GCE A LEVEL MARKING SCHEME

SUMMER 2018

A LEVEL
ECONOMICS - COMPONENT 3
A520U30-1

INTRODUCTION

This marking scheme was used by WJEC for the 2018 examination. It was finalised after detailed discussion at examiners' conferences by all the examiners involved in the assessment. The conference was held shortly after the paper was taken so that reference could be made to the full range of candidates' responses, with photocopied scripts forming the basis of discussion. The aim of the conference was to ensure that the marking scheme was interpreted and applied in the same way by all examiners.

It is hoped that this information will be of assistance to centres but it is recognised at the same time that, without the benefit of participation in the examiners' conference, teachers may have different views on certain matters of detail or interpretation.

WJEC regrets that it cannot enter into any discussion or correspondence about this marking scheme.

GENERAL MARKING GUIDANCE

Positive Marking

It should be remembered that learners are writing under examination conditions and credit should be given for what the learner writes, rather than adopting the approach of penalising him/her for any omissions. It should be possible for a very good response to achieve full marks and a very poor one to achieve zero marks. Marks should not be deducted for a less than perfect answer if it satisfies the criteria of the mark scheme, nor should marks be added as a consolation where they are not merited.

For each question there is a list of indicative content which suggest the range of economic concepts, theory, issues and arguments which might be included in learners’ answers. This is not intended to be exhaustive and learners do not have to include all the indicative content to reach the highest level of the mark scheme.

The level based mark schemes sub-divide the total mark to allocate to individual assessment objectives. These are shown in bands in the mark scheme. For each assessment objective a descriptor will indicate the different skills and qualities at the appropriate level. Learner’s responses to questions are assessed against the relevant individual assessment objectives and they may achieve different bands within a single question. A mark will be awarded for each assessment objective targeted in the question and then totalled to give an overall mark for the question.

<table>
<tr><td colspan="3">1 (a) Explain why demand curves slope downwards from left to right and supply curves slope upwards from left to right. [10]</td></tr>
<tr><td></td><td>AO1</td><td>AO3</td></tr>
<tr><td>Band</td><td>6 marks</td><td>4 marks</td></tr>
<tr><td>3</td><td>5-6 marks
Excellent understanding

Excellent understanding of the economic theory relating to the slopes of demand and supply curves

Both demand and supply curves are covered comprehensively</td><td></td></tr>
<tr><td>2</td><td>3-4 marks
Good understanding

Good understanding of the economic theory relating to the slopes of demand and supply curves

The answer may lack a little range or depth and coverage of either demand or supply curves may be limited</td><td>3-4 marks
Good analysis

Good analysis of why demand and supply curves slope downwards and upwards to the right

There is a clear analysis of how a change in price will affect quantity demanded and supplied

Diagrams may be used to support the analysis</td></tr>
<tr><td>1</td><td>1-2 marks
Limited understanding

Limited understanding of the economic theory relating to the slopes of demand and supply curves

The answer may amount to a little more than a few assertions and coverage of economic theory is very superficial</td><td>1-2 marks
Limited analysis

Limited analysis of why demand and supply curves slope downwards and upwards to the right

The analysis of the link between a change in price and quantity demanded and supplied is limited</td></tr>
<tr><td>0</td><td>0 marks
No knowledge or understanding present</td><td>0 marks
No valid analysis present</td></tr>
</table>

Indicative content:

Demand curve sloping down to the right explained by marginal utility analysis, substitution and income effect.

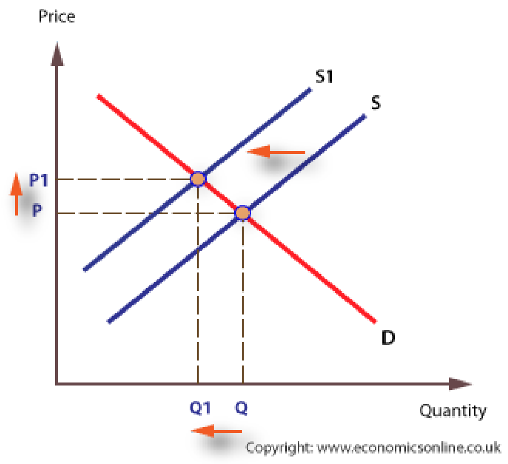
Demand curve is derived from consumers' marginal utility. Substitution effect - as price falls quantity demanded increases as the price of substitutes is relatively higher. Income effect – as price falls real income rises and thus if the product is a normal good quantity demanded increases.

Supply curves slope upwards to the right because at higher prices firms make higher profit and thus there is an incentive to increase quantity supplied. As quantity increases in the short run marginal costs increase (diminishing returns to a factor) thus higher prices are needed to cover increased marginal costs.

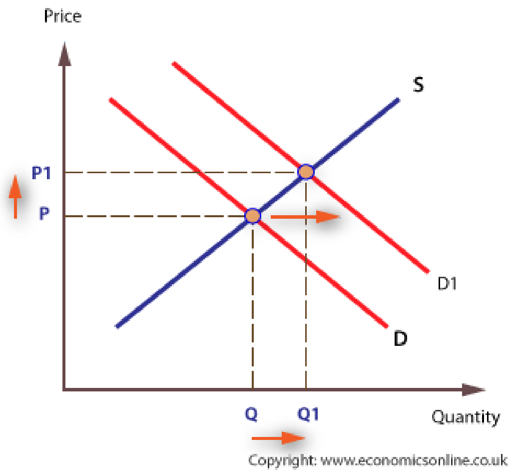
1 (b) **"A rise in price always leads to a fall in quantity demanded but a rise in demand always leads to a rise in price and a rise in quantity." With the aid of diagrams evaluate this statement.** **[20]**			
	AO1	**AO3**	**AO4**
Band	6 marks	6 marks	8 marks
3	**5-6 marks** Excellent understanding An excellent understanding of the difference between shifts and movements along a demand curve. There is a broad and comprehensive coverage with no significant omissions. Accurate diagrams with no significant errors are drawn which show the learner fully understands the concepts being tested.	**5-6 marks** Excellent analysis An excellent analysis of how changes in price affect quantity demanded and how changes in demand impact on price and quantity. Learner has a clear line of argument to explain how economic theory can explain the statement and may use appropriate examples. Accurate and relevant diagrams will support the analysis and these are well integrated into the answer.	**6-8 marks** Excellent evaluation A critical evaluation. Evaluative points are well developed and relevant diagrams are well integrated and support the evaluation. Learner demonstrates clearly that the statement is not accurate in all circumstances.
2	**3-4 marks** Good understanding Good understanding is shown of the difference between shifts and movements along a demand curve. There may be some lack of depth in the answer. Diagrams are generally accurate but have minor errors. Diagrams may not be fully integrated into the answer.	**3-4 marks** Good analysis A good analysis of how changes in price affect quantity demanded and how changes in demand impact on price and quantity. Analysis may lack depth and diagrams not always be well integrated or completely correct or key points are missing.	**3-5marks** Good evaluation A good evaluation. Evaluative points may not always be fully rounded. Diagrams are relevant to the evaluation but may contain minor errors or could be better integrated to the written answer.
1	**1-2 marks** Limited understanding Limited understanding of the difference between shifts and movements along demand curves. There will be gaps in knowledge and understanding. Diagrams may either not be present or be inaccurate.	**1-2 marks** Limited analysis A limited analysis of how changes in price affect quantity demanded and how changes in demand impact on price and quantity. The answer lacks key economic concepts and avoids technical analysis. Diagrams are either inaccurate or absent or don't support the analysis.	**1-2 marks** A limited evaluation A basic attempt is made to show that the statement is not always correct but there is a tendency to just make assertions. Diagrams are either absent, incorrect, or not integrated to the written answer.
0	**0 marks** No knowledge or understanding is shown.	**0 marks** No relevant analysis	**0 marks** No valid evaluation present.

Indicative content:

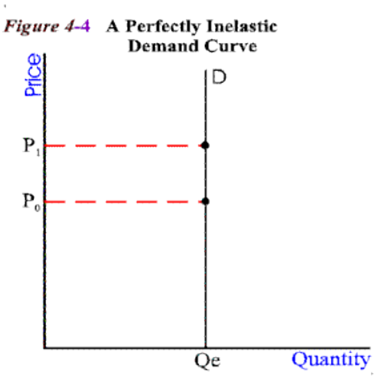
Rise in price leads to a fall in quantity demanded – relate to substitution and income effects. Diagram showing a fall in quantity demanded as a result of a shift to the left of the supply curve.



If there is a rise in demand then the demand curve shifts to the right leading to a rise in quantity. Learner explains the process that leads to this i.e. price cannot remain at P otherwise there would be excess demand.



Rise in price does not always lead to a fall in quantity demanded if demand is perfectly price inelastic.



Reward learners who explain and draw perverse demand curves e.g. Giffen and Veblen goods.

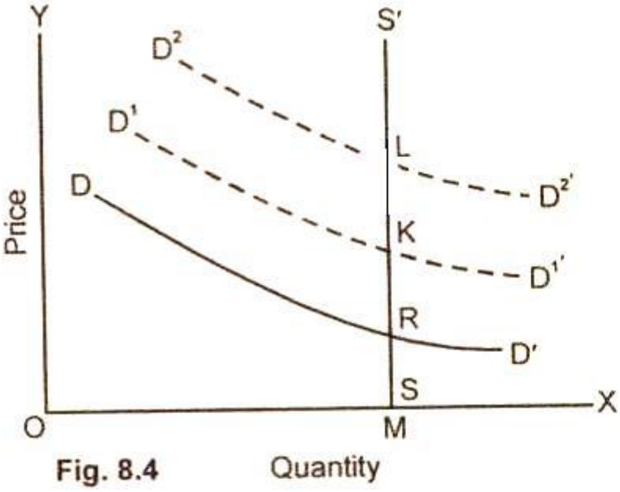


Fig. 8.4

A rise in demand will lead to a rise in price alone if supply is perfectly price inelastic.

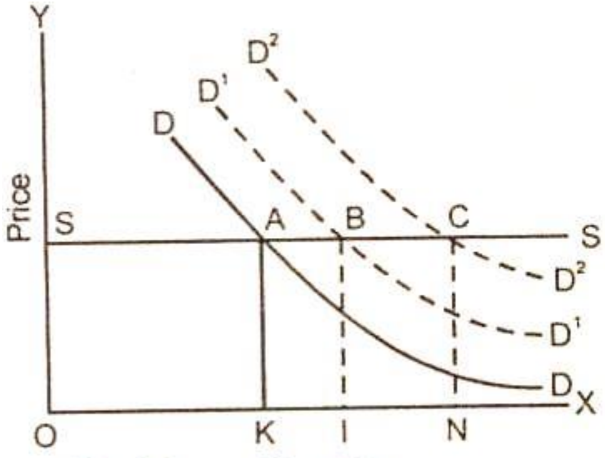


Fig. 8.3

A rise in demand will lead to a rise in quantity alone if supply is perfectly price elastic.

2 (a) Explain, using diagrams, the reasons that profit maximising firms in monopolistic competition might decide to increase their prices. [10]		
	AO1	**AO3**
Band	6 marks	4 marks
3	**5-6 marks** Excellent understanding Excellent understanding of monopolistic competition and the factors that might cause a price change. Accurate diagrams reflecting both cost and revenue factors.	
2	**3-4 marks** Good understanding Good understanding of monopolistic competition and the factors that might cause a price change. Accurate diagrams reflecting cost or revenue factors **or** excellent diagrams without a good understanding of monopolistic competition.	**3-4 marks** Good analysis Good analysis of why prices will rise explaining carefully how changes in costs and revenues can cause prices to rise.
1	**1-2 marks** Limited understanding Limited understanding of monopolistic competition and the factors that affect price. Diagrams contain errors and look at only one set of factors.	**1-2 marks** Limited analysis Limited analysis of why prices will rise, either explaining both cost and revenue factors superficially or explaining one set of factors well but ignoring the other. The analysis of the link between a change in price and quantity demanded and supplied is limited.
0	**0 marks** No knowledge or understanding is shown.	**0 marks** No valid analysis present.

Indicative content:

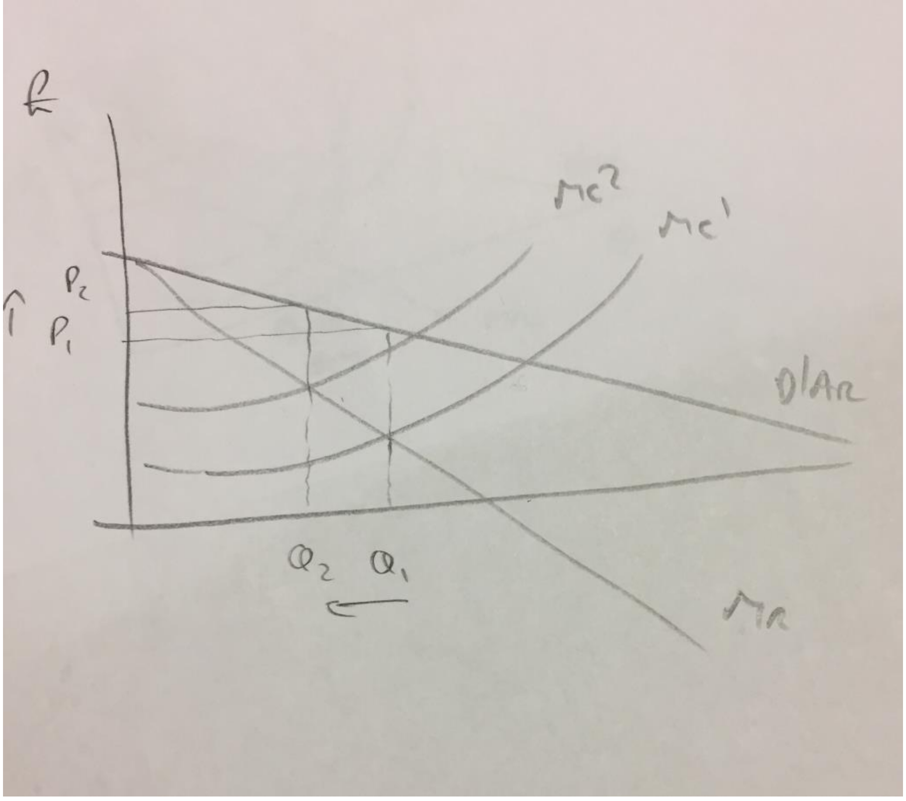
A profit maximising firm will only change price if there is a change in the profit maximising output, meaning that this can only occur if either MC or MR change.

MC – changes in raw material costs, direct labour etc.

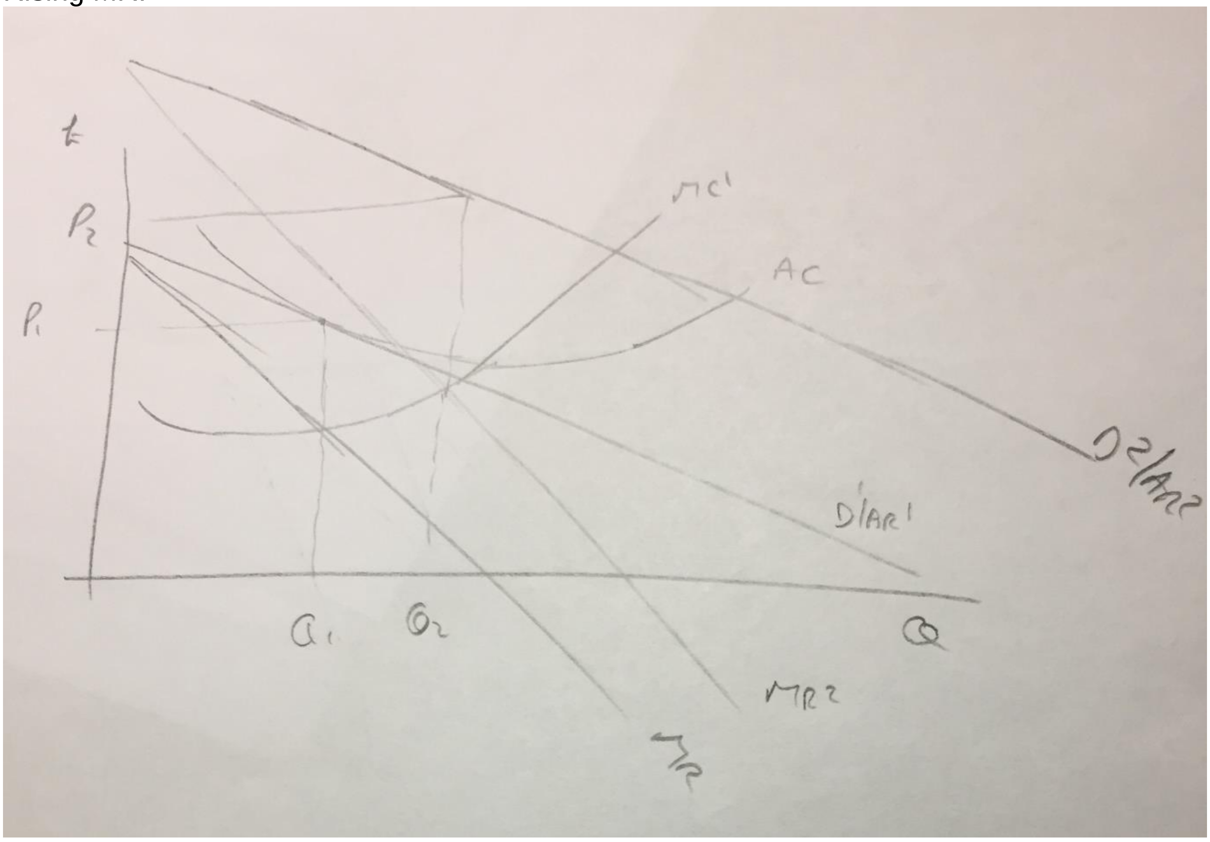
MR – rise in demand as a result of external factors, effective advertising campaigns etc.

In each case, the profit maximising output will change, resulting in a change in the profit maximising price.
Advertising/innovation may allow a firm to raise price.

Rising MC:



Rising MR:



2 (b) To what extent is monopolistic competition a more desirable market structure than perfect competition? [20]			
	AO1	**AO3**	**AO4**
Band	6 marks	6 marks	8 marks
3	**5-6 marks** Excellent understanding Excellent understanding of the differences between perfect competition and monopolistic competition, showing full understanding of the key features of each market structure	**5-6 marks** Excellent analysis An excellent analysis of the advantages of one market structure over another, looking at both efficiency and consumer effects. Diagrams will be present and will be well integrated into the answer.	**6-8 marks** Excellent evaluation Well-developed two sided answer that looks at the relative merits of the two structures. Comes to a reasoned judgement as to the extent to which one structure is more desirable than the other.
2	**3-4 marks** Good understanding One market structure is understood well and the other one to a more limited extent, missing key features of one of the market structures	**3-4 marks** Good analysis A good analysis of the advantages of one market structure over another. Answer looks only at efficiency or consumer effects. Diagrams are not well used.	**3-5 marks** Good evaluation A strong two-sided answer with effective points in favour of both market structures, but which never directly answers the question set in terms of coming to a reasoned conclusion.
1	**1-2 marks** Limited understanding Neither market structure is well understood, but there is limited understanding of each one. Key features of each market structure are missing.	**1-2 marks** Limited analysis A limited analysis of the advantages of one market structure over another. Diagrams are weak and poorly explained.	**1-2 marks** Limited evaluation Evaluation, although relevant, lacks depth of development.
0	**0 marks** No knowledge or understanding is shown	**0 marks** No valid analysis	**0 marks** No valid evaluation

Indicative content:

Perfect competition is the most price competitive market structure possible and is characterised by perfect knowledge, identical products, free entry and exit in the long run (contestability), and many buyers and sellers.

Monopolistic competition is similar, but lacks perfect knowledge and identical products.

Perfect competition is productively, allocatively and X efficient in the long run (might not be productively efficient in the short run), but will not be dynamically efficient. Products are identical, meaning that consumers lack meaningful choice, even though prices will be low.

In monopolistic competition, prices will be higher as a result of imperfect knowledge and product differentiation. Firms are neither productively nor allocatively efficient, although will probably be X efficient. Not dynamically efficient due to absence of long run abnormal profit. Product differentiation means that consumer needs are more closely met, possibly resulting in higher levels of consumer satisfaction.

Desirability explained in the context of monopolistic competition – more consumer choice/differentiated products.

Much will depend on the nature of the market itself as to which structure is more desirable.

3 (a) Outline two measures of inflation in the UK and explain how they are calculated. [10]		
	AO1	**AO3**
Band	6 marks	4 marks
3	**5-6 marks** Excellent understanding of how inflation is calculated. Strong understanding of two measures of inflation in the UK showing their key distinctive features	
2	**3-4 marks** Good understanding Strong understanding of one measure of inflation showing all of its key distinctive features with limited understanding of the other in which only the broad outline is given Or reasonable understanding of both measures is shown, but some salient features are missing from each.	**3-4 marks** Good analysis Good explanation of the calculation of inflation, with the key elements of inflation methodology explained.
1	**1-2 marks** Limited understanding Understanding of both measures is limited with a broad outline of each measure shown, but lacking in key details which make each measure limited.	**1-2 marks** Limited analysis Some explanation of the calculation of inflation, but important elements of the calculation are missing.
0	**0 marks** No knowledge or understanding is shown.	**0 marks** No valid explanation present

Indicative content.

Price collection
The CPI and RPI both measure the average change in price of a fixed basket of goods and services over time. Both indices are based on a comprehensive price collection that combines the price movements of around 180,000 price quotes collected each month, for a range of over 650 representative goods and services, from a selection of over 20,000 retail outlets in over 140 locations within the UK, as well as including a range of prices obtained from the internet.

Fixed basket approach
The basket of goods and services is fixed within each year and is selected to be representative of the items bought by UK households and is priced each month. Fixing the basket of goods and services means that as prices change within each year, the relative quantities of each type of product purchased remain constant. Thus within year movements, for example the monthly inflation rates, reflect only changes in prices.

Weights
Inflation also takes into account how much we spend on different items.
Thus, items are weighted - i.e. given more importance in the inflation indexes - according to how much we spend on them.

Quality adjustments: There is an attempt to ensure that the quality of products in the basket remains constant and where items disappear, replacements are carefully selected.

The main differences between the CPI and RPI relate to:

population base – the RPI excludes very high and low income households and hence the CPI has a wider population coverage than the RPI

commodity coverage - the CPI excludes owner occupiers' housing costs and hence the RPI has wider commodity coverage than the CPI

index methodology – formula*:* the CPI and CPIH mostly use the geometric mean (with some use of the arithmetic mean) whereas the RPI uses the arithmetic mean. The RPIJ uses the same formula as the RPI with the exception of one form of the arithmetic mean (known as the Carli) who's use has been replaced by the geometric mean.

Additional notes:

Key differences between CPI and RPI

	CPI	RPI
Origins	EU in 1996	UK in 1956
Purpose	To compare euro countries for compliance with Maastricht Treaty	To monitor cost of living for government planning and the basis of many agreements (e.g. wages)
Main exclusions (compared with household expenditure)	Council tax Mortgage interest payments House prices (depreciation) House purchase costs (e.g. stamp duty) Buildings insurance Ground rent Holiday spending abroad Income tax/National insurance	Income tax/National Insurance Life insurance and pension charges
But includes	Foreign students tuition fees Forex commission for tourists	Spending when abroad on holiday
How data averaged	Mainly geometric means Some normal ratio of averages	Mix of ratios of averages (i.e. normal average of all prices checked) and average of the relatives (i.e. work out the price change at each store and then average these)
Data source for weights	Household monetary consumption expenditure component of the national accounts (-> weighted towards consumption of the rich)	ONS's Living Costs and Food Survey
Population for weighting	All UK residents	Excludes the wealthy and pensioners on state benefits (i.e. 13% of population)

What are RPIJ and CPIH?

In response to criticisms of the large difference between CPI and RPI, in 2013 the ONS created some additional measures.

CPIH is similar to the CPI index but it includes household rents. Importantly it does not include any measure of house prices nor the cost of mortgages. It therefore typically creates an estimate of inflation that is lower than CPI. The H stands for Housing.

RPIJ is similar to RPI but instead of using ordinary mean scores to combine the prices it uses the geometric means which CPI uses. This ensures it will always produce a lower apparent level of inflation. The J stands for Jevons who was a statistician who promoted the use of geometric means.

3 (b) Deflation is more of a concern than inflation. Discuss.			[20]
	AO1	**AO3**	**AO4**
Band	6 marks	6 marks	8 marks
3	**5-6 marks** Excellent understanding Excellent understanding of the differences between inflation and deflation and knowledge of their costs.	**5-6 marks** Excellent analysis An excellent analysis of the costs of either inflation or deflation with good depth of explanation and range.	**6-8 marks** Excellent evaluation Well-developed two sided answer that qualifies the relative demerits of the inflation and deflation, looking at the underlying causes. Comes to a reasoned judgement as to the extent to which one is worse than the other.
2	**3-4 marks** Good understanding There is good understanding of inflation and deflation but knowledge of the costs of one of them is limited.	**3-4 marks** Good analysis A good analysis of either the costs of inflation and deflation. The range may be limited or depth of explanation may be lacking on one or the other.	**3-5 marks** Good evaluation A strong two-sided answer with qualified points against both deflation and inflation, but which never directly answers the question set in terms of coming to a reasoned conclusion.
1	**1-2 marks** Limited understanding Only one of the two is well understood or both are understood to a limited extent. The range of costs is limited.	**1-2 marks** Limited analysis Some costs of inflation and deflation are explained but both depth and breadth is limited.	**1-2 marks** Limited evaluation The answer is two sided and attempts to argue that both are bad, but qualification is quite limited and underdeveloped.
0	**0 marks** No knowledge or understanding is shown.	**0 marks** No valid analysis	**0 marks** No valid evaluation

Indicative content:

Inflation is a process of sustained increases in the price level over time.
Deflation is a process of sustained falls in the price level over time.

Inflation:
The impact will depend on the underlying causes (cost-push vs demand pull), the extent to which it has been anticipated, its relative level/how high it is, its duration and so on.

Key problems of inflation include:

Redistributive effects

- Low income/fixed income to high income
- Low skilled to high skilled
- Private sector to public sector (fiscal drag)
- Savers to borrowers

Macro effects

- Damage to confidence, hitting I/FDI
- Downward pressure on the exchange rate
- Risk of rising interest rates in response
- Risk of rising unemployment (cost-push)
- Risk of wage/price spiral developing

Efficiency effects

- Disguises inefficiency
- Interferes with price mechanism

Other effects

- Menu costs
- Shoe leather costs.

Deflation
Much will depend on the cause of deflation (supply-side vs demand side), how long it stays for (risk of deflationary expectations) its extent, the surrounding policy environment etc.

Key problems include

- Liquidity trap renders monetary policy powerless/real interest rates rise-less spending- higher unemployment
- Rising real burden of debt increases savings, further depressing AD
- Demand deflation shrinks profits, causing layoffs
- Increase in the real value of national debt
- Incentive to defer spending until a future date contributes to a deflationary spiral- economic stagnation-lower growth and rising unemployment
- Even supply side deflation carries the risks of ‘second round’ effects
- Real wage unemployment - sticky wages create a situation of excess supply of labour

4 (a) Explain why unemployment creates social and economic costs. [10]		
	AO1	**AO3**
Band	6 marks	4 marks
3	**5-6 marks** Excellent understanding Learner has an excellent understanding of the major costs of unemployment and has explained clearly why these costs may arise from unemployment. A top band response will have a well-developed understanding of several costs of unemployment. Lower in this band the response will have fewer costs developed, or development of a wider range may not be rather superficial.	
2	**3-4 marks** Good understanding Answers in this band will have fewer costs developed than a band 3 answer or development of a wider range may not be so full.	**3-4 marks** Good analysis Each cost of unemployment is explained in detail analysing its impact on individuals or society. There are clear lines of reasoning between unemployment and how it impacts on the economy and society.
1	**1-2 marks** Limited understanding Learner can only demonstrate a narrow knowledge of the costs of unemployment and depth of understanding may be limited.	**1-2 marks** Limited analysis Limited analysis of how unemployment imposes costs on individuals and society. Some linkage between unemployment and its impact on the economy and society.
0	**0 marks** No knowledge or understanding present.	**0 marks** No valid analysis present.

Indicative content:

Loss of earnings to the unemployed. Unemployment is one of the biggest causes of poverty and homelessness.

Depression, mental anxiety and health problems are higher among the unemployed. Costs to the NHS and society (external costs).

Long term unemployed find it difficult to get jobs deskilling/hysteresis.

Loss of tax revenues for the government and higher spending on unemployment related benefits – worsening of the fiscal deficit.

Lower GDP for the economy, loss of output, not working at full capacity thus not productively efficient.

Increased crime, vandalism, alienation.

4 (b) **"It is possible to reduce the natural rate of unemployment/NAIRU but not possible to reduce unemployment below the natural rate/NAIRU." Evaluate this statement. [20]**			
	AO1	**AO3**	**AO4**
Band	6 marks	6 marks	8 marks
3	**5-6 marks** Excellent understanding An excellent understanding of the concept of natural unemployment. Several labour market supply side policies identified which demonstrate how natural unemployment can be reduced. Learner shows an excellent understanding of how these policies will reduce natural unemployment. Learner shows understanding of why attempts to reduce unemployment below the natural rate will not succeed.	**5-6 marks** Excellent analysis An excellent analysis of why the successful implementation of supply side policies will reduce the natural rate of unemployment. Learner has a clear line of argument to explain how these policies will reduce natural unemployment and why attempts to reduce unemployment below the natural rate will be unsuccessful. Answers in this level will use appropriate diagrams to support their analysis and integrate them into the text of the answer.	**6-8 marks** Excellent evaluation An excellent critical evaluation. Evaluation points are well developed showing why the statement may not be correct. An overall judgement may be included which draws together issues from both sides of the argument. There is an integrated approach to evaluation.
2	**3-4 marks** Good understanding A good understanding of the concept of natural unemployment. Some labour market supply side policies are identified which demonstrate how natural unemployment can be reduced. There may be a lack of development or few policies are identified.	**3-4 marks** Good analysis A good analysis of why the successful implementation of supply side policies will reduce the natural rate of unemployment and why attempts to reduce unemployment below the natural rate will be unsuccessful. Some analysis will lack depth and diagrams may contain minor errors or not be well integrated.	**3-5 marks** Good evaluation Evaluation questions the accuracy of the statement but answers in this level will lack a fully rounded approach to the question. Evaluation may be a little fragmented and less integrated.
1	**1-2 marks** Limited understanding A limited understanding of the concept of natural unemployment. Supply side policies are identified but understanding of their link to the reduction of natural unemployment is not shown. There may be a tendency to merely produce assertions.	**1-2 marks** Limited analysis Limited analysis of how supply side policies will reduce natural unemployment and why attempts to reduce unemployment below the natural rate will be unsuccessful. Analysis is brief and superficial. There is little use of economic theory or technical analysis.	**1-2 marks** Limited evaluation A basic attempt is made to show that the statement can be challenged. Points are qualified to a limited extent but there is little depth of explanation.
0	**0 marks** No knowledge or understanding present.	**0 marks** No relevant analysis.	**0 marks** No valid evaluation present.

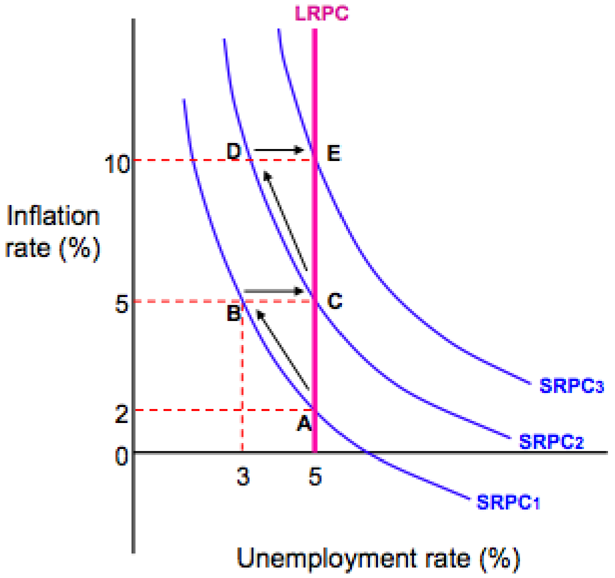
Indicative content:

Natural unemployment: the level of unemployment when the labour market is in equilibrium.

Supply side policies will reduce the natural rate of unemployment – trade union reform, increased skill levels, improved mobility of labour, benefit reform, better job information etc. Explanation of how these policies enable workers to compete more effectively in the labour market and reduce structural, frictional, real wage and voluntary unemployment.

Use of the LRPC and/or LRAS curve diagram.

Attempts to reduce unemployment below the natural rate through increased government spending will lead to higher inflation and no permanent fall in unemployment. Use of LRPC/SRPC analysis – adaptive expectations. Reward candidates who take an approach using rational expectations theory.



With adaptive expectations theory there is a short term fall in unemployment below the natural rate when governments reflate AD.

Keynesian viewpoint is that reflation does not cause inflation and leads to a fall in unemployment. There is a long run trade-off between unemployment and inflation.

The concept of natural unemployment is challenged by some economists.

5 (a) Explain the factors that might cause a country's exchange rate to depreciate. [10]		
	AO1	**AO3**
Band	6 marks	4 marks
3	**5-6 marks** Excellent understanding Excellent understanding of the factors that can cause a country's exchange rate to depreciate. At the top of this band a well-developed understanding of 3 or 4 factors will have been demonstrated.	
2	**3-4 marks** Good understanding Answers in this band will have fewer factors developed than a band 3 answer or development of a wider range of factors will not be as comprehensive. Answers in this level are likely to show a good understanding of only 2 factors or partial development of a number of factors.	**3-4 marks** Good analysis There is a logical development and clear analysis. Generally there are well-developed lines of reasoning shown between the factor being identified and its impact on the country's exchange rate. A diagram may have been used to support the analysis.
1	**1-2 marks** Limited understanding Only a basic knowledge of the factors that influence the exchange rate have been demonstrated. A few factors may have been identified but there is little or no development.	**1-2 marks** Limited analysis Reasoning is generally not well developed and lines of reasoning between the factor being identified and its impact on the exchange rate are unclear or undeveloped.
0	**0 marks** No knowledge or understanding is present.	**0 marks** No valid analysis present.

Indicative content:

There is a fall in the world price of a country's exports. This leads to a decline in export revenues and a fall in demand for the currency causing the exchange rate to fall.

There is an increase in the demand for imports and services coming into a country increasing the supply of currency causing the exchange rate to fall.

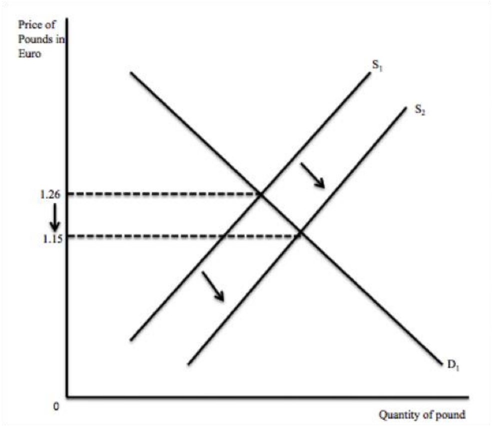
A deficit on the current account of the balance of payments leads to a net outflow of currency, causing the exchange rate to fall.

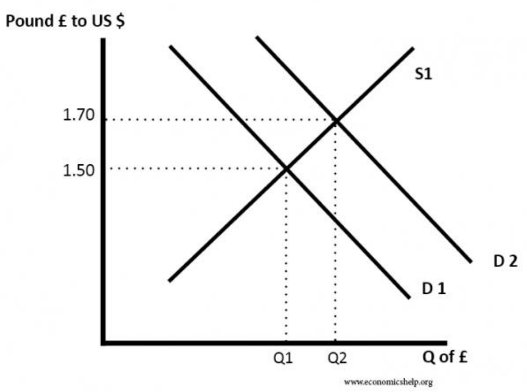
A country's central bank could cut interest rates, leading to a net outflow of hot money – increasing the supply of currency causing the exchange rate to fall.

Depreciation might be caused by Central Bank intervention if it enters the foreign exchange market to sell domestic currency and buy gold and foreign exchange. This increase in the supply of domestic currency causes the exchange rate to fall.

Demand for a currency might fall if currency traders / speculators expect the exchange rate to depreciate in the future causing them to sell on the market increasing the supply of currency causing it to fall.

If central banks pursue quantitative easing this can cause a fall in the exchange rate as it raises the prospect of future inflation (via increased money supply), making UK bonds less attractive to buyers.





5 (b) To what extent would an improvement in the terms of trade improve the balance of trade? [20]			
	AO1	**AO3**	**AO4**
Band	6 marks	6 marks	8 marks
3	**5-6 marks** Excellent understanding of the meaning of the terms of trade and the balance of trade and how they are inter-related. Answer shows a detailed understanding of a number of points on either side of the question i.e. that an improvement in the terms of trade can affect the balance of trade positively or negatively.	**5-6 marks** An excellent analysis of how an improvement in the terms of trade could affect the balance of trade. Learner has a clear line of argument explaining the causal relationship from a change in the terms of trade and its effect on the balance of trade.	**6-8 marks** An excellent critical evaluation. Evaluation is integrated effectively – each point is well-discussed and then challenged. At the top of the bands responses are likely to have an overall judgement.
2	**3-4 marks** Good understanding of the meaning of the terms of trade and balance of trade. There is a good understanding of how an improvement in the terms of trade may affect the balance of trade positively or negatively although some of the development may be limited or superficial.	**3-4 marks** A good analysis of the impact of an improvement in the terms of trade on the balance of trade. There may a good line of argument but clarity of analysis may be lacking.	**3-5 marks** A good evaluation. There are number of valid evaluation points although they are not effectively integrated. Some evaluative points lack development.
1	**1-2 marks** Limited understanding of the terms of trade and the balance of trade and how they relate to one another. There is a limited understanding of how an improvement in the terms of trade may affect the balance of trade.	**1-2 marks** Limited analysis of the impact of an improvement in the terms of trade on the balance of trade. The line of argument explaining how changes in the terms of trade affect the balance of trade may lack clarity.	**1-2 marks** A limited evaluation. A few evaluative points are made but merely as assertions. The points made are not developed and superficial.
0	**0 marks** No knowledge or understanding shown.	**0 marks** No valid analysis present.	**0 marks** No valid evaluation present.

Indicative content:

Understanding of terms of trade: the amount of imports an economy can purchase per unit of exports. Terms of Trade (TOT) Index = 100 x Average export price index / Average import price index. If a country can buy more imports with a given quantity of exports, its terms of trade have improved.

An improvement in the TOT means that export prices are rising relative to import prices and thus the economy is less price competitive. This may adversely affect the balance of trade because import demand may increase and export demand may fall.

There is an assumption that the Marshall-Lerner condition doesn't apply - if demand for exports and imports is relatively inelastic PEDx + PEDm < 1 then an improvement in the terms of trade will improve the balance of trade.

There could be a reverse J Curve effect, where an improvement in the terms of trade improves the balance of trade in the short term (inelastic demand) but worsens it in the long term (elastic demand).

An improvement in the TOT may be due to a rise in export demand causing a rise in export prices.

Exports may sell even if prices are rising as they offer non-price advantages such as quality, design, reliability etc.

6 (a) Explain the main ways in which countries can protect their domestic industries from foreign competition. [10]		
Band	AO1	AO3
	6 marks	4 marks
3	**5-6 marks** Excellent understanding of a good range of protectionist measures is given, probably using diagrams. It will be difficult for a very strong understanding of protectionist policies to be demonstrated without diagrams because the answers will tend to lack depth. It is likely that 3 main forms of protection will be covered here.	
2	**3-4 marks** Good understanding of a range of protectionist measures is given. A narrower range of factors is given, or a wide range but they are lacking in depth of analysis (weak diagrams or a lack of explanation).	**3-4 marks** Good analysis of methods of protection is well developed in terms of how domestic industries will be protected – answers link to higher market share, profitability and so on.
1	**1-2 marks** Limited understanding of a good range of protectionist measures is given. Protectionist policies are identified, but there is limited development in terms of how they actually operate.	**1-2 marks** Limited analysis of methods of protectionism. There is some attempt to relate or to link the policies to the benefits to domestic firms, but the answers tend to be general or simply based around diagrams (i.e. output rises from Q1 to Q2) without fully explaining how the firms will actually be protected.
0	**0 marks** No understanding shown.	**0 marks** No valid analysis.

Indicative content:

Tariffs – increase prices for imports allowing local firms to be more competitive, make more profit and expand market share.

Quotas/tariff quotas. The former restrict the absolute level of imported products, allowing domestic firms to have a higher market share and to sell at a higher price than would otherwise be the case. Tariff quotas allow only a limited number of imports in at reduced tariff levels.

Subsidies to domestic firms – reduce costs increase profits and allow market share to be expanded.

Precautionary bans drive up costs for imported firms or prevent them from selling altogether, again allowing higher price and market share for domestic firms, increasing profitability.

Managed exchange rates drive up the prices of imports, allowing domestic firms to undercut them more easily.

Regulations and standards, which favour domestic firms.

Allow other well-explained plausible policies.

6 (b) How effective are moves towards more free-market based systems involving internal and external liberalisation likely to be in raising living standards in LEDCs? [20]			
Band	AO1	AO3	AO4
	6 marks	6 marks	8 marks
3	**5-6 marks** Excellent understanding of both internal and external liberalisation has been clearly demonstrated.	**5-6 marks** Excellent analysis as to how both internal and external reforms can promote higher living standards/an excellent analysis as to why the reforms will **not** improve living standards. There are probably 3 well developed lines of argument here and will be likely to draw on specific cases to illustrate the theory.	**6-8 marks** There is a well-balanced assessment as to the value of liberalisation in terms of its impact on living standards. Answers are likely to look at the circumstances in which policies are likely to be more or less effective (it depends on and why). Answers in this band will be likely to have examples of some of the impacts of liberalisation.
2	**3-4 marks** Answers in this band are likely to focus on one type of liberalisation showing limited understanding of the other. Alternatively some understanding of each may be shown, but not in sufficient depth to warrant a band 3 mark	**3-4 marks** Good analysis of the effect of liberalisation (either good or bad) in terms of living standards is given, but either the answer focuses too heavily on one at the expense of the other, or the depth of analysis is not sufficient.	**3-5 marks** Answers in this band are strong two sided approaches which in the end fail to judge the actual significance of liberalisation in terms of raising living standards.
1	**1-2 marks** Answer shows some understanding of liberalisation but misses key elements from both.	**1-2 marks** Analysis tends to be superficial outlining some benefits or problems of liberalisation but not tying them back to living standards and not really showing a good understanding of the process through which improvement/deterioration will occur.	**1-2 marks** Some counter-arguments are present, but they tend to be asserted rather than analysed. Hence the depth of explanation that is required for a higher band is absent.
0	**0 marks** No valid understanding shown.	**0 marks** No valid analysis.	**0 marks** No valid evaluation.

Indicative content:

Internal liberalisation tends to involve policies such as privatisation, deregulation and reduction of government sector debt via cuts in government spending.

External liberalisation tends to involve the removal of trade barriers, free movements of capital, free floating exchange rates and liberalisation of FDI.

These policies broadly amount to a set of supply side reforms intended to strengthen the underlying economic base of LEDCs. Hence:

Reduction of public sector debt should reduce crowding out (stimulating private sector investment) and allow funds to be directed towards growth-promoting areas rather than debt repayments. Hence growth can be promoted expanding choice for individuals and raising living standards.

Privatisation and deregulation have similar aims in terms of increasing competition, driving up efficiency and productivity and therefore supporting growth.

Likewise, external liberalisation challenges domestic firms to become more efficient and outward looking, while FDI may create jobs and have positive supply chain spin-offs.

In all cases, GDP should rise in the long run and living standards should in principle rise. China might be viewed as an example of a country that has had success through a process of steady liberalisation – privatisation from the 90s onwards, WTO entry, liberalisation of rules on FDI, but the process has been a very long one and has been carefully managed. A similar argument could be made for some of the Asian tigers and Chile is often cited as a South American success story to set alongside cases that have been far less successful in their liberalisation attempts.

Generally although successful in MEDCs in many cases (UK, US more recently Cyprus), the track record of liberalisation in LEDCs has been more mixed.

External liberalisation has seemed to allow for dumping of surplus agricultural products from both the US and EU (dairy in Jamaica, groundnuts in Senegal etc.) creating food dependency.

Cuts in government spending have led to reductions in spending on areas such as health and education, damaging living standards in the short run. (Ivory Coast in the late 90s etc.)

Privatisation programmes have often fallen prey to maladministration allowing assets to be sold off for below market value. And have resulted in increases in the prices of basic products (water in Bolivia and other examples).

Overview

Liberalisation may be more appropriate for countries that have reached a platform for growth than for the very least developed economies.

May depend on the pace of implementation – often criticism has been that they have been introduced over too short a time scale.

Strong answers will have their own range of case studies – the examples above are only a small selection of possibilities.