

For candidates who:

define market failure:	**up to 3 marks**
define a negative externality:	**up to 3 marks**
define a positive externality:	**up to 3 marks**
provide examples of externalities:	**1 mark per example**

Maximum of 6 marks in total for definitions and examples

explain how a positive or a negative externality leads to market failure:	**Up to 7 marks**
develop the explanation to cover the opposite type of externality:	**Up to 3 marks**
draw an appropriate diagram to show a positive or a negative externality: (up to 2 marks for location of curves; up to 2 marks for correct labelling)	**Up to 4 marks**

Maximum of 8 marks for diagrams
Maximum of 14 marks if there is no appropriate diagram
Maximum of 12 marks if the explanation is restricted to negative externalities or positive externalities

MAXIMUM FOR PART (a) 20 MARKS

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3 (b) Evaluate the view that government intervention to correct market failure inevitably results in government failure. (*30 marks)*

Explanation/analysis is needed to reach Level 3, and some evaluation, building on the analysis, is required to score **19 marks or more**.

The candidate could evaluate by: discussing the implications of the word *'inevitably'* in the question; arguing that different conclusions can be reached for trivial and less trivial examples of market failure; arguing that even when market failure occurs, markets nevertheless function better when not subject to government intervention.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

Issues and areas for discussion include:

- The different types and examples of market failure
- Types of government intervention
- How intervention may correct or reduce market failure
- The meaning of government failure
- How attempts to correct market failure may cause government failure
- Distinction between different outcomes
- Application of efficiency and welfare criteria

Also give credit for:

- relevant use of the candidate's knowledge
- relevant use of evidence
- overall assessment

USE THE LEVELS MARK SCHEME ON PAGES 4 & 5

MAXIMUM FOR PART (b) 30 MARKS

TOTAL FOR THIS QUESTION: 50 MARKS

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4 **Total for this question: 50 marks**

4 (a) Explain the causes of absolute **and** relative poverty in the United Kingdom. (*20 marks)*

As the specification requires candidates to understand the difference between relative and absolute poverty, the causes of both must be explained for an answer to earn full marks. However, answers are likely to focus on relative poverty as absolute poverty is not significant in the UK. Absolute poverty occurs when income is below a critical level that enables people to consume essential goods. By contrast, a household suffers relative poverty if its income is below a specified proportion of average income for all households (e.g. less than a third of average income). Four of the main causes of relative poverty in the UK are old age, unemployment, the effects of the tax and benefits systems on those in work, and low wages for those in work. By contrast, the people who are affected by absolute poverty have fallen through the state safety net, failing, for whatever reason, to claim state welfare benefits.

For candidates who:

provide a very basic definition of absolute poverty: **1 mark**
develop the definition: **up to a further 3 marks**

provide a very basic definition of relative poverty: **1 mark**
develop the definition: **up to a further 3 marks**

Maximum of 6 marks for definitions

state a cause of absolute poverty: **1 mark**
explain the identified cause: **Up to a further 3 marks per cause**

state a cause of relative poverty: **1 mark**
explain the identified cause: **Up to a further 3 marks per cause**

explain any other relevant point e.g. the difference between poverty in the UK and poverty in many developing countries; the use of evidence: **2 marks per point up to a maximum of 6 marks for extra points**

Maximum of 12 marks for an answer that does not consider the causes of both relative and absolute poverty

MAXIMUM FOR PART (a) 20 MARKS

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4 (b) Evaluate the view that the most effective way to reduce poverty is to redistribute **both** income **and** wealth from the rich to the poor. (*30 marks)*

Relative poverty can be reduced by using progressive taxation and welfare benefits or transfers to reduce inequalities in the distribution of income. However, if in the drive to reduce inequality, these changes worsen labour market incentives, competitiveness and economic growth, causing the economy to stagnate or to decline, more people may end up *absolutely* poor even though *relative* poverty is successfully reduced. People on low incomes may end up receiving a larger share of a shrinking cake. Reward answers that argue the converse, namely that the best way to reduce absolute poverty is to use pro-free market supply side policies that simultaneously increase relative poverty.

Explanation/analysis is needed to reach Level 3, and some evaluation, building on the analysis, is required to score **19 marks or more**.

The candidate could evaluate by: arguing that it is true by definition that redistribution reduces *relative* poverty, but it does not follow that absolute poverty must also fall; showing awareness of the possibility that different arguments may be relevant for income and wealth; discussing trade-offs occurring over time.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

Issues and areas for discussion include:

- Understanding of the difference between income and wealth, and of the linkages between the two
- How policies that redistribute income may reduce poverty
- How policies that redistribute wealth may reduce poverty
- The different effects of redistribution on relative and absolute poverty
- Consideration of alternative policies e.g. policies to promote economic growth and full employment
- Efficiency arguments
- Effect of policies on incentives and disincentives

Also give credit for:

- relevant use of the candidate's knowledge
- relevant use of evidence
- overall assessment

USE THE LEVELS MARK SCHEME ON PAGES 4 & 5

MAXIMUM FOR PART (b) 30 MARKS

TOTAL FOR THIS QUESTION: 50 MARKS

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General Certificate of Education
June 2006
Advanced Level Examination

ASSESSMENT and QUALIFICATIONS ALLIANCE

ECONOMICS **ECN5**
Unit 5 Business Economics and the Distribution of Income

Monday 26 June 2006 1.30 pm to 3.00 pm

For this paper you must have:
- an 8-page answer book

You may use a calculator.

Time allowed: 1 hour 30 minutes

Instructions
- Use blue or black ink or ball-point pen. Pencil should only be used for drawing.
- Write the information required on the front of your answer book. The *Examining Body* for this paper is AQA. The *Paper Reference* is ECN5.
- In **Section A**, answer **all** parts of the question.
- In **Section B**, answer **one** question.

Information
- The maximum mark for this paper is 100.
- The marks for questions are shown in brackets.
- This paper is synoptic. It assesses your understanding of the relationship between the different aspects of Economics.
- You are reminded of the need for good English and clear presentation in your answers. All questions should be answered in continuous prose. Quality of Written Communication will be assessed in all answers.

Advice
- You are advised to spend approximately 45 minutes on **Section A** and approximately 45 minutes on **Section B**.

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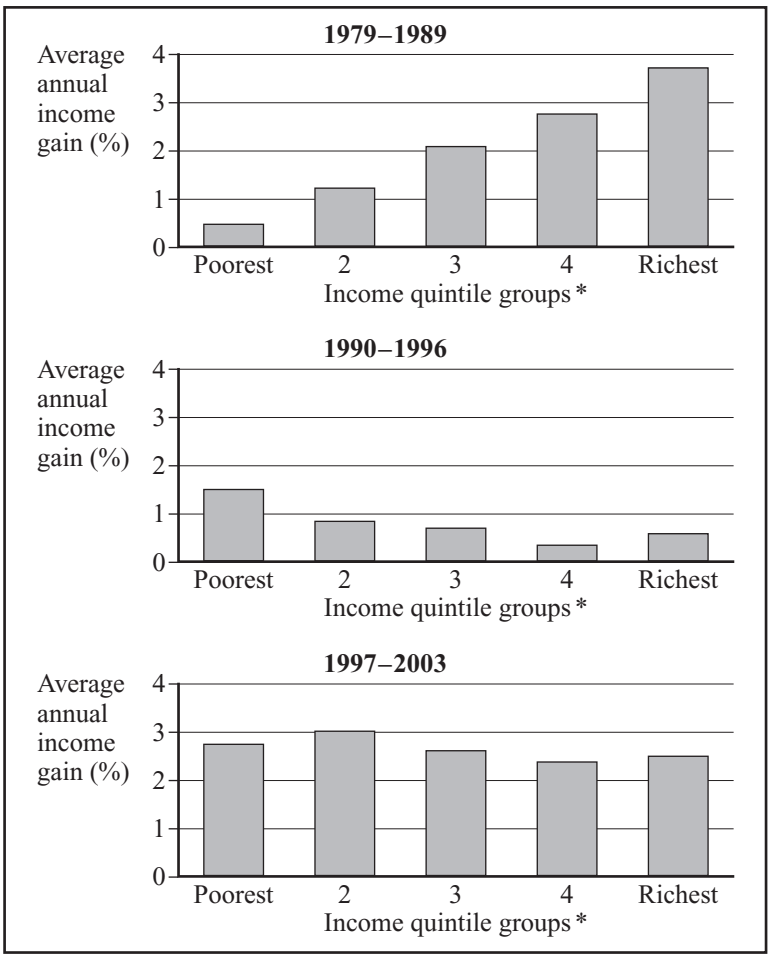
SECTION A

Answer **all** parts of this question.

Total for this question: 50 marks

1 Study **Extracts A, B and C**, and then answer **all** parts of Question 1 which follows.

Extract A: Real income growth of UK household groups, 1979-2003



* Extract A divides households into five equal-sized groups known as quintile groups. The bottom quintile group consists of the poorest 20 per cent of households and the top quintile group consists of the richest 20 per cent of households.

Source: adapted from BREWER, GOODMAN ET AL, *Poverty and inequality in Britain*, The Institute for Fiscal Studies, March 2004

Extract B: Changes in income inequality

In the 1980s, growing income inequality was partly caused by changes taking place in labour markets. A growing gap emerged between the fortunes of those who had jobs and those who did not. In the 1990s, falling unemployment and labour inactivity rates caused the growth in income inequality to slow. Since 1992, employment growth in a continuously growing UK economy has halted the increase in the number of workless households.

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Tax and benefit policy has also had an effect, increasing inequality in the 1980s, but halting its growth in the late 1990s. In the 1980s, reductions in top rates of income tax, increases in indirect taxes and the freezing of a number of welfare benefits, all contributed to rising inequality. The redistributive policies of Labour governments since the late 1990s have had the opposite effect, slowing what would otherwise have been a much bigger growth in income inequality.

Source: adapted from GOODMAN and OLDFIELD, *Permanent differences? Income and expenditure inequality in the 1990s and 2000s*, The Institute for Fiscal Studies, June 2004

Extract C: Rich nations wary about taking more from the wealthy

The UK government is reluctant to increase income tax rates for high earners because this would buck an international trend. Governments in most of the world's industrialised countries have cut their top tax rates because of worries about the disincentives they create.

High marginal income tax rates affect people's work effort, and this can reduce the total amount of tax people pay. But not everyone accepts that higher marginal tax rates reduce work incentives for high earners. Recent US tax cuts have so far reduced, rather than increased, the share of tax revenues from high earners.

Supporters of higher taxes argue that high earners have done exceptionally well from the tax system over recent decades. The income of the UK's top 1 per cent has grown much faster than that of other groups, and the group's share of national income now stands at a level not seen since the 1950s. The 500 000 people in this group have incomes, after tax, of more than £82 000 a year.

Source: adapted from an article by VANESSA HOULDER in the *Financial Times*, 21 January 2005

Question 1

(a) Using **Extract A**, briefly compare the real income growth of the poorest and richest households for the periods 1979–1989 and 1997–2003. *(4 marks)*

(b) Explain why changes in unemployment and labour inactivity rates caused the growth of income inequality in the UK to slow in the 1990s. *(6 marks)*

(c) 'High marginal income tax rates affect people's work effort, and this can reduce the total amount of tax people pay' (**Extract C**, lines 5 and 6). Analyse how an increase in income tax rates can affect total tax revenue. *(10 marks)*

(d) Using the data and your economic knowledge, evaluate the view that the benefits resulting from a more equal distribution of income exceed the costs. *(30 marks)*

Turn over for the next question

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SECTION B

Answer **one** question from this section.

Each question carries 50 marks.

2 (a) With the use of examples, explain the various ways in which a business may grow in size. *(20 marks)*

(b) Evaluate the view that the economic advantages resulting from the growth of firms always exceed the disadvantages. *(30 marks)*

3 (a) Explain the functions of profit in an economy. *(20 marks)*

(b) The Office of Water Regulation (OFWAT) regulates the prices charged by companies in the water industry. Do you think that prices charged by all firms in an economy should be regulated by government agencies? Justify your answer. *(30 marks)*

4 (a) Explain the various causes of environmental market failure. *(20 marks)*

(b) 'Intervention by the state to correct an environmental market failure inevitably leads to government failure.' Evaluate this view. *(30 marks)*

END OF QUESTIONS

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ASSESSMENT and QUALIFICATIONS ALLIANCE

General Certificate of Education

Economics 6141

ECN5 Business Economics and the Distribution of Income

Mark Scheme

2006 examination - June series

Mark schemes are prepared by the Principal Examiner and considered, together with the relevant questions, by a panel of subject teachers. This mark scheme includes any amendments made at the standardisation meeting attended by all examiners and is the scheme which was used by them in this examination. The standardisation meeting ensures that the mark scheme covers the candidates' responses to questions and that every examiner understands and applies it in the same correct way. As preparation for the standardisation meeting each examiner analyses a number of candidates' scripts: alternative answers not already covered by the mark scheme are discussed at the meeting and legislated for. If, after this meeting, examiners encounter unusual answers which have not been discussed at the meeting they are required to refer these to the Principal Examiner

It must be stressed that a mark scheme is a working document, in many cases further developed and expanded on the basis of candidates' reactions to a particular paper. Assumptions about future mark schemes on the basis of one year's document should be avoided; whilst the guiding principles of assessment remain constant, details will change, depending on the content of a particular examination paper.

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Advanced Level Economics

June 2006 **ECN5**

Mark Scheme

General Instructions

Marks awarded to candidates should be in accordance with the following mark scheme and examiners should be prepared to use the full range of marks available. The mark scheme for most questions is flexible, permitting the candidate to score full marks in a variety of ways. Where the candidate's response to a question is such that the mark scheme permits full marks to be awarded, full marks **MUST** be given. A perfect answer is not necessarily required for full marks. But conversely, if the candidate's answer does not deserve credit, then no marks should be given.

Occasionally, a candidate may respond to a question in a reasonable way, but the answer may not have been anticipated when the mark scheme was devised. In this situation, **OR WHENEVER YOU HAVE ANY DOUBT ABOUT THE INTERPRETATION OF THE MARK SCHEME**, you must in the first instance telephone your team leader to discuss how to proceed.

Two approaches have been used in the construction of the mark scheme:

(i) **An 'issue' based approach.** The mark scheme for parts (a) and (b) of the data response question and part (a) of the essay questions adopts this approach. The questions do not generally require that the candidate demonstrates evaluative skills although some explanation and analysis may be expected. The mark scheme lists the marks that can be awarded for particular issues (and associated development) that the candidate might include in the answer. Marks awarded for development should take into account the Quality of Written Communication used by candidates as indicated on page 4 of this mark scheme.

(ii) **A 'levels' approach.** This approach is used for parts (c) and (d) of the data response question and part (b) of the essay questions. The mark scheme summarises the information required to answer the question, but without attaching marks to particular issues. Marks should be awarded according to whether the answer displays the skills indicated by the five Mark Band Descriptors or "Levels of Skill" included in the mark scheme. The Mark Band Descriptors are set out on page 3. When using a 'levels' mark scheme the marker **must** identify where a particular skill is being demonstrated. The **key** to be used to identify the skill is shown on page 4. The level chosen should be the one which **best fits** the answer provided by the candidate. It is **not** intended that the answer should satisfy every statement in the level description.

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APPLYING THE 'LEVELS' MARK SCHEME

Levels of Response Mark Band Descriptors

Level 1
Few, if any, relevant issues are recognised. Economic concepts and principles are not adequately understood or applied to the question and its context. No satisfactory analysis or evaluation. Little, if any, appreciation of the inter-relatedness of economic issues, problems and institutions. A poorly organised response which generally fails to answer the question. Descriptions and explanations lack clarity. Spelling, punctuation and grammar may be poor. There is little use of specialist vocabulary.
0 to 6 marks (*Mid-Point: 3 marks)*

Level 2
A few issues are recognised but there is only limited evidence of the candidate's ability to apply relevant economic concepts. An attempt is made to answer the question but there is little satisfactory analysis or evaluation. Some very limited appreciation of the inter-relatedness of economic issues, problems and institutions. A poorly organised answer which does not have a clear structure. Descriptions and explanations are sometimes hard to follow. The candidate demonstrates some ability to spell commonly used words and to follow the standard conventions of punctuation and grammar. Some use of specialist vocabulary is made but this is not always applied appropriately.
7 to 12 marks *(Mid-Point: 10 marks)*

Level 3
A few issues are recognised. The candidate has attempted to apply relevant economic concepts and ideas to the question and its context. A reasonable understanding of some concepts and theories is demonstrated. However, the evaluation of the issues, arguments and evidence is limited or superficial. Some understanding of the inter-relatedness of economic issues, problems and institutions. There is some logic and coherence in the organisation of the answer. The candidate is generally able to spell commonly used words and usually follows the standard conventions of punctuation and grammar. Some descriptions and explanations are easy to understand but the answer may not be expressed clearly throughout. Some use of specialist vocabulary which is applied appropriately.
13 to 20 marks *(Mid-Point: 17 marks)*

Level 4
Several relevant issues are identified. Good understanding of some economic concepts and principles is demonstrated. The candidate is able to apply these concepts and principles to the context to help answer the question. There is some appreciation of alternative points of view. Satisfactory use is made of evidence and/or theoretical analysis to evaluate the issues and arguments identified. Good understanding of the inter-relatedness of economic issues, problems and institutions is demonstrated. Shows the ability to think as an economist making effective use of the economist's 'tool kit' of concepts, theories and techniques. Spelling is generally accurate and the standard conventions of punctuation and grammar are usually followed. The answer is well organised. Descriptions and explanations are usually clearly expressed. A wide range of specialist vocabulary is used with facility. **21 to 26 marks** *(Mid-Point: 24 marks)*

Level 5
Several relevant issues are identified. Good understanding of economic concepts and principles is demonstrated throughout. The candidate is able to apply these concepts and principles to the context to help answer the question. There is an appreciation of alternative points of view. Good use is made of evidence and/or theoretical analysis to evaluate the issues and arguments identified. The candidate demonstrates the ability to synthesise the arguments presented and come to a reasonable conclusion albeit tentative. A clear understanding of the inter-relatedness of economic issues, problems and institutions is demonstrated. Shows the ability to think as an economist making very effective use of the economist's 'tool kit' of concepts, theories and techniques. Spelling is accurate and the standard conventions of punctuation and grammar are followed. The answer is well organised. Descriptions and explanations are expressed with clarity throughout. Extensive use of specialist vocabulary which is applied adeptly and with precision. **27 to 30 marks** *(Mid-Point: 29 marks)*

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THE KEY TO BE USED WHEN USING THE 'LEVELS' MARK SCHEME

D Where a particular economic term is correctly **DEFINED** in order to help the candidate to answer the question properly.

I Where a relevant **ISSUE** is raised by the candidate.

K Where the candidate demonstrates **KNOWLEDGE** of recent developments or features of the economy which help enhance the candidate's response to the question. This should also be used where the candidate quotes relevant examples.

Ap Where the candidate demonstrates the ability to **APPLY** knowledge and **CRITICAL UNDERSTANDING** to problems and issues.

A Where the candidate demonstrates the ability to **ANALYSE** the problem using appropriate economic ideas.

E Where the candidate **EVALUATES** and makes judgements about the significance of various issues and arguments.

QUALITY OF WRITTEN COMMUNICATION

The Mark Band Descriptors, which are used for assessing Question 1 (d) and part (b) of the essay questions, incorporate statements which relate to the Quality of Written Communication used by the candidates.

However, it is also important to assess Quality of Written Communication **whenever** candidates produce answers using continuous prose. When applying an issue based mark scheme, examiners must take into account the following when deciding how many marks to award for development:

(i) use of an appropriate form and style of writing to organise relevant information clearly and coherently;
(ii) use of specialist vocabulary, where appropriate;
(iii) legibility of handwriting;
(iv) accuracy of spelling, punctuation and grammar.

Synoptic Assessment

All questions in this unit are synoptic. Therefore, candidates will need to demonstrate that they are able to think as an economist and to use effectively the economist's 'tool kit' of concepts, theories and techniques.

They should demonstrate that they:

- understand the inter-relatedness of many economic issues, problems and institutions;
- understand how certain economic concepts, theories and techniques may be relevant to a range of different contexts;
- can apply concepts, theories and techniques in analysing economic issues and problems and in evaluating arguments and evidence.

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SECTION A

1 **Total for this question: *50 marks***

1 (a) Using **Extract A**, briefly compare the real income growth of the poorest and richest households for the periods 1979-1989 and 1997-2003. *(4 marks)*

Candidates may compare the poorest and richest income groups (quintiles) over the period of the data, or the bottom two (representing the poorest) and the top two (representing the richest). Whichever approach is used, to earn all four marks, reference must be made to both the periods specified in the question, 1979-89 and 1997-2003.

Award one mark for each valid point made and one mark for the supporting reference to the data. Points might include:

- the percentage income increase of the richest groups was greatest from 1979 to 1989
- the percentage income increase of the poorest groups was greatest in the later period
- the absolute increase in the income of the top quintile was greater than that of the bottom quintiles in both periods (because of the top quintile group's much higher initial level of income).

A maximum of **1 mark** may be awarded if the candidate simply trawls through the data, with no attempt at comparison, or if only one time period is referred to**.**

A maximum of **2 marks** may be awarded if no use is made of statistics**.**

A maximum of **3 marks** may be awarded where there is evidence of an overview having been taken, even though parts of the answer give an impression of a trawl through the data.

MAXIMUM FOR PART (a) 4 MARKS

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1 (b) Explain why changes in unemployment and labour inactivity rates caused the growth of income inequality in the UK to slow in the 1990s. *(6 marks)*

Note: the data states that the growth of income inequality slowed, rather than income inequalities were reduced. This is because high incomes were (are) rising by larger absolute amounts than low incomes. Candidates can earn full marks without recognising this fact, but the mark scheme allows a mark to be earned for the recognition, and a further mark for explanation or evidence.

For candidates who:

define unemployment:	**1 mark**
define labour inactivity:	**1 mark**
explain the meaning of income inequality:	**1 mark**
note that **both** unemployment **and** labour inactivity rates fell in the 1990s:	**1 mark**

Maximum of 2 marks for the above points.

For candidates who:

explain how falling unemployment caused the rate of growth of income inequality to slow:	**up to 3 marks**
explain how falling labour inactivity rates caused the rate of growth of income inequality to slow:	**up to 3 marks**

MAXIMUM FOR PART (b) 6 MARKS

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1 (c) 'High marginal income tax rates affect people's work effort, and this can reduce the total amount of tax people pay' (**Extract C**, lines 5 and 6). Analyse how an increase in income tax rates can affect total tax revenue. *(10 marks)*

Issues and areas for discussion and explanation include:

- Explanation of high income tax rates affect marginal and average tax rates;
- Explanation of the meaning of labour market incentives;
- How higher income tax rates affect labour market incentives and disincentives;
- How this affects the amount of labour time workers are prepared to supply;
- How this affects total tax revenue;
- Comparing the effect of upward-sloping and backward-bending supply curves of labour;
- Laffer curve analysis;
- Discussion of different labour markets.
- Tax avoidance/evasion;
- 'Brain drain' and effect on international mobility of labour,
- Relevant macroeconomic analysis e.g. the effect on aggregate demand; negative multiplier effects; effect on unemployment.

LEVEL 1
At the bottom of the range, no understanding of the effect of income tax rates on the economy. At the top of the range, some understanding but no relevant application to how they affect total tax paid.
1 to 3 marks

LEVEL 2
At the bottom of the range, some relevant application of how high tax rates may affect total tax paid, but the analysis lacks rigor. At the top of the range, a more rigorous but incomplete analysis, for example, focusing solely on macroeconomic explanation. **4 to 7 marks**

LEVEL 3
At the bottom of the range, good wide-ranging analysis, but at least one mistake or lack of precise analysis. At the top of the range, accurate analysis and focus on the question which involves explicit and accurate explanation of the effect of **margina**l tax rates on work effort. **8 to 10 marks**

Candidates who introduce accurate analysis of the Laffer curve are likely to reach Level 3. However, such analysis is not required as the Laffer curve is not a specification concept. Likewise, relevant analysis of the effect of the slope of the supply curve of labour is likely to reach Level 3, though the specification does not require candidates to be able to use theory to explain the shape (of upward-sloping and backward-bending supply curves of labour).

MAXIMUM FOR PART (c) 10 MARKS

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1 (d) Using the data and your economic knowledge, evaluate the view that the benefits resulting from a more equal distribution of income exceed the costs. *(30 marks)*

Explanation/analysis is needed to reach **Level 3**, and some evaluation building on the analysis is required to score **19 marks or higher**.

An answer which is restricted to a list of benefits and costs, without analysis or evaluation should be restricted to **Level 2**.

To reach **Level 3**, an answer must identify one benefit and one cost and provide very basic evaluation.

To reach **Level 4**, more analysis and evaluation should be provided, possibly considering two or more benefits and costs.

A **Level 5** answer will provide good analysis and convincing evaluation.

Benefits resulting from a more equal distribution of income include greater fairness and/or social cohesion, and possibly better health across the population. Costs include disincentives for the well paid to work harder and for the poor to choose jobs rather than unemployment (if the greater income equality results from progressive taxation and transfers). Credit relevant reference to evidence and examples drawn from the data or from the candidate's economic knowledge.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

Issues and areas for discussion include:

- Equity and social fairness arguments;
- Advantages and disadvantages of a more equal distribution for particular income groups;
- Advantages and disadvantages of a more equal distribution for society as a whole;
- Conflicts of a more equal distribution with other policy objectives, eg economic growth;
- Market failure arguments;
- Government failure arguments;
- Impact of the law of unintended consequences;
- Macroeconomic effect on aggregate demand, due to different MPCs of different income groups.

Also give credit for:

- relevant use of data and the candidate's knowledge;
- relevant use of evidence and examples;
- overall assessment

A maximum of 24 marks if no use is made of the data

USE THE LEVELS MARK SCHEME ON PAGES 3 & 4

MAXIMUM FOR PART (d) 30 MARKS

TOTAL FOR QUESTION 1: 50 MARKS

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SECTION B

Each question carries 50 marks

2 (a) With the use of examples, explain the various ways in which a business may grow in size. *(20 marks)*

Ways in which a business may grow in size include: internal growth, external growth via takeover or merger, vertical growth, horizontal growth, lateral and conglomerate growth.

For candidates who:

distinguish between internal and external growth: **up to 3 marks**
explain how internal growth takes place, eg through:
- exploiting the benefits of economies of scale **up to 2 marks**
- ploughing back profit: **up to 2 marks**
- expanding an existing market i.e. horizontal internal growth: **up to 2 marks**
- expanding into new markets i.e. lateral internal growth: **up to 2 marks**
- vertical internal growth: **up to 2 marks**
- any other relevant way: **up to 2 marks**

For each of these points, **1 mark** for a very basic statement, **1 further mark** for expansion

explain how external growth takes place, eg through:
- acquiring the benefits of economies of scale **up to 2 marks**
- merger: **up to 2 marks**
- takeover: **up to 2 marks**
- vertical, horizontal or lateral external growth: **up to 2 marks each**
- any other relevant way: **up to 2 marks**

For each of these points, **1 mark** for a very basic statement, **1 further mark** for expansion

use examples: **1 mark per example, up to a maximum of 4 marks**

Use diagrams to support their explanations e.g. LRAC diagram. For each diagram, **1 mark** for correct labelling of axes, **1 mark** for correct labelling of information provided eg LRAC, **1 mark** for accurate drawing and labelling of coordinates, **1 mark** for correct representation of information eg economies of scale occurring as a firm moves down its LRAC curve.

up to 4 marks per diagram to a maximum of 6 marks

Some candidates may write about *why* a business may choose to grow in size, eg to maximise profit. Award a maximum of 2 marks for one such argument, and a maximum of 4 marks in total for such an approach.

Maximum of 12 marks for an answer restricted to either internal or external growth

MAXIMUM FOR PART (a) 20 MARKS

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2 (b)	Evaluate the view that the economic advantages resulting from the growth of firms always exceed the disadvantages. *(30 marks)*

Explanation/analysis is needed to reach **Level 3**, and some evaluation building on the analysis is required to score **19 marks or higher**.

An answer which only considers advantages *or* disadvantages should be restricted to **Level 2**.

To reach **Level 3**, an answer must identify at least one advantage and one disadvantage, and provide explanation and analysis.

To reach **Level 4**, the answer must be broader (covering more advantages and/or disadvantages) and deeper, providing more analysis and some reasonable evaluation.

A **Level 5** answer will provide convincing evaluation.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

Issues and areas for discussion include:

- Efficiency gain advantages;
- Economy of scale advantages;
- Monopoly and/or market power advantages;
- Inefficiency disadvantages;
- Diseconomy of scale disadvantages;
- Monopoly abuse and exploitation disadvantages;
- Awareness that advantages/disadvantages for a firm may not be the same as advantages/disadvantages for consumers and/or the public interest
- Application of static arguments;
- Application of dynamic arguments;

Also give credit for:

- Relevant use of candidate's knowledge;
- Relevant use of evidence and examples;
- Relevant use of diagrams
- Overall assessment

USE THE LEVELS MARK SCHEME ON PAGES 3 & 4

MAXIMUM FOR PART (b) 30 MARKS

TOTAL FOR QUESTION 2: 50 MARKS

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3 (a) Explain the functions of profit in an economy. *(20 marks)*

Functions include: signalling information; providing incentives; conveying information; improving resource allocation; rewarding risk-taking; a source of investment finance; in the case of normal profit, keeping incumbent firms in the market; in the case of supernormal (abnormal, above-normal) profit, attracting new firms into the market.

For candidates who:

define profit: **up to 2 marks**

define normal profit: **up to 2 marks**

define supernormal (abnormal, above-normal or economic) profit: **up to 2 marks**

identify a function profit performs: **1 mark**

develop the explanation of a particular function: **up to a further 6 marks**

give an example or examples of the function: **1 mark**

Use diagrams to support their explanations e.g. monopoly diagram to distinguish between normal and supernormal profit. For each diagram, 1 mark for correct labelling of axes, 1 mark for correct labelling of information provided eg cost and revenue curves, 1 mark for accurate drawing and labelling of coordinates, 1 mark for correct representation of information eg supernormal profit.

up to 4 marks per diagram to a maximum of 6 marks

Maximum of 6 marks for definitions

MAXIMUM FOR PART (a) 20 MARKS

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3 (b)	The Office of Water Regulation (OFWAT) regulates the prices charged by companies in the water industry. Do you think that prices charged by all firms in an economy should be regulated by government agencies? Justify your answer. *(30 marks)*

Explanation/analysis is needed to reach **Level 3**, and some evaluation building on the analysis is required to score **19 marks or higher**.

To reach **Level 3**, an answer must show some understanding of the possible reasons for regulation **or** the possible effects of regulation.

To reach **Level 4**, the answer will address reasons or effects more fully, and consider the implications of the word **'all'** in the question.

A **Level 5** answer might provide a convincing evaluation of both the reasons for, and the effect of regulating prices.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

Issues and areas for discussion include:

- The case for: preventing the abuse of monopoly power, particularly in natural monopolies;
- The case for: distributional arguments;
- The case against: regulatory capture arguments;
- The case against: information problem arguments;
- The case against: other strategies are preferable, eg removing entry barriers and promoting competition;
- Market failure arguments;
- Government failure arguments;
- Possible impact of the law of unintended consequences.

Also give credit for:

- Relevant use of candidate's knowledge;
- Relevant use of evidence and examples;
- Relevant use of diagrams
- Overall assessment

USE THE LEVELS MARK SCHEME ON PAGES 3 & 4

MAXIMUM FOR PART (b) 30 MARKS

TOTAL FOR QUESTION 3: 50 MARKS

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4 (a) Explain the various causes of environmental market failure. *(20 marks)*

Causes of environmental market failure include: (i) failures resulting in resource depletion; (ii) failures resulting in resource degradation; (iii) missing markets in public goods (and public bads); (iv) over-production of goods producing negative externalities; (v) under-production of positive externalities; (vi) merit good aspects of the environment; (vii) demerit good aspects of the environment.

Examples include:

(i) failure to recycle and depletion of finite environmental resources;
(ii) pollution destroying environmental quality;
(iii) clean air as a public good or polluted air as a public bad;
(iv) overproduction of fossil fuels because they are too cheap;
(v) under-planting of trees;
(vi) markets failing to provide environmental amenities such as public parks;
(vii) markets over-providing ugly housing estates.

For candidates who:

define market failure: **up to 2 marks**

identify a cause of environmental market failure (eg state that negative externalities harm the environment): **up to 2 marks**

explain the identified cause of environmental market failure: **up to 6 further marks**

state a relevant example: **1 mark**

develop the example: **1 further mark**

Use diagrams to support their explanations e.g. marginal private, external and social cost and benefit diagram. For each diagram, **1 mark** for correct labelling of axes, **1 mark** for correct labelling of information provided eg the cost and benefit curves, **1 mark** for accurate drawing and labelling of coordinates, **1 mark** for correct representation of information eg welfare loss, or resource misallocation.

up to 4 marks per diagram to a maximum of 6 marks

Do not award marks for more than two examples per cause.
Do not award marks for a supposedly additional cause, insufficiently different from an earlier cause identified.

Maximum of 10 marks per cause.

MAXIMUM FOR PART (a) 20 MARKS

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4 (b)	'Intervention by the state to correct an environmental market failure inevitably leads to government failure.' Evaluate this view. *(30 marks)*

Explanation/analysis is needed to reach **Level 3**, and some evaluation building on the analysis is required to score **19 marks or higher**.

An answer which shows no understanding of government failure should be restricted to **Level 1**.

An answer which uncritically agrees (or disagrees) with the view expressed in the sentence should be restricted to **Level 2**.

To reach **Level 3**, an answer may take issue with the view, but provide little analysis.

To reach **Level 4**, the answer must provide relevant analysis, though there may be an occasional mistake or omission, together with reasonable evaluation.

A **Level 5** answer will contain accurate and focused analysis and convincing evaluation.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

Issues and areas for discussion include:

- The meaning of market failure, and environmental market failure
- The case for reducing or correcting market failures;
- How governments or the state might intervene to reduce or correct market failures;
- The possibility of non-governmental organisations (NGOs) intervening instead;
- Methods of government intervention: taxation, regulation, creating markets in pollution permits etc.;
- A 'carrot' approach versus a 'stick' approach;
- Working with the market versus working against the market;
- The meaning of government failure, and environmental government failure;
- Discussing whether government intervention creates adverse or unintended consequences;
- Discussion of whether any government failures are more significant than the market failures the state was trying to correct

Also give credit for:

- Relevant use of candidate's knowledge;
- Relevant use of evidence and examples;
- Relevant use of diagrams
- Overall assessment

USE THE LEVELS MARK SCHEME ON PAGES 3 & 4

MAXIMUM FOR PART (b) 30 MARKS

TOTAL FOR QUESTION 4: 50 MARKS

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General Certificate of Education
January 2006
Advanced Level Examination

ASSESSMENT and QUALIFICATIONS ALLIANCE

ECONOMICS **ECN5**
Unit 5 Business Economics and the Distribution of Income

Monday 30 January 2006 9.00 am to 10.30 am

For this paper you must have:
- an 8-page answer book

You may use a calculator.

Time allowed: 1 hour 30 minutes

Instructions
- Use blue or black ink or ball-point pen. Pencil should only be used for drawing.
- Write the information required on the front of your answer book. The *Examining Body* for this paper is AQA. The *Paper Reference* is ECN5.
- In **Section A**, answer **all** parts of the question.
- In **Section B**, answer **one** question.

Information
- The maximum mark for this paper is 100.
- The marks for questions are shown in brackets.
- This paper is synoptic. It assesses your understanding of the relationship between the different aspects of Economics.
- You are reminded of the need for good English and clear presentation in your answers. All questions should be answered in continuous prose. Quality of Written Communication will be assessed in all answers.

Advice
- You are advised to spend approximately 45 minutes on **Section A** and approximately 45 minutes on **Section B**.

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SECTION A

Answer **all** parts of this question.

Total for this question: 50 marks

1 Study **Extracts A and B**, and then answer **all** parts of Question 1 which follows.

Extract A:

Extract A was a table of data.
It has not been reproduced here due to third-party copyright constraints.

Extract B: Kodak faces an uncertain future

Since digital cameras revolutionised the photography market, Kodak has not made a profit from manufacturing film-based cameras. However, Kodak still makes a profit from manufacturing photographic films and the paper used for printing photographs. But both these products are now also in sharp decline. This is because digital cameras do not require film, and many digital camera users do not want the pictures they take transferred to photographic paper. Instead, they prefer to keep photographic images stored on their computers.

Entry barriers are much lower in the digital camera market than in markets for photographic film and paper, both of which are dominated by Kodak. Sony has made the transition successfully from video technology to digital photography. And now computer-makers, such as Hewlett-Packard, and mobile phone manufacturers have also entered the market. Mobile phone handsets capable of taking digital pictures will soon outsell both film and ordinary digital cameras. By contrast, Kodak's traditional photographic film and paper market is protected by higher entry barriers. To enter this market, investment in specialist equipment is required, together with knowledge of chemical processes that are not used in digital photography.

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Recently, Kodak has been reducing its dependence on traditional photography by diversifying into the digital photography market. Kodak's strategy is based on takeovers rather than on internal or organic growth through investment in new production capacity. Kodak has just spent $35m on taking over Chinon Industries, a Japanese digital camera manufacturer. But having suffered a falling share price, Kodak itself is potentially vulnerable to a takeover bid. Some say this is no bad thing, arguing that a successful takeover, or merely the threat of a takeover bid, performs a useful function in an economy, improving resource allocation and converting assets to more efficient and profitable uses.

Question 1

(a) Using **Extract A**, describe the structure of the United States' digital camera market over the period shown in 2003. *(4 marks)*

(b) Explain **two** possible economic reasons why Kodak has continued to manufacture traditional film-based cameras, even though the company makes a loss on these cameras (**Extract B**, lines 1 and 2). *(6 marks)*

(c) Lines 13–16 of **Extract B** refer to barriers to market entry protecting Kodak.

Analyse why Kodak is facing greater competition, despite being protected by high entry barriers. *(10 marks)*

(d) Firms may grow internally by investing in new production capacity, or they may grow externally through merger or takeover.

Using the data and your economic knowledge, assess the case **for** and **against** firms growing solely by merger or takeover. *(30 marks)*

Turn over for the next question

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SECTION B

Answer **one** question from this Section.

Each question carries 50 marks.

2 Successful firms such as BP, Tesco and British Gas regularly make large amounts of profit.

(a) Explain the role of profit in an economy. *(20 marks)*

(b) Discuss the case **for** and **against** a government regulating the amount of profit firms are making. *(30 marks)*

3 (a) Explain the impact of gender, ethnic and other forms of discrimination on wages **and** levels and types of employment. *(20 marks)*

(b) Evaluate the view that trade unions raise wage rates but reduce levels of employment. *(30 marks)*

4 (a) Using economic theory, explain the causes of the unequal distribution of income in the UK. *(20 marks)*

(b) Discuss whether a more equal income distribution can only come about through government intervention. *(30 marks)*

END OF QUESTIONS

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ASSESSMENT and QUALIFICATIONS ALLIANCE

General Certificate of Education

Economics 6141

ECN5 Business Economics and the Distribution of Income

Mark Scheme

2006 examination – January series

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Advanced Level Economics

January 2006 **ECN 5**

MARK SCHEME

General Instructions

Marks awarded to candidates should be in accordance with the following mark scheme and examiners should be prepared to use the full range of marks available. The mark scheme for most questions is flexible, permitting the candidate to score full marks in a variety of ways. Where the candidate's response to a question is such that the mark scheme permits full marks to be awarded, full marks **MUST** be given. A perfect answer is not necessarily required for full marks. But conversely, if the candidate's answer does not deserve credit, then no marks should be given.

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Two approaches have been used in the construction of the mark scheme:

(i) **An 'issue' based approach.** The mark scheme for parts (a) and (b) of the data response question and part (a) of the essay questions adopts this approach. The questions do not generally require that the candidate demonstrates evaluative skills although some explanation and analysis may be expected. The mark scheme lists the marks that can be awarded for particular issues (and associated development) that the candidate might include in the answer. Marks awarded for development should take into account the Quality of Written Communication used by candidates as indicated on page 4 of this mark scheme.

(ii) **A 'levels' approach.** This approach is used for parts (c) and (d) of the data response question and part (b) of the essay questions. The mark scheme summarises the information required to answer the question, but without attaching marks to particular issues. Marks should be awarded according to whether the answer displays the skills indicated by the five Mark Band Descriptors or "Levels of Skill" included in the mark scheme. The Mark Band Descriptors are set out on page 3. When using a 'levels' mark scheme the marker must identify where a particular skill is being demonstrated. The **key** to be used to identify the skill is also shown on page 4. The level chosen should be the one which **best fits** the answer provided by the candidate. It is not intended that the answer should satisfy every statement in the level description.

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APPLYING THE 'LEVELS' MARK SCHEME
Levels of Response Mark Band Descriptors

Level 1:
Few, if any, relevant issues recognised. Economic concepts and principles are not adequately understood or applied to the question and its context. No satisfactory analysis or evaluation. Little, if any, appreciation of the inter-relatedness of economic issues, problems and institutions. A poorly organised response which generally fails to answer the question. Descriptions and explanations lack clarity. Spelling, punctuation and grammar are likely to be poor. There is very little use of specialist vocabulary.
0 to 6 marks *(Mid-Point: 3 marks)*

Level 2:
A few issues are recognised but there is only limited evidence of the candidate's ability to apply relevant economic concepts. An attempt is made to answer the question but there is little satisfactory analysis or evaluation. Some very limited appreciation of the inter-relatedness of economic issues, problems and institutions. A poorly organised answer which does not have a clear structure. Descriptions and explanations are sometimes hard to follow. The candidate demonstrates some ability to spell commonly used words and to follow the standard conventions of punctuation and grammar. Some use of specialist vocabulary is made but this is not always applied appropriately. **7 to 12 marks** *(Mid-Point: 10 marks)*

Level 3:
A few issues recognised. The candidate has attempted to apply relevant economic concepts and ideas to the question and its context. A reasonable understanding of some concepts and theories is demonstrated. However, the evaluation of issues, arguments and evidence is limited and superficial. Some understanding of the inter-relatedness of economic issues, problems and institutions. There is some logic and coherence in the organisation of the answer. The candidate is generally able to spell commonly used words usually follows the standard conventions of punctuation and grammar. Some descriptions and explanations are easy to understand but the answer may not be expressed clearly throughout. Some use of specialist vocabulary which is applied appropriately. **13 to 20 marks** *(Mid-Point: 17 marks)*

Level 4:
Several relevant issues identified. Good understanding of some economic concepts and principles is demonstrated. The candidate is able to apply these concepts and principles to the context to help answer the question. There is some appreciation of alternative points of view. Satisfactory use is made of evidence and/or theoretical analysis to evaluate the issues and arguments identified. Good understanding of the inter-relatedness of economic issues, problems and institutions is demonstrated Shows the ability to think as an economist making effective use of the economist's 'tool kit' of concepts, theories and techniques. Spelling is generally accurate and the standard conventions of punctuation and grammar are usually followed. The answer is well organised. Descriptions and explanations are usually clearly expressed. A wide range of specialist vocabulary which is used with facility.
21 to 26 marks *(Mid-Point: 24 marks)*

Level 5:
Several relevant issues identified. Good understanding of economic concepts and principles demonstrated throughout. The candidate is able to apply these concepts and principles to the context to help answer the question. There is an appreciation of alternative points of view. Good use is made of evidence and/or theoretical analysis to evaluate the issues and arguments identified. The candidate demonstrates the ability to synthesise the arguments presented and come to a reasonable conclusion albeit tentative. A clear understanding of the inter-relatedness of economic issues, problems and institutions is demonstrated Shows the ability to think as an economist making very effective use of the economist's 'tool kit' of concepts, theories and techniques. Spelling is accurate and the standard conventions of punctuation and grammar are followed. The answer is well organised. Descriptions and explanations are expressed with clarity throughout. Extensive use of specialist vocabulary which is applied adeptly and with precision. **27 to 30 marks** *(Mid-Point: 29 marks)*

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THE KEY TO BE USED WHEN USING THE 'LEVELS' MARK SCHEME

D Where a particular economic term is correctly **DEFINED** in order to help the candidate to answer the question properly.

I Where a relevant **ISSUE** is raised by the candidate.

K Where the candidate demonstrates **KNOWLEDGE** of recent developments or features of the economy which help enhance the candidate's response to the question. This should also be used where the candidate quotes relevant examples.

Ap Where the candidate demonstrates the ability to **APPLY** knowledge and **CRITICAL UNDERSTANDING** to problems and issues.

A Where the candidate demonstrates the ability to **ANALYSE** the problem using appropriate economic ideas.

E Where the candidate **EVALUATES** and makes judgements about the significance of various issues and arguments.

QUALITY OF WRITTEN COMMUNICATION

The Mark Band Descriptors, which are used for assessing Question 1 (d) and part (b) of the essay questions, incorporate statements which relate to the Quality of Written Communication used by the candidates.

However, it is also important to assess Quality of Written Communication whenever candidates produce answers using continuous prose. When applying an issue based mark scheme, examiners must take into account the following when deciding how many marks to award for development:

(i) use of appropriate format and style of writing to organise relevant information clearly and coherently;
(ii) use of specialist vocabulary, where appropriate;
(iii) legibility of handwriting;
(iv) accuracy of spelling, punctuation and grammar.

Synoptic Assessment

All questions in this unit are synoptic. Therefore candidates will need to demonstrate that they are able to think as an economist and to use effectively the economist's 'tool kit' of concepts, theories and techniques.

They should demonstrate that they:

- understand the inter-relatedness of many economic issues, problems and institutions;
- understand how certain economic concepts, theories and techniques may be relevant to a range of different contexts
- can apply concepts, theories and techniques in analysing economic issues and problems and in evaluating arguments and evidence.

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SECTION A

1 **Total for this question: *50 marks***

1 (a) Using **Extract A**, describe the structure of the United States' digital camera market over the period shown in 2003. *(4 marks)*

Most candidates will describe the market as an oligopoly, or as highly or relatively concentrated. However, given the facts that the five-firm concentration ratio is 76.4% and that 'others' account for 9.3% of the market, reward an answer that states that the market is an example of monopolistic competition (even though this market structure is not on the Module 5 specification).

For candidates who:

identify an element of the market structure e.g. oligopoly, concentrated market: **1 mark**

develop the description: **up to a further 2 marks**

Up to 3 marks per element

Maximum of 2 marks if there is no accurate use of statistics

MAXIMUM FOR PART (a) 4 MARKS

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1 (b) Explain **two** possible economic reasons why Kodak has continued to manufacture traditional film-based cameras, even though the company makes a loss on these cameras (**Extract B**, lines 1 and 2). *(6 marks)*

Possible reasons include: manufacturing traditional film-based cameras so as to make a profit on complementary goods, namely film and photographic paper (i.e. the cross-subsidy argument); inertia; lack of accurate information; non-profit maximising objective(s); a hope that the market will recover; impossibility of recovering sunk and/or fixed costs; a profit may be made if only variable costs are considered; desire to maintain the brand name or image.

For candidates who:

make a basic statement of a reason: **1 mark**

develop an explanation of the reason: **up to a further 4 marks**

Maximum of 4 marks if only one relevant reason is explained

If a candidate explains more than 2 reasons, reward the best 2 explanations.

MAXIMUM FOR PART (b) 6 MARKS

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1 (c) Lines 13–16 of **Extract B** refer to barriers to market entry protecting Kodak. Analyse why Kodak is facing greater competition, despite being protected by high entry barriers.
(10 marks)

Issues and areas for discussion and explanation include:

- explanation of how entry barriers may protect Kodak;
- relevant discussion of the difference between natural and artificial barriers;
- identification of the fact that the entry barriers protect a shrinking market;
- discussion of Kodak's market facing competition from a new photographic technology
- relevant discussion of the more competitive nature of the market into which Kodak is diversifying

LEVEL 1

At the bottom of the range, the candidate who explains the meaning of entry barriers but who makes no relevant use of the concept. At the top of the range, the candidate who explains the meaning of entry barriers but who discusses their significance solely in the context of Kodak's traditional market.

1 to 3 marks

LEVEL 2

At the bottom of the range, the candidate who makes a superficial analysis of the two markets. At the top of the range, the candidate who makes a more developed analysis of the two markets.

4 to 7 marks

LEVEL 3

At the bottom of the range, the candidate who provides strong and rigorous analysis of competition and entry barriers in one of the two markets, but whose analysis is thin with regard to the other market. At the top of the range, the candidate who provides full and contrasting analysis of competition and entry barriers in both markets, perhaps using concepts such as cross elasticity of demand for the two products, substitutability, sunk costs, or dynamic change.

8 to 10 marks

MAXIMUM FOR PART (c) 10 MARKS

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1 (d) Firms may grow internally by investing in new production capacity, or they may grow externally through merger or takeover. Using the data and your economic knowledge, assess the case **for** and **against** firms growing solely by merger or takeover. *(30 marks)*

Explanation/analysis is needed to reach Level 3, and some evaluation, building on the analysis, is required to score **21 marks** or higher (Levels 4 and 5). An answer which considers only the case for, or the case against, growing solely by merger or takeover should be restricted to Level 2. To reach Level 3, an answer must consider both the case for and the case against. To reach Level 4, the candidate must discuss external growth and internal growth, implicitly or explicitly. A Level 5 answer might discuss the significance of the word *solely* in the context of the question.

Credit relevant use of real world case histories.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

Issues and areas for discussion include:

- Understanding of external growth and takeovers or mergers;
- Understanding of internal or organic growth;
- Discussion of advantages of external growth such as speed and the acquisition of other firms' assets and know how;
- Discussion of disadvantages of external growth such as lack of management expertise with regard to the acquired company and the creation of external diseconomies of scale;
- How external and/or internal growth can improve resource allocation and the efficient and profitable use of assets, e.g. by switching under-performing assets to more efficient uses;
- How external and/or internal growth may harm resource allocation and the efficient and profitable use of assets, e.g. through unproductive speculation;
- Relevant application of vertical, horizontal and lateral growth;
- Consideration of the possibility that a mix of external and internal growth is optimal.

Also give credit for:

- Relevant use of data and/or candidate's knowledge;
- Relevant use of evidence;
- Overall assessment.

A maximum of 24 marks if no use is made of the data

USE THE LEVELS MARK SCHEME ON PAGES 3 & 4

MAXIMUM FOR PART (d) 30 MARKS

TOTAL FOR QUESTION 1: 50 MARKS

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SECTION B

Each question carries 50 marks

Successful firms such as BP, Tesco and British Gas regularly make large amounts of profit.

2 (a) Explain the role of profit in an economy. *(20 marks)*

For candidates who:

define profit:	**1 mark**
define normal profit:	**1 mark**
explain the role of normal profit in an economy:	**up to a further 3 marks**
define supernormal (above normal or abnormal) profit:	**1 mark**
explain the role of supernormal profit in an economy:	**up to a further 3 marks**
state that low entry barriers may reduce profit, or high entry barriers may increase profit:	**1 mark**
state that profit is the factor reward earned by a firm or entrepreneur:	**1 mark**
state that profit is the reward for risk taking:	**2 marks**
explain the role of profit in creating incentives;	**up to 3 marks**
explain the role of profit in creating competitive conditions;	**up to 3 marks**
explain the role of profit in relation to market contestability;	**up to 3 marks**
explain the role of profit in resource allocation, i.e. attracting resources from less profitable to more profitable uses;	**up to 6 marks**
explain how monopoly profit, protected by entry barriers, may lead to resource misallocation:	**up to 4 marks**
explain the role of profit as a source for financing investment:	**up to 4 marks**
explain how profit may accelerate economic growth:	**up to 4 marks**
make relevant use of a diagram, e.g. the effect of supernormal profit on a market:	**4 marks per diagram** **up to a maximum of 8 marks**

MAXIMUM FOR PART (a) 20 MARKS

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2 (b) Discuss the case **for** and **against** a government regulating the amount of profit firms are making. *(30 marks)*

Explanation/analysis is needed to reach Level 3, and some evaluation, building on the analysis, is required to score **21 marks** or higher (Levels 4 and 5). Also, to reach Level 3, the case for and the case against arguments must be briefly addressed. To reach Level 4, both the case for and the case against argument must be analysed with some evaluation. Greater analysis and evaluation is required to reach Level 5.

Credit relevant reference to evidence and examples

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

Issues and areas for discussion include:

- How prices could be regulated;
- Relevance to market structure;
- Relevance to the privatised utility industries;
- Regulation to reduce abuse of oligopolistic and/or monopolistic market power;
- Regulation to reduce exploitation of producer sovereignty and to promote consumer sovereignty;
- Why regulation may not succeed;
- Efficiency arguments
- Equity arguments;
- Government intervention to correct market failure;
- Government failure arguments.

Also give credit for:

- Relevant use of data and/or candidate's knowledge;
- Relevant use of evidence;
- Overall assessment.

USE THE LEVELS MARK SCHEME ON PAGES 3 & 4

MAXIMUM FOR PART (b) 30 MARKS

TOTAL FOR QUESTION 2: 50 MARKS

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3 (a) Explain the impact of gender, ethnic and other forms of discrimination on wages **and** levels and types of employment. *(20 marks)*

For candidates who:

provide a definition of labour market discrimination: **up to 3 marks**

For candidates who

for each form of discrimination:

provide a basic statement of how the discrimination affects wages: **1 mark**
develop the explanation: **up to 5 further marks**

(Explanations may relate to the effect of discrimination on education and skills; on aspirations; on relative wage rates of workers subjected to and not subjected to discrimination.)

provide a basic statement of how the discrimination affects levels of employment: **1 mark**
develop the explanation: **up to 5 further marks**

(Explanations may relate to the effect on overall employment and unemployment via the creation of labour market immobility; and failure to use talent to the full.)

For candidates who

relate their explanation(s) to a particular cause or type of unemployment: **up to 2 marks per cause or type**

provide a relevant diagram or diagrams: **up to 4 marks per diagram up to a maximum of 8 marks**

Some candidates may introduce the theory of wage discrimination, although full marks can be earned without this theory. Wage discrimination theory is similar to the theory of price discrimination, but related to the labour market.

Maximum of 12 marks for explanation of the effect of discrimination on wages
Maximum of 8 marks for explanation of the effect of discrimination on *levels* of employment
Maximum of 8 marks for explanation of the effect of discrimination on *types* of employment

Maximum of 12 marks if only wages or employment is discussed

MAXIMUM FOR PART (a) 20 MARKS

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3 (b) Evaluate the view that trade unions raise wage rates but reduce levels of employment. *(30 marks)*

Explanation/analysis is needed to reach Level 3, and some evaluation, building on the analysis, is required to score **21 marks** or higher (Levels 4 and 5). An answer which describes but does not analyse or evaluate trade union activity should be restricted to Level 2. To reach Level 3, an answer must analyse and evaluate one labour market structure, e.g. perfect competition or monopsony (or highly competitive and less competitive labour markets). To reach Level 4, two market structures must be analysed and evaluated, although answers may contain some mistakes. A Level 5 answer must analyse and evaluate two market structures without making any significant mistakes. Award marks for relevant diagrams.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

Issues and areas for discussion include:

- The meaning of trade unions;
- Trade unions' objectives;
- Whether trade unions' objectives are consistent with employers' objectives;
- Perfectly competitive labour markets;
- Monopsony (or imperfectly competitive) labour markets;
- The effect of trade unions on wages and employment in otherwise perfectly competitive labour markets;
- The effect of trade unions on wages and employment in monopsony or imperfectly competitive labour markets;
- The effect of trade unions on factors such as labour productivity and market flexibility.

Also give credit for:

- Relevant use of data and/or candidate's knowledge;
- Relevant use of evidence;
- Overall assessment.

USE THE LEVELS MARK SCHEME ON PAGES 3 & 4

MAXIMUM FOR PART (b) 30 MARKS

TOTAL FOR QUESTION 3: 50 MARKS

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4 (a) Using economic theory, explain the causes of the unequal distribution of income in the UK. *(20 marks)*

For candidates who:

define income: **1 mark**
explain the meaning of an unequal distribution of income: **up to 3 marks**

use measures such as a Lorenz curve and/ or a gini coefficient to show income inequality: **up to 2 marks for each measure**

Maximum of 5 marks for defining and measuring income and income inequality

For candidates who:

provide information about the extent to which income is unequally distributed in the UK: **up to 4 marks**
provide a basic statement of a cause of inequality: **1 mark**
develop the basic statement: **up to 6 further marks per cause**

(Causes include: different supply conditions for different types of labour; different demand conditions for different types of labour; different productivities; different labour market equilibria; the effect of different natural talents and aptitudes; the effect of different education and investment in human capital; the effect of multi-income households versus single income households, including dependants; the effect of discrimination in labour markets; effects of taxes and benefits.)

provide a relevant diagram or diagrams: **up to 4 marks per diagram up to a maximum of 8 marks**

Maximum of 7 marks for an answer that only explains causes of the unequal distribution of *wealth*.

Maximum of 9 marks for an answer that is solely descriptive and makes no use at all of economic theory

MAXIMUM FOR PART (a) 20 MARKS

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4 (b) Discuss whether a more equal income distribution can only come about through government intervention. *(30 marks)*

Most candidates will probably agree that an unequal income distribution is a market failure, but reward candidates who take issue with the question and argue that an unequal distribution can be justified. But give little reward for assertion. Arguments must be explained, analysed and evaluated.

Explanation/analysis is needed to reach Level 3, and some evaluation, building on the analysis, is required to score **21 marks** or higher (Levels 4 and 5). An answer which describes market failure, but does not explain and analyse why an unequal distribution of income might be a market failure should be restricted to Level 2. To reach Level 3, an answer must explain how government intervention might correct the market failure, without however addressing the word *only* in the question. To reach Level 4, answers must consider whether other market-orientated solutions are possible, e.g. 'trickle-down effects'; redistribution by charity or gift. A Level 5 answer must evaluate fully both the case for and the case against the view expressed in the question, for example by considering how government intervention may fail, as well as the use of alternatives to government intervention.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

Issues and areas for discussion include:

- Methods of intervention such as progressive taxation and welfare benefits;
- Explanation of benefits of particular methods of intervention for individuals;
- Explanation of benefits of particular methods of intervention for the economy;
- Explanation of costs of particular methods of intervention for individuals;
- Explanation of costs of particular methods of intervention for the economy;
- Discussion of winners and losers;
- Discussion of efficiency gains and/or losses;
- Discussion of welfare gains and/or losses;
- Discussion of static versus dynamic effects;
- Application of equity criteria;
- Discussion of market-orientated alternatives to government intervention;
- Market failure considerations.

Also give credit for:

- Relevant use of data and/or candidate's knowledge;
- Relevant use of evidence;
- Overall assessment.

USE THE LEVELS MARK SCHEME ON PAGES 3 & 4

MAXIMUM FOR PART (b) 30 MARKS

TOTAL FOR QUESTION 4: 50 MARKS

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ASSESSMENT and QUALIFICATIONS ALLIANCE

General Certificate of Education

Economics 6141

ECN5 Business Economics and the Distribution of Income

Mark Scheme

2005 examination – June series

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Advanced Level Economics

June 2005 **ECN 5**

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Two approaches have been used in the construction of the mark scheme:

(i) **An 'issue' based approach.** The mark scheme for parts (a) and (b) of the data response question and part (a) of the essay questions adopts this approach. The questions do not generally require that the candidate demonstrates evaluative skills although some explanation and analysis may be expected. The mark scheme lists the marks that can be awarded for particular issues (and associated development) that the candidate might include in the answer. Marks awarded for development should take into account the Quality of Written Communication used by candidates as indicated on page 4 of this mark scheme.

(ii) **A 'levels' approach.** This approach is used for parts (c) and (d) of the data response question and part (b) of the essay questions. The mark scheme summarises the information required to answer the question, but without attaching marks to particular issues. Marks should be awarded according to whether the answer displays the skills indicated by the five Mark Band Descriptors or "Levels of Skill" included in the mark scheme. The Mark Band Descriptors are set out on page 3. When using a 'levels' mark scheme the marker must identify where a particular skill is being demonstrated. The **key** to be used to identify the skill is also shown on page 4. The level chosen should be the one which **best fits** the answer provided by the candidate. It is not intended that the answer should satisfy every statement in the level description.

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APPLYING THE 'LEVELS' MARK SCHEME
Levels of Response Mark Band Descriptors

Level 1:
Few, if any, relevant issues recognised. Economic concepts and principles are not adequately understood or applied to the question and its context. No satisfactory analysis or evaluation. Little, if any, appreciation of the inter-relatedness of economic issues, problems and institutions. A poorly organised response which generally fails to answer the question. Descriptions and explanations lack clarity. Spelling, punctuation and grammar are likely to be poor. There is very little use of specialist vocabulary.
0 to 6 marks *(Mid-Point: 3 marks)*

Level 2:
A few issues are recognised but there is only limited evidence of the candidate's ability to apply relevant economic concepts. An attempt is made to answer the question but there is little satisfactory analysis or evaluation. Some very limited appreciation of the inter-relatedness of economic issues, problems and institutions. A poorly organised answer which does not have a clear structure. Descriptions and explanations are sometimes hard to follow. The candidate demonstrates some ability to spell commonly used words and to follow the standard conventions of punctuation and grammar. Some use of specialist vocabulary is made but this is not always applied appropriately. **7 to 12 marks** *(Mid-Point: 10 marks)*

Level 3:
A few issues recognised. The candidate has attempted to apply relevant economic concepts and ideas to the question and its context. A reasonable understanding of some concepts and theories is demonstrated. However, the evaluation of issues, arguments and evidence is limited and superficial. Some understanding of the inter-relatedness of economic issues, problems and institutions. There is some logic and coherence in the organisation of the answer. The candidate is generally able to spell commonly used words usually follows the standard conventions of punctuation and grammar. Some descriptions and explanations are easy to understand but the answer may not be expressed clearly throughout. Some use of specialist vocabulary which is applied appropriately. **13 to 20 marks** *(Mid-Point: 17 marks)*

Level 4:
Several relevant issues identified. Good understanding of some economic concepts and principles is demonstrated. The candidate is able to apply these concepts and principles to the context to help answer the question. There is some appreciation of alternative points of view. Satisfactory use is made of evidence and/or theoretical analysis to evaluate the issues and arguments identified. Good understanding of the inter-relatedness of economic issues, problems and institutions is demonstrated Shows the ability to think as an economist making effective use of the economist's 'tool kit' of concepts, theories and techniques. Spelling is generally accurate and the standard conventions of punctuation and grammar are usually followed. The answer is well organised. Descriptions and explanations are usually clearly expressed. A wide range of specialist vocabulary which is used with facility.
21 to 26 marks *(Mid-Point: 24 marks)*

Level 5:
Several relevant issues identified. Good understanding of economic concepts and principles demonstrated throughout. The candidate is able to apply these concepts and principles to the context to help answer the question. There is an appreciation of alternative points of view. Good use is made of evidence and/or theoretical analysis to evaluate the issues and arguments identified. The candidate demonstrates the ability to synthesise the arguments presented and come to a reasonable conclusion albeit tentative. A clear understanding of the inter-relatedness of economic issues, problems and institutions is demonstrated Shows the ability to think as an economist making very effective use of the economist's 'tool kit' of concepts, theories and techniques. Spelling is accurate and the standard conventions of punctuation and grammar are followed. The answer is well organised. Descriptions and explanations are expressed with clarity throughout. Extensive use of specialist vocabulary which is applied adeptly and with precision. **27 to 30 marks** *(Mid-Point: 29 marks)*

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THE KEY TO BE USED WHEN USING THE 'LEVELS' MARK SCHEME

D Where a particular economic term is correctly **DEFINED** in order to help the candidate to answer the question properly.

I Where a relevant **ISSUE** is raised by the candidate.

K Where the candidate demonstrates **KNOWLEDGE** of recent developments or features of the economy which help enhance the candidate's response to the question. This should also be used where the candidate quotes relevant examples.

Ap Where the candidate demonstrates the ability to **APPLY** knowledge and **CRITICAL UNDERSTANDING** to problems and issues.

A Where the candidate demonstrates the ability to **ANALYSE** the problem using appropriate economic ideas.

E Where the candidate **EVALUATES** and makes judgements about the significance of various issues and arguments.

QUALITY OF WRITTEN COMMUNICATION

The Mark Band Descriptors, which are used for assessing Question 1 (d) and part (b) of the essay questions, incorporate statements which relate to the Quality of Written Communication used by the candidates.

However, it is also important to assess Quality of Written Communication whenever candidates produce answers using continuous prose. When applying an issue based mark scheme, examiners must take into account the following when deciding how many marks to award for development:

(i) use of appropriate format and style of writing to organise relevant information clearly and coherently;
(ii) use of specialist vocabulary, where appropriate;
(iii) legibility of handwriting;
(iv) accuracy of spelling, punctuation and grammar.

Synoptic Assessment

All questions in this unit are synoptic. Therefore candidates will need to demonstrate that they are able to think as an economist and to use effectively the economist's 'tool kit' of concepts, theories and techniques.

They should demonstrate that they:

- understand the inter-relatedness of many economic issues, problems and institutions;
- understand how certain economic concepts, theories and techniques may be relevant to a range of different contexts
- can apply concepts, theories and techniques in analysing economic issues and problems and in evaluating arguments and evidence.

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Section A

1 **Total for this question: *50 marks***

1 (a) Using **Extract A**, identify **one** external cost and **one** external benefit resulting from the development and introduction of Concorde, **and** briefly explain why each is an external cost or benefit. *(4 marks)*

For candidates who:

identify an external cost (costs 4 or 5 in Extract A): **1 mark**

provide an explanation of why it is an external cost: **up to 2 marks**

(The explanation can be related to third-party or spin-off effects, or the cost being generated and received outside the market, or a clear explanation of why it is not a private cost. The explanation must refer to costs rather than to benefits.)

identify an external benefit (benefits 2 or 5 in Extract A): **1 mark**

provide an explanation of why it is an external benefit: **up to 2 marks**

(The explanation can be related to third-party or spin-off effects, or the benefit being generated and received outside the market, or a clear explanation of why it is not a private benefit. The explanation must refer to benefits rather than to costs.)

Maximum of 2 marks for an answer restricted to accurate identification and explanation of EITHER an external cost OR an external benefit

MAXIMUM FOR PART (a) 4 MARKS

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1 (b) Explain why the demand for Concorde flights was thought to be "more price elastic than that for long-haul air flights in general" (**Extract B**, lines 7 and 8). *(6 marks)*

For candidates who:

define price elasticity of demand, or provide a correct formula for its measurement: **1 mark**

explain that a larger price elasticity of demand statistic means that the proportionate response of consumers to a price change is greater than in the case of a smaller elasticity: **1 mark**
illustrate price elasticity of demand accurately on one or more diagrams: **1 mark**

state that a determinant of price elasticity of demand is substitutability: **1 mark**
explain how substitutability affects price elasticity of demand: **1 mark**
explain that because there are no close substitutes for long-haul air travel, demand is price-inelastic: **2 marks**
explain that because subsonic air travel is a substitute, demand for Concorde is more price-elastic: **2 marks**

make any other relevant point in this context eg, explaining price elasticity of demand in terms of the width of the definition of the market: **2 marks per relevant point**

MAXIMUM FOR PART (b) 6 MARKS

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1 (c) Shortly after the information in **Extract B** was published, and before most governments deregulated routes, individual airlines began to break collusive agreements they had made with other airlines. Analyse why an airline might wish to break the collusive agreement described in lines 9-12 of **Extract B**. *(10 marks)*

Reasons why an airline might wish to break the collusive agreement include: believing the airline can be more profitable outside such an agreement; lack of trust in other members of the agreement; the agreement's lack of effectiveness; a desire to pre-empt possible governmental attacks on the agreement.

Issues and areas for discussion and explanation include:

- The meaning of collusion, especially in the context of oligopoly and cartels
- Collusion as a means of reducing uncertainty
- Collusion and joint profit maximisation
- Collusion and 'an easy life'
- How collusion prevents competition
- The owner's desire to be entrepreneurial
- The benefits of competition for a particular airline
- Profit-maximising and other possible business objectives
- Explanation and analysis in terms of elasticity of demand.
- Relevant use of game theory or a theoretical model of oligopoly

LEVEL 1

At the bottom of the range, the candidate who does not attempt any analysis, but whose answer understands collusion. At the top of the range, the candidate who analyses a reason for collusion, but who does not address the issue posed by the question. **1 to 3 marks**

LEVEL 2

At the bottom of the range, the candidate who briefly mentions one reason why an airline may wish to break a collusive agreement, but who does not develop the answer. At the top of the range, the candidate develops the analysis of at least one reason, but incoherently or with mistakes. **4 to 7 marks**

LEVEL 3

At the bottom of the range, the candidate relevantly develops the analysis of one reason for breaking a collusive agreement in good detail. Alternatively two or more reasons may be analysed less well. At the top of the range, the candidate provides a confident and full analysis of one reason for breaking a collusive agreement, or analyses two or more reasons in some detail and without significant mistakes. The answer may take issue with the question, arguing that some airlines may continue to collude. **8 to 10 marks**

MAXIMUM FOR PART (c) 10 MARKS

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1 (d) Before investing in the development of Concorde, the United Kingdom government decided against undertaking a cost benefit analysis of the project.
Using the data and your economic knowledge, evaluate the case **for** and **against** a government undertaking cost benefit analysis of projects such as Concorde. *(30 marks)*

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

Explanation/analysis is needed to reach Level 3, and some evaluation, building on the analysis, is required to score 21 marks or higher (Levels 4 and 5). An answer which describes the techniques of cost benefit analysis, but which does not address the issue posed by the question, should be restricted to Level 2. An answer which explains at least one argument in favour of CBA of a project such as Concorde, and at least one argument against such a CBA, but which does not evaluate the arguments, either implicitly or explicitly, should be restricted to Level 3. Level 4 answers will contain analysis and evaluation, but some mistakes and/or narrowness of answer. Level 5 answers will analyse and evaluate a wider range of issues, and they will be largely free of mistakes. Level 5 answers also require application of the Concorde case study. Knowledge of discounting the future and shadow pricing is **not** required.

Maximum of 21 marks if there is no use of the data

Issues and areas for discussion include:

- the meaning of cost benefit analysis
- reasons why cost benefit analysis is undertaken
- the disadvantages of undertaking cost benefit analysis
- the difference between CBA and private sector investment appraisal
- analysis of private and external costs and benefits
- the problem of quantifying external costs and benefits, and future costs and benefits
- the political reasons for using, or not using, cost benefit analysis
- relevant use of the data
- application of knowledge
- assessment of strengths and weaknesses of opposing arguments

Also give credit for:

- relevant use of data and/or candidate's knowledge
- relevant use of evidence
- overall assessment

USE THE LEVELS MARK SCHEME ON PAGES 3 & 4

MAXIMUM FOR PART (d) 30 MARKS

TOTAL FOR THIS QUESTION: 50 MARKS

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Section B

Total for this question: *50 marks*

2

2 (a) Explain why economists usually regard monopoly as an undesirable form of market structure. *(20 marks)*

For candidates who:

define market structure: **2 marks**

define a pure monopoly: **2 marks**
define a monopoly in some other relevant way, eg a firm with 25% of a market: **1 mark**
distinguish between monopoly and monopoly power: **up to 3 marks**
provide an example of a monopoly, or of a firm with considerable monopoly power, eg Microsoft (only one example needed for the mark): **1 mark**

state that a monopoly may restrict output and raise the price: **up to 2 marks**
explain this: **up to a further 4 marks**

explain why a monopoly is inefficient: **1 plus 3 marks per type of inefficiency**

explain any other relevant point, eg;

- that monopolies exercise producer sovereignty at the expense of consumer sovereignty
- the adverse effects of monopoly price discrimination
- restriction of choice
- loss of consumer choice and economic welfare
- the effect of supernormal profit on consumers: **1 plus 3 marks per point**

draw a diagram to illustrate any of the above points: **up to 4 marks per diagram**

Maximum of 8 marks for diagrams
Do not award marks for arguments justifying monopoly

MAXIMUM FOR PART (a) 20 MARKS

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2 (b) Evaluate policies a government might use to reduce the problems caused by monopoly. (*30 marks)*

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

Explanation/analysis is needed to reach Level 3, and some evaluation, building on the analysis, is required to score 21 marks or higher (Levels 4 and 5). Two policies analysed and evaluated in depth, or three or more policies analysed and evaluated in a little less depth can reach Levels 4 and 5. An answer which explains only one method of reducing the problem of monopoly should be restricted to Level 2. An answer which considers only the advantages (or the disadvantages) of two or more policies should be restricted to Level 3. To reach Levels 4 and 5, advantages and disadvantages of two or more policies must be analysed and evaluated. A Level 4 answer will contain some mistakes and less depth, whilst a Level 5 answer will be largely mistake free and in greater depth.

Policies include: breaking up monopolies; removing entry barriers and making markets contestable; imposing price caps and other forms of regulation; taxing monopoly profit; taking private monopoly into public ownership; privatising state-owned monopolies.

Issues and areas for discussion include:

- understanding of the problem or problems of monopoly
- identification of different policies
- analysis of how a policy may reduce the problem of monopoly
- the benefits and costs of particular policies
- awareness that policies may complement each other
- second-best arguments
- market failure and government failure arguments
- assessment of strengths and weaknesses of opposing arguments

Also give credit for:

- relevant use of the candidate's knowledge
- relevant use of evidence
- overall assessment

USE THE LEVELS MARK SCHEME ON PAGES 3 & 4

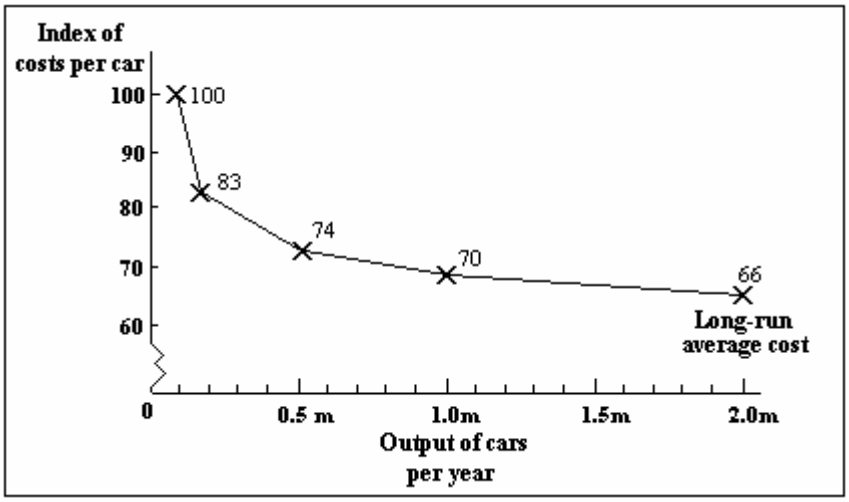
MAXIMUM FOR PART (b) 30 MARKS

TOTAL FOR THIS QUESTION: 50 MARKS

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3 **Total for this question: *50 marks***

3 (a) Draw a long run average cost curve on a diagram to illustrate the information in the table, **and** then explain the shape of the long run average cost curve. (*20 marks)*



For candidates who:

draw and correctly label the axes:	**2 marks**
draw the curve with a roughly accurate shape and position:	**2 marks**
or draw the curve accurately:	**4 marks**
label the curve as long-run average cost(s) or LRAC:	**2 marks**
define the long run:	**1 mark**
define average costs:	**1 mark**
state that the table (and/or curve) show(s) falling long-run average cost(s):	**1 mark**
state that economies of scale explain falling long-run average cost(s):	**2 marks**
state a type of economy of scale (technical, managerial, financial etc.):	**1 mark each**
explain a type of economy of scale:	**up to a further 3 marks per type**

Maximum of 8 marks for the diagram based on plotting the data
Maximum of 2 marks for an LRAC diagram that has not been based on the data and is instead of a diagram plotting the data
Maximum of 15 marks for the written explanation

Maximum of 17 marks if explanation is not related in any way to car manufacturing

MAXIMUM FOR PART (a) 20 MARKS

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3	(b)	Evaluate the view that the government should give financial assistance to firms producing cars in the UK to increase their competitiveness. *(30 marks)*

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

Explanation/analysis is needed to reach Level 3, and some evaluation, building on the analysis, is required to score 21 marks or higher (Levels 4 and 5). An answer which goes no further than describing one reason for giving, and one reason for not giving, financial assistance should be restricted to Level 2. An answer which goes no further than relating reasons to competitiveness, with no relevant reference to the car industry, should be restricted to Level 3. To reach Levels 4 and 5, advantages and disadvantages of giving financial assistance must be analysed and evaluated in the context of evidence. A Level 4 answer will contain some mistakes and less depth, whilst a Level 5 answer will be largely mistake free and in greater depth.

Issues and areas for discussion include:

- the meaning of government financial assistance
- the forms financial assistance may take, eg grants, tax breaks
- the meaning of competitiveness
- how financial assistance may improve competitiveness
- how financial assistance may attract FDI
- how financial assistance may reduce competitiveness
- opportunity cost arguments
- market failure and government failure arguments
- analysis and evaluation of factors relevant to the car industry, eg economies of scale, the role of MNCs in car production
- recent examples relating to car manufacturing in the UK, eg Rover, Japanese-owned plants, and related to UK government policy
- assessment of strengths and weaknesses of opposing arguments

Also give credit for:

- relevant use of the candidate's knowledge
- relevant use of evidence
- overall assessment

USE THE LEVELS MARK SCHEME ON PAGES 3 & 4

MAXIMUM FOR PART (b) 30 MARKS

TOTAL FOR THIS QUESTION: 50 MARKS

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4 **Total for this question: *50 marks***

4 "Workers in pleasant occupations, such as 'soap celebrities', often receive high pay, while those in disagreeable occupations, such as road sweepers, are among the most lowly paid."

(a) How does economic theory explain such differences in pay? (*20 marks)*

For candidates who:

state that a worker's reward for supplying labour divides into two parts, the money wage and the welfare, utility or satisfaction yielded by the work: **2 marks**
explain this point in relation to people in pleasant occupations: **up to 3 further marks**
apply this to an example, including the example in the question: **1 mark**
(maximum of 1 mark for examples)

explain that some jobs yield negative welfare, disutility or dissatisfaction: **2 marks**
explain this point in relation to people in disagreeable occupations: **up to 3 further marks**
apply this to an example, including the example in the question: **1 mark**
(maximum of 1 mark for examples)

state that factors other than job satisfaction or dissatisfaction affecting the demand for and supply of labour may be more important: **2 marks**

explain a factor affecting the demand for labour, eg a worker's productivity: **up to 3 marks per factor**
explain a factor affecting the supply of labour, eg a limited pool of talent: **up to 3 marks per factor**

make a relevant application of the wage elasticity of demand for labour: **up to 3 marks**
make a relevant application of the wage elasticity of supply of labour: **up to 3 marks**
bring demand and supply conditions together to explain differences in workers' pay: **up to 6 marks**
use one or more diagrams relevantly to illustrate a particular point, eg the effect of the elasticity of supply of labour: **up to 4 marks per set of diagrams**

make further relevant reference to 'soap celebrities' and road sweepers in the answer: **up to 3 marks**

relevantly apply the theory of wage discrimination and / or monopsony theory: **up to 6 marks per theory**
use an alternative theory, such as the Marxist theory of labour exploitation: **up to 6 marks per theory**

Maximum of 6 marks for a descriptive approach with no relevant use of economic theory
Maximum of 14 marks for an answer that does not consider the effects of the pleasantness or unpleasantness of a job

MAXIMUM FOR PART (a) 20 MARKS

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4	(b)	Assess the case **for** and **against** the government intervening to raise the disposable income of workers on low pay. *(30 marks)*

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

Methods of intervention include minimum wage laws, tax credits and other forms of pay and poverty related welfare benefit, tax cuts and taking the low-paid out of the tax net so as to raise disposable income.

Explanation/analysis is needed to reach Level 3, and some evaluation, building on the analysis, is required to score 21 marks or higher (Levels 4 and 5). Two methods of intervention analysed and evaluated in depth, or three or more policies analysed and evaluated in a little less depth can reach Levels 4 and 5. An answer which only describes intervention should be restricted to Level 2. An answer which considers only the case for (or the case against) intervention should be restricted to Level 3. To reach Levels 4 and 5, the case for and the case against must both be analysed and evaluated. A Level 4 answer will contain some mistakes and less depth, whilst a Level 5 answer will be largely mistake free and in greater depth.

Issues and areas for discussion include:

- the meaning of disposable income
- methods of intervention
- how intervention may affect disposable income
- the meaning of disposable income
- efficiency arguments
- equity arguments
- the correction of market failure
- the promotion of government failure.
- effects on incentives and disincentives
- issues of resource allocation and misallocation, opportunity costs
- assessment of strengths and weaknesses of opposing arguments

Also give credit for:

- relevant use of the candidate's knowledge
- relevant use of evidence
- overall assessment

USE THE LEVELS MARK SCHEME ON PAGES 3 & 4

MAXIMUM FOR PART (b) 30 MARKS

TOTAL FOR THIS QUESTION: 50 MARKS

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General Certificate of Education
January 2005
Advanced Level Examination

ASSESSMENT and QUALIFICATIONS ALLIANCE

ECONOMICS ECN5
Unit 5 Business Economics and the Distribution of Income

Monday 31 January 2005 Afternoon Session

In addition to this paper you will require:
an 8-page answer book.
You may use a calculator.

Time allowed: 1 hour 30 minutes

Instructions
- Use blue or black ink or ball-point pen. Pencil should only be used for drawing.
- Write the information required on the front of your answer book. The *Examining Body* for this paper is AQA. The *Paper Reference* is ECN5.
- In **Section A**, answer **all** parts of the question.
- In **Section B**, answer **one** question.

Information
- The maximum mark for this paper is 100.
- Mark allocations are shown in brackets.
- This paper is synoptic. It assesses your understanding of the relationship between different aspects of Economics.
- You will be assessed on your ability to use an appropriate form and style of writing, to organise relevant information clearly and coherently, and to use specialist vocabulary where appropriate. The degree of legibility of your handwriting and the level of accuracy of your spelling, punctuation and grammar will also be taken into account.

Advice
- You are advised to spend approximately 45 minutes on **Section A** and approximately 45 minutes on **Section B**.

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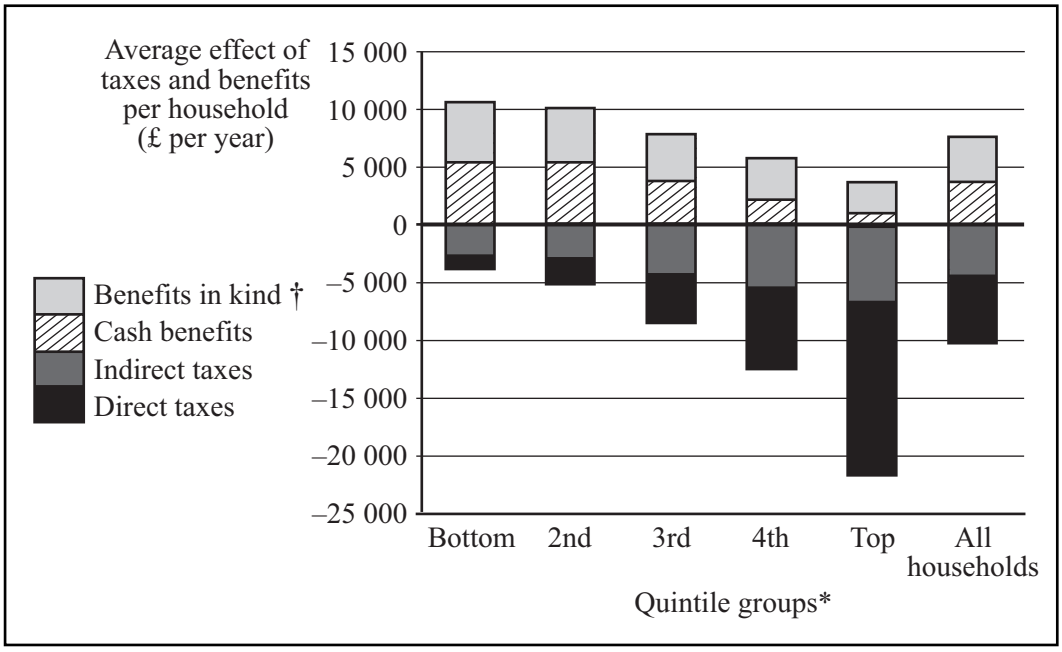
SECTION A

Answer **all** parts of this question.

1 **Total for this question: *50 marks***

Study **Extracts A**, **B and C**, and then answer **all** parts of Question 1 which follows.

Extract A: The effects of taxes and benefits on gross household income in the UK, by quintile group*, 2001–02



* Extracts A and B divide households into five equal size groups known as quintile groups; for example the bottom quintile group consists of the 20% of households with the lowest gross incomes.

† Benefits in kind include free state education and healthcare.

Source: Office for National Statistics, October 2003

Extract B: Selected taxes in the UK: percentage of gross household income paid in taxation, 2001–02

Tax	Quintile groups*					All households
	Bottom	2nd	3rd	4th	Top	
Income tax	3.2	6.3	10.3	13.5	18.3	13.7
National insurance contributions (NICs) paid by workers	1.2	2.4	4.0	4.8	3.8	3.8
Council tax (& local tax in N Ireland)	7.1	4.8	3.7	2.9	1.8	3.0
Value added tax	11.3	7.5	7.0	6.2	4.6	6.1
Duty on alcohol	1.6	1.0	1.0	0.9	0.6	0.8
Duty on tobacco	3.1	1.8	1.5	0.9	0.3	1.0

Source: Office for National Statistics, October 2003

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Extract C:

Extract C was an extract of text.
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Question 1

(a) Using **Extract A**, briefly compare how taxes and benefits affected the income of the different quintile groups of households in 2001–02. *(4 marks)*

(b) **Extract B** shows that as household income increases in the UK, the percentage of income paid in tax increases for some taxes, but falls for others. Using **two** examples of taxes shown in **Extract B**, explain why this is so. *(6 marks)*

(c) With the help of the data, use diagrams to analyse how changes in income tax may affect incentives in UK labour markets. *(10 marks)*

(d) Evaluate the case for **and** against the government changing the structure of the UK tax and benefit systems in order to make the distributions of income and wealth more equal. *(30 marks)*

TURN OVER FOR THE NEXT QUESTION

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SECTION B

Answer **one** question from this Section.

Each question carries 50 marks.

2 "When markets are contestable and efficient, there is no need for competition policy."

(a) Explain why contestable markets generally function more efficiently than non-contestable markets. *(20 marks)*

(b) Do you agree that there is no need for competition policy? Justify your answer. *(30 marks)*

3 (a) Explain how the law of diminishing returns and returns to scale affect a firm's costs of production. *(20 marks)*

(b) Evaluate the view that the separation of ownership from control in large firms inevitably causes diseconomies of scale. *(30 marks)*

4 (a) Explain how, by adversely affecting the environment, economic activity can lead to market failure. *(20 marks)*

(b) Evaluate the view that government intervention can correct all the market failures caused by the effects of economic activity on the environment. *(30 marks)*

END OF QUESTIONS

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GCE 2005
January Series

ASSESSMENT and QUALIFICATIONS ALLIANCE

Mark Scheme

Economics

ECN5
Business Economics and the Distribution of Income

Mark schemes are prepared by the Principal Examiner and considered, together with the relevant questions, by a panel of subject teachers. This mark scheme includes any amendments made at the standardisation meeting attended by all examiners and is the scheme which was used by them in this examination. The standardisation meeting ensures that the mark scheme covers the candidates' responses to questions and that every examiner understands and applies it in the same correct way. As preparation for the standardisation meeting each examiner analyses a number of candidates' scripts: alternative answers not already covered by the mark scheme are discussed at the meeting and legislated for. If, after this meeting, examiners encounter unusual answers which have not been discussed at the meeting they are required to refer these to the Principal Examiner.

It must be stressed that a mark scheme is a working document, in many cases further developed and expanded on the basis of candidates' reactions to a particular paper. Assumptions about future mark schemes on the basis of one year's document should be avoided; whilst the guiding principles of assessment remain constant, details will change, depending on the content of a particular examination paper.

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Further copies of this Mark Scheme are available to download from the AQA website: www.aqa.org.uk

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Advanced Level Economics

January 2005 **ECN 5**

Mark Scheme

General Instructions

Marks awarded to candidates should be in accordance with the following mark scheme and examiners should be prepared to use the full range of marks available. The mark scheme for most questions is flexible, permitting the candidate to score full marks in a variety of ways. Where the candidate's response to a question is such that the mark scheme permits full marks to be awarded, full marks **MUST** be given. A perfect answer is not necessarily required for full marks. But conversely, if the candidate's answer does not deserve credit, then no marks should be given.

Occasionally, a candidate may respond to a question in a reasonable way, but the answer may not have been anticipated when the mark scheme was devised. In this situation, **OR WHENEVER YOU HAVE ANY DOUBT ABOUT THE INTERPRETATION OF THE MARK SCHEME**, you must in the first instance telephone your team leader to discuss how to proceed.

Two approaches have been used in the construction of the mark scheme:

(i) **An 'issue' based approach.** The mark scheme for parts (a) and (b) of the data response question and part (a) of the essay questions adopts this approach. The questions do not generally require that the candidate demonstrates evaluative skills although some explanation and analysis may be expected. The mark scheme lists the marks that can be awarded for particular issues (and associated development) that the candidate might include in the answer. Marks awarded for development should take into account the Quality of Written Communication used by candidates as indicated on page 5 of this mark scheme.

(ii) **A 'levels' approach.** This approach is used for parts (c) and (d) of the data response question and part (b) of the essay questions. The mark scheme summarises the information required to answer the question, but without attaching marks to particular issues. Marks should be awarded according to whether the answer displays the skills indicated by the five Mark Band Descriptors or "Levels of Skill" included in the mark scheme. The Mark Band Descriptors are set out on page 4. When using a 'levels' mark scheme the marker **must** identify where a particular skill is being demonstrated. The **key** to be used to identify the skill is shown on page 5. The level chosen should be the one which **best fits** the answer provided by the candidate. It is **not** intended that the answer should satisfy every statement in the level description.

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APPLYING THE 'LEVELS' MARK SCHEME

Levels of Response Mark Band Descriptors

Level 1
Few, if any, relevant issues are recognised. Economic concepts and principles are not adequately understood or applied to the question and its context. No satisfactory analysis or evaluation. Little, if any, appreciation of the inter-relatedness of economic issues, problems and institutions. A poorly organised response which generally fails to answer the question. Descriptions and explanations lack clarity. Spelling, punctuation and grammar may be poor. There is little use of specialist vocabulary. **0 to 6 marks** *(Mid-Point: 3 marks)*

Level 2
A few issues are recognised but there is only limited evidence of the candidate's ability to apply relevant economic concepts. An attempt is made to answer the question but there is little satisfactory analysis or evaluation. Some very limited appreciation of the inter-relatedness of economic issues, problems and institutions. A poorly organised answer which does not have a clear structure. Descriptions and explanations are sometimes hard to follow. The candidate demonstrates some ability to spell commonly used words and to follow the standard conventions of punctuation and grammar. Some use of specialist vocabulary is made but this is not always applied appropriately. **7 to 12 marks** *(Mid-Point: 10 marks)*

Level 3
A few issues are recognised. The candidate has attempted to apply relevant economic concepts and ideas to the question and its context. A reasonable understanding of some concepts and theories is demonstrated. However, the evaluation of the issues, arguments and evidence is limited or superficial. Some understanding of the inter-relatedness of economic issues, problems and institutions. There is some logic and coherence in the organisation of the answer. The candidate is generally able to spell commonly used words and usually follows the standard conventions of punctuation and grammar. Some descriptions and explanations are easy to understand but the answer may not be expressed clearly throughout. Some use of specialist vocabulary which is applied appropriately. **13 to 20 marks** *(Mid-Point: 16 marks)*

Level 4
Several relevant issues are identified. Good understanding of some economic concepts and principles is demonstrated. The candidate is able to apply these concepts and principles to the context to help answer the question. There is some appreciation of alternative points of view. Satisfactory use is made of evidence and/or theoretical analysis to evaluate the issues and arguments identified. Good understanding of the inter-relatedness of economic issues, problems and institutions is demonstrated. Shows the ability to think as an economist making effective use of the economist's 'tool kit' of concepts, theories and techniques. Spelling is generally accurate and the standard conventions of punctuation and grammar are usually followed. The answer is well organised. Descriptions and explanations are usually clearly expressed. A wide range of specialist vocabulary is used with facility. **21 to 26 marks** *(Mid-Point: 24 marks)*

Level 5
Several relevant issues are identified. Good understanding of economic concepts and principles is demonstrated throughout. The candidate is able to apply these concepts and principles to the context to help answer the question. There is an appreciation of alternative points of view. Good use is made of evidence and/or theoretical analysis to evaluate the issues and arguments identified. The candidate demonstrates the ability to synthesise the arguments presented and come to a reasonable conclusion albeit tentative. A clear understanding of the inter-relatedness of economic issues, problems and institutions is demonstrated. Shows the ability to think as an economist making very effective use of the economist's 'tool kit' of concepts, theories and techniques. Spelling is accurate and the standard conventions of punctuation and grammar are followed. The answer is well organised. Descriptions and explanations are expressed with clarity throughout. Extensive use of specialist vocabulary which is applied adeptly and with precision.
27 to 30 marks *(Mid-Point: 29 marks)*

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THE KEY TO BE USED WHEN USING THE 'LEVELS' MARK SCHEME

D Where a particular economic term is correctly **DEFINED** in order to help the candidate to answer the question properly.

I Where a relevant **ISSUE** is raised by the candidate.

K Where the candidate demonstrates **KNOWLEDGE** of recent developments or features of the economy which help enhance the candidate's response to the question. This should also be used where the candidate quotes relevant examples.

Ap Where the candidate demonstrates the ability to **APPLY** knowledge and **CRITICAL UNDERSTANDING** to problems and issues.

A Where the candidate demonstrates the ability to **ANALYSE** the problem using appropriate economic ideas.

E Where the candidate **EVALUATES** and makes judgements about the significance of various issues and arguments.

QUALITY OF WRITTEN COMMUNICATION

The Mark Band Descriptors, which are used for assessing Question 1 (d) and part (b) of the essay questions, incorporate statements which relate to the Quality of Written Communication used by the candidates.

However, it is also important to assess Quality of Written Communication **whenever** candidates produce answers using continuous prose. When applying an issue based mark scheme, examiners must take into account the following when deciding how many marks to award for development:

(i) use of an appropriate form and style of writing to organise relevant information clearly and coherently;
(ii) use of specialist vocabulary, where appropriate;
(iii) legibility of handwriting;
(iv) accuracy of spelling, punctuation and grammar.

Synoptic Assessment

All questions in this unit are synoptic. Therefore, candidates will need to demonstrate that they are able to think as an economist and to use effectively the economist's 'tool kit' of concepts, theories and techniques.

They should demonstrate that they:

- understand the inter-relatedness of many economic issues, problems and institutions;
- understand how certain economic concepts, theories and techniques may be relevant to a range of different contexts;
- can apply concepts, theories and techniques in analysing economic issues and problems and in evaluating arguments and evidence.

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SECTION A

1 **Total for this question: *50 marks***

1 (a) Using **Extract A**, briefly compare how taxes and benefits affected the income of the different quintile groups of households in 2001-02. *(4 marks)*

For candidates who:

state that, for low income households, total benefits received are greater than total tax paid: **1 mark**
and back the point up with a relevant statistic or statistics: **1 mark**

state that, for higher income households, total benefits are less than total tax paid: **1 mark**
and back the point up with a relevant statistic or statistics: **1 mark**

make any relevant point about changes in total taxation, indirect taxation, direct taxation; changes in total benefits, benefits in kind and cash benefits: **1 mark**
and back the point up with a relevant statistic or statistics: **1 mark**

Maximum of 1 mark if the candidate trawls through the data, displaying no comparison
Maximum of 2 marks if no use is made of statistics
Maximum of 3 marks if the candidate does not make the comparison that benefits exceed taxes for low income households, but taxes exceed benefits for higher income households

Candidates do not have to use information from all the quintile groups to earn full marks, but they must compare at least one low and at least one high quintile group and make some relevant use of statistics

MAXIMUM FOR PART (a) 4 MARKS

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1 (b) **Extract B** shows that as household income increases in the UK, the percentage of income paid in tax increases for some taxes, but falls for others. Using **two** examples of taxes shown in **Extract B**, explain why this is so. *(6 marks)*

In Extract B, income tax is progressive, employees' NIC is partly progressive, but all the other taxes, including council tax, are regressive. To answer the question fully, and thus to earn full marks, candidates must select one example of a progressive tax and one of a regressive tax, and explain why the chosen taxes are respectively progressive and regressive. It is not necessary to use the terms progressive and regressive explicitly, though many candidates will use these terms. Do not award the available marks for inaccurate definitions of progressive and regressive taxation, e.g. defining a progressive tax as one for which total tax paid increases with income.

For candidates who:

describe the extent to which the tax paid in income tax or employees' NIC increases as income rises: **1 mark**

state that the tax is therefore progressive: **1 mark**

explain a particular feature of the tax which contributes to this result e.g. different marginal tax rates; the band of untaxed income: **up to 2 marks per explanation**

describe the extent to which the tax paid in one of the other taxes decreases as income rises: **1 mark**

state that the tax is therefore regressive: **1 mark**

explain a particular feature of the tax which contributes to this result e.g. richer households having given up smoking, the relatively low upper limit on the highest council tax band: **up to 2 marks per explanation**

Maximum of 2 marks for an answer in which there is no explanation
Maximum of 3 marks if only one tax is described and explained
Maximum of 4 marks for describing and explaining a tax for which the percentage of income paid in tax increases as income increases
Maximum of 4 marks for describing and explaining a tax for which the percentage of income paid in tax falls as income increases

MAXIMUM FOR PART (b) 6 MARKS

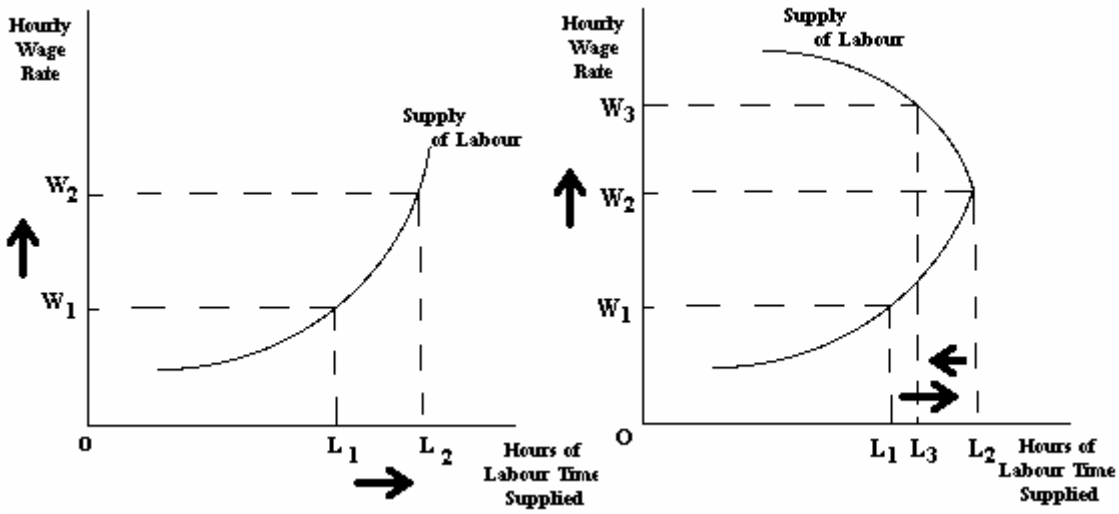
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1	(c)	With the help of the data, use diagrams to analyse how changes in income tax may affect incentives in UK labour markets. *(10 marks)*

Issues and areas for discussion and explanation include:

- How income tax affects disposable income;
- The effect of higher marginal rates of income tax as income increases;
- Analysis of the effect of the shape of the supply curve of labour;
- Comparing the effect of upward-sloping and backward-bending supply curves of labour;
- Explanation of the meaning of incentives;
- Analysis of the offsetting effects of fringe benefits, tax avoidance etc.;
- Discussion of different labour markets;
- Use of the data on income tax in Extract B and on the nature of the supply of labour in Extract C.
- Changes in marginal tax rates versus changes in personal tax allowances

The question requires candidates to use the data and to use diagrams. In a very good answer, there will be at least two diagrams (probably supply curve of labour diagrams such as one or both of those below), related to the information in Extract C. In the diagrams, a cut in marginal income tax rates increases the hourly wage rate from W_1 to W_2 or from W_2 to W_3. Full marks can be awarded for an answer, which, with the use of diagrams, analyses the effect of changes in marginal tax rates, with some relevant and accurate reference to Extract C. The effect of changes in personal tax allowances on incentives may also be discussed, though this is less likely.



Upward-sloping supply curve of labour

Backward-bending supply curve of labour

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LEVEL 1
At the bottom of the range, no accurate analysis or use of the data and no relevant diagrams. At the top of the range, an answer which attempts relevant analysis **or** use of the data and at least one relevant diagram, but both analysis or data use and diagrams contain significant inaccuracies. **1 to 3 marks**

LEVEL 2
At the bottom of the range, better analysis **or** at least one relevant and accurate diagram, but not both together and little use of the data. At the top of the range, incomplete but competent analysis and use of the data **and** at least one relevant and accurate diagram. **4 to 7 marks**

LEVEL 3
At the bottom of the range, good analysis and use of the data, but let down by incomplete diagrams or by the use of only one diagram. At the top of the range, good analysis and use of data, linked to two good diagrams. **8 to 10 marks**

MAXIMUM FOR PART (c) 10 MARKS

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1	(d)	Evaluate the case for **and** against the government changing the structure of the UK tax and benefit systems in order to make the distributions of income and wealth more equal. *(30 marks)*

The data provides two main prompts in relation to the possible effects of tax changes on the UK tax and benefit systems. Extract B indicates that certain taxes are progressive but that others are regressive. Extract C suggests that whether or not an increase in marginal tax rates has a disincentive effect in the labour market depends on the shape of a worker's supply curve of labour. However, the data makes no direct mention of the possible effects of redistributional policies via changes in welfare benefits (though there are some relevant numbers in Extract A). Explanation/analysis of the effect of changes to *either* tax *or* benefits is needed to reach Level 3, and some analysis/evaluation of both is required to score 21 marks or higher (Levels 4 and 5). A good Level 5 answer is likely to identify and explain at least two 'for' arguments, and at least one 'against' argument (or vice versa), explain or analyse each argument identified, and then evaluate whether on balance the case for is stronger than the case against.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

Issues and areas for discussion include:

- The extent to which the distribution of income is unequal;
- Different possible types of tax change e.g. marginal tax rates versus tax allowances;
- Different possible types of benefit change e.g. means tested versus universal benefits;
- Appreciation that for redistribution to occur, tax changes alone are not enough, though tax changes can alter the distribution of income when there are no changes in benefits;
- Incentive and disincentive effects of tax changes;
- Incentive and disincentive effects of benefit changes;
- Discussion of whether a more equal income distribution is desirable;
- Conflicts with other policy objectives e.g. economic growth;
- Government failure arguments.

Also give credit for:

- Relevant use of data and/or candidate's knowledge;
- Relevant use of evidence;
- Overall assessment.

USE THE LEVELS MARK SCHEME ON PAGES 4 & 5

MAXIMUM FOR PART (c) 30 MARKS

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SECTION B

Each question carries 50 marks

2

2 "When markets are contestable and efficient, there is no need for competition policy."

(a) Explain why contestable markets generally function more efficiently than non-contestable markets. *(20 marks)*

For candidates who:

define a contestable market in terms of:

a lack of or low barriers to entry: **2 marks**
a lack of or low sunk costs: **2 marks**

develop either of the above definitions, e.g. in the context of a particular market structure: **up to a further 4 marks per development**

define a relevant efficiency concept (e.g. productive, allocative, dynamic): **2 marks per definition**

explain why a contestable market may be more productively efficient: **up to a further 6 marks**

explain why a contestable market may be more allocatively efficient: **up to a further 6 marks**

explain why a non-contestable market may be more dynamically efficient: **up to a further 6 marks**

explain any other relevant point e.g. other efficiency concepts; application of market structure analysis for perfect competition, monopoly or oligopoly: **up to 3 marks per point**

Maximum of 10 marks for an answer with a full explanation of market contestability but no explanation of efficiency in the context of contestable and non-contestable markets, or vice versa.

MAXIMUM FOR PART (a) 20 MARKS

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2 (b) Do you agree that there is no need for competition policy? Justify your answer. *(30 marks)*

Answers which are solely provide historical description of competition policy will not reach Level 3. However, a candidate who distinguishes between interventionist competition policy and the less interventionist policy suggested by contestable market theory is likely to reach at least Level 3, even if the answer lacks descriptive detail. Analytical skills will be displayed if and when a candidate applies relevant theory, e.g. contestable market theory, or market structure, conduct and performance theory, to particular market structures. Evaluatory skills will be displayed when candidates discuss the significance of their analysis. They might argue that competition policy in the form of regulation is needed to make markets more contestable but that the policy can be removed or reduced once contestability has been established. Good answers may distinguish between *actual* and *potential* contestability. Some evaluation, building on analysis, is required to score 21 marks or higher (Levels 4 and 5).

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

Issues and areas for discussion include:

- The meaning of competition policy;
- Different aspects of competition policy towards monopoly, mergers and restrictive practices;
- Different types of competition policy, interventionist and non-interventionist;
- Theoretical approaches to competition policy, 'structure, conduct and performance', contestable market theory etc;
- Relevant application of theory to different market structures;
- Natural monopoly arguments;
- The role of regulation and competition policy;
- Application of efficiency concepts;
- Discussion of advantages of competition policy;
- Discussion of disadvantages of competition policy;
- Use of evidence;
- Overall evaluation and assessment.

Also give credit for:

- Relevant use of data and/or candidate's knowledge;
- Relevant use of evidence;
- Overall assessment.

USE THE LEVELS MARK SCHEME ON PAGES 4 & 5

MAXIMUM FOR PART (b) 30 MARKS

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3 **Total for this question: *50 marks***

3 (a)	Explain how the law of diminishing returns and returns to scale affect a firm's costs of production. *(20 marks)*

For candidates who:

explain the meaning of 'returns' in a short-term context: **up to 2 marks**

explain the law of diminishing returns: **up to 6 marks**

illustrate the law on a diagram: **up to 3 marks**

Maximum of 6 marks

For candidates who:

explain how the law of diminishing returns affects short-run costs: **up to 6 marks**

illustrate short-run costs on a diagram: **up to 3 marks**

Maximum of 6 marks

For candidates who:

explain the meaning of 'returns' in a long-run context: **up to 2 marks**

explain returns to scale: **up to 6 marks**

illustrate returns to scale on a diagram (if a LRAC diagram is used, do not double mark in the next section): **up to 3 marks**

Maximum of 6 marks

For candidates who:

explain how returns to scale affect long-run cost curves: **up to 6 marks**

illustrate long-run costs on a diagram: **up to 3 marks**

Maximum of 6 marks

Maximum of 10 marks if only returns or costs are covered.
Maximum of 14 marks if the linkage between returns and costs is explained ONLY in the short run OR in the long run.

MAXIMUM FOR PART (a) 20 MARKS

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3	(b)	Evaluate the view that the separation of ownership from control in large firms inevitably causes diseconomies of scale. *(30 marks)*

Good answers may explain why the growth of large firms often leads to a separation of ownership and control, and that the growth may lead to diseconomies of scale. The answer might argue that the two are not necessarily linked, and that, in many cases, separation of ownership from control is accompanied by economies of scale rather than by diseconomies of scale. Answers which solely explain and discuss the significance of diseconomies of scale, without addressing the issue posed by the question cannot reach Level 3, but a good answer of this type will be at the top of Level 2. Some knowledge of the advantages and disadvantages of large size and a reasonable attempt to analyse the issue posed by the question will reach Level 3, and will reach a mid to higher Level 3 if there is an attempt at evaluation. Fuller evaluation, building on analysis, is required to score 21 marks or higher (Levels 4 and 5). The main argument in support of the assertion is that the separation of ownership from control, by reducing shareholders' power to discipline executive directors pursuing managerial objectives at the expense of shareholders' interests, may promote managerial diseconomies of scale. The main counter-arguments relate to the word 'inevitably' in the question, and to the fact that separation of ownership from control may coexist with diseconomies of scale but not be their cause.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

Issues and areas for discussion include:

- Causes of the separation of ownership from control in large firms;
- Analysis and evaluation of its significance;
- Analysis of how the separation of ownership from control may create disadvantages for large firms;
- Causes of disadvantages of size / diseconomies of scale etc.;
- Relevant discussion of particular diseconomies of scale e.g. managerial diseconomies
- Analysis and evaluation of the significance of diseconomies of scale;
- Relevant discussion of economies of scale;
- Understanding of coincidence, and cause and effect
- Use of evidence from real world firms;
- Quality of the evaluation;

Also give credit for:

- Relevant use of data and/or candidate's knowledge;
- Relevant use of evidence;
- Overall assessment.

USE THE LEVELS MARK SCHEME ON PAGES 4 & 5

MAXIMUM FOR PART (b) 30 MARKS

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4 **Total for this question: *50 marks***

4 (a)	Explain how, by adversely affecting the environment, economic activity can lead to market failure. *(20 marks)*

For candidates who:

define market failure: **2 marks**

identify a type of environmental market failure e.g. a missing market in environmental pollution: **up to 2 marks**

explain the identified type (max 4 if there is no reference to effect of economic activity): **up to 8 marks**

providing a relevant example of the type: **up to 2 marks each example, up to a maximum of 4 mark per type**

use a relevant diagram: **up to 4 marks**

MAXIMUM FOR PART (a) 20 MARKS

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4	(b)	Evaluate the view that government intervention can correct all the market failures caused by the effects of economic activity on the environment. *(30 marks)*

Good answers may explain that governments can use the usual policies of taxation, subsidy, regulation, fines, exhortation, education, research, provision of recycling facilities etc. to reduce and sometimes eliminate **some** of the market failures caused by the effect of economic activity on the environment. To reach Levels 4 and 5, answers must analyse the implications of, and evaluate the significance of, the word **all** in the question. Many market failures related to the environment have international effects that are beyond the scope of an individual government to reduce or eliminate. Also, world-wide economic growth may increase the global effect of the market failure at a faster rate than the rate at which an individual government can reduce it. Reward answers that make these distinctions, particularly the distinction between individual government policy and co-operative policy between governments. Reward also evidence of examples of success, e.g. the inter-government agreement to reduce emissions of gases that created the gap in the atmospheric ozone layer. Good answers will argue that governments may be able to correct some but not all market failures caused by the effect of economic activity on the environment.

Answers which solely provide a narrow text-bookish description of policies to deal with externalities etc., without properly addressing the question, cannot rise above Level 2, but a reasonably full description will be at the top of Level 2. Accurate analysis, using appropriate diagrams, e.g. the effect of a tax on an MSB/MSC diagram, can take such an answer into Level 3, but no higher. To score 21 marks or higher (Levels 4 and 5), there must be wider and deeper analysis, developing ideas such as those in the paragraph above.

The issues identified below are intended to provide an indication of some of the areas which might be discussed. Candidates can only be expected to consider a few of these issues in the time available.

Issues and areas for discussion include:

- Identification of the most serious market failures causing environmental change, e.g. global warming;
- Explanation of the international nature and effects of such market failure;
- Description and analysis of policies an individual government can implement to reduce or eliminate particular market failures;
- Evaluation of the effect(s) of policies implemented by individual governments;
- The effects of world-wide economic growth;
- Discussion of the need for multilateral governmental activity;
- Analysis and evaluation of whether this can be sufficiently forthcoming;
- Does government failure, e.g. through wars and benign neglect, worsen market failures and create new failures?
- Discussing whether government intervention creates adverse or unintended consequences;
- Sustainable growth arguments;
- Can the market itself reduce the market failures, e.g. through price changes as resources are depleted, and through peoples' demand for more normal goods (a better environment) as they become richer?
- Overall analysis and evaluation.

Also give credit for:

- Relevant use of data and/or candidate's knowledge;
- Relevant use of evidence;
- Overall assessment.

USE THE LEVELS MARK SCHEME ON PAGES 4 & 5

MAXIMUM FOR PART (b) 30 MARKS

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