

**CAMBRIDGE INTERNATIONAL EXAMINATIONS**

**Pre-U Certificate**

## **MARK SCHEME for the May/June 2013 series**

### **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 should be read in conjunction with the question paper and the Principal Examiner Report for Teachers.

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The purpose of the essay paper is to enable candidates to select appropriate economic models, that theories and concepts 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 – 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 Economists traditionally assume that firms seek to maximise profit.

**Evaluate the usefulness of this assumption.**

**[25]**

Candidates should show complete understanding of the concept of profit maximisation and be able to use an accurate diagram to demonstrate their understanding. Candidates need to be clear in identifying the marginal cost = marginal revenue condition and why the profit maximising equilibrium occurs where it does. In order to get into Level 4, candidates must ensure that they address the idea of whether profit maximisation is useful, both as an economic model and in describing firm behaviour, as well as considering alternatives to the assumption of profit maximising.

**Answers may include:**

**Knowledge and understanding** of the profit maximising condition. Candidates should be capable of explaining and illustrating this, using diagrams. However, they should also be aware that a firm may have a range of alternative objectives – sales maximisation, revenue maximisation, either of these subject to some profit constraint, the possibility of profit satisficing. There may well be some attempt to explain that the assumption of profit maximisation is necessary in as much as it allows for the easiest analysis of the firm and that, empirically, it corresponds to how most firms are believed to behave.

**Application** to real life, perhaps by looking at a range of different firms, perhaps focusing on how differences in ownership structure, or the market structure in which they operate, will determine the extent to which they are likely to be profit maximisers.

**Analysis** of various different objectives, starting with profit maximisation

Examples:

- The profit maximising condition and its applicability to all types of firm.
- Alternative objectives – sales maximisation, revenue maximisation, perhaps with some mention of the need to break-even in the long run.
- Behavioural views of the firm – the idea of the firm as a coalition of interests and thus the need for profit satisficing.

Answers which attempt to analyse the extent to which the assumption of profit maximisation is useful, with reference to specific examples (e.g. differentiating between public sector and private sector firms) should be rewarded.

**Evaluation** of the issues involved

Examples:

- An assessment of the extent to which profit maximisation is useful as an analytical tool.
- An assessment of the degree to which it is impossible to determine price-output decisions in the manner suggested by economic theory – the difficulty of measuring marginal cost and marginal revenue, a lack of knowledge of these concepts, the undesirability of maintaining the profit maximising position.
- Consideration of the extent to which profit maximisation is likely in particular markets: is profit maximisation more likely in competitive markets? How different ownership structures impact upon the likelihood of profit maximising.
- Awareness of the fact that profit maximising allows economists to model the firm in a meaningful way – it is relatively straightforward and allows for comparison between firms, it has empirical validity to a great extent.
- An assessment of the extent to which market specifics and the nature of firm ownership determine the degree to which the assumption of profit maximisation is 'useful'.

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### Theory and analysis

Level 4 (13–17 marks) Mid mark 15	<p>There is a clear understanding of the profit maximising condition – including, almost certainly, a diagram illustrating the <math>MC=MR</math> condition – but also awareness of at least two other alternative objectives of the firm.</p> <p>At this level there will also be awareness of the fact that the objectives of the firm are constrained by the need to break even. This need not be stated explicitly but must be implied. Candidates may also look at how the interests of individual shareholders might not be served by profit maximisation.</p>
Level 3 (9–12 marks) Mid mark 11	<p>Candidates are likely to be able to explain and draw the profit maximising condition but might not be able to develop alternatives to the firm as profit maximiser. They may fail to draw diagrams looking at these alternatives, are unlikely to consider a behavioural approach and at the bottom end might struggle to direct their material towards the issue of whether profit maximisation is useful.</p>
Level 2 (5–8 marks) Mid mark 7	<p>There is a clear appreciation of what is meant by profit maximisation but there are errors or omissions in the candidate's answer. The candidate is likely to give a simplistic account of some alternatives to profit maximisation but without any depth. Application of material to the question of whether profit maximisation is genuinely a useful assumption is likely to be largely ignored.</p>
Level 1 (1–4 marks) Mid mark 3	<p>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 why firms profit maximise.</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>• Some attempt to ascertain that whilst it might not be necessary to assume profit maximisation, it is perhaps the best way of modelling firm behaviour.</li> <li>• Evaluation of reasons why the theoretical model of profit maximisation can only be an approximation of how firms behave in practice.</li> <li>• The extent to which profit maximisation is realistic.</li> <li>• The extent to which the market structure of the relevant market/ownership structure of the firm have implications for whether or not profit maximisation is realistic – firms in monopoly might not face significant pressure to profit maximise, the pursuit of profit is the explicit aim of shareholders, not always other economic shareholders.</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 and indeed there might be the odd comment that suggests an area for potential evaluation, the point is not developed.</p> <p>For example: ‘There are lots of objectives that firms could pursue but most choose to profit maximise and on that basis it is useful that we make this assumption.’</p>

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**2 With reference to examples, identify the factors which determine market structure and assess the reasons why many market structures in the UK tend towards oligopoly. [25]**

Candidates should show a good understanding of market structure, and the factors that determine the prevailing market structure: total market demand, the minimum efficient scale, the ability of incumbent firms to erect barriers to entry, the nature of the product being produced and the relationship between firms in a given market. The best candidates will necessarily be cautious about dealing in general terms: comments on market structure can only be relevant if they reflect the reality of the market. Any judgement about the national market might not reflect reality in specific locations. Nevertheless, candidates should be capable of arguing that given the assumptions of the various market structures, most UK industries do tend towards imperfect competition, if not oligopoly, largely because of the relationship between total market demand and minimum efficient scale.

**Answers may include:**

**Knowledge and understanding** of how the prevailing market structure is determined. Initially, the nature of a market will largely reflect the relationship between total market demand and the minimum efficient scale in an industry. However, over time the nature of the market may change as a result of the actions of incumbent firms seeking to protect their positions and possible subsequent government intervention. However, many UK industries do appear to be oligopolistic: grocery retailing, electricity generation and supply, banking. Candidates should have a clear understanding of what this implies about the number and size of firms, the nature of their products and competition and so on. The very best candidates may seek to look beyond this simplistic approach and consider the market in particular regions/locations or exceptions to this: markets that actually are more competitive, perhaps a farmers' market, and the existence of natural monopolies such as the provision of the rail network. Some candidates may look at the definition of a market and perhaps consider market segmentation and the existence of niche markets.

**Application** to real life, candidates should be prepared to relate the theory of market structure to examples. At a basic level they would be expected to characterise a particular industry as a specific type of market structure and justify it. However, development of this should be rewarded. For example, the motor car industry is broadly oligopolistic if we consider the mainstream market (Toyota, Ford, Nissan etc.) but at the margin, such as the market for luxury cars, it tends towards a monopolistically competitive market. Equally, whilst on a national scale grocery retailing may appear oligopolistic, in a specific location with only one supermarket, the market may be more monopolistic.

**Analysis** of what determines the prevailing market structure

Examples:

- The relationship between total market demand and the minimum efficient scale – again, reward both the use of examples and the ability to differentiate between naturally occurring and artificially erected barriers to entry.
- The ability of incumbent firms to influence market structure via their actions – integration, the use of artificially erected barriers to entry. Again reward examples: most mature industries in the UK have evolved into imperfectly competitive markets over time.
- The ability of the government to affect the market structure of an industry, again rewarding examples.

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### Evaluation of the issues involved

Examples:

- Attempts to evaluate the extent to which the application of market structure is dependent upon the type of market being studied – e.g. differentiating between national and local markets.
- Evaluation of the theoretical assumptions of market structure and whether or not they are applicable in reality.
- Some comment on whether or not many of the UK's markets are oligopolistic or not.
- Evaluation of the extent to which it is the actions of firms which determine market structure or whether consumers also play a role in this: might not consumer demand for product variety mitigate against markets becoming too highly concentrated and thus oligopolistic?

### Theory and analysis

Level 4 (13–17 marks) Mid mark 15	<p>There should be clear understanding of the term market structure, especially oligopoly and its characteristics. Good candidates should be able to link total market demand and minimum efficient scale, although only the very best may relate the former to consumer demand and differentiate between naturally occurring and artificially erected barriers to entry in determining how a market may evolve. It is expected that accurate diagrams will be drawn.</p> <p>Candidates who make intelligent use of applied example to prove/disprove the statement should be rewarded, especially if they are able to link this to the characteristics of other market structures.</p>
Level 3 (9–12 marks) Mid mark 11	<p>Candidates should be able to directly address the issues of market structure and oligopoly, going a long way towards linking the features of oligopolistic markets with specific examples; however, their ideas will lack real depth and/or diagrammatic accuracy. At the bottom of the level, candidates may struggle to analyse why a given market structure initially emerges and subsequently develops.</p>
Level 2 (5–8 marks) Mid mark 7	<p>Candidates show limited ability to apply material relating to oligopolistic markets and at the bottom of the level there may be generalised statements about why certain markets are oligopolies without much consideration of the alternatives.</p>
Level 1 (1–4 marks) Mid mark 3	<p>Candidates are only able to examine the issues of market structure and oligopoly with little, if any, reference to a specific industry. The answer will not deal with the factors that determine market structure in a meaningful way.</p> <p>There are likely to be few diagrams, and those that are drawn are likely to be poorly explained.</p>

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## Evaluation

Level 3 (6–8 marks) Mid mark 7	<p>A good answer is likely to discuss issues such as:</p> <ul style="list-style-type: none"> <li>• Whether or not many UK markets are oligopolistic or not.</li> <li>• Whether the consumers' and firms' actions make this likely – perhaps with a reference to the impact of technology.</li> <li>• Whether generalising about whether an industry conforms to a particular market structure is appropriate in all/any circumstances.</li> </ul> <p>Candidates should be able to reach some sort of view about the quotation and credit should be given for any attempt to back this up with evidence, either appropriate data or an anecdote.</p>
Level 2 (3–5 marks) Mid mark 4	<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.</p>
Level 1 (1–2 marks) Mid mark 2	<p>Whilst there might be some appreciation 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: 'A lot of UK industries are oligopolistic, although this is changing over time'.</p>

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**3 Evaluate the view that wage differentials are only a reflection of differences in the marginal productivity of workers. [25]**

Candidates should be able to define ‘wage differentials’ either as workers receiving different wages for doing the same job, or workers receiving different amounts for doing different jobs. They should explain that such differentials occur for a variety of reasons, not least because of differences in marginal productivity. However, they should quickly go beyond this and highlight other factors that cause wage differentials: different demand and supply conditions in different labour markets, different labour market structures, differentiating between perfectly competitive labour markets and imperfectly competitive labour markets; the impact of national minimum wage/trades unions; gender, educational and ethnic wage differentials. Better candidates should be prepared to argue that some differentials can arise because of the efficient operation of the labour market but also because of discrimination within the labour market.

**Answers may include:**

**Knowledge and understanding** of how wages are theoretically determined in different labour markets, with clear focus on what is meant by ‘marginal productivity’, and thus how wage differentials can arise depending upon demand and supply conditions, how different labour market structures – perfectly competitive and imperfectly competitive – affect wage determination and how a national minimum wage/trades unions can cause wage differentials.

Good candidates will go on to argue that other factors may cause wage differentials – notably gender, education and ethnicity but that these factors may have nothing to do with marginal productivity.

**Application** to specific labour markets. Candidate should be able to draw accurate diagrams showing how marginal productivity is central to wage determination and how it goes some way to explaining wage differentials. They should also demonstrate how different elements of market structure may influence wage determination and thus wage differentials.

**Analysis** of the extent to which it is differences in marginal productivity that are the main cause of wage differentials

Examples:

- Whether those in receipt of the highest pay are the most productive, and perhaps how this can be defined.
- The degree to which wage differentials reflect monetary compensation for differences in the non-monetary characteristics of jobs undertaken by workers with identical skill levels.
- The fact that the wages that firms pay may deviate from those implied by economic theory – the efficiency wage hypothesis

**Evaluation** of the issues involved

Examples:

- The extent to which labour markets conform to theoretical models – are most labour markets perfectly or imperfectly competitive? What factors determine this?
- The extent to which a firm is able to determine the marginal productivity of an individual worker and reward them in line with this, and the extent to which this may/may not be desirable.
- The degree to which other factors offset differences in productivity in determining wages – e.g. difference in prevailing labour market conditions, existing pay structures, different levels of bargaining power.

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### Theory and analysis

Level 4 (13–17 marks) Mid mark 15	The best candidates are likely to argue that wage differentials are caused by a range of factors, not least marginal productivity theory. However, they will also assert that there are many other factors to bear in mind. There will be good understanding of theoretical models of wage determination but the strongest candidates will look at factors other than differences in marginal productivity, reflecting the complexity of wage determination across an industry, in different industries and across different labour market structures.
Level 3 (9–12 marks) Mid mark 11	Candidates must be able to explain how, in theory, different levels of marginal productivity will cause wage differentials. However, at the top of this level candidates should be capable of identifying at least two other factors which may cause wage differentials. At the lower end of the mark bracket, answers may lack a degree of accuracy but credit should be given for recognising the diversity of factors which may cause wage differentials.
Level 2 (5–8 marks) Mid mark 7	Candidates show limited appreciation of the significance of marginal productivity in causing wage differentials. There are likely to be errors and omissions in candidates' answers and little awareness of the broad range of other factors at work. At the bottom of this bracket, answers are likely to generalise rather than examine how market-specific conditions are likely to generate wage differentials.
Level 1 (1–4 marks) Mid mark 3	Candidates can only conceive of wage differentials resulting from different levels of marginal productivity. There are likely to be few diagrams, and those that are drawn are likely to be poorly explained.

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## Evaluation

Level 3 (6–8 marks) Mid mark 7	<p>A good answer is likely to discuss issues such as:</p> <ul style="list-style-type: none"> <li>• Whether or not ‘marginal productivity’ of workers really is a key determinant of wage differentials: can firms measure it? Are they likely to pay workers different amounts on this basis?</li> <li>• An assessment of the level at which wages are determined: nationally, firm level, at the level of the individual – good candidates might argue that the more decentralised the labour market, the more likely it is to be the case that differences in marginal productivity are likely to cause wage differentials.</li> <li>• An attempt to discern whether or not factors other than marginal productivity are more important in determining wage differentials.</li> <li>• Whether or not wage differentials reflect the efficient operation of the labour market or discrimination in other markets such as education.</li> </ul> <p>Good candidates will look at a range of determinants of wage differentials before offering some assessment of the extent to which it is ‘marginal productivity’ which is the single most important cause of wage differentials.</p>
Level 2 (3–5 marks) Mid mark 4	<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 relationship between marginal productivity and a variety of other factors.</p>
Level 1 (1–2 marks) Mid mark 2	<p>Whilst there might be some appreciation that evaluation could be undertaken, the point is not developed.</p> <p>For example: ‘It is clearly the case that marginal productivity is important in explaining wage differentials but difficult to ascertain how differences in marginal productivity come about’.</p>

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### Section B

- 4 Explain why many countries have adopted inflation targets and evaluate the extent to which the Bank of England should be blamed for failing to achieve its inflation target in recent years. [25]

Candidates should be able to correctly define an inflation target, perhaps with reference to the UK target of 2.0%, [ $\pm 1\%$  of CPI] (up to December 2003 the target was 2.5% [ $\pm 1\%$ ] of RPIX). Candidates should be rewarded for identifying price stability and recognising its importance as a macroeconomic objective. The answer might be developed to identify the main purpose of the inflation target to act as a monetary anchor and thus affect inflationary expectations. However, the second part of the question is somewhat more nuanced: the determinants of UK inflation are clearly both domestic and increasingly international. The best candidates will necessarily attempt to ascertain whether the deviation from target is the fault of the Bank of England or if it is the result of global economic circumstance. Equally, some may briefly contemplate whether the current target is still appropriate or whether the target is attainable if it continues to include things such as commodity prices over which UK monetary authorities have no control.

#### Answers may include:

**Knowledge** and **understanding** of why governments sought to adopt inflationary targets. Good candidates may identify theoretical constructs, such as the importance of controlling inflationary expectations and the impact of these expectations on wage and price-setting. Good candidates will blend theoretical constructs with direct reference to recent UK experience, perhaps contrasting the NICE decade with the current circumstances. The best candidates will be clear in suggesting that the high level of inflation between 2007 and 2011 was largely cost-push and attempt to identify the causes of this, notably with reference to commodity and energy prices. Exceptional candidates might highlight the fact that there has been some debate about whether the Bank of England has focused more on output and employment than control of inflation in the wake of the 2007–08 financial crisis.

**Application** to the UK's recent inflationary performance will be rewarded. Candidates should have an overview of recent inflation performance in relation to the inflation target.

**Analysis** of the recent causes of inflation and the performance of the Monetary Policy Committee in combating recent inflation. The factors which have been most significant in moving inflation away from target and whether or not the MPC has/could be expected to combat them.

#### Evaluation of the issues involved

Examples:

- The extent to which inflation has been caused by various factors, either domestic or global.
- An assessment of whether domestic inflationary expectations remain a significant determinant of the level of inflation in the UK in an increasingly global world.
- Evaluation of the relative importance of a range of factors in determining inflation – for example, globalisation, technological improvements, commodity prices, and the state of the global economy.
- The extent to which the Monetary Policy Committee can realistically be expected to see far enough into the future to realistically be able to set the correct level of interest rates.
- The extent to which the inflationary target and an independent monetary policy have been 'successful' – there might even be some speculation as to what is meant by 'success' in this context.

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### Theory and analysis

Level 4 (13–17 marks) Mid mark 15	There is understanding of why inflation targets were adopted and a clear grasp of recent UK inflationary performance. Candidates should be able to differentiate between domestic and international causes, with particular focus on energy and commodity prices. They should also have an accurate overview of the rate of inflation and its relationship with the inflation target, and analyse the degree to which the Monetary Policy Committee has been successful in guaranteeing price stability in the UK. The best candidates might argue that recent economic circumstances are almost unprecedented, and that the MPC faced an exceptionally difficult task in tackling inflation over the time period.
Level 3 (9–12 marks) Mid mark 11	The candidate will be able to comment on the existence of inflation targets and have good knowledge of recent inflationary performance. However, at the bottom of the level it will be inaccurate or incomplete. There is likely to be some consideration of the range of factors which contribute to inflation but little appreciation of their relative importance. There is likely to be little ability to consider all of this within the current monetary policy framework.
Level 2 (5–8 marks) Mid mark 7	There is limited appreciation of the extent to which inflation targets exist and recent inflationary performance but there are errors or omissions in the candidate's answer. The candidate is likely to give a simplistic account of the causes of inflation but overlook the context of the question. There will be little reference to the UK's inflation target or the performance of the Monetary Policy Committee.
Level 1 (1–4 marks) Mid mark 3	Explanations are either missing or inaccurate. The answer is likely to fail to address the issue of whether or not it is the target itself or other factors that have had greatest influence on inflationary performance. There will be little if any attempt to weigh up the performance of the Monetary Policy Committee over the period of the inflation target.

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### Evaluation

Level 3 (6–8 marks) Mid mark 7	<p>A good answer is likely to discuss issues such as:</p> <ul style="list-style-type: none"> <li>• An assessment of the relative weight of the factors which affect inflation.</li> <li>• Some attempt to evaluate whether the increasingly global causes of inflation have made control of inflation exceptionally difficult.</li> <li>• An assessment of what is meant by ‘successful’ in the context of monetary policy?</li> <li>• The extent to which the success of a given target depends upon the credibility of the monetary policy framework perhaps with reference to other forms of monetary policy/inflation target.</li> <li>• A consideration of alternative inflation targets – core inflation, for example.</li> <li>• The fact that there are different types of inflation target and that there is no ‘best’ form of inflation targeting.</li> </ul>
Level 2 (3–5 marks) Mid mark 4	<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 separate the performance of the Monetary Policy Committee from the impact of external factors in determining inflation performance.</p>
Level 1 (1–2 marks) Mid mark 2	<p>Whilst there might be some appreciation 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: ‘Inflation has been caused by external factors and thus the inflation target has been an increasingly irrelevant part of the government’s economic policy.’</p>

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**5 Recovery from recessions is often characterised by stubbornly high levels of youth unemployment.**

**Explain the costs associated with youth unemployment and evaluate possible economic policies to deal with it. [25]**

Candidates should be capable of defining unemployment, specifically youth unemployment and identify the costs of youth unemployment: to the economy as a whole, the government and the individual. Candidates must focus on the specific costs of youth unemployment, particularly for the economy as a whole, before considering policy solutions. The better candidates will avoid parroting text book theory; they will look at specific policy solutions adopted by the world's leading economies and evaluate their effectiveness, perhaps in the light of the prevailing fiscal position, but certainly with awareness of the opportunity cost, risk of government failure and the distributional issues of any policies introduced.

**Answers may include:**

**Knowledge and understanding** of the definition of unemployment, and perhaps the different ways it is measured. This should be specifically focused on youth unemployment. Candidates should appreciate the fact that youth unemployment is associated with costs for a variety of economic agents: the economy as a whole, the government and the individual. For the whole economy this will be the opportunity cost of lost output as well as the implications of deterring potential workers from entering the labour market in future, the fall in potential GDP, implications for income equality and the external costs of unemployment. For the government this sees a rise in welfare spending and a fall in tax revenue. For individuals, the costs include lower income, a falling standard of living, worsening health and a decline in their human capital. The latter is particularly important when considering youth unemployment.

**Application** to youth unemployment and possible solutions to it. Candidates may focus on the disincentive effects of youth unemployment and the implications of this for long-run GDP and move on to consider policy solutions.

**Analysis** of various forms of intervention

Examples:

- Provision of schemes to try to get young people into work such as the New Deal or jobs guarantees for the young.
- Increased access to education and training, including vocational training.
- Increased security of apprenticeships.

**Evaluation** of the issues involved

Examples:

- The potential drawbacks of interventionist approaches to the problem of youth unemployment.
- The time frame involved – policies to tackle youth unemployment may take a considerable period of time to have an effect.
- The issue of how unemployment policy is only one aspect of government policy and that the present fiscal position might restrict the ability of the government to intervene to tackle youth unemployment.

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### Theory and analysis

Level 4 (13–17 marks) Mid mark 15	There is precise understanding of what constitutes unemployment. The very best candidates must consider the specific costs of youth unemployment. The answer should move on to consider the different approaches to tackling youth unemployment via intervention in the labour market and within education. There should be some reference to real world examples of government policy and balanced assessment of the likelihood of these policies being successful.
Level 3 (9–12 marks) Mid mark 11	There will be reasonable understanding of youth unemployment and some ability to identify its costs, although these might not be comprehensive and may not be well focused on youth unemployment. There will be some analysis of how governments use policy to tackle youth unemployment but less awareness of its effectiveness.
Level 2 (5–8 marks) Mid mark 7	There is awareness of unemployment but little awareness of anything other than elementary costs of unemployment. At the lower end of this bracket answers may mention specific policy initiatives with little evidence of being able to apply or evaluate them to youth unemployment.
Level 1 (1–4 marks) Mid mark 3	Explanations are necessarily limited. There might be some awareness of some costs of unemployment but little sense of the cost to the young. The answer is likely to struggle to address the issue of youth unemployment and to have little, if any, understanding of the use of policy instruments.

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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>• An attempt to differentiate between different interventionist approaches to youth unemployment.</li> <li>• Assessment of whether or not spending on reducing youth unemployment produces the appropriate returns. For example, does spending on programmes like the New Deal or Future Jobs Fund result in the creation of permanent jobs for young people?</li> <li>• Whether education policy is likely to be effective in tackling youth unemployment.</li> <li>• Whether the government can create viable vocational alternatives to formal education.</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>Whilst there might be some appreciation that evaluation could be carried out but the candidate will struggle to pursue it.</p> <p>For example: 'Youth unemployment poses a specific challenge to the government but all attempts to tackle it are likely to be successful.'</p>

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- 6 Identify the advantages of free floating exchange rates and evaluate whether less economically developed countries (LEDCs) should always adopt such an exchange rate regime. [25]

Candidates should be able to define a free floating exchange rate as a situation where market forces determine the value of one currency in terms of another without government intervention. They should recognise what this means and its implications for a nation's economy. They should be aware that free floating exchange rates are associated with a range of advantages: that a free floating exchange rate will automatically adjust to correct a current account deficit, that in a recession a depreciation of a nation's currency may act as a counter-cyclical policy instrument, there is no need for foreign exchange reserves, it may limit the prospect of currency speculation, it means that monetary policy can target other macroeconomic objectives. However, they should also be aware that it can also have a range of disadvantages for less economically developed countries (LEDCs): it can cause volatile levels of export earnings, it can be associated with a worsening of the terms of trade over time – largely because of the low income elasticity of demand for primary products; it can be subject to speculation; it might permit 'importing inflation'.

**Answers may include:**

**Knowledge and understanding** of how a free floating exchange rate operates. This may include a diagram showing how a change in market conditions will result in either an appreciation or depreciation of a currency in a bilateral exchange rate. Candidates should also have awareness of the theoretical advantages of a free floating exchange rate as well as attempt to discern the disadvantages that are specific to less economically developed countries (LEDCs). It is not expected that candidates have a comprehensive list of these: however, credit will be given to candidates who at the very least attempt to come up with a context-specific answer.

**Application** to the specific circumstances of a less economically developed country. Candidates are likely to conclude that the advantages can apply to all economies but that perhaps in an LEDC there are greater risks from adopting a free floating exchange rate: in circumstances where an LEDC experiences a depreciating currency, this will have adverse implications for a nation's terms of trade and it may reduce the ability of LEDCs to import capital. This will also be associated with cost-push inflation. It might also be the case that a free floating exchange rate is associated with a volatile currency and thus fluctuating export revenues, which may reduce certainty and thus reduce the level of economic activity in an economy.

**Analysis** of the advantages of a free floating exchange rate

Examples:

- Consideration of the theoretical advantages of a free floating exchange rate.
- Consideration of how these advantages can apply to less economically developed nations.
- Awareness that there may be specific drawbacks to free floating exchange rates in LEDCs.

**Evaluation** of the issues involved

Examples:

- The extent to which a free floating exchange rate actually is advantageous – some candidates might argue that the fact that most MEDC economies have adopted a free floating exchange rate implies that it is more advantageous than alternative methods of exchange rate determination.
- The degree to which the supposed advantages of a free floating exchange rate apply to LEDCs.
- The degree to which the possible disadvantages of a free floating exchange rates can affect LEDCs – although it should not be assumed that it applies to all LEDCs equally.
- The best candidates might point out that some LEDCs choose to adopt some form of fixed or pegged exchange rate system to provide increased certainty and thus boost the level of

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economic activity. In the light of this it is difficult to argue that LEDCs should always adopt free floating exchange rates.

### Theory and analysis

Level 4 (13–17 marks) Mid mark 15	Candidates should have an excellent grasp of what a ‘free floating exchange rate’ is and define less economically developed countries. They should be aware that a ‘free floating exchange rate’ is associated with a number of theoretical advantages. At the top of this level, candidates will endeavour to discern whether or not these advantages apply to less economically developed countries and may reach the conclusion that whilst there are undoubted advantages, these may be more likely to accrue to more economically developed countries (MEDCs) and that there are more risks of a free floating exchange rate for less economically developed countries (LEDCs).
Level 3 (9–12 marks) Mid mark 11	There will be good understanding of what is meant by the term a ‘free floating exchange rate’ and awareness of the advantages of free floating exchange rate determination. There may be some analysis of how this applies to different types of economies but this will contain some inaccuracies or be incomplete.
Level 2 (5–8 marks) Mid mark 7	Candidates are aware of what a ‘free floating exchange rate’ is but are imprecise in developing this. Explanations may contain errors and omissions and little sense of structure. At the bottom of this level there will be limited awareness of the advantages of a ‘free floating exchange rate’ and little attempt to contextualise the question.
Level 1 (1–4 marks) Mid mark 3	Explanations are necessarily limited. There might be some awareness of different forms of exchange rate determination but negligible understanding of the advantages of free floating exchange rates. The answer is likely to fail to address the question of the applicability of a free float to more and less economically developed countries.

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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 countries operate truly ‘free floating’ exchange rates and the fact that there may be more management of exchange rates than theory suggests.</li> <li>• The extent to which the advantages of a free floating exchange rate accrue to different types of economy.</li> <li>• The extent to which free floating exchange rates can also be dangerous for particular economies, particularly less economically developed countries (LEDCs).</li> </ul> <p>The use of examples to illustrate these evaluative points should be rewarded.</p>
<p>Level 2 (3–5 marks) Mid mark 4</p>	<p>Some 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 appreciation that evaluation could be carried out and that the issue of the choice of method of exchange rate determination has different implications for the different types of economy but this is not developed.</p> <p>For example: ‘The appropriateness of a free floating exchange rate differs from country to country’.</p>