

# Example Candidate Responses

Cambridge  
**Pre-U**

Cambridge International Level 3  
Pre-U Certificate in  
**ECONOMICS (9772)**



# Example Candidate Responses

## Economics (9772)

Cambridge International Level 3  
Pre-U Certificate in Economics (Principal)

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**Cambridge International Level 3 Pre-U Certificate**

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# Economics

## 9772

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## Introduction

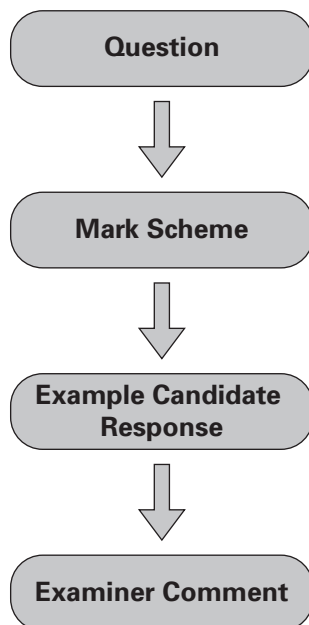
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The main aim of this booklet is to exemplify standards for those teaching Cambridge Pre-U, and to show how different levels of candidates' performance relate to the subject's curriculum and assessment objectives.

Cambridge Pre-U is reported in three bands (Distinction, Merit and Pass) each divided into three grades (D1, D2, D3; M1, M2, M3; P1, P2, P3).

In this booklet a range of candidate responses has been chosen to illustrate as far as possible each band (Distinction, Merit and Pass). Each response is accompanied by a brief commentary explaining the strengths and weaknesses of the answers.

For ease of reference the following format for each paper of the subject has been adopted:



Each question is followed by an extract of the mark scheme used by Examiners. This, in turn, is followed by examples of marked candidate responses, each with an examiner comment on performance. Comments are given to indicate where and why marks were awarded, and how additional marks could have been obtained. In this way, it is possible to understand what candidates have done to gain their marks and what they still have to do to improve their grades.

Teachers are reminded that a full syllabus and other teacher support materials are available on [www.cie.org.uk](http://www.cie.org.uk). For past papers and Examiner Reports please contact CIE on [international@cie.org.uk](mailto:international@cie.org.uk).

## Components at a Glance

Component	Component Title	Duration	Weighting (%)	Type of Assessment
<b>Paper 1</b>	Multiple Choice, Short Answers and Data Response	2 hours 15 minutes	40	Written paper, externally set and marked
<b>Paper 2</b>	Essay Paper	2 hours 15 minutes	40	Written paper, externally set and marked
<b>Paper 3</b>	Investigation	1¼ hours	20	Essay, written in examination conditions and externally marked

## Paper 1 Short Answers and Data Response

### Question 1 (a)

Real GDP per head is often used as an indicator for the standard of living.

Why do we use 'real' values for this purpose?

### Mark Scheme

For an answer that recognises that 'real' values take inflation into account (1) and hence it makes figures more comparable (or similar explanation) (1).

### Example Candidate Response

1a) This is to allow for ~~to~~ easier comparison with a certain "base year", as inflation may have created higher nominal <sup>GDP</sup> ~~rather than real~~ ~~output~~ ~~output~~. ~~output~~ while real GDP ~~remains~~ <sup>compared with</sup> unchanged. 2

### Examiner Comment

This answer clearly addressed the set question and so was awarded full marks.

### Example Candidate Response

1a) In this context, real is used to take the rate of inflation into account.

### Examiner Comment

Whilst this candidate understood that 'real' values meant that there was something to do with inflation, there was no further explanation and so, in accordance with the mark scheme, this answer received just 1 of the 2 available marks. This answer demonstrates the fact that for questions worth more than 1 mark, it will not be sufficient to make a single statement and achieve full marks.

## Example Candidate Response

(a) The difference between 'nominal' and 'real' GDP values is that real GDP is a factored figure rather than a projected one. ~~It takes into~~ 2

## Examiner Comment

The short answers on Paper 1 are aimed to be the accessible part for all candidates, but this answer clearly demonstrates that if basic concepts are not understood, candidates will not be able to pick up any marks.



## Question 1 (b)

With the use of an example, explain why the distribution of income is also of relevance when comparing the standard of living in different countries.

## Mark Scheme

For an answer that explains that per head just gives the average value but does not consider inequalities within a country (2).

For providing an example of this – e.g. oil rich states or a numerical example (1).

No mark if wealth used instead of income.

## Example Candidate Response

1 b) In order to compare standards of living in different countries GDP per head is the total GDP of a country divided by the population. It doesn't show whether this is mostly owned by a very small % of the population. If ~~an~~ income is very unevenly distributed then standards of living for many will be very low. China is an example. Even though GDP per head is not very low, the proportion of people that own most of the income is small and the majority are very poor. Purchasing power parity must be calculated in order to compare standards of living.

5

## Examiner Comment

This answer clearly recognises that the question is asking candidates to discuss whether the 'average' real GDP per head is a useful measure of what the situation is for the 'average' person in the country. They also make the point that Purchasing Power Parity is of relevance when comparing between countries which, whilst being a valid point in general, was not of direct relevance to this question and so received no credit – although the candidate had already achieved full marks for this question. It should be noted that candidates should be encouraged specifically to answer the set question within the short answers, as this is not a place where digressions will be rewarded.

## Example Candidate Response

b) It is important to see distribution of income because one must be able to see income inequality of a country. With a high level of distribution one can see how developed a country is and it is therefore closer to experiencing economic growth. With a low level of income distribution it means many live below the poverty line compared to high earners earning most of the national income within the economy. An example of a better way to measure this is the Lorenz Curve.

1

## Examiner Comment

This candidate clearly had some understanding of what the question was all about, but failed to relate their understanding to the question and hence received just 1 mark.

## Example Candidate Response

b) ~~Mexico for example~~ has very China and Russia for example, China has relatively equal distribution of income, and since this a minor macro-economic objective one could perceive it as a sign of development; Russia however, a more developed country with its literacy and health values, has less equality throughout its income structure so to truly understand and compare economies, having ~~more~~ a statistic like income distribution can be useful. ? Doesn't answer the set question

## Examiner Comment

Whilst this answer superficially is quite similar to the one from the previous candidate, there is absolutely nothing that relates the answer to the set question and hence it received no marks.

## Question 2 (a)

**Using an example, explain the term 'seasonal unemployment'.**

## Mark Scheme

For an accurate definition that it is unemployment that only occurs at certain times of the year/season (1).  
For providing an example of this – e.g. fruit pickers only employed in the summer months (1)

## General Comment

The vast majority of candidates answered this question correctly. A lot of candidates gave the same example of the ski instructor.



## Example Candidate Response

Q.a) Seasonal unemployment is when it is not the time of year in which that industry usually operates. For example, ski instructors will experience seasonal unemployment in the summer, as the ski industry does not operate then. 2

## Examiner Comment

This answer gained full marks as there was a definition and an example.

## Example Candidate Response

2 a) Seasonal, or cyclical unemployment, is caused by recessions: for example, the recent financial crisis of 2008 resulted in a huge contraction of demand (especially the consumption and investment bits), which forced the firms to lower their supply in order to meet match the lower demand; As lower supply, i.e. lower output produced, required less workers to be employed, the unnecessary workers were fired, which caused an increase in unemployment

## Examiner Comment

When candidates did not know their definitions, they were unable to secure any marks.



Question 2 (b)

Using an example, explain what can give rise to structural unemployment.

Mark Scheme

For a clear understanding that events such as 'de-industrialisation/globalisation/out-sourcing can lead to the loss of a certain type of job within an economy – up to (2). For the use of a suitable example – e.g. decline in UK steel industry (1).

General Comment

Several candidates confused structural unemployment with technological unemployment. To secure full marks for this part of the question, candidates had to explain 'what can give rise to structural unemployment', rather than just giving an example of what structural unemployment is.

Example Candidate Response

b) Structural unemployment is when there is a mismatch between the skills of the labour force and the jobs available.

This can occur when an industry shuts down, leaving the employees with redundant skills. This happened in the UK under Thatcher when the mining industry closed. It left many workers with the wrong set of skills to apply for any new jobs in expanding industries e.g. the financial sector. The size of the unemployment depends on whether the skills are transferable i.e. on the level of occupational mobility. 3

(5)

Examiner Comment

A solid answer that achieved full marks.

## Example Candidate Response

b) A structural unemployment can be caused by a change in the ease of capital-labour substitution: for example, a new technology which allows to mechanise some steps of production and produce at lower costs will result in the substitution of labour (i.e. workers) for capital, resulting in higher unemployment.

①

## Examiner Comment

This is an answer that demonstrates a misunderstanding of the term and hence the answer received no marks.

## Question 3 (a)

**Explain the likely implications for the price competitiveness of UK exports and imports if the sterling exchange rate appreciates.**

## Mark Scheme

For a correct explanation that exports are likely to become less price competitive and imports more price competitive (2). Need to mention both for both marks.

## Example Candidate Response

3a | An increase in the value of the sterling leads to a reduction in price competitiveness for UK exports. As prices of UK exports increase in terms of other currencies, demand for them abroad will decrease.

## Examiner Comment

The question specifically asked for the likely implications for the price competitiveness of both exports and imports and hence some candidates lost marks by only mentioning one or the other. Here is an example of such an answer.

Example Candidate Response

3 a) If sterling appreciates, then the UK exports will become more expensive in terms of other currencies, i.e. they will become less price competitive; at the same time, the imports will fall in price in terms of sterling and become more competitive.

Examiner Comment

Many candidates provided solid answers for the question as shown above.

Question 3 (b)

**Explain why time lags are important when considering the effect that such an appreciation will have on the current account of the balance of payments of the UK.**

Mark Scheme

An explanation that for several goods that are exported and imported, orders have to be placed well in advance of delivery (1) and hence it takes time for changes in price competitiveness to feed through into changes in quantity (1) and hence into total export earnings/spending on imports (1).

Note – any answer that mentions inverse J curve effects should receive a minimum of 2 marks. If answer follows through from incorrect answer to part (a) then marks for (b) still available if consistent.



## Example Candidate Response

b) Time lags are important factors as they determine the PED of imports and the PED of exports.

The longer the time under consideration, the more price elastic these will be, as contracts will have ended and habits can be changed.

This means in the short run, an appreciation of rates will mean that volume of exports will not change but the price will increase, so revenue will increase, and the volume of imports will not change but revenue will fall. Thus the balance of payments will improve in the short run.

But once people realise UK goods are relatively more expensive, ~~UK exports~~ contracts end and consumer habits change, UK exports will fall, and UK volume and revenue of imports will rise, as UK consumers substitute domestic for imported goods/services. Thus in the long run, an appreciation will actually worsen the balance of trade.

The point of change is the length of time before which  $PED_x + PED_m \geq 1$ , the Marshall-Lerner condition.

5

## Examiner Comment

This demonstrates a very good answer to the question and the mention of the Marshall-Lerner condition ensures that all 3 marks were awarded.



## Example Candidate Response

b Without time lags, an increase in the value of sterling and thus a reduction in the price competitiveness of exports would have an instant effect on the country's balance of payments. This is because as the ~~rate~~ <sup>price</sup> value increases, the propensity to buy imports also increases. If the ~~domestic~~ domestic demand for imports is greater than the global demand for exports then the UK's balance of payments position will worsen. ~~Just~~ Time lags are caused by lack of instant information, speculation on future exchange rates and also contracts agreed between <sup>domestic</sup> exporters and foreign importers. These factors create a delay between the value of the sterling increasing and the balance of payments worsening. 2

## Examiner Comment

Whilst it is clear that this candidate certainly understands most of the relevant points, the analysis was not precise enough and so limited the answer to just 2 of the 3 available marks.

## Question 4 (a)

Explain the phrase 'fiscal deficit'.

## Mark Scheme

For an accurate definition of government expenditure being greater than the revenue from tax receipts in a particular year.

## Example Candidate Response

4.a) Fiscal deficit is the amount by which government spending exceeds tax revenue. It is therefore the money which it has had to borrow from elsewhere ~~and~~ as a loan. It is also called the PSBR or the budget deficit. 2

## Example Candidate Response

4a Fiscal deficit is when government has attempted to increase aggregate demand by way of spending. ~~These type of inflationary policies can include~~ The deficit is the amount the government is in debt because of such inflationary policy. 0

## Examiner Comment

Candidates either knew the answer and, in the majority of cases, with an accurate definition scored both marks or they did not and scored zero on this part. These two extracts demonstrate one of each.

## Question 4 (b)

**With the use of examples, explain why a government's fiscal position is likely to worsen during a recession.**

## Mark Scheme

During a recession, revenue is likely to be lower (1) due to less income earned, less profits made and fewer goods being bought and at the same time government expenditure on transfer payments e.g. income support and Job Seekers Allowances will be higher (1). Final mark (1) only to be awarded if at least two examples are used in the answer – even if both explain the same thing – i.e. either higher expenditure or lower tax receipts. Examples must aid explanation. Also accept any relevant discretionary changes as examples – e.g. reduction in rate of VAT.

## Example Candidate Response

b) During a recession, businesses profits fall, and unemployment rises, meaning corporation tax revenue and income tax revenue both fall.

The government also has to spend more on the economy, for example on more benefits for the unemployed, or money for quantitative easing like has happened in the UK in 2009 and is still continuing.

This means therefore expenditure is more than revenue by an increasing amount, so the fiscal deficit worsens. This is the automatic stabiliser principle, and so long as a ~~tax~~ fiscal surplus is run in boom periods, ~~it will~~ the deficit will not harm the economy in the long run.

(5)



## Example Candidate Response

(b) During a recession many people lose their jobs which decreases tax revenue from income tax. It also increases the amount of money given out by the government in the shape of unemployment benefits. Gordon Brown took the attitude of 'spending your way out of a recession'. With the increase in government spending that has entailed, although employment was created through the opening of new workplaces, the fiscal deficit for the government would only increase.

3 (5)

## Examiner Comment

The key here was whether candidates used examples – not just an example – in their explanation. If they did, it was quite easy for them to achieve all 3 marks. The first two extracts show answers that received full marks – the first reflected the standard 'automatic stabiliser' effect whilst the second also demonstrated a knowledge of recent events by including the Labour Government's attempt to increase discretionary spending.

## Example Candidate Response

b During recession, government attempts to boost aggregate demand and keep economic growth and inflation at steady levels. In a recession there tends to exist higher levels of cyclical and structural unemployment than when not in recession. Government will try to reduce the level of unemployment by subsidising firms to continue producing and being employers. For the unemployment that cannot be rectified, however, the government must pay unemployment benefits, increasing government expenditure. During the recent global recession we have seen countries, the USA and UK in particular, that have very high budget deficits, to the point where the UK is in contravention of EU entry guidelines.

2  
-One except.

## Examiner Comment

This extract only really talked about an increase in Government spending and far too much of the answer concentrated on issues irrelevant to the question. At no time were candidates asked anything about EU entry guidelines. There was enough though for the candidate to receive 2 of the 3 available marks.

## Example Candidate Response

b) Again, the UK government provides a good example but the Greek government too; as the recession hits, governments try to stimulate aggregate demand, they therefore spend or in the case of Britain, Greece, Italy or Spain, they borrow, and since a government's fiscal position is there debt or deficit, this is of course likely to worsen as more borrowing occurs. However, this is only the case for the Keynesian model, if let us say governments, unlike Britain's, did not believe that spending would be a viable solution to a recession, the worsening of fiscal position ~~was~~ would be unexpected.

①

## Examiner Comment

This extract demonstrates a superficial understanding that spending may go up during a recession but then becomes unfocused and it only received 1 mark.



## Question 5

**Section C**Answer **all** questions.

Look at the following article and table and then answer the questions.

<p>From Wrexham to Eastbourne and in virtually every part of the country, the demand for allotment space is rising much faster than local councils can supply. The economics of having your own allotment land have changed significantly in the last few years. Allotments peaked in popularity in the immediate post-war years as people looked to grow their own food in order to reduce the effects of food shortages and government-imposed rationing. But gradually the number of allotments declined as the food availability improved, real prices fell and the number of supermarkets expanded. By the 1980s using an allotment was widely regarded as the preserve of the 'Good Life' crowd and those in retirement wanting a way to pass the time.</p>	5
<p>But now the combined effect of rising food prices, growing concerns over the environmental effects of food miles and demand for locally-grown organic produce has prompted a fresh wave of demand for scarce allotment space.</p>	10
<p>Sadly the supply of plots is inelastic. Long and lengthy waiting lists have remained the method of choice for dealing with this imbalance between supply and demand. In some parts of our major towns and cities there are no allotments at all as land has been sold to private property developers by local councils strapped for cash. Councils are legally obliged to provide 15 allotments per 1000 households and, under current rules, no more than six people are allowed to be waiting for a plot at any one time.</p>	15
<p>Another non-market approach has been to divide up current allotment space into smaller plots so that more people can have access to one. Another has been to give beginners smaller areas of land.</p>	20
<p>If demand is running well ahead of supply, the market approach would be to raise the annual rent or perhaps introduce an auction system for allotment land as it becomes available. However, charging market prices might have equity considerations especially when a large number of people tending their plots are elderly and on low incomes. In Harlow, for example, the cost of renting a plot is typically just £18.00 for the whole year, with concessions given for pensioners or those on benefit.</p>	25
<p>Looking ahead, if food prices are to remain high and councils and the government are truly serious about improving access to land for people to grow their own fruit and vegetables as a means of improving health, the approach must be to make more land available. This could be done by turning brownfield land in urban areas back into land that is available for cultivation. A combination of economics and some vision is needed.</p>	30

Table 1: Estimated elasticities for the UK

Change in	Demand for supermarket food	Demand for allotments
Price of supermarket food	-0.3	+0.8
Rent for allotments	+0.2	-0.4

## Question 5 (a)

According to the article, what was the cause of the peak in demand for allotments?

## Mark Scheme

	Knowledge Q5 (a)
2 marks	Demonstration of use of allotments to get around the problem of food shortages and rationing in the post-war years
1 mark	A recognition that it was something to do with either shortages or rationing
0 mark	No relevant understanding shown

No credit should be given for any answer that just states that people wanted to grow their own food, with no mention as to 'why'.

## Example Candidate Response

5a) The cause of the peak in demand for allotments was to "reduce the effects of food shortages" and "government-imposed rationing." (2)

## Example Candidate Response

5a) The peak in demand for allotments has been caused by the rising food prices, the increase in concern about food miles and the increase in demand for locally grown organic food. (0)

## Examiner Comment

This was simply a matter of whether the candidates were able correctly to read and comprehend both the question and the information in the extracts.



## Question 5 (b) (i)

Using Table 1, calculate the effect on the demand for allotments if the price of supermarket food rises by 10 %.

## Mark Scheme

	Application <b>Q5 (b) (i)</b>
2 marks	
1 mark	<p>Cross elasticity of demand:  <math display="block">= \frac{\% \text{ change in quantity demanded of allotments}}{\% \text{ change in price of supermarket food}}</math> <math display="block">\% \text{ change in } Q_a / \% \text{ change in } P_F = +0.8</math>           As <math>\% \text{ change in } P_f = +10\%</math>, <math>\% \text{ change in } Q_a = \mathbf{+8\%}</math>            Mark still given for +8% or 8% increase or just 8% even if working is not shown</p>
0 mark	Failure to reach correct answer, regardless of any accurate intermediate working

## Example Candidate Response

bi)  $XED = +0.8 = \frac{\% \Delta QD \text{ allotments}}{\% \Delta P \text{ supermarket}}$

$$0.8 = \frac{x}{10}$$

$\Rightarrow$  demand for allotments rise by 8%

/ ①

## Examiner Comment

This extract clearly gives an excellent explanation as to why the answer is 8%. However, it should be noted that there was just 1 mark available, no explanation was specifically requested and answers that simply wrote down 8% did, of course, also receive the mark.

## Question 5 (b) (ii)

**Explain why a change in the price of food has an effect on the demand for allotments.**

## Mark Scheme

	Knowledge <b>Q5 (b) (ii)</b>
2 marks	Clear understanding demonstrated of the fact that food and allotments are, in effect, substitute goods; if food bought in shops costs more, then the demand for allotments, upon which to grow one's own food, rises
1 mark	Some understanding of the link shown but not precise and clumsy or inaccurate use of terminology, e.g. just stating that they are substitutes
0 mark	No knowledge shown

## Example Candidate Response

bii) If the price of food goes up people are more likely to want to produce their own food so the demand for allotments goes up too. Similarly if food prices go down less allotments will be demanded because people will be more ~~willing~~ willing and able to buy food. (1)

## Examiner Comment

Correct use of economic language is encouraged. This answer made no mention of the economic term 'substitutes' and so received just 1 mark.



Example Candidate Response

ii) The price of supermarket food and the demand for allotments have a cross elasticity of demand equal to 0.8; the reason why this is so is due to the ~~complementary~~ substitution nature of these goods, meaning an allotment provides a way of obtaining food, since the price of super. market food rises the incentive to buy allotments in order to ~~make~~ ~~you~~ grow your own food ~~allotment~~ rises, they are substitute goods, to some extent. ~~also~~

(2)

Examiner Comment

This answer clearly demonstrated very sound knowledge of the relationship in question and hence scored full marks.

Question 5 (c)

The article mentions two possible ‘market solutions’ to the problem of excess demand for allotments (lines 21–22). With the aid of a diagram, analyse how one of these solutions could be used to reduce this problem.

Mark Scheme

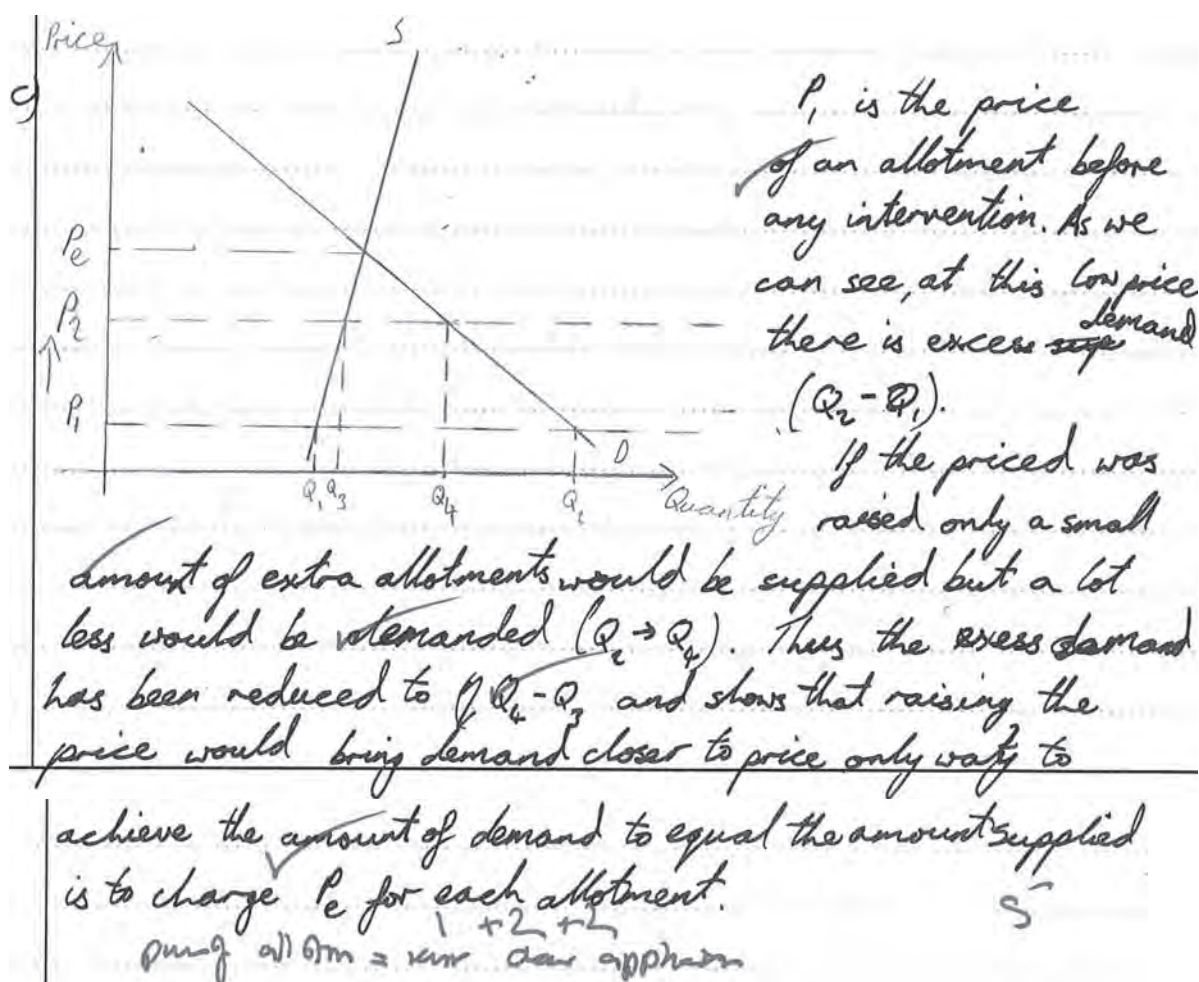
	Knowledge	Application	Analysis
2 marks		Good, accurate application to this case Must consider excess demand	Good explanation of solution <b>through use of diagram</b> showing excess demand
1 mark	Identification of either annual rents or auctions	Either some application to allotments or general application to cases of excess demand	Partial explanation but too much is likely to be left just stated
0 mark	No or very limited understanding of either term	No attempt to apply the market solutions	No relevant analysis as to how solution will reduce the problem

Candidates should consider only one of the two suggestions of a raise in annual rents or an auction to allocate the allotments. If they cover both then credit only the better answer of the two.

## General Comment

Candidates who were able to produce the correct diagram scored highly on this question as the following extracts show.

## Example Candidate Response



## Examiner Comment

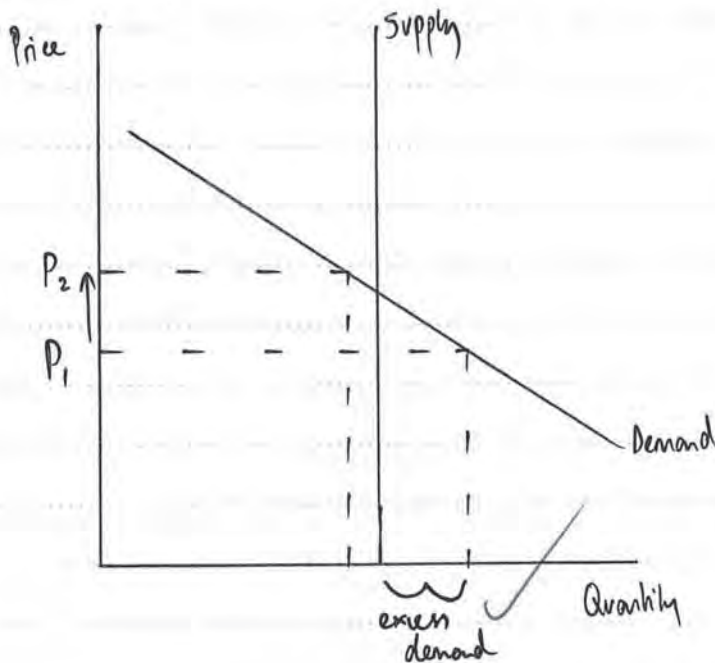
This answer gave a very sound explanation of the situation and was what was expected to be seen by the examiners.

Example Candidate Response

5

c

I have picked an increase in annual rent



Line 12 states that supply is inelastic. However, I have shown it to be perfectly price inelastic to make the example easier to explain.

Originally the price was set at  $P_1$ . This caused demand to exceed supply. The council then decided to increase rent to  $P_2$  causing a movement along the demand curve. I have shown an example where the council has raised the price too much causing oversupply. It is often difficult for the council to decide the price because they do not know how much people value the good. If it is set too high the council can reduce it until all allotments are being rented

5

30

1 2 2

Examiner Comment

This answer, whilst slightly unusual with the use of a totally inelastic supply curve, still reflects a very good understanding of the economics involved.

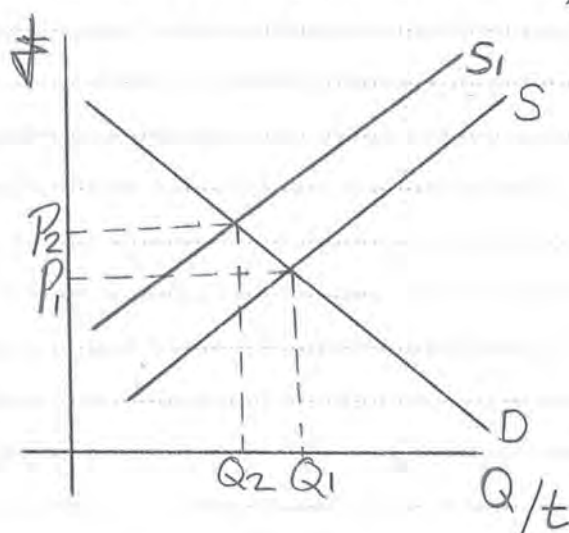
However, too many candidates failed to display the existence of initial excess demand and hence failed to secure full marks. The following is an example of this error.



## Example Candidate Response

(c) When buying anything people have to consider the value of the next best alternative forgone, the opportunity cost. Through the price mechanism it is clear that as price rises, demand for a good will fall. The problem we have with these alternatives is that they are too cheap and

therefore there is excess demand. By raising the price the local council can successfully reduce demand while also increasing their revenue.



As the supply curve shifts inwards from  $S$  to  $S_1$ , the price is driven up from  $P_1$  to  $P_2$  and therefore the quantity demanded drops from  $Q_1$  to  $Q_2$ . The council can keep raising the rent until demand equals supply.

*1 + 1 + 1 = 3*  
*incomplete application*

## Examiner Comment

Although the candidate clearly states the existence of excess demand, the diagram fails to show the lack of an initial equilibrium between supply and demand and hence the analysis of the transition to an actual equilibrium is inevitably flawed.



## Question 5 (d)

Consider how far the ‘non-market’ approaches (lines 12–20) may provide an effective solution to the problem of excess demand.

## Mark Scheme

	Analysis	Evaluation
6 marks		Clear evidence of evaluation and excellent awareness of the relative strengths of the arguments given
5 marks		Clear evidence of evaluation and very good awareness of the relative strengths of the arguments given
4 marks	Good explanation of a suitable range of relevant issues within a clear structure	Clear evidence of evaluation and good awareness of the relative strengths of the arguments given
3 marks	Reasonable explanation of a limited range of relevant issues: some structure to the answer	Some evidence of evaluation and/or limited awareness of the relative strengths of the arguments given; may well have no final summary
2 marks	Partial explanation given: a limited or unstructured answer	Some evidence of evaluation but no clear conclusion
1 mark	Partial explanation given; a very limited answer	Unsupported assertion
0 mark	No relevant explanation	No evaluation

The article discusses the idea of:

- waiting lists
- sub-dividing current allotments
- the similar but not identical suggestion of giving new allotment holders smaller plots.

If only one suggestion is considered then the maximum mark available is 6 marks, regardless of the depth of analysis or evaluation.

The following issues might be addressed

## Analysis

- Explaining how the suggestion will reduce current excess demand

## Evaluation

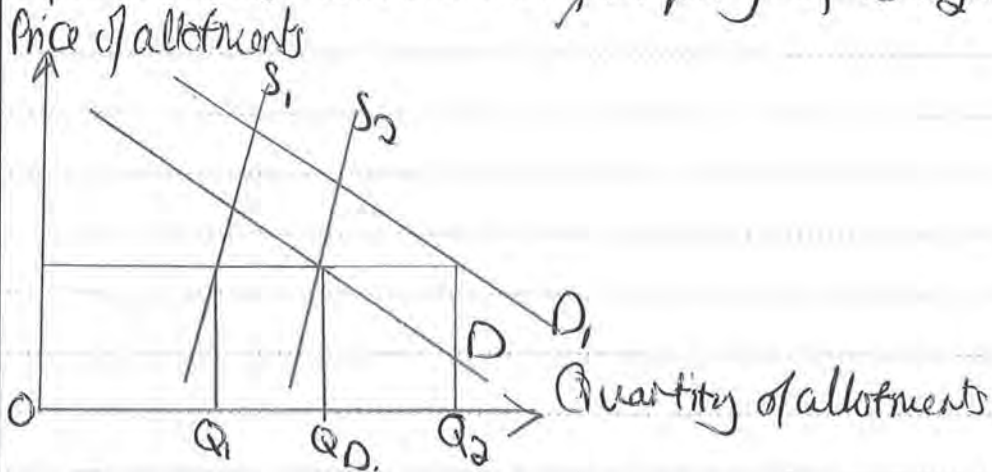
- Discuss possible problems in terms of ‘secondary markets’ etc.
- Consider the effects on existing plot holders and new plot holder.

To achieve 4 marks or more for evaluation, there must be some consideration of the relative merits of the policies considered

Credit can also be awarded under evaluation if the candidate dismisses all proposals and puts forward one of their own, but this idea can achieve no marks for analysis

## Example Candidate Response

d) Dividing up current allotments means that the supply of allotments will increase, shifting  $S_1$  to  $S_2$ . This



could solve the problem of excess demand by matching the quantity demanded to the supply - satiating the previous shortage of  $Q_1 \rightarrow Q_D$ . This is very effective at solving the excess demand as it satiates it but without needing to raise prices. This is very equitable to those on low or fixed incomes like pensioners, who would have been priced out if rents had increased.

However, this may not be the most allocatively efficient. Those farmers who would utilise their allotment fully would have been able to pay the higher prices, and so the land would have been allocated to where it would provide the most utility. With this practise, everyone gets land, so those people who do not fully utilise it are taking land away from the more efficient farmers.

Additionally, due to the decrease in plot size, people may demand more plots each, shifting demand out from  $D$  to  $D_2$ . This does not then solve the problem of excess demand, as now



$Q_1$  to  $Q_2$  is shortage, thus increasing the problem it sets out to solve - the law of unintended consequences. //

To have waiting lists for allotments keeps effective demand low at the equilibrium point. This is fair to those pensioners as it ensures they are not priced out of the market. However, there is still the same number of people waiting and so there is still a shortage. This ~~me~~ stops the market mechanism from signalling that there is a shortage to suppliers i.e. to land owners. Therefore land in the city is not being allocated effectively, as the waiting lists cloud the market, so price does not reflect market value.

In conclusion, both solutions do not provide the best market outcome, however they are both the most fair to those people who cannot afford the substitute of higher supermarket food. They may not solve the excess demand, but they do allow those with no alternative, or who really want one, a fair chance of getting one.   
 V good An + R 4+6

(10)

### Examiner Comment

This answer secured full marks and is a good example of some of the excellent answers that were seen from candidates. It is thoughtful and incisive and clearly demonstrates the required skill of being able to evaluate and consider various possibilities. The phrases such as 'However, this may not be the most allocatively efficient.' 'This does not then solve the problem..' 'This is fair to ....., however there is still....' show a thoughtful approach to the question.

## Example Candidate Response

d) Non-market approaches can be effective because they are giving bigger land to those with ~~exper~~ expertise <sup>with</sup> ~~the~~ with allotments. By doing this they allow the most efficient people to use their efficiency to produce more. ~~if~~ If however,

Extract continues on next page



they gave more land to beginners, they still wouldn't be used to what their role entails and so, when they gather experience they can become a more efficient user of the land thereby producing more, not wasting it. However, many will see this as unfair. This is because they will believe they have the right to use just as much land as the others. They will not see/understand the role of efficiency thereby using their land to an even lesser extent.

Due to this, the other approach taken has been to split the spaces even smaller and more equally. This benefits the ~~new~~ beginners because they have a chance to prove themselves with their allotment and gradually use them more efficiently in the long run. Also because they are more equally distributed, ~~they~~ they will all tend to feel like their income has been spread equally.

However, this is not always a good thing, because the more efficient producers are losing out

in the short run. Therefore they will not be able to use their gains to make advances and so improve efficiency even more. V. strange 2+2

(4)

### Examiner Comment

This answer fails to use sufficiently accurate economic terminology. The use of the phrase 'efficient' is never explained; although clearly there is some appreciation that efficiency is important for economists. The lack of a conclusion limited the evaluation mark to just 2 marks, although the use of the key evaluative words 'However.' – for example in the phrase 'However, many will see this as unfair.' – did show that some attempt at evaluation had been made.

### Question 5 (e)

**To what extent do you agree with the proposal of the author in the final paragraph that more land should be made available for allotments?**

### Mark Scheme

	Analysis	Evaluation
6 marks		Clear evidence of evaluation and excellent awareness of the relative strengths of the arguments given
5 marks		Clear evidence of evaluation and very good awareness of the relative strengths of the arguments given
4 marks	Good explanation of a suitable range of relevant issues within a clear structure	Clear evidence of evaluation and good awareness of the relative strengths of the arguments given
3 marks	Reasonable explanation of a limited range of relevant issues: some structure to the answer	Some evidence of evaluation and/or limited awareness of the relative strengths of the arguments given; may well have no final summary
2 marks	Partial explanation given: a limited or unstructured answer	Some evidence of evaluation but no clear conclusion
1 mark	Partial explanation given; a very limited answer	Unsupported assertion
0 mark	No relevant explanation	No evaluation

Candidates will be expected to examine both the effectiveness of providing more land and also consider whether this is a sensible use of the land. Candidates may wish to briefly revisit the issue of other alternative solutions as well as considering the other possible uses of the land and to open the whole issue of whether we need/should have more allotments.

Issues that may be considered include:

### **Analysis**

- Explain how more land will address the issue of excess demand – possibly through the use of a supply and demand diagram
- Analyse why this is claimed to be the only long-term solution – as opposed to a short-term solution

### **Evaluation**

- Discussion of whether use of scarce land for allotments is for the best, even if it were to solve the problem of excess demand for allotments
- Consideration of the phrase ‘must be to make more land available’ in the article
- Consideration of whether an increase in supply might not actually lead to a further increase in demand and hence exacerbate the problem of excess demand
- Discussion of whether, in the last paragraph, the author is looking to solve the problem of excess demand or merely to achieve greater output of home grown fruit and vegetables

### **General Comment**

This final question again had 6 of the 10 marks available for evaluation and there were some excellent answers provided by candidates. The following two example candidate responses show the standard that it is hoped that all candidates will aspire to achieve.



## Example Candidate Response

e The author assumes that food prices are going to remain high. However, in the long run improvements in technology may increase the productivity of farmland, increasing supply of food and thus reducing prices. This would then lead to a reduction in demand for allotments.

The council would have to buy back land from private owners in order to increase supply. Land in brownfield sites is often expensive because more money can be made by building houses on it rather than collecting £15 of rent per year. The cost of the council buying back the land will very probably be higher than the cost of giving out <sup>discount</sup> coupons for residents to use in the supermarkets which account for increasing price levels. The soil quality of brownfield sites will also be lower than that in the greenbelt because of pollution. Therefore the marginal productivity would be lower on the brownfield site than on a greenbelt site.

On the otherhand, creating allotments in brownfield sites would improve health, not only through production of fresh fruit and vegetables, but also through people getting more fresh air. Allotments are also more pleasant to look at than concrete and can reduce pollution in the area, increasing value and desirability of land.

The council may also over provide allotments so that some of them are not in use. This would be a waste of money and would also push down the rental rate if they were left unused.

Overall I believe that the costs are greater than the benefits using this method. This method could result in government failure which would not be beneficial for society as it would cause welfare loss.

Excellent 4 + 6

(10)



## Example Candidate Response

e) To some extent I do agree with the author that more land must be designated to allotments. The excess demand is obviously signalling that more resources should be given to the supply of them. For the reasons of improving health and the ever increasing food bills, demand is not likely to suddenly shrink leaving many empty allotments, ~~suggest~~ suggesting turning unwanted brownfield sites into allotments would increase social welfare as they would be getting allocated ~~to~~ efficiently.

However, there are some alternatives the author has not considered. Firstly, the land which would become allotments could be used for other things, so the opportunity cost must be considered. Large brownfield sites could be

turned into commercial farms who would be better at producing more food than individuals on their allotments. This ~~would~~ food could then be sold on to the locals who would usually ~~eat~~ <sup>buy</sup> it, and as it would be more efficiently produced, the cost of this food would be cheaper, solving the problem of the rising food prices. Additionally, if the food grown is healthy vegetables, health would also be improved. This use of the land would be more productively efficient than allotments and would solve the excess demand. The excess land could also be used for a pensioners centre, giving them a place to socialise, again decreasing allotment demand for its use to "while away the time".

However, having allotments may not be just for the monetary advantages. It could just be about non-monetary factors like living the "Good Life."

In conclusion, more land should be given to allotments, but not alot. Ideally, the demand for allotments for cheap ~~food~~ and healthy food should be identified, and this land should be turned into commercial farming, as this is more efficient. Additionally, the demand for allotments because of the need to while away time should be identified, and that proportion of land should be turned into a centre. However, the demand for allotments for individual freedom and the "good life" should not be ignored. It would be important to strike a balance between the three, to maximise productive, allocative efficiency, and consumer satisfaction.

Nishy structured answer

4/6

10

28



## Paper 2 Essays

The following candidate responses demonstrate general points that can be used in order to aid the performance of candidates in future years. It is essential that these essays and comments should be read in conjunction with both the specific mark schemes and also the Principal Examiner Report for this paper.

### Question 1

**'If the price of a good or service rises, the demand for that product will always fall'. To what extent does economic analysis support this statement?**

### Mark Scheme

Candidates should show a good understanding of the theory behind the downward sloping demand curve and the use of the word 'always' in the question should lead them on to some discussion of possible exceptions.

#### Answers may include:

**Knowledge** and **understanding** of the theory behind the downward sloping demand curve and reasons why this might not be the case.

#### Examples

- Indifference curve analysis
- Marginal Utility analysis
- Giffen goods
- Veblen/Ostentatious goods

Note that candidates would not be expected to use both indifference curve and marginal utility analysis. Candidates who merely state an inverse relationship between price and demand are unlikely to achieve more than Level 1, unless they show real depth of understanding in the rest of their answer.

**Application** of the theory to real life examples including at the higher levels examples of where this basic relationship does not seem to hold.

**Analysis** of why the relationship between price and demand is as it is

#### Examples

- Considering income and substitution effects
- Looking at marginal utility/price relationships
- Consideration of goods as a 'store of value'
- Consideration of the whole issue of 'rational behaviour'

**Evaluation** of the issues involved

#### Examples

- Considering whether theory relates to reality
- Showing awareness of there being different reasons why a demand curve may appear to be upward sloping
- Considering that more demand at a higher price does not automatically mean that the demand curve is upward sloping, but that rather, one of the conditions of demand may have changed

**Theory and analysis**

Level 4 (13 – 17 marks) Mid mark 15	There is a clear, precise and accurate explanation of one of the two main theories to explain the rationale behind the downward sloping demand curve. Exceptions are discussed and explained and, at the top of this level, the issue of either rational behaviour and/or changes in the conditions of demand is likely to be considered.
Level 3 (9 – 12 marks) Mid mark 11	An attempt is made to explain the downward sloping demand curve using one of the two recognised theories but it is likely that there will be slight inaccuracies and/or omissions in the theory. Exceptions are recognised but there is little accurate analysis of these items.
Level 2 (5 – 8 marks) Mid mark 7	One of the two theories will be considered but it is likely that either too much will be just stated rather than explained or there will be very little consideration of 'exceptions to the rule'. Alternatively, the answer gives good explanation of 'exceptions', but fails to explain the downward-sloping demand curve.
Level 1 (1 – 4 marks) Mid mark 3	There will be no theoretical explanation and the answer will rely on statements of fact too much. Any mention of exceptions will be just that – a mere statement without any attempt to analyse or explain the reasoning behind the exception.

**Evaluation**

Level 3 (6 – 8 marks) Mid mark 7	A good discussion might consider some of the following points: Is the theory realistic in explaining consumer everyday behaviour – indeed is rational behaviour a feature of everyday life? Is an apparent perverse demand curve indeed that or might it in fact be nothing of the sort but be a collection of points from different downward sloping demand curves? What other conditions might be important – for example whether the 'good' is essential/a luxury? Possible consideration of the link with elasticity of demand. There will be a conclusion drawn at the end to explain the candidates overall view – even if this is that there is no clear-cut answer.
Level 2 (3 – 5 marks) Mid mark 4	One of the above will be discussed in reasonable detail or a couple of points touched on, but only in a relatively superficially way.
Level 1 (1 – 2 marks) Mid mark 2	Whilst there might be some appreciation that evaluation could be carried out and indeed there might be the odd comment that suggests an area for potential evaluation, it stops at the comment, and the point is not developed. For example: 'We need to appreciate that standard theory doesn't explain Giffen goods'.



## Example Candidate Response – Distinction

## 1 Section A

'If the price of a good or service rises, the demand for that product will always fall.'

\*

Assume consumer ~~and that~~ is always rational and chooses the outcome which brings him most utility.

The statement describes the law of demand ~~that~~ that if a price of a good rises, the demand ~~for~~ <sup>quantity</sup> for that product will always fall. It is debatable that <sup>quantity</sup> to what extent that this law of demand is valid for goods (in the economy). When there is a price rise ~~in the~~ of the good, there are always two effects taking place = substitution effect and income effect affecting the quantity demanded by consumers. This essay will use indifference curve model to analyse ~~that~~ <sup>and examine</sup> the law of demand and how far it ~~reflects~~ reflects in the demand curve is downward sloping.

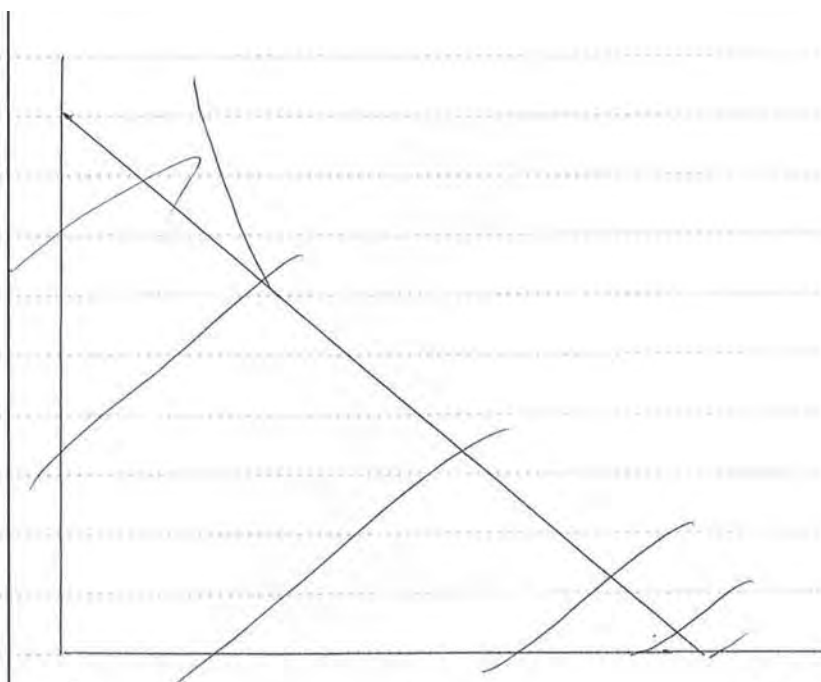
> \*

Firstly, an indifference curve model has to be constructed before we use analysis to examine. An indifference curve is defined as bundles of goods which provides same level of utility to consumers. And well-behaved indifference curve is consisted three characteristics = ~~first~~ transitive which means that if  $A \succ B$ ,  $A$  is preferred to  $B$ , and  $B$  is preferred to  $C$ ,  $B \succ C$ , then  $A \succ C$ .  $A$  is preferred to  $C$ . Second one is monotonic so that consumers always prefer larger bundles than small. Last one is convex so consumers choose to prefer average bundles than extreme bundles. All these are shown in diagram, figure 1. Budget ~~constraint~~

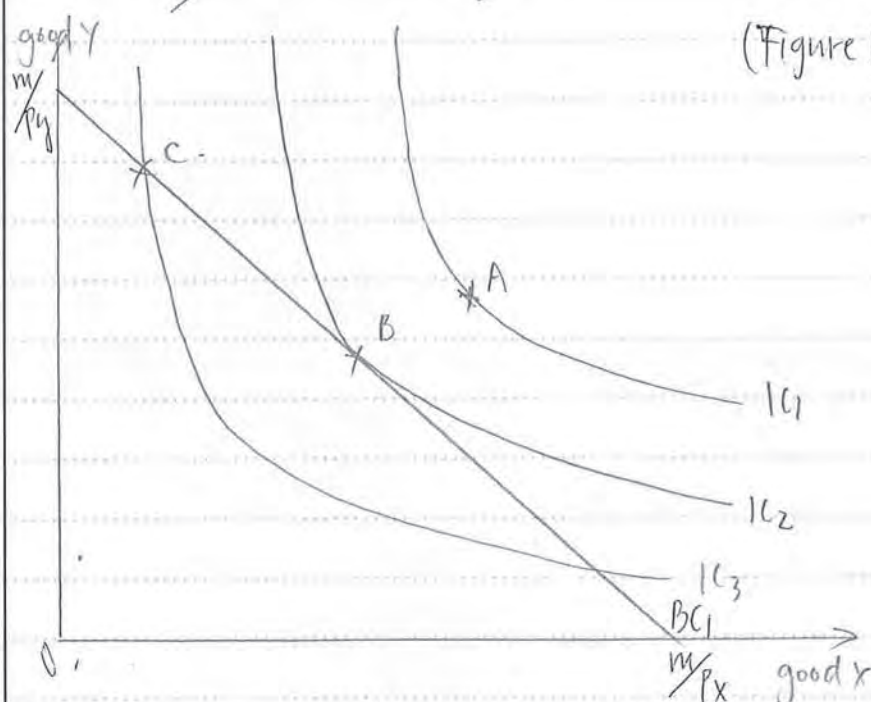
Budget constraint shows the bundles that consumer can afford to purchase with given level of income and price level.

Go on with it!

ATQ!!



(Figure 1).



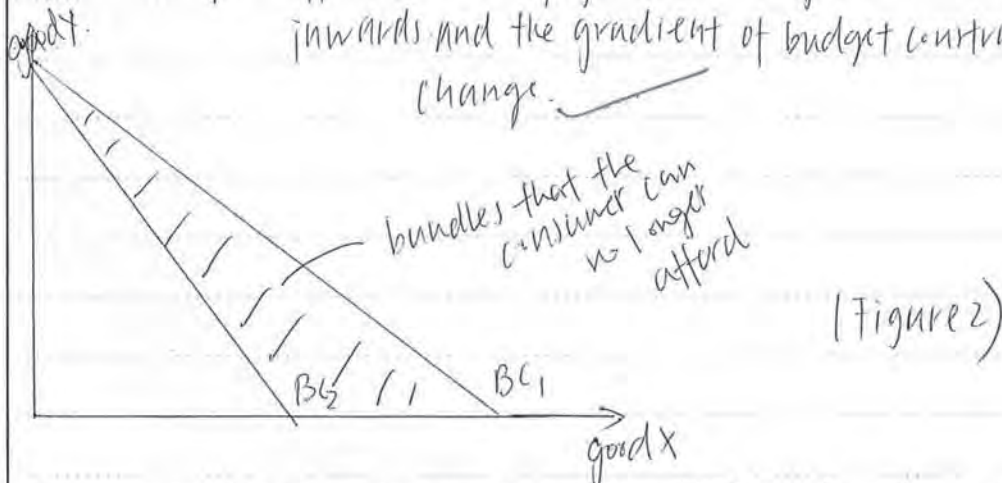
It is illustrated by the formulae:  $P_x X + P_y Y = m$ . Budget constraint is also illustrated in figure 1. B is the optimal outcome because it is when ~~budget constraint~~ budget constraint is tangential to the ~~in~~ budget constraint. Indifference curve Outcome A is not possible to achieve given current level of income. B is preferred to C because indifference curve 2 ~~has~~ gives higher utility to consumers to IC3. The gradient of budget constraint shows the

Why is it optimal?

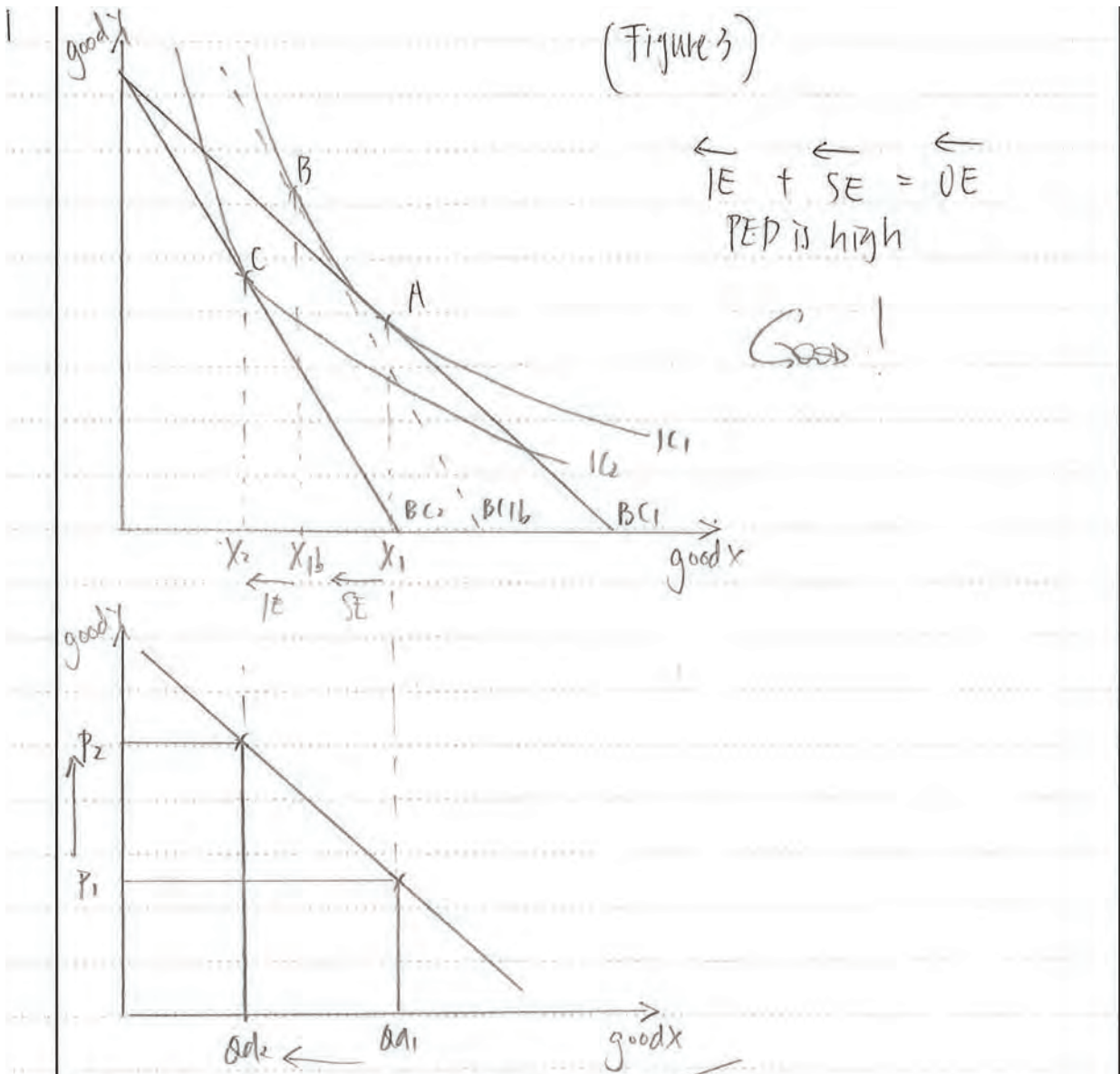


rate of exchange,  $-\frac{P_x}{P_y}$ .

When there is a price increase of good, assumed good X is in this case, there are two effects that take place. Substitution As price of good X increases, the ~~good~~ good X is now ~~to~~ more expensive relative to good Y, which is the substitution effect. As price increases quantity demanded for good X will fall assume that good X is a normal good. ~~with~~ Income effect is when price of good X rises, consumer can only afford ~~less~~ <sup>fewer</sup> bundles than before as real income decreases. This effect shows in figure 2 as budget constraint pivot inwards and the gradient of budget constraint will change.



Assume good X is a normal good which is defined as when income increases, quantity demanded for this good also increases. As the price of good X increases, there is a negative substitution effect taking place ~~so less quantity of good X will be bought~~ as shown in the diagram and negative income effect. As substitution effect and income effect are both negative and reinforce each other, the overall negative effect. Therefore the ~~negative~~ price elasticity <sup>resulted in</sup> of good X will be quite high,  $PED > 1$ , price elastic demand. This shows that an increase in price ~~quantity demanded~~ does lead to a fall in quantity demanded for good X, thus an inverse relationship between price



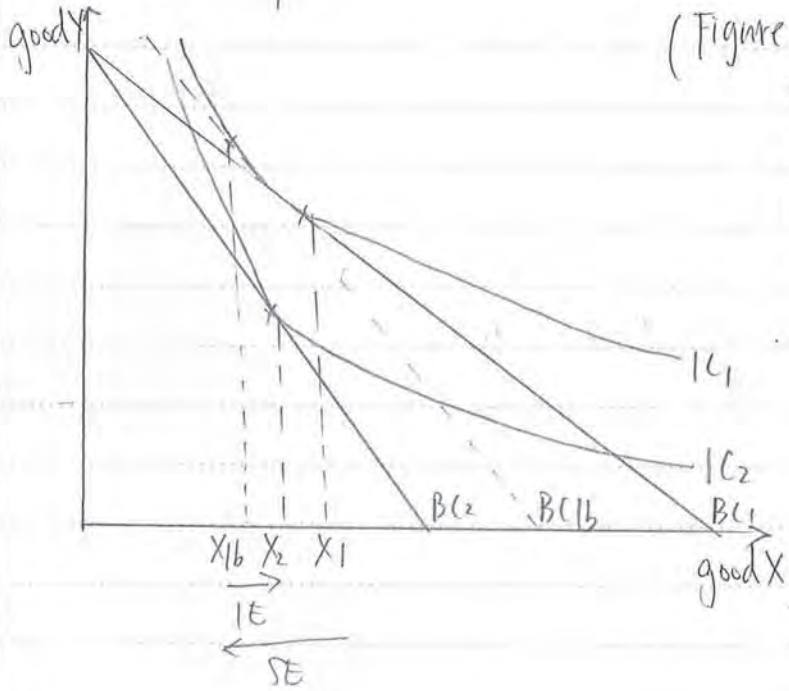
and quantity as shown in figure 3.

However, it is the different case for inferior good which means an rise in consumer income will lead to a decrease in consumption of this type of goods. For example, bus tickets because people will switch to buy cars. When there is a rise in the price of inferior goods, there will be a relatively small positive income effect with large substitution effect offset it. So the overall effect will still be negative. Because the substitution and income effect counteract each other so the overall change

How is it? effect?



in quantity demanded of the good X will be smaller. (Assume good X is inferior now). So it has a very low price ~~and~~ elasticity of demand, thus price inelastic demand,  $PEP < 1$ .



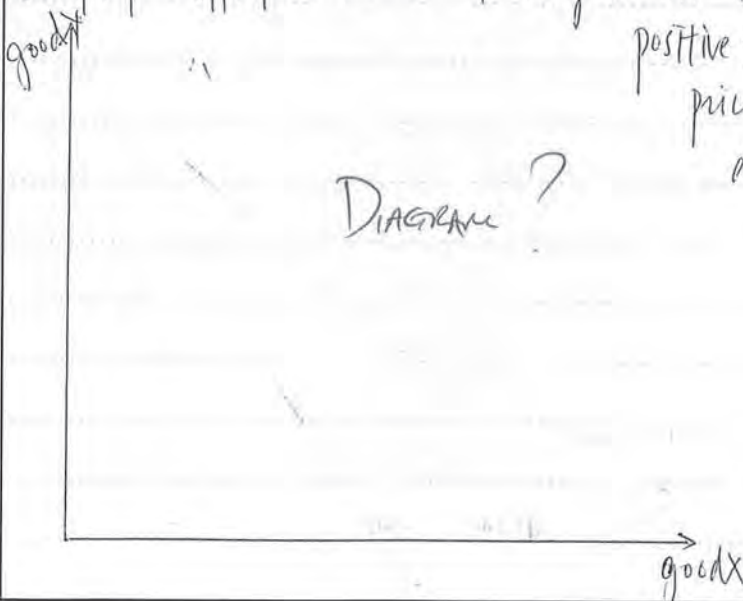
(Figure 5) As shown in the diagram, the substitution effect is too large, thus ~~eliminates~~ counteracted the effect of the positive income effect, gives ~~Good~~ Overall effect is negative.

$\overrightarrow{IE} + \overleftarrow{SE} = \overleftarrow{OE}$

So that

Giffen good is an exception <sup>from</sup> of inferior good which has a very large positive income effect which means <sup>when</sup> the price of Giffen rises, the <sup>real</sup> income ~~to~~ to afford the good X increases. The substitution effect in this case is ~~very~~ small. The overall effect is

positive for giffen goods. As price increases, the quantity demanded also increases in the case of Giffen good.



1.

~~Conclusion~~

~~Normal~~

In conclusion, the statement, hence the law of demand applied to most goods and services in the economy except for Giffen <sup>goods</sup>. For normal goods and ~~the~~ inferior goods, when there is a price increase, quantity demanded for the good will fall, forms a downward sloping demand curve. However, demand curve for Giffen good is upward sloping with ~~low~~ <sup>low</sup> PED. ~~Argue~~ Arguably, in real world, Giffen goods ~~is~~ <sup>are</sup> very rare, an example could be the potato in the famine in Ireland during 19th century. Another type of good is called Veblen good referring to the 'snob effect'. ~~The~~ Quantity demand will soar high when the price of good increase because consumer wanted to be seen rich to buy it. For example, Ferrari cars and brand watches. By using indifference curve analysis, the ~~same~~ statement is true to a significant extent, but we should be aware of the limitation and flaws in the indifference curve analysis.

T & A ✓

Ev.

~~15~~

~~5~~

L4 Mic

L2 Ex. ✓

L3. Bottom

~~Example on Normal + Inferior~~

~~Giffen needs diagram.~~

~~Good during package.~~

~~19~~  
~~26~~  
21

Examiner Comment

This was an answer that clearly was of a Distinction level. It achieved the highest levels both for theory and analysis and also evaluation. It might be argued that the mark given to this answer is harsh but the failure to provide the diagram for a Giffen good and hence to provide full analysis of this 'exception', resulted in full marks not being awarded. It was also felt that possibly for a (suggested) 40 minute answer, there was perhaps slightly too much 'setting the scene'. If this could have been condensed, then there would have been more time for greater in-depth evaluation. However, as already stated, overall this was an excellent answer.

Example Candidate Response – Merit

1 plan  
 p↑ D↓ ✓  
 Inverse relationship of p and Qd ✓  
 Rational consumer = equates MU ✓  
 $\frac{MU_x}{P_x} = \frac{MU_y}{P_y}$  when  $P_x \uparrow$   $\frac{MU_x}{P_x} < \frac{MU_y}{P_y}$  ✓  
 ∴ buy more y ✓  
 Disposable income ✓  
 However Giffen Goods (Show off) = P↑ D↑ ✓  
 upwards sloping D curve ✓  
 speculation P↑ D↑  
 future  
 Ceteris Paribus



1  
1/2

If the price of a good or service rises, the Demand for that product will fall. To what extent does economic analysis support this statement?

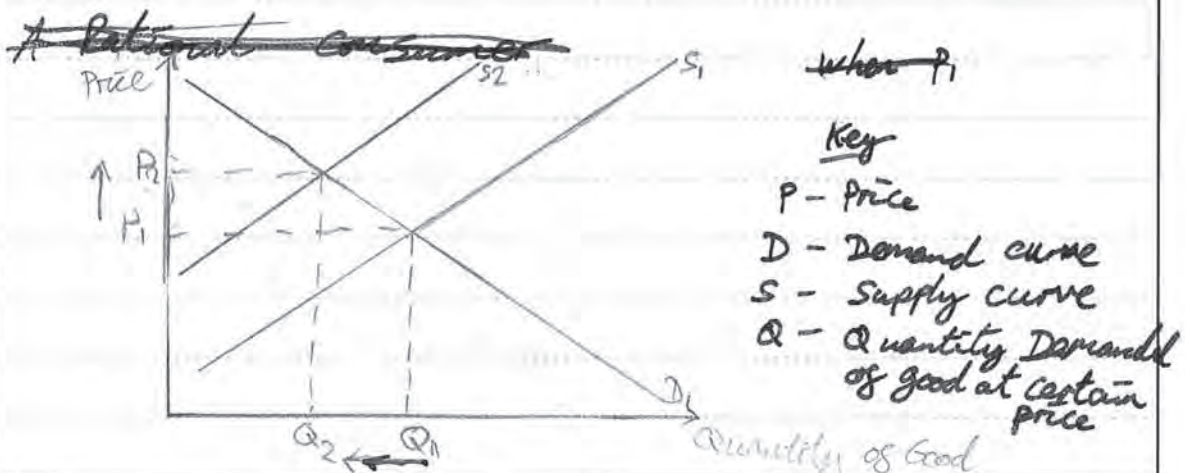
The Law of Demand states that there is an inverse relationship between price <sup>(P)</sup> and quantity Demanded (Qd), where every other factor remains the same ("ceteris Paribus").

Following the Law of Demand, when a good "x" (Mars Bar) rises in price, <sup>fewer</sup> less Mars Bars are demanded. This due to Marginal Utility. Marginal utility is the satisfaction a consumer gains from consuming every extra unit of a ~~certain~~ given good (every extra Mars Bar).

Some p

Demand is where a consumer or group of consumers wish to buy a given good at a given price. Demand for a good is where supply and Demand find an equilibrium.

?





~~When  $P_1 \rightarrow P_2$  (price rises),  $Q_1 \rightarrow Q_2$~~   
 When price rises, Quantity Demanded falls from  $Q_1 \rightarrow Q_2$ , therefore signifying that when price of good  $x$  increases, ~~the~~  $Q_d$  of that good decreases and the when price decreases, ~~quantity~~  $Q_d$  should rise. ~~when the price is rising~~  
 Price rises because of a fall in supply of the good  $S_1 \rightarrow S_2$ .

MR!

A Rational Consumer aims to equate his Marginal Utility (MU) between the goods he gains most satisfaction from.

good  $x$  = Mars Bar

good  $y$  = ~~Wendy~~ Milky Way

The consumer wishes to spend his disposable income so that:

$$\frac{MU_x}{P_x} = \frac{MU_y}{P_y}$$

Therefore gaining Maximum Marginal Utility from both goods with the consumer's current income

When the price of good  $x$  rises, the consumer's Marginal utility changes to:

$$\frac{MU_x}{P_x} < \frac{MU_y}{P_y}$$

This is because the consumer gains the same amount

of utility from good  $y$  as before, but ~~not~~ now milky ways are cheaper than Mars Bars, (assuming the utility the consumer gains from consuming either good is equal), the consumer buys more of good  $y$  (more milky ways).

therefore when price rises, the consumer buys less of that good.

OK.  
Good  
Answer!

However, there are exceptions to this law. ~~in~~ that "Giffen Goods" are goods which are bought to "show off". The rich tend to buy these good because as the price rises, <sup>richer</sup> less people can buy this good, for example, Diamonds. This situation actually causes an upwards sloping Demand curve.

Confuses  
Giffen  
+  
Veblen  
goods

Another exception is "speculation". This is where economists foresee that a certain good will rise in price in the near future. Therefore a consumer can buy that good now and sell it for a profit in future, therefore as price rises, demand also rises. An example of this is shares.

Finally, in theory the law of Demand takes on the Assumption of Ceteris Paribus, where all other factors (including income) remains constant. This in practice does not



occur as consumer's incomes change and so does the cost of production and technological advances, therefore the ~~theory~~ law ~~is~~ only works in theory, without exceptions.

In practice, when the price of a good or service does increase, (and the good is a normal good), the demand for that good will fall. But there are some exceptions.

T & A  
9  
L3. Ben

Ev  
5  
L2. Top

had marginal utility analysis;  
some evaluation!

14

**Examiner Comment**

This candidate did finally use Marginal Utility analysis to explain why a demand curve is downward sloping. They mixed up Giffen goods and Ostentatious goods and hence for theory and analysis the answer just scraped into the Level 3. Whilst there was some evaluation, it was not enough to reach Level 3. Overall the mark of 14 equated to a Merit.



## Example Candidate Response – Pass

1. The price of a good or service is a main determinant of demand for that product under normal circumstances. This extent to which this holds depends on a variety of aspects: the type of good in question; the elasticity of demand and supply for that product; and ~~other~~ macroeconomic variables. Economic analysis shows that the statement holds for a normal good, ~~with~~ when no other factors <sup>are</sup> taken into account:

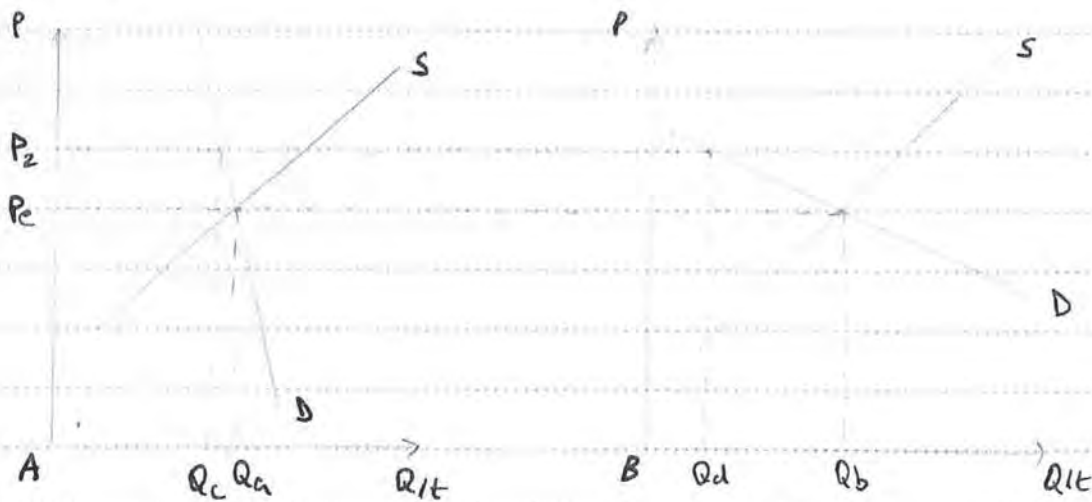


applies to a normal good.

Other types of good ~~no~~ not apply to the statement. ~~They~~ <sup>these</sup> include Veblen and Giffen goods. A Veblen good is demanded ~~more~~ as price increases because of the social 'snob' factor associated with it. The demand curve for a Giffen good is also upwards sloping, ✓

because as price for that good increases, consumers must substitute towards it because they are unable to consume other goods. A Giffen good is a type of inferior good, an example of which is rice in Bangladesh. This shows that the statement does not hold in these circumstances. (valid, but more subtle, desirable)

The price elasticity of demand for the good also affects the degree to which demand changes with a change in price.



For a normal good, the price elasticity of demand affects the demand when there is a change in price. The price elasticity of demand for good A is highly inelastic ( $< 1$ ). With a change in price from  $P_e$  to  $P_2$ , a less than proportionate change in demand occurs.

For good B, such a change in price brings about a large change in quantity demanded. This proves that the statement holds in this circumstance but shows the degree to which demand changes.

Other factors such as interest rates and the presence of substitutes and complements affect the demand for a good. With high interest rates, even a decrease in price may not attract consumers to consume the good as the money earns high rates of interest. Also, ~~comp~~ if a complement to a good has a consistently higher price, then even ~~with~~ a decrease in price for the good may not attract consumers to consume it. Equally if the price for the good falls but a substitute good's price falls more, consumers are ~~more~~ likely to substitute towards it rather than consume the good.

Thus it would seem that the statement holds in theory for a normal good, however, when other factors such as the price of related goods and macroeconomic variables are taken into account, the statement cannot be



justified. Therefore, economic analysis shows that this statement is in fact incorrect.

f. high L2 (no basis), 7  
L2 eval: 4

(11)

### Examiner Comment

This answer fell into the mistake of not actually explaining 'why' but merely stating far too much. The syllabus clearly shows that candidates must be able to explain why a demand curve is downward sloping. This answer is indicative of an answer that only managed to be awarded a Pass due to its lack of explanation.

### Question 2

**'Perfect competition results in a more efficient outcome than is the case with monopoly'. Evaluate this statement.**

### Mark Scheme

Candidates should show a good knowledge and understanding both of the models of perfect competition and monopoly and also of the various different aspects of economic efficiency. There should be a clear comparison of the two models within the answer.

#### Answers may include:

**Knowledge** and **understanding** of the relevant economic efficiencies and how these relate to the two models in question. It will be expected that candidates would consider:

- Productive efficiency
- Allocative efficiency
- Dynamic efficiency

Although discussion of other forms of efficiency can be awarded credit, this should only be the case if they are considered in a way that involves comparison.

**Application** of the two models to real life situations and an appreciation that theoretical models rarely occur in the real world

**Analysis** of why the two models produce different results and an appreciation of the role of the profit maximising assumption in the analysis

## Examples

- Explain why  $MC = AR$  gives allocative efficiency
- Explain why the minimisation of AC is said to give productive efficiency – note whilst this is the standard explanation at schools, universities usually say that any production that occurs on the average cost curve is productively efficient. Whilst the former will be the expected answer, the latter should most certainly not be penalised
- Consider the difference between short and long run outcomes, with particular emphasis on dynamic efficiency – probably highlighting the different views that exist concerning the two market structures and hence the likelihood of dynamic efficiency being pursued/achieved.

**Evaluation** of the issues involved

## Examples

- Are theoretical models relevant to real world experience?
- Are the definitions used for the various efficiencies always accurate?
- What happens when we relax the profit maximising assumption?
- Does it matter if we ignore the time span involved?

**Theory and analysis**

Level 4 (13 – 17 marks) Mid mark 15	A good answer is likely to show an accurate diagrammatic explanation of the standard reason used to support the statement. At the top of this level there is likely to be consideration of exceptions to the rule, such as in terms of non-profit maximising monopolists or through analysis of different cost curves.
Level 3 (9 – 12 marks) Mid mark 11	Candidates may focus on just one form of efficiency with a clear and accurate explanation of the different outcomes in the two models or they may touch on several issues but without full explanation as to why we would get differences. Diagrams may either be missing or incomplete.
Level 2 (5 – 8 marks) Mid mark 7	Whilst there is some mention of at least one type of economic efficiency, there is no real attempt to discuss how the two models produce different outcomes with regard to efficiency. Any diagrams included are likely to be inaccurate or not explained.
Level 1 (1 – 4 marks) Mid mark 3	There is likely to be a lot of confusion over the concept of efficiency and there will be little, if any, accurate application to either perfect competition or monopoly.

**Evaluation**

Level 3 (6 – 8 marks) Mid mark 7	A good answer is likely to discuss issues such as: <ul style="list-style-type: none"> <li>• Do the models of perfect competition and monopoly actually exist?</li> <li>• Even if they do, are the outcomes that they achieve as theory suggests?</li> <li>• Is one form of efficiency more important than another?</li> <li>• Should we be more concerned with 'second best' solutions?</li> <li>• How important is the issue of time-scale in all this?</li> </ul> There will be a conclusion drawn at the end to explain the candidates overall view – even if this is that there is no clear-cut answer.
Level 2 (3 – 5 marks) Mid mark 4	One of the above will be discussed in detail or a couple of points touched on, but only in a relatively superficially way.
Level 1 (1 – 2 marks) Mid mark 2	Whilst there might be some appreciation that evaluation could be carried out and indeed there might be the odd comment that suggests an area for potential evaluation, it stops at the comment, and the point is not developed. For example: 'Perfect competition might be better in most cases but there will be exceptions'.

Example Candidate Response – Distinction

2

Plan

PC - perfect knowledge ✓  
 very contestability ✓  
 + Price take, Indust = Price maker ✓  
 Homogeneous Goods ✓  
 Lots of small firms ✓  
 Monop - price taker ✓  
 + only one firm in industry ✓  
 + MKT is not very contestable ✓

$A_e = (MC = AR)$  price to cons = MC of firm ✓  
 $P_e = (ATC_{min} = MC)$  firm produces at min ATC ✓

PC =  $A_e$  +  $P_e$   
 LR + SR | LR  
 ✓ SNP (SR) | NP (LR) ✓

due to rising cost condition  
 $ATC \uparrow$  LR  
 $NP$  (LR) ✓

M = Not  $A_e$  or  $P_e$  but potential to be  $D_e$  provided in centive

DWL  $\Delta$  to society, welfare consumer ↓  
 + aim to SNP  $\therefore$  take CS ✓

PC is more eff than Monop

However if given Incentive  
 Could be more  $A_e + P_e$   
 + DE

However  
 LR  
 $P_e$   
 not SR



2

Perfect competition results in a more efficient outcome than is the case with monopoly. Evaluate this statement

Perfect competition is a market in which there are many small firms, producing ~~homogeneous~~ homogeneous goods. The market is perfectly contestable, (No Barriers to entry or exit of the market) and the market takes the industry price of goods, making the firms, price-takers. The firms also have perfect knowledge.

Monopoly is ~~is~~ when <sup>only a</sup> single firm is operating in an entire industry. All Monopolies are price-makers, (the firm sets the price for their goods) - Monopolies ~~are~~ are <sup>likely to be</sup> not very contestable.

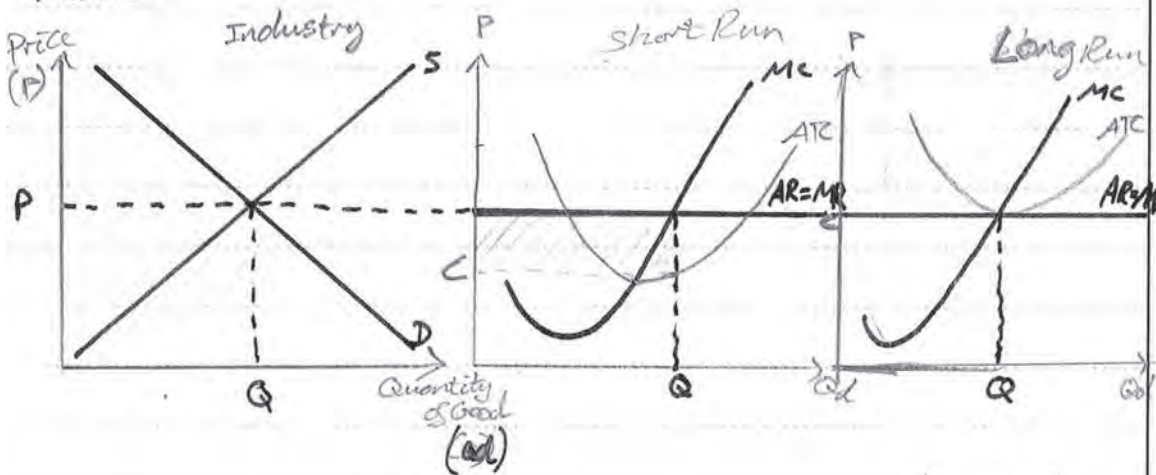
An example of perfect competition is ~~water~~ bottled water companies. No. Branding Means Non-Homogeneity!

An example of a monopoly is ~~the~~ <sup>De Beers</sup> Du Beers (supplier of diamonds).

Allocative Efficiency <sup>(AE)</sup> is where the price paid by the consumer for a good, is equal to the Marginal costs (MC) the firm pays to make that good. ~~on~~ on the graph, it is where Average Revenue = Marginal Costs (AR = MC)

productive Efficiency (PE) is where a firm produces at its minimum Average Total costs ( $ATC_{min}$ ) which on a graph is where  $(ATC_{min} = MC)$  -

Perfect competition is Allocatively Efficient in Both the Short and Long runs. But it is only productively efficient in the Long Run -



Q. Why do the 2 models differ?

MR = super Normal Profit (SNP)

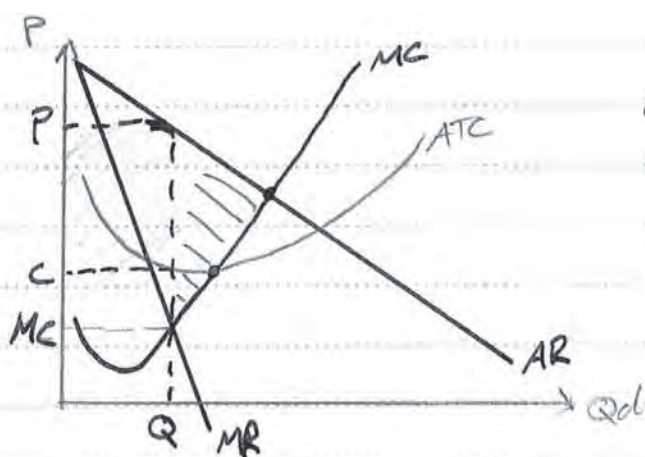
c = cost

Q = Quantity to produce at,  $(MC = MR) =$  Profit Maximisation

Short Run -  $MC = AR \therefore AE$  (at Q)

Long Run -  $MC = AR \therefore AE$  (at Q) and  $ATC_{min} = MC \therefore PE$  (at Q)





- /// - SNP
- /// - Dead Weight loss (to society) also welfare loss
- C - Cost

This graph represents monopolies in both short and long runs.

The monopoly is neither AE (as  $MC \neq P$ ) nor PE (as it does not produce at  $ATC_{min}$ )

Monopolies aim to continue to gain SNP at the consumer's expense, taking as much consumer surplus from consumers as possible.

In Prod<sup>VE</sup> / Alloc<sup>VE</sup> levels? Perfect competition is more efficient than monopoly both in the long and short runs. However, is monopolies where given the incentive to be efficient by government intervention increase contestability in the market, Monopolies with increase efficiencies due to benefitting from economies of scale.



This would reduce ATC and help the monopoly to be more PE. By helping the consumer, passing on the low ATC in the form of lower prices would help them to be more AE. But still perfect competition would be the most AE and PE.

Diagram?  
Relative v. Absolute Terms!!!

Monopolies could however, due to their SNP be more dynamically efficient, (improving quality of goods due to investing in research and development). Perfect competition cannot be dynamically efficient as they only produce normal profits in the long run.

Therefore perfect competition is more efficient than monopoly, but not always more dynamically efficient.

T & A	Ev.
13	5
L4. Bottom	L2. Top

18

Examiner Comment

This essay demonstrates that answers do not need to be 'faultless' to be awarded a Distinction. However, what this essay does benefit from is an attempt at lots of analysis and therefore it just crept into the top level for theory and analysis. As far as evaluation is concerned, it was not so strong and therefore it was placed in Level 2 for this category. However, overall this was sufficient for this essay to gain just enough marks to be the equivalent of a Distinction.

## Example Candidate Response – Pass

2 Define perfect competition - normal profit ←  
 monopoly ~~the~~ ←  
 efficiency ←  
 Examples agriculture ←  
 Google / Microsoft ←  
 state intervention ←  
 no brand loyalty ←  
 homogeneous goods ←  
 many firms

Analysis → efficiency?  
 natural monopoly  
 economies of scale  
 international competition  
 can ever get perfect comp?

Evaluate - not always

Perfect competition describes a market with 5 key characteristics. Firstly there can be no abnormal profit (profit other than that required to keep factors of production in current occupation) in the long run. Secondly there are no barriers to entry, meaning that firms can enter into the market freely without worrying about sunk or exit costs. Thirdly there is perfect information, both firms and customers have perfect knowledge of the goods and without any information asymmetry. Fourthly there

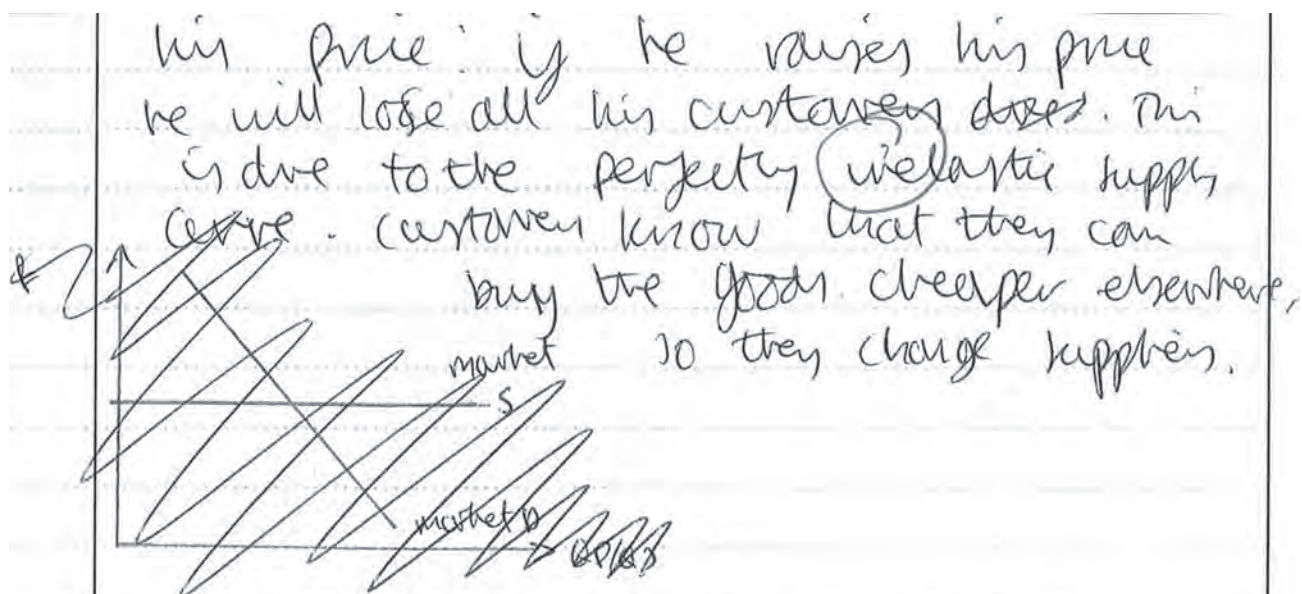


is no brand loyalty, ~~that is to say~~ and the goods / products sold are homogeneous. That is to say there is no reason for choosing one firm's goods over another. Finally there is a large number of firms in the market.

A monopoly on the other hand is the opposite. Abnormal profit can be made in the long term, firms usually erect large barriers to entry ~~through~~ ~~ways~~ by spending exorbitant amounts on advertising & expensive machines, there is a large amount of information asymmetry in that customers know little regarding the cost of the product; there is a large amount of brand loyalty due to heavy advertising, as the products are often very specialised and finally there is usually only one firm.

perfect competition are  
 in the real world, text book definitions of these market structures are hard to find. Agriculture is often cited as the closest market to perfect competition as the products are homogeneous, the number of firms large and ~~the~~ the main buyer (ie super markets) ~~are~~ usually ~~have~~ very unswayed as to the costs of production. Because of this, a farmer has very little control over





Real world examples of monopolies are unpatented, not so difficult to find. Large computer firms such as Microsoft, Google and IBM each own the lion's share of the market in their respective markets.

Unlike in agriculture, there are few, if any, substitutes to other goods these companies manufacture. Also they have an ingrained brand loyalty and require extreme financial investment making other firms entry into the market ~~very~~ extremely difficult. Anyone can grow potatoes, yet the resources and expense required to make a micro chip are immense. If ~~the~~ these firms raise prices, people have no choice? but to pay the difference. Often, the only thing preventing these firms from constantly raising their prices is state

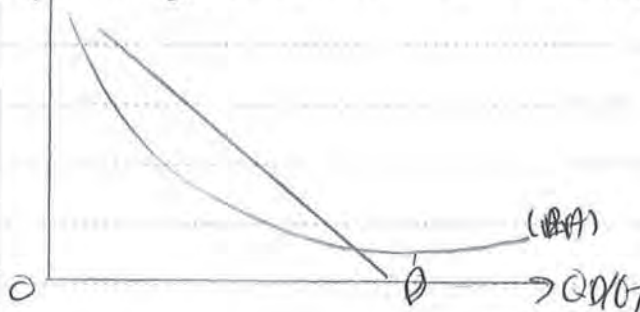


intervention <sup>in the</sup> form of competition  
 can harm <sup>(may be)</sup>

That is not to say however that  
 perfect competition is perfect and ought  
 to be tried for many countries,  
 or that monopolies are always Leviathanic  
 bulgies.

Due to the high number of firms in  
 perfect competition, firms may be  
 unable to benefit from economies of  
 scale that would be available to

price



them if they had a  
 higher market  
 share - the  
 extreme example of  
 this is natural  
 monopoly, where

the demand in a market is too small to  
 allow any more than 1 firm to achieve  
 the minimum efficient scale on the ~~(Q\_M)~~  
 curve. In this instance, anything  
 other than monopoly would result in the  
 good not being supplied at all,  
 which is hardly an efficient outcome

In many cases, ~~the~~ the existence of monopolies  
 is transparent in lower prices for the  
 customer due to ~~the~~ economies of scale  
~~price~~ If perfect competition were imposed



on such markets, prices would rise, hurting consumers, which is not efficient.

Another issue is the attainability of perfect competition. The lack of real world examples is indicative of the difficulty of ever achieving it. The fact is that all markets have barriers to entry. Perfect information is nothing more than a theoretical ideal ~~to gain~~ and can never be a reality.

To look at the agriculture example, growing vegetables requires large amounts of land and machines to harvest. Although the products are similar they are marketed in different ways eg organic, free range etc. As a result, different farms operate at different costs, making it impossible for consumers to ever have perfect information.

in conclusion, although <sup>theoretically</sup> ideally perfect competition results in a more efficient outcome, in reality it is never attainable. Even if it were, its efficiency would be completely dependent on the market to which it was applied.

Many markets simply do not have space for a multitude of small firms, and the existence of a large firm is the



most economically viable. However, it is very important that, in the absence of competition, the government intervenes to prevent x inefficiency and cost manipulation. heavy

Another issue is that sometimes national monopolies are required to compete in international markets. The removal of monopolies in a given country would make it unable to compete in international markets, which would be detrimental to the country's economy and therefore inefficient. or.

In some cases the excessive profits created by monopolies allow them to invest in very expensive research and development projects. This has the effect of making production more efficient due to better production methods. Such vast spending could never happen in perfect competition as any profit is competed away.

V. good understanding of the  
2 nat. str., 2. eff. lic.  
L2 6 but no all/prod. eff. (can link  
at dyn. eff./X-eff)  
L2 4 dead end, the or  
an impressionistic eff. with

10

### Examiner Comment

This was an essay that suffered from a lack of theoretical analysis. Whilst several points about efficiency were mentioned, none of them were analysed and therefore the essay could only be awarded Level 2 for theory and analysis. It is hard to evaluate an answer that only contains superficial analysis, and overall this essay was of a Pass standard.

### Question 3

**‘Given the lack of perfect knowledge, government intervention in markets for goods and services is doomed to fail and therefore markets should be left alone’. Evaluate whether economic analysis supports this argument.**

### Mark Scheme

Candidates should show a good understanding of the different reasons why governments intervene in particular markets and should appreciate that government failure is a potential occurrence. The relevance of perfect information should be explained, however, the use of the phrase ‘is doomed to fail’ should be used by the candidate to appreciate that the answer is in not quite so ‘clear cut’ as is suggested.

#### Answers may include:

**Knowledge and understanding** of some of the reasons behind government intervention such as:

- Merit/Demerit goods
  - Public goods
  - Ability to pay issues
  - Abuse of monopoly power
  - Cost-Benefit analysis
- and the relevance of perfect knowledge in particular situations

**Application** of the above to a particular market or markets of the candidate’s choice

**Analysis** of why the lack of perfect knowledge may or may not have a significant role to play

Examples

- The inability to know what the external costs and/or benefits in any particular market might be
- The problem of ‘missing markets’

**Evaluation** of the issues involved

Examples

- Just because intervention isn’t perfect, does this mean that it should not occur?
- Even if there is perfect knowledge, could there not be arguments to suggest that government intervention should not occur?
- Consideration of normative economics; namely why there might be differing views as to the wisdom of certain government intervention

**Theory and analysis**

Level 4 (13 – 17 marks) Mid mark 15	There is a clear discussion as to the reason behind government intervention in at least two instances and the candidate makes specific and relevant mention of the importance played by the existence or otherwise of perfect knowledge. At the top of this level the analysis of the candidate will be accurate and robust and will clearly have identified the failures that occur when certain goods and services are left to the market to allocate.
Level 3 (9 – 12 marks) Mid mark 11	The reason for government intervention in at least one case will be covered and there will be some attempt to address the issue that lack of perfect knowledge brings to a government. However, the answer will fail to adequately consider the overall benefits that might come from the intervention.
Level 2 (5 – 8 marks) Mid mark 7	An answer is likely to either just address the reason behind a government intervening or to look at the outcome of the intervention with no comparison or thought of what market provision has been replaced. There may well be some confusion between terms such as merit and public goods.
Level 1 (1 – 4 marks) Mid mark 3	A very limited knowledge of why governments intervene is shown and there is no appreciation of why a lack of perfect knowledge has any significance whatsoever.

**Evaluation**

Level 3 (6 – 8 marks) Mid mark 7	<p>A good answer is likely to discuss issues such as:</p> <ul style="list-style-type: none"> <li>• Is government intervention always based on economic rationale?</li> <li>• Does government failure mean a less than perfect outcome or one that is worse than the market solution?</li> <li>• Can perfect knowledge ever exist?</li> <li>• Might the search for greater information cause a greater 'cost' in both financial terms and in the level of bureaucracy required?</li> </ul> <p>There will be a conclusion drawn at the end to explain the candidates overall view – even if this is that there is no clear-cut answer.</p>
Level 2 (3 – 5 marks) Mid mark 4	One of the above will be discussed in detail or a couple of points touched on, but only in a relatively superficially way.
Level 1 (1 – 2 marks) Mid mark 2	Whilst there might be some appreciation that evaluation could be carried out and indeed there might be the odd comment that suggests an area for potential evaluation, it stops at the comment, and the point is not developed. For example: 'We need to remember that the government has intervened because there are problems with the market system.'



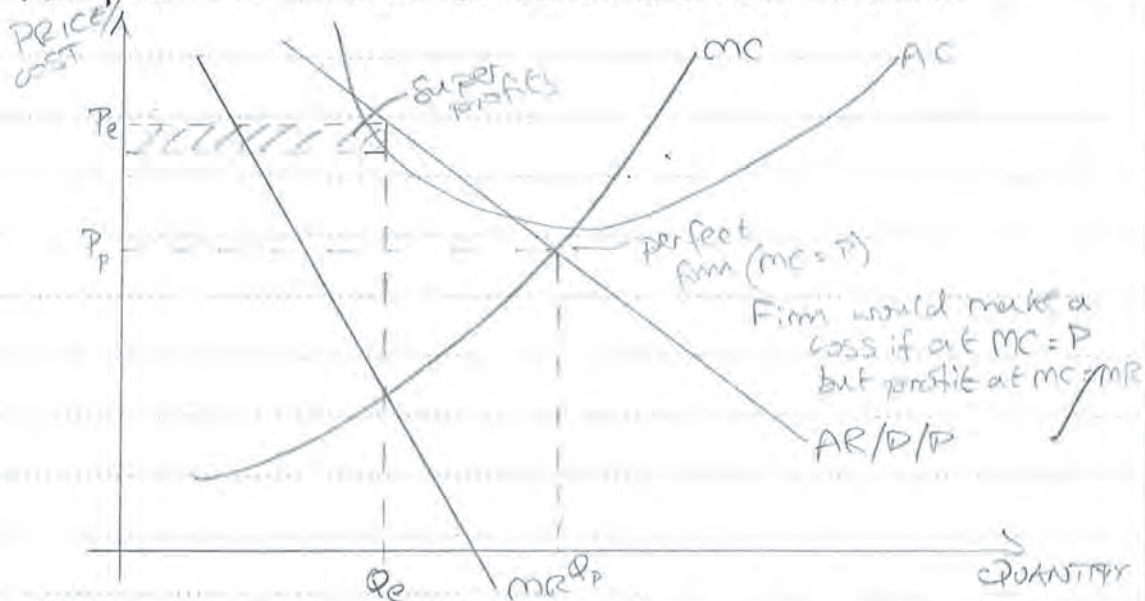
## Example Candidate Response – Distinction

3. It is commonly assumed that a major market failure is the lack of perfect information. This can come in the form of asymmetric information, wrong information or even the absence of information. However, this is also true for government. Government is itself not a monopoly holder of information and there is not always able to accurately correct market failures when they occur. This does not necessarily mean, however, that government failure is an inevitable outcome or that ~~the~~ it would be more damaging than the market failure. The theory of Second Best states that we may have to allow one failure in the form of intervention in order to fix the even bigger imperfection in the market. In some cases it may result in a net gain for society. The main types of market failures that occur, and therefore government intervention is often seen are in market power, externalities, inequality, imperfect information, instability and public goods.

In the first case of market power, such as a monopoly dominating the market and thus abusing its power by exploiting the consumer there are a number of government solutions. A price cap via regulation and control and command are the two main forms. Here we see an example of government failure in forcing the monopolist to produce at an unacceptable price and output and thus cause the firm to fail. Take the example shown in the diagram on the next page. When normally operating at  $MC=MR$  there is a welfare loss. If the government forces the monopolist to produce at the allocatively efficient point of  $MC=P$ , the monopoly may not be able to cope and eventually shut down. The information of the

P.T.O

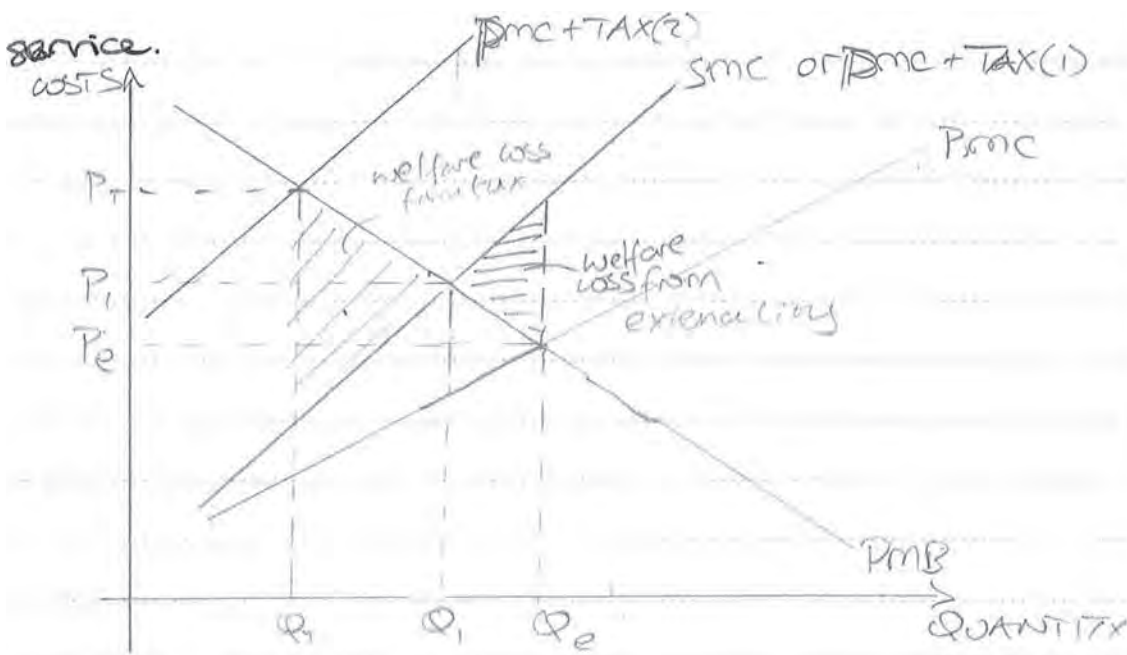
government was clearly not sufficient to prevent the greater loss of social welfare due to the closure of the firm. This would be command and control.



If however the government regulated the market by say an 'RPI-X' formula a more socially desirable outcome may be reached over time. Eventually the job of the regulator would be made redundant and the monopoly would still be able to survive but producing at lower prices. It all depends on the measure used by the government and whether time is taken to carefully consider the advantages and disadvantages of intervention in the market, for in many cases it may succeed.

If the government lacks information this can also affect the hardness of a measure used. When a negative externality is produced, the social and private costs of production and consumption diverge. This can be seen in the diagram on the next page. One solution is to use Pigorian taxes to correct the market failure and eliminate the welfare/deadweight loss caused by the demerit good or

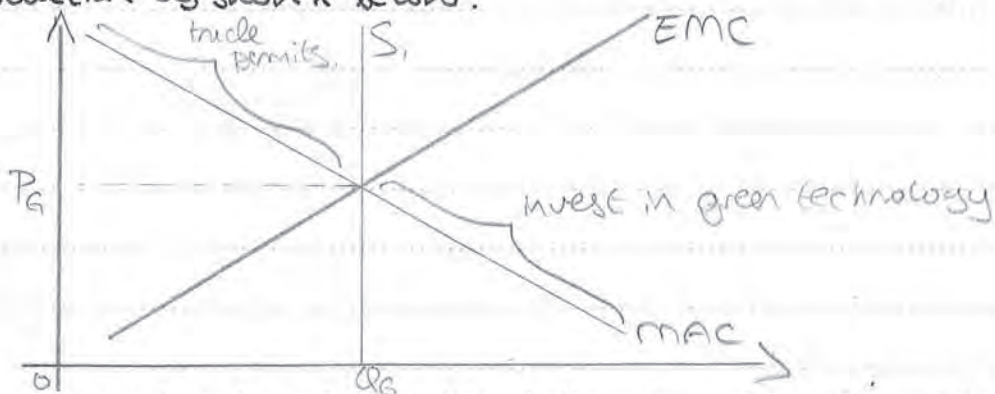




The government may however impose a tax that is too high and would thus result in a net social welfare loss as shown in the diagram above. Equally the tax may not be high enough and thus not cover the externality.

In these cases it is indeed better to have no government intervention. Government intervention does, however, have to involve taxes, subsidies or legislation. It may involve distributing property rights or introduce tradeable permits for pollution as shown below.

why?  
is it?



Here government intervention either internalises the externality or applies a market mechanism to try and minimise while the not harming firms. In the case of tradeable permits, it encourages firms to invest in green technology and then uses the theory of P.T.O



demand and supply through the price mechanism to correct the market failure. The risk of imperfect information is less obvious in these cases. The only problem might be setting the permit at the wrong rate. However, over time the price would settle at the market price for carbon and thus the problem would no longer exist. Thus it is important to distinguish between different methods of government intervention when analysing the potential failures due to lack of information.

In all market failures, if government decides to intervene there are also opportunity cost and distributional considerations to take into account. In the case of provision of a public good or using a buffer stock scheme to correct an instability there are often huge costs involved. These obviously have an opportunity cost attached to them when the government could be better spending funds on unemployment benefits or building roads, for example. These are examples of where a lack of information has allowed an eventual failure to correct the problem. This could be seen in faulty cost benefit analysis where a discounting rate is incorrect. This could be seen in the Stern Review on climate change. Many criticised government for not having the correct information and thus overspending and not tackling the real problem caused by the market failure.

It is important therefore to distinguish between government failure which arises from imperfect knowledge that on one hand leads to the market failure being simply not corrected and on the other leading to a waste of government funds or a creation of a welfare loss whilst

The market failure is still actually corrected. Therefore using the economic analysis of the most common market failures as seen in this essay it is evident that the critical factor is not necessarily the lack of perfect knowledge but actually the leading to what type of method of intervention is used. We have seen that it is possible to have imperfect information and yet still correct the market failure in the provision of goods and services. It is also possible that though there may be government failure arising from the lack of information this can be outweighed by the market failure that already existed. It is wrong therefore to conclude definitively that government intervention is always doomed to fail, but it is important to look at the varieties of possibilities open to government when tackling market failure.

Question 4 is overleaf

Ans - 16  
 Ex - 7

23

#### Examiner Comment

This candidate produced a highly impressive answer. The important points to note are that it stayed focused on the set question – many candidates across all the questions failed to do this – and used good analysis. It was very thoughtful in its approach and the level of evaluation was extremely strong. This was awarded a high Distinction.

#### Question 4

**‘Economic growth is necessary to ensure an improvement in the standard of living and hence should be a government’s primary economic objective’. To what extent do you agree with this view?**

#### Mark Scheme

Candidates should show a good understanding of what is meant by the terms ‘economic growth’ and ‘standard of living’ and should be able critically examine the link between the two and also to focus upon the use of the phrase ‘primary objective’.

#### Answers may include:

**Knowledge and understanding** of economic growth and of the fact that there are different definitions in terms of ‘short-run and long-run’, ‘potential and actual’. Candidates should consider how standard of living is measured and there is plenty of opportunity for discussion of this in relation to general well-being/‘quality of life’. Knowledge of the different objectives that a government might have is likely to be shown.

**Application** of the possible links between growth and well-being will be expected and specific examples that the candidate has covered during the course will be expected to be shown within answers

**Analysis** of how economic growth can affect standard of living in terms of how an increase in GDP can lead to an increase in GDP per head will be expected at the superficial level, with a much more detailed look at other variables such as the distribution of income etc. expected from better answers

#### Examples

- Greater output can lead to greater consumption
- Looking at both the composition of the output and the distribution on income within an economy
- Analysis of whether any link means that other objectives are less important

#### Evaluation of the issues involved

#### Examples

- Is growth sufficient?
- Even if this is the case, does this mean that it must be the primary objective? What about protection of the environment?
- Similarly, is the economic growth sustainable?
- Don’t other objectives make it much easier to have growth – such as stable inflation? Might it not be that concentrating on other objectives will provide us with economic growth?



## Theory and analysis

Level 4 (13 – 17 marks) Mid mark 15	There is a clear discussion of the potential link between the two concepts and a good appreciation of the terms used. The answer also stays focused on that part of the question which is to do with 'primary objective'. At the top of this level the analysis of the candidate will be accurate and robust and will clearly have identified that there is far more that needs to be considered than just the fact that economic growth will bring about an increase in the standard of living. Concepts such as the HDI or the 'Happiness Index' may well be discussed.
Level 3 (9 – 12 marks) Mid mark 11	The answer will address the main link between the two concepts of economic growth and standard of living and the analysis is likely to be fairly robust. However the answer will either not consider whether the common measure of standard of living has problems or will fail to address the implications of the explained link as far as a primary government objective is concerned.
Level 2 (5 – 8 marks) Mid mark 7	Very little will be explained as far as terms used are concerned and it is likely that the answer will simply assume that economic growth must lead to an increase in the standard of living. There is very unlikely to be any consideration of government objectives.
Level 1 (1 – 4 marks) Mid mark 3	A very limited knowledge of the whole concept of economic growth and standard of living will be shown and there will be no attempt made to try to consider any line of causality.

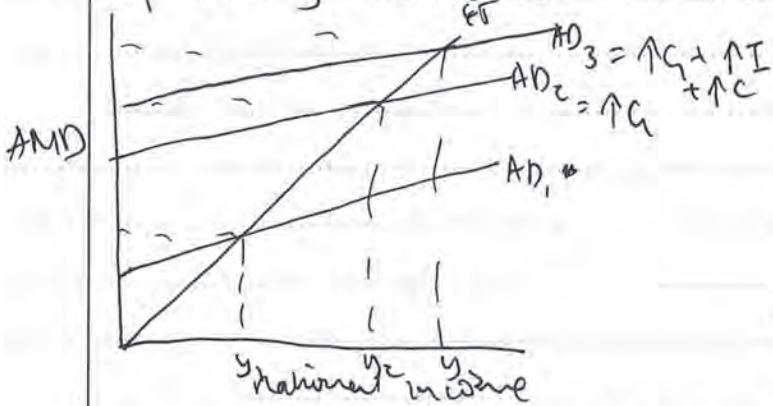
## Evaluation

Level 3 (6 – 8 marks) Mid mark 7	<p>A good answer is likely to discuss issues such as:</p> <ul style="list-style-type: none"> <li>• The problem of sustainable growth and the environment</li> <li>• The distribution of income within an economy and its implications</li> <li>• The whole issue of whether a government should focus on 'an end' or on 'a means to an end'</li> <li>• Consideration of the composition of the extra output</li> <li>• Consideration of the phrase 'and hence' in the title</li> </ul> <p>There will be a conclusion drawn at the end to explain the candidates overall view – even if this is that there is no clear-cut answer.</p>
Level 2 (3 – 5 marks) Mid mark 4	One of the above will be discussed in detail or a couple of points touched on, but only in a relatively superficially way.
Level 1 (1 – 2 marks) Mid mark 2	Whilst there might be some appreciation that evaluation could be carried out and indeed there might be the odd comment that suggests an area for potential evaluation, it stops at the comment, and the point is not developed. For example: 'It must be remembered that just because an economy grows, this does not make it a good thing.'

Example Candidate Response – Distinction

4 Economic growth can be described as the long run increase in the economy's productive capacity, identifiable by an increase in the real levels of national income over a period of time. ~~Economic growth~~ sustainable economic growth has <sup>always</sup> been one of the major macroeconomic objectives for government, as it has been associated with numerous beneficial implications, such as high levels of employment, ~~and~~ which ~~will~~ <sup>might</sup> translate into higher standards of living. Although this may be definitively true for developing countries, this cannot be guaranteed for developed ones, where growth is often associated with ~~the~~ high levels of inflation, ~~and~~ balance of payments deficit and widening inequality of income. However the measure of growth, real GDP per capita, is an imperfect one, neglecting the impacts of externalities and not reflecting the true level of happiness in an economy.

~~Actual~~ Actual growth can be promoted through increasing any of the components of AD ( $= C + I + X - M$ ). This will increase the level of output in an economy, representing an increase in the level of factor



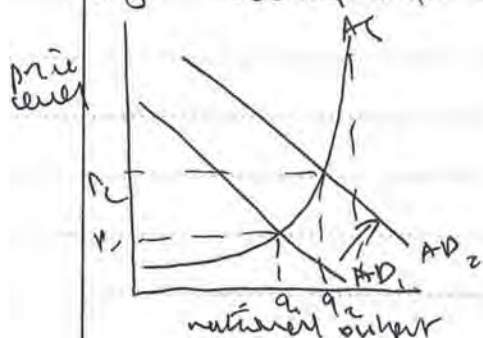
utilization in an economy. Indeed the level of increase in the autonomous expenditure may result in a more than proportional increase in the level of national income, through

the multiplier effect ( $y_1 \rightarrow y_3$  instead of  $y_1 \rightarrow y_2$ ). This ~~will~~ <sup>will</sup> translate the increased demand in the domestic economy, which ~~will~~ <sup>will</sup> result in an



increased demand for factor inputs, including labour. This will be beneficial for the standards of living of those who now have a job due to growth.

However, rising growth and employment levels may have negative consequences, in the form of high levels of inflation. If the economy lacks spare capacity,



capacity, ~~the~~ increase demand ( $AD_1 \rightarrow AD_2$ ) ~~there~~ will be accompanied by supply side bottlenecks, ~~it~~ inevitably giving rise to rising price levels ( $P_1 \rightarrow P_2$ ). This will be exacerbated by the imperfections in the labour

market, namely trade union monopolies, who will have seen their bargaining power increase with decreasing unemployment.

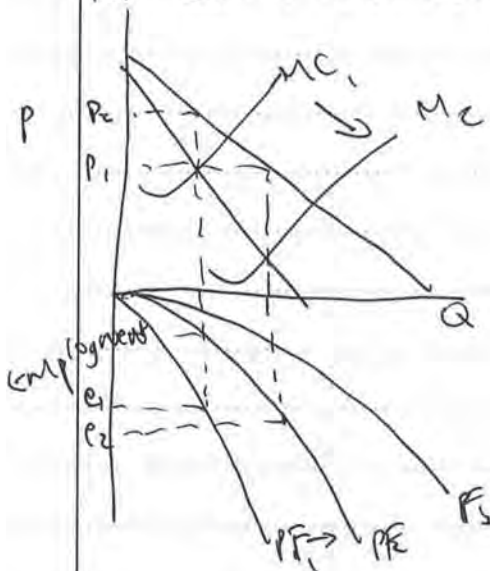
~~This might be detrimental~~ A wage price inflationary spiral will be detrimental to the standards of living, especially ~~the~~ for those on a fixed income in undiversified industries.

However, this does not necessarily have to be the case with sustainable levels of economic growth.

This can be defined as a level ~~which~~ lower than that of the trend rate of growth on the demand side matched by a growth of the supply side prices. ~~It is not growth~~ If there is an ~~increasing~~ increasing productive capacity ~~of the~~ in the economy brought about by rising increasing quantity or productivity of factors of production, inflation can be kept at a relatively low level. For instance, an increased investment in education ~~and a decrease in corporation~~ will raise the labour productivity



(and thus the TFP) of the labour force. This will help firms to come down its LRAC and reduce its prices. At the same time this will incentivise them to expand their supply, meaning their demand for labour will increase. This ~~raises~~ lowered



MC ( $MC_1 \rightarrow MC_2$ ) will translate into lower costs, while rising productivity ( $PF_1 \rightarrow PF_2$ ) will also increase ~~the~~ employment levels ( $e_1 \rightarrow e_2$ ).

Even sustained growth may still impose negative consequences on an economy and the standards of living of

its citizens in the form of ~~rising levels of~~ a widening inequitable distribution of income and a worsening current account position. However, both ~~may not~~ do not need to have such ~~year~~ detrimental implications. Low levels of inflation might encourage a country to enter a virtuous cycle, where import prices are kept low and this ~~is~~ reinforces the low inflationary pressures. However this may contribute to the fact that the current account may be in deficit, particularly because an economy's MPM rises as an economy grows. Yet, if the deficit is due to importation of cutting edge technology and <sup>much needed</sup> capital, it might see its productivity rise and have beneficial supply side implications. Moreover, ~~rising and~~ increasing prominence of globalisation and the

increasing role of financial liberalisation of means that deficits on the current account ~~do~~ <sup>need</sup> not have adverse results on the economy as it can be met with a surplus on the capital account.

There have also been claims that rising import penetrations have caused a rise in structural unemployment and exacerbated the inequality of income. This is because as production lines become increasingly mobile and fragmented, ~~the~~ low cost labour from emerging nations increasingly compete with the workers in developed economies. However, such claims are likely to be exaggerated as there exists little overlap ~~between~~ in ~~the~~ production. ~~It is~~ ~~in the long~~ Even if there is, no developed country will be more likely to use more capital intensive methods, rather than labour intensive methods more prominent in developing countries. The pay differentials are created by the market to create a dynamic economy where wages act as a signal, incentivising those with higher human capital to take jobs with greater MRP.

Thus, the bleak fact that growth is not always favourable to living standards is most clearly depicted by the ~~de~~ rapid degradation of the environment. GDP or other ~~no~~ statistical data ignore the third party spillover effects such as pollution. ~~Because~~ Thus negative externalities, an inevitable factor of growth will damage standards of living without formal monetary compensation.

An -14 24 -14  
Pr. -13 -7

21



Examiner Comment

This answer stayed focused on the set question and the candidate considered several issues, allowing it to be awarded a low Level 4 for theory and analysis. The evaluation was good with a strong final conclusion. As can be seen by the mark scheme, in order to score in the top level for evaluation, it is always necessary for the candidate to draw things together in a conclusion – even if the conclusion might happen to be that there is no clear cut answer. This essay was marked at the Distinction level.

Example Candidate Response – Pass

4 Plan - E on growth - non-caring gas  
 - standard of living

Trade = gain - growth 0.30%  
 - employment 2.8%  
 - inflation 3.5%  
 - B of P  
 - standard of living

① growth - low  
 - problems

② employment - H?  
 - P

③ Inflation - +1?  
 - P

④ B of P - H?  
 - P

Conc



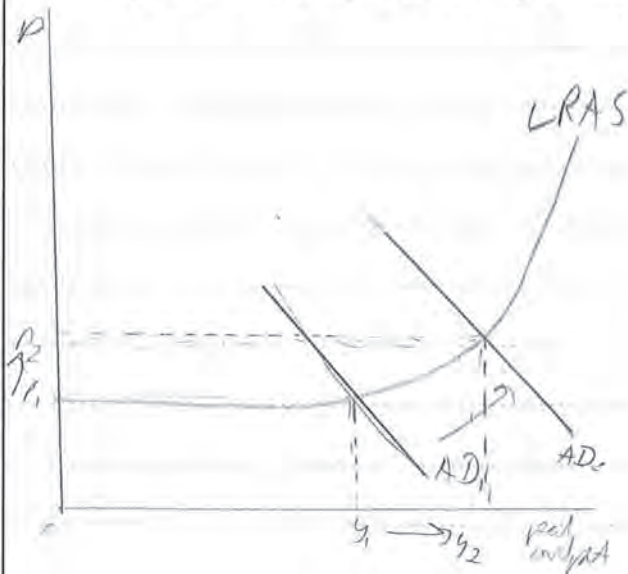
4/ Economic growth is one of the governments four major economic objectives, the other 3 being: unemployment, inflation and Balance of Payments. Economic growth is measured by <sup>REAL</sup> GDP and in the first quarter was at +0.31% in the UK. Unemployment is the total number of people currently not in work, but actively looking, and the UK current rate is at 2.81%. Inflation is the price increase in an economy and is currently at 3.51%. Whilst the governments target is set at 2%. Balance of Payments consists of the current account, financial account and capital account and is the inflow and outflow of money into the economy. The standard of living is vital in not improving the quality of life for the population in the economy.

Really?

Amo!

Growth is needed to improve the overall economy and especially the standard of living. It is already one of the governments primary economic objectives.

BUT it can lead to ~~an~~ a risk as inflation rise if growth gets too much. The government looks for a stable and constant, manageable growth. Growth



will lead to  $AD_1 \rightarrow AD_2$  and  $P_1 \rightarrow P_2$  which will lead to inflation if the increase is too great

Meaning?

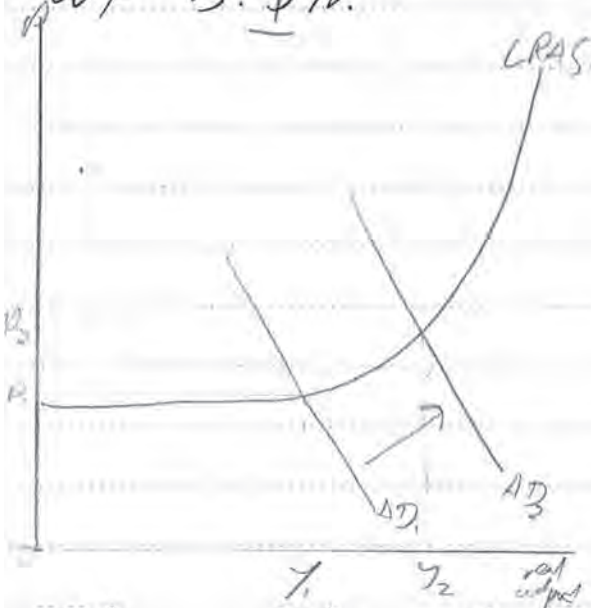


Unemployment rates play a huge role in helping the standard of living. If unemployment decreases, more people are getting wages, so ~~there~~ the ~~ex~~ money in circulation in the economy will therefore increase. This will help increase the standard of living via the multiplier effect. But it ~~is~~ can be expensive for the government to try and reduce unemployment. ~~and~~ If the rate of unemployment gets too low, then inflation can start to increase, which ~~will~~ may bring about a recession and a decrease in the standard of living.

?

Confusion

Inflation levels is one of the most important macroeconomic objectives for the Government. The Government has a target of 2% for inflation, but the current rate is at 3.5%.



Inflation will cause AD to move to AD2, which will increase the price level from  $P_1 \rightarrow P_2$

Inflation will  
If inflation is kept at a low and stable level.

Reactive

Can GDP?

then the standard of living can continue to increase along with economic goals.



The Balance of Payments looks at the money ~~is~~ entering and leaving the economy. If there is a lot of investment into the economy, then ~~there~~ there is an increase in money ~~is~~ in circulation in the economy. This will allow the standard of living to increase due to the multiplier effect. However, the Balance of Payments can be slow to come into effect, as in ~~the~~ there will be a time lag between when the money enters the market and an increase in standard of living is seen.

Economic growth to some extent is needed to ensure an improvement in the standard of living, ~~but~~ ~~there~~ and that is why it is one of the Government's major macroeconomic objectives. ~~At~~ To see a serious increase in the standard of living in an economy, you need along with economic growth; reduced unemployment, low stable inflation and a good Balance of Payments. This is why these ~~four~~ are the ~~four~~ Government's four major economic aims.

T & A  
8  
12 Top

Ev. Identifies goals as important; says it focuses INFLATION !!! Good.  
3  
12. Been ~~the~~ ~~all~~ ~~good~~ ~~bits~~ + not much evidence.

(11)



### Examiner Comment

This essay did not address the set question. Rather it simply went through the four main economic objectives in turn without relating them to the question of their impact on the standard of living (which was never actually defined). There was also some confusion in the answer meaning that it only reached Level 2 for both categories and overall was of a Pass standard.

### Question 5

**‘Recent UK experience has shown that monetary policy can be implemented more quickly but that fiscal policy is more effective in dealing with underlying economic problems.’ Evaluate this statement.**

### Mark Scheme

Candidates should show a good understanding of what is involved with both monetary and fiscal policy. There should be sound knowledge of how these two have been used in recent years within the UK economy. Explanations should be given as to why the two types of policy might have different time periods for implementation and there should be some discussion as to what is meant by ‘underlying economic problems’. It is certainly not expected that the candidate will automatically agree with the statement.

#### Answers may include:

**Knowledge** and **understanding** of what both policies involve and how they are likely to affect an economy, both in the short run and the long run.

#### Examples

- Interest rate policy and all its implications
- Taxation and spending policies and the links to incentives to work
- Spending and implications for the infrastructure of the economy

#### **Application** of the policies in respect to the current UK experience

For example candidates may well wish to consider what is driving the government to make the decisions that they do – and indeed candidates should be aware that much of the decisions to do with monetary policy have been taken away from the government and handed to the Monetary Policy Committee (MPC) of the Bank of England.

**Analysis** of how both policies affect the economy – in particular with the monetary transmission mechanism and with how fiscal policy can more directly affect the supply-side within the economy.

#### Examples

- How interest rate decisions affect decisions of both consumers and firms and affect the exchange rate, and all the implications of this
- Implication of spending on education and other public services on the performance of the economy

#### **Evaluation** of the issues involved

## Examples

- A discussion as to the potency of any government policy within a global economy
- A realisation that short-term effects may be superficial whilst underlying changes may take longer to take hold
- Consideration of crowding-out and implications for the effectiveness of government policies
- A consideration of whether the UK has handed over control of monetary policy to the Bank of England and whether countries within the Eurozone have any control of either monetary policy or indeed fiscal policy

## Theory and analysis

Level 4 (13 – 17 marks) Mid mark 15	There is a clear, precise and accurate understanding of what is involved in both monetary and fiscal policies and the answer focuses upon how both of these can affect the economy. At the top level there is likely to be a discussion as to what is meant by the phrase ‘underlying economic problems’ and whether the effects caused by the various policies can indeed change the ‘underlying’ nature of anything. There will also be detailed analysis of what has been happening within the UK economy over the past few years. At low-level 4, there will be little appreciation of the existence of the word ‘underlying’ – though mid-level 4 can be accessed if such appreciation is by inference only.
Level 3 (9 – 12 marks) Mid mark 11	There is a clear understanding of the distinction between the two policies but the answer is likely to be more theoretical than based on recent UK experience.
Level 2 (5 – 8 marks) Mid mark 7	The answer will concentrate upon either monetary or fiscal policy or there will be evidence that the candidate doesn’t really understand the difference between the two. Whilst it may be stated that policies can affect the economy, little, if any, attempt to analyse such an affect will be made.
Level 1 (1 – 4 marks) Mid mark 3	There is real confusion with what constitutes monetary and fiscal policy and the answer will fail to address the issue of how they can affect the wider economy.

## Evaluation

Level 3 (6 – 8 marks) Mid mark 7	A good answer is likely to discuss issues such as: <ul style="list-style-type: none"> <li>• Whether any government has the ability to make underlying changes to its economy in isolation of external influences</li> <li>• Short-run versus long-run changes and the degree to which their effects can have influence</li> <li>• Whether the two policies are mutually exclusive or whether the only way to have real influence is to have both policies working in conjunction</li> <li>• The effect that inflation targets have had on the potency of any monetary policy within the UK</li> </ul> There will be a conclusion drawn at the end to explain the candidates overall view – even if this is that there is no clear-cut answer.
Level 2 (3 – 5 marks) Mid mark 4	One of the above will be discussed in detail or a couple of points touched on, but only in a relatively superficially way.
Level 1 (1 – 2 marks) Mid mark 2	Whilst there might be some appreciation that evaluation could be carried out and indeed there might be the odd comment that suggests an area for potential evaluation, it stops at the comment, and the point is not developed. For example: ‘We need to consider whether it needs to be an either/or policy’

## Example Candidate Response – Distinction

5.

Economic issues, largely including negative growth in an economy such as the recent global and UK recession, are dealt with in two ways - monetary policy, and fiscal policy. Monetary policy refers to the use of interest rates, while fiscal policy involves taxes and government spending. In the UK, both have been used.

Good.

Since 2007, interest rates have fallen from 5% to the current level of 0.5%. This was a gradual, but quick response to the economic problems. There is no <sup>time frame?</sup> doubt that changing interest rates has some very quick effects - repayments of loans, especially mortgages, will become cheaper as the interest ~~of~~ these loans falls, giving people more disposable income, and so more means to spend, increasing AD which helps growth. This effect is relatively quick - another effect is slower. As interest rates fall, there is less incentive to save, as the reward for saving is lower. Therefore, theoretically, over time consumers should save less and spend more, increasing AD (aggregate demand), helping growth.

Vague.

Quick though these effects maybe, they may not be all that effective as they, in theory, should be. Many ~~mortgages~~ mortgages and loans will have fixed rates of interest - so some consumers will be unaffected by a reduction. The drop in rates is also initiated by the Bank of England - high street banks are under no obligation to pass on cuts to their consumers - Therefore, some people will not be affected by a fall in interest rates, so they will not



increase spending. Similarly, they may also not choose to save less, even with a lower interest rate, especially in an unstable, shrinking economy with an uncertain future, many consumers will want to save more in order to feel more secure for the future. Therefore, a fall in interest rates may not be all that effective.

The other way to deal with economic problems is by using fiscal policy, which involves government spending and taxes.

Lowering certain taxes, such as the fall in VAT from 17.5% to 15%, is one way of dealing with these problems by increasing AD. Lowering this tax makes goods cheaper, so more should be sold. However, there are problems with this. Firstly, a 2.5% fall in prices, for the majority of goods, is a small decrease which will have little impact on demand. Secondly, any increase in consumers' disposable income, whether it be through monetary or fiscal policy, may not increase AD as much as intended - more money will just be as readily spent on imported goods, which does not help domestic firms. Again, firms are under no obligation to pass on VAT changes - this could also hinder its effectiveness. However, on some purchases, this part of fiscal policy may be relatively quick. This is not always true, however. The biggest effect will be seen just before the VAT rises - as consumers can more obviously save a bit of money - this presents a

time lag.

Government spending is the other part of fiscal policy. This spending can be on projects, such as road-building, or on education, or health care, etc. Spending on projects, like the commissioning of new aircraft carriers to be built in the UK, will provide new jobs, which, through the multiplier effect will increase spending, etc., addressing the economic problem of negative growth (and, of course, unemployment). This, however, will take time. Spending on education and training, so as to improve the skills of workers, making them more productive, is another way to increase output and restore economic growth. However, there are severe time-lags with this method - proper education and training, for it to have a good impact, is a slow process, this is very much a long term way to deal with economic problems of negative growth and unemployment.

Spending is also very expensive, as well as slow to act. Billions of pounds are spent, and have been spent, by the government to deal with these problems. This rapidly increases the fiscal deficit (especially as taxes have fallen) - which suggests that this is a short term, not 'quick fix' but as quick as possible to solve short-term problems, but creating ones for the future, not least reduced spending and increased taxes, which may cause future problems.



Monetary policy is certainly a quicker solution to economic problems than fiscal policy. Decreased ~~interest~~ interest rates will have a reasonably rapid effect, however, although they will have an effect, it may not be too substantial. Fiscal policy is more dramatic and in some cases (i.e. tax cuts) will have quick, or reasonably quick, effects. Some forms of spending, that provide jobs, may have a ~~real~~ quick effect on increasing AD, ~~and~~ the effect should also be noticeable. However, some forms of spending, particularly on education, suffer from severe time-lags, their long term effectiveness is also hard to determine. Therefore, monetary policy is a quicker solution than fiscal policy, however, it would appear that fiscal policy will, at least long-term, be more successful, which would suggest that the most effective solution to negative growth and unemployment is to use a combination of both policies.

T&A: L4  
Er: L3

(7)  
(20)

Able account;  
credible evaluation  
of current scenarios.

T&A	Er
L3	7
L4 Ben.	L3 Mia

(20)

**Examiner Comment**

This candidate stuck to answering the question – and this fact, more than any other, was crucial in determining whether a candidate scored highly on a question. The answer assumed that recession was ‘the underlying economic problem’ and based the analysis around this fact. A strong conclusion helped push the answer into the top level for evaluation and overall this answer was awarded a Distinction.



Example Candidate Response – Merit

5 Plan BOP deficit  $AD = C + I + G + \checkmark$   
 $+ (E - m)$

MP - IR  $\uparrow$  or  $\downarrow$   
 $\therefore$  influence  $DS \downarrow$   
 $VF \downarrow$   
 $Dm \downarrow \therefore$  BOP improve  $\therefore AD \uparrow$   
 $\uparrow \alpha = \text{more price Comp}$   
 $\therefore \alpha \uparrow$   
 $m \downarrow$

However Inflation  $\uparrow$  + less/stable

FP - G and T

Contractionary FP  $G \downarrow$  /  $T \uparrow$   
 $=$  less  $DY \therefore$  less  $C \therefore$  less  $AD$   
 $+ G \downarrow$   
 $\therefore Dm \downarrow$

Marshall Lerner  
 $-ve \neq 1$   
 $\text{one or inelastic}$   
 $= \text{deficit}$

~~However conflicting Macro eco obj~~

MP - changeable per month by MPE but aim to keep target Inflation at  $2\% \pm 1\%$

IR cannot change much to keep Inflation stable and  $VF \downarrow$

FP - can be changes less frequently but but can fluctuate more  
 $\therefore$  more effective to econ

Econ growth Inflation unemployment

5

Plan

BOP deficit

$$AD = C + I + G + (X - M)$$

MP - IR  $\uparrow$  or  $\downarrow$

$\therefore$  influence  $DS \downarrow$   
 $VS \downarrow$

$Dm \downarrow$

$\therefore$  BOP improve

$\therefore AD \uparrow$

However Inflation  $\uparrow$  + less/stable

$\uparrow x =$  more price comp

$\therefore x \uparrow$   
 $m \downarrow$

FP - G and T

Marshall Lerner  
-ve  $\neq 1$

Contractionary FP  $G \downarrow$  /  $T \uparrow$

= less  $DY \therefore$  less  $C \therefore$  less  $AD$   
 $+ G \downarrow$

or inelastic  
- deficit

$\therefore Dm \downarrow$

~~However conflicting Macro eco obj~~

MP - changeable per month by MPE but aim to keep target Inflation at  $2\% \pm 1\%$

IR cannot change much to keep Inflation stable and  $VS \downarrow$

FP - can be changes less frequently but but can fluctuate more  
 $\therefore$  more effective to econ

Econ growth

Inflation

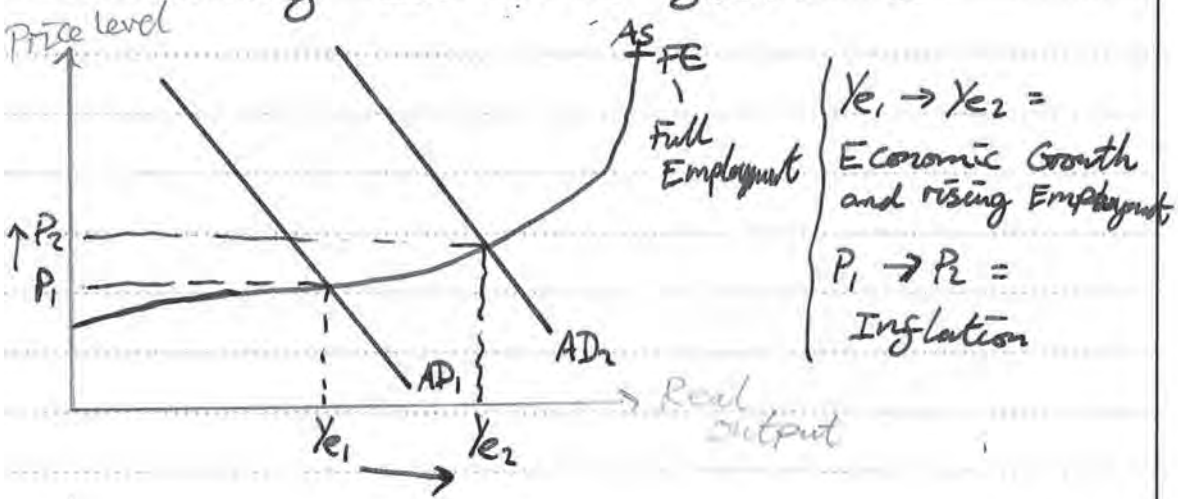
unemployment



~~Monetary~~ ~~po~~

MP can be used to correct a Balance of Payments (BOP) deficit by lowering IR, hot money will leave the country causing the Demand for the £ to decrease and therefore the value of the £ will also decrease. This will cause the country's x's to be more price competitive, and m's to be more expensive, therefore Demand for x increase and Demand for m decreases causing AD to increase and causing economic growth ✓

Is this the major underlying problem?



However by decreasing IR, Inflation has ~~increased~~ increased. Inflation must be kept at +2% ± 1%, therefore ~~by~~ ~~using~~ MP cannot be changed too much in order to meet ~~both~~ Inflation targets and increase AD to support lowering unemployment, increasing Economic growth and reducing the BOP deficit. ~~The~~ ~~MP~~ (By reducing IR, consumers marginal propensity to spend increases ∴ C ↑ and Investments ↑ m ↓ and x ↑ ∴ AD ↑)

What do you mean?



The Monetary policy committee <sup>M</sup> of the Bank of England can change IR on a monthly basis.

+ Comment?

Fiscal policy cannot be altered so frequently, however by altering  $G$  and  $T$ , Inflation is not affected so much. Contractional Fiscal policy can be used ( $G \downarrow$   $T \uparrow$ ) - This reduces consumer's Disposable Income and therefore Demand for  $n$  falls, therefore improving the BoP deficit -  $G \downarrow$  as well, but  $G$  does not carry as much weight as the other components of  $AD$ , therefore ~~AD~~  $AD$  increases. Inflation is mainly affected by IR, but it is also slightly affected by  $AD$ .

Real? Why?

Why be BoP? Fine?

Therefore FP can be changed more and can fluctuate more without affecting inflation too much, therefore, although monetary policy can be implemented more quickly, Fiscal policy ~~is~~ is more effective in dealing with underlying economic problems.

Real?

Supply-side policies affecting  $WAS$  may also be considered as a good policy to use. Education + training - Although it is a long term effect (time lag of 10-20 years) it can help to decrease Inflation, make domestic

goods more competitive (reduce D&M),  
 so reduce BOP deficit and in cause?

T & A  
 10

Ev  
 4

Understands the difference  
 but doesn't really  
 talk "underlying" (Ev.)  
 problems or recent  
 history

13. low → Merit.

12. Merit.

14

**Examiner Comment**

This candidate looked at several different policies. The answer fell into the trap of somehow believing that 'supply-side policies' were unconnected in any way to fiscal policy, even when using the example of extra spending for education and training. The main problem with this answer was that it never really considered the issue of 'underlying problems' and hence failed to score more highly for theory and analysis.

Another more general point that can be made about this essay, which was graded as being worthy of a Merit, is that there is no need for candidates to copy out the title of the essay at the start of their answer. This only uses up time that could be put to more profitable use.

## Question 6

**‘The main influence on the pattern of UK trade with other countries continues to be differences in comparative advantage’. Discuss.**

## Mark Scheme

Candidates will be expected to show both a sound understanding of the economic rationale behind the theory of comparative advantage and also to display knowledge of at least some UK trading patterns in today’s world to illustrate whether the statement is true. Better answers are also likely to consider trading blocs and it is anticipated that the EU will be used as an example to further demonstrate UK trade. It is anticipated that some centres will have taught the more general concept of ‘competitive advantage’ and where this is used in a relevant way in answer to the question, appropriate credit should be given.

**Answers may include:**

**Knowledge and understanding** of the theory of comparative advantage and the implications for specialisation and trading between countries

**Application** of the theory to UK trade in goods and services to illustrate the benefits

**Analysis** of whether actual trade is based specifically on the principle of comparative advantage and how tariffs and other forms of trade barriers can distort the ‘free market’ situation and hence influence trade. Candidates may well use trade-creation/trade diversion diagrams to explain how free-trade areas can influence trading patterns.

**Evaluation** of the issues involved

## Examples

- Consideration of some of the assumptions made in the theory of comparative advantage and how, if these are unrealistic, the actual potential benefits may not be that great
- How political considerations can be just as important in trade decisions
- Whether ‘competitive advantage’ is more appropriate in today’s world
- Consideration of whether the main influence has ever really been comparative advantage, let alone continuing to be so
- How globalisation and the emergence of China in recent years has changed the pattern of trade almost beyond any recognition for several countries, including the UK



## Theory and analysis

Level 4 (13 – 17 marks) Mid mark 15	There is a clear, precise and accurate understanding of the potential benefits that can be derived from the exploitation of comparative advantage. At the top of this level it is possible that a numerical example will be used to demonstrate these benefits. There will also be some detailed knowledge shown of the trading pattern of the UK and any other influences, such as membership of a free-trade area etc. will be considered.
Level 3 (9 – 12 marks) Mid mark 11	There will be a reasonable understanding of the theory behind comparative advantage but the answer will lack clear evidence that the concept is fully understood. The answer will certainly consider other potential influences and there will be some precise knowledge shown.
Level 2 (5 – 8 marks) Mid mark 7	The answer is likely to be superficial and there will be practically no explanation as to how benefits can be derived from the exploitation of comparative advantages. Whilst other potential influences may be touched upon, there will be a distinct lack of any 'concrete facts' for the UK.
Level 1 (1 – 4 marks) Mid mark 3	There will be little of any relevance. The answer may well focus on trade between particular countries but will merely state facts and make no attempt to explain any rationale for the trade that is undertaken.

## Evaluation

Level 3 (6 – 8 marks) Mid mark 7	<p>A good answer is likely to discuss issues such as:</p> <ul style="list-style-type: none"> <li>• Are the theoretical benefits ever that achievable or are the assumptions upon which it is based too unrealistic to be of any use?</li> <li>• In today's world, aren't political considerations of greater importance than free-trade theoretical considerations</li> <li>• Can we talk about just one main influence? Is the UK different from other countries?</li> <li>• The question uses the word 'continues'. This assumes that comparative advantage <b>was</b> the main influence in the past. Can this not also be challenged?</li> </ul> <p>There will be a conclusion drawn at the end to explain the candidates overall view – even if this is that there is no clear-cut answer.</p>
Level 2 (3 – 5 marks) Mid mark 4	One of the above will be discussed in detail or a couple of points touched on, but only in a relatively superficial way.
Level 1 (1 – 2 marks) Mid mark 2	Whilst there might be some appreciation that evaluation could be carried out and indeed there might be the odd comment that suggests an area for potential evaluation, it stops at the comment, and the point is not developed. For example: 'At various times, the UK has had other main influences.'

## Example Candidate Response – Pass

b. Comparative advantage occurs when a country can produce more of one good using the same resources as another country. If two countries devoted half their labour force to the production of two different goods then the comparative advantage will be held by whichever country produces the most in each separate good. It is clear that some countries will have a massive advantage because they have significantly larger labour forces ~~than other~~ or other factors of production than other countries. This theory is called the Heckscher-Ohlin theory and an example is China where there is an abundant supply of cheap labour available, particularly when comparing it to somewhere like the UK. ✓

There is a large benefit for the UK from ~~engaging~~ <sup>engaging</sup> in trade with a country like China. In the UK the <sup>cost of</sup> production of labour intensive products will be much greater than in China because of the national minimum wage which means labour will never be as cheap as it is in China. In this situation it is beneficial for both China and the UK to trade. nb

There are other factors which could influence a country's decision to engage in trade however. ~~Increased global trade allows economies to specialise in the production of~~ Increased global trade means that consumers will have a much greater choice of goods which they can consume. This can also lead to an increase in the standard of living whilst not being too expensive at the same time. Again, this relates back to a country like China who produce goods cheaply for the global market. This can also mean that

economic growth in countries which are importing these goods can be non-inflationary. ✓<sup>why?</sup>

There are also arguments against the UK from <sup>Q?</sup> engaging in trade. China has the ability to undercut most UK firms in the production of a good so it would be devastating if British consumers all switched to consuming Chinese made goods. The consequence of this would be massive structural unemployment which occurs when an industry goes out of business and the workers in that industry lose their jobs. This can be countered with re-training programmes and increased factor mobility so that it is easier for workers to find a new job. The effects on engaging in too much trade with China are still very serious and there is nothing that can be done to counter this. The World Trade Organisation (WTO) have banned putting any tariffs or quotas on ~~export~~ imports so the UK government cannot prevent ~~control~~ British consumers importing Chinese goods.

Although there are a number of benefits to the UK engaging in trade perhaps the most important is ~~still~~ specialisation. Increased global trade would allow the UK and other countries to produce the goods in which it holds a comparative advantage over other countries. When all countries are producing something in which they hold a comparative advantage then global output will be increased ✓ whilst at the same time consumers stand to gain because of greater choice, higher quality and lower global prices. It is important therefore that the UK chooses to trade with



countries which specialise in the production of different goods than those produced in the UK economy so as not to run the risk of structural unemployment.

Rather answer the Q.

Analysis just L3 - see c/a, other info. weak - 9  
Eval. f. superficial - 16 - 12 - 3

(12)

### Examiner Comment

This answer was graded as a Pass standard for the following reasons. First it failed to address the set question, the analysis was thin with the advantages of trade being merely stated rather than fully explained (although the answer was better on the potential benefits). Finally, the evaluation was superficial, as, it is very hard to provide convincing evaluation if the candidate fails to answer the set question.

## Paper 3 Investigation

### Question 1

#### Transport and the Environment

**Discuss the extent to which a more sustainable transport system is being created by UK government policy.**

#### Mark Scheme

Candidates should demonstrate that they understand the concept of sustainability and be able to apply this concept in a transport context. They should demonstrate a good understanding of UK government policy as it applies to transport, including future proposals. They should be able to apply a sustainability test to the current UK transport situation and the transport system that current policy aims to create. They should use appropriate analytical tools and data to support their arguments. International comparisons are likely to be useful when considering the effectiveness of policy proposals and in making criticisms of the UK system. They should reach a clear and well-supported conclusion on the extent to which current policy is likely to make the UK transport system more or less sustainable. Candidates are likely to focus primarily on passenger transport. Those who recognise that freight transport is also part of the problem should be rewarded. Analysis may be assisted by the use of diagrams.

#### Answers may include:

**Knowledge** and **understanding** of current UK transport policy and sustainability

Examples:

- Existing transport policy as it affects the major modes
- Future proposals for transport policy
- Sustainability in terms of increasing capacity in line with demand
- Sustainability in terms of limiting environmental damage and the depletion of non-renewable resources
- Sustainability in terms of the capacity and efficiency of the transport systems inherited by future generations

**Application** of sustainability in a UK transport context

Examples:

- Current sustainability problems, including;
  - Congestion
  - Greenhouse gas emissions
  - Use of fossil fuels
- Existing and proposed solutions to these problems, including;
  - Road pricing
  - Emissions reduction
  - Alternative energy sources

**Analysis** of UK transport policies and their impact on sustainability

Examples:

- Policies to deal with congestion, notably congestion charging and road pricing
- Policies to improve the efficiency of the networks, notably integrated transport and reducing bottlenecks
- Policies to reduce environmental damage, notably taxation, regulation and planning restrictions
- Policies to encourage use of alternative fuels
- Policies to encourage modal shift

Good candidates are likely to support their analysis with appropriate diagrams as well as relevant and recent data on, for example, existing traffic forecasts and the statistical effectiveness of policies in the UK and elsewhere. Extensive use of international examples which are not specifically applied to the UK context should not be well rewarded.

**Evaluation** of the extent to which current policy is likely to create a more sustainable transport system

Basic evaluation may take the form of identifying areas in which policy is encouraging sustainability, such as congestion charging, and ways in which it is not, such as continued airport expansion. Candidates at this level are likely to understand sustainability in a purely environmental sense.

Stronger candidates are likely to recognise that sustainability is a more complex concept and may even explicitly revisit their definition of sustainability and evaluate policy in the light of this definition:

- Sustainability in terms of increasing capacity in line with demand – to what extent is policy leading to infrastructure improvement? Discussion here may well look at the success/failure of Public Private Partnerships (PPP) schemes and the likelihood of direct provision of new infrastructure in future. Candidates may consider the nature of market failure in the provision of such infrastructure and the need for intervention. They may contrast the provision of new capacity for the key modes – road, rail and air. They may also consider the macro-economic implications of infrastructure provision, or the lack of it, particularly relating to business costs and international competitiveness.
- Sustainability in terms of limiting environmental damage and the depletion of non-renewable resources – to what extent is policy limiting, or even reversing, destruction of the natural environment, air pollution and resource depletion? Candidates may discuss relevant legislation and its effectiveness, the support for alternative fuels and transport technologies and the extent to which this support is likely to result in increased sustainability.
- Sustainability in terms of the capacity and efficiency of the transport systems inherited by future generations – to what extent is the transport system left to future generations likely to be more capable efficient than it is at present? This is a more complex question and requires a combination of factors to be considered from the first two bullet points. Candidates may argue that sustainability requires a combination of new infrastructure, managing use of the existing systems more effectively and utilising new technologies.

Candidates may also consider the political dimension of government policy and the difficulties of pursuing economically necessary but politically unpopular policies. A relevant example here is likely to be congestion charging and road pricing where power has been devolved to local authorities and the electorate. They may argue that it is difficult to see some policies being implemented, despite favourable economic arguments, because they only give benefits to voters in the very long-run.

UK policy may be evaluated in comparison with policies elsewhere and relative success or failure considered. Comparisons should be related to specific policies and should consider the similarities and differences between economies.

Some candidates may broaden the debate beyond the confines of transport policy and suggest that planning, housing, energy and education policy, among others, are equally relevant here. They may argue that sustainable transport is not possible in isolation and without fundamental changes to the way in which we live, work, shop, school our children and enjoy our leisure time.



Some students may question the need for government to intervene in transport markets at all and may argue that the market mechanism will effectively deal with the sustainability problem by efficiently allocating scarce resources. Government intervention may well lead to government failure which results in an inefficient allocation and a reduction in sustainability.

### Theory and analysis

Level 4 (18–22 marks) Mid mark 20	There is clear evidence of a thorough knowledge of what the UK's transport policies are and their likely impact on sustainability. A range of policies relating to at least two of the major modes of transport should be analysed in detail, with supporting data. At the top end there should be comprehensive coverage of the three major modes; road, rail and air as well as some references to other modes such as walking and cycling.
Level 3 (12–17 marks) Mid mark 15	The answer will still address the potential solutions and some of their limitations. However, the analysis lacks breadth or depth and is more likely to read as a prepared list of advantages or disadvantages rather than a well-structured essay. Lacking critical awareness in some areas. May only cover policies concerning a narrow range of modes.
Level 2 (6–11 marks) Mid mark 9	Whilst various policies will be considered, there may be some inaccuracies or oversimplifications – for example, confusing congestion charging with road pricing. Any analysis will be very superficial – for instance, 'increased taxation will reduce private car usage'. Limited critical awareness. May focus narrowly on one or two specific policies.
Level 1 (1–5 marks) Mid mark 3	There may well be limited understanding of sustainability or current UK transport policy.

### Evaluation

Here follows a re-cap of some of the areas that might be included and a breakdown of what will be expected at the various Levels.

Issues include:

Which aspects of policy encourage sustainability?

Will policy lead to an increase in capacity?

Will policy lead to a reduction in environmental damage?

Will policy improve the efficiency of transport networks?

Are policies politically acceptable?

Does sustainable transport lie outside the scope of transport policy alone?

Is intervention needed?

Level 3 (13–18 marks) Mid mark 16	Given the length of this paper, to achieve this level of evaluation there must be significant and comprehensive coverage of several relevant areas. At the top end of this Level, there will signs of real in-depth research and/or originality. In all cases there will be a clear conclusion drawn at the end that relates specifically to the set question.
Level 2 (7–12 marks) Mid mark 10	At least two relevant issues will be considered in reasonable depth but the overall scope of evaluation leaves areas unexplored and conclusions may lack any rigorous justification.
Level 1 (1–6 marks) Mid mark 4	Some of the issues that could be open to evaluation may be introduced into the discussion but there is no attempt to go further than to show an appreciation of the issue – for example, 'some aspects of policy may encourage sustainability whereas others may not'. There is no attempt to draw together the relevant issues in a conclusion.

## Example Candidate Response – Distinction

1. Plan.

Intro - def. sustainable transport policy - 4 parts through Dep. of Transport.


Why it isn't sustainable at the moment?  
~~Stern Report~~ CO<sub>2</sub> emissions - what ~~Stern Report~~ how planes/cars/shipping

Congestion + problems → ↑ accidents.  
~~Not the good~~ Why just going to get worse? Prices will ↓  
 Tyndall report + UK aviation - low cost airlines  
 Shipping forecast Demand ↑ 37% by 2041

What is in place at the moment  
 Fuel tax - regressive - 55p a litre (not enough)  
 Congestion charge - working but causes it elsewhere  
 Air APD - not good enough.  
 Modal shift to trains  
 ↳ public good + externalities  
 FLbn p.a. Subsidise through PPP Virgin trains  
 West Coast line eg.

Not enough - pledged ↓ 80% by 2050  
 deal with ↑ demand.  
 - mainly only used for commuting

Comprehensive; integrated transport policy that doesn't have  
 ↳ objectives  
 HS2 - Eddington report each on CBA





1. A sustainable transport system ~~has been~~<sup>is</sup> the aim of the UK government, and it means meeting the needs of the present generation without ~~having~~ future generations' ability to meet their own needs. Transport policy is handled by the Department of Transport, and Gordon Brown's 4 aims of transport policy was that it should aid UK GDP growth, improve health and safety, tackle climate change and promote equality of opportunity.

This essay shall look at why the transport sector is not sustainable, what is being done presently, how these affect the 4 targets of Gordon Brown and sustainability, and their limitations.

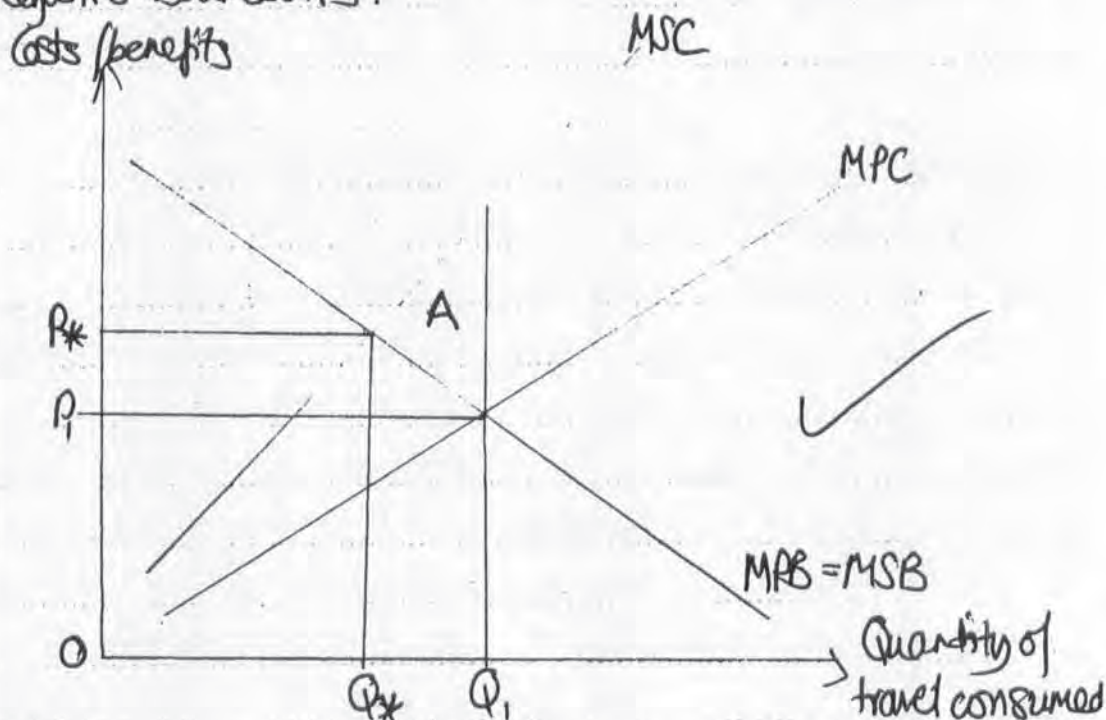
One of the largest problems with transport today is the problem of pollution. The Stern Report said that CO<sub>2</sub> emissions are the "greatest and widest ranging market failure of all time." CO<sub>2</sub> emissions are examples of a negative externality - meaning a cost is felt by a 3<sup>rd</sup> party not involved in the decision to travel. As cars, planes or ships consume fuel, they release gases like CO<sub>2</sub> into the atmosphere, and these trap heat into the Earth's atmosphere, causing surface temperature to rise. The Stern Report also stated that if levels of CO<sub>2</sub> remain at present levels, up to 40% of Earth's species could become extinct due to changed climates and freak weather patterns. Currently, car travel accounts for 9% of total UK emissions, UK aviation is 6.4% of UK emissions, and global shipping emissions are greater than total UK emissions. This therefore shows current transport systems are unsustainable.

The other large problem with transport today is congestion as it reaches full capacity. As each car takes to the road,



not only does it emit more, but it causes more congestion and increases journey time for itself and other 3rd party road users. The opportunity cost of this time could be working, or studying and as such time is very valuable. The fact that 25% of UK trunk roads are congested for more than an hour a day highlights this problem, additionally the UK is ~~the~~ one of the most congested countries in the EU, second only to Spain.

These two problems of congestion and pollution are examples of negative externalities.



This means, due to the 3rd party costs, MSC is greater than MPC. As consumers only take into account private costs and benefits, consumption will be at  $Q$ , at  $P$ , instead of the social optimum  $Q^*$  at  $P^*$ . This overconsumption and overproduction leads to a deadweight welfare loss of area A. The Adam Smith Institute estimates negative externalities on the road are equivalent to 5.4 pence per vehicle kilometer. A sustainable transport system would not have these negative

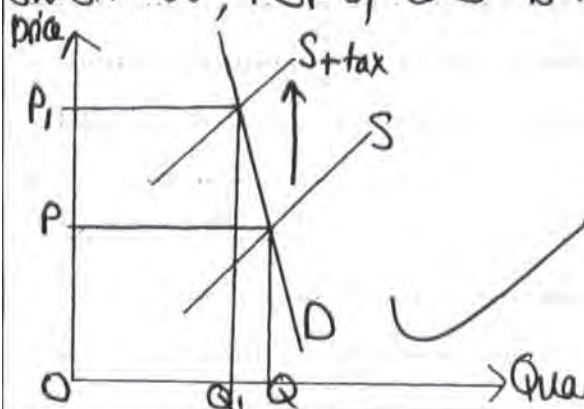


externalities, or at least, they would be incorporated in the price mechanism i.e. internalised.

To put further pressure on government policy, these problems are set to get worse as demand for transport increases. Transport is a normal good with positive YED, and as the UK GDP grows, demand will increase. The Tyndall report predicts UK road demand will increase by 37% by 2041, and also that UK aviation emissions will rise so that its 2036 emissions will be the same as total UK emissions in 2009. Both of these statistics suggest a drastic increase in the future, which government policy must account for.

One policy the government has in place to reduce emissions is fuel tax. This is a specific tax levied per litre sold and is currently at 55p per litre. Making fuel more expensive should reduce demand, so less fuel is bought so less journeys are made (only those with the highest utility are made) so less fuel burnt, thus reducing  $\text{CO}_2$  emissions and taking cars off the road so reducing congestion.

However, due to the non-pecuniary benefits of car travel like great convenience, great flexibility, and lack of substitutes, PED of cars is very inelastic. Thus an increase



in tax shifts  $S$  to  $S+tax$ , pushing price  $P$  to  $P_1$ . However, quantity hardly falls to  $Q_1$  from  $Q$ . Thus suggesting fuel tax is an ineffective method to get sustainable travel.



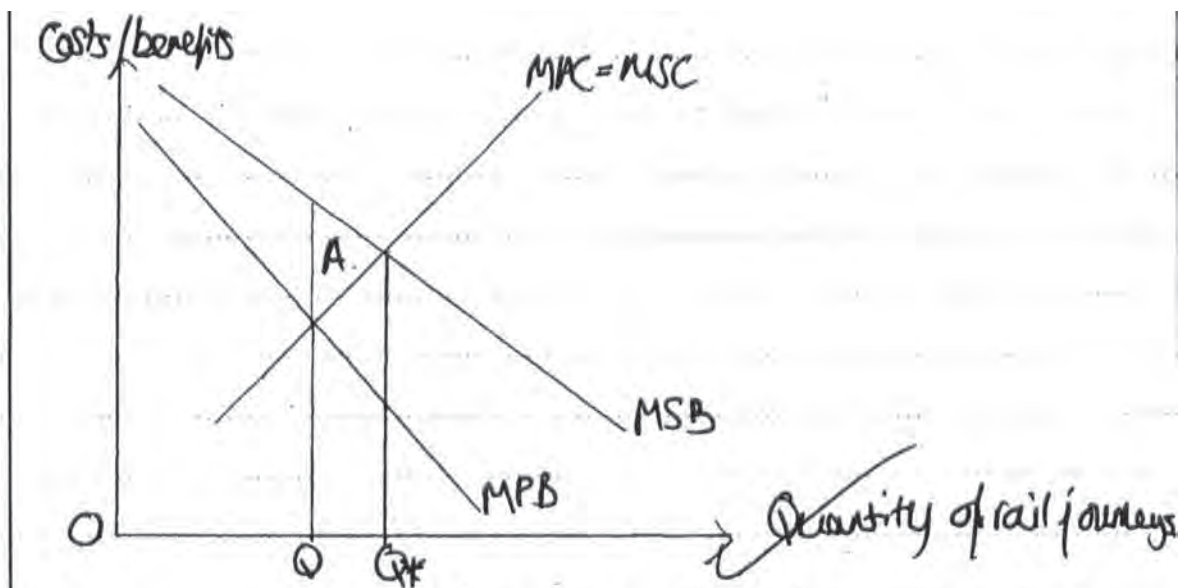
The main reason for inelastic car PED is the lack of ~~substitutes~~ substitutes. The government currently is trying to change this by subsidising trains £4 billion per annum. Additionally the revenue from fuel tax could be hypothecated and spent on public transport.

This would cause a modal shift from cars to trains, if their reliability, price and speed were to fall from investment.

The government is encouraging investment in rail travel, beginning with its privatisation in 1995. This has led to greater competition as TOCs compete for franchises and ROSCOs compete on price to lease out their rolling stock. It also has introduced OFRAIL, the regulatory body, who sets price with the RPI+x formula. However, this should give incentive for companies to invest and get efficiency savings and so long as x is not too high, consumers gain from better service for just a fraction of the increase in price.

The government wants a modal shift from cars to rail as rail is a quasi-public good and sustainable. As it takes cars off the roads, it decreases emissions, helping to tackle climate change, it also reduces accidents on the road and is a safer mode of transport, and it improves equality of opportunity as everyone can travel by train, not just those who are old enough, or can afford a car. These are all examples of positive externalities, meaning that MPB is less than MSB. As shown in the next diagram, this means ~~the~~ quantity is at Q' instead of Q\*. Thus rail is currently underconsumed leading to a DWL shown by area A.





However, current government policy is not doing enough to switch cars to rail. This is shown by the fact that only 7% of UK journeys are made by train.

- One reason for this could be that rail tickets have increased in real terms by 40% in price since privatisation, so there is no price incentive to move from cars to rail. This suggests OFRAIL has been "regulatory captured", suggesting government failure.

Another reason could be that for many people, they do not live near high speed train links, so it is easier to take the car.

- This can be solved by implementing a more integrated transport system linking buses and trains more efficiently. This has not been done so far by the government, as shown by only 86% of trains being on time.

Another policy the government has implemented to encourage modal shift is the congestion charge. This is an £8 charge levied when one drives in central London in certain times of the day. Since implementation, traffic levels in the city have fallen by 16% at peak time. Thus congestion has fallen,



pollution has fallen, fuel efficiency has increased and use of sustainable public transport has increased. This would appear to be a success.

However, there are signs of government failure. Shops in central London reported a drop in trade, suggesting the needs of today are not being met (the point of sustainable transport), and congestion on the M25, a bypass of central London, increased, offsetting the benefits of the fall in congestion in central London. This suggests that although the congestion charge has been successful in central London, it does have costs. Additionally, this policy is only in London, whereas there are many large polluting cities that have not been tackled yet elsewhere.

Another step the government has taken is imposing air passenger duty on flights. Flying is the most climate intensive forms of transport, and it is set to grow the most rapidly. Although only 12% of domestic journeys are done by flight, they cause 6-7% of UK emissions.

Air passenger duty charges the airline per passenger per flight, supposedly making them pay for the externalities each passenger creates.

However, it is not based on how polluting the aircraft is, how long the flight is or how many passengers are being carried, all of which contribute to pollution, and to noise pollution to residents under a flight path.

This therefore suggests unsustainability.

Additionally, the government has pledged a 6<sup>th</sup> terminal at Heathrow by 2020 and a second runway at Birmingham by 2016.



This will only increase flights, pollution (and decrease sustainability). The reason the government has done this is because of the great importance in international competitiveness of having sufficiently large airports.

However, to offset this the government is also trying to substitute domestic flights to train. For example the planned HS2 line between London, Birmingham, Manchester and Leeds. This should reduce congestion on the corridor between London to Manchester, reduce accidents, of which there are 2000 each year, and reduce congestion.

However, the Eddington Report said that no new large scale infrastructure was needed in the UK, it just has to be utilised better. Additionally, one cost benefit analysis said it would not be worth it, whereas another said it should go ahead. This suggests this government policy is not sustainable and is instead inspired by other motives, like political popularity.

In conclusion, the government is not doing enough to create a more sustainable transport system in the UK. Most of the policies that it has implemented show signs of government failure, although the idea of modal shift should continue to be pursued between road and rail, although perhaps through a more comprehensive integrated fashion than pure fuel tax and train subsidies.

A - L3 Generally clear but with some mistakes + spelling, 12/15  
 E - L2 Clear evaluation though some but limited attempt to draw issues together + thoroughly deal with the question 11

(27)



### Examiner Comment

The answer begins with a clear explanation of the concept of sustainability and then goes on to contextualise the problem with reference to UK transport issues. The use of economic theory is relevant and clearly explained. Suitable supporting data is utilised to reinforce points.

Coverage of government policy relating to road transport is equally assured and evaluative points are clearly stated in context. The flow of the argument is good. Coverage of similar issues in the rail industry is generally clear and some good evaluative points are made about the difficulties of achieving modal shift. Some points in the analysis are unsupported and the basis of the reasoning is not always clear.

The conclusions are rather rushed and it appears that the candidate was running out of time. As a result the essay is weakened as it does not really directly address the question in a holistic manner. Brief reference to the Eddington Report offers some evaluative potential but the comments are rather superficial and the last paragraph adds nothing new.

The answer scored 27/40. The candidate is given credit for clear structure, generally accurate coverage of three transport modes and relevant and accurate use of economic theory. Some illustrative examples are not entirely clear and some sweeping and unsupported claims are made. It was awarded Level 3, 16/22 for theory and analysis. There are several good evaluation points in the body of the answer but the final judgement is disappointingly weak and rather superficial compared with the standard of the rest of the answer. It was awarded Level 2, 11/18 for evaluation.

Example Candidate Response – Merit

Plan

- 5 points:
1. Growth
  2. CO<sub>2</sub> emissions
  3. Health & Safety
  4. Equity or Opportunities
  5. Improve Standard of Living

Delivering a Sustainable...

needs of today whilst jeopardising ...

Integrated policy

Stern: wider implications of climate change (Review)

Eddington: No large infrastructure projects. (Transport Study)  
Road pricing.  
1.2% of domestic

40% of emissions.

Road - 84%      28% ↓ RPI  
25%      Quasi-public good.

Rail - 60%      £32bn wider Social benefits. Capacity  
40%      £5bn - 2009      40% RPI

Airports - 4x rail      9% to 27% & CPI  
ICAO, UNFCCC

Freight

Macro

International



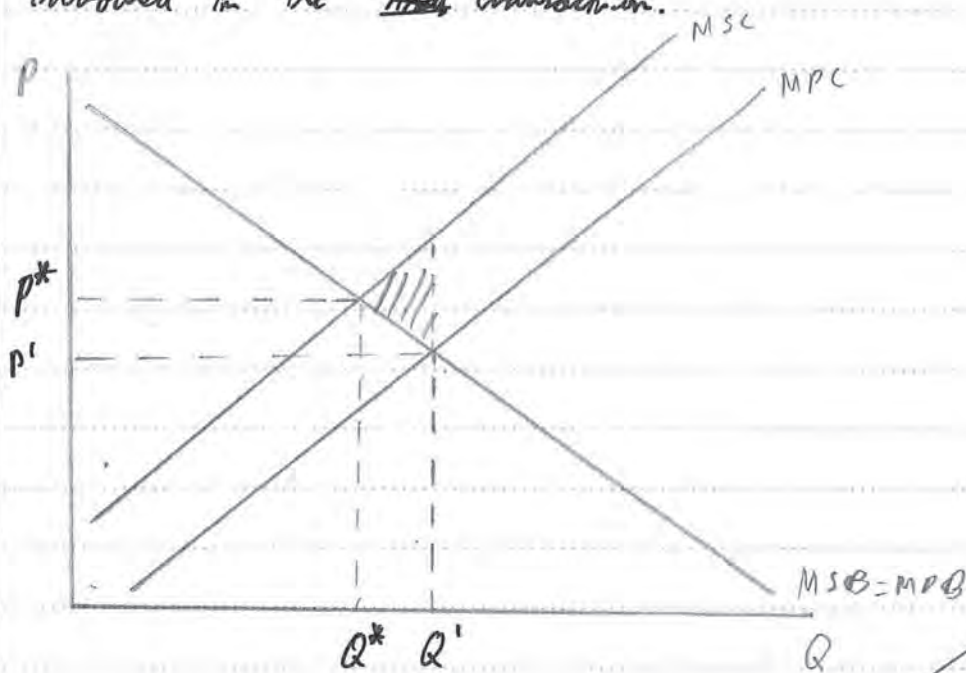
in transport industries we should be looking at reducing growth in these markets. The aim is to keep global warming ~~down~~ to below 2 degrees by 2050, but this is unlikely to be achieved if the Government allow the continued growth of such transport industries, such as Aviation, which has increased demand of 3% every year, and contributes 9% of the 14% of greenhouse gases in transport. To encourage a sustainable transport policy, should look to affect demand directly in transport industries.

Reduction of CO<sub>2</sub> emissions is at the forefront of the UK's sustainable transport system. Stern, who is an economist commissioned by the former Government under Gordon Brown, says that there wider implications to the current unsustainable transport policies. Whilst using Cost Benefit analysis, he believes that the long term future benefits will be far greater than expected; by using lower discount rates. The future benefits are there for all to see, as Global warming becomes a bigger problem, more action is needed now to reduce CO<sub>2</sub> emissions. The Government have failed to achieve this in the aviation market, where at the recent Summit in Copenhagen, the conflict of power between the UNFCCC & ICAO, in dealing with what methods to go forward with, no policies got arranged. And with aviation expected to rise by a further 50% by 2050, this shows how the Governments



inability to have a sustainable transport policy could have countering effects.

The one industry that the ~~the~~ UK government has looked greatly at is the road industry. Road space is regarded as a quasi-public good, where in most circumstances it is non-excludable & non-rival, but on some occasions, it can be seen to neither due to the prolonged problem of congestion. Congestion symbolises increased pollution from more cost waiting in queues, and is a negative externality - an external cost to the third party who were not involved in the ~~street~~ transaction.



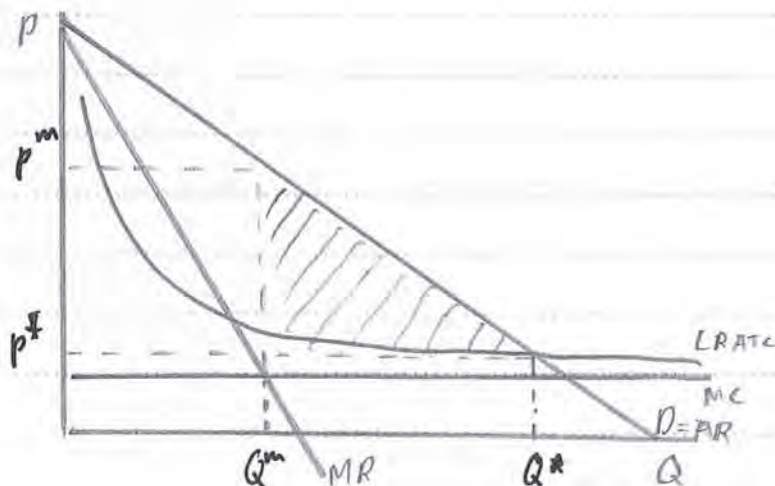
This represents an over consumption of the good, placing a cost on a third party. The dead weight welfare loss to society is represented by the shaded area. This proves that intervention from the UK Government is required in order to have a

Sustainable transport policy. We have seen the great success of the implement of the Congestion Charge in 2003, by reducing congestion by 15% and improving journey times by 22%. But more needs to be done. Road transport accounts for 54% of transport emissions to the environment. Current charging of fuel tax & VED, currently gives an incentive to be more fuel efficient but not to target congestion, which is pollution within context. Alistair Darling, when transport Secretary, was the first to state that road pricing should be used. Many agree this to be a sound idea, including economist Edlington, one is also mentioned in the Government booklet. This would allow to the Government to specify charge prices in a flexible manner, therefore enabling them to target peak times. The international example of Singapore, with its satellite system, has shown the great success of the policy. Also the revenue generated by such a scheme would also allow for further investment in other transport markets. However, the UK Government failure to the initiative to take the policy on due to potential loss in political power, means that the problem will continue. Alternatives ideas are also not as good as road pricing or internalising the externalities & placing a cost on the consumer.

What is regarded as extremely important is having an integrated transport policy, in order to be more successful at creating a more sustainable transport



System. This is where all the transport policies are linked to making key ideas happen. The major policy behind this is getting consumers from the road onto rail. We have seen substantial subsidies to the rail industry, in fact the previous year it was at £5bn. This is due to the rail being a positive externality, where there are external benefits to the third party, not involved in the transaction. These external benefits include a significant reduction in pollution & congestion and also a significant improvement in local economies. If cases are taken on a one to one basis, through cost benefit analysis, then the Government will be able to implement a sustainable policy. Since the privatisation of rail in 1993, there has been a significant increase in passengers of 60%. However, over the period of 1997 to 2007 there has also been a significant increase in prices, to 40% RPI. This is due to a natural monopoly arising in the market, as there are barriers to entry, through high fixed in building tracks.





As can be seen, by acting  $MC=MR$ , the natural monopoly is able to profit maximise & create a dead weight welfare loss. However, through regulation from OFRAIL, they are made to act at  $ATC=D$ . This is through a pricing structure of RPI-X, counting for the efficiency savings. This allows for a lower price, but not at allocatively efficient, where the monopoly would make a loss. However, does this regulation lead to more passengers choosing rail rather than road? This is dependant on the  $XED_x$ , which is likely to be very low & the demand for road is very inelastic. Thus, the increased policy adopted by the UK Government may be unable to trigger this modal ~~switch~~ switch.

The High Speed Two, rail transport policy is aimed at looking to a more sustainable transport policy, by reducing congestion off the M4? & reducing domestic aviation flights. It will run through London, Birmingham & Manchester & 250 mph, reducing by train times by up to half. It will cost around £32 bn to construct. Eddington is the for the project as he believed that large infrastructure projects were not the way forward. The pollution created from constructing the project would be greater than the quantity of air saved. He also believed that as domestic aviation only accounts for

1.2% of overall emissions, the policy is not worth having in place. He reckoned it to be more sustainable to develop local rail networks, combined with road pricing to look to this switch. However, the example of France new ~~transport~~ high speed rail policy, the TGV development, has signalled how these industries can be successful. Capacity of rail is also needed to be considered. If demand was to significantly switch, how would this be dealt with.

The UK Government transport policies have looked to encompass all of its economic, social & environmental goals when ~~come~~ deciding on transport policy system. However, as we have seen from various approaches thus far, there has been much confliction between the goals of sustainability along with the macro goals for economic success. I believe that ~~the~~ the UK Government has failed to implement a successful ~~transport~~ sustainable transport system, with the need of this growing ever more as markets continue to fail. So, there will have to be dramatic action to coincide with global warming, which would even worse effects on these markets. I suggest for greater action now, in such as local or road pricing, in order to prevent these problems by taking on a sustainable transport system.

(20)

Analysis L3 - Some good analysis but occasional inaccuracies + clarity drops in places 12  
 Evaluation L2 - limited range of issues considered in some depth 8

### Examiner Comment

The candidate begins with a clear explanation of sustainability and proceeds to firmly establish the current significance of this issue in a transport context. The framework of government policy is apparent but the candidate does not make it clear which aspects of this framework would be regarded as part of sustainable transport by an economist. However, some valid evaluative points are made and some criticism of this framework is apparent.

There is a lack of clarity in the paragraph about the Stern review and it is not clear which cost-benefit analysis the candidate is referring to. However, some valid evaluative points about the difficulty in reducing aviation emissions are made.

The candidate is not always sufficiently selective in their use of economic theory and the sections relating to roads as public goods and the existence of natural monopoly in the rail industry are not adequately linked to the question. There is some good coverage of policy measures designed to increase sustainability and an attempt to make an international comparison, although understanding of the congestion charging system in Singapore is not clear. There is also relevant coverage of HS2 and the Eddington Report.

The final judgement is reasonably clear and the conflict between increasing sustainability and economic growth is a valid one, although little is made of it. The concept of road-pricing is introduced right at the end as a possible solution, but no profitable use is made of it.

The answer scored 20/40. The candidate is given credit for reasonably accurate coverage of two transport modes and generally relevant use of economic theory. However, there is a lack of selectivity, some inaccuracies and a lack of critical awareness in places. It was awarded Level 3, 12/22 for theory and analysis. There are some brief evaluation points in the body of the answer and a decent attempt to come to a judgment at the end, but the potentially valid points in this conclusion are not rigorously examined. It was awarded Level 2, 8/18 for evaluation.



Example Candidate Response – Pass

Global warming

Plan

① What is it - Policies meets the transport needs  
 At current, doesn't envisaged the future

② Why - Market failure - Road - congestion → 25% traffic road in hour  
 - pollution → cars 90% road pollution

draw

- Aviation negative ← ex pollution

- Rail → good - modal shift

monopoly under provided

draw trees

1980s OAP ↑ 1993 ↑

Gov INTERVING do to it? (privatise Air & rail)

What did gov do to it?

- Road Pricing

→ MS2 why → CBA 1.3 : 1 discount

- Good - because 5 goals

Adv

- econ growth
- tackle climate change
- better health & safety
- + regenerate impoverished areas
- better links
- improve quality of life

Free market under provided  
 gov need to do something

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Flowers

Medu

- Building of cars cause pollution

→

Chatter hills (pollution noise, air)

~~the~~ Air Mode → more competition  
 → usage ↑ ~~strength~~ 78% to 2020

rail → usage less ↑ too

→ HS2 should be good — modal shift from  
~~the~~ road to rail,  
 — mass ppl from polluting places

<sup>2006</sup>  
 Eddisston — report — Big infrastructure net  
 needed  
 → UK needs to improve current  
 transport links, ↑ the capacity

— Like (East London line / light railways

— Also take into acc of town planning  
 e.g. build town and the rail lines  
 more effectively.

— So is it a bad thing that GOV

FAILURE ?

Depends on the economy development diff settings,  
 — i.e. China High speed rail.

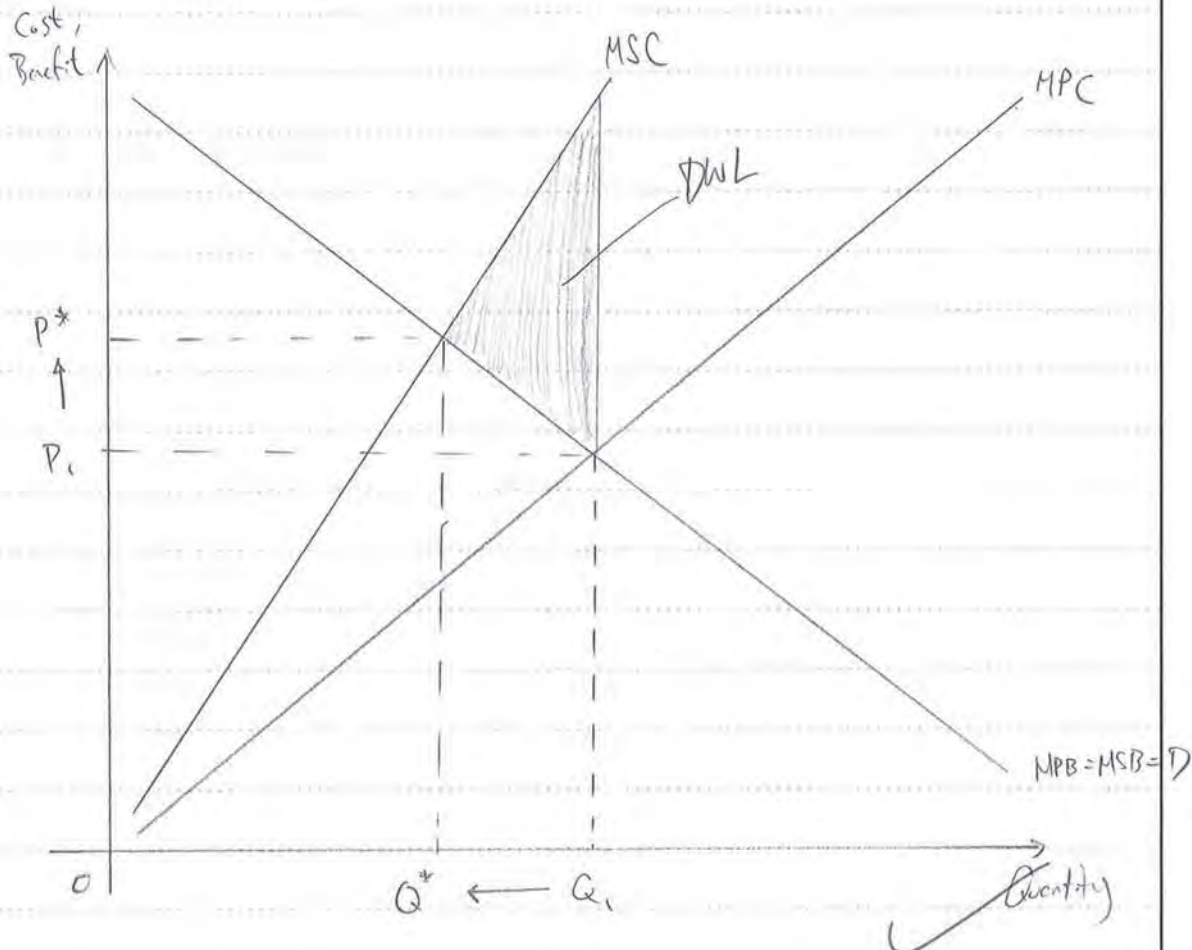
17

A ~~st~~ sustainable transport system is a system that meets the transport needs at the current level, but doesn't compromise the future generation. The reason for ~~having~~ needing such a system is that: there ~~is~~ a market failure in the transport sector in the UK. Road usage has increased dramatically since ~~that~~ <sup>the</sup> actual price of cars has decreased, and more people can afford to buy car. Hence, the increase in ~~car~~ use has caused air, noise pollution, and also congestions on roads. As ~~a result~~ <sup>the</sup> congestion takes up people's time and ~~the~~ pollution is causing global warming, it imposed a negative external cost on the society. It is a cost on a third party who is not ~~in~~ directly involved in the transaction. (i.e. pollution ~~to~~ damages the society/world; congestion affects the other road users).

Apart from ~~cars~~ road, the air transport is causing ~~on~~ some sort of pollution to the environment. It has become more serious after the deregulation of the air industry in the 1980s, which ~~is~~ is called the Open Skies Policy. Both roads and air usage is causing an external cost on the society, (shown



in Fig 1), as it is overconsumed.



Since people are not aware of the external cost that they are imposing on the society, level of consumption is at  $Q_1$  and the current price is at  $P_1$ . However, ideally, in order to achieve social optimum output (where marginal social cost equals to marginal ~~psi~~ social benefit), the level of demand should reduce to  $Q^*$ , and the price should increase to  $P^*$  to discourage consumption.

In order to solve this problem,

the government has imposed a road pricing system, i.e. charging the congestion zone, (Central London for £8), looking to reduce the level of car usage. Nevertheless, the demand for car usage is quite inelastic at the moment, and people are not wanting to move away from it. Since then, government has been finding ways to provide a more sustainable transport system. ~~In 2006, government had paid Stern & Eddington to write reports on the environment and the transport system.~~

~~Recently, a~~

As the rail <sup>industry was</sup> is privatised in 1993, the usage of rail has increased. The level of investment on rail has increased by 300%. ~~As~~ Train ~~journey~~ journeys are less damaging to the ~~social~~ environment as it ~~is~~ <sup>produces</sup> less emission. It is actually imposing an external benefit on the society, since it can carry many passengers from one place to another, with less emission per head. However, rail ~~is~~ industry has a nature monopoly features, as it has large infrastructure cost, vast economies of ~~scale~~ scale and a decreasing in long run average cost. Therefore, the level of provision ~~will~~ <sup>will</sup> be low & as



rail company can abuse their monopoly power. As a result, government intervene and ~~try to~~ improve efficiency of the rail industry, ~~it will be~~ by privatisation (as mention before) and through regulations. ~~The~~ Government intervene made the UK rails more competitive, and hence, leads to growth, better health and safety, etc... which to an extend, it is achieving a more sustainable transport system.

In recent years, the government has spend £34 bn on a rail project — the High speed 2, ~~and~~ It links London, Manchester, Birmingham and Leeds. By using a cost-benefit analysis, with a ~~also~~ reasonable discount rate, the government has decided to take in the project. (The analysis should evaluate case by case) From building this, the HS2, government can achieve the five sustainable transport policies goal:

- ~~The~~ Improve UK competitiveness, hence leads to economic growth
- Tackling the climate change problem, as it can potential more people from road to rail, which means less pollution & congestions.
- Regenerate impoverished areas
- Provide a better ~~health~~<sup>health</sup> and safety, as road accident should reduce.



- Improve the quality of life of the UK citizens.

This project seems to be good to make UK transport system more sustainable.

However, Eddington report (2006) states that there is no need for big infrastructure for the UK. Eddington also says that UK should be improving their current transport capacity, since it is reaching its full capacity. ~~As a~~ ~~thus, this leave us~~ ~~at~~ ~~the~~ ~~future~~ Furthermore, while building the high infrastructure for rails, ~~the~~ it is causing pollution to the surrounding areas. Also, this project is cutting through Chiffan Hills, (which is seen as a nature beauty for the local citizens), it will ~~for~~ produce air, noise pollution in the future.

Thus, this leave us wondering whether that is a government failure or not. Because the benefit of building the HS2 in the future is unknown; and the current damage to the environment is quite significant, I would believe the HS2 project is not needed.

~~The same~~ In order to become more sustainable, the government should improve

the current transport links, i.e. ~~the government is~~ <sup>providing</sup> & new high speed railways in London (which is building now - the East London line). Government should also consider about town planning, which mean ~~the~~ city should be developing around the transports (rails).

In conclusion, ~~a~~ <sup>as</sup> ~~because~~ there is a market failure in the transport sector, the government has intervened in different ways such as raising pricing, privatising and building HS2. There are ~~inevitably~~ some government failure in this intervention, due to the fact that the government doesn't have a perfect knowledge. However, not ~~an~~ all government intervention is bad, it is needed to an extent. Government should consider the ~~effect~~ <sup>level of</sup> economic development of the country, in order to make an action. ~~If government able to provide a modal choice for road users, pollution and congestion can be reduced.~~ Hence, the UK is moving towards a more sustainable transport system.

Analysis 12 - Some inaccuracies +  
oversimplification 10

Evaluation 11 - Some evaluation but lacking  
depth + not drawing the relevant conclusion together  
-6

(16)

## Examiner Comment

The candidate begins with a reasonable attempt to define sustainability, but this lacks precision and further explanation. There is also some clear understanding of relevant market failures in the road transport context. The candidate also considers air transport and draws a reasonably accurate diagram illustrating the impact of negative externalities. There is some relevant coverage of measures to deal with this market failure and a brief comment on elasticity which indicates basic evaluation, although this is not developed. Coverage of the rail industry follows and some relevant points are made, although the candidate does not explicitly tie them in with the specific question that has been asked.

The first explicit link with sustainability since the opening sentence involves outlining the previous government's sustainable transport objectives. Some of these are relevant but the candidate does not recognise that this is a political document and does not therefore differentiate between policies derived from economic theory and those influenced by political expediency. This lack of critical awareness undermines their ability to come to a judgment at the end of the answer.

The introduction of the Eddington Report offers some opportunities for limited evaluation. However, there is continued lack of critical awareness here and the candidate accepts Eddington's recommendations uncritically, leading to an overly simplistic conclusion on the benefits of HS2. Final conclusions seem to be based entirely on the Eddington Report rather than the weight of evidence so far accumulated in the essay. The final paragraph attempts to draw points together but generally succeeds only in revisiting previous comments without adding anything new.

This answer scored 16/40. The candidate is given credit for a clear structure and demonstrating understanding of some of the relevant theory in context. However, there are some misunderstandings and oversimplifications and the answer does not consistently focus on answering the question. It is, in the main, a very general answer to a very specific question. It was awarded Level 2, 10/22 for theory and analysis. There are also some undeveloped evaluation points in the body of the essay and an attempt to come to a conclusion at the end. However, the conclusion is ultimately unconvincing as it does not seem to be drawn from the arguments put forward in the rest of the answer. It was awarded Level 1, 6/18 for evaluation.



## Question 2

**China and the Global Economy**

**Discuss the extent to which the growth of the Chinese economy in recent years has been beneficial to the global economy.**

## Mark Scheme

Candidates should demonstrate their understanding of economic growth and its effects on the global economy. They should understand the benefits of growth for different groups of countries and economic agents in those countries and the limitations of these benefits. They are likely to refer to other key economic indicators and the trade-offs that occur as a result of growth, particularly in terms of employment, inflation and the balance of trade. They may also refer to the impact on standards of living and the environment. They should illustrate their answer with examples from China and other selected countries. They should use appropriate analytical tools and data to support their arguments. They should be able to come to a clear and supported conclusion on the extent to which growth is beneficial. Good candidates are likely to differentiate their conclusions between specific groups of countries and/or economic agents. They are also likely to make specific reference to the 'rapid' nature of the growth in question. Analysis may be assisted by the use of diagrams.

**Answers may include:****Knowledge** of economic growth

Examples:

- The nature of growth
- Measurement of growth
- Causes of growth

**Application** of growth in both Chinese and global contexts

Examples:

- Growth rates in China relative to other economies and over time
- Effects of growth on the Chinese economy in terms of key economic indicators
- Effects of growth on other economies in terms of key economic indicators

**Analysis** of the effects of Chinese economic growth on the global economy

Examples:

- Benefits of China's growth to other economies, including:
  - Cheaper consumer goods
  - Increased consumer choice
  - Lower production costs
  - Cheaper component costs

- Limitations of the benefits of growth to other economies, including:
  - Inflationary pressure on commodities
  - Structural change
  - Environmental damage
  - Resource depletion

Candidates should be rewarded for supporting their analysis with diagrams. For the higher analytical marks candidates should be able to support their answer with relevant data on, for example, relative production costs, prices of consumer goods, global commodity prices, unemployment levels and CO<sub>2</sub> emissions. Good candidates will be able to use data from China and other economies. Consideration may also extend to the effects of economic slowdown and its impact on the global economy

**Evaluation** of the extent to which growth is beneficial or harmful

At the lower end, marks should be awarded for recognition that economic growth involves trade-offs and that improved living standards for the Chinese population, in terms of employment and living standards, may be matched by rising unemployment and declining living standards elsewhere. There may also be reference to the effects on global warming and consumption of finite resources, especially energy. There is not likely to be any explicit attempt to deal with the magnitude of these effects.

At higher levels candidates will be expected to consider how the effects vary:

between different groups of economies, including:

- developed economies
- less developed economies
- transition economies

between different groups of economic agents in other countries, including:

- consumers
- firms and their employees in competition with Chinese producers
- firms and their employees re-locating production to China
- firms and their employees sourcing materials and components from China

This discussion is likely to lead on to a consideration of the response of other economies and trading blocs to this phenomenon, including protectionism and its effects on economic efficiency.

Strong candidates should deal more explicitly with the rapidity of growth and the specific problems this causes, including;

- commodity inflation
- rapid structural change
- sustainability issues

Candidates may suggest suitable policies for economies, trading blocs and global financial institutions to adopt in order to maximise the benefits and minimise the drawbacks. However, they may also suggest that this is a purely academic exercise as there is little that they can do to influence the Chinese economy in a meaningful way.

Candidates may also consider the magnitude of the impact of the economic slowdown and the extent to which lower growth rates in China have had a beneficial effect on the global economy. They may explicitly contrast the effects on the global economy pre- and post-‘credit-crunch’.

**Theory and analysis**

Level 4 (18–22 marks) Mid mark 20	The answer shows a thorough understanding of the effects of growth on China and the world economy. There will be in-depth analysis of the current benefits and drawbacks of Chinese growth. At the top end of this Level, there is likely to be a clear distinction of the effects on different groups of countries and economic agents, with supporting data.
Level 3 (12–17 marks) Mid mark 15	A good understanding of growth effectively applied to the current conditions in the global economy. However, the analysis lacks breadth or depth and is more likely to read as a prepared list of advantages or disadvantages rather than a well-structured essay. Lacking critical awareness in some areas.
Level 2 (6–11 marks) Mid mark 9	Some understanding of the effects of growth on the global economy but possibly considering it only from the perspective of one country or group of economic agents. Any analysis will be very superficial, for example, arguing that growth in China leads to the loss of manufacturing jobs in the UK. Limited critical awareness.
Level 1 (1–5 marks) Mid mark 3	There is limited understanding of the concept of growth or no meaningful attempt to apply the effects of Chinese economic growth to the global economy.

**Evaluation**

Here follows a re-cap of some of the areas that might be included and a breakdown of what will be expected at the various Levels.

Issues include:

Which groups/economies are likely to benefit?

Which groups/economies are likely to suffer?

Do the benefits for the global economy outweigh the drawbacks?

How have the policy responses of other economies/trading blocs influenced the effects?

What effect does the rapidity of the growth have?

Can policy responses mitigate the negative effects and increase the positive ones?

Level 3 (13–18 marks) Mid mark 16	Given the length of this paper, to achieve this level of evaluation there must be significant and comprehensive coverage of several relevant areas. At the top end of this Level, there will signs of real in-depth research and/or originality. In all cases there will be a clear conclusion drawn at the end that relates specifically to the set question.
Level 2 (7–12 marks) Mid mark 10	At least two relevant issues will be considered in reasonable depth but the overall scope of evaluation leaves areas left unexplored and conclusions may lack any rigorous justification.
Level 1 (1–6 marks) Mid mark 4	Some of the issues that could be open to evaluation may be introduced into the discussion but there is no attempt to go further than to show an appreciation of the issue – for example, ‘there is likely to be a trade off between lower prices and higher unemployment’. There is no attempt to draw together the relevant issues in a conclusion.



Example Candidate Response – Distinction (D1)

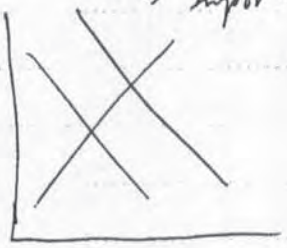
Developed economies  
the cheap products  
exporting into the  
externalities  
higher st. of l.  
→ Labour in  
unemployment  
C.I  
other countries  
recession

Developed countries  
they credit  
Not as they gov. I 224  
with

Imprudent

Global imbalance

Developing economies  
Wishing to be serious  
to Import but not  
extractions  
Debt financing to + Additions  
↑ bad prices



~~Advanced Emerging Economic Role model~~  
~~change the~~  
~~rise in demand~~  
~~Structural~~  
~~Push up to high value products~~

2

The past 30 years have seen China's growth average to 9.0% per annum, a rate impressive for any economy. An economist must thus ask what effect such a rate may have on the global economy. This essay aims to address four main issues: cheap Chinese products for the developed world, cheap credit for the developed world, the influence of China on African/Latin American economies, and ~~the effect of Chinese competition on emerging, newly industrialized markets~~ case for China as a role model for development.

One of the most widely discussed issues about China is its ability to supply cheap products to developed countries such as US, UK, and the EU. As China has a vast supply of labour, its wages are relatively low and thus China has a comparative advantage in labour intensive manufacturing. The direct result of these cheap goods on the West is that developed economies export their inflation to China. In addition, externalities are exported to China. Consider the level of CO<sub>2</sub> emissions the US has avoided in its own country by having China produce steel for the US. As such, over the past 30 years, developed economies have been able to grow at high levels without correspondingly high levels of inflation and pollution. Thus, consumers enjoy a higher standard of living.

Nevertheless, there has been considerable debate amongst US politicians about Chinese workers 'stealing' US jobs. This comment refers to the diversion of demand from domestically produced goods towards Chinese imports. These critiques are unfounded as this is only to be expected by the theory of comparative advantage. China has a comparative



advantage in labour intensive manufacturing, so it specializes. The US and UK, in turn, specializes in high technology and financial services. China demands these goods from the US and UK. Loss of jobs in the labour intensive sector only produces job elsewhere, jobs that are most probably better paid. Furthermore, even if China was not to produce these goods, other emerging economies would still have higher comparative advantage than the US. Thus, countries like Brazil, Vietnam, and India would have exactly the same effect via trade on US unemployment. ~~Thus~~ Hence, China has been beneficial to developed economies by forcing US workers to retrain and have jobs higher up in the value chain.

However, China does artificially boost its comparative advantage by buying up western government bonds. The devalued Yuan directly gives price competitiveness to Chinese goods. This is a distortion of the theory of comparative advantage. Perhaps if the Yuan was allowed to float, the true mechanism of free trade will come into play, dispersing US demand for ~~Chinese goods~~ cheap goods over a variety of different countries. As such, China may not be the US's biggest creditor in a floating Yuan rate.

The second issue to consider is the supply of cheap credit given by the Chinese. Normally, if the US or EU wanted to ~~raising~~ raise money from government bonds, they would need to increase interest rates to attract investors. However, with the demand from <sup>the</sup> Chinese government, the developed economies are able to keep IR

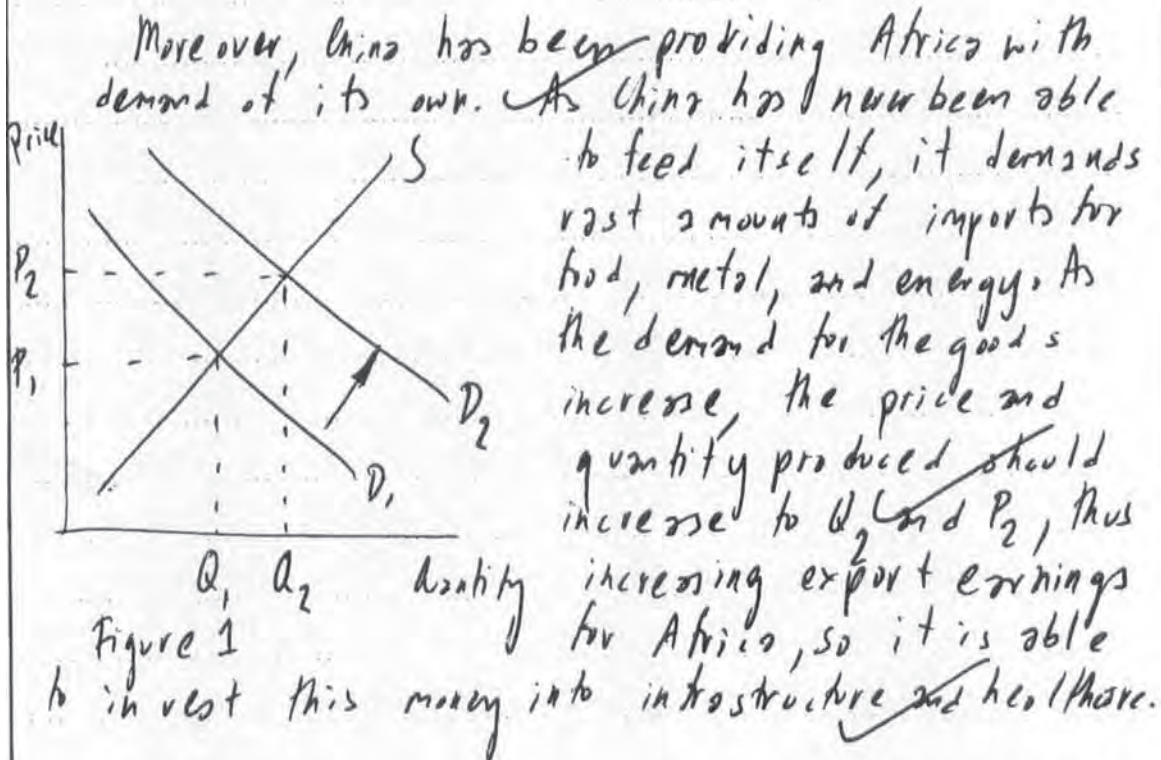


low, while enjoying abundant supplies of credit. This results in cheap credit cards and investment loans for US consumers and firms, effectively a heightened standard of living.

While this scenario of Chinese investors sending money to the rich world may seem ideal, cheap credit also entails imprudent investment decisions. Without the risk of high IR, investors are more likely to enter into contracts without first considering the likelihood of losses. A prime example of this phenomenon is the 2008-2009 subprime mortgage crisis. As cheap credit gives rise to a housing boom, investors eventually realize that the value of houses are not consistent with the price of the associated CDOs. Consequently, the bubble bursts resulting in a full blown recession. This is arguably due to the global imbalance of credit created by the Chinese government.

The other main group of economies affected is the developing world. As China grows in size, it will gain increasing influence at world trade talks. As a result, China has been gathering groups of poor economies, including itself, to challenge the Washington Consensus. Up until now, the US and the EU dominated talks on tariffs and trade barriers, both agreeing to subsidize heavily their domestic market for textiles and agriculture. Policies such as the Common Agricultural Policy directly undermine the theory of comparative advantage. If African countries and China are able to access these market

Through the removal of subsidies in the US and EU, ~~to~~ Africa is likely to experience tremendous amounts of growth. In addition, the EU and US themselves are likely to benefit from lower priced agricultural and textile products.



On the other hand, China has been setting up extraction plants of its own all over Africa. Since more often than not Africa is unable to build factories of its own, Chinese firms will benefit by extracting the raw commodities and leaking profits back to China. Hence, the mutually advantageous agreement may be only hopeful if China takes advantage of African resources.

Furthermore, China's demand for food will push prices of commodities up in general. Thus, even as Africa earns more, it will also have to pay more for food and energy.

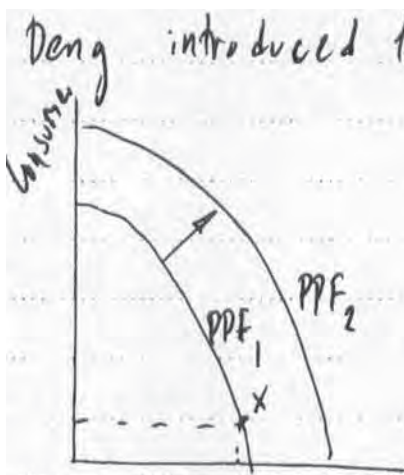


In addition, China's demand for natural resources will encourage African countries such as Sudan and Zambia to continue producing these goods without moving into more profitable industries like manufacturing. As such, Africa may become addicted to export led growth fuel by abusing its natural resources. Moreover, as prices for basic commodities rise at a slower rate than the prices of high tech and capital intensive goods, Africa will be stuck in a deteriorating terms of trade. This means that Africa will have to export increasing quantities of commodities in order to buy the same quantity of imports.

Another factor to consider is that China itself is providing Africa with cheap labour intensive manufacturing. This is critical to Africa's development as it is unable to produce these goods itself. However, it could be said that even if the prices are low most Africans are more worried about surviving by buying food and medicine. Since their income is so low, their priorities will not be in products that China produces.

The last factor to consider is China's case as a role model for development. Many economists have heralded China's growth as a demonstration of the benefits of the free market. As it introduces profit incentives and 'open door' policies, the economy grows and its population benefits. Nevertheless, one has to consider other issues that may have aided China. For example, by 1978 when





Deng introduced the free market, China was already industrialized by Mao's Great Leap Forward. By directing resources towards building factories, the population soared and the PPF expanded to PPF<sub>2</sub>, as shown in 'drag' figure 2. Moreover, China's large population is a feature that cannot be replicated anywhere else in the world. Perhaps more importantly, one must question the extent to which China is a free market. The devalued Yuan, and government regulated banks are hardly characters of the free market.

To conclude, having addressed the supply of cheap Chinese products and credit, ~~the that~~ and the developing world, the benefited parties can be divided into two main groups: the developed world and the developing world. Cheap Chinese products have undoubtedly elevated the developed world's standard of living, allowing for high levels of growth with inflation and pollution. The ~~per~~ influence of China on the US unemployment rate can be dismissed due to comparisons of specialization and moving up jobs to higher valued industries. Cheap credit may have inflated the subprime mortgage crisis, and caused the global recession in 2008-2009. While it is tempting to conclude that African economies benefit from higher export earnings, Chinese extraction plants, leakage of profit, and deteriorating terms of

trade must also be taken into account. Moreover, the cheap supply of Chinese goods probably had marginal effects on African consumers, considering the composition of the African consumerism pattern. Finally, the case of China as a role model may be overstated, as the conditions of its meteoric growth is unique to its economy.

A - L4 Clear + in-depth analysis of effects on different countries but limited comparisons 20  
 E - L3 Clear evaluation throughout and judgement in final conclusions 18

38

#### Examiner Comment

This answer covers a broad range of topics in an assured and precise manner. It is focused throughout on the demands of the question and builds steadily towards a coherent and well-reasoned conclusion. The use of economic theory is frequent, confident and accurate. It is clear that the student has a comprehensive command of both economic theory and the investigation context, although the analysis is weakened slightly by limited use of statistics.

There is a good deal of evaluative commentary throughout the text and much of this is very perceptive. The points relating to China's relationship with Africa, and the suggestion that China could be a role model for other developing nations, demonstrate particular insight. Final conclusions are well-reasoned and clearly stem from the previous analysis. There is a conscious attempt to weigh the magnitude of certain effects and to differentiate the impact of China's growth between different countries and firms.

The answer scored 38/40. The candidate is given credit for in-depth analysis and making a clear distinction between the effects on different groups of countries and firms. It was awarded Level 4, 20/22 for theory and analysis. Evaluation is comprehensive and persuasive, both in the body of the text and in the final judgement. It demonstrated insight and originality. It was awarded Level 3, 18/18 for evaluation.



## Example Candidate Response – Distinction

Discuss the extent to which the growth of the Chinese economy in recent years has been beneficial to the global economy.

China's impressive growth rates of over 9% over the last three decades has, unquestionably, had a huge impact on the world's economy. This is hardly surprising as ~~it~~<sup>she</sup> has gone from being a fairly closed country to become the ~~2~~<sup>second</sup> & third largest economy in the world (depending on which figures one takes). She is the largest exporter of goods, with over 10% of global exports, and the second largest importer in the world. ~~One of~~ trying to say whether China's growth is beneficial to the global economy is a highly normative judgement but it can be argued that ~~there are~~ the provision of cheap goods to foreign consumers, the increased choice of product and the provision of greater economic stability have all been beneficial to



the world in general. The increased openness in China due to its, and also its accession to the WTO in 2001, have meant that China has also become a large buyer of other <sup>countries'</sup> goods and caused an increase in global productivity. On the flip side to that it has to be questioned whether this growth is sustainable, both economically and environmentally. It is also worth asking who it has been desirable for as many would claim China has been directly responsible for increased unemployment, the deindustrialisation in several NICs...?

~~and~~ The first and most obvious effect that China's growth has had on the world economy is what has been termed 'The China Price'. This is the ability of China to produce between 30% and 50% cheaper than most other economies. This has had huge advantages world-wide as it has provided cheap goods for

consumers all around the world. It is not only beneficial for individuals, although the increase in choice and low prices does greatly boost their economic welfare, but for foreign economies as a whole. If ~~consumers~~ <sup>firms in the</sup> U.K. have found a new supply ~~buying cheap Chinese goods~~ of cheap Chinese goods their costs will go down, increasing profits. This may lead to an increase in investment from these firms acting through the multiplier to produce a more than proportional rise in national income. This means that growth in China could kick-start growth in the U.K.. Cheaper goods from ~~an~~ increased growth in China has also led to and ~~has~~ favourable inflationary environment as cheaper prices are keeping ~~prices~~ inflation low.

There is little question as to whether this ~~also~~ increase in cheap goods has been a result of growth in China as it has been estimated that 60%



of growth in China has come from net exports and investment. 'The China Price' is not necessarily a good thing however. Since 2000 an estimated 2.7 trillion people in ~~an~~ the US have lost their jobs in manufacturing. This is because of the China Price, which at first was of great benefit to the US as the China produced low-tech high labour-intensive goods that the US didn't produce, has also managed to move steadily into higher-tech products as well. This can be shown by looking at the period between 2001 <sup>and</sup> 2004 when 59 bedroom furniture manufactures shut causing a loss of 15,500 jobs whilst Chinese imports from China of the same goods rose 211%. It is clear to see how of China's growth could be causing an increase in structural unemployment around the world. This leads to greater income inequality in these countries but ~~is~~ <sup>is</sup> not however a bad thing.

for an economy.

This increase in structural unemployment in countries trying to compete with China is often used as a criticism of China. ~~as~~ this is especially true of America who claim the yuan is undervalued by ~~the~~ around 30% and say that this and the export subsidies are nothing more than protectionism. It could be argued, however, that China's ~~an~~ production of cheap goods has only increased competition in the international markets. This has indeed caused the closure of many firms but those that have survived have had to innovate and become more productive. This increase in global productivity ~~to~~ can only have been beneficial for the ~~an~~ global economy as a whole.

This growth in recent years will only be proved to be beneficial if it can be sustained. ~~China~~ <sup>The world</sup>



is now too reliant on China to see this as simply just a boom that will inevitably come to an end. It is however questionable, how sustainable this <sup>type of</sup> growth is. China's growth is heavily dependent on exports, foreign direct investment and government support. It is a very unbalanced economy with a lack of domestic consumption <sup>to</sup> ~~drive~~ growth. This unbalancedness shows itself with exports dominating domestic consumption, foreign firms in China dominating Chinese firms and private dominating state firms. This reliance on exports and FDI has meant China has purposefully manipulated the currency to keep it low and favour exports. This whilst greatly stimulating growth has added huge inflationary pressures which, if left unaddressed, will threaten this rapid growth.

Another area of unsustainability and a huge drawback of Chinese growth has been its impacts on

the environment. China has recently become the world's biggest  $\text{CO}_2$  emitter, and as such is a huge player in the cause, and hopefully the prevention, of global warming. A testament to how Chinese growth is damaging the environment is the fact that the US environmental agency claim 25% of the pollution in the air above Los Angeles originates in China. Coupled with the facts that the Chinese deserts are growing at a rate of 1,200 square miles a year and that 80% of the East China Sea is now unsuitable for fishing (up from 53% in 2000) due to pollution shows what a detrimental ~~fact~~ impact China's growth has had on the environment. China is the world's largest coal consumer and by 2030 is predicted to be consuming 99 million barrels of oil a day. With only 87 million a day being produced world wide at the moment



It seems China's growth is going to greatly push up energy prices and reverse the anti-inflationary effects it has had so far.

Coupled with this last point China's growth has not only led to a great increase in exports but in imports as well. This can be shown by looking at ~~the~~ her trade figures. Although China runs a huge trade surplus with the US she actually runs small deficits with many Asian countries including Japan, Taiwan and South Korea. This shows the growth in China has had a knock-on effect to other countries who have benefited greatly from China importing resources and technology. Few places have benefited more than Africa, however, where China is investing greatly in search of natural resources.

China's growth has ~~been~~ raised 500 million

people out of poverty in China as in 1981 64% of the population were living in poverty (according to the World Bank's \$1 a day definition). This has been reduced to just 10% in 2004. China's growth has, therefore, greatly benefited the domestic economy. It has also managed to benefit the global economy as well with an increase in imports, benign inflationary pressures, stability especially through the recent economic downturn, an increase in productivity and large investment abroad. The drawbacks of growth (taking FDI from developing nations, increased unemployment and damage to the environment) are concerning and getting more and more so. China needs dramatic changes in the balance of her economy to continue being beneficial but for the time being the benefits outweigh the drawbacks.

Analysis - good + clear generally but not always applied to the question 13 15

End - some clear parts but limited conclusions 12 10

(25)



### Examiner Comment

This candidate begins with an assured introduction to the Chinese context and is also able to introduce several relevant concepts. Understanding of these concepts is clear and there is some supporting data. The candidate quickly moves on to informed analysis of some of the key issues. The analysis is clear and further supported with accurate use of economic concepts and some supporting data. Some perceptive evaluative points are made and the analysis is generally focused on the specific question to hand.

However, there is a lack of depth in some areas and individual statistics are often assumed to make a point decisively when they may not. There are also some points which are not directly relevant to the question and areas where the candidate engages in reasonably lengthy description of an issue without utilising economic concepts to effectively analyse.

The concluding remarks generally flow from the preceding analysis but the length and depth of evaluation is slightly disappointing. The candidate makes no attempt to deal with the issues mentioned in a comprehensive fashion and the conclusions are very general. No attempt is made to weigh the benefits and drawbacks or to draw conclusions specific to certain economies or groups of economic agents.

The answer scored 25/40. The candidate is given credit for clear structure, generally accurate coverage of a good range of relevant issues and use of supporting data. Some illustrative examples are not entirely clear and opportunities to use economic concepts to good effect are not always taken. It was awarded Level 3, 15/22 for theory and analysis. There are a good number of evaluative points in the body of the answer but the final judgement is rather short and opportunities for developing the points contained therein have not been taken. It was awarded Level 2, 10/18 for evaluation.

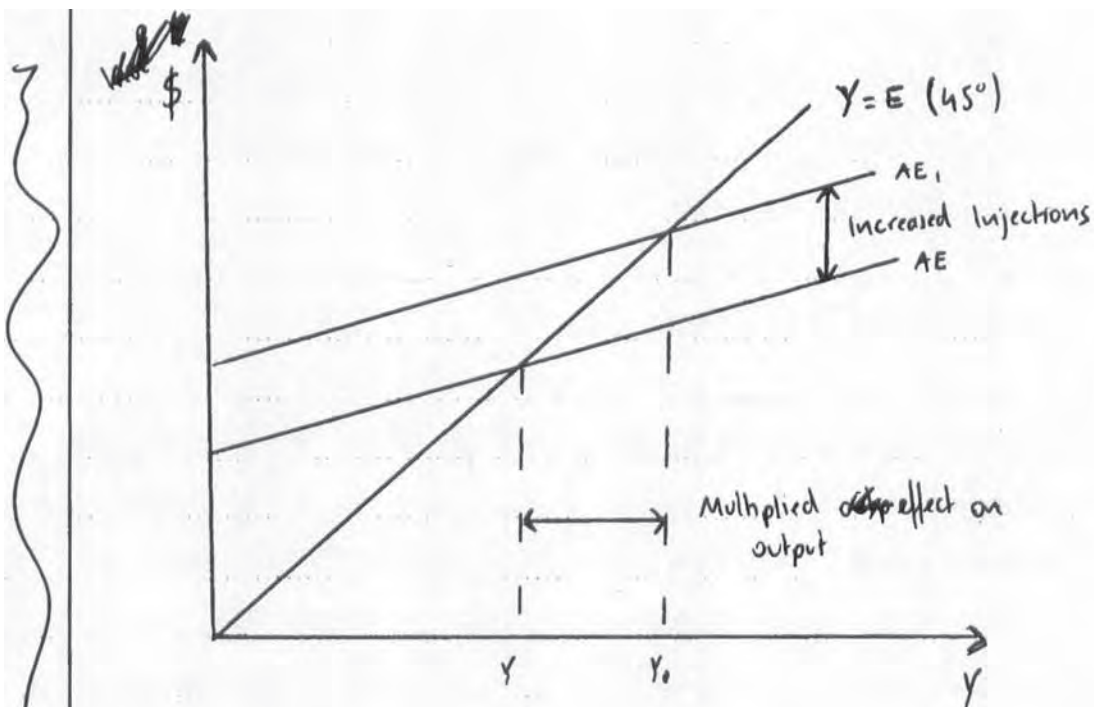
## Example Candidate Response - Merit

2. Growth is the sustained increase in an economy's output year on year in terms of GDP/capita. GDP can be calculated using the following formula:

$$GDP = C + I + G + X - M$$

This figure is then divided by the total population to give a per capita figure. China has shown impressive rates of growth over recent years; in 2009 GDP rose by 8.9% in 2008 the figure was 9% whilst GDP grew 13% in 2007. The key drivers behind China's outstanding growth rates are exports and huge levels of investment in the economy. Chinese exports have increased steadily over the last twenty years. During the 1980s Chinese exports grew an average of 5.7%/year, during the 1990s the figure was 12.4% whilst between 2000-2003 Chinese exports grew an average of 20.3%/year. China is now the world's largest exporter and the impact of these exports is clear to see in many western economies. Investment is any increase in the capital stock in an economy. In the Autumn of 2008 China spent \$585 billion on a fiscal stimulus package which was worth 14% of total GDP. This was an enormous investment compared with similar packages in Japan and the US which only accounted for 4% and 2% of total GDP respectively. Although this package boosted the short term growth of the economy it didn't help in remedying the more serious issues. ~~the~~ China missed an opportunity to ensure long term growth ~~as~~ well ~~as~~ ~~was~~ even if short term growth was compromised.





The 45° line above demonstrates how an increase in injections, which in China's case, was investment can have a multiplied effect on output. The size of the multiplier is dependent on the marginal propensity to consume (MPC). The multiplier is calculated as follows:

$$\frac{1}{1-MPC}$$

From this formula we can say that the higher the MPC the larger the multiplied effect will be. MPC in China is approximately 0.4 which means the multiplied effect will be:

$$\frac{1}{0.6}$$

The effects of increased Chinese exports have both positive and negative impacts on the global economy. China is able to

undercut many foreign producers because of the China Price. There are many factors leading to the China Price although the most important is China's abundant supply of labour. China gains an advantage from the Heckscher-Ohlin theory which occurs when a country has a <sup>natural</sup> abundance of a ~~factor of production~~ <sup>factor of production</sup>. It is important to stress that China doesn't ~~solely produce~~ labour-intensive goods but also technical computerised goods. Other factors contributing to the China Price are an undervalued currency, network clustering, high levels of FDI, lax environmental regulations, low health and safety regulations and counterfitting and piracy. The growth of Chinese exports in America ~~is~~ <sup>is</sup> obvious. 15.4% of the USA's total imports are Chinese made goods whilst only 4.2% of American exports go to China.

The benefits this brings to America are exclusive to certain sectors. Consumers will benefit from a wide choice of cheap but high quality Chinese goods. Firms using Chinese made parts in their production method will also benefit from the cheap Chinese prices. There are other sectors that will be at a disadvantage however. American firms may be forced out of business as they become uncompetitive compared to Chinese goods and this could lead to structural unemployment. 2.7% of Americans are structurally unemployed and the majority of this would have been caused by Chinese exporting industries. There are methods the American government can take to counter the effects of structural unemployment. Workers can be re-trained to find new jobs in other industries whilst geographical factor mobility can be improved through investment in the infrastructure.



The impact growth has had in China has not been entirely beneficial either. Whilst the exporting industry has boomed other industries have remained stagnant. Although GDP growth is impressive there are other issues. The gini-coefficient in China is 0.46 compared to 0.37 in India and 0.36 in the UK. A gini ~~coefficient~~ coefficient above 0.40 is considered politically hazardous and this goes alongside an unemployment rate of 4.7%. So long as China's growth continues to be driven by her export industries the gap between the rich and the poor is only going to get bigger. An indication is the difference between the industrial city Shanghai and the rural province Guizhou. Furthermore, there are horrendous environmental issues associated with Chinese growth. Approximately 380 000 people die each year from pollution related illnesses. Along with this, China is now the world's biggest CO<sub>2</sub> producer and 16 of the 20 most polluted global cities are Chinese. To place a figure on this, China is said to spend 5% of its GDP on environmental related issues.

The final perspective of the impact of Chinese growth comes from developing Third World countries. These economies can gain from China's recent growth explosion. China is the world's biggest exporter but produces a relatively small proportion of its own raw materials. As a result there is a large demand for foreign raw materials. This can be positive for developing countries with the prime example being Nigeria. China recently invested in the Nigerian infrastructure in return for preferential bidding rights over her oil supply. There is however the issue of exploitation and this

is demonstrated in countries like Indonesia where China ~~is~~ ignored the limits on timber consumption which has left the ~~Indonesian~~ timber industry in a poor state. This could be countered by enforcing stricter global regulations on imports and exports of raw materials.

Chinese growth in recent years has been very impressive in terms of GDP growth. There are however doubts as to whether or not this growth has been entirely beneficial. In foreign developed economies there is the risk of structural unemployment whereas in developing economies there is the issue of ~~exploitation~~. The most serious consequences appear to be in China however where the environmental issues are extremely damaging whilst there is also the serious issue of income inequality. In the short run the consumer benefits balance the costs but in the long term China needs to find a more balanced approach of maintaining its growth rather than relying so heavily on its export industries. It could be argued that organisations such as the ~~WTO~~ are preventing China from reforming itself by preventing tariffs and quotas on Chinese exports. If this wasn't the case China would be forced to develop its domestic demand as its exports would no longer be as competitive and growth would not be sustainable.

\* (World Trade Organisation)

A-13 - some clear analysis but lacking focus on the question + depth in para 12

E-12 - some valid points + attempt at a conclusion but lacking rigor 7

19



### Examiner Comment

The candidate begins with a reasonably clear explanation of economic growth and the factors relevant in the Chinese context, including some supporting data. The following section analysing the internal macroeconomic response to the economic crisis is not really relevant until the candidate starts to talk about the impact of this stimulus package on China's global position. The candidate's explanation of 'the China Price' is reasonably coherent, as is the analysis of the resultant benefits and drawbacks to the global economy.

The candidate struggles to stick to the global context indicated in the title of the topic area and reiterated in the question. As a result they waste time talking about domestic economic and social issues. Credit is only given where the candidate is able to draw out the global implications of these domestic problems. The analysis of China's influence on developing nations is coherent and fluent, with some limited evaluation, supporting data and examples. However, it is rather brief and some points are not fully explained.

The conclusion raises some relevant issues but these are not really developed and some do not draw on the previous analysis. The candidate fundamentally suffers from lack of selectivity and they may well have done better if they had stuck to the question and avoided wasting time on issues that were not directly relevant.

The answer scored 19/40. The candidate is given credit for a fluent and compact answer including reasonably accurate coverage of economic growth and two of the global issues that this creates. However, too much of the analysis is not directly relevant to the question. It was awarded Level 3, 12/22 for theory and analysis. There are some brief evaluation points in the body of the answer and a decent attempt to come to a judgment at the end, but the potentially valid points in this conclusion are not rigorously examined. It was awarded Level 2, 7/18 for evaluation.

Example Candidate Response – Pass

*USA - biggest trade partner, 2 gain but they rely on China who holds power over their currency.*

*Others - Vietnam Laos*

*Conc  
country  
+ country*

*Chinese Economy themselves  
L lost  
L should be  
L not better  
L not welfare  
L may suffer  
L effect what  
L growth sustainable*

**Plan**

**China on world**

**Developed (West):** - Cheap products  
L soft L P

- export pollution
- big market to sell to
- asset values ↑
- Export our inflation
- IR kept lower

*All of World*

**Developing (Africa)** - investment

- national incomes
- Trade negotiations
- Even Sudan → China buy but no one else because genocide

*although side w/ EU or US better*

*L good for countries China buys from but not those who China doesn't buy from.*

**Vietnam Laos + other export countries**

- Similar goods
- Competition P
- Investment from China

*- cannot compete in exports. L although hard to be diff goods country*

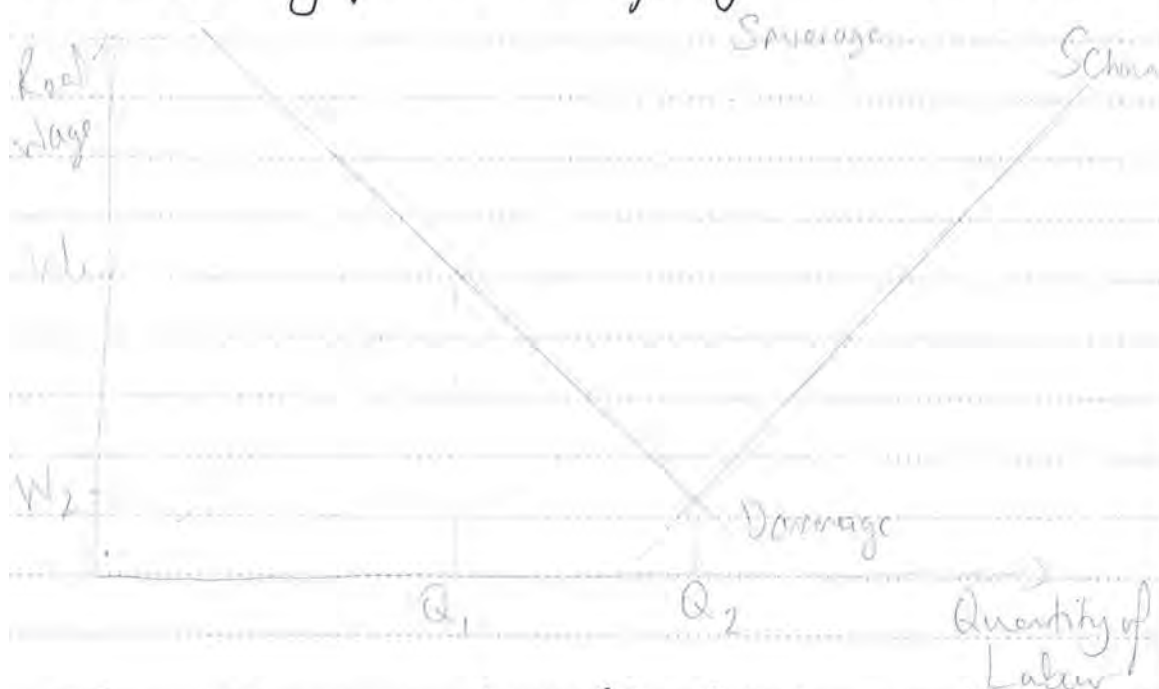
**Figures** - 1.2 billion pop  
8b mkt force  
4trillion GDP  
9% growth

**2.**

China's growth Growth is a measure of output of an economy, it is measured using GDP figures. In recent years China has developed into one of the biggest growing economy, or perhaps, the biggest. It boasts 9% rate of growth per annum of its ~~GDP~~ <sup>economy</sup> that is worth 4.23trillion. This transformation has benefited every single part of the world, some more than others. But this does not come without costs.



For those countries that are already developed (these are mostly the western countries, such as USA, UK and the rest of Europe) consumers benefit from cheaper products as China's exports are low in value. This is due to the large population (of 1.3b) China has, as there are 800 million people in the workforce, competition is high, driving the wages down, and thus cuts the cost of production for firms within China.



The diagram above (fig 1) shows that due to the large supply of labour, China produces at a much lower wage at  $w_2$  from the average of  $w_1$ , whilst producing more at  $Q_2$  rather than  $Q_1$ . As those "western" consumers buy these cheap products from China, their



cost of living falls and thus their standard of living rises as they have more income to spend. Although this is a benefit to consumers right now, it may be a problem to the government, this is due to the fact that China forces those westerners to demand for their products and thus causes these country to have debt as they import from China. China achieve this by its manipulation of the currency, as they are ~~an~~ <sup>massively</sup> export-orientated country, they need to keep their exchange rate low to keep exporting, thus they buy up currencies of those who they export to, especially the USA who is their biggest trading partner. This causes the demand for the US dollars to rise and the ~~and~~ supply of the Yuan to rise and thus the value of the USD goes up whilst the RMB goes down. ~~Moreover~~ <sup>Moreover</sup> this also means that they are tied up to the USA & the EU countries. This is because buying <sup>large amounts of</sup> up the (for eg.) US treasury bonds causes to keep their exchange rate low now means that once they sell them the market will self correct and this will not be good to either the Chinese or the US economy, which effectively ~~is a big~~ are the two biggest parts in world economy. Therefore China hold a significant control over the USA even though if they



choose to damage the USA, they will self-destruct ~~also~~ also, this therefore means that they have a significant control over the world economy also.

There are other benefits to the western (developed countries, <sup>(and others in the world)</sup> which are the fact they can export their pollution as well as inflation. This is because those countries effectively buy a large amount of products from China, who specialises in low cost production and thus does not care if they pollute much in their own country and so they do. The developed countries who buy from China, however, will not face this problem as China does it all for them whilst providing cheap goods also.

In terms of inflation, as the rest of the world buys Chinese products, price level in China rises rather than price level in their own country as the AD of Chinese products rises. <sup>(FR)</sup> This means that these countries can keep their interest rates low and thus increase their own investments, consumption & thus promote growth at a cost of less inflation than at originally. It also means that with these low interest rates, people will borrow more and thus consume even more Chinese products and thus it doubles the effect China imposed on them in the first place. This means that



both China and the rest of the world benefit from this transaction.

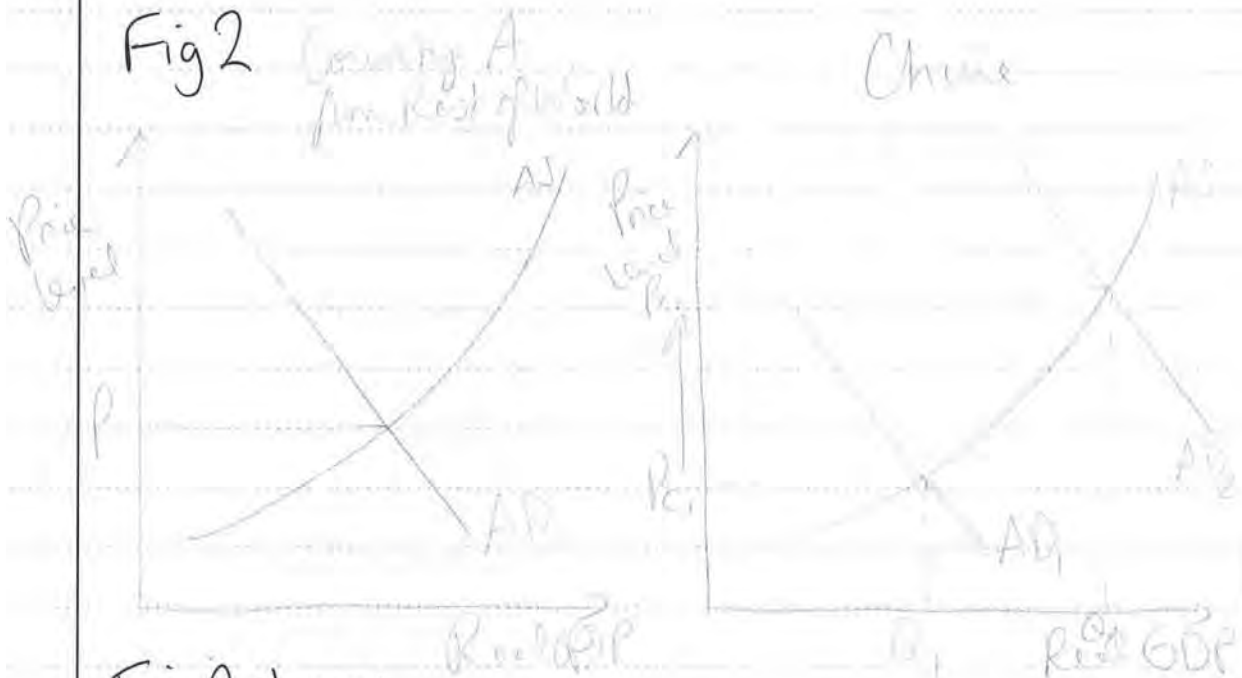


Fig 2 shows:

As the rest of world export their inflation to China their Price level stay constant whilst China's increases from  $P_{c1} \rightarrow P_{c2}$ . Whilst they also benefit from increase in real GDP from  $Q_1 \rightarrow Q_2$ .

As for those countries who are developing, China buys up a lot of commodities from them (mostly African countries) due to the fact that China lack raw materials & natural resources. This means that their They also do so with a higher price than average and this means that their national income will increase, which is therefore



beneficial to the people within the country if the government spends those profits gained from selling to China wisely. However, China does not buy these resources from every country who sells them, thus those who do not manage to sell to China suffer due to higher prices of commodities around them. ~~as~~ This will mean that for countries in Africa especially, those who can't sell to China receives no profits with facing higher costs also, and this will ultimately affect its own people's welfare.

However, as China owns a lot of state owned ~~ent~~ enterprises, they use these enterprises to buy the commodities in these developing countries, and thus those who manages to sell, will receive huge FDI from China also and this may provide better training skills and technology, that although China are not experts on, will undoubtedly be better than most African nations for eg..

These developing countries may also benefit from this communication with China as if they are on the right side of China, who is a major power, when they need to improve their trade, China could back them up in trade negotiations such as those held in WTO. However, it must be noted that it is



still better for ~~the~~ them to be on the right side of the UK or the USA, as the western power still holds greater power in trade talks than China ever in these days.

Another issue is in developing countries is that China will buy from countries that any other in the world will not bother with as they do not care for the reason. For, eg. China ~~to~~ imports resources from Sudan and thereby give Sudan a large amount of money which the Sudan government spends on ammunition used in its genocides and civil war that is going on with in Sudan right now! This is thus morally wrong but economically correct, but it is quite obviously not beneficial to Sudan citizens. Other countries may be facing problem with child slavery but China will not care and buy from them anyway. Some may argue that those income ~~due to~~ from China may be used to tackle poverty but under civil war or that of similar status, this seems <sup>very</sup> unlikely.

There are also other countries who are export-orientated such as Thailand, Vietnam and Cambodia who borders China. With China's



All of world - bigger market to sell to. esp developed

growth, these countries will benefit from FDI from China as China looks to expand ~~to them~~ its trading system. This is because these export-orientated countries tend to produce similar products to that of China and thus these investments will help these countries expand in terms of growth ~~the~~ interactions with a bigger market by having a ~~new~~ new innovations & ideas from the training systems from that of China.

Competitions will also increase and although this may cause concerns in the beginning as they cannot export & compete with China, it will mean that these countries have to innovate & diversify so that new & better products will be made to compete with China and this will benefit consumers around the world throughout.

The ~~whole~~ world also benefits <sup>(especially those developed countries)</sup> as a whole to the growth of China because with such a large land, population & economy, it is a large market to sell to, invest in, trade with and interact with and this will promote wealth and growth for ~~the~~ throughout the world even if a small minority loses out. (although they are

as they have more to spend than developing ones.

consider the poorest people who are in need)

It is also worth talking



about China themselves as this essay is about <sup>China's effect on the</sup> global economy & China is one of the biggest economy in the world ~~itself~~. As China experiences growth themselves, the country has made huge surpluses but due to the fact that they spend most of it ~~reinvest~~ (40%) investing in unnecessary products such as roadworks that are not much used by the Chinese. They also spend a lot on manipulating currencies and less on the welfare of its people and this is a huge opportunity cost. As these money that China uses to buy up other currencies is around 2 billion worth of shares, bonds & assets and many other things.

As China keeps having to produce more and more every year reducing its terms of trade and <sup>blinding</sup> the market prices for many goods & currency, <sup>as well as the housing bubble problem within the country itself</sup> it makes its growth unsustainable, and because it is such an important economy, if it falters, the ~~peop~~ everyone in the world will face problems especially the US, who is the biggest economy in the world at the current time and this fall may inevitably lead to one of the biggest recession ever.

As a whole, China's growth has benefited everyone throughout the

which is ~~the~~ part of the cause of current recession



world with the cost being much smaller, but as they continue to grow (and unsustainably) they continue to risk the whole world going under another depression & thus recession. <sup>They ~~they~~ cannot let the rest of the</sup> For the developed world, consumers benefit a huge amount in their living standards, but they cannot continue to just let China provide for them if China is unsustainable. For the developing world, those who China buys from benefit, as for other export orientated firms, it innovates many new products to compete with China and thus world consumers benefit. ~~But under all these benefits, there could be a massive cost that no one~~ But under all these benefits there could be a massive cost that no one can see in the future, as the economic cycle dictates.

Cannot  
world rely  
on them  
as it may  
be a problem  
in the  
future.

Analysis - L2 some superficial points made  
 Quality Objectivity - several areas - 10  
 Evaluation - L1 Attempts at a final conclusion  
 not really clear. Some basic points made 6

16

### Examiner Comment

This candidate begins with a reasonably clear explanation of economic growth in the Chinese context. There is some explanation of the causes of growth, but this is not comprehensive or convincingly backed up with theory. The candidate then begins to analyse the benefits and drawbacks of growth. Some valid points are made in this analysis but there is an overemphasis on the undervalued Yuan and this, whilst relevant, is discussed at excessive length and with insufficient objectivity.

There is also a lack of objectivity and balance in coverage of the environmental issues involved in growth. The candidate asserts that China “specialises in low-cost production and thus does not care if they pollute much in their own country”. These are broad assumptions which are not substantiated. The macroeconomic analysis also makes valid points about exported inflation, but it is rather simplistic and the candidate does not consider the effect of, for example, increasing imports on the AD of developed nations. Some relevant points are clearly made regarding China’s relationships with the developing world, including some basic evaluation. However, these points lack depth and sophistication. There is also a lack of objectivity and the candidate struggles to stick to the question at hand and is drawn into moralising about China’s trade policy.

In conclusion some valid points are made at some length. However, they lack sophistication and objectivity and there is relatively little economic content or evidence of conclusions which clearly flow from economic analysis.

This answer scored 16/40. The candidate is given credit for a reasonably clear structure and for covering a range of relevant points in context. However, there is very limited effective use of economic concepts and a lack of sophistication and objectivity throughout the answer. The candidate displays a clear antagonism towards the Chinese economic model which gets in the way of reasoned discussion. It was awarded Level 2, 10/22 for theory and analysis. There are few evaluation points in the body of the essay and, although a conscious attempt is made at the end to come to a clear conclusion, the final comments lack economic rigour. It was awarded Level 1, 6/18 for evaluation.



## Question 3

**Expansion of the EU**

**Discuss the extent to which all the expected economic advantages of EU enlargement will have been achieved within the next ten years.**

## Mark Scheme

Candidates should be familiar with the purpose of the EU and with the rationale for enlargement. They should have an awareness of the countries involved in the enlargement process and an appreciation of the economic characteristics of these countries. Candidates should be familiar with the experience of enlargement to date and the extent to which the expected benefits have been realised. They should also consider the prospects for the future. They should use appropriate analytical tools and data to support their arguments. They should reach a clear and well-supported conclusion on the extent to which the advantages of the enlargement process have already been met, or are likely to be so within ten years. Good candidates are likely to look at the issue from the perspective of different groups of EU member states. Analysis may be assisted by the use of diagrams.

**Answers may include:****Knowledge** of the EU and enlargement

Examples:

- The nature and purpose of the EU
- The process of enlargement to date
- Prospective future enlargements

**Application** of the economic arguments for enlargement in context

Examples:

- Identify lower cost economies
- Increased internal market size
- Increased labour mobility and labour market flexibility
- Greater growth prospects for all states
- Increased global influence

**Analysis** of the experience of enlargement so far and its future prospects

Examples of benefits, including:

- Trade creation
- Economic growth
- Increased labour market flexibility

Examples of limitations and problems, including:

- Trade diversion
- EU budgetary problems
- Structural change, unemployment and social problems
- Lack of market harmonisation
- Inflationary pressure in new member states
- Lack of fiscal harmonisation
- Difficulties in maintaining fiscal discipline

Candidates should be rewarded for supporting their analysis with diagrams, including AS/AD analysis. They may also introduce relevant economic concepts such as comparative advantage. For the higher analytical marks candidates should be able to support their answer with relevant comparative data on economic indicators in the new member states and the EU15 as well as aggregated data for the EU. Strong candidates may also compare performance with major global competitors and consider the effects on international competitiveness

**Evaluation** of the extent to which the benefits of enlargement are likely to be realised

Evaluation is likely to consider whether tangible benefits can be observed to date and whether the prospects for future benefits within ten years are good or not. At the lower end, candidates are likely to draw conclusions which identify some gains, such as lower production costs for EU firms, and some drawbacks, such as loss of manufacturing jobs in the EU15 countries. They may recognise that this is a 'trade-off' but are unlikely to deal with the magnitude of these effects.

Stronger candidates are expected to look at this question explicitly from the perspective of different groups of member states, or even from individual states. For example:

- Has the effect of migrant labour been beneficial or detrimental to the EU15?
- Have the Accession 8 countries (A8) benefited or lost from increased employment opportunities abroad and remittances received?
- Have EU firms and consumers benefited or lost from increased market size?

They may also look at the prospects for future costs or benefits in specific areas. For example:

- What are the prospects for future harmonisation?
- Will the Eurozone continue to expand and will this bring benefits or costs?
- Will EU budgetary problems be resolved?

For the higher evaluation marks candidates are likely to look at the question from the perspective of the EU as a whole and may wish to revisit the objectives of the EU and consider whether enlargement is likely to improve or reduce the chances of meeting these objectives. Candidates may contrast the static costs and benefits generated in the enlargement phase with the dynamic changes that are likely to be encountered in the long-run. They may also deal explicitly with the challenges that the EU faces from its major competitors, including Japan, USA, China and India. They should reach clear conclusion regarding the extent to which enlargement has strengthened the position of the EU nations in the global economy.

It is reasonable for candidates to make reference to the wider social and political objectives of the EU as well as the social and political issues and obstacles related to enlargement. However, these points should be peripheral to the answer which should focus on the economic issues.



**Theory and analysis**

Level 4 (18–22 marks) Mid mark 20	The answer shows a thorough knowledge of the issue of enlargement, its benefits and drawbacks. There is an explanation of the rationale behind such expansion and explicit analysis of a wide range of relevant economic issues, supported by reference to the effects of enlargement to date. At the top end of this level there should be some analysis of how the effects have varied among member states, with supporting data.
Level 3 (12–17 marks) Mid mark 15	The effects of enlargement of the EU are analysed in the context of EU economic objectives. However, the analysis lacks breadth or depth and is more likely to read as a prepared list of advantages or disadvantages, possibly more focussed on EU membership, rather than a well-structured essay. Lacking critical awareness in some areas.
Level 2 (6–11 marks) Mid mark 9	Some inaccuracies either with regard to the economic advantages or the experience of enlargement. Causal links between enlargement and the likely economic outcomes for EU member states are established but tenuous. Limited critical awareness.
Level 1 (1–5 marks) Mid mark 3	There is limited understanding of the economic advantages of the EU and/or what is meant by EU enlargement.

**Evaluation**

Here follows a re-cap of some of the areas that might be included and a breakdown of what will be expected at the various Levels.

Issues include:

What have been the tangible benefits of enlargement to date?

What drawbacks have been experienced?

How do these effects vary between member states?

What are the future prospects?

What dynamic benefits/costs can be expected over time?

Has enlargement strengthened the global position of the EU?

Level 3 (13–18 marks) Mid mark 16	Given the length of this paper, to achieve this level of evaluation there must be significant and comprehensive coverage of several relevant areas. At the top end of this Level, there will signs of real in-depth research and/or originality. In all cases there will be a clear conclusion drawn at the end that relates specifically to the set question.
Level 2 (7–12 marks) Mid mark 10	At least two relevant issues will be considered in reasonable depth but the overall scope of evaluation leaves areas left unexplored and conclusions may lack any rigorous justification.
Level 1 (1–6 marks) Mid mark 4	Some of the issues that could be open to evaluation may be introduced into the discussion but there is no attempt to go further than to show an appreciation of the issue – for example, ‘consumers have benefited from lower prices but some have lost their jobs’. There is most unlikely to be any attempt to draw together the relevant issues in a discussion.

## Example Candidate Response – Distinction

## ③ Expansion of the EU

Enlargement of the European Union is expected to bring many benefits to member states over the next 10 years.

The European Union was initially dreamed up after WWII, when the economies of Europe had been crippled by the costs of war - both financial and devastation. In 1952, 6 countries, France, Germany, Italy, Belgium, Luxembourg and the Netherlands, set up the European Coal and Steel Commission, which enabled them to compete with the USA. Further developments and expansions continued until the EU as we know it today was completed in 2007 with Bulgaria and Romania joining to make the EU27.

Sixteen of these countries are also members of the Euro Zone, and share the euro as their currency, the EZ16. This is set to become EZ17 as Estonia is almost set to join in January 2011. ✓

Enlargement of the EU has always been a controversial issue, especially for the original 6, who feared a weakening of the EU. As it has expanded, however, many advantages of having such a large union have arisen, and the success is forecast to



continue.

The European Union is a single market, which means all member countries can trade all their goods and services free of tax and barriers. The advantages of this extend both to the old members and the new.

For the old members, they have now a much larger number of consumers to sell to, which means that, hopefully, their demand should increase. As well as this, their competitors have also lost some of the market: goods which may previously have been cheaper in USA now will be cheaper and easier to access from within the EU, so consumers will switch.

Over the next ten years, this ~~is~~ <sup>type</sup> increase in market size is expected to continue, as the new economies entering the EU continue to prosper. As their own economies grow, their wealth will increase, meaning the population will have more money to spend; therefore, demand for goods in old member states, such as the UK, will continue to rise.

~~It has also been estimated~~

The benefits of a large market can also have a huge effect on economies of new member states. Companies in countries such

as Bulgaria would have had a market of only a few million people, and upon joining, they will instantly have access to over 500 million consumers, a number which is greater than the population of America and Russia combined. This means that their businesses can grow very quickly, if they are able to advertise properly and meet the demand.

Has this really happened though? Even before the recession, there were problems for both old and new members. The new members found that although their market had grown, the number of companies ~~was~~ also grew, and many manufacturing ~~comp~~ firms in the UK have been forced to close, as the goods become cheaper elsewhere. The old members also saw some companies struggle. Many simply could not cope with the massive increase in competition or demand and had to shut.

The recession, being global, also hindered progress, as you would expect. As well as affecting companies success, it has also hindered the expected economic growth.

Forecasts suggested that if all current candidates were accepted into the EU, the



UK economy would see an increase of about £175 billion to its economy. This was similar to the prediction made in 2004 before ten new countries were accepted.

The UK economy could grow like this for a number of reasons. It saw a growth in market share, an increase in tourism, and also an increase in migrant workers. These workers were able to fill all the unskilled and low paid positions, which are essential to keep an economy functioning.

The economy, however, has struggled, and this can, at least partially, be blamed on migrant workers.

Workers have flooded in to the UK, particularly from Poland. This greatly increased the labour force, and has had a negative impact in wages for UK workers. This has resulted in an overall reduction in wealth for British people, some coming from having to accept lower wages, and some having lost their jobs altogether. This has in turn led to an increase in benefits that the government has paid out. Not only to them have to provide more unemployment benefits, there has also been a considerable strain on the housing and other benefits,

which are claimed by the migrant workers.

As well as this, little extra wealth has actually entered the UK, as the majority of workers have sent their wages back to their home country.

Another advantage of having a large EU is that countries will have a greater global presence, which can be beneficial in decision making, about trade policy, for example. The EU is currently has the largest GDP in the world, of over 12,000 billion euros, compared to USA, Japan, China and Russia. It also has the largest percentage share of trade in goods and services, with 17% and 28.5% respectively. This has given the EU greater power ~~on~~ on the world stage, and also means that there is competitiveness with the other economic giants, such as America and the emerging BRIC countries. (Brazil, Russia, India and China).

A larger EU was expected to bring stability, both politically and economically. In many ways, it has done just that. Before joining the EU, all countries must meet EU standards, and ~~the~~ achieving these in itself can provide a country with



stability they had never previously known. Political stability is excellent throughout the EU, especially when one considers the background of a country. Germany, Italy and more recently Spain and Portugal all were once ruled by dictators, but are now fully democratic and stable. As well as this stability in the Eastern European countries has been achieved after the fall of Communism.

There have been many economic benefits as well. In 1974, inflation for EU averaged at around 14%, but ~~to~~ between 2002 and 2007, it remained consistent at 2%, with only the recession changing this. Tight EU rules, particularly in the Eurozone, have contributed to this, as well as a relatively steady Euro exchange rate.

Recently, however, it has emerged that although economies are stable in some ways, many more serious problems have emerged. The target for debt was at a maximum of 60% of GDP, however, many countries have struggled greatly with this. Many of the Eurozone countries have debts much larger than the targets, but none more so than Greece, which

is at around 120%, double the target. This has resulted in a fiscal crisis in Greece, which looks set to spread if something drastic is not done. Greece is so far in debt it has been forced to ask relatively stable and prosperous economies, such as Germany's for billions of euros to help bail them out. Unfortunately, no other country is in any real position to help, so Greece has found itself in real problems. It has been downgraded in its credit rating, which means it will struggle to borrow money, and its interest repayments are gigantic. This has led to massive tax increases ~~to~~ and vast reductions of Government Spending in an attempt to reduce ~~debt from 12.7%~~ of the budget deficit of 12.7% to 9.1% in the immediate future.

The problems in Greece, however, have not remained in Greece. When riots began in Greek cities, resulting in four deaths, confidence in the future of the Euro plummeted and the Euro weakened, affecting 15 other countries, directly, and also indirectly affecting the non Eurozone members.

Whilst a large monetary union can provide immense stability, when things go wrong, they stand to go very wrong, and



the fact that so many countries have high levels of debt and massive budget deficits, means the situation is likely to get worse. This includes the UK as the UK budget deficit is even larger than Greece's, at 13%.

Another advantage of having an enlarged EU is that many prices will fall. Between 2002 and 2006, for example, the cost of making phone calls plummeted by 40%. Transport costs have also greatly been reduced, especially air fares. This is something which is highly likely to continue for the next 10 years.

An increase in the EU and the single market has resulted in an increase in competition. This has forced companies to become much more efficient and therefore for prices to fall. As the EU recovers from the recession, and economies begin to grow, further competition will emerge leading to more efficiency and lower prices.

A very controversial topic of the European Union budget is CAP (Common Agricultural Policy). This uses up a highly significant amount of the budget despite agriculture ~~production~~ amounting to less than 5% of EU output. ~~The~~ ~~same~~

It subsidises farmers and causes supply of food to greatly exceed demand, and it also sees a lot of money 'wasted', where it could be more evenly distributed. An enlargement of the EU is likely to be a catalyst for ~~an~~ reform of policies such as CAP, which will be a great advantage for many countries, particularly the ~~of~~ UK.

It is very likely there will be reforms over the next ten years, such as the Treaty of Lisbon. ~~It is hoped that~~.

The European Union donates a lot of money to regions of the EU which need to be built up and redeveloped. For new member states, this means they will receive a relatively large proportion of the budget initially, in order to develop their infrastructure, and to help rural areas. This money provides a great advantage to new countries in the EU, as it will allow them to improve in ways they could not have done alone. It has proved to be successful in helping very poor countries such as Ireland become one of the wealthiest in the EU.

However, as more money is being spent on new members, it is being diverted away from other countries, who will still



have areas of need, for example the Highlands and Islands in rural Scotland. The advantage which should be being gained from the Regional Development Fund will not be gained, as the money will no longer be available for many countries.

There is also a fear that the short term beneficial development of a country could lead to long term disastrous, and potentially irreversible consequences.

Countries are borrowing a lot of money and as we have seen with Greece, debt and interest repayments can build up to unmanageable amounts, which within 10 years could see a country have to default its debts.

Overall, the European Union Enlargement has brought about many benefits, including the creation of an estimated 28 million jobs throughout the EU. It ~~can~~ is likely to see economic growth for both old and new countries, a greater world market share and stability.

However, we must be cautious and not go too far. As has been proved, the

merging of markets can drive companies out of business, and interdependence can lead to massive problems for the whole Eurozone if one country finds itself in trouble.

It seems likely, however, that once the recession becomes an increasingly distant memory, ~~and~~ the expected advantages of the EU shall ~~also~~ happen.

A - L3 Some good analysis, but causal links not always clear. Looking selectively in places 17

E - L2 Looking right in places but for attempt of a conclusion 12

(29)

### Examiner Comment

This candidate clearly understands the history of the EU (although this in itself is not likely to gain many marks) and the current context of enlargement. Several key issues are considered in considerable detail. Analysis is generally assured and fluent. The candidate uses relevant economic theory and supports their arguments with data. There is a lack of selectivity in places and the lengthy discussion of the crisis in Greece gains little extra credit as it is not successfully linked to EU enlargement.

Some analytical points lack clarity and there is a lack of critical awareness in places where sweeping statements are made but not explained or supported. For example, the implied link between enlargement and falling airfares.

There are a good number of evaluative points made throughout the essay and some extra credit is gained for the final conclusion which identifies some opportunity costs (although they are not identified as such). However, some points in the conclusion lack rigour and are not effectively linked to the question.

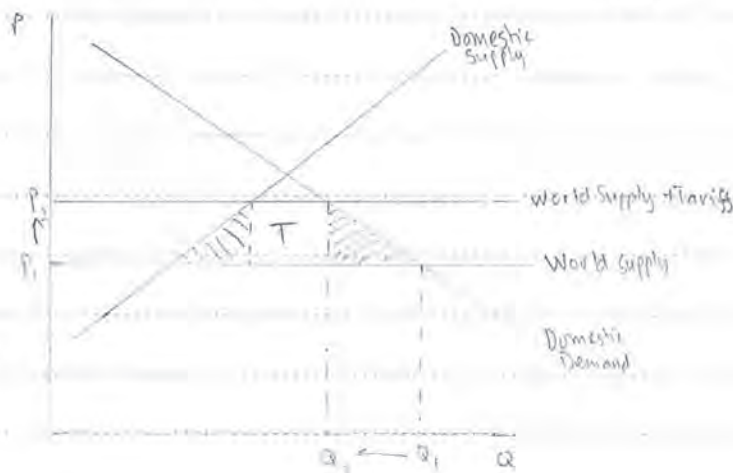
The answer scored 29/40. The candidate is given credit for clear structure and accurate coverage of a good range of relevant issues. There is also some good use of supporting data. There is a lack of selectivity in places and some unsupported claims made, but there is a good amount of solid analysis to outweigh these weaknesses. It was awarded Level 3, 17/22 for theory and analysis. There is generally good evaluation throughout the answer. The final judgment makes some good points but is disappointingly lacking in rigour in places. It was awarded Level 2, 12/18 for evaluation.



## Example Candidate Response – Distinction

3. The expansion of the European Union is a continuous and ongoing process. The trading bloc was enlarged ~~and~~ substantially in 2004 and Romania and Bulgaria were recently approved as new members. Countries including Turkey and Iceland? are currently seeking ~~accession~~ membership of the EU.

The rationale behind the enlargement of the EU is fairly simple: allowing new members to join increases the size of the single market within which no tariffs apply. This would allow for more free trade, which provides several dynamic and static gains. The diagram below demonstrates the effects of tariffs and how their removal benefits consumers.



As can be seen ~~from~~ in the diagram above, the application of tariffs raises prices and thus reduces consumer surplus. In the figure, the tariff reduces the quantity consumed from  $Q_1$  to  $Q_2$ . In other words, the higher price has driven some consumers out of the market. The shaded areas represent welfare loss, while the area T represents government revenue from the application of the tariff. The enlargement of the EU

benefits consumers in member countries as there are no tariffs on internal trade. The deadweight welfare loss can then be regained. These welfare gains are felt almost immediately after accession to the EU.

Some economists argue that enlarging the EU will lead to greater stability. This advantage will be felt most by new member states who sign the Stability and Growth Pact that encourages fiscal responsibility. It ~~very~~ requires member states to have <sup>annual</sup> budget deficits of no more than 3% of GDP and total national debts of no more than 60% of GDP. Having more members will also give the EU more negotiating power at the WTO.

The Schengen Agreement ~~allows for the~~ effectively ~~removes~~ removed border controls within the EU and allows for the free movement of workers within the trading bloc. Increasing the size of the EU would mean that more people would be given the great geographical mobility provided by the Schengen Agreement. Thus, labour, which is an important factor of production, could be allocated more efficiently. Migrant labour can plug significant gaps in labour markets. Some sectors of the UK economy, including the agricultural sector, often cannot find enough domestic workers to employ. The enlargement of the EU ~~will make~~ <sup>has made</sup> it possible for these vacancies to be filled by ~~the~~ European immigrants.

The expansion of the Eurozone has its own advantages. Members of this zone can trade with each other without worrying about the effects of exchange rate fluctuation. Also, consumers in these countries can easily compare domestic prices of goods to



prices in other countries. This brings the market closer to a state of perfect information.

Membership of the EU gives countries a competitive advantage. Without it, many countries, including the UK, may not be able to compete on the world stage.

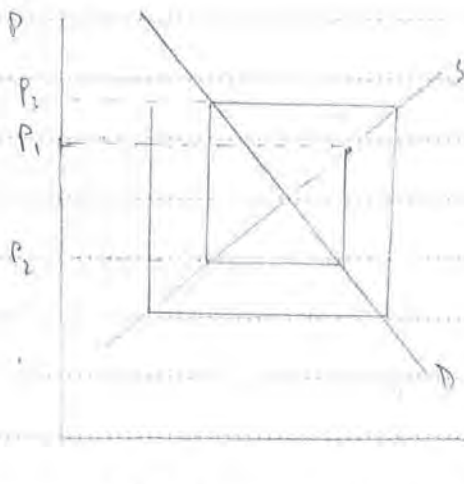
However, it must be noted that joining the European Union has disadvantages as well. Firstly, there is a possibility of a large scale brain-drain as the increased mobility of labour results in the emigration of many university-educated workers. Also, problems arise due to the differing agendas of member states. For example, Germany seems to pursue anti-inflationary policies above all others. It has repeatedly refused to boost domestic demand in order to bail out other EU countries.

Problems can also arise from the interconnectedness of the EU member states, especially since most of them operate under the same monetary authority - the European Central Bank. This interconnectedness can lead to some countries exposed to other countries' economic woes. For example, the Greek debt crisis has had serious repercussions for all members of the Eurozone.

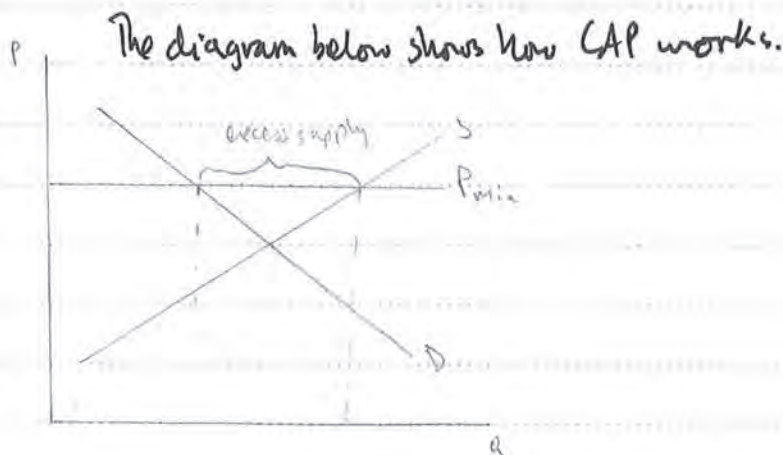
The adoption of the Euro by new member states can have further effects. Current account deficits ~~would not~~ do not necessarily lead to falling exchange rates as the actions of other member countries affect supply and demand of the Euro. This can cause confusion ~~and~~ and lead to balance of payments issues. The core problem is that Europe is not an Optimal Currency Area in the way that Mundell described

it. Members of the European Union do not have perfectly synchronized trade cycles or inflation levels and there is no governing & common fiscal authority. Some economists would argue that these disadvantages go a long way towards outweighing the advantages provided by the enlargement of the EU.

Many of the new member states are heavily involved in agriculture. Therefore, their accession into the EU has placed greater strain on the Common Agricultural Policy. CAP was implemented to protect farmers, ensure food security and provide stable food prices. The diagram below demonstrates what could happen in agricultural markets without CAP or other forms of government intervention.



This exploding cobweb diagram shows the instability of prices, which can drive some farmers out of the market. It assumes that farmers have adaptive expectations and that the supply of crops is perfectly inelastic in the short run.





As shown in the diagram, CAP guarantees farmers a minimum price for their produce. ~~While this does~~ Government buys the excess supply and uses it as buffer stocks. While this does stabilize price, it reduces consumer surplus and has resulted in the EU having exorbitant food prices. Enlargement will only exacerbate this problem.

~~The~~ In addition, there are global considerations we must take into account. Many would argue that enlargement is the only way for the EU to compete with other customs unions, such as the North American Free Trade Agreement. Under NAFTA, many US firms run their basic production facilities cheaply in Mexico. ~~providing~~ Thus, they achieve efficiency savings and have a competitive advantage when it comes to world trade. European firms can only compete with American ones because of the presence of countries that provide cheap labour and raw materials (such as the new member Baltic countries) in the European Union.

We must also remember that the structure of the EU could change dramatically <sup>within</sup> the next 10 years. The WTO currently allows ~~the~~ trading blocs to exist, but the organization's rules and regulations could change. For this reason, we cannot accurately predict how the economic provisions of EU enlargement will pan out in the long run.

We can now see that some of the advantages of European Union enlargement have already been achieved, while others will almost certainly have been achieved in the next decade, especially if the EU enlarges further. However, the EU also causes some market distortions and

membership can have adverse effects. Overall, it seems fair to ~~see~~ assume that ~~means~~ the enlargement of the EU will be largely beneficial to member states over the next 10 years. This is mostly because of the competitive advantages it provides on the world stage, especially with regard to competition with other powerful trading blocs.

A - generally good but lacking depth - places - ~~to~~ L3 15  
 E - rather vague - places + lacking objectivity. Valid attempt to draw conclusion together but lacking depth - ~~of~~ major 129

24

#### Examiner Comment

This candidate begins with a reasonably clear explanation of enlargement and identifies one of the primary aims of the process. They then go on to analyse this aim with some precision. Several other aims are then considered in turn and the analysis is generally accurate and fluent, with some illustration of points by the use of diagrams. Data is also used to contextualise and reinforce the analysis. Generally the analysis is effectively focused on the question, but occasionally the candidate slips into lengthy coverage of issues which are not directly relevant, such as the workings of the CAP.

The candidate offers some evaluative points in the body of the answer but also successfully deals with some new points in the concluding paragraphs. There are some perceptive points relating to the global context and relevant comments made about the limitations of the analysis offered so far. The candidate attempts to consider the ten-year timescale referred to in the question, but is not entirely successful in making these points count.

The answer scored 24/40. The candidate is given credit for clear structure, generally accurate coverage of a good range of relevant issues and use of supporting data. Some of the issues analysed were not directly relevant to the question. It was awarded Level 3, 15/22 for theory and analysis. There are few evaluative points in the body of the answer but the final judgment offers some new points which are generally well made, although the final paragraph adds little. It was awarded Level 2, 9/18 for evaluation.



## Example Candidate Response – Merit

There are several key aims of the EU enlargement. ~~Low interest rates, low national debt, low inflation,~~ ?  
 sustained long term growth and increased efficiency are the main aims. ?  
 Some of these aims have already been achieved in some part but low national debt has been set back by the recent economic climate with countries like Greece with national debt of 18% high above the level which the Maastricht treaty allows. The other aims have been largely successful despite this and it is hoped that increased enlargement will increase growth and efficiency in the future.

Growth has been the fastest to be promoted by EU enlargement. The benefits can be observed in countries like Poland and the other A8 nations which after joining the EU have seen large increases in GDP over a five year period. This is due to several factors such as increased trade and more competitive labour forces. The introduction of the Euro Zone along with enlargement means that the currency is becoming increasingly stable. As such there is less risk for investors and investment in the capital stock has risen promoting medium term growth as shown in figure 1. Increased GDP promotes additional savings which increases investment. In order for there to be long term growth because of enlargement there must be research and development. In the long term growth will be sustained by better technology. This is made more likely with enlargement of the EU as it increases the pool of information and encourages the sharing of information leading to increased technological development. This idea is shown in figure 2. Sustained investment helps to keep interest rates low as firms do not need to encourage further investment.

Efficiency has been increased by the Euro Zone and by the breaking down of trade barriers within the EU. A good example of an industry which has had a large amount of change since the EU began to expand is the airline industry. Before EU expansion and the Euro Zone there were primarily one airline in each country with Monopoly positions. As such they were inefficient due to a lack of competition and funded by the government if creating even less incentive to be self sustaining. After countries joined the EU government intervention in the fashion was disallowed. This meant that airlines were exposed to increased competition. Some firms went out of business and merged with other firms. Some large firms merged with other large firms (for example Liberia and BA) to increase their market share and make themselves more competitive. In the long run there are fewer but larger firms in the industry and all the firms are more efficient due to increased gains from economies of scale. There is also increased allocative efficiency for example in the airline industry firms can fill up empty seats on other airlines with their surplus resulting in increased revenue. This kind of development has been seen in many industries within the EU leading to decreased costs, decreased prices and therefore decreased inflationary pressure another one of the EU's objectives. Figure 3 shows the Competition Curve of the Airline industry.

Inflation has been kept low in several ways. As above increased efficiency and competition has kept inflation low. Also the elimination of tariffs and trade barriers within the EU have cut the cost of trading and the cost of products on the shelf. However inflation has also been kept low to demand side factors as well as supply side factors. Migration as the EU has expanded has resulted in many counter inflationary impacts. Migration of labour both skilled and unskilled have moved in large numbers as the EU has enlarged. Some estimates suggest that Poland sent as many as half a million migrant workers abroad in the first five years of its entrance into the EU. Unskilled labour usually has the effect of filling jobs which local populations don't want to do and allows costs to be cut as migrant work forces will work for less than local ones. In the event of some competition in this income bracket it will result in increased wage flexibility which is deflationary. Highly skilled workers entering the market increase competition in their various fields and thus lower the pressure for increased wages also acting in a counter inflationary manner. There are negative effects of this migration which include the so called brain drain effect which sees the highly skilled work forces of less developed countries such as Poland moving to countries like Germany and the UK leaving the local economy with a large number of job vacancies and not enough



skilled labour. Despite this all A8 countries have seen growth in the last five years. Figure 4 shows the wage differences between two countries and the pressure to migrate due to this factor.

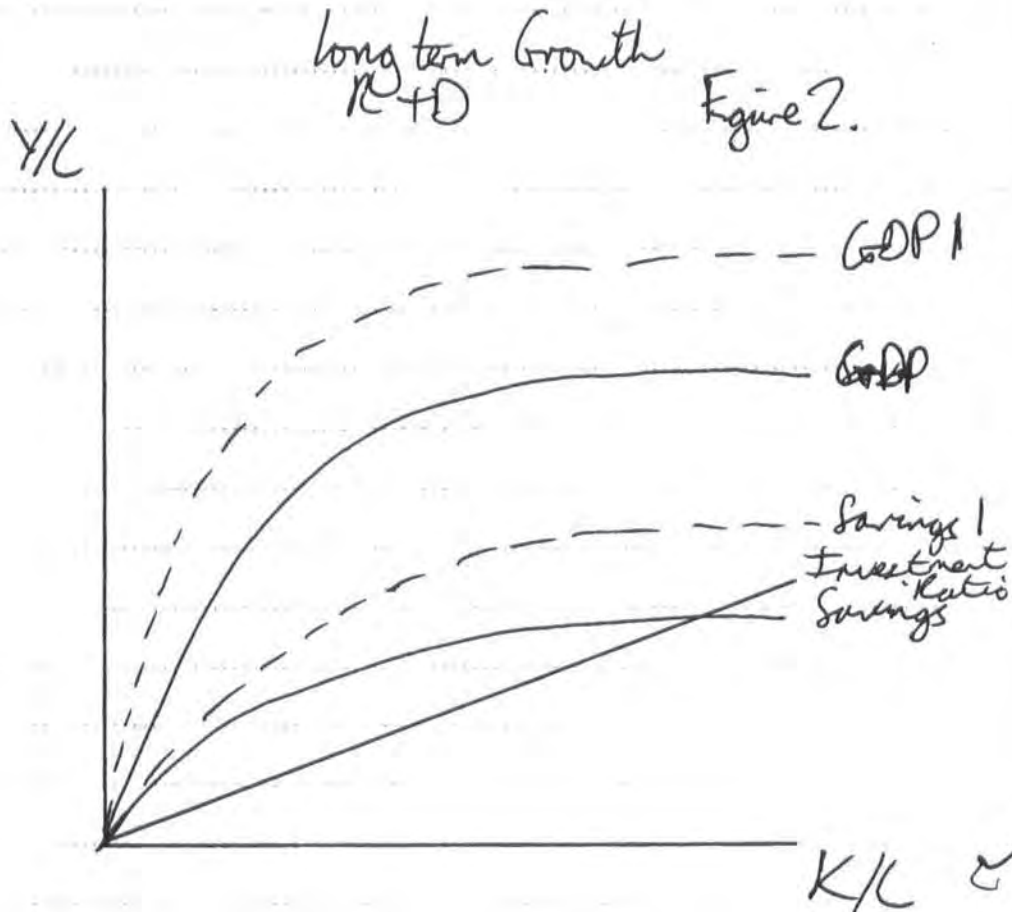
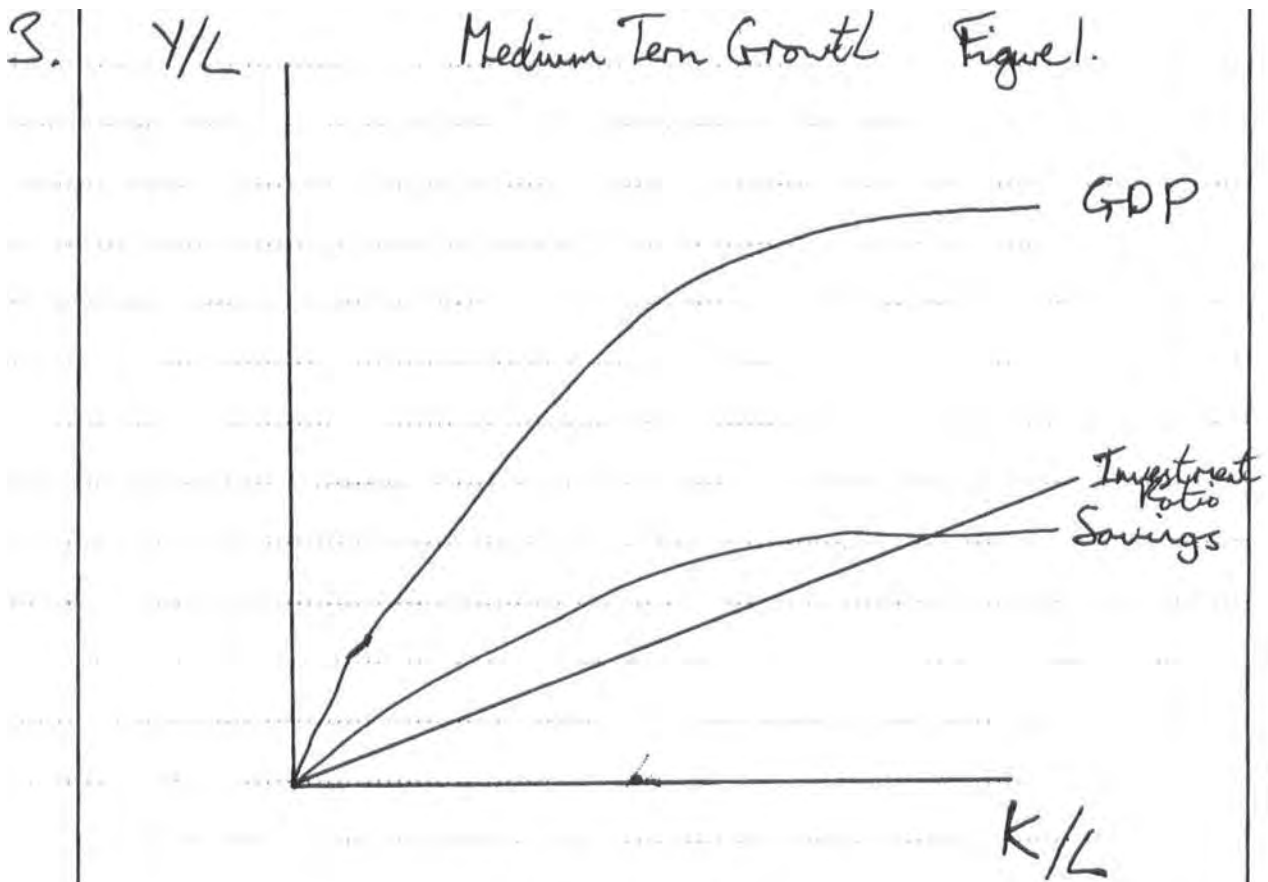
The Euro Zone, increased EU enlargement and increased confidence of investors and firms has not only had positive effects. The increased confidence in the Euro and countries like Germany and France which are responsible for maintaining the currency in the current climate led countries like Greece, Italy and Spain to run up massive debt as a percentage of GDP. Since the EU is largely a one currency zone the result of this irresponsible practice is being born by all. Germany has effectively had to bail out Greece because it didn't adhere to the Maastricht treaty. The question of responsibility has to be raised since there is much less risk in the Euro Zone does it create incentive for countries to act purely in self interest knowing that they are safe from harm as the EU can bail them out and incur the costs. EU enlargement has also not only promoted efficiency. In some areas such as agriculture efficiency has been massively reduced due to the Common Agricultural Policy. 50% of the EU budget for agriculture goes into France. These large subsidies have created incentives for EU farmers to over produce since the government will buy up all excess supply and reduced the incentive for efficiency since the government will buy from farmers at a price well above the market equilibrium. The price floor and subsidy of the CAP is shown in figure 5. This figure shows that the price on the shelves is market price and that the EU covers the excess supply at the price floor incurring a huge cost.

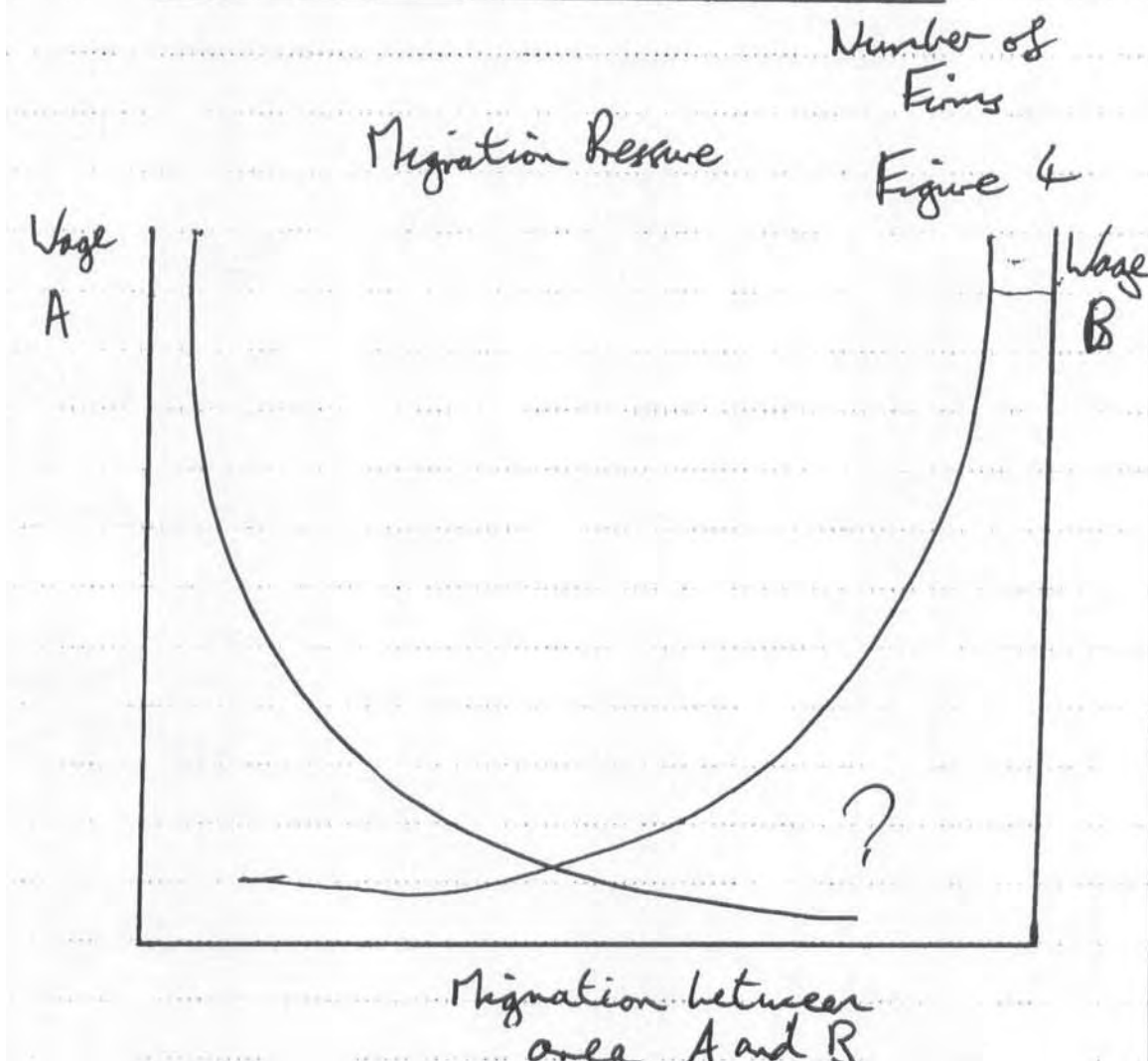
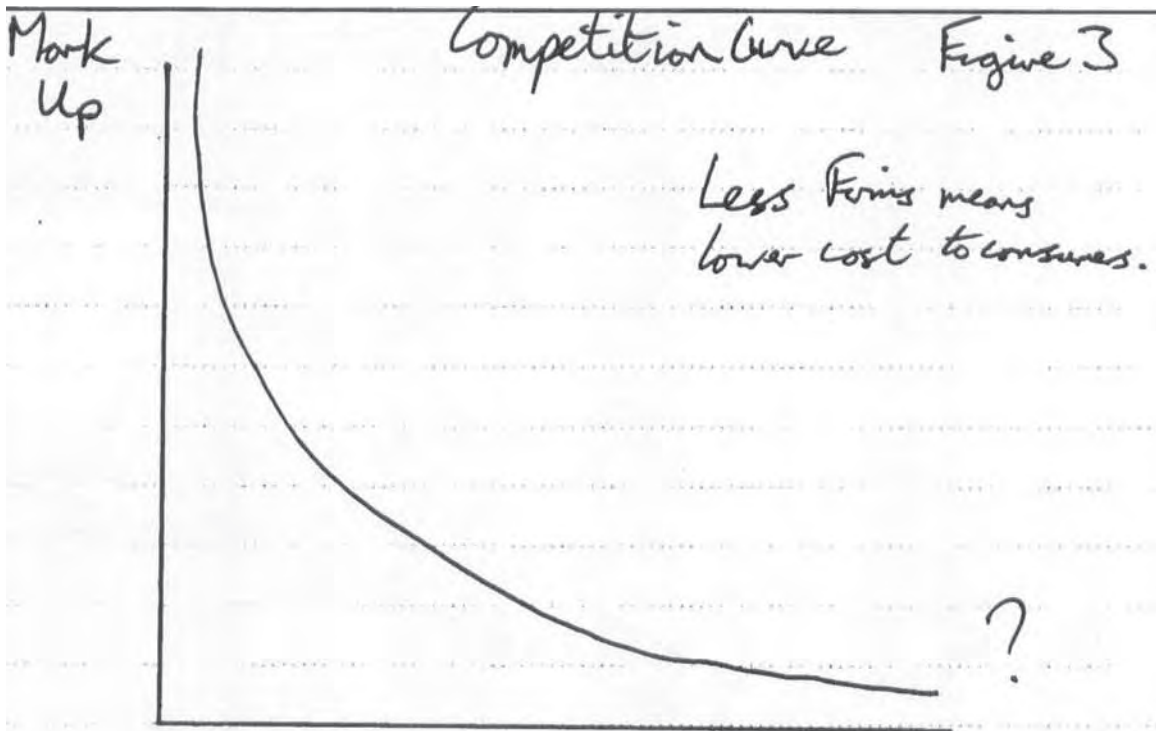
Low interest rates, low national debt, low inflation, sustained long term growth and increased efficiency are all achievable within the next ten years. However in keeping with the business cycle it is likely that in the next fifty years there will be periods of time where these aims are achieved or not achieved based on the current global climate. Due to the Euro Zone there is less that individual countries within the EU can do in times of recession to stimulate their economy due to the central bank. If the EU is unable to deal with the large amount of deficit currently incurred then there may be a break down of the Euro Zone all together as Germany tries to decide whether or not to continue to effectively prop up Europe single handedly. Assuming enlargement with countries like Turkey and Iceland in the next ten years there may be increased growth and efficiency and continued deflationary pressure due to migrant labour forces and the like. All of the goals of the EU can be met to a great extent in the next ten years apart from debt which may take longer to get under control in countries such as Greece.

A - some clear points but lacking depth in other areas + focus on the question 12 12  
 E - some evaluation points but limited final conclusions lacking rigor 12 8

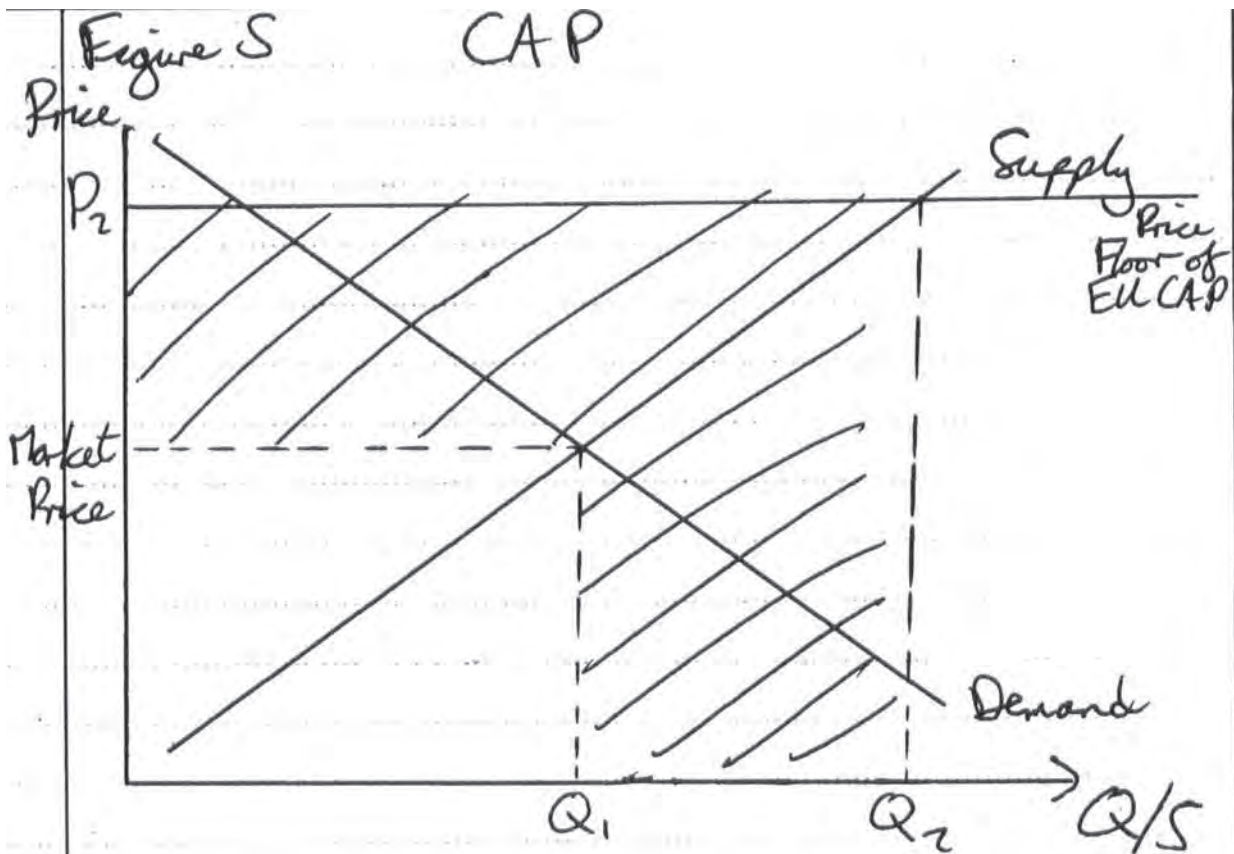
(20)











### Examiner Comment

This response opens with an attempt to clearly identify the aims of enlargement, but is only partially successful. The candidate then goes on to analyse the theory behind some of these aims and generally succeeds. However, there are some errors of fact, some points which are not relevant to the discussion and some points which lack clarity.

The candidate attempts to support their arguments with data and diagrams. However, the diagrams are generally not explained or utilised in an effective way to further the credibility of the analysis. Coverage of the Euro and the CAP are both potentially relevant in this context, but the candidate does not successfully link them into the question.

There is some evaluation in the body of the answer. The candidate also makes an attempt to evaluate against the aims of enlargement stated in the first paragraph. However, as these aims are inaccurate, the conclusions are weakened. The remainder of the conclusion is concerned with discussion of the Euro and speculation about future enlargement, neither of which add anything of significance to the answer.

The answer scored 20/40. The candidate is given credit for some good passages of analysis and the use of relevant diagrams. However, the candidate is not very selective in their use of material and does not use the diagrams to their full advantage. It was awarded Level 3, 12/22 for theory and analysis. There are some clear evaluation points in the body of the answer and an attempt is made to conclude logically, but this is flawed and the final conclusions lack relevance and rigour. It was awarded Level 2, 8/18 for evaluation.

## Example Candidate Response – Pass

~~PLAN~~ ~~Scrappage scheme~~ EU ~~A/c union / freer trade movement~~

3 The EU was expected to bring about many economic advantages when first created. As more members continue to join the union, the scope of these benefits increase and this essay will investigate if such enlargement will have brought about these advantages in the next ~~ten~~ years.

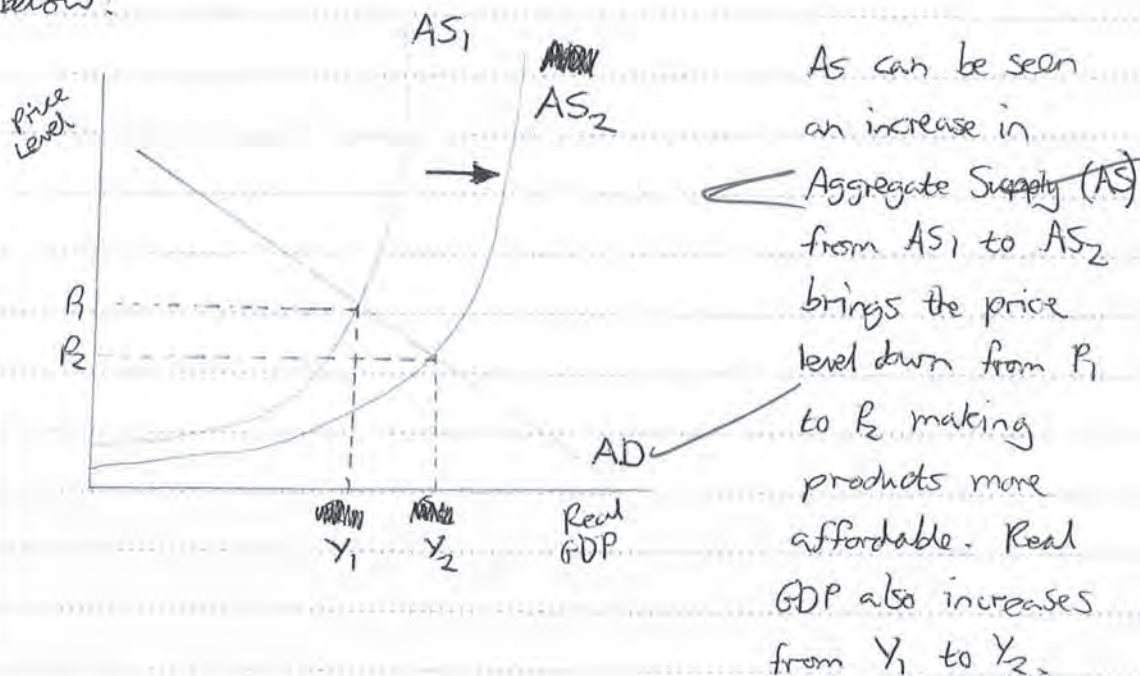
One of the principal ideas behind the union was that there could be freer movement of people and goods leading to a more efficient Europe where people could work where they are most needed and goods could be imported by countries who most need them. It would seem that this advantage is already starting to take place with European trade increasing every year perhaps due to the increasing ease of trade using the same currency, the Euro.

However this advantage is yet to be fully exploited with protectionist policies well documented in the car industry among countries such as France. The new UK government seeks to control immigration by imposing a cap on the annual figure. As a result, it seems that ideas of a freer Europe will continue to bring about economic advantages but it may not be fully exploited.

Another expected advantage is the ability of countries to specialise in goods that they have a comparative advantage in. This is where a country has a better trade-off with other goods when producing a certain



good than another country. The theory of absolute and comparative advantage states that both countries involved will produce more goods in total without production in either country decreasing. The UK, for example, is continuing to lose its manufacturing industry but is one of the leaders in the world when it comes to the finance sector. So there is evidence of specialisation. The increase in supply of goods as discussed earlier is shown below:



Some would argue that the EU has not contributed to such economic advantages that significantly with countries such as China, the biggest trader in the world, continuing to dominate production of <sup>certain</sup> goods in places such as the UK. However, it seems that as the EU expands, the ability to specialise will increase which will surely ~~bring~~ economic advantages in the next ten years.

Another ~~consideration~~ consideration of an economic advantage is an

attempt to establish a strong and stable currency. Most countries in the EU use the Euro as their official currency such as Spain and France. To evaluate whether this advantage will have been achieved in the next ten years, it is necessary to look at past data and to examine current situations. The Euro has strengthened in the past few years quite dramatically against the US Dollar and the pound although there were concerns recently when Greece and its large debts deterred investment in to the Euro. That said, the Euro is considered a fairly strong and stable currency due to the large amount of countries using it and the advantage of this is that it will attract investment, causing money to flow into the EU <sup>(causing economic growth)</sup>. As a result, we can expect to see this advantage occurring within the next few years.

A point touched on in the first paragraph is that of jobs.

A final economic advantage this essay will consider is lower unemployment since people can work where they are needed. For example, if the UK has a shortage of scientists then people from Scandinavian countries in the EU are free to move to the UK if they cannot find a job in their country. Unemployment in the UK continued to fall below levels that economists thought was not possible but the recent recession has caused the level to stand at 8 million. As a result, the theory seems

logical but a global crisis within the next ten years could prevent this economic advantage from occurring.

To evaluate, we can expect several economic advantages to be achieved to some extent within the next ten years. However, it is difficult to reach any firm conclusions



Since the extent of EU enlargement and global financial recovery in the next ten years is unknown, the idea of free trade seems to have already been brought about to a large extent by the EU but potential protectionist policies could halt this trend. However, the idea of total free trade seems impossible to achieve and this may be an advantage in itself due to the need for infant industries to become self-sufficient over time. The Euro is becoming a stronger currency and global trade is increasing rapidly so we can ~~expect~~ anticipate the expected advantages of EU enlargement to be achieved to a large extent in the next decade but realistically, only time will tell.

A - L2 Limited understanding of objectives of enlargement, ~~So~~ relied analysis on few countries 9  
 E - L2 Few clear ~~add~~ evaluative points, a vague final conclusion ~~by~~ ~~placidly~~ ~~opposed~~ ~~the~~ ~~the~~ 7

16

### Examiner Comment

This response begins with a general introduction to some of the purposes of the EU which, whilst of relevance, is not the central thrust of the question. Examples which attempt to place the issue in context are weakened by lack of clarity or relevance. There follows a reasonably accurate explanation of some of the underpinnings of the EU, but they are also not applied to the enlargement context. This theme continues with discussion of the Euro and unemployment, once again not placed in the enlargement context.

The candidate offers some evaluative commentary in the body of the answer and highlights some limitations and drawbacks of the EU project. They also make a valiant attempt to come to a conclusion at the end, but the comments made are very general and don't add anything of significant merit.

This answer scored 16/40. The candidate is given credit for valid analysis of some general issues relating to the EU. However, the candidate has not really addressed the question and tailored their arguments to fit the context of EU enlargement. It was awarded Level 2, 9/22 for theory and analysis. There are a few evaluation points in the body of the essay which are generally clearly explained. However, the final conclusion is vague and lacks support. It was awarded Level 1, 7/18 for evaluation.

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