

GCE 2005

January Series



Mark Scheme

Economics

ECN3

Markets at Work

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

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

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Advanced Subsidiary Economics**January 2005****ECN3****Mark Scheme****General Instructions**

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

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

Two approaches have been used in the construction of the mark scheme for the data response questions:

- (i) **An ‘issue’ based approach.** The mark scheme for parts (a) to (d) of the data response questions adopts this approach. The mark scheme lists the marks that can be awarded for particular issues (and associated development) that the candidate might include in the answer. Marks awarded for development should take into account the Quality of Written Communication used by candidates as indicated on page 5 of this mark scheme.
- (ii) **A ‘levels’ approach.** This approach is used for marking part (e) of the questions. The mark scheme summarises the information required to answer the question, but without attaching marks to particular issues. Marks should be awarded according to whether the answer displays the skills indicated by the five Mark Band Descriptors or “Levels of Skill” included in the mark scheme. The Mark Band Descriptors are set out on page 4. When using a ‘levels’ mark scheme the marker **must** identify where a particular skill is being demonstrated. The **key** to be used to identify the skill is shown on page 5. The level chosen should be the one which **best fits** the answer provided by the candidate. It is **not** intended that the answer should satisfy every statement in the level description.

APPLYING THE ‘LEVELS’ MARK SCHEME**Levels of Response Mark Band Descriptors**

In part (e) of the data response questions approximately half the marks are available to award to candidates who demonstrate that they can ‘evaluate economic arguments and evidence, and make informed judgements’. It is not necessary that the candidate identifies a wide range of issues. As indicated below, the Quality of Written Communication used should be taken into account when awarding the marks.

Level 1

Few, if any, relevant issues are recognised. Economic concepts and principles are not adequately understood or applied to the question. No satisfactory analysis or evaluation. A poorly organised response which generally fails to answer the question. Descriptions and explanations lack clarity. Spelling, punctuation and grammar may be poor. There is little use of economic terminology.

0 to 3 marks*Mid-Point: 2 marks***Level 2**

One or more relevant issues are recognised. An attempt is made to use basic economic concepts to answer the question but the candidate’s explanation may become confused. There may be some attempt to present alternative points of view but any attempt at evaluation is superficial. The answer is likely to be poorly organised and is unlikely to have a clear structure. The candidate demonstrates some ability to spell commonly used words and to follow the standard conventions of punctuation and grammar. Some use of economic terminology is made but this is not always applied appropriately.

4 to 6 marks*Mid-Point: 5 marks***Level 3**

Two or more relevant issues are recognised. The candidate has made a reasonable attempt to apply economic concepts and ideas. A satisfactory understanding of some basic economic concepts and theories is demonstrated. There will be some attempt to present alternative views and to evaluate the issues, arguments and/or data. There is some logic and coherence in the organisation of the answer. The candidate is generally able to spell commonly used words and usually follows the standard conventions of punctuation and grammar. Some descriptions and explanations are easy to understand but the answer may not be expressed clearly throughout. There is some evidence of the correct use of relevant economic terminology.

7 to 10 marks*Mid-Point: 9 marks***Level 4**

Two or more relevant issues are identified. Good understanding of some basic economic concepts and models is demonstrated. The candidate is able to apply these concepts and models to help answer the question. An appreciation of alternative points of view is shown. Satisfactory use is made of evidence and/or theoretical analysis to evaluate the issues/arguments identified and to support conclusions. Spelling is generally accurate and the standard conventions of punctuation and grammar are usually followed. The answer is well organised. Descriptions and explanations are usually clearly expressed. Appropriate use is made of relevant economic terminology.

11 to 13 marks*Mid-Point: 12 marks***Level 5**

Three or more relevant issues are identified. Good understanding of basic economic concepts and models is demonstrated throughout. The candidate is able to apply these concepts and models to help answer the question. Clear understanding of alternative points of view is shown. Good use is made of evidence and/or theoretical analysis to evaluate the issues/arguments identified and to support conclusions. Spelling is generally accurate and the standard conventions of punctuation and grammar are usually followed. The answer is well organised. Descriptions and explanations are clearly expressed. Appropriate use is made of relevant economic terminology.

14 to 15 marks*Mid-Point: 15 marks*

THE KEY TO BE USED WHEN USING THE ‘LEVELS’ MARK SCHEME

- D** Where a particular economic term is correctly **DEFINED** in order to help the candidate to answer the question properly.
- I** Where a relevant **ISSUE** is raised by the candidate.
- K** Where the candidate demonstrates **KNOWLEDGE** of recent developments or features of the economy which help enhance the candidate’s response to the question. This should also be used where the candidate quotes relevant examples.
- Ap** Where the candidate demonstrates the ability to **APPLY** knowledge and **CRITICAL UNDERSTANDING** to problems and issues.
- A** Where the candidate demonstrates the ability to **ANALYSE** the problem using appropriate economic ideas.
- E** Where the candidate **EVALUATES** and makes judgements about the significance of various issues and arguments.

QUALITY OF WRITTEN COMMUNICATION

The Mark Band Descriptors, which are used for assessing part (e) of the questions, incorporate statements which relate to the Quality of Written Communication used by the candidates.

However, it is also important to assess Quality of Written Communication **whenever** candidates produce answers using continuous prose. When applying an issue based mark scheme, examiners must take into account the following when deciding how many marks to award for development:

- (i) use of appropriate form and style of writing to organise relevant information clearly and coherently;
- (ii) use of specialist vocabulary, where appropriate;
- (iii) legibility of handwriting;
- (iv) accuracy of spelling, punctuation and grammar.

OPTION 1: THE HOUSING MARKET**Total for this question: 40 marks****1**

1 (a) Define the term “negative equity” (Extract A , line 9).	<i>(3 marks)</i>
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For an acceptable definition (e.g. a situation where the mortgage debt/loan on a property is greater than the market value of the property). **3 marks**

If the definition is incomplete, marks may be broken down, for example as follows:

a description of equity in this context; **1 mark**

recognition that houses tend to be bought with borrowed money; **1 mark**

the loan is usually less than or equal to the market value; **1 mark**

an increase in price creates ‘equity’ **1 mark**

a fall in price creates ‘negative equity’. **1 mark**

the selling price has fallen below the buying price **2 marks**

MAXIMUM FOR PART (a) 3 MARKS

1 (b) Using Extract B , explain one reason why the balance between variable and fixed-rate mortgages creates a particular problem for the UK economy.	<i>(4 marks)</i>
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For full marks candidates only need to identify and discuss a possible link between a large proportion of variable debt and price volatility, e.g. sudden changes in interest rates can lead to sudden changes in demand. Give credit (**up to 2 marks** per point) to candidates who make other valid points, e.g. by querying the notion of “real” house prices, or arguing that monetary policy in the UK might work differently than in France or Germany, where reactions to interest changes might differ. Award **up to 4 marks** for a sensible discussion; if a point by point breakdown is required, use the following as a guide:

Explanation of the difference between variable and fixed rate mortgages. **up to 2 marks**

Variable rates make borrowing more sensitive to interest rate changes. **up to 2 marks**

There appears to be some correlation (this word need not be used) between variable rates and price instability (German prices contrast with UK prices). **up to 2 marks**

Germany also has a higher proportion of rented properties and this might help to stabilise prices (**1 mark**) by reducing demand for owner-occupier houses (**1 mark**).

For a clear link with a problem other than price instability, e.g. consumer confidence. **up to 2 marks**

MAXIMUM FOR PART (b) 4 MARKS

- 1 (c) Explain the economic conditions that might cause mortgage interest rates to rise along with unemployment (as predicted in **Extract A**, lines 11-12). *(8 marks)*

Examples of points for which examiners can give credit:

- Mortgage interest rates are related to base rates; **1 mark**
- The ‘single golf club’ of the interest rate is used in inflation rate targeting; **1 mark**
- Base rates are altered by the Bank of England in response to economic conditions; **2 marks**
- High inflation projections are likely to lead to higher interest rates; **2 marks**
- Higher interest rates tend to depress demand and therefore lead in the short run to unemployment **2 marks**

As an alternative to the above ‘step-by-step’ approach, candidates could identify a circumstance or circumstances which could cause higher interest rates and unemployment simultaneously, e.g. an exogenous shock such as a business downturn caused by rapidly rising commodity prices.

For explaining why interest rates might rise: **up to 4 marks**

For explaining why unemployment might rise: **up to 4 marks**

For a comment making an overarching link between interest rates and unemployment: **up to 2 marks**

MAXIMUM FOR PART (c) 8 MARKS

- 1 (d) With the help of a supply and demand diagram, analyse how a decision to lend borrowers six times their incomes (**Extract A**, line 22) could affect the market for houses. (10 marks)

With diagram questions it is especially necessary to be flexible and to reward unanticipated answers which are economically valid.

This is a scenario where good candidates should realise that there clearly are both short-run and long-run possibilities. Full marks for the written answer can be achieved by a very good discussion of the short run or the long run or both. Similarly, full marks for the diagram can be achieved by clear and systematic illustration of the short run or the long run or both.

For a plausible short run change, e.g. increased borrowing facility shifts demand to the right. **up to 2 marks**

House prices increase. **1 mark**

Further explanation/analysis, e.g. for comment on the importance of prices/incomes/interest rates/other influences as determinants of demand; or a comment on elasticity. **up to 2 marks**

For a plausible long-run change, e.g. increased indebtedness causes repayment difficulties/repossessions; householders encouraged to sell, shifting supply of houses to the right **2 marks**

..... and lowering prices **1 mark**

Further explanation/analysis, e.g. the lower prices are a disincentive to building and selling houses (but might encourage first time buyers). **up to 2 marks**

Max. 6 marks for written explanation

(Max. 5 marks if no diagram)

For a relevant diagram for either short or long run (or for both) **5 marks**

Diagram:

Axes labelled (1), S and D labelled (1)

Shift in appropriate direction (1)

Change in price (1)

Change in quantity (1)

MAXIMUM FOR PART (d) 10 MARKS

1 (e) Identify and evaluate the costs and benefits of a prolonged fall in house prices. (15 marks)

Relevant points that could be raised include:

- Costs:
 - Negative equity;
 - Defaulting on debts;
 - Re-possession;
 - Collapse of consumer confidence;
 - Downward multipliers
 - Impact on other sectors, e.g. DIY industry.
- Benefits
 - Affordability;
 - Lower general rate of inflation;
 - Policy response: lower interest rates
 - Knock-on effects of lower interest rates (e.g. industrial investment);
 - Increased mobility of labour.

Evaluation is likely to come from a consideration of the costs versus benefits. Give credit to candidates who recognise that whether something is a cost or benefit depends on one's point of view, e.g. existing owner versus first time buyer; borrower or lender.

Maximum of 7 marks if there is no attempt to evaluate the significance of the various costs and benefits identified.

USE THE LEVELS MARK SCHEME ON PAGES 4 & 5

MAXIMUM FOR PART (e) 15 MARKS

OPTION 2: THE ENVIRONMENT**2****Total for this question: 40 marks**

2 (a) Define the term “market forces” (Extract C , line 28).	<i>(3 marks)</i>
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For an acceptable general definition of market forces, e.g. use of supply and demand (and or prices) for allocating resources **3 marks**

If the definition is incomplete, marks may be broken down, for example:

- A notion of supply **1 mark**
- A notion of demand **1 mark**
- Price signalling/incentive/rationing. **up to 2 marks**

MAXIMUM FOR PART (a) 3 MARKS

2 (b) State and explain one reason why (contrary to the claim in Extract C , lines 19-20) the tax on electricity use might actually increase “competitiveness”.	<i>(4 marks)</i>
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For an explanation of why costs might rise in the short run, but be lowered in the longer term, e.g. due to energy efficiency **up to 4 marks**

If a point by point breakdown is required, use the following as a guide:

- Explanation of the concept of ‘competitiveness’, e.g. in terms market prices **1 mark**
- Reference to costs as an influence on price. **1 mark**
- The incentive of a refund has an impact on competitiveness **1 mark**
- Less polluting technology is likely to be costly in the short run, but pay for itself in the long run **2 marks**

MAXIMUM FOR PART (b) 4 MARKS

2 (c) Explain why it could be argued that the Climate Change Levy is good for the environment but bad for employment. (8 marks)

Points for explanation include:

Good for the environment:

- Levy forces polluters to pay
- External costs internalised.

Argument that there is an environment/employment ‘trade-off’:

- Cost of levy puts firms under pressure, some may go out of business
- Investors will favour businesses without the levy
- Levy appears to be particularly directed at manufacturing, which is already under pressure
- Manufacturing employment harder hit than service employment, even though some services (e.g. transport) have a part in pollution.

Up to 3 marks per point stated (1) and explained (2)

Constraint: **max. of 5 marks** overall if only one of ‘environment’ and ‘unemployment’ mentioned

MAXIMUM FOR PART (c) 8 MARKS

2 (d) With the help of a supply and demand diagram, analyse how the price of permits for CO₂ emissions is likely to change under a carbon trading scheme (**Extract C**, lines 23-31). (10 marks)

With diagram questions it is especially necessary to be flexible and to reward unanticipated answers which are economically valid.

This is a scenario where good candidates should realise that there clearly are both short-run and long-run possibilities. Full marks for the written answer can be achieved by a very good discussion of the short run or the long run or both. Similarly, full marks for the diagram can be achieved by clear and systematic illustration of the short run or the long run or both.

- | | |
|--|----------------------|
| For a plausible short run effect, e.g. with factory closures, demand shifts left | 2 marks |
| Prices fall | 1 mark |
| For further short run discussion, e.g. a comment on elasticity | up to 2 marks |
| For a plausible long run effect, e.g. as the quota is reduced, supply shifts left | up to 2 marks |
| Prices rise. | 1 mark |
| The short run and long run effects on price as described above cancel each other out, so effect on price is indeterminate. However, it is highly likely that quantity supplied and demanded will fall in the long run. | up to 2 marks |

**Max. 6 marks for written explanation
(Max. 5 marks if no diagram)**

For relevant diagram for either short or long run (or for both). **5 marks**

- Axes labelled (1), S and D labelled (1)
- Shift in appropriate direction (1)
- Change in price (1)
- Change in quantity (1)

MAXIMUM FOR PART (d) 10 MARKS

- 2 (e) Explain why governments concern themselves with greenhouse gas emissions, and discuss whether it is better to introduce schemes such as the Climate Change Levy and carbon trading, rather than simply to ban emissions. *(15 marks)*

Points that could be raised include:

- Reasons for intervention
 - External costs;
 - Market failure;
 - Encouragement of sustainability for future generations;
- Levy and trading are examples of market based policies
 - Advantages, e.g.
 - Difficult to evade
 - Work well over time.
 - Disadvantages, e.g.
 - ‘Polluter pays’ might result in polluters choosing to pay and continuing to pollute
- A ban is a ‘command and control’ method
 - Advantages, e.g.
 - Can be made to work quickly.
 - Disadvantages, e.g.
 - Require policing

Evaluation should come from assessing the alternatives, and could draw on some real world examples.

Maximum of 7 marks if there is no attempt to evaluate the significance of the various factors identified.

USE THE LEVELS MARK SCHEME ON PAGES 4 & 5

MAXIMUM FOR PART (e) 15 MARKS

OPTION 3: THE ECONOMICS OF SPORT AND LEISURE

3

Total for this question: 40 marks

3 (a) Define the term “investment” (**Extract E**, line 5). (3 marks)

For an acceptable definition, e.g. expenditure on fixed capital. **3 marks**

If the definition is incomplete, marks may be broken down, for example as follows:

recognition that investment is an ‘injection’; **1 mark**

notion that investment to an economist is ‘real’ rather than ‘monetary’. **2 marks**

for a purely monetary view of investment if correct, irrespective of detail **1 mark**

MAXIMUM FOR PART (a) 3 MARKS

3 (b) Explain **one** reason why infrastructure investment (**Extract E**, line 5 and **Extract F**) can be important to an economy. (4 marks)

For full marks, candidates should comment on the nature of ‘infrastructure’ and link this concept to the wider economy.

If a point by point breakdown is required, use the following as a guide:

For a suitable general example, e.g. a property development, transport **1 mark**

For relating this example to the Olympic bid, e.g. a stadium, ‘Olympic village’, infrastructure project **1 mark**

For identifying a benefit or principle, e.g. re-sale land value; efficiency, multiplier. **up to 2 marks**

MAXIMUM FOR PART (b) 4 MARKS

3 (c) Using examples from the extracts, explain why some claims made for the economic effects of the Olympics are based on positive statements, while others are based on value judgements. (8 marks)

Examples of points for which examiners can give credit:

• Distinction between positive and value statements/questions **up to 4 marks**

• Examples of each from text **2 marks for a positive statement**
 (mention = 1 mark, justification = 1 mark) = **2 marks for a normative statement**

For further elaboration, e.g.

- Costs tend to be underestimated, revenues over optimistic
- Political as well as economic agendas
- Projections necessarily involve predicting the future
- Past success (or failures) are not necessarily reliable indications of the future
- The longer the projection, the greater the risks and uncertainties

up to 4 marks

MAXIMUM FOR PART (c) 8 MARKS

- 3 (d) With the help of a supply and demand diagram, analyse how a successful Olympic bid might affect the price of hotel rooms in London. (10 marks)

With diagram questions it is especially necessary to be flexible and to reward unanticipated answers which are economically valid.

This is a scenario where good candidates should realise that there clearly are both short run and long run possibilities. Full marks for the written answer can be achieved by a very good discussion of the short run or the long run or both. Similarly, full marks for the diagram can be achieved by clear and systematic illustration of the short run or the long run or both.

For a plausible short run change, e.g. increased demand during the event shifts demand to the right **up to 2 marks**

Prices increase **1 mark**

For further short run discussion, e.g. a comment on elasticity **up to 2 marks**

For a plausible long-run change, e.g. supply has permanently increased after the event, but demand might not be sustained (shifts to the left) **up to 2 marks**

..... and prices fall. **1 mark**

.....depending on the ability of the city government and business sector to capitalise on the legacy, e.g. by creating long-running tourist attractions centred on the Olympic site. **up to 2 marks**

**Max. 6 marks for written explanation
(Max. 5 marks if no diagram)**

For a relevant diagram for either short or long run (or for both) **5 marks**

Diagram:

Axes labelled (1), S and D labelled (1)

Shift in appropriate direction (1)

Change in price (1)

Change in quantity (1)

MAXIMUM FOR PART (d) 10 MARKS

- 3 (e) Explain why mega-events like the Olympics cannot be provided entirely by the private sector without involving the government and taxpayers, and assess the economic advantages and disadvantages of staging the Olympics in London. *(15 marks)*

Relevant Points that could be raised include:

- Reasons for government intervention
 - The event provides an opportunity for master-planning;
 - There are too many uncertainties, the amounts involved are too large, and returns are too long term, for funding to come entirely from the private sector;
 - Externalities (both positive and negative);
 - Creates merit goods.
- Give credit for candidates who question the assumption that government intervention is necessary, e.g.
 - If the economic returns are truly so attractive, why shouldn't the whole event be privatised?
- Advantages, e.g.
 - Internal benefits, e.g. higher wages
 - External benefits, e.g. improved built environment
- Disadvantages, e.g.
 - Internal costs, e.g. higher taxes
 - External costs, e.g. congestion, disruption during events, regional imbalances, local population displaced.

Give credit for critical comments on the 'main' and 'additional' costs and benefits mentioned in the extracts, and for reference to previous experience, e.g. would residents of Barcelona necessarily regard tens of millions of new tourists as a good thing?

Evaluation is likely to come largely from a consideration of the advantages versus disadvantages. Give credit to candidates who recognise that whether something is a cost or benefit depends on one's point of view, and also depends on questions of distribution; mega events can, for example, displace local people rather than enrich them.

Maximum of 7 marks if there is no attempt to evaluate the significance of the various costs and benefits identified.

USE THE LEVELS MARK SCHEME ON PAGES 4 & 5

MAXIMUM FOR PART (e) 15 MARKS