

Economics

Advanced GCE **A2 7812**

Advanced Subsidiary GCE **AS 3812**

Mark Schemes for the Units

June 2009

3812/7812/MS/R/09

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Advanced Subsidiary GCE Economics (3812)

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2881 The Market System

- (a) (i) Describe what is meant by a market.

Where or how buyers and sellers meet (1) for the purpose of exchange or trade (1). For one mark any means by which buyers and sellers are brought together for trade or exchange

(2)

- (ii) How is the price of package holidays determined in the market?

Where the demand and supply of the good or service are equal or interact (2). Award 1 mark for demand **and** supply only.

(2)

- (b) (i) Using the information provided, state and explain two reasons for the fall in demand for package holidays.

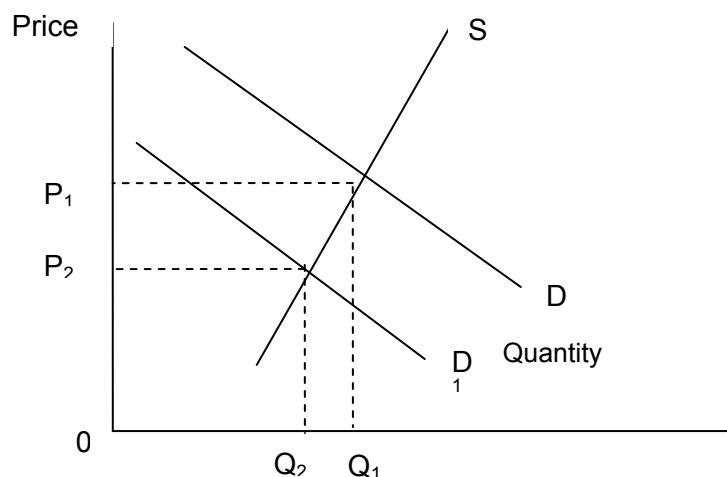
The information provided gives three reasons for a shift in demand:

- the huge growth of low cost flights (\uparrow in substitutes)
- more bookings being made on the internet (Δ in taste)
- 'silver surfers' in particular have reduced their demand

1 mark for identification of any of the above points plus 1 further mark for an explanation as to how this has affected the demand for conventional package holidays. Must explain why there has been a fall in demand. (no credit for Δ price leading to movement along Demand Curve)
2x2 marks.

(4)

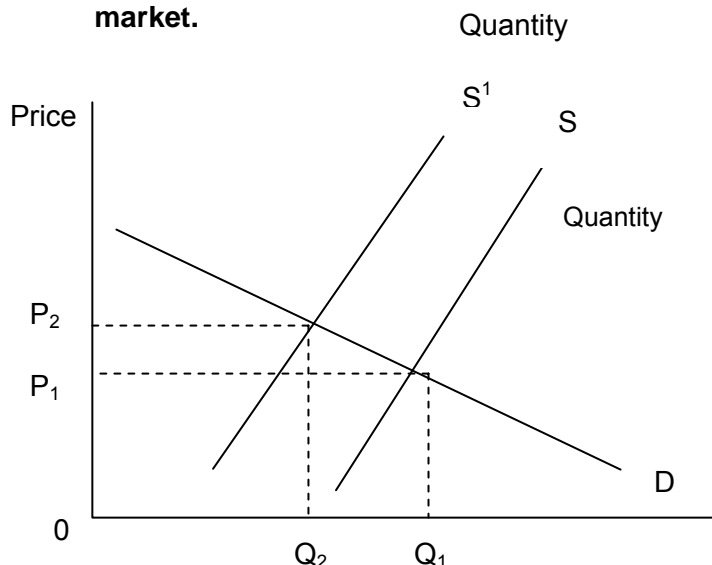
- (ii) Using a demand and supply diagram, show how the fall in demand for package holidays has affected the market price.



Award 1 mark for correct axes
Award 1 mark for downward shift of D
Award 1 mark old equilibrium price
Award 1 mark new equilibrium price

(4)

- (c) **Tour operators have reduced supply in order to maintain prices. Using a diagram, explain the effect of a reduction in supply on the market.**



For the diagram,

Award 1 mark for the shift to the left of S

Award 1 mark for the new equilibrium price (this should be above the old price) and 1 mark for new equilibrium quantity (this should be below the old quantity) (Maximum 3 marks)

For explanation,

Award 1 mark for analysis of the reduction in supply, ie shift to left of S

Award 1 mark for analysis of the final effect on price and quantity

Award 1 mark for recognition that the overall effect depends upon the extent of the fall in S

Award 1 mark for recognition of the impact of elasticity of demand (Maximum 3 marks)

(5)

- (d) (i) **Define the term price elasticity of demand.**

For a correct definition eg the responsiveness of demand to a change in price – 2 marks.

Accept a correct formula – 2 marks.

Award 1 mark for less than precise definition which for example does not recognise change.

(2)

- (ii) **Explain why the price elasticity of demand for package holidays 'is becoming more price elastic'. (lines 14-15)**

The main reason is due to the increased availability of substitutes such as holidays booked on the Internet, people booking independently and increased competition.

Award 1 mark for recognition of substitute

Award 1 mark for an appropriate example

Award 1 mark for an understanding of 'increasingly price elastic'

Award 1 mark for an explanation of how the increased availability of substitutes affects price elasticity of demand.

Award 1 mark for the impact of time, improved consumer knowledge or other valid explanation.

(4)

- (e) **Comment on one alternative objective to profit maximisation which package holiday firms might pursue in the current market conditions. (lines 25-27).**

Up to 3 marks for an analysis of alternative objectives such as

- survival in a competitive market
- satisficing
- sales maximisation
- revenue maximisation
- loss minimisation in short run

1 mark for recognition plus 2 further marks for analysis

Up to 3 marks for an appropriate comment such as

- Firms might be looking to survive in the current market situation with a view to maximising profits later
- Firms may leave the industry and move into another area of business
- Problems of knowing the profit maximising position
- Impact of changing market structure (or regulation) on firms' ability to choose and meet goals

(6)

- (f) (i) **Using examples from the information provided, explain the difference between the fixed costs and variable costs of a package holiday.**

Examples of fixed costs – flights, accommodation (1)

Examples of variable costs – airport transfers (1)

Award 2 marks for a clear explanation of the difference in terms of economic theory, for example,

- fixed costs do not change with output
- variable costs change directly with output

Award 1 mark for a less clear explanation.

Note that in the data, fuel is classed as a fixed cost (line 21).

(4)

- (ii) **Discuss the likely effects of a substantial increase in the cost of aircraft fuel on the market for package holidays.**

The cost of aircraft fuel is around 53 per cent of the total costs of a package holiday. It is, therefore, substantial and any increase in fuel costs will increase the cost of flights. The most likely outcome of which is an increase in the price of a package holiday. There would seem to be little opportunity to absorb the increase due to the highly competitive nature of this business. Relevant points of discussion could be:

- the cost of all flights will presumably be affected, so the rise in price affects all tour operators
- the rise will also apply to the cost of flights booked on the Internet
- the extent of the price increase of package holidays will depend on the increase in the price of fuel and the price elasticity of demand for package holidays
- the rise in price of aircraft fuel could prompt further firms to leave the industry

(12)

Level 4	For a discussion of the likely effects of a substantial increase in the cost of flights	(7 - 12)
Level 3	For an analysis of the likely effects of a substantial increase in the cost of flights	(5 - 6)
Level 2	For application and critical understanding of the likely effects of a substantial increase in the cost of flights	(3 - 4)
Level 1	For a description of the likely effects of a substantial increase in the cost of flights	(1-2)

Possible subject examples for levels 1-4**Level 4 (7-12 marks)**

Answers at this level should include at least one of the bullet points stated earlier. One such point well argued can get 9 marks. For 10-12 marks, other points should be incorporated. . QWC applies to this question.

Level 3 (5-6 marks)

An analysis of the impact of the substantial increase in the price of aircraft fuel is required. **For 6 marks** this analysis should recognise the **price elastic** nature of the demand for package holidays. So, a large rise in price is likely to result in an even greater fall in the quantity of holidays demanded.

Level 2 (3-4 marks)

Such answers should develop the basic level 1 statement by drawing upon the material provided. This should refer to

- the cost of aircraft fuel is two thirds of fixed costs
- this approximates to 53% of total costs service typically fixed costs can be up to 80% of the price of a package holiday.

Level 1 (1-2 marks)

For a basic description that service aircraft fuel is the largest cost item, it follows that a substantial increase in the cost of fuel will increase the price of package holidays.

Specification Grid

	a(i)	a(ii)	b(i)	b(ii)	c	d(i)	(d)(ii)	e	(f)(i)	(f)(ii)	Total
AO1 Target: 13-14	2		2			2	2	1	2	2	13
AO2 Target: 13-14			2	2	2		2	2	2	2	14
AO3 Target: 9		2		2	3					2	9
AO4 Target: 9								3		6	9

2882 Market Failure & Government Intervention

(a) (i) Define the term 'external cost'. [2]

A cost which is imposed upon a third party (2 marks)

A cost imposed upon someone outside the decision making process (2 marks)

A negative effect upon a third party (2 marks)

A negative spillover effect (2 marks)

Where social costs exceed private costs (2 marks)

Where innocent parties/groups are negatively affected by the actions of others
(1 mark – fails to explicitly develop idea of 3rd parties)

A cost imposed upon someone else (1 mark)

A cost to the public/society (1 mark)

A spillover effect (1 mark)

A cost to someone outside of the market (1 mark)

A vague idea which lacks clear reference to both third parties and negative impact (0 marks). Likewise, simple reference to a negative externality alone does not receive any credit.

(ii) Using the article, identify ONE possible external cost that might arise from the expansion of Stansted Airport. [1]

1 mark for identification of any of the following factors from the article (note: the factor identified must be taken from the article)

Increase in noise pollution/loss of peace and quiet

Increase in carbon dioxide/greenhouse gas emissions (accept "air pollution")

Increase in nitrogen oxide emissions

Greater chemical emissions

Damage to ancient trees

Damage to the "historic and scientific values of the forest"

(b) Explain why air travel is classed as being a private good.

[4]

2 marks for the identification of relevant characteristics and 2 marks for relevant development/explanation of these.

Note: The explanation must include clear application of the characteristics to why air travel is excludable/rival

Rival/diminishable (1 mark):

Air travel is rival because the consumption of this product by one consumer will reduce the amount available for others (1 mark)

OR

This effectively means that consumers are rivals/competitors for the seat on the flight (1 mark). In other words, consumption by one person does diminish the amount of the good available to others

Excludable (1 mark) (Do not accept the statement that there is a lack of 'free riders'):

Air travel is excludable because those who are unable to afford the tickets will be stopped from consuming/using the flights (1 mark).

Likewise, accept any other valid application of excludability, for example, passengers without passports will be unable to board flights and, in this sense, will be excluded from flying

OR

Alternatively, accept reference to the fact that there will be an absence of free riders as non-payers can be stopped from using the flights (1 mark)

Rejectability (1 mark):

Air travel is rejectable as consumers do not have to fly if they do not want to (1 mark)

OR

This means that they can avoid consuming the product if they so wish (1 mark)

Note: Factors which are not identified but which are correctly applied in context can still receive both application marks, although clearly cannot receive the first 2 identification marks.

(c) (i) Define the term productive efficiency. [2]

Where maximum output is produced from the minimum number of inputs (2 marks)

Where production takes place where average/unit costs are minimised (2 marks)

Where production takes place at Minimum Efficient Scale (2 marks)

Where production takes place at a point on the PPF (2 marks)

Where production occurs where $AC = MC$ (2 marks)

1 mark for a vague idea. For example:

Where maximum output is produced (1 mark)

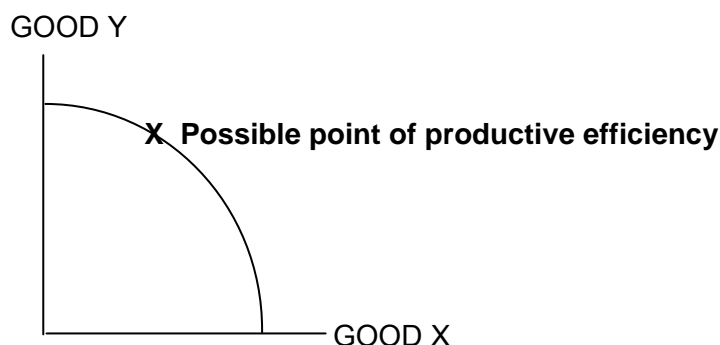
Where production takes place at the lowest cost (no reference to unit/average costs) (1 mark)

Where the minimum number of resources are used in production (1 mark)

(ii) Using a production possibility curve diagram, identify ONE possible point of productive efficiency. [3]

2 marks for simple diagram, as shown below (1 mark for correct labelling of axes and 1 mark for correct shape of PPC)

1 mark for identifying a relevant point of productive efficiency on the curve (NOTE: this point must be labelled eg 'X' or 'Y')

**(iii) Define the term allocative efficiency. [2]**

Where scarce resources are used to produce those goods and services which consumers want (2 marks)

Producing where $P=MC$ (2 marks)

Producing where $MSB=MSC$ (2 marks)

1 mark for a vague statement, for example:

Where you produce those goods and services which people want (1 mark)

A vague idea of using scarce resources in the best possible way (1 mark)

Where scarce resources are not wasted (1 mark)

Where you produce those goods which consumers want but lacking any reference to scarce resources (1 mark)

Where supply equals demand (1 mark)

(iv) Explain how the existence of external costs causes allocative inefficiency. [3]

1 mark for simple recognition/knowledge that there will be over-consumption/over-production

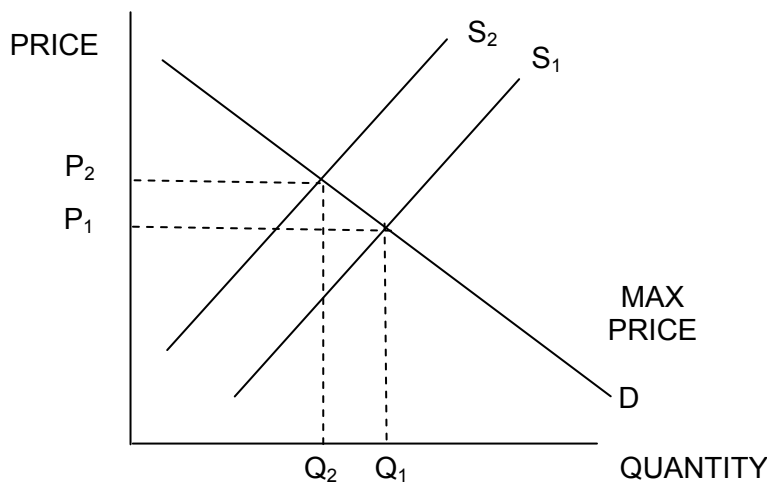
2 further marks are available for explaining why this might be the case:

- consumers fail to take into account their external costs OR consumers fail to take in to account the full costs OR the full costs are not paid
- therefore consumers effectively receive the product for a lower price than they would if the full social costs were taken in to account ie the good will be cheaper than ideally it should be/it is underpriced
- in turn, this means that too many scarce resources are devoted towards the production of these goods/services which results in allocative inefficiency. (Accept the idea that there is an over allocation of resources but do not accept vague references to the fact that scarce resources are not being used in the best possible way)

- (d) The production of some goods and services causes negative externalities. One possible solution to this market failure would be to tax the production of such goods and services.

Use a diagram to analyse how a tax on production may correct the market failure arising from negative externalities. [10]

Up to 6 marks are available for an accurate diagram (accept S/D or MSC/MSB approach):



1 mark for both axes (accept P/Q) – only accept cost/benefit in place of price if costs/benefits approach has been taken

1 mark for original demand curve

1 mark for original supply curve

1 mark for initial equilibrium

1 mark for new supply curve

1 mark for new equilibrium P/Q

Up to 6 marks are available for the explanation:

higher tax on the provision of flights will result in increased costs of production for firms OR tax acts as an extra cost faced by the firm;

this, in turn, results in less incentive for firms to supply air flights as they will make lower profits OR there will be less supplied OR output falls;

this results in the supply curve for the product shifting to the left;

this, in turn, results in the fares charged for such flights rising;

finally, there will be a contraction of demand as a result of the tax.

The overall impact of the tax depends upon what the PED is

A maximum of 10 marks are available for this question

(e) Comment on the effectiveness of subsidies to producers as a solution to the market failure arising from positive externalities. [6]

2 marks are available for a simple analysis of why subsidies will be effective. Each correct statement gains 1 mark.

- Subsidies to producers will lower firms' costs of production.
- This, in turn, will raise the supply of goods and services OR output increases OR more is produced OR the supply curve shifts to the right
- This will lead to a fall in price
- This results in an extension of demand (which corrects the under-consumption)

Accept relevant diagram showing a shift to the right of the supply curve for relevant analysis.

A further 4 marks are available for relevant evaluation/discussion. Any one point of evaluation which is fully developed can gain all 4 marks. Possible evaluative comment may include:

- in order to fully correct the under-consumption, the subsidy must be set at the correct level. This is very difficult to do as, often, it is extremely difficult to measure the external benefits accurately. In other words, the effectiveness of the subsidy often depends upon the level at which it is set;
- the impact of the subsidy will depend upon the price elasticity of demand for the product. If PED is inelastic, then a huge subsidy will be needed in order to have any significant impact upon demand;
- the cost of the subsidy to the government may well be so large that it outweighs any possible benefit gained. Hence there will also be an opportunity cost to the government of funding such subsidies.
- If producers fail to pass on the subsidy in the form of lower prices then there will be no extension of demand and hence market failure will remain
- Subsidies may encourage (productive) inefficiency if firms become too reliant upon them
- Time lag – a subsidy may have less impact in the short run if it takes time for firms to develop, produce and supply new products.

- (f)* **Two alternative forms of government intervention to correct market failure are regulation and the use of tradeable pollution permits.**

Discuss how effective ONE of these policies might be in correcting market failure.

[12]

Level 4	For a discussion of the effectiveness of regulation/pollution permits in correcting market failure.	7-12 marks
Level 3	For an analysis of how regulation/pollution permits can correct market failure	5-6 marks
Level 2	For an application of knowledge and critical understanding of how regulation/pollution permits may be used	3-4 marks
Level 1	For knowledge and understanding of what regulation/pollution permits are/description only	1-2 marks

Regulation:

Accept a wide interpretation of 'regulation' to include government competition policy (the work of the Office of Fair Trading and the Competition Commission) and also price controls

Level 4 answers will introduce relevant evaluative comment/discussion such as:

- in order to be effective, regulations must be policed and this will involve government expenditure. This, in turn, implies the existence of opportunity cost;
- Regulation may also result in significant bureaucracy which may incur additional costs;
- the effectiveness of regulation depends upon the size of fines/action taken against firms which are found to be breaking the law;
- if output is not banned completely, then what is the optimum level of regulation? How can the government actually measure this? There is the possibility of government failure if regulation is introduced at the wrong level
- if only the UK introduces regulations, then it will be very easy for companies to relocate overseas. Therefore, the effectiveness of such regulation depends upon whether other countries introduce regulations/laws as well;
- regulation is not a market based solution
- regulation may fail if there is the possibility of illegal supplies available through the shadow economy
- Possible time lag – there could be legislative delay or delay in implementing the regulation

Level 3:

Here, answers will look at how such policies actually correct market failure. In other words, there must be a clear analysis of how regulation will work.

For example, by making children remain in school up until the age of 18, the government is reducing what may well be significant under-consumption of education as a merit good. This will occur because there is the threat of fines/legal action/prosecution which provides a clear disincentive to people thinking of breaking the law

Level 2:

Here, answers will provide relevant examples of how regulation could be used to tackle different forms of market failure. For example, laws passed to stop pollution, laws which make children remain in schooling up until the age of 18, laws banning the sale of drugs and age restrictions placed upon the sale of certain products such as cigarettes.

Level 1:

Answers simply refer to what regulation is without any application or development of this in terms of correcting market failure.

Pollution permits:

Level 4 answers will develop clear evaluation as to why there may be problems with such a system. This may include:

- what level of permits should be issued to begin with? Too many and the price will be too low, and therefore, there will be little incentive for firms to change.
- Therefore the price of permits will be important too. If the price is too low then it may be cheaper for firms to buy the permits rather than to invest in new technology. In this respect, pollution permits will be ineffective
- such permits need to be introduced on an international scale. If they are only introduced in one country, firms can avoid the permit system by moving overseas;
- The costs of setting up the scheme (and the resulting bureaucracy) may be prohibitively expensive
- in order to be effective, the government will have to enforce fines/prosecute firms which do not have sufficient permits to cover their production levels. This could be expensive, especially as regular inspections and policing will be needed;
- if firms are fined for not buying sufficient permits, what size should the fine be?
- Permits may well be inflationary if they raise firms' costs and these rises are passed on to consumers. Clearly if firms are able to pass the cost of the permit on to consumers then they will be much less effective
- Permits may be ineffective in the short run if firms are unable to respond to these by changing production methods/techniques quickly
- Highly profitable firms will find it relatively cheaper to buy additional permits and therefore they may provide little disincentive for them and be ineffective

Level 3:

Candidates should analyse how such a scheme will work – for example: firms which are low polluters will be able to sell surplus permits and in this way are rewarded for their low pollution.

In contrast, high polluting firms will have to buy extra permits in order to continue production. In this sense, the polluter pays. Such a system is market based because the price of permits is determined by the supply and demand for permits in the market.

Level 2:

Answers will apply this by looking at a real world example (such as the EU Carbon Trading scheme) and how such a scheme works.

Level 1:

Here, candidates will simply look at what permits are – where firms are given a certain number of (free) permits which entitle them to produce so much pollution. If firms do not have the correct number of permits, then they are not allowed to continue with production.

Specification Grid

	a(i)	a(ii)	b	c(i)	c(ii)	c(iii)	c(iv)	d	e	f	Total
AO1 13-14	2		2	2	1	2	1	2		2	14
AO2 13-14		1	2		2		2	4		2	13
AO3 9								4	2	2	8
AO4 9									4	6	10
Spec.	5.2.2	5.2.2	5.2.2	5.2.1	5.2.1	5.2.1	5.2.2	5.2.3	5.2.3	5.2.3	

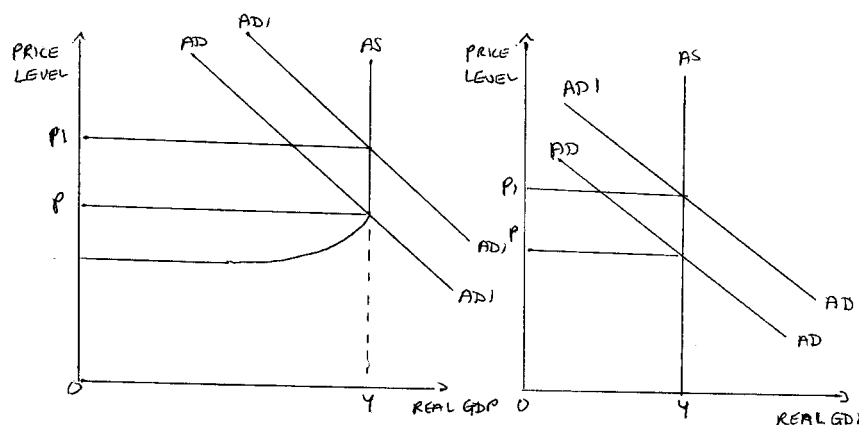
2883 The National & International Economy

- (a) Define the term 'budget deficit' (line 22). [2]

2 marks for government spending exceeding tax revenue.
1 mark for reference to government spending and tax revenue.

- (b) Assess whether the data in Fig 1 supports the view that countries with smaller populations have a better economic performance than those with larger populations. [5]

1 mark for unemployment rate figures do support the view.
1 mark for supporting comparative evidence, eg the ranking is the same, the country with the smallest population had the lowest unemployment rate whilst the one with the largest population had the highest unemployment rate.
1 mark for the economic growth rate figures do not support the view.
1 mark for supporting evidence, eg the ranking is different, the country with the smallest population has the lowest economic growth rate, the country with the second highest population had the highest growth rate.
1 mark for evaluative comment, eg the data is inconclusive, the data shows only one year, the data covers only two indicators of macroeconomic performance, data covers only five countries.



- (c) (i) What is the difference between internal and external trade? (lines 10-11) [2]

2 marks for idea that internal trade is trade within a country, whereas external trade is trade between countries.
1 mark for description of either internal or external trade.

- (ii) State and explain TWO reasons why a country's imports may decline. [4]

1 mark each for each of two reasons identified, eg a fall in the exchange rate, imposition of trade restrictions, a fall in income, a rise in the competitiveness of domestic producers.
1 mark each for each explanation, eg a fall in the exchange rate would make imports more expensive, the imposition of trade restrictions would raise the price of imports, a rise in the competitiveness of domestic producers would encourage people to switch some of their purchases from imports to domestically produced products.

- (d) (i) **Using Fig 2, calculate Norway's aggregate demand. Show your working.** [2]

2 marks for \$250bn.

1 mark for process/AD formula

- (ii) **Using an aggregate demand and aggregate supply diagram, explain why an increase in aggregate demand may have no impact on the real GDP of an economy.** [7]

Accurate diagram = up to a maximum of 5 marks.

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

1 mark for aggregate demand and aggregate supply curves correctly labelled.

1 mark for a shift of the AD curve to the right.

1 mark for AD curve starting and finishing on the vertical part of the AS curve.

1 mark for initial equilibrium.

1 mark for new equilibrium.

Accurate written explanation = up to a maximum of 4 marks.

1 mark for mentioning that the situation will occur on the vertical part of the AS curve.

1 mark for reference to full capacity/full employment.

1 mark for recognising that it is not possible to produce any more products.

1 mark for mentioning that in this situation AS would have to increase in order for a rise in real GDP to occur.

- (e) (i) **State ONE injection into the circular flow and ONE leakage from the circular flow.** [2]

1 mark for identifying an injection, ie exports, government spending or investment.

1 mark for identifying a leakage, ie imports, saving or taxation.

- (ii) **What evidence is there in the passage of the multiplier effect?** [2]

2 marks for reference to the final increase in real GDP being greater than the initial rise in government spending.

1 mark for reference to real GDP increasing.

- (f) **Comment on the likely impact on investment of a reduction in corporation tax.** [7]

1 mark for recognising that investment is likely to rise.

Up to 4 marks for explanation.

1 mark for explaining the effect that the reduction will have on post tax profit - firms will be able to keep more profit after tax.

1 mark for explaining that higher post tax profit will increase firms' ability to spend/borrow.

1 mark for recognising most investment if financed from retained profits.

1 mark for explaining that higher profit increases willingness to invest.

1 mark for explaining lower corporation tax may also attract foreign direct investment.

Maximum of 4 marks for explanation.

Up to 4 marks for evaluation, eg the effect will depend on the size of the cut; whether it is expected to last; the state of business confidence; whether it is offset by other influences, such as a rise in the rate of interest.

(g) Discuss the economic effects of a reduction in unemployment. [12]

A discussion of the economic effects of a reduction in unemployment. Evaluative comments may distinguish between different types of unemployment, extent to which unemployment falls, effects on other macroeconomic objectives, how long the reduction lasts. Candidates may include an AD/AS diagram or a PPC diagram but this is not essential.

L4 For a discussion of the economic effects of a reduction in unemployment. **(7 – 12)**

L3 For an analysis of the economic effects of a reduction in unemployment. **(5 – 6)**

L2 For an application of knowledge and critical understanding of the economic effects of a reduction in unemployment. **(3 – 4)**

L1 For knowledge and understanding of unemployment. **(1 – 2)**

Examples of possible content at different levels:

L4 For a discussion of the economic effects of a reduction in unemployment. (7 – 12)

Evaluative comments may include:

- the effects will be influenced by what unemployment was and what it falls to. A reduction from a high number/rate to a low number/rate will have more of an impact than a small fall
- the effects will be more beneficial if it stays low. Fluctuations in unemployment can cause instability and reduce investment and economic growth
- if unemployment falls to very low levels/below full employment, inflationary pressures may build up with employers bidding up wages and aggregate demand increasing
- a reduction in unemployment may increase a current account deficit on the balance of payments as demand for imports will increase and some good products may be diverted from the export to the home market
- a fall in the rate of unemployment does not necessarily mean that the number of people unemployed has decreased if the labour force has increased
- lower unemployment does not in itself increase aggregate supply. But if it encourages more people to enter the labour force, productive capacity will increase and the AS curve will shift.

L3 For an analysis of the economic effects of a reduction in unemployment. (5 – 6)

Examples:

- a reduction in unemployment will increase output. This may be illustrated by a movement from inside a PPC towards the curve or a shift in aggregate demand to the right on an AD/AS diagram
- a reduction in unemployment will increase tax revenue and reduce government spending on benefits. This might enable an increase in expenditure on health and education, promoting economic growth in the long run, and/or an improvement in the standard of living.

L2 For an application of knowledge and critical understanding of the economic effects of a reduction in unemployment. (3 – 4)

Identification of the economic effects of a reduction in unemployment.

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

Definition of unemployment/knowledge of employment.

Specification Grid

Questions	a	b	ci	cii	di	dii	ei	eii	f	g	Total
AO1	2		1		1	2	2	1	1	2	12
Target 13 - 14											
AO2		3	1	2	1	3		1		2	13
Target 13 - 14											
AO3		1		2		2			4	2	11
Target 9											
AO4		1							2	6	9
Total	2	5	2	4	2	7	2	2	7	12	45
Subject 5.3	3	1	4	4	2	2	2	2	3	1	

2884 Economics of Work and Leisure

Section A

- 1 (a) (i) **Using Fig 1, identify two differences between the labour markets in the UK and France;** [2]

1 mark for each valid difference – employment rate is much higher in UK; much smaller proportion of UK workforce employed in agriculture/primary and larger in services/tertiary.

- (ii) **Using Fig. 1, state and explain two possible labour market concerns for economic policy-makers in Italy.** [4]

For each concern, 1 mark for identification of it plus 1 for explanation of why it is a concern. The low level of employment is one clear concern – loss of potential output. Another might be the relatively high proportion of the workforce employed in the secondary sector – where it is subject to the growing competition from lower-wage countries such as China.

- (b) (i) **Explain the relationship which you would expect to exist between productivity and earnings in different industrial sectors.** [4]

1 mark for a clear understanding of the meaning of productivity. Would expect a positive relationship – the greater the labour productivity in an industrial sector, the greater the earnings. 1 for a statement of this plus up to 2 further marks for explanation. [It is necessary to use the concept of MRP explicitly to gain more than 1 of these 2 marks].

(NB. Answers may argue a different relationship, eg higher earnings causing greater productivity. The same 1+1+2 scheme should be applied.)

- (ii) **Comment on the extent to which the data in Fig. 2 is consistent with this relationship** [4]

Up to 3 marks for an analysis of the extent to which the data accords with the suggested relationship – it does, broadly [eg agriculture and retail trade are ranked 8 and 9 resp. on both productivity and earnings, and chemicals and computing are the top two on both criteria], though there are exceptions [eg food etc and law etc in particular].

Up to 2 further marks (though with an overall maximum of 4) for valid comment – which is most likely to be suggesting reasons why the correlation shown in Fig. 2 is not a perfect one; this might be in terms of supply shortages in law, etc., for example; or it might be broader, commenting on the difficulty of measuring productivity accurately, for example.

NB An OFR must be applied here; so an error made in part (i) should not be penalised again in (ii); accept the relationship explained in part (i), and then apply 2 plus 2 marks as the candidate responds in both identifying and commenting in part (ii).

- (c) **Evidence suggests that one reason for the UK's 8% average productivity gap compared to the EU is a deficiency in skills.**

Discuss the case for a significant increase in UK spending on skills training.[6]

The question refers to the UK specifically, and so requires reference to the data on comparative productivity in Table 2. The whole economy comparison shows how UK productivity lags behind that of the EU and even more so compared to the USA] – so there is a case for more UK spending on training targeted on skills improvement, since this should increase productivity. The different sector data shows that some UK sectors are much less efficient than others compared with USA/EU – hence, maybe focus most on the sectors with the lower comparative productivity sectors. However, one can also argue in favour of specialisation in the areas of comparative advantage. There is also the issue of whether or not significant increases in spending on training would be effective in increasing productivity – and there is also the issue of the opportunity cost of such spending.

Level 2	For an answer which considers the case for extra spending, and also [for >4] considers counter-arguments	(3-6)
Level 1	For an explanation of the link between the suggested policy and the data presented	(1-2)

Section B**2 (a) Explain why the elasticity of supply of labour varies between occupations. [10]**

Meaning of elasticity of supply for labour – responsiveness of amount of labour supplied to a change in the wage rate. Explanation of factors influencing the elasticity of supply in different occupations, both in the short-run and the long-run – amount of currently-unemployed labour with the relevant qualifications, wages in competitor occupations, levels of skill needed and available, etc. Explanation of the link between the labour supply and the value of elasticity.

Level 3	For a clear explanation of factors causing variations in elasticity of supply	(7-10)
Level 2	For application of knowledge and critical understanding of elasticity in different occupations	(4-6)
Level 1	For basic knowledge only of meaning of elasticity of supply of labour	(1-3)

(b) Discuss the extent to which wage differentials are a result of differences in elasticity of supply. [15]

Interpretation of the term wage differentials. Explanations of the determination of relative wages in terms of supply and demand in labour markets. Explanation of the effect which differences in elasticity of supply between occupations can have on wage differences – but also recognition that demand factors too have an impact. Discussion of there being long-run supply adjustments in some occupations to a greater degree than in others.

Level 4	For an evaluative discussion, focused for example on the long-run NB for > 12 needs to focus explicitly on the “extent to which” aspect	(9-15)
Level 3	For an analysis of the determination of relative wages in terms of factors underlying both supply and demand	(6-8)
Level 2	For application of knowledge and critical understanding of the relevance of elasticity of supply to the determination of wage differentials	(3-5)
Level 1	For basic knowledge only of wage differentials	(1-2)

- 3 (a) Explain the differences which exist between the short- and long-run levels of equilibrium price and output for firms which operate under conditions of monopolistic competition. [10]**

Identification of the characteristics of monopolistic competition. Explanation of the $MR = MC$ principle for profit maximisation for an individual firm. Explanation of the short-run profit maximisation position, with both price and output identified. Long-run impact of new entry/exit, with consequences explained for price and output. NB diagram not actually required, though of course credit should be given for use of an accurate diagram to illustrate.

Level 3	For clear explanation of the differences between short- and long-run levels of both price and output of the firm in monopolistic competition NB max of 8 if only one aspect explained	(7-10)
Level 2	For application of knowledge and critical understanding of profit-maximising position	(4-6)
Level 1	For basic knowledge only of the market structure	(1-3)

- (b) Discuss the extent to which the level of profit is determined by the degree of contestability in different leisure markets. [15]**

Meaning of contestability, emphasising variation of actual and potential threat of new entry/exit. Analysis of relationship between contestability and profitability, in theory. Application to different leisure industries – which may, but need not, be among the four named in the specification, but must be within the leisure sector – including discussion of contestability within them, and of the variation in profit demonstrated; if there is variation of profitability, this needs to be related to variations in extent of barriers to entry/exit. Evaluation linked to extent to which, which requires consideration of other factors influencing level of profit – eg. size of demand.

Level 4	For evaluative discussion, linked to variations in profitability NB needs to address “extent to which” explicitly for > 12	(9-15)
Level 3	For analysis of relationship between profit and contestability	(6-8)
Level 2	For application of knowledge and critical understanding of at least 2 leisure industries	(3-5)
Level 1	For basic knowledge only of contestability concept	(1-2)

4 (a) With the use of examples, explain what is meant by labour market failure. [10]

Explanation of labour market failure in general in terms of non-realisation of an optimum allocation of resources in the labour market, with this also clearly defined. Identification and explanation of a range of examples of reasons for such labour market failure – examples could include occupational or geographical immobility, information failure, monopoly or monopsony power, discrimination; for each example, clear explanation is required of the process through which the market fails.

Level 3	For clear explanation of labour market failure	(7-10)
Level 2	For application of knowledge and critical understanding of relevant examples only	(4-6)
Level 1	For basic knowledge only of the concept	(1-3)

(b) Discuss the view that government attempts to intervene in the labour market to try to correct market failure are likely to cause more problems than they solve. [15]

Identification of appropriate examples of government policies, with explanation of how they tackle the relevant labour market failure; eg education/training, provision of information, anti-discrimination legislation. Evaluation of each policy, with consideration given to an assessment of its effectiveness in tackling the identified problem, and to any possible undesirable consequences. The overall view then needs to be evaluated.

Level 4	For evaluative discussion, covering at least two relevant policies NB for > 12 needs to assess the overall view, not just individual policies	(9-15)
Level 3	For analysis of the operation of at least two relevant policies, explaining their impact on market failure	(6-8)
Level 2	For application of knowledge and critical understanding only of meaning of intervention	(3-5)
Level 1	For basic knowledge only of one policy	(1-2)

Specification Grid

June								
	1					2,3,4		Total
	a(i)	a(ii)	b(i)	b(ii)	c	a	b	
AO1		2	2			3	2	9
AO2	2	2		1		3	3	11
AO3			2	1	2	4	3	12
AO4				2	4		7	13
								45

2885 Transport Economics

- 1 (a) **Using Fig. 1, compare the changes in car user casualties in the East of England with London between 1995 and 2005.** [2]

1 mark for each comparison of changes in car user casualties between the East of England and London to a maximum of 2 marks. Comparisons can be absolute or relative to England as a whole.

eg both fell (1), London fell most (1), London fell more than average for England as a whole (1) whereas East of England fell less than average for England as a whole (1)

Maximum 2 marks

- (b) **Two economic benefits of improving the strategic road network are the reduction in serious accidents and the travelling time saved.**

- (i) **Using Extract A, identify and explain TWO other economic benefits of the road improvement at the Haughley Bends.** [4]

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

Explanation should refer to increased benefits or reduced costs in either quantitative or qualitative terms (there is no need to distinguish between private and external benefits).

eg, improved access for local residents (1) preventing economic dislocation of communities and reducing costs or increasing benefits to members of the community (1).

Reduced congestion for freight traffic (1) reducing vehicle user costs (1)

Benefit to UK economy through strengthened trade links (1) reducing cost of transport and possibly prices (1)

Increased benefit to walkers, etc (1) who can enjoy increased benefits of the countryside thus enhancing their welfare (1).

- (ii) **Explain the difficulties involved when estimating the economic benefit of reducing the loss of life following road improvements such as the scheme at Haughley Bends.** [4]

1 mark for knowledge and understanding of the problems involved in measuring the value of life.

1 mark for critical understanding that is because such costs as loss of life do not pass through the market but are imposed on others.

2 further marks for explanation of the difficulties involved in estimating the economic benefit of reducing loss of life or the cost of loss of life.

eg, averages are used and very few are average in terms of lifetime earnings or length of life; it is impossible to know how many lives will be saved; loss of life also involves grief, etc of other people.

Any attempts to elaborate on the information given describing how the value of human life may be estimated in order to explain the difficulties should be awarded 3 – 4 marks.

(iii) Use Fig 2. to comment on the significance of the different valuations of travel time incorporated into the appraisal of new road schemes. [4]

Explanation of the significance of the values, eg higher value of working time to represent opportunity cost of time spent in traffic; lower values of non-working time represents how much people are 'willing to pay' to get to destinations quicker.

Commentary on significance of valuations could take a variety of forms, eg routes where working time travelling is undertaken frequently are likely to be preferred for investment/traffic flow decisions; estimates may be inaccurate resulting in a misallocation of resources if a decision is based on this.

Level 2 Commentary on economic significance of valuation of time spent travelling in terms of resource allocation. (3 – 4)

Level 1 Explanation of economic significance of valuation of time spent travelling. (1 – 2)

(c) Discuss the extent to which improvements to the strategic road network, such as the A14 scheme, can be considered a move towards a more sustainable transport policy. [6]

Explanation of sustainable transport policy in terms of intergenerational resource use; road building not sustainable as greater use of car is encouraged. However, in this case the road is beneficial on safety issues (in addition to others) rather than to reduce congestion and may not generate more car use. Other similar schemes may remove bottlenecks in the strategic road network and create a more efficient use of overall road space. Land use issues could also be considered as agricultural land (or for any other use) is lost reducing sustainability.

Level 3 Evaluation including a judgement (underpinned by appropriate analysis) on the extent to which such road improvements is a move towards a more sustainable transport policy. (5 – 6)

Level 2 Evaluation of whether such road improvements are a move towards a more sustainable transport policy ie covers possible problems of road improvements. (3 – 4)

Level 1 Explanation of sustainable transport policy/road building without or with limited application to road improvements, or a one-sided view. (1 – 2)

Section B

- 2 (a) **Explain why the demand for both passenger and freight transport is a 'derived demand'.** [10]

Derived demand explained, with the use of appropriate examples, in terms of journey purpose; eg to go to work, to go to school, to visit friends and family, etc – not for the sake of the journey itself – for passenger transport.

Freight transport is ultimately derived from the demand for the final product but also the method of distribution will determine transport demand.

Reward explanations of exceptions and links to 'peaking' or choice of mode.

(Maximum 5 marks for just one)

Level 3 For an explanation of why the demand for both passenger and freight transport is a 'derived demand'. (7 – 10)

Level 2 For an application of knowledge and critical understanding of why the demand for both passenger and freight transport is a 'derived demand'. (4 – 6)

Level 1 For knowledge and understanding of 'derived demand'. (1 – 3)

- (b) **Discuss the effectiveness of different government policies aimed at increasing supply in the local bus market.** [15]

Government policy in terms of possible ownership by some councils (or past control); deregulation as reducing the legal barriers to entry, therefore, increasing contestability by increasing the threat of entry, the importance of sunk costs; regulation could be considered as the reverse of this or as an attempt to improve quality; possible use of subsidies to increase quantity.

Evaluation in terms of inelastic demand meaning fiscal incentives have little impact; subsidies negative impact on efficiency and therefore no effect on supply; legal barriers replaced by bus companies themselves gaining brand loyalty, etc. Government ownership unlikely to increase efficiency in comparison to other modes due to lack of incentive.

Level 4 For a discussion of the effectiveness of different government policies aimed at increasing supply in the local bus market. Requires judgement on effectiveness (underpinned) at top end. If only one policy – maximum of 10 marks. (9 – 15)

Level 3 For analysis of Government policy aimed at increasing supply in the local bus market. (6 – 8)

Level 2 For an application of knowledge and critical understanding of government policy aimed at increasing supply in the local bus market. (3 – 5)

Level 1 For knowledge and understanding of government policy/the local bus market. (1 – 2)

3 (a) Explain the relationship between contestability and efficiency within a market. [10]

Understanding of contestability in terms of threat of competition/potential competition. Importance of costless entry and exit into a market and, therefore, the absence of sunk costs. If potential competition exists incumbent firms will behave as though they are in a more competitive market and have to be more efficient – both productive (minimum average costs) and allocative (price equals marginal cost). Could also consider reducing X inefficiency. Reward use of examples, which do not have to be transport specific. Requires clear explanation of link between increased contestability and increased efficiency.

Level 3 For an explanation of the relationship between contestability and efficiency within a market. (7 – 10)

Level 2 For application of knowledge and critical understanding of the relationship between contestability and efficiency within a market or a good explanation of relationship between competition and efficiency, maximum of 5. (4 – 6)

Level 1 For knowledge and understanding of contestability/competition or efficiency. (1 – 3)

(b) Discuss the extent to which the entry of low cost airlines has increased efficiency in the air passenger transport market. [15]

Deregulation (open skies policy) removed legal restrictions in the market to allow for potential competition. Entry of low-cost airlines such as easyJet and Ryanair increased actual competition reducing price particularly on short haul flights. Incumbent firms have had to decrease costs; some left the market and others merged being unable to do so. Ownership of take-off/landing slots at major hub airports and brand loyalty of some incumbents have serviced the barriers to entry making the market less contestable particularly for long haul services. Large players in the market have also formed alliances that they argue increase efficiency through economies and increased investment. There is little doubt that the market is now more competitive in both price and service. The entry of low cost airlines has perhaps suggested that some passengers are less concerned about comfort than price. Such points need addressing in terms of both allocative and productive efficiency.

Level 4 For a discussion of the extent to which the entry of low cost airlines has increased efficiency in the air passenger transport market. Requires judgement (underpinned) of extent at top end. (9 – 15)

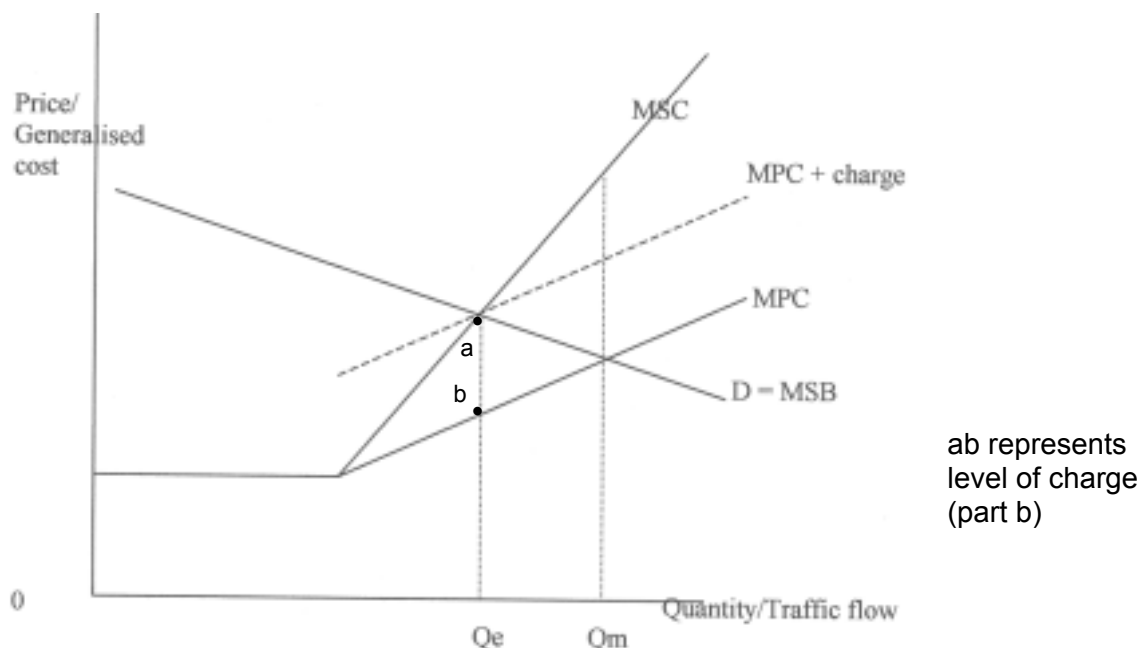
Level 3 For an analysis of the impact of the entry of low cost airlines on efficiency in the air passenger transport market. (6 – 8)

Level 2 For an application of knowledge and critical understanding of the impact of the entry of low cost airlines into the air passenger transport market. (3 – 5)

Level 1 For knowledge and understanding of low cost airlines/ the air passenger transport market. (1 – 2)

[15]

- 4 (a) With the aid of a diagram explain what is meant by 'road user charging'. [10]



Road user charging explained as charges for use of road rather than as a fixed cost to use roads over a period of time. Different types of user charging; cordon charging, per distance travelled, according to congestion level. Diagram, as above (accept accurate alternatives) to show how costs of road use increase as charges are imposed and demand falls. (No requirement to consider market failure in this part.) Reward reference to demand curve shifting to represent 'peaking'.

- | | | |
|---------|---|----------|
| Level 3 | For an explanation, with the aid of a diagram, of what is meant by 'road user charging'. | (7 – 10) |
| Level 2 | For application of knowledge and critical understanding of road user charging with the use of a relevant diagram. | (4 – 6) |
| Level 1 | For knowledge and understanding of road user charging. | (1 – 3) |

- (b) **Discuss whether road user charging is an appropriate means of correcting the market failure associated with traffic congestion in urban areas and on motorways.** [15]

Continuation of above to include consideration of market failure in terms of over consumption; effective use of charging to deal with market failure associated with congestion on inter-urban routes based on the value of external costs and therefore the level of congestion; in urban areas cordon charges could be used but will be a blunter instrument. Analysis of how such measures will correct market failure by internalising external costs; use of diagram above to identify correct level of charge that needs to be variable. Evaluation in terms of problems with valuation of external costs, information failure, practical issues, costs of schemes. Possible consideration of alternatives in comparison to road user charging.

- Level 4 For a discussion of whether road user charging is an appropriate means of correcting the market failure associated with traffic congestion in urban areas and/or on motorways. Both required for top end. (9 – 15)
Needs emphasis on market failure at top end.
- Level 3 For an analysis of the effective use of road user charging to correct market failure associated with traffic congestion in urban areas and/or on motorways. (6 – 8)
- Level 2 For an application of knowledge and critical understanding of the use of road user charging in urban areas or on motorways. (3 – 5)
- Level 1 For knowledge and understanding of market failure/traffic congestion. (1 – 2)

Specification Grid

	Question 1						Questions 2,3,4		Total	
	a	b(i)	b(ii)	b(iii)	c	Total	a	b	Total	Overall
AO1		2	2			4	3	2	5	9
AO2	2	2				4	3	3	6	10
AO3			2	2	2	6	4	3	7	13
AO4				2	4	6		7	7	13

Specification Section

Q1	5.5.3 & 5.5.4
Q2	5.5.1 & 5.5.4
Q3	5.5.2
Q4	5.5.3 & 5.5.4

2886 Economics of Development

1 (a) Using Fig. 1, explain:

(i) Which region is most likely to have achieved greatest economic growth between 1990 and 2002;

East Asia (1), biggest relative/absolute increase in GDP per capita(1)

[2]

(ii) Which region was the least developed in 2002

Southern Asia (1), data detail eg lowest GDP per capita, highest undernourishment (1), summary of greatest disadvantage (except water) (1).

[3]

(b) Comment on one possible reason why different regions within the same continent might have achieved different levels of economic development.

Development is affected by factor endowment, colonial history, government policies, economic and political stability, cultural attitudes, 2 marks for analysis of the impact of the influence, 2 marks for evaluation of the impact in different cases.

Analysis: Regions may receive aid (1), this = increased resources (1)

Evaluation: use for social spending promotes development (1) use for defence limits development (1) or

Analysis: has market oriented government (1) = efficient and dynamic (1)

Evaluation: rapid growth helps development (1) inefficiency checks development (1). Accept examples applied to countries.

[4]

(c) Using Fig. 2, explain:

(i) Which MDG is most likely to be achieved by 2015;

Reduce extreme poverty by half (1), already met in East, on track in others (1)

[2]

(ii) Which region is least likely to achieve its MDGs by 2015.

East Asia (1), data detail eg declining water access (1), summary or contrast to others (1). Accept alternative interpretation based on clearly stated normative assumptions.

[3]

(d) Discuss the extent to which the data in Figs 1 and 2 matches that needed to construct the Human Development Index.

HDI measures healthy life by life expectancy, knowledge by adult literacy (2/3) and school enrolment/years of schooling (1/3) and standard of living by real per capita GDP at ppp.

General understanding (1)

Fig 1 gives GDP per capita (1) and primary enrolment (1) but the other indicators are not used in HDI (1), it omits adult literacy (1) and life expectancy (1).

Fig 2 does not give any indicator used in HDI (1). Conclusion while related to some areas limited direct match (1) to max (6) marks.

Mention of both tables necessary for maximum (6).

[6]

- 2 (a) Explain the limitations of Rostow's model in accounting for the process of development. [10]

Rostow's model suggests transition through five stages from traditional to the age of high mass consumption. Take-off occurs with industrialisation and a significant increase in savings and investment. This was based on earlier experience of developed economies and it was thought could be followed by developing economies. The model is criticised in terms of over simplicity, the difficulty of distinguishing between different stages, the contrasting circumstances of economies then and now, the implication that the process ends with mass consumption and its failure to explain individual cases. It was also a model of growth rather than development.

- L3 For an explanation of the limitations of Rostow's model (7 – 10)
- L2 For an application of knowledge and critical understanding of Rostow's model (4 – 6)
- L1 For knowledge and understanding of Rostow's model (1 – 3)

- (b) Discuss the extent to which a country's level of development is solely the result of economic forces. [15]

The concept of development is multi-dimensional and relates to economic, social, cultural and political factors. Its measurement includes a range of diverse indicators. There are many influences which are economic and contribute both to material and non-material aspects. These would include production possibilities, trade and efficiency, which, in turn, determine employment, living standards and government financial strength. In addition to these, other factors are at work. Past political development through colonisation, instability and political institutions may affect the level and direction of development. Cultural views, eg the role of women and attitudes to change can be a determining factor. This can be illustrated through examples such as economies in Eastern Europe, Africa and Asia. High level four answers will make good use of examples.

- L4 For a discussion of economic and non-economic influences on development. (9 – 15)
- L3 For an analysis of economic or non-economic influences on development. (6 – 8)
- L2 For an application of knowledge and critical understanding of different levels of development. (3 – 5)
- L1 For knowledge and understanding of development. (1 – 2)

3 (a) Explain why developing countries often face macro-economic instability. [10]

Instability is found in AD (via export and import fluctuations), employment levels, the price level, the balance of payments position, growth rates and fiscal deficits. These result from international changes such as the terms of trade, international competitiveness, patterns of demand and technological progress and domestic factors, such as natural disasters, lack of economic competence and political upheavals. The difficulties of developing economies in terms of debt, dependency and inflexibility can make it impossible to correct the underlying influences.

L3 For an explanation of the reasons for macro instability (7 – 10)

L2 For an application of knowledge and critical understanding of influences on macro-economic instability (4 – 6)

L1 For knowledge and understanding of macro-economic indicators (1 – 3)

(b) Discuss the possible contribution of the World Bank, the IMF and non-government organisations (NGOs) in promoting greater macro-economic stability in developing countries. [15]

The World Bank and the IMF are official, international, financial institutions; while non-governmental organisations (NGOs) are private, voluntary groups including charities and research organisations. Depending upon the nature of the instability each can offer help. The World Bank can supply funds for growth and employment and expertise for economic management; it also negotiates debt relief. The IMF provides funds for balance of payments deficits, establishes conditions to encourage private finance and undertakes research on development and management issues. NGOs help with famine alleviation and smaller-scale infrastructure projects. These feed through to improve the strength of the economy and its macro performance. Problems may arise with the level of help, conditionality, dependence and side-effects.

High level four answers will link actions to specific institutions.

L4 For a discussion of the contribution of the WB, the IMF and NGOs to macro-economic stability. (9 – 15)

L3 For an analysis of the actions of the WB, the IMF and NGOs on macro-economic stability (6 – 8)

L2 For an application of knowledge and critical understanding of the WB, the IMF and NGOs actions (3 – 5)

L1 For knowledge and understanding of the WB, the IMF and NGOs (1 – 2)

- 4 (a) Explain how the employment situation in the world's least developed countries limits their prospects of development. [10]**

Employment/unemployment statistics are unreliable in developing economies. The unemployed have little incentive to register in the absence of financial support. The % of the population formally (paid) employed is usually higher in developed countries. The rate of underemployment is higher in developing countries as is the % in the informal economy. More are also likely to be working in the primary sector, possibly on a subsistence basis. Skill levels may be low. This suggests under-use of a scarce resource, employment in low productivity activities and non-recording of employment statistics. These restrict output, incomes, efficiency and government revenue, all of which hamper development.

- L3** For an explanation of how the employment situation limits prospects of development. **(7 – 10)**
- L2** For an application of knowledge and critical understanding of the nature of the employment situation. **(4 – 6)**
- L1** For knowledge and understanding of the employment situation. **(1 – 3)**

- (b) Discuss whether a policy of increasing fixed capital stock or improving human capital is better able to promote development. [15]**

Improving human capital involves health, education and training, while fixed capital stock involves machinery and buildings. Developing economies are reckoned to be endowed with labour but relatively short of capital. Labour is cheap and capital expensive. Improving human capital will raise productivity, incomes and self esteem, directly linking to development. There may be inadequate opportunities once educated/trained. Capital stock which is appropriate will increase productivity and employment. Inappropriate technology, which may be particularly expensive, may replace labour and generate income for a small group, so worsening income inequality. This may not promote development. There will also be opportunity costs to both courses of action. Higher level four answers will recognise the differentiation of the types of capital stock and the possibility of different circumstances.

- L4** For a discussion of the impact of increasing capital stock and improving human capital. **(9 – 5)**
- L3** For an analysis of the impact of increasing capital stock and improving human capital. **(6 – 8)**
- L2** For an application of knowledge and critical understanding of capital stock and human capital. **(3 – 5)**
- L1** For knowledge and understanding of capital stock and human capital. **(1 – 2)**

	Question 1						Question 2		Question 3		Question 4		
	(a) (i)	(a) (ii)	(b)	(c) (i)	(c) (ii)	(d)	(a)	(b)	(a)	(b)	(a)	(b)	Total
AO1 9	1	1		1	1		3	2	3	2	3	2	9
AO2 9	1	1		1	1		3	3	3	3	3	3	10
AO3 13 – 14		1	2		1	2	4	3	4	3	4	3	13
AO4 13 – 14			2			4		7		7		7	13
Subject reference	561	561	562	565	565	561	563	562	564	565	564	565	

2887 The UK Economy

1 (a) Explain what is meant by:

(i) the economic cycle (line 4); [2]

The economic, trade or business cycle is a recognised sequence of changes in GDP growth rates.

As these rates increase and slow, so the economy passes through phases of boom and slump (depressions) with recession and recovery as intermediate stages (2 marks).

To receive both marks candidates must mention at least ONE intermediate stage.

1 mark for a less precise statement. For example, the way the economy speeds up and slows down, or changing rates of economic growth.

Reference to changing growth rates can secure one of the available marks.

(ii) current budget surplus (line 7) [2]

1 mark for a reference to a situation in which income is in excess of expenditure.

1 mark for a clear indication that we are dealing with immediate expenditure, not capital expenditure.

(b) Using an AD/AS diagram, explain the impact that a budget deficit, as indicated in Fig 1, may have on the economy. [4]

Expected diagram for 2 marks would be a correctly labelled AD/AS diagram, showing a rightward shift in AD and a clear illustration of a potential consequence.

1 mark for a diagram that is not fully labelled or showing no shift.

No marks for diagram showing an incorrect shift. However OFR applies to second 2 marks.

A further 2 marks are then available for a written analysis of what the diagram illustrates. 1 mark for an answer that only considers an increase in output/increase in expenditure without reference to potential impact on the price level.

(c) State and explain one benefit the golden rule brings to macro-economic performance. [2]

Fiscal discipline is the obvious advantage that candidates should be stating for 1 mark. Although it may not be expressed quite so obviously, so we need to allow for a different wording but award the mark if the intention is clearly that of discipline. A straight copy from the text gains no marks.

1 mark for an explanation of such, eg the rule sets a limit to overspending on current expenditure which must be covered by income received before the end of the economic cycle. Debts amounting from current overspend cannot become a burden on future fiscal policy.

1 mark for considerations about future debt accumulation.

Up to 2 marks for candidates who consider the benefits of borrowing for capital expenditure, developing the idea that this improves supply-side conditions that can help target the key policy objectives of inflation, employment, growth and UK competitiveness.

- (d) Using Fig 1 and Fig 2, comment on whether the two fiscal rules were observed during the last economic cycle. [4]**

2 marks for an explanation/analysis of the way in which the two rules were observed over the economic cycle. 1 mark if only one rule is considered.

2 marks for any qualification of the above observation eg the sustainable rule was coming under threat towards the end of the cycle, or comment regarding the way in which the government did alter the dates pertaining to the economic cycle so as to allow for a more significant fit re the golden rule. 1 mark only if the candidate's answer is totally one-sided and fails to offer some evaluation as to the extent to which both rules were observed. Alternatively or additionally candidates may question the stability of net public sector debt evidenced by the pattern displayed in fig.2.

- (e) Discuss whether it is possible to forecast accurately the government's budget position. [6]**

Governments have always attempted to forecast their budget position as would any sensible firm or household. Drawing on their vast resources of talent and experience one would imagine that, as long as the economy behaved as predicted, their ability to accurately forecast the budget position should by now be well developed. Of course, the further they project into the future the less accurate their predictions are likely to be, even under normal circumstances. However, in the less normal and more turbulent days that have occurred since the publication of the details contained within the case, the ability of governments to predict their future fiscal position has become extremely difficult if not impossible.

Merit reference to debt figures announced since this data was produced eg 2008-09 43%, 2009-10 59%, 2010-11 68%, 2013-14 79%

- | | | |
|-----------|---|--------------|
| L3 | If L1 + L2 are covered and there is some judgement offered as to the accuracy particularly the further into the future the government chooses to project. | (5-6) |
| L2 | If L1 is covered, plus some reference to the difficulties attached to such economic forecasting. | (3-4) |
| L1 | For an account of how the government, drawing on past experience may be able to forecast the budget position in the future. | (1-2) |

- 2 (a) **Explain the factors that influence the current account position of the UK's balance of payments.** [10]

Candidates would be expected to cover at least two factors which could influence the size of a balance of payments deficit. These may include an over-valued currency, higher domestic prices perhaps due to inflation or relatively poor productivity, increased availability of cheap imports from growing economies like India and China, or increasing domestic incomes and a high mpm. These are just a few of the factors that could be covered. A maximum of 7 marks for an answer that considers one factor only.

L3 For an explanation of the factor(s) that influence the size of the UK's b of p deficit/surplus (7-10)

L2 For an application of knowledge and critical understanding of the factor(s) that influence the size of the b of p deficit/surplus (4-6)

L1 For a knowledge of the factor(s) that influence the size of the b of p deficit/surplus. (1-3)

- (b) **Discuss the extent to which a depreciation of sterling may help improve the UK's current account balance of payments position.** [15]

The question requires knowledge and application of a number of key economic terms and linkages.

Depreciation of the currency, current account, balance of payments problems.

Better answers should describe the theoretical process by which an orchestrated depreciation would bring down the foreign prices of a country's exports and increase the domestic prices of imports. In consequence the normal demand response would be a rise in exports, a fall in imports and an improvement in balance of payments position.

Some candidates may cover the methods that might be employed to achieve this currency depreciation; eg lower interest rates, talk down the currency, sell domestic currency on foreign exchange markets, etc.

The discussion aspect of the question should invite better candidates to explain the relevance of the Marshall Lerner Condition. In particular, much can be made of the significance of time scale, the potential short run J-curve effect and possibly, in addition, the fact that international trade is a dynamic dimension and subject to many other influences which may override the intended chain of events.

L4 Discussion of the extent to which this policy would improve the current account balance of payments position of the UK. (9-15)
9-12 marks for a standard two handed economic discussion built on at least some underlying analysis.

13+ marks for the above plus an evaluated conclusion as to the extent to which depreciation of sterling may be helpful.

L3 Analysis of the way in which this policy could improve the current account balance of payments position of the UK. (6-8)

L2 Application of knowledge concerning the link between a falling currency value and its potential impact on import and export prices. (3-5)

L1 Descriptive knowledge of depreciation and current account problems. (1-2)

3 (a) Explain how the distribution of income and wealth can be measured. [10]

The focus of the question is on the measurement of income and wealth distribution. It is important to make a clear distinction between income and wealth. Income is a flow of factor payments. Wealth is a stock of financial and physical assets.

Candidates must make reference to both income and wealth in order to achieve a score above L3, 7 marks. Many different approaches are anticipated, reference to deciles, quintiles or quartiles would be appropriate; as, of course, would be the use of Gini coefficients and the Lorenz curve. In order to achieve a top L3 mark candidates must demonstrate a clear understanding of both income and wealth and the way we measure distribution of both.

L3 For an explanation of how the distribution of income and/or wealth can be measured. **(7-10)**

L2 For an application of knowledge of how the distribution of income and/or wealth can be measured. **(4-6)**

L1 For a knowledge of how the distribution of income or wealth can be measured. **(1-3)**

(b) Discuss how economic policy could be used to affect the distribution of income and wealth in the UK economy. [15]

Candidates are expected to cover a range of policy options to address the problem of unequal income and wealth distribution in the UK. Policies may include, making the tax system more progressive, alter benefits in terms of both value and targeting, skills training and lifelong education, analysing the effects of indirect taxes etc. These policies should be clearly analysed using the economist's toolkit; then an evaluation of their ability to influence distribution and the side effects must be discussed for a L4 mark.

Discussion may include, risk, expense, time and the general consensus that raising skill levels and high employment are the best ways to achieve a more equitable distribution of income and wealth.

L4 Discussion of the extent to which economic policy could be used to affect the distribution of income and/or wealth in the UK economy. **(9-15)**
9-12 marks for a standard two handed economic discussion built on at least some underlying analysis.

13+ for the above plus an evaluated conclusion as to how effective economic policy can be in changing income and wealth distribution.

L3 Analysis of the way in which economic policy could be used to affect the distribution of income and/or wealth in the UK economy. **(6-8)**

L2 Application of knowledge concerning the way in which economic policy could be used to affect the distribution of income and/or wealth in the UK economy. **(3-5)**

L1 Descriptive knowledge of the way in which economic policy could be used to affect the distribution of income or wealth in the UK economy. **(1-2)**

- 4 (a) Explain the significant sources of inflation currently affecting the UK economy. [10]**

The expected most likely answers would adopt a cost push and demand pull approach to their answers.

However, two types of cost push pressure, clearly distinguished, would be equally acceptable.

Alternatively, a classic Monetarist rapid money supply expansion explanation and/or the same approach with the Keynesian causation order could also be accepted.

Supply side shocks would provide another appropriate approach.

Candidates should be limited to a maximum of 7 marks if only one source of inflation is explained.

L3 For an explanation of possible cause(s) of a rise in the rate of inflation in the UK. **(7-10)**

L2 For an application of knowledge and critical understanding of two possible cause(s) of inflation in the UK. **(4-6)**

L1 For a knowledge of possible cause(s) of inflation. **(1-3)**

- (b) Discuss the extent to which the control of inflation is the most important macroeconomic policy objective in the UK. [15]**

Clearly candidates must offer a discussion to achieve L4, built on a clear analytical foundation. The expected answer is likely to be based around the starting point on the economic cycle. Sometimes, especially in the short term, problems of unemployment or balance of payments difficulties may take priority. Alternatively, a candidate may wish to make a valid case for either growth or employment to be the permanent major goal on the one hand, then consider on the other, the strength of the argument that supports the statement in the question.

L4 Discussion of the extent to which the control of inflation is the most important macroeconomic policy objective in the UK. **(9-15)**
9-12 marks for a standard two handed economic discussion built on at least some underlying analysis.

13+ for the above plus an evaluated conclusion as to the extent to which control of inflation is the most important macro policy objective in the UK.

L3 Analysis of the way in which the control of inflation is the most important macroeconomic policy objective in the UK. **(6-8)**

L2 Application of knowledge concerning the control of inflation as the most important macroeconomic policy objective in the UK. **(3-5)**

L1 Descriptive knowledge concerning the control of inflation. **(1-2)**

SPECIFICATION GRID

Q1	1ai	aii	b	c	d	e	2a	b	3a	b	4a	b	Total
AO1	2	2					3	2	3	2	3	2	9
AO2			2	1			3	3	3	3	3	3	9
AO3			2	1	2	2	4	3	4	3	4	3	14
AO4					2	4		7		7		7	13

2888 Economics in a European Context

1 (a) Using Extract 1:

- compare the trend in the world wholesale price of butter with that in the EU in 2006 and in 2007;
- describe the trend in farm input costs in the UK 2006 – 07 as shown in Figs. 1.3 and 1.4.

[6]

Outline of content

World and EU wholesale prices of butter	
Comparison	Quantification
2006 <ul style="list-style-type: none"> Both prices fell in the first half of the year and increased in the second half of the year. The world price fell relatively more than the EU price to July/Aug Both unchanged over the full year 	<ul style="list-style-type: none"> World price fell by 15%, whereas the EU price fell by 6% <p style="text-align: right;">(max 2 marks)</p>
2007 <ul style="list-style-type: none"> Both prices rose over the whole period The world price rose continuously through 2007, whereas the EU price rose for only 7 months (Feb to Sept) or reverse. The world price rose relatively more than the EU price 	<ul style="list-style-type: none"> World price rose 83% during 2007, whereas the EU price rose by only 38% (70% to its peak) <p style="text-align: right;">(max 2 marks)</p>

1 mark for each point of comparison

1 further mark for each quantification

Maximum of 4 marks

UK farm input costs	
Description	Quantification
<ul style="list-style-type: none"> Input costs rose over the period 	<ul style="list-style-type: none"> Price of feed wheat increased by 100% Price of fertiliser increased by 27%

0 marks for data regurgitation/sub-periods

1 mark for each point of description

1 further mark for each quantification

Maximum of 3 marks

Overall maximum of 6 marks

- (b) Assuming constant farm input costs, use a diagram to analyse how the release of EU intervention stocks of butter should have affected the market for butter in the EU.

[9]

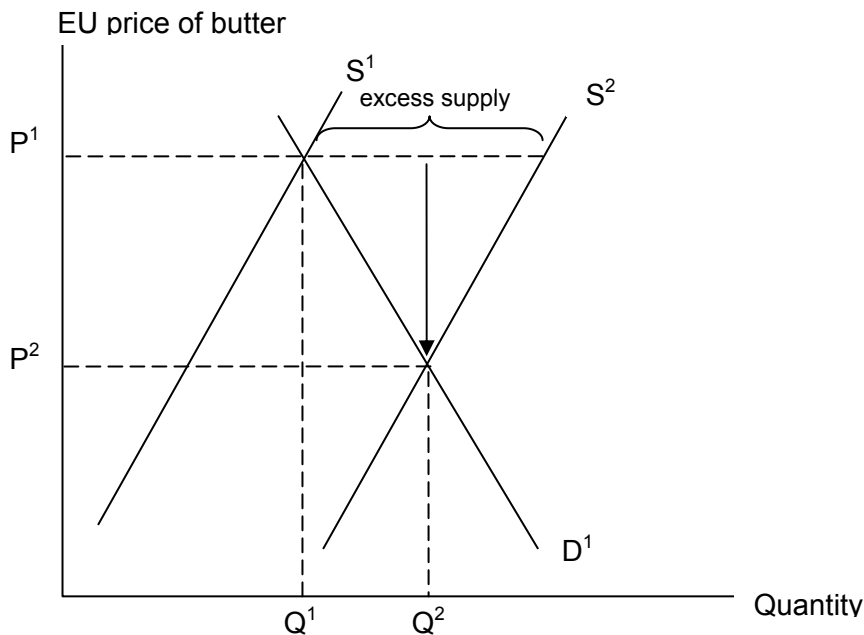
Synoptic knowledge

Module 2881 – Section 5.1.2

Competitive markets and how they work (demand, determinants of demand, supply, determinants of supply, equilibrium, changes in demand and supply, effects of changes on equilibrium price and quantity, price elasticities of demand and supply)

Outline of content

Candidates are expected to use a demand and supply diagram to analyse the effect of releasing butter stocks on equilibrium price and quantity in the EU butter market. Simple description of what is shown by the diagram cannot be awarded more than 1 mark for analysis. It is expected that candidates will analyse the effects either by reference to the mechanism by which equilibrium price and quantity changes (excess supply) or by reference to the likely PED or PES of butter.



Knowledge marks

- 1 for correct labelling of axes (price and quantity is fine)
- 1 for drawing and labelling downward sloping demand curve
- 1 for drawing and labelling upward sloping supply curve

Application marks

- 1 for rightward shift of S
- 1 for reduction in market price
- 1 for increase in market equilibrium quantity

Analysis marks

Maximum of 1 mark for simple statement in relation to the diagram, including shift of supply, reduction in market price and increase in equilibrium quantity

Up to 3 marks for either:

- an explanation of the mechanism by which the market price and equilibrium quantity change;
- an explanation of the significance of the PED of butter in terms of the changes in market price and equilibrium quantity (ie. given price inelastic demand for butter the reduction in market price can be expected to be relatively large and the increase in equilibrium quantity relatively small).

- 2 **Comment on the case for governments setting limits on market prices, such as those on basic foodstuffs in Russia.**

[10]

Synoptic knowledge

Module 2882 – Section 5.2.3

Making choices and the impact of government intervention on market outcomes and efficiency

(The way governments, in pursuit of their economic, social and distributional objectives, intervene in markets to correct market failure, for example, through price controls. The impact of these forms of intervention on markets. The ways in which governments may create rather than remove distortions.)

Module 2883 – Section 5.3.1

Government macro-economic policy objectives
(consequences of inflation)

Outline of content

Analysis

Candidates are expected to analyse the case for setting limits on market prices by analysing the costs of inflation and the impact of rising food prices on the social and distributional objectives of governments.

- With respect to inflation, candidates should analyse the impact on resource allocation, investment incentives, income and wealth distribution and competitiveness.
- With respect to the social and distributional impact, analysis should focus on the regressive effect of rising food prices, given that expenditure on food is a higher proportion of income for those lower down the income distribution. Depending on the route taken through the specification, some candidates might analyse this aspect of the case for by reference to poverty issues.

Commentary

Valid commentary can take different forms. Any one approach done well can score maximum marks. Commentary might focus on:

- the impact of price controls on the market for food – this is likely to be expressed in terms of a case against setting limits on prices and involve an explanation of the likely shortages resulting from setting maximum prices (a diagram is not necessary, though is likely);
- other approaches to the problems of rising food prices – commentary here could seek to establish why the alternatives are less appropriate/desirable (Extract 3 suggests that increasing interest rates is unlikely to reduce the increase in global food prices). Some might recognise that where there are no tariffs on food imports, action needs to be taken to reduce domestic prices. Alternatively, the material in Extract 3 on tariffs could be used to comment that a ‘better way’ of reducing domestic food price rises might be available and would avoid the consequent shortages from setting maximum prices.

Level 4	For a commentary on the case for governments setting limits on market prices, such as those on basic foodstuffs in Russia.	[8 – 10]
Level 3	For an analysis of the case for governments setting limits on market prices only, OR an analysis of the case against only. Critical understanding of 2 sides plus limited analysis of 1 point must only be awarded a bottom L3 mark.	[5 – 7]
Level 2	For an application and critical understanding of the case for and/or against governments setting limits on market prices.	[3 – 4]
Level 1	For knowledge and understanding of maximum prices only.	[1 – 2]

- 3 “Energy crops’ ...are eligible for an EU subsidy of ~~€~~45 per hectare.’Comment on the case for subsidies to encourage EU farmers to produce ‘energy crops’

[15]

Synoptic knowledge

Module 2881 – Section 5.1.2

Competitive markets and how they work (demand, determinants of demand, supply, determinants of supply, equilibrium, changes in demand and supply, effects of changes on equilibrium price and quantity, PED)

Module 2882 – Section 5.2.2

Why markets may not work efficiently

(The causes and consequences of why markets may not work efficiently to include the market failures of externalities)

Module 2882 – Section 5.2.3

Making choices and the impact of government intervention on market outcomes and efficiency

(The way governments, in pursuit of their economic, social and distributional objectives, intervene in markets to correct market failure, for example, through **subsidies**. The impact of these forms of intervention on markets. The ways in which governments may create rather than remove distortions.)

Outline of content

Analysis

Analysis can take a range of different approaches to the question. One approach is to focus on the market failure created by burning fossil fuels. An alternative approach is to analyse the positive externalities of biofuels, being a reduction in negative externalities. Another approach is to explain how subsidies will work to encourage production of ‘energy crops’.

Another approach is to explain the nature of non-renewable resources and resource depletion (eg oil) and issues related to sustainability.

Another is to explain the impact on farm/rural incomes and employment. In all cases the treatment of these issues should make explicit use of appropriate economic analysis.

Commentary

Valid commentary can take different forms. Any one approach done well can score maximum marks. Commentary might focus on:

- the impact of re-allocating resources away from the production of food in terms of reduced supply and consequent higher food prices;
- uncertainties about the benefits of biofuels in terms of reducing negative externalities;
- the impact of subsidies on the EU budget and expenditure on the CAP;
- the extent to which production subsidies will reduce the price of biofuels for motorists;
- the extent to which biofuels will be taken up by motorists or industry – short and long run PEDs are relevant to the evaluation of the impact on consumption of biofuels

Level 4	For a commentary on the case for subsidies to encourage EU farmers to produce 'energy crops'.	[10 – 15]
Level 3	For an analysis of the case for subsidies to encourage EU farmers to produce 'energy crops' only OR the case against subsidies to encourage EU farmers to produce 'energy crops' only.	[5 – 9]
Level 2	For an application and critical understanding of the case for and/or the case against subsidies to encourage EU farmers to produce 'energy crops'	[3 – 4]
Level 1	For knowledge and understanding of subsidies only.	[1 – 2]

Critical understanding of 2 sides plus limited analysis of 1 point must only be awarded a bottom L3 mark.

- 4 Discuss the effectiveness of pollution permits, such as the EU's Emissions Trading Scheme, in tackling the market failure created by negative externalities.

[20]

Synoptic knowledge

Module 2881 – Section 5.1.2

Competitive markets and how they work

(demand, determinants of demand, supply, determinants of supply, equilibrium, changes in demand and supply, effects of changes on equilibrium price and quantity)

Module 2882 – Section 5.2.1

Economic efficiency within competitive markets

(The conditions for efficient allocation of resources including the concepts of allocative, productive and Pareto efficiency. Competition and the efficient allocation of resources)

Module 2882 – Section 5.2.2

Why markets may not work efficiently

(The causes and consequences of why markets may not work efficiently to include the market failures of negative externalities)

Module 2882 – Section 5.2.3

Making choices and the impact of government intervention on market outcomes and efficiency

(The way governments, in pursuit of their economic, social and distributional objectives, intervene in markets to correct market failure. The impact of these forms of intervention on markets. The ways in which governments may create rather than remove distortions.)

Modules 2884/5 – Sections 5.4.2 and 5.5.2

Theories of market structure and competitive behaviour in markets

(The models of perfect competition, monopolistic competition, oligopoly and monopoly. The concept of contestability in markets. Comparison of outcomes in terms of prices, output, profit and efficiency)

Outline of content

The basic structure to candidates' responses should be that of the 'two-handed economist', namely:

- on the one hand, pollution permits are likely to be effective because....
- on the other hand, pollution permits may not be effective because...

AND/OR

- on the other hand, the effectiveness of pollution permits will depend upon...

Analysis

Candidates are expected to analyse why pollution permits can be expected to be effective in reducing the market failure created by negative externalities. There should be an explicit explanation of the nature of the market failure in terms of over-production and under-pricing, which should be related to the conditions for an efficient allocation of resources.

The analysis is likely to be based on how a pollution permits/emissions trading scheme works, but the focus should be on the effectiveness rather than a description of the mechanics. Expect to see reference to: the allocation of a fixed number of permits; annual emissions must not exceed the amount held in permits; firms polluting below their allocated permits can trade spare permits at a price determined by the market; firms polluting above their allocation must buy permits at the market price; gradual reduction in the supply of permits raises their price and creates incentives for firms to reduce pollution; works with the market mechanism and internalises the negative externality by allowing the market to determine a price for pollution.

Commentary

Commentary begins when candidates question the effectiveness of pollution permits in tackling the market failure created by negative externalities or when candidates start to recognise that their effectiveness is dependent on a number of conditions being fulfilled.

To be effective:

- it must be possible to measure pollution and to monitor it;
- it must be possible for authorities to enforce permits;
- there must be a clear target set for emissions and this should correspond to an output at which the $MSB = MSC$;
- there should be a large number of firms involved in the scheme so that a 'correct' market price can be determined by a large number of buyers and sellers;
- there should be firms who find it easy and less costly to reduce pollution than others;
- there should be few 'transactions' costs in trading and there should be perfect information and knowledge for the market to function well;

These points can be developed by explaining what might happen if the conditions are not met and the implications this would have for the effectiveness of the scheme to tackle the market failure created by negative externalities.

Commentary could also seek to establish the relative effectiveness of pollution permits through consideration of alternative measures (eg regulation, taxation, subsidisation).

- Level 4 For a discussion of the effectiveness of pollution permits, such as the EU's emissions trading scheme, in tackling the market failure created by negative externalities.
Responses should include analytical underpinning to the discussion of and pollution permits on both sides. **[12 – 20]**
- Band 2 – the discussion will be developed beyond simple points or statements and include explanation, justification and judgement. **[17 – 20]**
- Band 1 – answers in this Band will consider the problems of pollution permits but there will be little development beyond simple points or statements. **[12 – 16]**
- Level 3 For an analysis of why pollution permits might be effective in tackling the market failures created by negative externalities only OR why pollution permits might not be effective in tackling the market failures created by negative externalities only. **[5 – 11]**
- Level 2 For an application and critical understanding of why pollution permits might be effective in tackling the market failures created by negative externalities AND/OR why pollution permits might not be effective in tackling the market failures created by negative externalities. **[3 – 4]**
- Level 1 For knowledge and understanding of pollution permits and/or market failure only. **[1 – 2]**

Specification Grid

AO	Question 1		Question 2	Question 3	Question 4	TOTAL
	(a)	(b)				
AO1	3	3	2	2	2	12
AO2	3	3	2	2	2	12
AO3		3	3	5	7	18
AO4			3	6	9	18
TOTAL	6	9	10	15	20	60

Grade Thresholds

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

Unit Threshold Marks

Unit		Maximum Mark	A	B	C	D	E	U
2881	Raw	45	33	30	27	24	22	0
	UMS	90	72	63	54	45	36	0
2882	Raw	45	35	31	27	23	20	0
	UMS	90	72	63	54	45	36	0
2883	Raw	45	34	30	27	24	21	0
	UMS	120	96	84	72	60	48	0
2884	Raw	45	29	26	23	20	18	0
	UMS	90	72	63	54	45	36	0
2885	Raw	45	31	28	25	23	21	0
	UMS	90	72	63	54	45	36	0
2886	Raw	45	33	29	26	23	20	0
	UMS	90	72	63	54	45	36	0
2887	Raw	45	28	25	22	19	17	0
	UMS	90	72	63	54	45	36	0
2888	Raw	60	46	41	36	31	27	0
	UMS	120	96	84	72	60	48	0

Specification Aggregation Results

Overall threshold marks in UMS (ie after conversion of raw marks to uniform marks)

	Maximum Mark	A	B	C	D	E	U
3812	300	240	210	180	150	120	0
7812	600	480	420	360	300	240	0

The cumulative percentage of candidates awarded each grade was as follows:

	A	B	C	D	E	U	Total Number of Candidates
3812	37.5	63.1	81.8	92.8	98.5	100.0	1912
7812	34.5	63.1	82.5	93.9	99.1	100.0	6216

6216 candidates aggregated this series

For a description of how UMS marks are calculated see:

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

Statistics are correct at the time of publication.

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