

**MARK SCHEME for the May/June 2012 question paper  
for the guidance of teachers**

**9772 ECONOMICS**

**9772/02**

Paper 2 (Essays), maximum raw mark 75

This mark scheme is published as an aid to teachers and candidates, to indicate the requirements of the examination. It shows the basis on which Examiners were instructed to award marks. It does not indicate the details of the discussions that took place at an Examiners' meeting before marking began, which would have considered the acceptability of alternative answers.

Mark schemes must be read in conjunction with the question papers and the report on the examination.

- Cambridge will not enter into discussions or correspondence in connection with these mark schemes.

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The purpose of the essay paper is to enable candidates to select appropriate economic models, theories and concepts that they apply to the circumstances of the question and produce good, logical arguments and draw conclusions. The best essays will have a substantial conclusion that may recognise that various answers are possible, or that it is not possible to draw firm conclusions in all cases. Full justification should be given for the conclusions drawn. The questions are set deliberately to require candidates to plan and structure an answer.

Candidates should try to illustrate their arguments with recent and contemporary examples. Examiners should reward these appropriately. Certainly, a well-illustrated essay should score more highly than one which, while being sound in terms of theory used, does not draw on actual events.

For each question there follows a preamble of what is expected from candidates – but always remembering that an ‘unexpected but accurate approach’ must be rewarded. A general list of areas that might be included is then given, followed by an example of the sort of answer that would fall into each level of assessment, both in terms of Theory and Analysis and in terms of Evaluation.

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## Marking criteria for Paper 2

For this paper, marks should be awarded in two categories. The first covers the knowledge and understanding of relevant economics, how this is applied and how the information/issues are analysed (Theory and Analysis) and the second covers the candidate's evaluation of the issues involved (Evaluation). Examiners should look to mark the essay holistically and decide into which relevant Levels the answer lies. The Levels will not necessarily be the same for the two categories.

### Theory and Analysis

Level 4 (13–17 marks) Mid mark 15	An excellent answer that shows accurate and comprehensive application of relevant theory. There will be in-depth and coherent analysis. At the top end there will be signs of real insight and/or originality, not normally expected to be seen at this level.
Level 3 (9–12 marks) Mid mark 11	An answer that logically addresses the issues involved and generally shows a correct application of the relevant theory. An attempt is made to analyse and there is some depth or coherence but not necessarily both.
Level 2 (5–8 marks) Mid mark 7	Some correct application of relevant theory will be shown but there may well be inaccuracies contained within the answer. An appreciation of the need to analyse may be demonstrated, but not much more than this. The answer is likely to lack any real coherence.
Level 1 (1–4 marks) Mid mark 3	The answer contains something of relevance to the set question. However, theory may be misunderstood, or incorrectly applied. At this level, any analysis shown will be extremely superficial.
Level 0 (0 marks)	Nothing of any relevance to the set question is shown within the answer.

### Evaluation

Level 3 (6–8 marks) Mid mark 7	There is in-depth, coherent, comprehensive and well-balanced evaluation. At the top end there will be signs of real insight and/or originality, not normally expected to be seen at this level.
Level 2 (3–5 marks) Mid mark 4	There is a definite attempt to consider various points of view or outcomes for different economic agents or distinction between short-run and long-run consequences etc. but the coverage of these is less than comprehensive.
Level 1 (1–2 marks) Mid mark 2	There is some attempt at evaluation but issues are more likely to be stated than examined.
Level 0 (0 marks)	There is no evidence of any evaluation whatsoever.

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### Section A

- 1 A national supermarket chain is thinking of introducing a new range of locally sourced, organic fruit and vegetables across its stores. Before it launches the range, it commissions a national survey for its proposed pricing strategy and the survey produced these estimates for middle income consumers:
- price elasticity of demand  $-2.4$ ;
  - income elasticity of demand  $+1.9$ ;
  - cross elasticity of demand with respect to the prices of regular fruit and vegetables  $+3.7$ .

Discuss how the supermarket might use this information to increase overall profit. [25]

Candidates should be able to define and explain the significance of the different types of elasticity. There should be clear distinction between the different types of elasticity, the determinants of the different elasticities and the significance of the different elasticity coefficients. Good candidates will apply this information to the practical competitive strategies adopted by supermarkets in pricing and promoting a product. Candidates are also invited to go beyond the demand implications of the elasticity figures and think about how altering competitive strategies may affect supply conditions.

**Answers may include:**

**Knowledge and understanding** of the three different types of elasticity. Candidates should be capable of identifying what the elasticity coefficients mean with reference to the extent to which demand is inelastic, the degree to which the good is a normal good – differentiating between luxury and necessity goods, the degree of substitutability. Candidates should be able to relate these values to the ability of the firm to earn profit.

**Application** to real life, with good candidates showing clear evidence of how the different elasticity coefficients can be explained, with reference to the determinants of the different types of elasticity. Candidates should also consider how these values will impact upon the competitive strategies of the firm with reference to price. Strong candidates may look at other factors – how non-price competition may affect the elasticities of demand – and the implications of this for a supermarket's profits. Candidates might consider market segmentation and price discrimination as possible outcomes.

**Analysis** of the elasticity coefficients and whether or not there are compelling grounds for altering their initial strategy to boost profit.

Examples:

- Whether changing the price of the fruit and vegetables will increase the supermarket's revenue.
- Whether the income elasticity figure might have implications for store location/the type of store where the range should be introduced.
- The extent to which non-price competition can affect the elasticity coefficients.
- The impact of any change in strategy on the firm's cost structures, and by implication, the impact on its profit.

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### Evaluation of the issues involved

Examples:

- Consideration of the extent to which the elasticity data are accurate and reasons why they might not be.
- The absence of information about the nature of the national survey – how many people were surveyed, the fact that elasticities will vary across income groups, regions etc.
- The danger of using national data to determine competitive strategy in a specific location (i.e. a particular town/region) where consumers may face differing conditions of demand and supply.
- The uncertain impact of altering competitive strategy on demand and supply conditions and the profit earned by a firm.
- Consideration of instances where the firms may adopt competitive strategies which are not consistent with traditional models of the firm – e.g. non-profit maximising strategies that the firm may adopt in seeking to maximise profit in the long-term.

### Theory and analysis

Level 4 (13–17 marks) Mid mark 15	There is a clear understanding of the different types of demand elasticity—including clear understanding of the significance of the elasticity coefficients. At this level there will also be adroit application of the elasticity values to determining the supermarket's competitive strategy. Good candidates will consider a range of issues, both demand and supply side, and come up with practical suggestions for the firm.
Level 3 (9–12 marks) Mid mark 11	The candidate is likely to be able to define the different types of elasticity and shows some understanding of the significance of the coefficients though they may have little appreciation of how they provide important information when determining competitive strategy.
Level 2 (5–8 marks) Mid mark 7	There is a clear appreciation of the different types of elasticity but there are significant errors in the candidate's answer. The candidate is likely to give a simplistic account of the different coefficients without really grasping their significance or the importance that this information has for the firm in determining its competitive strategies.
Level 1 (1–4 marks) Mid mark 3	Explanations and diagrams are either missing or inaccurate. The answer is likely to fail to address the set question but instead be a poor attempt to re-hash a textbook explanation of the different types of elasticity.

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### Evaluation

<p>Level 3 (6–8 marks) Mid mark 7</p>	<p>A good answer is likely to discuss issues such as:</p> <ul style="list-style-type: none"> <li>• The extent to which the data is accurate.</li> <li>• The dangers of applying national survey data to particular localities.</li> <li>• The uncertain impact of changing strategies for a firm – both on the new product range but also with regard to existing products.</li> <li>• Consideration of the 'ceteris paribus' assumption.</li> </ul> <p>There will be a conclusion drawn at the end to explain the candidate's overall view – even if this is that there is no clear-cut answer.</p>
<p>Level 2 (3–5 marks) Mid mark 4</p>	<p>One of the above will be discussed in detail or a couple of points touched on, but only in a relatively superficial way.</p>
<p>Level 1 (1–2 marks) Mid mark 2</p>	<p>Whilst there might be some appreciation that evaluation could be carried out the point is not developed. For example: 'The elasticity data clearly suggests that supermarkets will lower their prices: this will inevitably boost their profits.'</p>

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**2 With reference to examples, evaluate the degree to which oligopolistic markets will result in collusion. [25]**

Candidates should show a good understanding of oligopolistic market structures with particular reference to applied examples. They should be aware of the characteristics of oligopolistic markets and that there are a number of models of oligopoly, ranging from competitive oligopolies where firms are engaged in price wars to formal collusion, with firms acting as a cartel engaging in joint profit maximisation. However, they should also be aware that the most likely oligopoly outcomes lie somewhere between these extremes, with tacit collusion or price leadership possible outcomes. These models should be developed, through diagrammatic analysis, notably the kinked demand curve, or game theory. However, strong candidates will focus on the crux of the question: the characteristics of oligopolistic markets that will foster collusion and the extent to which appropriate regulation may curtail collusive activity. The best answers should look to discuss these factors rather than simply regurgitate textbook models of oligopoly.

**Answers may include:**

**Knowledge and understanding** of the characteristics of oligopoly and different oligopoly models. These will be clearly explained, often diagrams. Better candidates will explain that the existence of relatively few firms, both incumbents and potential entrants, with similar and stable cost structures, producing similar products with near perfect information and the existence of credible threats to firms who deviate from agreed pricing decisions are most likely to encourage collusion. Some candidates may move on to consider the extent to which regulation can deter collusion and the difficulties that authorities may have in proving that collusion has taken place.

**Application** of models of oligopoly with regard to specific industries: for instance, supermarkets, the pharmacies, sports retailers, bus companies, public schools, the music industry and car dealership might all be cited as areas where collusion has taken place. The key to applying knowledge is not to quote specific data but to explain why some oligopolies have tended towards collusion and why some have not.

**Analysis** of the extent to which the features of an oligopolistic market structure may lend itself to collusion

Examples:

- Whether the existence of a small number of firms in oligopoly will inevitably lead to collusion – this may depend upon the threat of new entrants in an industry.
- The use of game theory, notably the prisoners' dilemma to illustrate the likelihood of collusion.
- Whether it is possible for price rigidity in oligopolistic markets to be a feature of something other than formal collusion. The kinked demand curve posits that price stability is in the interests of the individual firm.
- The possibility of regulatory intervention in monitoring specific markets and deterring collusive activity.

**Evaluation** of the issues involved

Examples:

- Attempts to evaluate the extent to which oligopolistic models depict the behaviour of firms in the real world – is there price stability in markets? How is this price stability arrived at?
- Whether or not collusion is likely to be sustained in the long-run and consideration of factors that might see the breakdown of collusion.
- Whether regulation is effective in stopping instances of collusion and whether it should seek to deter collusion in all instances.

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### Theory and analysis

<p>Level 4 (13–17 marks) Mid mark 15</p>	<p>There should be clear understanding of what is meant by oligopolistic markets and collusion. Good candidates should use accurate diagrams or game theory to illustrate market outcomes. The best candidates will explore a range of outcomes and perhaps differentiate between formal and tacit collusion. At this level candidates will be expected to move beyond textbook theory and consider the specific features of oligopolistic markets which might encourage collusion. Candidates are likely to conclude that collusion is a possible outcome but that it is far from inevitable.</p>
<p>Level 3 (9–12 marks) Mid mark 11</p>	<p>Candidates should be able to define an oligopolistic market and give a clear explanation of different outcomes in oligopoly, showing an understanding of why collusion occurs. They should be aware that collusion involves firms 'acting together' but explanation of the features which encourage collusion may either be missing or incomplete. Diagram(s) may contain occasional lapses.</p>
<p>Level 2 (5–8 marks) Mid mark 7</p>	<p>Candidates show an appreciation of what is meant by an oligopolistic market but not fully appreciate the range of outcomes that this implies. Candidates are likely to focus on one or two models of oligopoly with little mention of collusion. There are likely to be errors and omissions in candidates' answers and generalised statements about how collusion can occur but with little grasp of the features that make it likely.</p>
<p>Level 1 (1–4 marks) Mid mark 3</p>	<p>Candidates are only able to explain what an oligopoly is, some of its characteristics but without relating this to any specific industries. There are likely to be few diagrams, and those that are drawn are likely to be poorly explained.</p>

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### Evaluation

<p>Level 3 (6–8 marks) Mid mark 7</p>	<p>A good answer is likely to discuss issues such as:</p> <ul style="list-style-type: none"> <li>• Whether models of oligopoly are realistic or analytical – good candidates might highlight the fact that the kinked demand curve is merely descriptive.</li> <li>• The extent to which the features of a given oligopoly lend themselves to collusion.</li> <li>• Whether or not collusion is a stable outcome.</li> <li>• Whether or not regulation can limit the capacity for firms to collude.</li> </ul> <p>Candidates are likely to conclude that collusion is far from inevitable and the best candidates will look at a range of different potential outcomes, with the very best looking directly at specific examples.</p>
<p>Level 2 (3–5 marks) Mid mark 4</p>	<p>One of the above will be discussed in detail or a couple of points touched on, but only in a relatively superficial way. There will be little attempt to consider the question in an industry-specific context or whether economic models reflect the real world.</p>
<p>Level 1 (1–2 marks) Mid mark 2</p>	<p>Whilst there might be some appreciation that evaluation could be carried out and there might be the odd comment that suggests an area for potential evaluation but the point is not developed.</p> <p>For example: 'Collusion is a possible outcome but this just depends upon the attitude of individual firms and managers.'</p>

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- 3 The best way to tackle the market failures associated with the consumption of alcohol is through the introduction of a minimum price.  
 To what extent do you agree with this statement? [25]

Candidates should have clear understanding of the impact of a minimum price. Candidates will not be expected to explicitly refer to a minimum price per unit of alcohol but a minimum price in general. They should be quick to define the term 'market failures' and be able to identify specific market failure associated with alcohol consumption – increased costs of health care, lower productivity, greater likelihood of anti-social behaviour, marital breakdown and so on.

**Answers may include:**

**Knowledge and understanding** of relevant theory concerning:

- The impact of a minimum price on a specific market – strong candidates may highlight the fact that in order to be effective it will need to be higher than equilibrium price. It is likely that they will draw a diagram illustrating this.
- A diagram/discussion of the market failures (negative externalities, demerit goods, imperfect information) associated with the consumption of alcohol.

**Application** of issues relating to the elasticities of demand and supply and the level at which the minimum price is set. Good candidates are likely to highlight the inelasticity of demand for alcohol, particularly among certain groups, and question the effectiveness of a minimum price.

**Analysis** of the impact of any proposed minimum price. Will it alter the market for drinks, perhaps altering patterns of consumption and reversing the move towards higher levels of home consumption? Some candidates might look at the impact of the minimum price on the drinks industry suggesting that the impact of the tax will depend upon who it is levied on – drinks producers or drinks retailers.

**Evaluation** of the issues involved:

- The extent to which the minimum price is the 'best way' to tackle the market failures associated with the consumption of alcohol.
- Some assessment of the fact that the introduction of a minimum price will have different effects upon different sectors of the population/drinks market. A minimum price per unit is likely to affect cheaper drinks, for example.
- The issue that different groups of consumers have different demand elasticities. A minimum price might deter younger drinkers but not alter the behaviour of alcoholics.
- An assessment of the extent to which the tax will be borne either by producers or retailers rather than consumers.
- A consideration of other forms of intervention attempting to tackle these market failures – increasing the drinking age, better education relating to the effects of alcohol consumption, better labelling of drinks, regulation regarding aspects of the drink industry – e.g. advertising restrictions.
- Some assessment of whether the effects of alcohol consumption actually are market failures: might some drinkers have made a rational economic decision to consume beyond recommended drinking limits? Who decides what 'demerit goods' are?

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### Theory and analysis

<p>Level 4 (13–17 marks) Mid mark 15</p>	<p>There will be clear and detailed explanation of the impact of a minimum price. Candidates will also be aware of what is meant by the term 'market failures' with reference to a range of market failures. Diagrams will be accurate. Candidates will consider the significance of elasticity and the level at which the minimum price will be set. At the top level, candidates will differentiate the impact of a minimum price on different economic agents or on different market sectors.</p>
<p>Level 3 (9–12 marks) Mid mark 11</p>	<p>Analysis of a minimum price will be accurate but there may not be development of the model or reference to the importance of elasticities or the level of the minimum price. At the bottom end there is likely to be awareness of the fact the consumption of alcohol may lead to different market failures but some of the diagrams might be inaccurate.</p>
<p>Level 2 (5–8 marks) Mid mark 7</p>	<p>Analysis is likely to be superficial and contain inaccuracies. Candidates might struggle to discuss the effect of a minimum price and there might be limited appreciation of the different forms of market failure. Candidates are likely to see market failure purely in terms of negative externalities.</p>
<p>Level 1 (1–4 marks) Mid mark 3</p>	<p>Very little appreciation of the elementary theory how a minimum price will affect the market. Diagrams will be inaccurate and/or largely irrelevant. The weakest candidates may be unable to demonstrate how the minimum price will affect the market and make little mention of market failures.</p>

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## Evaluation

<p>Level 3 (6–8 marks) Mid mark 7</p>	<p>A good answer is likely to focus on:</p> <ul style="list-style-type: none"> <li>• The extent to which a minimum price will impact upon the market for alcohol being dependent upon demand and supply elasticities and the level of the minimum price.</li> <li>• The fact that government intervention will have different effects on different sectors of the drinks market.</li> <li>• The extent to which alternative solutions – altering the drinking age, education, different forms of regulation – are better than a minimum price at tackling the market failures associated with alcohol consumption.</li> <li>• Some assessment of the difficulties involved in setting a minimum price – the opportunity cost, the likelihood of government failures, the possible distributional issues. A minimum price might have regressive implications.</li> <li>• Whether or not the potential drawbacks of government intervention might outweigh the benefits of government intervention.</li> </ul> <p>The candidate is likely to conclude that there are market failures associated with alcohol consumption but that tackling them will be far from straightforward and that no single policy will be successful in isolation.</p>
<p>Level 2 (3–5 marks) Mid mark 4</p>	<p>One of the above will be discussed in detail or a couple of points touched on, but only in a relatively superficial way. The candidate will struggle to identify the complexity of policy responses to the different market failures.</p>
<p>Level 1 (1–2 marks) Mid mark 2</p>	<p>Whilst there might be an appreciation of the fact that evaluation could be carried out and indeed there might be the odd comment that suggests an area for potential evaluation, the point is not developed.</p> <p>For example: 'Minimum prices are inevitably going to reduce the market failures associated with high levels of alcohol consumption. But they might not be the best solution to the problem.'</p>

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## Section B

### 4 To what extent should governments prioritise the control of inflation over the goal of low unemployment? [25]

Candidates should be able to define the key terms in the question – inflation and low unemployment. Answers may start by suggesting that control of inflation is seen as key in allowing governments to pursue a range of macroeconomic goals. In the long-run, stable, low inflation may well be consistent with sustainable growth, low levels of unemployment and a balance of payments equilibrium. However, to some degree whether they prioritise this depends upon their macroeconomic objectives: a government committed to reducing inequalities of income and wealth might view low unemployment as more important than inflation. Good candidates might adopt an alternative approach: they might argue that although inflation and unemployment both impose costs on individuals within an economy, the former imposes costs on a greater proportion of the population and thus should be prioritised.

#### Answers may include:

**Knowledge** and **understanding** of what inflation is and how it can be controlled, principally by monetary policy in the short-run. An awareness of how low unemployment can be defined perhaps with reference to the number of unemployed people in the economy and a corresponding number of job vacancies. Candidates should look to develop a number of points.

Examples:

- The fact that in there need not be a trade-off between inflation and unemployment. Candidates may focus on supply-side reform as a way of combating inflation and decreasing unemployment.
- Strong candidates may refer to the long-run or expectations-augmented Phillips curve.
- The various costs of inflation and unemployment, for both the economy and the individual.

**Application** to the decisions of government will be rewarded. This may include reference to the nature of inflation targets in the UK, the Eurozone and the US.

**Analysis** of the implications of targeting inflation for other macroeconomic objectives. Overly tight fiscal and monetary policy might have detrimental consequences for an economy. There may be detailed assessment of the relationship between inflation and growth, and inflation and unemployment.

#### Evaluation of the issues involved

Examples:

- The extent to which control of inflation necessarily compromises the achievement of low unemployment: in the short-run there might be conflict between the two objectives but not in the long-run with supply-side policies. Indeed, control of inflation could increasingly be seen as a supply-side policy.
- An assessment of whether the costs of inflation or unemployment are larger.
- A danger of strict focus on inflation possibly precipitating deflation.
- An attempt to establish whether the setting of explicit inflationary targets has been successful and if those inflationary targets are appropriate. For example, Robert Barro has argued that in MEDCs, stable inflation of 8-10% might not jeopardise growth and this might be consistent with higher levels of employment.
- The extent to which governments actually have prioritised inflation over low unemployment.

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### Theory and analysis

<p>Level 4 (13–17 marks) Mid mark 15</p>	<p>There is a clear discussion of the potential link and possibly trade-off between the two concepts and some attempt to focus on the degree to which inflation has been 'prioritised'. At this level, candidates' analysis will be accurate and they should be capable of moving beyond the belief in the inevitability of a trade-off between inflation and unemployment and accepting that there are circumstances where both objectives can be achieved.</p> <p>Excellent candidates would prioritise discussion of the respective costs of inflation and unemployment, and the nature of inflation targeting in practice.</p>
<p>Level 3 (9–12 marks) Mid mark 11</p>	<p>The candidate will identify the main link between inflation and full employment and analysis of this will be accurate. The answer will also consider how this analysis has affected the conduct of economic policy. However there will be limited consideration of other possible relationships between inflation and unemployment.</p>
<p>Level 2 (5–8 marks) Mid mark 7</p>	<p>There is some appreciation of there being a relationship between inflation and full employment but little ability to develop it. At the bottom of this level, candidates might assume that inflation and full employment are always mutually exclusive. There is very unlikely to be much application of economic theory.</p>
<p>Level 1 (1–4 marks) Mid mark 3</p>	<p>There will be limited knowledge of the relationship between the two concepts and few, if any diagrams. The answer may fail to address the set question, particularly in looking at the issue of 'prioritising' and the weakest candidates may simply focus on one of the concepts.</p>

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### Evaluation

<p>Level 3 (6–8 marks) Mid mark 7</p>	<p>A good answer is likely to discuss issues such as:</p> <ul style="list-style-type: none"> <li>• Whether governments actually do prioritise inflation over the maintenance of full employment.</li> <li>• Whether inflation targeting has been associated with higher unemployment than would otherwise have been the case.</li> <li>• Whether the current monetary policy regimes are appropriate in the current circumstances, and if not, how they might be altered to take more account of the level of employment.</li> <li>• The extent to which the short-run Phillips curve has disappeared from economic debate.</li> </ul> <p>There will be a conclusion drawn at the end of to explain the candidate's overall position – even if there is no clear-cut answer.</p>
<p>Level 2 (3–5 marks) Mid mark 4</p>	<p>One of the above will be discussed in detail or a couple of points touched on, but only in a relatively superficial way.</p>
<p>Level 1 (1–2 marks) Mid mark 2</p>	<p>Whilst there might be some appreciation that evaluation could be carried out, the point is not developed. For example: 'Low inflation may have detrimental consequences for employment levels, depending upon the circumstances.'</p>

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**5 Discuss the extent to which fiscal policy alone can reduce income inequality. [25]**

Candidates should define fiscal policy, and be capable of identifying what is meant by income inequality and how it is measured. They should be capable of demonstrating how the use of fiscal policy can, in theory, reduce inequality and look to relate this to recent UK and/or other experience. Candidates should argue that fiscal policy can reduce income inequality but that there are reasons for believing that it is not as effective as it might be. Supply-side policy also has an important part to play in tackling income inequality. The best candidates will suggest that legislation, attempt to change social attitudes and market-based approaches can also reduce income inequalities.

**Answers may include:**

**Knowledge and understanding** of how fiscal policy operates and theoretically can reduce inequalities of income.

Examples:

- Explanation of how income inequality is measured with reference to Lorenz curves or the Gini co-efficient.
- The different ways in which fiscal policy can tackle income inequality via the use of progressive taxation and/or redistribution via benefits, both in cash and in kind.
- The use of supply-side policy – e.g. better education and training – to tackle income inequalities.
- The use of other methods of tackling income inequality: some may argue that reducing income inequality is no longer an objective of government.

**Application** in explaining how individual fiscal policy instruments can affect the distribution of income. Candidates could look at a range of measures: altering tax bands, altering marginal rates of tax, looking to make the tax system more progressive, or increasing government spending. Good candidates may put this in the context of a sizeable government deficit.

Candidates then need to make some attempt to look at alternatives to fiscal policy, not least supply-side policy. Good candidates will probably not that some forms of fiscal policy might be employed for their supply-side effects. Time permitting, they should look beyond obvious policy instruments and consider market-based approaches.

**Analysis** of the extent to which fiscal policy actually has affected income distribution

Examples:

- The introduction and withdrawal of the 10p tax band; the introduction and announced withdrawal of the 50p tax band.
- Changes to benefit – the introduction of the Working Families Tax Credit.
- Reference to how changes in public sector spending may affect income inequality.
- Consideration of the effectiveness of supply-side policy in reducing income inequality.
- Other attempts to reduce income inequality: the introduction of a national minimum wage, anti-discrimination legislation.

Reference to specific examples will be rewarded; excellent candidates will have an understanding of how recent changes in UK fiscal policy have, or have not, altered income inequality.

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**Evaluation** of the issues involved.

Examples:

- The extent to which reduction of the inequality of income is still a macroeconomic objective.
- Whether fiscal policy is the only way that inequality can be reduced. Are there supply-side alternatives? Might industrial policy help?
- The extent to which the degree to which fiscal policy will be successful in tackling inequality depends upon correctly identifying the causes of inequality.
- Reasons why making the tax and benefit system more progressive may not have as large an effect on inequality as expected.
- Contextualising this within the context of the UK's recent economic history – to what extent might this have been tackled in the 16 years of unbroken growth and to what extent is this unlikely to happen in the near future with the public finances in their current state.

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### Theory and analysis

<p>Level 4 (13–17 marks) Mid mark 15</p>	<p>Candidates should clearly define fiscal policy and income inequality and identify how the latter is measured. There should be a clear explanation of how, in theory, fiscal policy can be used to tackle this problem. At the top of this level, candidates may question whether governments still use fiscal policy for this purpose. It is likely that the best candidates are able to highlight specific policies and comment on their effect on the inequality of income distribution, in theory and practice.</p>
<p>Level 3 (9–12 marks) Mid mark 11</p>	<p>There will be good understanding of fiscal policy, both taxation and government spending, and the ways in which it can reduce inequality. However, candidates are likely to adopt a rather theoretical approach and show reluctance to relate their answers to recent UK or other experience. There may be generalised knowledge that income inequality has worsened but little grasp of the factors that might have caused this. Explanation of these factors may lack accuracy.</p>
<p>Level 2 (5–8 marks) Mid mark 7</p>	<p>Candidates are aware that fiscal policy can be used to reduce inequality but with incomplete explanations of the range of ways in which this can be achieved. Development of argument is likely to be confused and may contain errors.</p>
<p>Level 1 (1–4 marks) Mid mark 3</p>	<p>Explanations are necessarily limited. At the top end there will be some awareness of how inequality can be tackled but the weakest candidates may be confused.</p>

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### Evaluation

<p>Level 3 (6–8 marks) Mid mark 7</p>	<p>The best answers are likely to evaluate issues such as:</p> <ul style="list-style-type: none"> <li>• The extent to which fiscal policy can reduce income inequality.</li> <li>• Whether fiscal policy is the only way that income inequality can be tackled.</li> <li>• The degree to which fiscal policy is still used to tackle this problem, even by a Labour government.</li> <li>• Government failure, such as the extent to which people do not claim benefit to which they are entitled.</li> <li>• The extent to which changes in the structure and performance of the UK economy have reduced the ability of fiscal policy to reduce income inequality.</li> <li>• The extent to which supply-side policy can tackle income inequality.</li> <li>• Whether other measures can also reduce income inequality.</li> </ul>
<p>Level 2 (3–5 marks) Mid mark 4</p>	<p>One of the above will be discussed in detail or a couple of points touched on, but only in a relatively superficial way.</p>
<p>Level 1 (1–2 marks) Mid mark 2</p>	<p>There is some appreciation that fiscal policy can reduce income inequality but little awareness of the range of other alternatives, and little ability to evaluate the relative effectiveness of different measures.</p> <p>For example: 'Fiscal policy always looks to improve income distribution by taxing the rich more than the poor.'</p>

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- 6 Free trade creates many losers as well as winners, particularly in manufacturing. Thus, there is a strong case for protectionism in more economically developed countries (MEDCs).

To what extent do you agree with this argument for protectionism? [25]

Candidates should define free trade and protectionism. They should be aware of the fact that comparative advantage is dynamic and that a country may lose comparative advantage to other nations at any time. The quotation is designed to lead weaker candidates to infer that protectionism is always a good thing when MEDC manufacturers are incapable of competing with rivals elsewhere. However, the stronger candidates should argue that even accepting the fact that, in the short-term, some lose out if there is free trade, in the long-term free trade is generally beneficial to all, particularly in MEDCs where there is likely to be higher factor mobility and a more developed social safety net for the unemployed. There should be some attempt, probably diagrammatic, to analyse the impact of protectionist measures in greater detail.

**Answers may include:**

**Knowledge and understanding** of what free trade is. Candidates should argue that the absence of protectionism will allow resources to be employed in their most efficient locations and should generate gains for all: global output will increase, domestic firms will face greater competitive pressure and there will be dynamic gains from greater product choice. There may be an attempt to differentiate between tariff and non-tariff barriers, but candidates should be aware that in most instances protectionist measures are designed to protect vested interests and have little long-term economic validity. Thus, in this case, instead of devoting resources to protectionism, MEDC governments may be better advised to devote them to improving factor mobility allowing for factors to relocate to those areas where an economy retains comparative advantage.

**Application** to specific examples would help develop these points. For example, candidates might highlight that the influx of cheap Chinese steel might have disadvantaged US steel companies and saw steelworkers made redundant. However, they should be aware that the decision to protect US steel firms from cheaper Asian imports also has significant negative implications for the US economy, in the form of higher prices for firms buying US steel, such as car manufacturers.

**Analysis** of the implications of restricting free trade via protectionism. Candidates should avoid getting bogged down in lengthy explanations of the benefits of trade and focus on the disadvantages of introducing protectionism.

Examples:

- Consideration of the fact that, in the short-term, economic agents in MEDCs may feel that free trade allows foreign firms access to their markets, driving domestic firms out of business, increasing unemployment.
- Diagrammatic analysis of the impact of a tariff and the welfare implications.
- Why MEDCs introduce tariffs, given that they have disadvantages.
- Analysis of instances where there may be some justification for introducing protectionism – where national security is an issue, when the costs of introducing the tariff are less than the cost of increased benefit payments to unemployed workers.

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**Evaluation** of the issues involved

Examples:

- The extent to which tariffs are actually able to protect employment in MEDCs.
- Consideration of the likelihood of government failure: the government may introduce tariffs in the wrong sector of industry, the fact that once tariffs have been introduced it will be virtually impossible to remove them.
- Some evaluation of the distributional issues involved. Why should the government favour one sector of industry over another? The fact that protectionism may discriminate against consumers.
- Assessment of other damaging implications of protectionism in reducing the level of competition facing domestic firms and the long-term consequences of this.

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### Theory and analysis

Level 4 (13–17 marks) Mid mark 15	Candidates should define free trade and highlight the fact that this is likely to see LEDCs better able to exploit their comparative advantage and manufacture goods and services at lower cost than MEDC producers. Candidates should be able to analyse the effect of this, especially on employment in certain sectors. They should be capable of highlighting how, in the short run, protectionism can counteract this. Diagrams are likely to be drawn demonstrating that protectionist barriers can maintain employment levels. Good candidates are likely to develop these arguments in a sophisticated manner, perhaps referring to elasticity of demand and supply in looking at tariffs. However, it is vital that candidates consider the adverse welfare implications of the introduction of protectionism for an economy; this makes it likely that they will conclude that the reason given in the quotation is not a justification for introducing protectionism, certainly in the long run.
Level 3 (9–12 marks) Mid mark 11	There will be good understanding of free trade and some understanding of the implications of protectionism, although this analysis might be incomplete in places. There should be some recognition that protectionism has both a case for and a case against, with a focus on the practical context given.
Level 2 (5–8 marks) Mid mark 7	Candidates are broadly aware that free trade is generally good and that protectionism is bad but explanations may contain errors and omission and little sense of structure. At this level, weaker candidates may misinterpret the question to some degree and either argue in favour of protectionism or merely highlight the benefits of free trade.
Level 1 (1–4 marks) Mid mark 3	Explanations will be limited. There might be some awareness of what 'free trade' is but the weakest candidates are likely to have an uncertain view of the implications of protectionism. The answer is likely to have few, inaccurate diagrams.

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### Evaluation

<p>Level 3 (6–8 marks) Mid mark 7</p>	<p>The best answers are likely to evaluate issues such as:</p> <ul style="list-style-type: none"> <li>• The extent to which protectionism can actually protect employment levels in the short-run and the long-run.</li> <li>• Reference to the impact of protectionism on specific industries and whether the protectionism could be justified.</li> <li>• The extent to which tariffs are self-defeating: in protecting manufacturers, this may keep firms inefficient and ensure that the only way to maintain employment is to continue to protect them.</li> <li>• Evaluation of the idea that protectionist measures have an opportunity cost, may be an example of government failure and raise distributional issues.</li> </ul>
<p>Level 2 (3–5 marks) Mid mark 4</p>	<p>One of the above will be discussed in detail or a couple of points touched on, but only in a relatively superficial way.</p>
<p>Level 1 (1–2 marks) Mid mark 2</p>	<p>There might be some sense that evaluation could be carried out but the candidate may choose to make sweeping generalizations. For example: 'Protectionism is always a big help to MEDC manufacturing industries because it allows them to stave off unfair competition.'</p>