# GCE A LEVEL MARKING SCHEME

**SUMMER 2019**

**A LEVEL**
**ECONOMICS - COMPONENT 3**
**A520U30-1**

## INTRODUCTION

This marking scheme was used by WJEC for the 2019 examination. It was finalised after detailed discussion at examiners' conferences by all the examiners involved in the assessment. The conference was held shortly after the paper was taken so that reference could be made to the full range of candidates' responses, with photocopied scripts forming the basis of discussion. The aim of the conference was to ensure that the marking scheme was interpreted and applied in the same way by all examiners.

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

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

## GENERAL MARKING GUIDANCE

### Positive Marking

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

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

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

| 1 (a) Distinguish, using examples, between structural and behavioural barriers to entry. [10] | | |
|---|---|---|
| | AO1 | AO3 |
| **Band** | 6 marks | 4 marks |
| 3 | **5-6 marks**<br>Excellent understanding.<br><br>Excellent understanding of both structural and behavioural barriers to entry and the differences between them.<br><br>Understanding is detailed and comprehensive. | |
| 2 | **3-4 marks**<br>Good understanding.<br><br>A good understanding of structural and behavioural barriers to entry, although detail may be lacking; perhaps understanding may be strong on one type of barrier and weak on the other. | **3-4 marks**<br>Good analysis.<br><br>Each type of barrier to entry is explained in detail and the examples used are appropriately analysed. |
| 1 | **1-2 marks**<br>Limited understanding.<br><br>Candidate only demonstrates a narrow knowledge of the two different types of barrier to entry, and understanding is limited. | **1-2 marks**<br>Limited analysis.<br><br>Each type of barrier to entry could be explained in more detail with use of examples; lacks some analysis. |
| 0 | **0 marks**<br>No knowledge or understanding present. | **0 marks**<br>No valid analysis. |

**Indicative content:**

Barriers to entry occur when it is too costly or difficult for potential rivals to enter the market. Structural entry barriers are those barriers that exist which are barriers that naturally exist in the market, e.g. economies of scale, network effects, control of key resources, high start-up costs, high R&D costs, advertising, legal barriers, etc.

Behavioural (or strategic) barriers to entry are erected deliberately by the incumbent(s), such as limit pricing, vertical integration, switching costs, exclusive contracts and licencing, loyalty schemes, etc.

| 1 (b) | **Evaluate the extent to which competition and contestability are desirable in product markets. [20]** | | |
|---|---|---|---|
| | AO1 | AO3 | AO4 |
| **Band** | 6 marks | 6 marks | 8 marks |
| 3 | **5-6 marks**<br>Excellent understanding.<br><br>An excellent understanding is shown of the benefits of having competition and contestability in markets: looking at consumers, producers and connections to the whole economy. | **5-6 marks**<br>Excellent analysis.<br><br>An excellent analysis of how competition and contestability will be beneficial to producers and consumers, with reference to the wider economy.<br><br>Answers in this level may use appropriate diagrams and examples and integrate them into the rest of their answer. | **6-8 marks**<br>Excellent evaluation.<br><br>Evaluation points are well developed, showing why competition and contestability may not be desirable.<br><br>An overall judgement draws together issues from both sides of the argument and/or there may be an integrated approach to evaluation. |
| 2 | **3-4 marks**<br>Good understanding.<br><br>A good understanding of the benefits but there may be a lack of development in some of the benefits identified.<br><br>Not all of consumers, producers and the economy will be covered. | **3-4 marks**<br>Good analysis.<br><br>A good analysis of how competition and contestability will be desirable to producers, consumers and the wider economy.<br><br>Some analysis will lack depth although not all aspects will be looked at. Any diagrams may contain minor errors or not be well integrated. | **3-5 marks**<br>Good evaluation.<br><br>A strong two-sided answer with effective points on both sides of the argument, but which never directly answers the question set in terms of coming to a reasoned conclusion. |
| 1 | **1-2 marks**<br>Limited understanding.<br><br>A limited understanding of the benefits with few identified and/or little development of each. | **1-2 marks**<br>Limited analysis.<br><br>A limited analysis of how competition and contestability will be desirable for producers, consumers and the wider economy.<br><br>Analysis is brief and superficial and will not address all aspects. | **1-2 marks**<br>A limited evaluation.<br><br>A basic attempt is made to show that the competition and contestability in markets may not be desirable.<br>Points are qualified to a limited extent but there is little depth of explanation. |
| 0 | **0 marks**<br>No knowledge or understanding is shown. | **0 marks**<br>No relevant analysis. | **0 marks**<br>No valid evaluation. |

**Indicative content:**

Distinction made between competition and contestability.
Contestability is a measure of the ease with which a firm can enter or leave an industry.

Competition and contestability drives up quality, productivity, variety, choice, etc. It leads to lower prices (higher consumer surplus), promotes R&D and reduces the chance of anti-competitive practices/abuse of dominance. Contestability leads to better resource allocation/reduces market failure in the economy, good for productivity and economic growth. Firms more likely to be closer to allocative efficiency (P=MC).
Competition can increase dynamic efficiency relative to monopoly because, even if profits are lower, there will be a greater incentive to use them.
Lack of competition leads to poor international competitiveness.

BUT

Competition and contestable markets can drive down profits and thus markets have no funds for investment – loss of dynamic efficiency.

Consumers can be confused and produce less rational decisions with high levels of competition and face increased shoe leather costs.

Danger of a chase to the bottom with low prices/poor quality.

Markets may be contestable but new entrants will not be able to challenge the largest firms, e.g. energy, groceries.

Even in contestable markets, firms can still engage in anti-competitive practices, e.g. limit pricing.

Benefits of contestability depend on HOW contestable it is. Also, some markets are competitive but do not function effectively, e.g. energy – tacit collusion/price leadership.

Contestable markets may allow in firms which are ill-equipped or lack the expertise to operate effectively.

| 2 (a) Explain why public goods are an example of market failure. [10] | | |
|---|---|---|
| | AO1 | AO3 |
| **Band** | 6 marks | 4 marks |
| 3 | **5-6 marks**<br>Excellent understanding.<br><br>Excellent understanding of public goods and market failure has been shown, including:<br><br>A clear understanding of (i) non-excludability and (ii) non-diminishability/rivalry or non-rejectability.<br><br>A clear understanding of market failure as a misallocation of resources, resulting in a welfare loss. | |
| 2 | **3-4 marks**<br>Good understanding.<br><br>Good understanding of public goods and market failure.<br><br>The two characteristics of public goods above have been covered effectively. | **3-4 marks**<br>Good analysis.<br><br>Strong explanation of why public goods cause a free market economy to misallocate resources – explanation of why they will be under-supplied, meaning that welfare is lost. |
| 1 | **1-2 marks**<br>Limited understanding.<br><br>Limited understanding of public goods and market failure.<br><br>Only one of the two characteristics of public goods has been developed or two have been identified without development. | **1-2 marks**<br>Limited analysis.<br><br>Some attempt has been made to explain why welfare has been lost in the case of public goods, but there is no clear link back to misallocation of resources. |
| 0 | **0 marks**<br>No knowledge or understanding present. | **0 marks**<br>No valid analysis. |

**Indicative content:**

**AO1**

Public goods are an example of complete market failure. Market failure occurs when an unregulated/free market results in an equilibrium output that does not maximise societal welfare (community surplus); hence, resources have been misallocated.

Public goods are non-excludable, meaning that non-payers cannot be prevented from accessing the goods, and non-diminishable/rivalrous, meaning that an additional user does not affect total supply/availability to others. A pure public good is also non-rejectable, e.g. national defence.

**AO3**

Because public goods are non-excludable, this means that it is not possible to prevent non-payers (free-riders) from accessing the good. Therefore, it is not possible for firms to make a profit and therefore they will not be supplied.

As a result, resources are misallocated, either because we fail to produce goods for which the MSB would have been greater than MSC, or because resources are not being used here where they would have been valuable; they will have been used in other less-desirable sectors. Either way, welfare is not maximised.

A diagram here could be very effective but is not essential.

| 2 (b) | **Discuss whether government attempts to correct market failure do more harm than good. [20]** | | |
|---|---|---|---|
| | AO1 | AO3 | AO4 |
| **Band** | 6 marks | 6 marks | 8 marks |
| 3 | **5-6 marks**<br>Excellent understanding.<br><br>An excellent understanding of government failure (or equivalent) and the ways in which governments can intervene is demonstrated. | **5-6 marks**<br>Excellent analysis.<br><br>An excellent analysis of how government policies to correct market failure do more harm than good.<br><br>There is a clear link back to welfare loss as a result of government intervention and this outweighs the attempted resolution. | **6-8 marks**<br>Excellent evaluation.<br><br>Well-developed two-sided answer that looks at the relative merits and demerits of government intervention in markets.<br><br>Comes to a reasoned judgement as to the circumstances under which government intervention is likely to do more harm than good. |
| 2 | **3-4 marks**<br>Good understanding.<br><br>Good understanding is shown of government failure (or equivalent) or the ways in which governments can intervene is demonstrated. | **3-4 marks**<br>Good analysis.<br><br>A good analysis of how government policies to correct market failure do more harm than good.<br><br>There is a clear link back to welfare loss as a result of government intervention | **3-5 marks**<br>Good evaluation.<br><br>A strong, two-sided answer with effective points on both sides of the argument, but which never directly answers the question set in terms of coming to a reasoned conclusion. |
| 1 | **1-2 marks**<br>Limited understanding.<br><br>Limited understanding is shown of government failure (or equivalent) or the ways in which governments can intervene is demonstrated. Neither of the two is well developed and understanding of each is only superficial. | **1-2 marks**<br>Limited analysis.<br><br>There is some sense that government intervention can backfire, but there is no link back to the overall issue of resource allocation/welfare loss. | **1-2 marks**<br>Limited evaluation.<br><br>A basic attempt is made to show that the statement is not always correct but there is a tendency to just make assertions. |
| 0 | **0 marks**<br>No knowledge or understanding is shown. | **0 marks**<br>No relevant analysis. | **0 marks**<br>No valid evaluation. |

**Indicative content:**

**AO1**

Government failure is a situation in which government intervention in a market leads to a misallocation of resources and welfare loss.

The law of unintended consequences is an analogous concept in which government policy actions to correct one failure result in unexpected negative outcomes that make the intervention suspect in terms of its desirability.

Almost any appropriate policy can be discussed – to get high AO1, a clear understanding of how it is supposed to work needs to be shown. Policies may well fit into:

Financial interventions such as taxes, subsidies and direct government provision
Legislative interventions such as usage restrictions, quotas, bans, and so on
Information interventions such as labelling, public awareness campaigns, and so on

Credit use of diagrams as either good understanding or also as analysis (AO3) if they are used effectively to illustrate welfare loss.

**AO3**

Clear link between the policies identified and some form of clear negative outcome such as government failure. Diagrams may well be used here to show how the intervention leads to a welfare loss.

Examples may include:
Over-provision of public goods due to the difficulty with calculating social benefits
Excessive taxes which then lead to smuggling and black markets
Quotas on fishing which result in excess dead fish being thrown back into the sea rather than being eaten
Laws which create distortions and mis-incentives – for example, the energy-efficient lightbulb regulations or the government's subsidies for diesel cars back in the late 90s/early 00s

But any credible intervention which was (i) clearly intended to correct a market failure and (ii) created some form of negative effect should be credited here.

**AO4**

A fair amount of ground can be made here by showing that government intervention often does correct market failure and therefore does more good than harm. A strong, two-sided answer which does this can get to the top of 'Good'.

Other evaluative approaches might be to argue that interventions might create negative side-effects, but that the outcome is still better than it would have been without any intervention at all. This sort of answer, if done well, should be able to access excellent evaluation.

Other lines might think that it depends on the type of government intervention – that some forms of intervention are more likely to create net harm than others. If well-developed with some examples, this too should be well worth excellent evaluation.

| **3 (a)** | **Explain why economies such as the UK need a legal framework of regulation for the financial sector. [10]** | |
|---|---|---|
| | AO1 | AO3 |
| **Band** | 6 marks | 4 marks |
| 3 | **5-6 marks**<br>Excellent understanding.<br><br>Candidate has a good understanding of the major reasons why a country such as the UK needs to have a framework of financial regulation.<br><br>A top band response will have a well-developed understanding of the key reasons. At the bottom of this band there will be fewer reasons developed. | |
| 2 | **3-4 marks**<br>Good understanding.<br><br>Answers in this band will have fewer reasons developed than in a band 3 answer or development of a wider range may not be so comprehensive.<br><br>Answers in this level are likely to show a good understanding of only two reasons for financial regulation, although, at the top of the band, answers may also have partial development of further reasons. | **3-4 marks**<br>Good analysis.<br><br>There is logical development and clear analysis. Generally, there are well-developed lines of reasoning shown between the reason being identified and its impact on the financial sector. |
| 1 | **1-2 marks**<br>Limited understanding.<br><br>Candidate can only demonstrate a basic knowledge of why the UK economy needs financial regulation.<br><br>For the top of this band, it is likely that the key reasons for regulation will have been simply identified. Alternatively, the learner illustrates a basic understanding of only two reasons for financial regulation. | **1-2 marks**<br>Limited analysis.<br><br>Reasoning is generally not well developed. There is some explanation and development, but this is either superficial or covers only one or two of the points identified. |
| 0 | **0 marks**<br>No knowledge or understanding present. | **0 marks**<br>No valid analysis. |

**Indicative content:**

A key objective for financial regulation and supervision is to increase the effective functioning of the financial system in order to enhance the ability to absorb shocks and maintain financial stability.

Previous crises in the 1930s and, more recently, in 2008-09, are a good reason for regulation. Voluntary codes do not work in a fiercely competitive business. If the financial sector can get away with behaving irresponsibly, some firms will.

Competition does not work well in finance. The "product" of the financial industry often involves promises marketed as dreams that can readily become nightmares. Customers are persuaded by exaggerated promises, irrational beliefs, misplaced trust and sometimes sheer skulduggery.

Practitioners: basing risk management on limited data and inadequate models is a good example.

An important function of financial regulation is to balance the interests of unsophisticated consumers of financial products and their sophisticated sellers. There is asymmetry of information and other forms of market failure present in the financial sector, e.g. moral hazard, thus there is a need for regulation.

The costs of a failure of the financial system are far in excess of the costs to the shareholders of the banks that fail.

Need to control monopoly power in financial markets' abuse of dominance – market rigging (LIBOR).

| 3 (b) | **Evaluate the extent to which the UK's financial sector is beneficial to the UK economy.** **[20]** | | |
|---|---|---|---|
| | AO1 | AO3 | AO4 |
| **Band** | 6 marks | 6 marks | 8 marks |
| 3 | **5-6 marks**<br>Excellent understanding.<br><br>Excellent understanding of the impact of the financial sector to the UK economy. Answer shows a detailed understanding of a number of points on either side of the question, i.e. some positive some negative. | **5-6 marks**<br>Excellent analysis.<br><br>Excellent analysis of how the financial sector in the UK impacts on the wider economy.<br><br>Candidate shows a clear line of argument in their analysis. | **6-8 marks**<br>Excellent evaluation.<br><br>Well-developed, two-sided answer that looks at the relative merits of the financial sector to the UK economy.<br><br>Candidate comes to a reasoned judgement as to the extent to which the UK's financial sector is likely to be beneficial. |
| 2 | **3-4 marks**<br>Good understanding.<br><br>Good understanding of the impact of the financial sector on the UK economy; some negative, some positive, although some of the development may be limited or superficial. | **3-4 marks**<br>Good analysis.<br><br>A good analysis of how the financial sector impacts on the wider economy.<br><br>The answer may have a good line of argument, but clarity of analysis may be lacking. | **3-5 marks**<br>Good evaluation.<br><br>A strong, two-sided answer with effective points on both sides of the argument, but which never directly answers the question set in terms of coming to a reasoned conclusion. |
| 1 | **1-2 marks**<br>Limited understanding.<br><br>Limited understanding of the impact of the financial sector on the UK economy.<br><br>The points made are undeveloped and superficial. | **1-2 marks**<br>Limited analysis.<br><br>Limited analysis of the impact of how the financial sector impacts on the economy.<br><br>The line of argument will show a lack of clarity. | **1-2 marks**<br>A limited evaluation.<br><br>Evaluation is very limited. A few evaluative points are made but merely as assertions.<br><br>The points made are not developed and superficial. |
| 0 | **0 marks**<br>No knowledge or understanding is shown. | **0 marks**<br>No relevant analysis. | **0 marks**<br>No valid evaluation. |

**Indicative content:**

Contribution of the financial sector to employment, GDP, exports, etc.

Financial sector is the country's largest taxpayer (£71bn)/biggest exporting sector.

Financial sector plays an important role in personal finance, business finance, and directly and indirectly generates growth through loans which finance investment.

Employment in the financial sector is spread across the whole of the UK and thus benefits all the regions.

UK has a comparative advantage in this area of activity, thus it must benefit the economy and contribute to competitiveness. It is a major earner on the current account of the balance of payments.

BUT

Overdependence on this sector has made the UK economy unbalanced and vulnerable, e.g. Brexit and new financial centres.

Financial sector is prone to crises as evidenced recently in 2008-09. The sector is hard to regulate and prone to various forms of market failure.

UK financial sector is vulnerable to crises in other countries, e.g. British banks are particularly exposed to instability in China – recent figures from the Bank for International Settlements showed them holding a staggering 28% of all China's overseas loans, more than those of any other country.

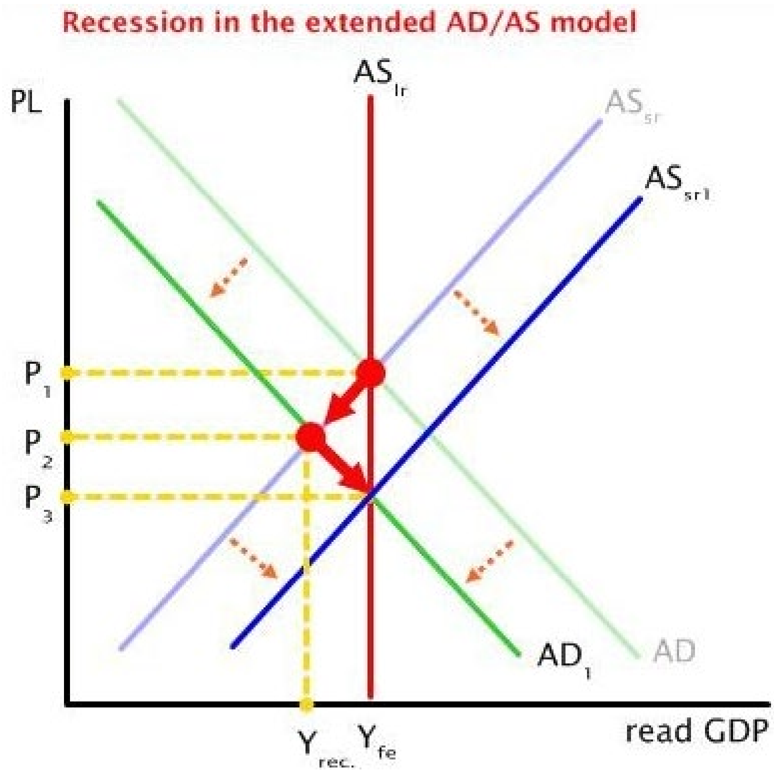
A 2015 study showed that rapid financial sector expansion is bad for growth. Where skilled labour works in finance, the financial sector grows more quickly at the expense of the real economy. It goes on to show that, consistent with this theory, financial growth disproportionately harms financially dependent and R&D-intensive industries.

Why does financial sector growth crowd out real economic growth? by Stephen G Cecchetti and Enisse Kharroubi (February 2015).

| Q4 (a) | **Explain the process by which neo-classical economists argue that the economy can adjust to long-run equilibrium following a negative demand side shock. Use a diagram to support your answer. [10]** | |
|---|---|---|
| | AO1 | AO3 |
| **Band** | 6 marks | 4 marks |
| 3 | **5-6 marks**<br>Excellent understanding.<br><br>Excellent understanding of neoclassical self-stabilisation with a well-integrated, effective diagram in which new AD and a new SRAS curve are present.<br><br>There is a clear outline of the fall in AD and clear diagram used to illustrate short-run and long-run equilibria. There is no need for LRAS to be drawn in, but long-run equilibrium must be identified. | |
| 2 | **3-4 marks**<br>Good understanding.<br><br>A clear diagram with AD shifting to the left is shown and a new SRAS curve is also shown in the right place.<br><br>There is a lack of clarity as to why one of these two curves has shifted. | **3-4 marks**<br>Good analysis.<br><br>Excellent chain of analysis explaining the process through which self-stabilisation takes place. |
| 1 | **1-2 marks**<br>Limited understanding.<br><br>A diagram with either AD shifting to the left or a new SRAS curve in the right place.<br><br>Or both are drawn in the right place but there is no correct outline as to why either of the curves has shifted. | **1-2 marks**<br>Limited analysis.<br><br>Limited analysis of the process in which it is clear only either (i) why prices fall or (ii) why this causes AD to rise. |
| 0 | **0 marks**<br>No knowledge or understanding present. | **0 marks**<br>No valid analysis. |

**Indicative content:**

**AO1**




A negative demand shock means that AD falls at all prices, causing the economy to move to short-run equilibrium at an output below NAIRU/full employment

SRAS shifts downwards because, in the long run, wages (and other factor prices) are driven down, reducing firms' costs. At a given level of real GDP, the SRAS function is therefore lower.

The reduction in prices leads to the establishment of a new equilibrium back at the original supply-side constraint, but at a lower aggregate price level.

**AO3**

As AD falls, this creates unemployment in labour markets (and other factor markets). Therefore, wages are driven down, which reduces firms' costs. Consequently, given perfect markets, there is downward pressure on the aggregate price level in the economy.

This fall in prices causes an extension in AD because of (i) the real balance effect; (ii) the trade effect; and (iii) the real interest effect (only one of these needs to be explained). Hence, real GDP rises until the excess supply in factor markets has been eliminated and the economy returns to its supply side constraint in the long run (NRU/NAIRU/full employment – allow whatever the candidate chooses).

| 4 (b) | **Discuss the extent to which economies are likely to recover quickly from negative demand side shocks in reality**. **[20]** | | |
|---|---|---|---|
| | AO1 | AO3 | AO4 |
| **Band** | 6 marks | 6 marks | 8 marks |
| 3 | **5-6 marks**<br>Excellent understanding.<br><br>Excellent understanding of factors that might cause an economy to recover or not in the long run.<br>A good range is covered with clear outline shown. It is likely that three factors will be covered, but depth of understanding can replace breadth here. | **5-6 marks**<br>Excellent analysis.<br><br>An excellent analysis of the reasons why an economy might not self-stabilise.<br><br>Shows a strong understanding of the theoretical objections to self-stabilisation. Or an answer with weaker theory but strong real-world context can score 'excellent' here. | **6-8 marks**<br>Excellent evaluation.<br><br>Well-developed, two sided answer with effective points on both sides made.<br><br>The answer qualifies theoretical objections or produces strong, real-world counter-arguments.<br><br>Answer comes to a judgement as to the extent to which economies are likely to self-stabilise, making it clear what it depends on. |
| 2 | **3-4 marks**<br>Good understanding.<br><br>Good understanding of factors that might cause an economy to recover or not in the long run.<br><br>The clarity of the outline or range of issues covered is insufficient for band 3. | **3-4 marks**<br>Good analysis.<br><br>A good analysis of the reasons why an economy might not self-stabilise.<br><br>Answer shows some understanding of the theoretical objections, but these are not fully explained.<br>Or<br>Answer uses real world evidence in great depth to make the argument but has very few or no theoretical objections. | **3-5 marks**<br>Good evaluation.<br><br>A strong, two-sided answer with effective points on both sides made.<br><br>Answer qualifies theoretical objections or produces strong real-world counter-arguments, but there is no overall judgement. |
| 1 | **1-2 marks**<br>Limited understanding.<br><br>Limited understanding of factors that might cause an economy to recover or not in the long run.<br><br>Answers in this band are likely simply to identify relevant factors, showing knowledge rather than understanding. | **1-2 marks**<br>Limited analysis.<br><br>A limited analysis of the reasons why an economy might not self-stabilise.<br><br>The answer makes only superficial use of theory and the real world to object to self-stabilisation, but some chains of reasoning are present, if highly underdeveloped. | **1-2 marks**<br>A limited evaluation.<br><br>A basic attempt is made to qualify and judge the statement, but points are not well-developed. |
| 0 | **0 marks**<br>No knowledge or understanding is shown. | **0 marks**<br>No relevant analysis. | **0 marks**<br>No valid evaluation. |

**Indicative content:**

**AO1/AO3**

Theoretically, self-stabilisation may be prevented by:

Imperfections in labour markets which prevent wages from falling (sticky wages). These can be as a result of employment protection legislation, minimum wage legislation, trade union power, and so on. If wages (and/or other factor prices) cannot fall, then the price level cannot fall either, meaning that self-stabilisation will be prevented.

Imperfections in product markets might prevent prices from falling even if factor prices do (sticky prices). This might be because of monopoly/oligopoly power – energy prices/train prices/mobile phone contract prices, etc.

The interest rate effect might be prevented from having full force by a liquidity trap.

The general, in the long run we're all dead – even if wages and prices aren't completely sticky, they may be somewhat so.

In practice the process may be slow too
Greece and Spain are still suffering, mainly due to factor and product market imperfections.
Japan hasn't really recovered from 1990.

**AO4**

All economies recover eventually – it simply depends on the timescale.

Germany, the UK and US are all close to their NAIRUs again, showing that recovery is possible because, in some economies, markets are clearly more flexible than in others.

Even if economies don't self-stabilise they can be encouraged to do so via fiscal and monetary interventions – the interest rate cuts and QE programmes plus fiscal expansions of many OECD countries have probably contributed to the speed of recovery (although some argue that this is not really recovery due to the network of problems that they have caused (debt, asset bubbles, and so on).

Automatic stabilisers reduce the effects of negative demand side shocks.

Supply side policies can be used to make product and labour markets more flexible, therefore overcoming the issues associated with inflexible product and labour markets.

| 5 (a) Explain some of the possible measures/indicators of economic development in a LEDC. [10] | | |
|---|---|---|
| | AO1 | AO3 |
| **Band** | 6 marks | 4 marks |
| 3 | **5-6 marks**<br>Excellent understanding.<br><br>Candidate has a good understanding of the major indicators of economic development in an LDC.<br>A top band response will have a well-developed understanding of three to four indicators.<br>A response at the lower end of this band will show less development of the indicators identified. | |
| 2 | **3-4 marks**<br>Good understanding.<br><br>Answers in this band have identified fewer (one to two) indicators or development of a wider range may not be so comprehensive.<br><br>Answers at this level are likely to show a good understanding of perhaps only one major indicator, although, at the top of the band, answers may also have partial development of another one to two indicators. | **3-4 marks**<br>Good analysis.<br><br>There is a logical development and clear analysis. Generally, there are well-developed lines of reasoning shown between the reason being identified and economic development. |
| 1 | **1-2 marks**<br>Limited understanding.<br><br>Candidates may only demonstrate a basic knowledge of the indicators of economic development.<br><br>A few indicators may have been identified with little understanding shown. | **1-2 marks**<br>Limited analysis.<br><br>Reasoning is generally not well developed.<br><br>There is some explanation and development, but this is either superficial or covers only one or two of the points identified. |
| 0 | **0 marks**<br>No knowledge or understanding present. | **0 marks**<br>No valid analysis present. |

**Indicative content:**
GDP per capita
HDI
HPI
Energy consumption per capita/depth of hunger, incidence of malnutrition
Unemployment rates and vulnerable employment rates, % of female population in paid work
High-technology exports (% of manufactured exports), patterns of exports
Degree of primary export dependence
Progress in achieving the stated Millennium Development Goals (MDGs)/Sustainable Development Goals (SDGs)
% of homes with water, sanitation, energy, TV sets, etc
Purchasing power of the average wage

| 5 (b) | **Evaluate the possible approaches to raising the level of economic development in LEDCs. [20]** | | |
|---|---|---|---|
| | AO1 | AO3 | AO4 |
| **Band** | 6 marks | 6 marks | 8 marks |
| 3 | **5-6 marks**<br>Excellent understanding.<br><br>Excellent understanding of the possible approaches to increasing economic development.<br><br>A clear understanding of all the suggested approaches is shown. | **5-6 marks**<br>Excellent analysis.<br><br>An excellent analysis of the approaches to raising economic development.<br><br>The candidate has a clear line of argument explaining the approach's impact on economic development. | **6-8 marks**<br>Excellent evaluation.<br><br>A well-developed, two-sided answer that looks at the relative merits and demerits of different approaches to economic development.<br><br>Candidate comes to a reasoned judgement. |
| 2 | **3-4 marks**<br>Good understanding.<br><br>A good understanding of the possible approaches to increasing economic development.<br><br>There may be some gaps in the understanding of the suggested approaches. | **3-4 marks**<br>Good analysis.<br><br>A good analysis of the approaches' impact on economic development.<br><br>The analysis might at times lack detail or some areas may not be covered or be unconvincing. | **3-5 marks**<br>Good evaluation.<br><br>Answers clearly identify positive and negative impacts of various approaches to raising economic development.<br><br>There is a lack of an overall judgement. |
| 1 | **1-2 marks**<br>Limited understanding.<br><br>A limited understanding of the approaches to increasing economic development.<br><br>The response may contain only assertions. | **1-2 marks**<br>Limited analysis.<br><br>A limited analysis of the impact of possible approaches to raise economic development.<br><br>Analysis tends to be superficial and lacks sophistication. | **1-2 marks**<br>A limited evaluation.<br><br>A limited evaluation of the possible approaches to raising economic development.<br><br>A superficial attempt is made to qualify each approach. |
| 0 | **0 marks**<br>No knowledge or understanding is shown. | **0 marks**<br>No relevant analysis. | **0 marks**<br>No valid evaluation. |

**Indicative content:**

- Rapid industrialisation
- Import substitution
- Investment in tourism and other services
- Trade liberalisation
- Policies to attract inward investment
- Greater role for the price mechanism in allocating resources
- Measures to increase incomes and savings (reduce savings gap)
- Improving institutions (good governance/rule of law/property rights)
- Overseas aid (tied/bilateral/multilateral)/soft loans/microfinance
- Debt cancellation
- Infrastructure investment
- State investment in welfare systems
- Control disease and improve health and nutrition
- Improve education, reduce illiteracy and train workers/human capital.

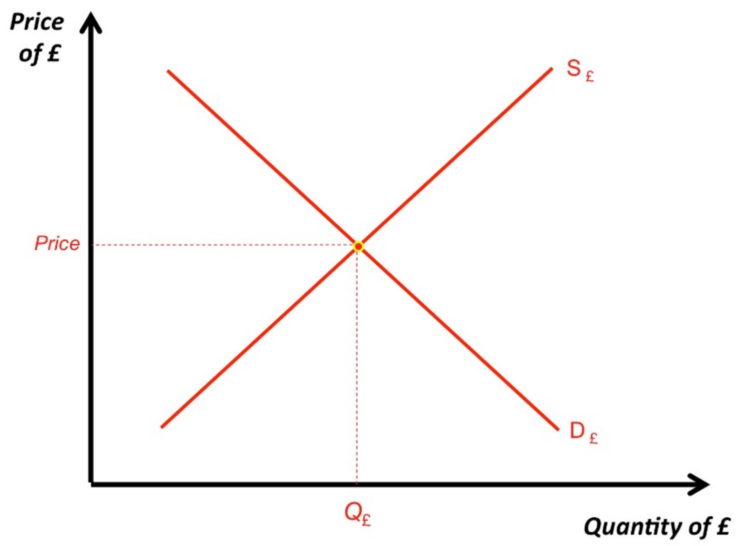
Candidates will be expected to explain two to three of the above strategies and qualify their effectiveness, then conclude with an overall judgement.

Needs to be LEDC-focused.

<table>
<tr><td colspan="3">6 (a) Using a diagram(s), explain how the exchange rate will be determined in a free-floating exchange rate system. [10]</td></tr>
<tr><td></td><td>AO1</td><td>AO3</td></tr>
<tr><td>Band</td><td>6 marks</td><td>4 marks</td></tr>
<tr><td>3</td><td>5-6 marks<br>Excellent understanding.<br><br>Learner has an excellent understanding of how a floating exchange rate is determined, explaining how the exchange rate reaches equilibrium.<br><br>An accurate diagram(s) is drawn, showing how the value of a currency is determined by the forces of demand and supply, showing a clear understanding of the composition of the demand and supply of a currency.</td><td></td></tr>
<tr><td>2</td><td>3-4 marks<br>Good understanding.<br><br>Candidate has a good understanding of how a floating exchange rate is determined, but does not demonstrate how the exchange rate reaches equilibrium.<br><br>Some understanding of the composition of the demand and supply of a currency is shown.<br><br>The diagram(s) is generally accurate but may contain minor errors and may not be fully integrated into the text of the answer.</td><td>3-4 marks<br>Good analysis.<br><br>Good analysis of how a floating exchange rate is determined. There is a clear line of reasoning shown in the explanation.</td></tr>
<tr><td>1</td><td>1-2 marks<br>Limited understanding.<br><br>Candidate has a limited understanding of how a floating exchange rate is determined.<br><br>Answers in this band demonstrate vague or confused understanding of how a floating exchange rate is determined.<br><br>The diagram(s) may contain significant errors or not be attempted.</td><td>1-2 marks<br>Limited analysis.<br><br>Reasoning is generally not well developed, and the line of reasoning is unclear or undeveloped.</td></tr>
<tr><td>0</td><td>0 marks<br>No knowledge or understanding shown.</td><td>0 marks<br>No valid analysis.</td></tr>
</table>

**Indicative content:**

**AO1**




The exchange rate is determined by free market forces, the demand and supply of currency. The equilibrium is the market exchange rate.

Demand for currency comes from buyers of domestic exports of goods and services and overseas investors in the economy.

Supply of currency comes from domestic importers of goods and services and domestic investors buying assets overseas.

The exchange rate will change when either or both demand and supply curves shift position.

**AO3**

Clear explanation of how the exchange rate is determined and clear analysis of the processes at work.

If the exchange rate is below equilibrium, excess demand on currency markets will cause the exchange rate to rise, choking off demand for UK assets and increasing capital outflows as overseas assets are cheaper in sterling terms. This will continue until the market clears.

The reverse will be true for an exchange rate which is above equilibrium.

In a free-floating system, government/central bank intervention will not be present.

Diagram(s) are used effectively to support this analysis.

| 6 (b) Discuss the extent to which it is desirable for a central bank to use foreign currency reserves to support its exchange rate. **[20]** | | | |
|---|---|---|---|
| | AO1 | AO3 | AO4 |
| **Band** | 6 marks | 6 marks | 8 marks |
| 3 | **5-6 marks**<br>Excellent understanding.<br><br>Excellent understanding of central bank intervention – the answer shows a clear link between foreign exchange reserves and the exchange rate.<br><br>The answer is clear that foreign currency is sold to buy the domestic currency and that any central bank has only a finite stock with which to do this. | **5-6 marks**<br>Excellent analysis.<br><br>An excellent analysis of one side of the case, showing a range of reasons as to whether intervention is or is not desirable.<br><br>There is a clear link back to the desirable or undesirable impact of the intervention. | **6-8 marks**<br>Excellent evaluation.<br><br>A well-developed, two-sided argument, with effective points on both sides made.<br><br>Candidate comes to a reasoned judgement as to the extent to which intervention is likely to be desirable or not, explaining what the merits of the decision will depend on (i.e. circumstances in which intervention might be more or less justified). |
| 2 | **3-4 marks**<br>Good understanding.<br><br>There is good understanding of central bank intervention.<br><br>The answer shows a clear link between foreign exchange reserves and the exchange rate. | **3-4 marks**<br>Good analysis.<br><br>Some well-developed points are made on one side of the case, explaining the reasons for or against intervention. The case is not fully linked back to the question. | **3-5marks**<br>Good evaluation.<br><br>A strong, two-sided answer, with effective points on both sides made. |
| 1 | **1-2 marks**<br>Limited understanding.<br><br>There is some understanding that the government sells foreign reserves, but it is not clear how this has any effect. | **1-2 marks**<br>Limited analysis.<br><br>Some points are made and briefly explained on one side of the case. | **1-2 marks**<br>A limited evaluation.<br><br>The answer is two-sided but points are not well-developed. |
| 0 | **0 marks**<br>No knowledge or understanding is shown. | **0 marks**<br>No relevant analysis. | **0 marks**<br>No valid evaluation. |

**Indicative content:**

The government can use foreign currency reserves to plug the gap between supply and demand of its currency, therefore preventing a depreciation. The central bank sells foreign exchange to buy its own currency, which is then removed from circulation, but there is obviously a limit to how long this can be done for, as the UK knows to its cost from 1992.

**Intervention makes sense**

Intervening can prevent a sudden and catastrophic depreciation of the exchange rate, with all of the associated negative short-term effects of that (cost-push inflation, slower growth, increased living costs for citizens, and so on).

Intervention can help to smooth the exchange rate, even if it falls, helping to build greater business and investor confidence, therefore having pay-offs in the longer term.

Reserves can be used to fend off speculative attacks as the underlying principles of the economy suggest that the current level is sustainable in the longer run.

LEDCs sometimes overvalue their currency to allow cheap access to imported technology and capital equipment.

Supporting the exchange rate can be an anti-inflation policy.

Exports are price inelastic.

**Intervention is ill-advised**

The central bank is simply using up valuable foreign currency reserves to no good long-term purpose; it is highly unlikely to be able to rebuild these reserves, which could have been used for something more sustainable.

It won't work – nobody can beat speculators and the central bank is therefore simply wasting money.

The exchange rate may simply be overvalued, and a reduction may help the economy in the longer run by boosting exports and domestic producers.

Supporting the exchange rate might make exports uncompetitive and cause a trade deficit.

**AO4**

It depends on:

Why the currency is overvalued – is this a short-term blip or are there structural issues?
Why the central bank is intervening – what does it hope to achieve and over what timeframe?
The level of reserves the central bank has at its disposal
The amount that will need to be committed
The extent to which other policies (such as interest rates) will also be used to support the exchange rate
The needs of the domestic economy – is it a net importer and, if so, of what?
Relationships with other countries/organisations who may step in to support the currency manipulation