GCE MARKING SCHEME

SUMMER 2022

ECONOMICS - UNIT 4
1520U40-1

INTRODUCTION

This marking scheme was used by WJEC for the 2022examination. It was finalised after detailed discussion at examiners' conferences by all the examiners involved in the assessment. The conference was held shortly after the paper was taken so that reference could be made to the full range of candidates' responses, with photocopied scripts forming the basis of discussion. The aim of the conference was to ensure that the marking scheme was interpreted and applied in the same way by all examiners.

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

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

Positive Marking

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

Below are the assessment objectives for this specification. Learners must demonstrate their ability to:

AO1 Demonstrate knowledge of terms/concepts and theories/models to show an understanding of the behaviour of economic agents and how they are affected by and respond to economic issues

AO2 Apply knowledge and understanding to various economic contexts to show how economic agents are affected by and respond to economic issues

AO3 Analyse issues within economics, showing an understanding of their impact on economic agents

AO4 Evaluate economic arguments and use qualitative and quantitative evidence to support informed judgements relating to economic issues.

GCE A LEVEL ECONOMICS - UNIT 4

SUMMER 2022 MARK SCHEME

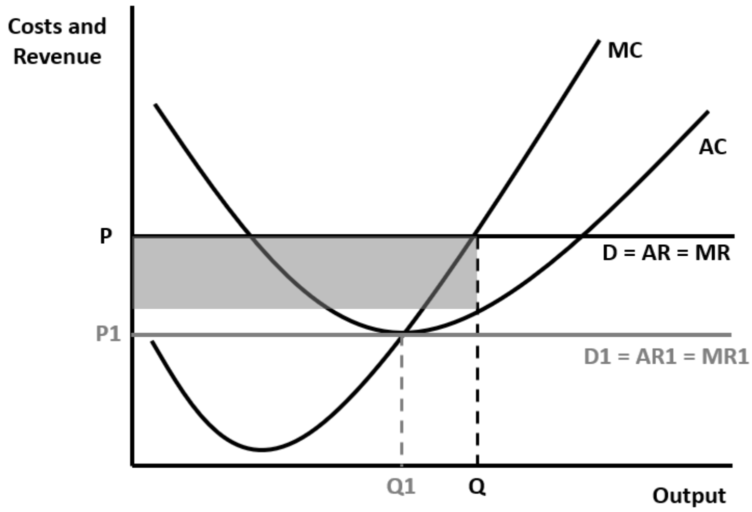
SECTION A

1. (a)	**Using relevant diagrams, explain how a long-run equilibrium position is reached in a perfectly competitive market structure. [10]**	
Band	**AO1**	**AO3**
	6 marks	**4 marks**
3	**5-6 marks** Excellent, accurate and comprehensive understanding of the long-run position in perfect competition. Accurate diagrams with no errors or omissions. Excellent use of relevant terminology.	
2	**3-4 marks** Good understanding of the long-run position in perfect competition. Mostly accurate diagrams with few errors or omissions. Good use of relevant terminology.	**3-4 marks** A good, accurate and comprehensive analysis of how a long-run position is achieved in perfect competition. Diagrams are embedded within the analysis and explained / used
1	**1-2 marks** Some recognition of what is meant by the long-run position in perfect competition. Diagrams may be attempted but with significant errors or omissions. Limited use of relevant terminology.	**1-2 marks** Limited analysis of how a long-run position is achieved in perfect competition. Diagrams are unlikely to be fully embedded within the analysis.
0	**0 marks** No valid understanding.	**0 marks** No valid analysis

Indicative content:

- Assumptions underpinning perfect competition
- relevant cost/revenue diagrams showing a firm in perfect competition in the short run either earning abnormal profit or making a loss
- relevant cost/revenue diagrams showing a firm in perfect competition in the long run earning normal profit
- reference to contestability of perfectly competitive markets
- reference to price competition when goods are homogenous
- shut-down positions in the short run and long run (link with variable and fixed costs)
- analysis of the dynamic movement / adaptation from the short run to the long run

Possible diagram:



In this example, the firm is initially earning abnormal profit (shaded area); the lack of entry barriers attracts new firms to the industry which increases the market supply and pushes down the market price. Because firms in PC are price-takers they have to take the new price of P1 – this process continues until all abnormal profit is appropriated away and only normal profit is earned. Candidates may draw the long-run position only; this is acceptable.

1. (b)	**Assess the reasons why the reduction of monopoly power in an economy may not be entirely desirable.** **[20]**		
Band	**AO1**	**AO3**	**AO4**
	6 marks	**6 marks**	**8 marks**
3	**5-6 marks** Excellent understanding of the impact of a reduction in monopoly power, probably considering a range of stakeholders and the wider economy Both breadth and depth of coverage is excellent. Excellent use of relevant terminology.	**5-6 marks** An excellent analysis of the desirability of reducing monopoly power. Chains of argument are well developed.	**6-8 marks** An excellent critical evaluation of the extent to which a reduction in monopoly power is desirable. A clear judgement is reached at the very highest level.
2	**3-4 marks** Good understanding of the impact of a reduction in monopoly power. Answers in this band may omit significant content or the breadth of coverage is good but the depth of understanding is not sufficient to reach the highest band. Answers in this band may focus on the pros/cons of monopoly rather than full consideration of reasons for a reduction in monopoly power. Good use of appropriate terminology.	**3-4 marks** A good analysis of the desirability of reducing monopoly power. Answers in this band show developed chains of argument, but may focus on the pros/cons of monopoly Answers in this band may lack depth, and any diagrams used may not always be well-integrated or completely correct	**3-5 marks** A good evaluation that includes most of the key issues. At least 2 issues are evaluated. Answers in this band may focus on evaluating the pros/cons of monopoly
1	**1-2 marks** Limited understanding of the impact of a reduction in monopoly power.	**1-2 marks** Limited analysis of the desirability of reducing monopoly power. Answer tends to lack key economic concepts and avoid technical analysis	**1-2 marks** Limited evaluation; candidates may show awareness of some evaluative points but do not develop them.
0	**0 marks** No valid knowledge or understanding	**0 marks** No relevant analysis	**0 marks** No relevant evaluation

Indicative content:

Reasons why reducing monopoly power may not be desirable:

- Lower profit can lead to a reduction in dynamic efficiency and innovation, which could reduce long run economic growth
- If firms with monopoly power are relatively large, then reducing their power could reduce opportunities to benefit from economies of scale, therefore less efficient use of resources
- Some firms are natural monopolies, and so reduced monopoly power may cause total market failure if there is no incentive for these firms to continue operating
- The process of reducing monopoly power may be undesirable e.g. risk of government failure
- Monopolies may be large employers so a reduction in monopoly power may reduce employment
- Fewer opportunities for monopoly firms to use price discrimination could mean that lower-income consumers are less able to participate in some markets
  (note – for the 2022 exam series, price discrimination was removed from the specification, but can be rewarded if candidates use this concept)

Reasons why reducing monopoly power may be desirable:

- Greater allocative efficiency as prices fall
- Lower prices can also lead to rising consumer surplus and therefore increased consumer welfare
- Less risk of x-inefficiency, and therefore improved use of resources
- Greater variety of products and choice for consumers if there are more suppliers
- Less government spending on regulators / competition authorities

General evaluative comments:

- Depends on the industry in question – some industries benefit from there being stronger monopoly power e.g. natural monopolies
- Depends on how we define the market and therefore how are we defining monopoly power, as a share of the market
- Firms may appear to be monopolies due to having a high market share, but barriers to entry could be relatively low and so the market is reasonably contestable
- Very few firms with strong monopoly power last a long time – creative destruction and market forces may reduce monopoly power anyway without the need for intervention
- Consideration of “entirely” desirable

2. (a)	**Using a diagram and examples, explain what is meant by a monopolistically competitive market structure. [10]**	
Band	**AO1**	**AO3**
	6 marks	**4 marks**
3	**5-6 marks** Excellent, accurate and comprehensive understanding of monopolistic competition, including its conditions/characteristics and SR/LR positions Accurate diagram with no errors or omissions. Appropriate examples. Excellent use of relevant terminology.	
2	**3-4 marks** Good understanding of monopolistic competition, including its conditions/characteristics. Possibly some reference to the differences between SR/LR positions Mostly accurate diagram with few errors or omissions. Mostly appropriate examples. Good use of relevant terminology.	**3-4 marks** A good, accurate and comprehensive analysis of monopolistic competition. The diagram is embedded within the analysis.
1	**1-2 marks** Some recognition of what is meant by monopolistic competition. A diagram may be attempted but with significant errors or omissions. Few, if any, relevant examples Limited use of relevant terminology.	**1-2 marks** Limited analysis of monopolistic competition The diagram is unlikely to be fully embedded within the analysis.
0	**0 marks** No valid understanding.	**0 marks** No valid analysis

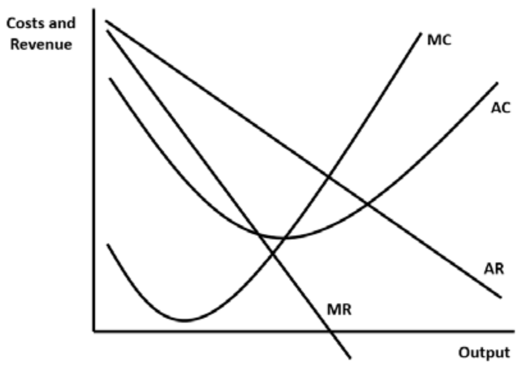
Indicative content:

- characteristics of monopolistic competition:
  - o many buyers and sellers
  - o no barriers to entry/exit, and therefore a degree of contestability
  - o differentiated products
  - o perfect knowledge/information
  - o profit maximising firms

- Relevant examples:
  - o Restaurants, hairdressers, pubs, global car manufacturing etc – accept any sensible suggestion
  - o Examples linked with the characteristics

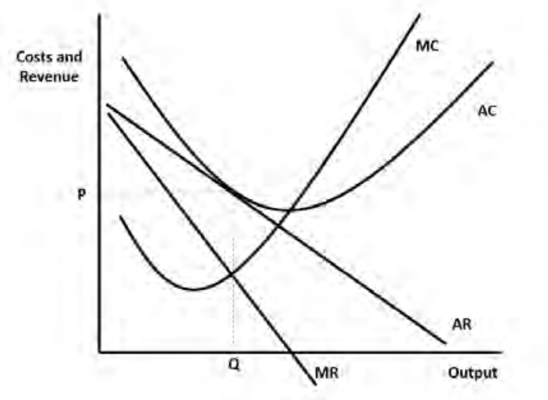
- Diagram
  - o Either a short-run or long-run diagram (good candidates may do both)
  - o Explanation of monopolistic competition linked to the diagram(s)

Short Run



In the SR, firms in MP can earn abnormal profit. Because of the lack of entry barriers, though, new firms are attracted to the industry. This reduces the market share of existing (incumbent) firms, causing their AR curve (and associated MR curve) to shift left as demand for their differentiated product falls. This continues until the firm is earning normal profit only.

Long run



Note: do not penalise candidates for writing ‘monopolistic markets’ rather than ‘monopolistically competitive markets’, if it is clear that they are explaining monopolistic competition

2. (b)	**Evaluate the view that firms in monopolistically competitive markets are always less efficient than firms in other market structures. [20]**		
Band	**AO1**	**AO3**	**AO4**
	6 marks	**6 marks**	**8 marks**
3	**5-6 marks** Excellent understanding of efficiency in both monopolistically competitive market structures and at least one other structure. Both breadth and depth of coverage is excellent i.e. consideration of a wide range of types of efficiency (allocative, productive, dynamic) Likely use of excellent diagrams (although not necessary). Excellent use of relevant terminology.	**5-6 marks** An excellent analysis of efficiency in monopolistically competitive markets. Chains of argument are well developed. If diagrams are used, they are accurate and carefully integrated into the written analysis.	**6-8 marks** An excellent critical evaluation of the relative efficiency of monopolistic competition to other structures. Evaluation will consider both the theory v practice of efficiency in monopolistic competition, as well as compare with other structures. A clear judgement on the efficiency of firms in monopolistic competition compared to other structures. he very best candidates will respond to the discriminator word 'always'.
2	**3-4 marks** Good understanding of efficiency in monopolistic competition, although may be less good in terms of considering efficiency in at least one other market structure, or may not cover a range of efficiencies. Answers in this band may omit significant content or the breadth of coverage is good but the depth of understanding is not sufficient to reach the highest band Good use of appropriate terminology.	**3-4 marks** A good analysis of efficiency in monopolistically competitive markets. Answers in this band show developed chains of argument. Answers in this band may lack depth, and any diagrams used may not always be well-integrated or completely correct	**3-5 marks** A good evaluation that includes most of the key issues. At least 2 types of efficiency in monopolistic competition are evaluated. The arguments may simply be focused on a comparison of efficiency between market structures.
1	**1-2 marks** Limited understanding of monopolistic competition, different types of efficiency, or other market structures.	**1-2 marks** Limited analysis of efficiency in monopolistic competition. Answer tends to lack key economic concepts and avoid technical analysis	**1-2 marks** Limited evaluation; candidates may include simple comparisons with other structures but do not fully evaluate.
0	**0 marks** No valid knowledge or understanding	**0 marks** No relevant analysis	**0 marks** No relevant evaluation

Indicative content:

- **Productive efficiency**: producing at lowest AC, gaining the most output for minimal input, not wasting resources
  - Monopolistic competition: no productive efficiency in theory in the SR or LR
  - Perfect competition: not productively efficient in the SR but it is in the LR
  - Monopoly: not productively efficient
  - Possible evaluation points: all profit-maximising businesses have an incentive to keep costs as low as possible; firms may share some operations to keep costs down (e.g. using the same food suppliers for restaurants in a local town), economies of scale in larger firms

- **Allocative efficiency**: producing where MC = AR i.e. demand = supply; roughly means that firms are producing what consumers actually want to buy, maximising ‘community surplus’
  - Monopolistic competition: not allocatively efficient in SR or LR
  - Perfect competition: allocatively efficient in SR and LR
  - Monopoly: not allocatively efficient
  - Possible evaluation points: slightly differentiated goods in MC might mean that consumer needs are closely met i.e. niche markets, catering to different tastes

- **Dynamic efficiency**: improvements to the production process can push AC down and/or investment into R&D for new / improved products; can require abnormal profits in order to be able to fund changes and investment
  - Monopolistic competition: firms earn abnormal profit in the SR but not the LR, therefore unclear as to whether they have the funds to be able to be dynamically efficient
  - Perfect competition: as above – but without differentiated products, it is unlikely that firms will be able to change products, as this will alter the market structure anyway
  - Monopoly: yes in theory because of the LR abnormal profits
  - Possible evaluation points: there are alternative sources of funds and firms do not need to rely on reinvested profits to initiate change i.e. borrowing from bank, loans from shareholders / owners, share-issue, bond issue (more likely for larger firms) etc; MP firms are characterised by differentiated products therefore innovation is a key part of their nature

- **General evaluation points**:
  - Firms are difficult to categorise neatly into market structures – they exist along a spectrum
  - Efficiency may depend on the degree of contestability
  - Efficiency is not necessarily wholly desirable
  - Depends on the objectives of firms – the above analysis suggests that they are all profit maximisers but in reality firms have a range of different objectives

SECTION B

<table>
<tr><td>3. (a)</td><td colspan="2">Using a PPF diagram, explain the possible causes of actual growth and potential growth in an economy. [10]</td></tr>
<tr><td rowspan="2">Band</td><td>AO1</td><td>AO3</td></tr>
<tr><td>6 marks</td><td>4 marks</td></tr>
<tr><td>3</td><td>5-6 marks
Excellent, accurate and comprehensive understanding of both actual and potential growth, and possible causes of both

Accurate diagram(s) with no errors or omissions, illustrating both actual and potential growth

Excellent use of relevant terminology.</td><td></td></tr>
<tr><td>2</td><td>3-4 marks
Good understanding of both actual and potential growth, and possible causes of both (this may be unbalanced)

Mostly accurate diagram(s) with few errors or omissions, perhaps focusing on either actual or potential growth.

Good use of relevant terminology.</td><td>3-4 marks
A good, accurate and comprehensive analysis of the causes of both actual and potential growth

The diagram is embedded within the analysis and fully explained.</td></tr>
<tr><td>1</td><td>1-2 marks
Some recognition of what is meant by actual and potential growth

A diagram(s) may be attempted but with significant errors or omissions.

Limited use of relevant terminology.</td><td>1-2 marks
Limited analysis of the causes of actual and potential growth – candidates may focus more on one than the other

The diagram is unlikely to be fully embedded within the analysis.</td></tr>
<tr><td>0</td><td>0 marks
No valid understanding.</td><td>0 marks
No valid analysis</td></tr>
</table>

Indicative content:

- Understanding of actual growth: increase in real GDP, growth in AD, reduction in spare capacity/negative output gap

- Understanding of potential growth: increase in the capacity of the economy, right shift of LRAS, shift outwards of a PPF, rise in the potential growth rate of the economy

- PPF diagram:
  - Actual growth: movement of production point closer to the frontier
  - Potential growth: outwards shift of the PPF

- Causes of actual growth (accept any reasonable demand-side causes)
  - Expansionary fiscal policy e.g. fall in direct tax rate, rise in government spending, increase in the budget deficit, rise in government borrowing
  - Expansionary monetary policy e.g. fall in interest rates, use of QE, forward guidance
  - Fall in the exchange rate causing exports to be more competitively priced
  - Rising business/household confidence
  - Multiplier / accelerator

- Causes of potential growth (accept any reasonable supply-side causes)
  - Net inwards migration
  - Rising investment
  - Improvement in human capital
  - Deregulation / privatisation

3. (b)	**Evaluate the extent to which economic growth always leads to conflicts with other policy objectives. [20]**		
Band	**AO1**	**AO3**	**AO4**
	6 marks	**6 marks**	**8 marks**
3	**5-6 marks** Excellent understanding of growth and possible conflicts / non-conflicts Both breadth and depth of coverage is excellent i.e. consideration of a range of conflicts, different types of economy etc Excellent use of relevant terminology.	**5-6 marks** An excellent analysis of the conflicts / non-conflicts between growth and other objectives Chains of argument are well developed. If diagrams are used, they are accurate and carefully integrated into the written analysis.	**6-8 marks** An excellent critical evaluation of the extent to which growth leads to conflicts or otherwise A clear judgement focused on the discriminator word 'always'
2	**3-4 marks** Good understanding of growth and possible conflicts / non-conflicts Answers in this band may omit significant content or the breadth of coverage is good but the depth of understanding is not sufficient to reach the highest band Good use of appropriate terminology.	**3-4 marks** A good analysis of the conflicts / non-conflicts between growth and other objectives Answers in this band show developed chains of argument. Answers in this band may lack depth, and any diagrams used may not always be well-integrated or completely correct	**3-5 marks** A good evaluation that includes most of the key issues. At least 2 conflicts / non-conflicts are evaluated.
1	**1-2 marks** Limited understanding of the possible conflicts / non-conflicts between growth and other objectives	**1-2 marks** Limited analysis of conflicts / non-conflicts between growth and other objectives Answer tends to lack key economic concepts and avoid technical analysis	**1-2 marks** Limited evaluation.
0	**0 marks** No valid knowledge or understanding	**0 marks** No relevant analysis	**0 marks** No relevant evaluation

Indicative content:

- The meaning of growth

- Alternative macroeconomic objectives include:
  - o Low inflation
  - o Low unemployment
  - o Balanced BOP
  - o Fiscal balance
  - o Reduced inequality

- The meaning of conflicts / trade-offs

- Growth and inflation: possible use of AD/AD diagram to show demand-pull inflation occurring as a result of actual growth, with explanation linked to increasingly scarce resources / rising bargaining power of workers
  - o BUT: not necessarily true if an economy has a large negative output gap, or if there is significant investment boosting the economy's supply-side, or if the authorities are intervening to help manage inflationary pressure
  - o BUT: possible use of Phillips curve analysis in the SR and LR, to show temporary trade-offs but none in the LR (link with money illusion, inflation expectations etc) (note – for the 2022 exam series, the LRPC was removed from the specification, but can be rewarded if candidates use this concept)
  - o BUT: also the possibility of stagflation; consideration of global downwards pressure on commodity/raw materials prices

- Growth and unemployment: likely that there is no conflict here – rising growth tends to reduce unemployment because of the derived demand for labour
  - o BUT: depends on whether growth is achieved as a result of improvement in technology, therefore less demand for labour; depends on regional issues i.e. growth could be concentrated in some industries / regions etc
  - o BUT: depends on whether growth is short-run (actual) or long-run (potential) – potential growth may increase the size of a negative output gap

- Growth and the trade balance: rising growth tends to lead to increased demand for imports, because a) households have more income and want to buy a greater range of goods/services, and b) businesses demand more raw materials/commodities in order to meet demand for the finished product.
  - o BUT: many other factors affect the trade balance; growth could be as a result of rising export sales etc

- Growth and the fiscal balance: rising growth should automatically improve the fiscal balance through less G and more T
  - o BUT: consider structural issues in the economy and current/capital spending; consider the impact of a 'race to the bottom' with tax rates etc; interest payments on debt etc

- General evaluative comments could include:
  - o Need to consider the government / economy in question – they may have different priorities, especially economies at different stages of development
  - o Consider the nature of the growth: actual or potential? There are fewer trade-offs if we consider LR growth
  - o Impact of intervention by the government / monetary authorities

4. (a)	Explain how inflation is calculated using a weighted price index. [10]	
Band	**AO1**	**AO3**
	6 marks	**4 marks**
3	**5-6 marks** Excellent, accurate and comprehensive understanding of types of price indices and how inflation is measured, with detailed knowledge of the process / method Excellent use of relevant terminology.	
2	**3-4 marks** Good understanding of the types of price indices and how inflation is measured Good use of relevant terminology.	**3-4 marks** A good, accurate and comprehensive analysis of how inflation is calculated, with detailed reference to the methodology of how a weighted price index is calculated
1	**1-2 marks** Some recognition of what is meant by price indices and inflation measures and the process of measuring inflation Limited use of relevant terminology.	**1-2 marks** Limited analysis of how inflation is calculated. Reference to price indices is unlikely to be fully integrated into the analysis, if at all
0	**0 marks** No valid understanding.	**0 marks** No valid analysis

Indicative content:

- Types of price indices used in the UK: RPI (introduced 1947), CPI (replaced RPI in 1996), CPIH (the official measured adopted in 2017 – Consumer Price Index including Owner-Occupiers Housing Costs)

- What is meant by inflation i.e. the change in the general level of prices in an economy

- Price indices:
  - o A base year is determined
  - o Surveys determine what households spend their money on
  - o This determines a typical shopping basket of goods/services (in the UK this is around 700 items)
  - o Each group of goods/services is assigned a ‘weight’ corresponding to the proportion of income spent on that item
  - o The prices of those items are tracked regularly (in the UK, each month – 180 000 prices of the 700 items are tracked) – the price of each item is multiplied by its ‘weight’
  - o The changes in the price of the basket give us the inflation rate

4. (b)	**Discuss the view that inflation is always costly and never beneficial.** **[20]**		
Band	**AO1**	**AO3**	**AO4**
	6 marks	**6 marks**	**8 marks**
3	**5-6 marks** Excellent understanding of inflation, and its costs and benefits Both breadth and depth of coverage is excellent i.e. consideration of a range of benefits and costs Excellent use of relevant terminology.	**5-6 marks** An excellent analysis of the benefits and costs of inflation. Chains of argument are well developed. If diagrams are used, they are accurate and carefully integrated into the written analysis.	**6-8 marks** An excellent critical evaluation of the extent to which inflation is beneficial or costly, including a clear judgement. The best candidates will consider the discriminator words 'always' and 'never'
2	**3-4 marks** Good understanding of inflation, and its costs and benefits, although it may be unbalanced. Answers in this band may omit significant content or the breadth of coverage is good but the depth of understanding is not sufficient to reach the highest band Good use of appropriate terminology.	**3-4 marks** A good analysis of the benefits and costs of inflation. Answers in this band show developed chains of argument. Answers in this band may lack depth, and any diagrams used may not always be well-integrated or completely correct	**3-5 marks** A good evaluation that includes most of the key issues. At least 2 points (benefits or costs) are evaluated
1	**1-2 marks** Limited understanding of inflation, and its costs or benefits. Answers in this band are likely to be one-sided.	**1-2 marks** Limited analysis of the benefits and costs of inflation. Answer tends to lack key economic concepts and avoid technical analysis	**1-2 marks** Limited evaluation.
0	**0 marks** No valid knowledge or understanding	**0 marks** No relevant analysis	**0 marks** No relevant evaluation

Indicative content:

Costs of inflation:

- Menu costs / shoe-leather costs
    - o BUT: businesses may accept small changes simply as a reduction in their profit margins; easier to change prices in the digital world
- Redistributes income from savers to borrowers
    - o BUT: this may improve inter-generational equality; depends on interest rates
- Reduces confidence
    - o BUT: depends on degree of inflation and the causes; depends if the Central Bank has a credible response
- Fall in real income and therefore living standards
    - o BUT: depends on regularity of wage increases / union strength etc
- Fall in international competitiveness
    - o BUT: depends on inflationary pressure in other economies; depends on whether the economy operates a floating exchange rate system which can automatically adjust
- Risk of fiscal drag
    - o BUT: depends on wage increases / extent to which the government changes the tax boundaries
- Risk of wage-price spiral
- Impact on the poor

Benefits of inflation:

- Demand-pull inflation is indicative of growth; it could even cause some growth as spending speeds up to avoid price rises
    - o BUT: need to consider the cause of the growth and its distribution
- Inflation targets are usually positive which suggests a little inflation is a good thing; it allows relative prices to adjust more easily
- Less likely to have real-wage unemployment: wages for some but not all may be raised – workers do not like to take nominal wage cuts
    - o BUT: assumes workers do not understand the difference between real and nominal wages
- Avoids deflation, which can lead to depression
    - o BUT: deflation is very rare
- Can reduce the size of government debt
    - o BUT: depends on the currency in which the debt is denominated

General evaluative comments:

- Consideration of degree of economic development and sophistication of Central Bank in managing inflation
- Cause of inflation – demand-pull vs cost-push…the former is probably better for the economy because it implied that there is growth / rise in employment
- Degree / level of inflation – hyperinflation is very different to inflation of 5%
- Anticipated v unanticipated inflation / consideration of inflationary expectations
    - o Possible use of SR and LR Phillips Curves

SECTION C

<table>
<tr><td>5. (a)</td><td colspan="2">Explain the likely link between changes in the terms of trade and changes in the current account balance. [10]</td></tr>
<tr><td rowspan="2">Band</td><td>AO1</td><td>AO3</td></tr>
<tr><td>6 marks</td><td>4 marks</td></tr>
<tr><td>3</td><td>5-6 marks
Excellent, accurate and comprehensive understanding of both the terms of trade and the current account balance

Excellent use of relevant terminology.</td><td></td></tr>
<tr><td>2</td><td>3-4 marks
Good understanding of both the terms of trade and the current account balance

Good use of relevant terminology.</td><td>3-4 marks
A good, accurate and comprehensive analysis of how the terms of trade is linked with changes in the current account balance</td></tr>
<tr><td>1</td><td>1-2 marks
Some recognition of the terms of trade and the current account balance

Limited use of relevant terminology.</td><td>1-2 marks
Limited analysis of how changes in the terms of trade affect the current account balance</td></tr>
<tr><td>0</td><td>0 marks
No valid understanding.</td><td>0 marks
No valid analysis</td></tr>
</table>

Indicative content:

- Understanding of the terms of trade
  - Index price of exports / index price of imports x 100
  - Improvement refers to a higher value i.e. export prices rising more relative to import prices
  - The number of imports that can be bought per unit of exports

- Understanding of the current account balance
  - One of the accounts on a country's BOP
  - Current account comprises the trade balance, net primary income, and net secondary income

- The relationship between the two
  - An improvement in the terms of trade may worsen the current account balance
  - This is because exports become relatively more expensive and the law of demand suggests therefore that fewer exports will be demanded
  - Imports are relatively cheaper and so the law of demand suggests that more imports will be demanded
  - This worsens the trade balance
  - In turn, ceteris paribus, this worsens the current account balance

- Candidates may explain instead that the trade balance may improve if the Marshall-Lerner condition does not hold, because relatively price inelastic X and M will cause export revenues to rise and import revenues to fall – this may be the case in the UK (exporting financial services / technology, and importing food/necessities)

5. (b)	Evaluate the ways in which governments could reduce a sustained current account deficit, in both LEDCs and MEDCs. [20]		
Band	**AO1**	**AO3**	**AO4**
	6 marks	**6 marks**	**8 marks**
3	**5-6 marks** Excellent understanding of methods of reducing current account deficits in LEDCs and MEDCs Both breadth and depth of coverage is excellent i.e. consideration of a range of policies to reduce sustained deficits Excellent use of relevant terminology.	**5-6 marks** An excellent analysis of ways in which governments can reduce CA deficits in LEDCs and MEDCs Chains of argument are well developed. If diagrams are used, they are accurate and carefully integrated into the written analysis.	**6-8 marks** An excellent critical evaluation of the methods discussed, in light of both LEDCs and MEDCs The best candidates will consider the issue of 'sustained' current account deficits and perhaps reach a judgement on the 'best' policy / approach
2	**3-4 marks** Good understanding of methods of reducing current account deficits in LEDCs and MEDCs, although the understanding may be unbalanced towards LEDCs or MEDCs Answers in this band may omit significant content or the breadth of coverage is good but the depth of understanding is not sufficient to reach the highest band Good use of appropriate terminology.	**3-4 marks** A good analysis of the methods of reducing current account deficits. Answers in this band show developed chains of argument. Answers in this band may lack depth, and any diagrams used may not always be well-integrated or completely correct	**3-5 marks** A good evaluation that includes most of the key issues. At least 2 policies are evaluated
1	**1-2 marks** Limited understanding of current account deficits, methods for correcting deficits, or issues in LEDCs/MEDCs Answers in this band are likely to be one-sided.	**1-2 marks** Limited analysis of the methods of reducing current account deficits Answer tends to lack key economic concepts and avoid technical analysis	**1-2 marks** Limited evaluation.
0	**0 marks** No valid knowledge or understanding	**0 marks** No relevant analysis	**0 marks** No relevant evaluation

Indicative content:

- The nature of a current account deficit i.e. more outflows than inflows
    - o Can be caused by a trade deficit, and/or greater outflows on the net primary income or secondary income accounts
    - o Accompanied by inflows on the financial/capital accounts

- Consideration of the reasons why governments may want to reduce current account deficits:
    - o Increase injections to circular flow / AD
    - o Over-exposure to goods and services from other countries, undercutting your own businesses, making it difficult for infant industries to survive etc
    - o Balanced by short-term capital flows on the financial account i.e. hot money – this is more likely to cause an exchange rate crisis / BOP crisis than if balanced by longer-term capital flows

- Consideration of the need for different policies to reduce current account deficits caused by different factors
    - o Uncompetitive / undesirable exports: policies include - subsidised exports, improved education/training, improved transport infrastructure, tax breaks on R&D, manipulation of exchange rates (i.e. devaluation)
        - ▪ BUT: These policies may be more challenging to implement in LEDCs because of lack of government funds – maybe more likely to encourage FDI to help develop appropriate infrastructure and build skills
        - ▪ BUT: can take considerable time to implement these policies – less likely in times of austerity (conflicts with other objectives)
        - ▪ BUT: involves the government 'picking winners'
        - ▪ BUT: devaluation requires intervention from a Central Bank to buy foreign currency using domestic reserves – many MEDCs have floating currencies therefore this policy is irrelevant, and LEDCs may not have enough reserves to do this
    - o Large demand for imports (could be necessities; could be because of a rise in income combined with a high MPM; could be imported capital): policies include protectionist measures (tariffs, quotas, exchange rate manipulation), import substitution industrialisation (ISI), expenditure reducing measures (e.g. raising income tax rates to reduce disposable income)
        - ▪ BUT: risk of trade wars / tit-for-tat retaliation (LEDCs more likely to lose out)
        - ▪ BUT: ISI can take time – but has been successful in LEDCs (e.g. S Korea)
        - ▪ BUT: expenditure reducing policies can be politically unpopular, and reduce living standards
        - ▪ BUT: some imports might be absolutely essential e.g. food, energy, medicine, therefore imports should continue – possibly more likely in LEDCs

- General evaluation comments
    - o Policies chosen depend on the cause of the deficit
    - o Choosing to 'do nothing' is also a policy – some governments may be unconcerned especially if they have a floating exchange rate (technically, imbalances are self-correcting in this case) or the deficit is balanced by a large long-term capital inflow on the financial account
    - o Governments of different political persuasions will have different views on the best policy

6. (a)	Explain the possible impacts of industrialisation on an LEDC. [10]	
Band	**AO1**	**AO3**
	6 marks	**4 marks**
3	**5-6 marks** Excellent, accurate and comprehensive understanding of industrialisation, LEDCs, and impacts on LEDCs. Excellent use of relevant terminology.	
2	**3-4 marks** Good understanding of industrialisation, LEDCs and impacts. Good use of relevant terminology.	**3-4 marks** A good, accurate and comprehensive explanation of the impacts of industrialisation on LEDCs. Diagrams (if used) are embedded within the analysis.
1	**1-2 marks** Some recognition of industrialisation and LEDCs. Limited use of relevant terminology.	**1-2 marks** Limited explanation of the impacts of industrialisation on LEDCs. Diagrams (if used) are unlikely to be fully embedded within the analysis.
0	**0 marks** No valid understanding.	**0 marks** No valid analysis

Indicative content:

- Meaning of industrialisation
- Reference to concepts such as urbanisation, primary / secondary sector, manufacturing etc
- Understanding of the characteristics of an LEDC e.g. low living standards, poor infrastructure, low HDI value, low levels of education etc
- Explanation of possible links between industrialisation and LEDCs, for example:
  - More stable income due to less primary product dependency and the associated volatility of income
  - Less risk of suffering from the resource curse / Dutch disease with a move away from primary products and towards manufactured goods
  - Production of goods with a higher ‘value-added’ therefore higher incomes
  - More job opportunities in the formal economy rather than the informal economy
  - MNCs may cause knowledge transfer and technology transfer, which can improve the supply side of the economy
  - Larger / more consistent tax base for the government
  - Multiplier effects
  - Higher risk of pollution and other negative production externalities
  - Risk of labour exploitation

6. (b)	**Evaluate the extent to which high levels of national (public sector) debt are damaging for LEDCs. [20]**		
Band	**AO1**	**AO3**	**AO4**
	6 marks	**6 marks**	**8 marks**
3	**5-6 marks** Excellent understanding of the impact of high levels of public sector debt in LEDCs. Both breadth and depth of coverage is excellent Excellent use of relevant terminology.	**5-6 marks** An excellent analysis of the impact of high levels of public sector debt in LEDCs. Chains of argument are well developed.	**6-8 marks** An excellent critical evaluation of the impact of high levels of public sector debt in LEDCs. A clear judgement is reached at the very highest level.
2	**3-4 marks** Good understanding of the impact of high levels of public sector debt Answers in this band may omit significant content or the breadth of coverage is good but the depth of understanding is not sufficient to reach the highest band. Answers in this band may also not be fully linked to LEDCs. Good use of appropriate terminology.	**3-4 marks** A good analysis of the impact of high levels of public sector debt. Answers in this band show developed chains of argument. Answers in this band may lack depth, links to LEDCs, and any diagrams used may not always be well-integrated or completely correct.	**3-5 marks** A good evaluation that includes most of the key issues. At least 2 impacts must be evaluated
1	**1-2 marks** Limited understanding of the impact of high levels of public sector debt in LEDCs.	**1-2 marks** Limited analysis of the impact of high levels of public sector debt in LEDCs. Answer tends to lack key economic concepts and avoid technical analysis	**1-2 marks** Limited evaluation; candidates may show awareness of some evaluative points but do not develop them
0	**0 marks** No valid knowledge or understanding	**0 marks** No relevant analysis	**0 marks** No relevant evaluation

Indicative content:

- Understanding of public sector debt (i.e. national debt or sovereign debt)
- Understanding of 'high levels' of public sector debt i.e. debt as a proportion of GDP is high, perhaps close to or above 100%
- Understanding of the reasons why LEDCs may have high levels of public sector debt:
    - o Low tax revenue due to low incomes, informal economy, MNCs repatriating profit, cost of tax collection
    - o High levels of government spending due to high interest rates on debt, spending on essentials such as healthcare etc
- Recognition that different causes of debt will have different impacts e.g. high spending on health and education or infrastructure could be beneficial to the LEDC whereas high spending on government cars/buildings/offices may be less beneficial
- Reference to crowding out
- Understanding of the terms of the public sector debt
    - o Conditional loans from the World Bank / IMF – could be connected with unhelpful conditions such as reducing government spending, which could reduce spending on healthcare, education, infrastructure etc
    - o High interest rates due to low credit ratings of the country's government – high opportunity cost, and so tax revenues cannot be put to productive uses
    - o Ability to borrow more in the future could be hampered by difficult terms today
- General evaluative points:
    - o Depends on just how high the debt is
    - o Depends on the economy's growth rate and whether growth is faster than the rate at which debt is accumulating
    - o Depends on the currency in which the debt is expressed, and therefore movements in exchange rates and inflation
    - o Depends on the ability of the government to negotiate debt relief terms