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AQA

General Certificate of Education
January 2011

ECONOMICS   ECON3

Unit 3:   Business Economics and the
             Distribution of Income

Final

Mark Scheme

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

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

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Advanced Level Economics Unit 3

General Instructions

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

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

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

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

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

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AQA ADVANCED LEVEL (A2) ECONOMICS

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

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

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THE KEY TO BE USED WHEN USING THE LEVELS MARK SCHEME

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

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

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

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

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

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

Synoptic Assessment

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

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

QUALITY OF WRITTEN COMMUNICATION

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

Candidates will be assessed according to their ability to:

- ensure that text is legible, and that spelling, grammar and punctuation are accurate, so that meaning is clear

- select and use a form and style of writing appropriate to purpose and complex subject matter

- organise information clearly and coherently, using specialist vocabulary when appropriate.

No specific marks are awarded for QWC.

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

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1   THE GLOBAL CONTEXT   **Total for this question: 40 marks**

> **01**   Using **Extract A**, identify **two** significant points of comparison between sales of digital and physical formats over the period shown.   *(5 marks)*

Award one mark for each valid point made and two marks for the supporting reference to the data, up to a maximum of 5 marks. Points might include:

- Download singles have increased ($802 million to $1023 million), while CD singles have fallen by a greater percentage from a much smaller base ($12 million to $4 million).

- CD albums have fallen ($7452 million to $5471 million) while download albums have risen ($425 million to $569 million) but CDs are still more significant than downloads in terms of value

- Digital music video has not quite doubled ($28 million to $41 million) while CD/DVD has more than halved ($485 million to $219 million)

- Ringtones and mobile downloads have declined slightly ($881 million to $816 million) while, from a lower base, vinyl albums have more than doubled ($23 million to $58 million)

- Total physical sales have declined, but physical sales of $5752 million are still more significant than digital sales of $2449 million

Award a maximum of **1 mark** for use of data if $ sign is not shown or 'millions' not mentioned.

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

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

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

MAXIMUM FOR QUESTION 01: 5 MARKS

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02 Explain the term 'Barriers to entry' (**Extract B**, line 20) **and** analyse **two** ways in which technological change can affect entry into creative industries such as recorded music.

(10 marks)

The question says '**such as recorded music**', so references to other industries can be rewarded if relevant.

For candidates who:

Explain (eg define/describe) barriers to entry
- eg in terms of technological or economic conditions of a market which raise the costs of firms entering a market **Up to 4 marks**

Analyse **two** effects of technological change which either increase or reduce barriers, for example:
- an argument to the effect that digital/ virtual products are 'weightless' (this word need not be used) (1 mark) and can be brought to market/ retailed at lower cost (1 mark) than traditional, physical products (1 mark) thus reducing entry barriers (1 mark), increasing competition (1 mark).
- economies of scale are less important when small firms can have easy access to mass markets through the internet, thus reducing barriers
- technological change can increase the influence of product differentiation, eg by monopolising a new industry format (Blu-Ray), or building in features to thwart industry-wide standards (mobile phone chargers, printer ink cartridges); all the above increasing barriers
- the question refers to Extract B. However, it is perfectly legitimate for candidates also to refer to Extract C where there is mention of legal barriers. Technology can be used to support these and therefore reinforce barriers to entry and restrict access to products (make them more excludable), eg through encryption (satellite TV). On the other hand, technology can be used (often illegally) to circumvent barriers.

Up to 5 marks for each of the points made
(1 mark for identification and up to 4 marks for elaboration)

If more than two ways are analysed, reward the best two.

Make relevant use of a diagram (1 mark for labelling, up to 2 marks for correctly showing relevant information) **Up to 3 marks**

Maximum of 8 marks if only the second part of the question is attempted.

MAXIMUM FOR QUESTION 02: 10 MARKS

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03	'Although monopolies are generally regarded by economists as undesirable, legally-backed monopolies created by IPRs can be justified as being in the public interest' (**Extract C**, lines 12-14). Evaluate the case for stronger action by governments to protect the monopoly power of firms involved in UK creative industries. *(25 marks)*

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

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

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

Issues and areas for discussion include:

Introductory:
- definintion of monopoly
- examples of monopolies
- explanation of 'legally backed' monopoly (IPR as an entry barrier)
- discussion of the idea of 'public interest'

Developing a response to the question:
- General advantages/ justification of monopolies (economies of scale, etc)
- IPRs are justified because
  - They support the creative industries
  - Reference to economic importance of these industries (Extract C)
  - Innovation, creativity, dynamic efficiency
  - Return on risky investment
- Arguments against 'stronger action' (general arguments against monopoly applied to the specific case of IPRs), eg
  - Artificially high prices
  - Loss of efficiency
  - Reduced consumer choice

Evaluation:
- role of government/ legal sanctions

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- market failure versus government failure
- producer versus consumer sovereignty
- alternatives to the legal approach, eg
  - o Regulators
  - o Leave it to market forces
  - o The need for international/global action/agreement

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

Also give credit for:
- use of data
- relevant use of evidence and examples not contained in the data
- diagrams
- an overall judgement on the issues raised

USE THE LEVELS MARK SCHEME ON PAGES 4 & 5

MAXIMUM FOR QUESTION 03: 25 MARKS

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

04	Using **Extract D**, identify **two** significant points of comparison between the data shown in the two bar charts. *(5 marks)*

Award one mark for each valid point made and two marks for the supporting reference to the data, up to a maximum of 5 marks. Points might include:

- construction is the third largest in terms of migrant employment in the sector (30%) and the third largest sector shown in terms of UK employment (9%)
- manufacturing is the fourth largest in terms of migrant employment in the sector (15%) and the second largest sector shown in terms of UK employment (10%)
- agriculture is the largest in terms of migrant employment in the sector (95%) and the smallest sector shown in terms of UK employment (2%)
- distribution etc is the second largest in terms of migrant employment in the sector (55%) and the largest sector shown in terms of UK employment (20%).

Award a maximum of **1 mark** for use of data if % sign is not shown.

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

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

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

MAXIMUM FOR QUESTION 04: 5 MARKS

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> **05** **Extract E** gives examples of wage differentials.
>
> Explain what is meant by the term 'wage differentials' **and** analyse **two** reasons, suggested by economic theory, why wage differentials occur. *(10 marks)*

For candidates who:

Explain (eg define/describe) wage differentials
- eg in terms of the payment of a different wage rate (or price of labour) to different groups of workers, and/ or between individual workers within the same occupational group **up to 4 marks**

Analyse **two** reasons for wage differentials, for example:
- differences in the supply of labour (1 mark) such as inter-occupational skills (1 mark), training (1 mark), responsibilities (1 mark) and elasticity of supply (1 mark)
- differences in the demand for labour (derived demand)
- differences in inter-industry marginal revenue productivity
- growth rates/competition between industries (eg the media are a growth industry, the DG of the BBC claims he could earn more elsewhere)
- regional differences/differentials encourage mobility
- non-market factors, eg government intervention, trade unions, professional groups
- discrimination. **up to 5 marks per reason analysed** **(1 mark for identification and up to 4 marks for analysis)**

Candidates who treat demand and supply as one inter-linked reason can still gain credit for a second reason

If more than two ways are analysed, reward the best two

Make relevant use of a diagram (1 mark for labelling, up to 2 marks for correctly showing relevant information). **Up to 3 marks**

Maximum of 8 marks if only the second part of the question is attempted.

MAXIMUM FOR QUESTION 05: 10 MARKS

06 'The European Union (EU) wishes to improve the mobility and flexibility of labour' (**Extract F**, line 6).

Evaluate the possible **costs** and **benefits** for the UK economy of the free movement of labour within the European Union. *(25 marks)*

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

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

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

Issues and areas for discussion include:

Introductory:

- distinction between mobility and flexibility
- mobility: occupational, geographical
- flexibility: hiring and firing, skills, etc.

Developing a response to the question:

- Costs to UK economy, eg
    - Wages depressed by cheap influx of labour
    - Shortages re-appear when migrants return home
    - Loss of spending power when earnings are repatriated
- Benefits to UK economy, eg
    - Better information
    - Recognition of UK qualifications in EU
    - Job opportunities in EU for UK workers
    - Possible harmonisation of working conditions, tax rates, pension rights, health services
    - Skills gaps filled
    - Labour shortages alleviated

Evaluation:

- benefits versus costs

- discussion of the 'proper' role of government/NHS/other bodies
- Consideration of monetary/ non-monetary factors (Extract F suggests that a 'scheme' was considered necessary to attract dentists)
- complications arising from cross-border movements, eg
    - 'British jobs for British workers'
    - Difficulty of long-term stability, when workers can leave as easily as they can arrive
    - Effects on economic welfare in the countries that dentists/other workers leave (the question is UK centric, but there is such a thing as 'interdependence' – what if other countries respond by trying to 'poach' key UK workers?)
- Other considerations
    - Pressure on housing/schools and benefits
    - Possible multiplier effects
    - Implications for government tax revenues
    - Impact on wage inflation and economic growth
    - Significance of 'flexibility' in general.

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

Also give credit for

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

USE THE LEVELS MARK SCHEME ON PAGES 4 AND 5

MAXIMUM FOR QUESTION 06: 25 MARKS

SECTION B

Question 3   **Total for this question: 40 marks**

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07 Many of the world's large companies, such as *Microsoft* and *Ryanair*, started out as small businesses.

Explain the different ways in which a firm can grow in size.   *(15 marks)*

For candidates who:

Explain (eg define/describe) how the size of a firm can be measured (eg in terms of capital employed, profits, market share, employment).   **Up to 4 marks**

Explain the different ways in which a firm can grow, eg
- internal (organic) growth (1 mark) which can arise through, for instance, selling to an expanding market (1 mark), or achieving greater market share (1 mark) and can be financed through means such as ploughed-back profits (1 mark) or borrowing/leverage (1 mark)
- external growth (mergers/ takeovers)
- vertical integration
- horizontal integration
- diversification (lateral/ conglomerate integration)

                            Up to 5 marks per issue explained
         (1 mark for identification and up to 4 marks for the explanation)

Make relevant use of supporting diagram(s)   **Up to 2 marks per diagram**
                            To a maximum of 4 marks

                         MAXIMUM FOR QUESTION 07: 15 MARKS

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08 Discuss whether the objective of profit maximisation becomes less important than other possible objectives as a firm grows in size. *(25 marks)*

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

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

A candidate who makes little or no reference to size of firms should be limited to a maximum of 19 marks.

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

Issues and areas for discussion include:

Introductory:
- the meaning of profit
- profit maximisation as an objective (MC=MR)
- other possible objectives, eg
  - Revenue/ sales maximisation
  - Output maximisation
  - Welfare maximisation (supply maximisation/public service)
  - Satisficing

Developing a response to the question:
- Reasons why small firms might be more profit-orientated, eg
  - Entrepreneurial attitudes
  - Need profits to grow (fewer sources of finance than large firms)

- Reasons why large firms might become less profit-orientated, eg
  - Inertia/ lack of competition
  - A 'quiet life' (wish to avoid attention from competition authorities)
  - Greater divorce between ownership and control

Evaluation:
- consideration of why one of the other possible objectives might increase in importance

(eg Bill Gates focuses on charitable activities, leaves profit chasing to others)
- questioning whether profit maximising becomes less important (eg *Ryanair* appears to follow every possible opportunity to charge new prices)
- possibility that many firms, large or small, follow a range of objectives
- and that none of the other objectives are possible if a firm is unprofitable
- short term/long term perspectives on the importance of profit maximisation

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

USE THE LEVELS MARK SCHEME ON PAGES 4 AND 5

MAXIMUM FOR QUESTION 08: 25 MARKS

Question 4   **Total for this question: 40 marks**

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09 'Oligopolistic markets, such as supermarkets or car manufacturing, can be defined in terms of market structure or in terms of market conduct (behaviour)'

Using examples of particular industries, explain this statement.   *(15 marks)*

Candidates do not have to cover either named industry. They can introduce an example of their own.

For candidates who:

Explain (define/describe) 'oligopoly' in general terms, eg
- Oligopoly can be defined as competition among a few sellers (2 marks), and is a feature of 'concentrated markets' (1 mark). Concentration can be indicated by means such as market share (1 mark) of, say, the 5 largest firms in the market (1 mark)

Up to 2 marks for a definition and up to a further 2 marks for mentioning how oligopoly can be measured, e.g. measuring the market share of a group of the largest firms (the phrase 'concentration ratio' should be rewarded but need not be used)
Up to 4 marks

Explain 'structure', eg in terms of
- the number of firms
- market shares
- barriers to entry

Explain 'conduct (behaviour)', eg in terms of
- collusion /competition
- interdependence/uncertainty/gaming behaviour/reactive market behaviour
- price leadership/price following
- price seeking/price stickiness/non-price competition

Up to 5 marks per explanation
(1 mark for identification and up to 4 marks for elaboration)

Make relevant use of a supporting diagram (eg kinked demand curve)
Up to 2 marks per diagram to a maximum of 4 marks

If there is no reference to particular industries, award a maximum of 10 marks.

MAXIMUM FOR QUESTION 09: 15 MARKS

10	Assess the view that making an oligopolistic market more contestable is the best way to improve the efficiency of that market.	*(25 marks)*

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

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

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

Issues and areas for discussion include:

Introductory
- definition/explanation of efficiency: allocative, productive, dynamic
- definition/explanation of contestability, eg in terms of a market where new entrants face similar low barriers, but particularly in terms of costs to existing firms and where firms can exit easily, in particular, upon exit, firms can recoup their capital costs.

Developing a response to the question
- Consequences of contestability, eg
  - Established firms find it difficult to earn supernormal profits, as these will be eroded by new entrants or
  - The mere threat of new entrants will alter conduct (behaviour)
  - Oligopolistic markets might become less oligopolistic/ more competitive
  - Or might resort to collusion/ cartels, etc, if regulatory framework is weak
  - Firms might behave in some ways (eg pricing) as if in perfect competition
  - Firms might also become more allocatively/productively efficient
- Examples of contestability/ non contestability, eg using the cases of supermarkets, car manufacturing

Evaluation
- consideration of alternative ways of improving efficiency
- role of government
- further examples, eg The National Lottery, theoretically a contestable market, but in practice has high entry and exit costs, and few competitors while the franchise runs
- an overview statement, eg to the effect that a market might 'look' like an oligopoly but behave like a price taker (car manufacturing), at least partly due to contestability

- the possibility that truly contestable markets might be as difficult to find in the real world as perfect markets
- the question of how to create contestability: eg de-regulation might lead to monopoly rather than competition
- use of MSC/MSB analysis to consider the difference between efficiency in private and social terms.
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Also give credit for
- reference to the UK and/ or other economies
- diagrams
- an overall judgement of the issues raised.

USE THE LEVELS MARK SCHEME ON PAGES 4 AND 5

MAXIMUM FOR QUESTION 10: 25 MARKS

Question   **Total for this question: 40 marks**

> **11**   'Imperfect information may lead to market failure.'
>
>   Explain how imperfect information may result in the failure of markets for merit and
>   demerit goods.   *(15 marks)*

For candidates who:

Explain (eg define/describe) 'market failure', eg in terms of failure to reach an optimal
allocation of resources, and 'imperfect information', e.g. in terms of a missing feature of a
'perfect' market (where 'perfect information' on the part of both buyers and sellers is assumed)
or merit and demerit goods   **Up to 4 marks**

Explain linkages between imperfect information and the consumption of merit/ demerit goods,
eg
  * the difficulty of measuring externalities
  * consumers might, for example, base decisions on whether to use a car on the basis of
    average rather than marginal costs
  * in the absence of price signals or regulations, the socially sub-optimal course of action
    might seem rational to the consumer
  * some goods are excludable (eg road space) but are treated by the government as
    'public goods', whereas the arguably more environmentally friendly option (rail
    transport) is charged as a private good. This is related to 'information' in the sense that
    inappropriate 'signals' are being sent out
  * asymmetric information (doctor/patient; professor/student)
  * short term versus long term (eg long term effects of drinking alcohol)
  * markets can tell us that, say, oil is in demand now and coal is not; they do not predict
    demand in 20 years' time
  * lack of awareness of all costs and benefits.
                                          Up to 5 marks per issue explained
                       (1 mark for identification and up to 4 marks for the explanation)

Make relevant use of supporting diagram(s)
                            Up to 2 marks per diagram to a maximum of 4 marks

                                MAXIMUM FOR QUESTION 11: 15 MARKS

12	Discuss whether markets alone can be relied upon to reduce the problems of environmental pollution. *(25 marks)*

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

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

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

Issues and areas for discussion include:

Introductory
- an explanation of the problems in terms of MSC/MSB analysis
- a clean environment as a public good
- environment can be damaged by market forces (ozone layer, coal tips)
- environment can be protected by market forces (property rights/the 'tragedy of the commons')
- polluting activities and demerit goods.

Developing a response to the question
- What markets can do alone, eg
    - o   Treat a clean environment as a scarce resource
    - o   Supply and demand, price incentives
    - o   Assertion of property rights
- How markets can be 'nudged' by government, eg
    - o   Carbon trading/ pollution permits
    - o   Road pricing
    - o   Taxation (the polluter pays)
    - o   Creation of property rights where they do not exist
    - o   Creation/assertion of communal/societal rights (eg a right to clean air)
- Circumstances where governments try to avoid/replace markets, eg
    - o   Command and control methods
    - o   Bans and regulations

Evaluation
- command and control versus market based policies

- market failure and government failure
- equity implications of reliance on markets (eg costs and benefits might accrue to different people/groups/countries).

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

USE THE LEVELS MARK SCHEME ON PAGES 4 & 5

MAXIMUM FOR QUESTION 12: 25 MARKS