Qualification Accredited

Oxford Cambridge and RSA

A LEVEL

Exemplar Candidate Work

ECONOMICS

H460
For first teaching in 2015

Component 3
Themes in Economics

Version 1

Contents

Introduction

We produced further exam-style questions for A Level Themes in economics (H460/03) and asked students to answer them.

The sample answers in this resource have been extracted from original candidate work to maintain their authenticity.

To facilitate different ways for using this resource, you will find the student answers twice, once without and then with examiner comments and marks.

Please note that this resource is provided for advice and guidance only and does not in any way constitute an indication of grade boundaries or endorsed answers.

Please always refer to the specification (http://www.ocr.org.uk/qualifications/as-a-level-gce-economics-h060-h460-from-2015/) for full details of the assessment for this qualification.

Oxford Cambridge and RSA

…day June 20XX – Morning/Afternoon

A Level in Economics

H460/03 Themes in economics

MARK SCHEME

MARKING INSTRUCTIONS

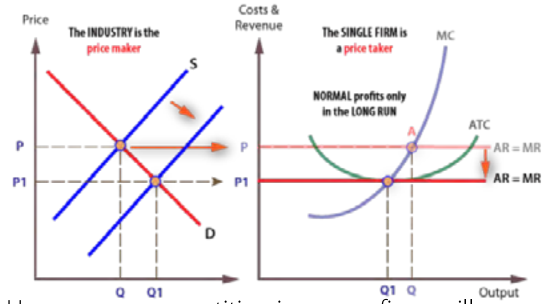
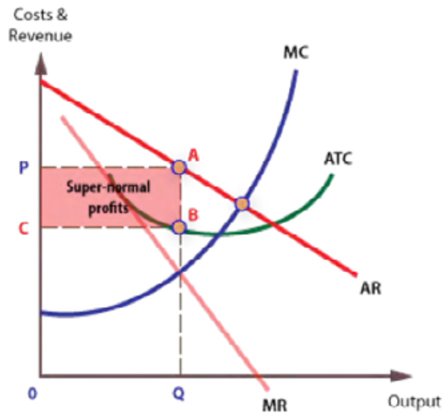
Descriptor	Award mark
Consistently meets the criteria for this level	At top of level
Meets the criteria but with some slight inconsistency	Above middle and either below top of level or at middle of level (depending on number of marks available)
Meets most of the criteria with some inconsistencies	Middle of level
Just enough achievement on balance for this level	Above bottom and either below middle or at middle of level (depending on number of marks available)
On the borderline of this level and the one below	At bottom of level

Levels of response – Level descriptors

<table>
<tr><th></th><th>Knowledge and understanding/ Application</th><th>Analysis</th><th>Evaluation</th></tr>
<tr><td>Strong</td><td rowspan="2">Precision in the use of the terms in the question and applied in a focused way to the context of the question.</td><td>An explanation of causes and consequences, fully developing the links in the chain of argument.</td><td>A conclusion is drawn weighing up both sides, and reaches a supported judgement.</td></tr>
<tr><td>Good</td><td>An explanation of causes and consequences, developing most of the links in the chain of argument.</td><td>A conclusion is drawn weighing up both sides, but without reaching a supported judgement.</td></tr>
<tr><td>Reasonable</td><td>Awareness of the meaning of the terms in the question and applied to the context of the question.</td><td>An explanation of causes and consequences, which omit some key links in the chain of argument.</td><td>Some attempt to come to a conclusion, which shows some recognition of the influencing factors.</td></tr>
<tr><td>Limited</td><td>Awareness of the meaning of the terms in the question.</td><td>Simple statement(s) of cause and consequence.</td><td>An unsupported assertion.</td></tr>
</table>

1			**Explain the term 'barriers to entry'.** A barrier to entry is a characteristic of a market that prevents new firms from joining the market (1) such as sunk costs/licencing/R&D costs/brand loyalty/economies of scale/geographical barriers (1) OR barriers to entry will reduce the amount of competition in the market (1)	**2** AO1 × 2	Also accept: factors which make it difficult or impossible for firms to enter an industry and compete with existing producers (1) One mark for knowledge and understanding of the definition of barriers to entry One mark for an example or understanding of the impact on competition within a market/industry.
2			**Using Fig.1 calculate the three firm concentration ratio for the UK banking market.** Lloyds = 27% Barclays = 18% RBS = 18% 27+18+18 = 63% Correct identification of the three firms with the largest market share (1) **and** correct calculation of the three firm concentration ratio (1)	**2** AO2 ×2	*Guidance* Allow 1 percentage point difference on the data due to the grid lines in Fig.1
3			**Evaluate, with reference to Extract 1, how a change in ownership of a firm, such as a bank, can benefit the consumer.** **Level 2 (5–8 marks)** **Good** knowledge and understanding of the concept of a change in ownership. **Good – strong** analysis of how a change in ownership can benefit the consumer. **Good analysis** will be in the form of developed links. These links are developed through a chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct and linked to the analysis. **Strong** analysis will have **consistently** well-developed links through a **coherent** chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct with no significant errors that affect the validity of the analysis. Any diagrams must be integral to the analysis. **Reasonable – strong** evaluation of how a change in ownership can benefit the consumer, considering both sides/comparing alternatives. **Good evaluation** will weigh up both sides/comparing alternatives but without reaching a supported judgment. **Strong evaluation** should include a supported judgment. **Level 1 (1–4 marks)** **Limited – reasonable** knowledge and understanding of the concept of a change in ownership. **Limited – reasonable** analysis of how a change in ownership can benefit the consumer. **Limited analysis** will have little	**8** AO1 x 1 AO2 x 1 AO3 x 2 AO4 x 4	*Indicative content* A change in ownership (through privatisation) could benefit the consumer through a reduction in market prices as firms are now seeking efficiency gains in order to achieve their profit motive. Firms will use more competitive prices (on products such as overdrafts and current account charges) and consumers will enjoy greater consumer surplus. Ownership by the government can result in x-inefficiency and organisational slack through a lack of profit motive which allows long run average costs to rise. Greater competition may also drive firms to be dynamically efficient and invest into non-price competition such as a greater range of services (range of different banking options) and investing into technological advancement (such as Lloyds bank investment into a giant video wall) enhancing the experience of the customer. However, the impact of a change in ownership depends on the business objectives, if a business aims for profit maximisation it is more likely to pursue strategies that are not necessarily in the interest of the consumer, for example, to increase dominance of the market and the concentration ratio firms may merge which could result in an abuse of monopoly power and higher prices. Governments are more likely to work in the interest of the consumer to ensure there is no discrimination and a good service available for all. A business that aims to achieve sales revenue maximisation or utility maximisation may be more likely to put the consumer as a higher priority through both price and non-price competitive strategies.

			evidence of reasoning that addresses the question asked. There is a lack of a clear structure. **Reasonable** analysis will have correct analysis largely in the form of single links. These address the question **but** are not developed into a clear chain of reasoning. Any relevant diagram(s) may be imperfectly labelled or not linked to the analysis. **Limited** evaluation of how a change in ownership can benefit the consumer in the form of an unsupported statement or no evaluation. **0 marks** no response or no response worthy of credit.		*A diagram may be used but should not be expected*

4			**Evaluate, using an appropriate diagram(s), the extent to which a more competitive market always increases efficiency.** **Level 3 (11–15 marks)** **Good** knowledge and understanding of competitive markets and efficiency. **Good – strong** analysis of whether a more competitive market always increases efficiency. **Good analysis** will be in the form of developed links. These links are developed through a chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct and linked to the analysis. **Strong** analysis will have **consistently** well-developed links through a **coherent** chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct with no significant errors that affect the validity of the analysis. Any diagrams must be integral to the analysis. **Good - strong** evaluation of whether a more competitive market **always** increases efficiency, weighing up both sides/ comparing alternatives. Strong evaluation should include a supported judgment. *There is a well-developed line of reasoning which is clear and logically structured. The information presented is relevant and substantiated.* **Level 2 (6–10 marks)** **Good** knowledge and understanding of competitive markets and efficiency. **Reasonable** analysis of whether a more competitive market always increases efficiency. There is correct analysis largely in the form of single links. These address the question **but** are not developed into a clear chain of reasoning. Any relevant diagram(s) may be imperfectly labelled or not linked to the analysis. **Reasonable** evaluation of whether a more competitive market **always** increases efficiency. *There is a line of reasoning presented with some structure. The information presented is in the most-part relevant and supported by some evidence.*	**15** (AO1 ×2 AO2 ×3 AO3 ×4 AO4 ×6)	*Indicative content* Greater competition will result in pressure on firms to be more productively and allocatively efficient, operating at the lowest point on the average cost curve, and pricing at a point equal to marginal costs.  However, as competition increases firms will only make normal profit and so won't be able to fund investment. Monopolies (and firms in an oligopoly market) will generate supernormal profit as they are price makers and can benefit from economies of scale – assuming their not prioritising shareholder desires for dividends - this supernormal profit will be invested into innovation and technological advancement resulting in dynamic efficiency. 

4			**Level 1 (1–5 marks)** **Limited – reasonable** knowledge and understanding of competitive markets and efficiency. **Limited** analysis of whether a more competitive market always increases efficiency. There is little evidence of reasoning that addresses the question asked. There is a lack of a clear structure. **Limited** evaluation of whether a more competitive market **always** increases efficiency in the form of an unsupported statement or no evaluation. *The information is basic and communicated in an unstructured way. The information is supported by limited evidence and the relationship to the evidence may not be clear.* **0 marks** no response or no response worthy of credit.		There are also times when a monopoly can be more productively efficient than a more competitive firm: a natural monopoly. Due to high fixed costs and the greater inefficiency of having more than one firm duplicating activities resulting in diseconomies of scale, diminishing marginal returns. Hence, the downward sloping average cost curve for a natural monopoly – most commonly seen in infrastructure markets such as water supplies. A more competitive market doesn't always increase efficiency, it depends on whether the efficiency in question is static or dynamic as well as the extent of the barriers to entry because the threat of new entrants can make a monopolist productively efficient if it will prevent new firms entering the market and competing away the incumbent firms market share.

5			**Explain, with reference to Fig. 2, two reasons for the slow increase in world trade.** Lack of business/investor confidence (1) will result in less investment and therefore lower supply of products and lower exports (1) Less consumer confidence (1) will result in lower consumption and less demand for imports (1) Increase in protectionist measures (1) resulting in lower volume of trade (1) Increase in transportation costs (1) increase the relative price of internationally traded goods resulting in less demand (1) Increase in FDI and mergers/acquisitions for market seeking reasons (1) resulting in slower growth in trade as firms are now closer to their markets (1)	**4** AO1 x 1 AO2 x 1 AO3 x 2	Candidates must refer to the **slow** increase in **world** trade. Do not credit answers that explain why trade has risen Do not credit answers that only explain UK trade patterns, such as BREXIT or exchange rate changes
6			**Economists would expect a negative relationship between a nation's HDI and Gini index, using data in Fig. 5 explain whether the data in the table supports this.** There is a negative relationship between HDI and the Gini index for all countries other than Cyprus and Austria (1) And/or For instance, in Argentina the HDI increases from 0.792 to 0.831 and Gini index falls from 49.27 to 42.49 (1) And/or In Cyprus and Austria the HDI rises between 2005 and 2012 (0.824 to 0.852 and 0/854 to 0/831 respectively) but the Gini index also rises (30.26 to 34.31 and 28.72 and 30.48 respectively) (1) And/or In four out of the six countries there is a fall in inequality (falling Gini index) as economic development increases (as measured by HDI) (1) And/or In two countries (Austria and Cyprus) there is a rise in inequality as economic development increases (1) And/or The data doesn't fully support the expectation of a negative relationship between HDI and the Gini index (1)	**4** AO1 x 2 AO2 x 2	Candidates must recognise the change in both indicators Credit answers that use data to support their explanation Full marks awarded if a candidate recognises that **both** Austria and Cyprus have a positive relationship between HDI and Gini index. Award a maximum of two marks to answers which explain Allow: *The Netherlands has the highest HDI in 2012 and the lowest Gini whereas Columbia has the highest Gini and one of the lowest HDI*

7			**Evaluate, with reference to the stimulus material, the view that multinational companies are more beneficial for developed countries than developing countries.** **Level 3 (11–15 marks)** **Good** knowledge and understanding of multinational companies and developed and developing countries. **Good – strong** analysis of the benefits of multinational companies for both developed and developing countries. **Good analysis** will be in the form of developed links. These links are developed through a chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct and linked to the analysis. **Strong** analysis will have **consistently** well-developed links through a **coherent** chain of reasoning which addresses the question. Any relevant diagram(s) are predominantly correct with no significant errors that affect the validity of the analysis. Any diagrams must be integral to the analysis. **Good - strong** evaluation of whether multinational companies are more beneficial for developed countries, weighing up both sides/comparing alternatives. Strong evaluation should include a supported judgment. *There is a well-developed line of reasoning which is clear and logically structured. The information presented is relevant and substantiated.* **Level 2 (6–10 marks)** **Good** knowledge and understanding of multinational companies and developed and developing countries. **Reasonable** analysis of the benefits of multinational companies for both developed and developing countries. There is correct analysis largely in the form of single links. These address the question **but** are not developed into a clear chain of reasoning. Any relevant diagram(s) may be imperfectly labelled or not linked to the analysis. **Reasonable** evaluation of whether multinational companies are more beneficial for developed countries, considering both sides/comparing alternatives *There is a line of reasoning presented with some structure. The information presented is in the most-part relevant and supported by some evidence.*	**15** AO1 x 2 AO2 x 3 AO3 x 4 AO4 x 6	• Analysis and evaluation should only be awarded up to 'Reasonable' unless the stimulus material is used to support at least one analysis or evaluation point. *Indicative content* Multinational companies (through FDI) are often either efficiency seeking or market seeking and their investment will bring both skills and technology transfer to the recipient country, whether it be a developed or developing country. In both economies the injection of a long term capital flow can increase AD through a rise in consumption, investment and exports (assuming the MNC sells its goods overseas) which increases GDP/capita and standards of living. A developing country is often thought to be more likely to be the recipient and the developed country where FDI and MNCs originate from but this isn't always the case and more recent changes in the direction of capital flows begs the question: which countries benefit most, developed or developing. MNC and FDI long term capital flow can provide productivity enhancing technology that would help an economy transition from primary sector to secondary or tertiary sector, providing a more diverse economic structure and reducing vulnerability to external shocks as well as the possibility of the resource curse - Lewis model and Prebisch and Singer hypothesis (declining terms of trade). If MNCs largely originate from developed countries they will benefit from being able to outsource production and services and the requisite efficiency gains which should be passed on to the consumer in the form of lower prices thus increasing consumer surplus and reducing cost-push inflationary pressures. Whilst the outward investment is a debit on the financial account of the balance of payments the income from that investment is a credit on the current account that will improve the value of primary income on the current account. Profits are often repatriated rather than used for further investment into a developing country by the MNCs thus increasing corporation tax receipts for governments and injections into the circular flow of income. However, developing countries have far greater need for FDI by MNCs as they lack the necessary capital stock to increase the rate of economic growth and development. Inward investment into infrastructure and technology could facilitate

7			**Level 1 (1–5 marks)** **Limited – reasonable** knowledge and understanding multinational companies and developed and developing countries. **Limited** analysis of the benefits of multinational companies for both developed and developing countries. There is little evidence of reasoning that addresses the question asked. There is a lack of a clear structure. **Limited** evaluation of whether multinational companies are more beneficial for developed countries, in the form of an unsupported statement or no evaluation. *The information is basic and communicated in an unstructured way. The information is supported by limited evidence and the relationship to the evidence may not be clear.* **0 marks** no response or no response worthy of credit.		into infrastructure and technology could facilitate both a more efficient allocation and transfer of resources, reducing bottlenecks and improving wellbeing and HDI as well as increasing total factor productivity as well as up-skilling the labour force. FDI will plug the savings gap that can exist in a developing country due to a low savings ratio and high MPC as a consequence of higher levels of poverty and low average household incomes as well as a less robust and available financial sector. This relies on MNCs committing to the country they invest into and not simply relocating as wage differentials are diminished and also employing local workers for managerial and more skilled roles. FDI from MNCs can perpetuate the exploitation of their source of comparative advantage resulting in the resource curse. Developed countries can be susceptible to this as seen in the UK and the consequence of the 2008/09 financial crisis but generally labour is more occupational and geographically mobile and the structure of the economy is more diverse. In both countries the benefits of MNCs rely on the ability of the government to manage the investment and extract guarantees from the firm that domestic labour and resources will be properly employed and not exploited. It is often the case that developed countries have more sophisticated and advanced legal and political systems to protect domestic workers and governments are more transparent and less corrupt but there is still the risk of capital flight if governments intervene in the market, as threatened by HSBC.

CANDIDATE STYLE ANSWERS

WEAK ANSWER – UNANNOTATED

Q1 Explain the term 'barriers to entry'. [2]

Barriers to entry are factors which make it difficult not impossible for firms to enter an industry and compete with existing producers.

Q2 Using Fig.1 calculate the three firm concentration ratio for the UK banking market. [2]

26.5 + 18+ 18 = 62.5%

Q3 Evaluate, with reference to Extract 1, how a change in ownership of a firm can benefit the consumer. [8]

This depends on whether the business is owned public or private sector. If a business which is a private sector like the bank, as George Osbourne promised to increase retail banking competition, this can benefit the consumers because they now have more choices to make.

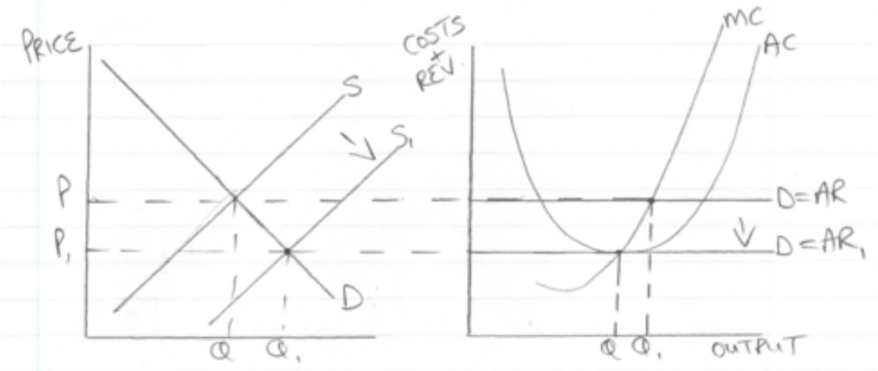
Greater choice means there will be greater competition between firms in order to attract more customers, so they might provide better deals on lending so they might reduce the rate of interest in order to attract more customers as interest rate decreases the repayment cost on variable rate mortgages and loans will fall and this will increase household (discretionary) income, consumer will respond by increasing their demand for consumer durables (especially those with a positive income elasticity). If the business is owned by the government if they privatise the business this might reduce competition, e.g. if electricity, as it is a necessity it can have a monopolist power which it can abuse the power as a monopoly to maintain high market power and set the market pre as monopolist is know as profit maximiser, they will charge higher prices for goods, which is not beneficial for consumers as they will have less income to spend on other goods.

Also, new owners might introduce more products which is beneficial for consumer because they will have better access to a wider range of product in the market. Also being more innovative means the business can benefit from economies of scale, and therefore cost per unit will decrease and as costs are reduced price can fall because of lower cost which means consumers don't need to spend as much to get the same product so they will have more money to spend on other goods and services.

Q4 Evaluate, using an appropriate diagram(s), the extent to which a more competitive market always increases efficiency. [15]

Monopolies are usually neither productively or allocatively efficient as there are strong barriers to entry and exit. However, in competition it can create allocative, productive and dynamic efficiency.

Allocative efficiency measures whether resources are allocated into goods and services demanded by consumers. Allocative efficiency occurs when scarce resources are used to produce a bundle of goods which satisfies consumer preferences. Productive efficiency can be achieved when production is at its maximum and costs at its minimum. And finally dynamic efficiency is concerned with how resources are allocated over a period of time, i.e. would there be a greater efficiency if a firm distributed less profit over time to its shareholders and used the money to finance more investment?



Q4 Evaluate, using an appropriate diagram(s), the extent to which a more competitive market always increases efficiency. (contd) [15]

The diagram above illustrates where there is greater competition in the market, as there are barriers to entry, supernormal profit and normal profit can be made which attracts new firms to enter the market and when there are more firms entered the market supply will increase and cause the supply curve to increase shifting to the right from S1 – S2, causing output to increase from Q1-Q2 and finally price to fall from P1 – P2. This means firms are forced to lower their prices in order to maintain their market share and customers. As a result supernormal profit will change to normal profit.

A perfectly competitive firm will both be productively and allocative efficient. This is because the firm will operate at a low average cost and the price will be low. However it is important to note that perfect competition doesn't necessarily represent the perfect market structure. Many economists have argued supernormal profits are essential to fund R&D to create innovative processes and product. Therefore perfect competition is said to be dynamically inefficient and can occur when the firms reduce their price, firms that were maximising profit in the fast will now not be able to maximise that profit. Which means firms will have less capital to reinvest back into the business on R&D.

To sum up, the increase in competition within a market will increase different types of efficiencies for a firm, both in allocative and productive efficiency. Monopolists often aren't concerned about efficiency, however as the degree of competition gets larger, we can see there are more efficiency in the market. Competition can stop firms from the higher level of profit which are needed to invest into R&D, this means that the firm can not be dynamically efficient. In my judgement greater competition can only increase some degree of efficiency but not increase all the efficiency.

Q5 Explain, with reference to Fig. 2, two reasons for the slow increase in world trade. [4]

There has been a slowdown in world trade due to the fact that there is uncertainty in the economic system along with many important world events in the past. As shown in fig. 2 during the financial crisis between 2007 and 2009 that the world trade has been affected heavily with a negative % change of 9%. Firms might not trade with each other and consumers will stop the purchases of government bonds and firms share during the financial situation at the time.

Also the case with the UK EU referendum in 2016 which increase the degree of uncertainty in the nurture is trade block by the EU and UK government the economic agents has to come up with solution to counter this uncertainty in the market.

Q6 Economists would expect a negative relationship between a nation's HDI and Gini index, using Fig. 5 explain whether the data in the table supports this. [4]

HDI is a composite indicator; there are three components – indicator of the health of the population, indicator of knowledge and education and finally an indicator of living standard. HDI focuses on outcomes rather than just economic growth. The Gini index is a measure of inequality. A high HDI shows there is high development in the economy and a high Gini index shows there is high inequality.

The data doesn't really show the fact that there is a negative relationship between HDI and the Gini index e.g. Argentina has a score of HDI 0.831 in 2012 showing that it is a developed country but it also had the 2nd highest level of inequality in 2012 with the Gini being 42.49 but Cambodia was the least developed, HDI was 0.539 and Gini was 30.78 which was the third lowest for the year.

However the data does show in some countries there is a negative relationship, such as Netherlands with HDI of 0.920 showing there is very high development and their Gini is 27.99 which was the lowest for 2012 suggesting low inequality.

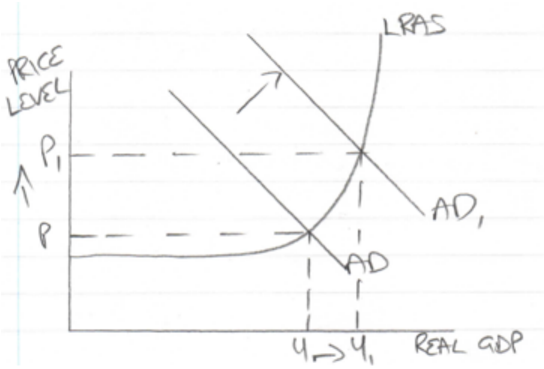
In conclusion there are some information showing there is a negative relationship like the case of the Netherlands however there are statistic result that suggest there isn't a negative relationship like the case for Argentina and Cambodia.

Q7 Evaluate, using an appropriate diagram, the extent to which an oligopoly market is preferable to a competitive market. [15]

Foreign Direct Investment is known as the investment by multinational companies, which is a long term flow of money.

MNCs can benefit developed countries by investing into technology. Technology transfer can lead to increased quality and quantity of resources. This can improve standards of living as they can have greener technology that is less polluting and new technology can also increase aggregate supply. The government gets more tax revenue and this can be used to spend more on job seekers allowance and education.

On the other hand investment from MNC can bring more jobs for developing countries and can improve the skills and productivity, which means the company can benefit from economies of scale.



The graph above illustrates when the opportunity of employment increases due to investment this can increase the average household income and increases consumption and so increases real GDP.

However MNCs may crowd out smaller businesses in developing countries, abusing their monopoly power, which can reduce competition in the market and create unemployment and inflationary pressure.

Also MNCs can create greater pollution especially if they aren't concerned about their activities and the impact they have on the environment and there is no government regulation around activities.

In my judgement I believe that the developing countries and MNCs have more of an advantage over the developed countries due to the fact that they will be able to invest more into the developing country and therefore increase economic growth. Although there are some negative consequences they aren't large enough to outweigh the positive ones.

CANDIDATE STYLE ANSWERS

WEAK ANSWER – ANNOTATED

Q1 Explain the term 'barriers to entry'. [2]

Barriers to entry are factors which make it difficult not impossible for firms to enter an industry and compete with existing producers.

One mark for understanding the definition of barriers to entry

1 mark

Q2 Using Fig.1 calculate the three firm concentration ratio for the UK banking market. [2]

26.5 + 18+ 18 = 62.5%

One mark for correctly identifying the three firms with the largest market share

One mark for correctly calculating the three firm concentration ratio

2 marks

Q3 Evaluate, with reference to Extract 1, how a change in ownership of a firm can benefit the consumer. [8]

This depends on whether the business is owned public or private sector. If a business which is a private sector like the bank, as George Osbourne promised to increase retail banking competition, this can benefit the consumers because they now have more choices to make.

Greater choice means there will be greater competition between firms in order to attract more customers, so they might provide better deals on lending so they might reduce the rate of interest in order to attract more customers as interest rate decreases the repayment cost on variable rate mortgages and loans will fall and this will increase household (discretionary) income, consumer will respond by increasing their demand for consumer durables (especially those with a positive income elasticity). If the business is owned by the government if they privatise the business this might reduce competition, e.g. if electricity, as it is a necessity it can have a monopolist power which it can abuse the power as a monopoly to maintain high market power and set the market pre as monopolist is know as profit maximiser, they will charge higher prices for goods, which is not beneficial for consumers as they will have less income to spend on other goods.

Also, new owners might introduce more products which is beneficial for consumer because they will have better access to a wider range of product in the market. Also being more innovative means the business can benefit from economies of scale, and therefore cost per unit will decrease and as costs are reduced price can fall because of lower cost which means consumers don't need to spend as much to get the same product so they will have more money to spend on other goods and services.

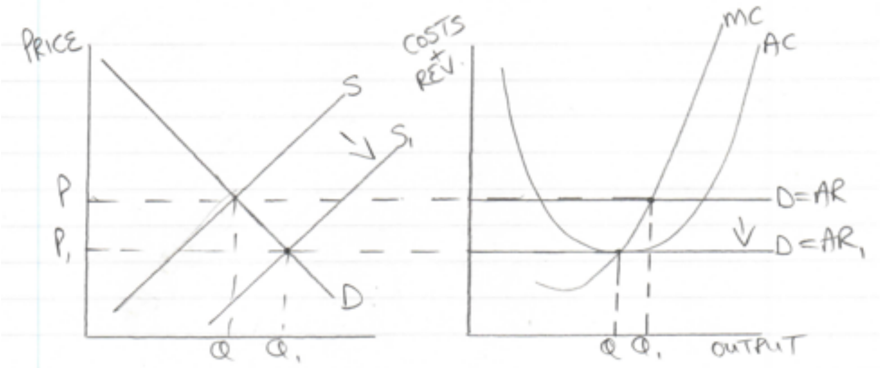
Just good analysis and reasonable evaluation – the candidate focuses on the consumer throughout and does produce some coherent analysis that is formed of coherent and developed links.

L2 5 marks

Q4 Evaluate, using an appropriate diagram(s), the extent to which a more competitive market always increases efficiency. [15]

Monopolies are usually neither productively or allocatively efficient as there are strong barriers to entry and exit. However, in competition it can create allocative, productive and dynamic efficiency.

Allocative efficiency measures whether resources are allocated into goods and services demanded by consumers. Allocative efficiency occurs when scarce resources are used to produce a bundle of goods which satisfies consumer preferences. Productive efficiency can be achieved when production is at its maximum and costs at its minimum. And finally dynamic efficiency is concerned with how resources are allocated over a period of time, i.e. would there be a greater efficiency if a firm distributed less profit over time to its shareholders and used the money to finance more investment?



The diagram above illustrates where there is greater competition in the market, as there are barriers to entry, supernormal profit and normal profit can be made which attracts new firms to enter the market and when there are more firms entered the market supply will increase and cause the supply curve to increase shifting to the right from S1 – S2, causing output to increase from Q1-Q2 and finally price to fall from P1 – P2. This means firms are forced to lower their prices in order to maintain their market share and customers. As a result supernormal profit will change to normal profit.

A perfectly competitive firm will both be productively and allocative efficient. This is because the firm will operate at a low average cost and the price will be low. However it is important to note that perfect competition doesn't necessarily represent the perfect market structure. Many economists have argued supernormal profits are essential to fund R&D to create innovative processes and product. Therefore perfect competition is said to be dynamically inefficient and can occur when the firms reduce their price, firms that were maximising profit in the fast will now not be able to maximise that profit. Which means firms will have less capital to reinvest back into the business on R&D.

To sum up, the increase in competition within a market will increase different types of efficiencies for a firm, both in allocative and productive efficiency. Monopolists often aren't concerned about efficiency, however as the degree of competition gets larger, we can see there are more efficiency in the market. Competition can stop firms from the higher level of profit which are needed to invest into R&D, this means that the firm can not be dynamically efficient. In my judgement greater competition can only increase some degree of efficiency but not increase all the efficiency.

The candidate has a reasonable knowledge of static and dynamic efficiency.

There is reasonable analysis of whether a competitive market always increases efficiency and there is a conclusion but the candidate doesn't really get to grips with the issue and doesn't emphasise whether this is always the case.

L2 8 marks

There has been a slowdown in world trade due to the fact that there is uncertainty in the economic system along with many important world events in the past. As shown in fig. 2 during the financial crisis between 2007 and 2009 that the world trade has been affected heavily with a negative % change of 9%. Firms might not trade with each other and consumers will stop the purchases of government bonds and firms share during the financial situation at the time.

Also the case with the UK EU referendum in 2016 which increase the degree of uncertainty in the nurture is trade block by the EU and UK government the economic agents has to come up with solution to counter this uncertainty in the market.

The candidate offers an initial idea of the reason for the slow increase in world trade but doesn't really answer the question. The candidate also uses confusing wording in the final paragraph. See guidance in the mark scheme for common errors in this question.

1 mark

Q6 Economists would expect a negative relationship between a nation's HDI and Gini index, using Fig. 5 explain whether the data in the table supports this. [4]

HDI is a composite indicator; there are three components – indicator of the health of the population, indicator of knowledge and education and finally an indicator of living standard. HDI focuses on outcomes rather than just economic growth. The Gini index is a measure of inequality. A high HDI shows there is high development in the economy and a high Gini index shows there is high inequality.

The data doesn't really show the fact that there is a negative relationship between HDI and the Gini index e.g. Argentina has a score of HDI 0.831 in 2012 showing that it is a developed country but it also had the 2nd highest level of inequality in 2012 with the Gini being 42.49 but Cambodia was the least developed, HDI was 0.539 and Gini was 30.78 which was the third lowest for the year.

However the data does show in some countries there is a negative relationship, such as Netherlands with HDI of 0.920 showing there is very high development and their Gini is 27.99 which was the lowest for 2012 suggesting low inequality.

In conclusion there are some information showing there is a negative relationship like the case of the Netherlands however there are statistic result that suggest there isn't a negative relationship like the case for Argentina and Cambodia.

The candidate doesn't have a strong understanding of what the data in Fig. 5 shows although they do effectively explain the negative relationship shown by the Netherlands data – but by only using one country they are only credited with one mark.

Information about HDI isn't necessary, neither is a conclusion.

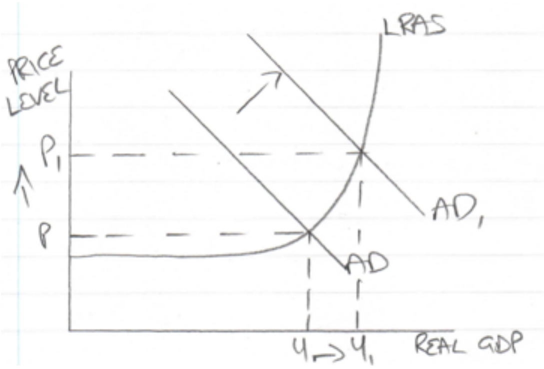
1 mark

Q7 Evaluate, with reference to the stimulus material, the view that multinational companies are more beneficial for developed countries than developing countries. [15]

Foreign Direct Investment is known as the investment by multinational companies, which is a long term flow of money.

MNCs can benefit developed countries by investing into technology. Technology transfer can lead to increased quality and quantity of resources. This can improve standards of living as they can have greener technology that is less polluting and new technology can also increase aggregate supply. The government gets more tax revenue and this can be used to spend more on job seekers allowance and education.

On the other hand investment from MNC can bring more jobs for developing countries and can improve the skills and productivity, which means the company can benefit from economies of scale.



The graph above illustrates when the opportunity of employment increases due to investment this can increase the average household income and increases consumption and so increases real GDP.

However MNCs may crowd out smaller businesses in developing countries, abusing their monopoly power, which can reduce competition in the market and create unemployment and inflationary pressure.

Also MNCs can create greater pollution especially if they aren't concerned about their activities and the impact they have on the environment and there is no government regulation around activities.

In my judgement I believe that the developing countries and MNCs have more of an advantage over the developed countries due to the fact that they will be able to invest more into the developing country and therefore increase economic growth. Although there are some negative consequences they aren't large enough to outweigh the positive ones.

The candidate addresses a number of the merits and disadvantages of MNC activity but never fully develops their arguments to provide good analysis characterised by consistently well-developed links forming coherent analysis.

Their final judgement links back to the question but isn't supported by previous analysis of the different experiences of developed and developing economies.

L2 9 marks

Total marks = 27/50

Summary examiner comments

The candidate demonstrates reasonable analysis of the issues raised in the questions and stimulus material. A number of arguments need to be explored in more depth to provide a well-developed chain of reasoning rather than single links. Evaluation sometimes weighs up both sides but isn't supported.

CANDIDATE STYLE ANSWERS

MEDIUM ANSWER – UNANNOTATED

Q1 Explain the term 'barriers to entry'. [2]

Barriers to entry are factors that make it difficult or even impossible for firms to enter an industry and compete with existing producers e.g. high start up costs or a geographical barrier.

Q2 Using Fig.1 calculate the three firm concentration ratio for the UK banking market. [2]

28.00% + 18.00% + 18.00% = 64%

Q3 Evaluate, with reference to Extract 1, how a change in ownership of a firm can benefit the consumer. [8]

If there is a change of ownership of a firm (e.g. a bank) it may have benefits for the consumer. The main benefit being more competition in the market, this allows consumers to apply more pressure on banks (due to increased choice). There is increased competition through government interference in markets such as banks. The increased competition would lead to higher interest rates on savings which in turn leads to an increase in saving. More saving means more money and therefore allowing consumers to apply pressure to banks potentially getting higher value loans or reduced interest on loans. Banks may subsequently invest in more non-price competition methods of attracting consumers (Lloyds video wall).

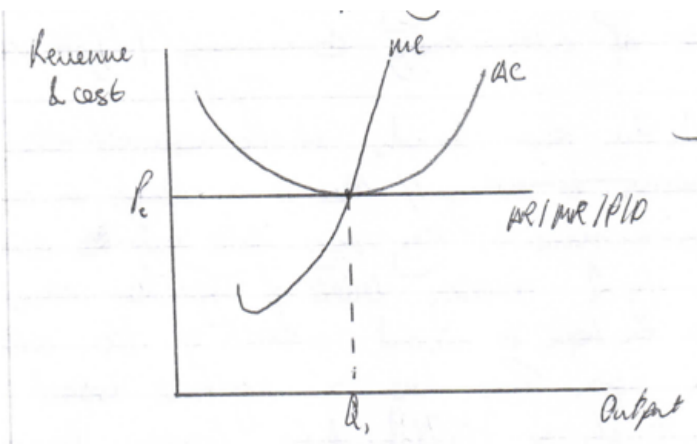
On the other hand if there is a change in ownership to the government they may take over control. As stated in extract 1, increasing levels of regulation around the banking sector in the hope of avoiding a repeat of the collapse seen 8 years ago. This has a negative impact on leading banks, such as HSBC, who have threatened to relocate their headquarters if regulations become too restricting threatening jobs in this key sector of the UK economy.

To conclude, the change in ownership of the bank can benefit the consumer, if there is more competition consumers will be able to get better interest rates on loans and hence have more discretionary income. However, this depends on how strict the government regulated the market as banks may be unhappy about the high levels of regulation and threaten relocation.

Q4 Evaluate, using an appropriate diagram(s), the extent to which a more competitive market always increases efficiency. [15]

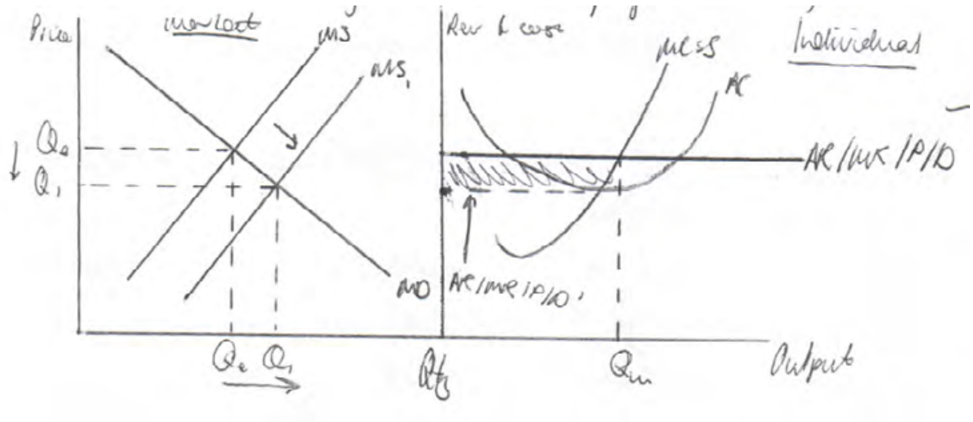
There are three main types of efficiency. Productive efficiency occurs when the largest number of goods and services are produced with a given amount of inputs at the lowest point on the average cost curve. Allocative efficiency occurs when goods and services are distributed according to consumer preferences and price of goods sold is equal to the marginal cost of production. Dynamic efficiency concerns the optimal rate of innovation and investment into research and development to improve production that helps to reduce long run average costs.

On the one hand a perfectly competitive firm will be allocatively and productively efficient as the firm is producing output (Q1) at the lowest point on the long run average cost curve (productive efficiency) and price (P1) equals marginal cost hence allocative efficiency (shown below).



Q4 Evaluate, using an appropriate diagram(s), the extent to which a more competitive market always increases efficiency. (contd) [15]

However, perfect competition does not necessarily represent the perfect structure. Supernormal profits are essential to fund R&D to create innovative processes and products, therefore perfect competition is said to be dynamically inefficient; firms enter the market attracted by supernormal profits and no barriers to entry shifting the supply curve to shift right (MS to MS1) and decreasing price (Q1 – Q2) taking supernormal profit to just normal profit (AR=AC).



On the other hand, monopolists are found in industries with product differentiation as a possibility. This market is less efficient than perfect competition because a good is always priced higher than its MC therefore it can never be productive or allocatively efficient. However, firms may be dynamically innovative in terms of new production processes or new products.

In conclusion, monopolistic competition generates dynamic efficiency whereas perfect competition (in theory) creates productive and allocative efficiency.

Q5 Explain, with reference to Fig. 2, two reasons for the slow increase in world trade. [4]

There is slow world trade due to uncertainty from world events such as the global financial crisis and more recently Brexit. Another reason may be large multinational firms merging and taking over firms may have halted deals.

Q6 Economists would expect a negative relationship between a nation's HDI and Gini index, using Fig. 5 explain whether the data in the table supports this. [4]

In Argentina HDI and Gini index have a negative relationship as expected and this is also seen in Cambodia, Columbia and Netherlands however in Austria and Cyprus there is a positive relationship. In Cyprus HDI increases from 0.824 to 0.881 (2005 – 2012) and the Gini index increases from 30.26 to 34.31 (2008 – 2012).

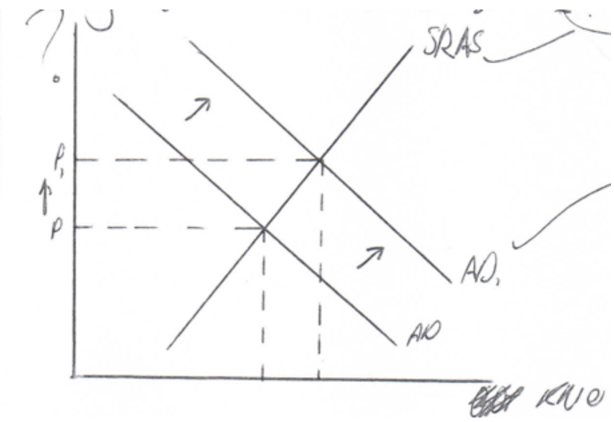
Q7 Evaluate, using an appropriate diagram, the extent to which an oligopoly market is preferable to a competitive market. [15]

Investment is the addition to the capital stock of an economy. A multinational company (MNC) is a company with significant product operations in at least two countries. A developing country is a poor agricultural country that is seeking to become more advanced economically and socially. Whereas a developed country is a country of high incomes and technological infrastructure.

Inward investment (FDI) from a MNC can be very beneficial from the perspective of a developed and developing countries the main one being the creation of jobs. As shown in extract 2 in the UK, Nissan employs 8000 people directly and a further 32,000 jobs that are supported by the company hence this is an example of the multiplier effect caused by the investment in a developed country. However, this increase in employment could be said is more beneficial in developing countries as they often have higher rates of unemployment. Many of these countries have low labour costs which encourages large amount to investment from MNCs. This FDI can shift the economic structure of a developing countries transitioning it from the primary sector (based on agriculture) to secondary sector which can also increase the skills of the labour force through skills and technology transfer. Along with training schemes, the workforce can become more educated and increase both labour productivity and labour market flexibility.

On the other hand, in developing countries the investment can be a negative thing; for example, investment into oil in Africa. This advancement in technology can have a negative impact socially and economically to the recipient nation (such as environmental degradation). The funding into the extraction of oil can cause large scale damage to the environment such as forested areas through deforestation and the destruction of many habitats resulting in a loss of environmental capital. The pollution given off when extracting oil is damaging to the environment resulting in negative externalities and a greater divergence between marginal social and marginal private costs. In continuation, MNCs receive the majority of their profits made and it is repatriated to their home nation, little has a positive effect on the recipient country through the trickle down effect. This could lead to negative impacts to the country through government corruption. Many large MNCs are able to abuse their monopoly power (such as BP and Shell) potentially through their economies of scale with the objective of increasing their profits, but this is at the expense of the host country through the loss of domestic firms as they are competed out of their markets unable to match the market dominance of MNCs.

As mentioned previously increasing employment through investment by MNCs will improve living standards leading to increases in GDP and HDI.



An increase in household incomes will lead to more consumer expenditure (a component of aggregate demand) causing a shift in AD to the right (AD1 – AD2). This increases the price level (P1 – P2) as well as the real national output (Y1 – Y2).

In conclusion, investment from MNCs is beneficial to both developed and developing countries. However, it is the negative effect that differentiates the two. In developed countries the Dutch disease can occur due to over specialisation and over reliance on an exporting goods leading to deindustrialisation. In developing countries due to little effect of the trickle down effect and the risk of corrupt governments.

CANDIDATE STYLE ANSWERS

MEDIUM ANSWER – ANNOTATED

Q1 Explain the term 'barriers to entry'. [2]

Barriers to entry are factors that make it difficult or even impossible for firms to enter an industry and compete with existing producers e.g. high start up costs or a geographical barrier.

One mark for understanding the definition of barriers to entry

One mark for understanding an example of a barrier to entry

2 marks

Q2 Using Fig.1 calculate the three firm concentration ratio for the UK banking market. [2]

28.00% + 18.00% + 18.00% = 64%

One mark for correctly identifying the three firms with the largest market share

One mark for correctly calculating the three firm concentration ratio – see guidance in the mark scheme for margin of error allowance.

2 marks

Q3 Evaluate, with reference to Extract 1, how a change in ownership of a firm can benefit the consumer. [8]

If there is a change of ownership of a firm (e.g. a bank) it may have benefits for the consumer. The main benefit being more competition in the market, this allows consumers to apply more pressure on banks (due to increased choice). There is increased competition through government interference in markets such as banks. The increased competition would lead to higher interest rates on savings which in turn leads to an increase in saving. More saving means more money and therefore allowing consumers to apply pressure to banks potentially getting higher value loans or reduced interest on loans. Banks may subsequently invest in more non-price competition methods of attracting consumers (Lloyds video wall).

On the other hand if there is a change in ownership to the government they may take over control. As stated in extract 1, increasing levels of regulation around the banking sector in the hope of avoiding a repeat of the collapse seen 8 years ago. This has a negative impact on leading banks, such as HSBC, who have threatened to relocate their headquarters if regulations become too restricting threatening jobs in this key sector of the UK economy.

To conclude, the change in ownership of the bank can benefit the consumer, if there is more competition consumers will be able to get better interest rates on loans and hence have more discretionary income. However, this depends on how strict the government regulated the market as banks may be unhappy about the high levels of regulation and threaten relocation.

The candidate starts by producing relatively basic arguments about the benefits to the consumer that shows reasonable analysis and they have drawn on the case study. However, the candidate has not explained, in the first paragraph, why there might be more competition. *The second paragraph focuses on the producer and so loses focus on the question. The conclusion contains some credit worthy evaluation but it is limited and not sufficient to access L2.*

L1 4 marks

Q4 Evaluate, using an appropriate diagram(s), the extent to which a more competitive market always increases efficiency. [15]

There are three main types of efficiency. Productive efficiency occurs when the largest number of goods and services are produced with a given amount of inputs at the lowest point on the average cost curve. Allocative efficiency occurs when goods and services are distributed according to consumer preferences and price of goods sold is equal to the marginal cost of production. Dynamic efficiency concerns the optimal rate of innovation and investment into research and development to improve production that helps to reduce long run average costs.

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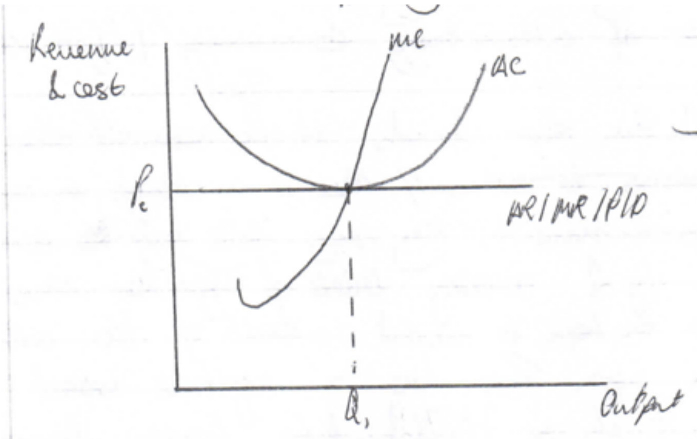
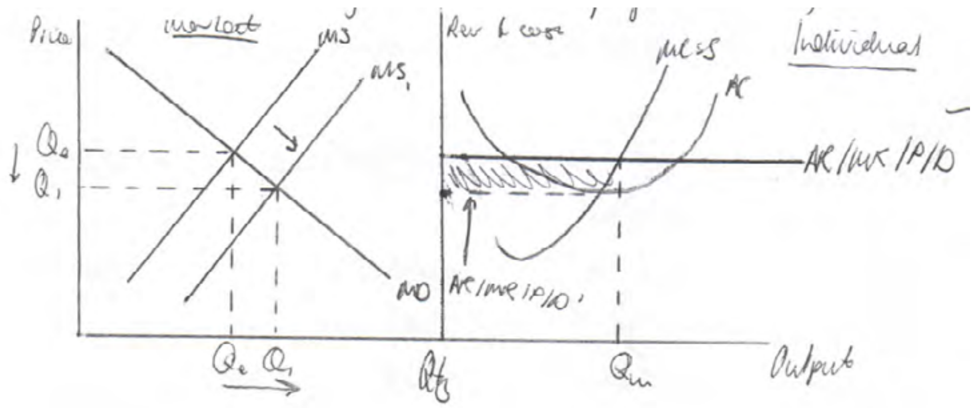


However, perfect competition does not necessarily represent the perfect structure. Supernormal profits are essential to fund R&D to create innovative processes and products, therefore perfect competition is said to be dynamically inefficient; firms enter the market attracted by supernormal profits and no barriers to entry shifting the supply curve to shift right (MS to MS1) and decreasing price (Q1 – Q2) taking supernormal profit to just normal profit (AR=AC).



On the other hand, monopolists are found in industries with product differentiation as a possibility. This market is less efficient than perfect competition because a good is always priced higher than its MC therefore it can never be productive or allocatively efficient. However, firms may be dynamically innovative in terms of new production processes or new products.

In conclusion, monopolistic competition generates dynamic efficiency whereas perfect competition (in theory) creates productive and allocative efficiency.

There is reasonable analysis at the start and the candidate looks like they will access L3 but their whole answer isn't holistically analytical enough – single links are given, especially in the second half rather than consistently coherent chains of argument. However, diagrams are integral to the analysis. The labelling of the last diagram isn't entirely correct with Q denoting price, and in the second diagram the position of the line at the bottom of the shaded area implies that the firm is producing at the bottom of the AC curve rather than where AC is rising and below MC.

The answer could have been improved by greater analysis of why monopolists are not allocatively and productively efficient and how (as a counter argument) monopolists use supernormal profit to be dynamically efficient and therefore leading to a more supported final judgement.

L2 10 marks

There is slow world trade due to uncertainty from world events such as the global financial crisis and more recently Brexit. Another reason may be large multinational firms merging and taking over firms may have halted deals.

The candidate offers two valid reasons but doesn't develop them and the reference to 'deals' is vague.

2 marks

Q6 Economists would expect a negative relationship between a nation's HDI and Gini index, using Fig. 5 explain whether the data in the table supports this. [4]

In Argentina HDI and Gini index have a negative relationship as expected and this is also seen in Cambodia, Columbia and Netherlands however in Austria and Cyprus there is a positive relationship. In Cyprus HDI increases from 0.824 to 0.881 (2005 – 2012) and the Gini index increases from 30.26 to 34.31 (2008 – 2012).

TThe candidate has a good understanding of the expected relationship and uses the data in Fig. 5 to support this and also demonstrate exceptions.

4 marks

Q7 Evaluate, with reference to the stimulus material, the view that multinational companies are more beneficial for developed countries than developing countries. [15]

Investment is the addition to the capital stock of an economy. A multinational company (MNC) is a company with significant product operations in at least two countries. A developing country is a poor agricultural country that is seeking to become more advanced economically and socially. Whereas a developed country is a country of high incomes and technological infrastructure.

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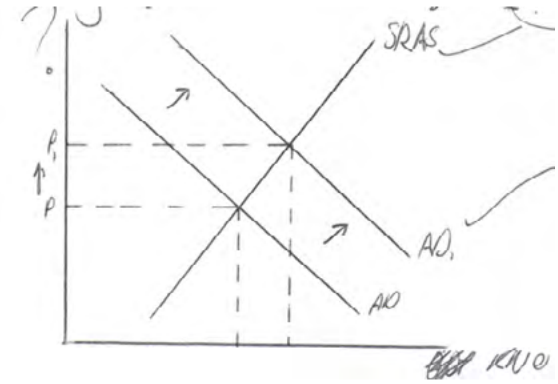
On the other hand, in developing countries the investment can be a negative thing; for example, investment into oil in Africa. This advancement in technology can have a negative impact socially and economically to the recipient nation (such as environmental degradation). The funding into the extraction of oil can cause large scale damage to the environment such as forested areas through deforestation and the destruction of many habitats resulting in a loss of environmental capital. The pollution given off when extracting oil is damaging to the environment resulting in negative externalities and a greater divergence between marginal social and marginal private costs. In continuation, MNCs receive the majority of their profits made and it is repatriated to their home nation, little has a positive effect on the recipient country through the trickle down effect. This could lead to negative impacts to the country through government corruption. Many large MNCs are able to abuse their monopoly power (such as BP and Shell) potentially through their economies of scale with the objective of increasing their profits, but this is at the expense of the host country through the loss of domestic firms as they are competed out of their markets unable to match the market dominance of MNCs.

As mentioned previously increasing employment through investment by MNCs will improve living standards leading to increases in GDP and HDI.

There is good analysis of the consequences for developing nations and reasonable analysis of the consequences for developed economies leading to a slightly imbalanced answer but there is sufficient use of coherent and well-developed chains of reasoning to justify good analysis and L3. Evaluation does weigh up both sides but the judgement isn't well supported, drawing on previously unused information in the final paragraph – a shame that Dutch disease wasn't discussed in the bulk of the essay.

L3 12 marks

Q7 Evaluate, with reference to the stimulus material, the view that multinational companies are more beneficial for developed countries than developing countries. [15]



An increase in household incomes will lead to more consumer expenditure (a component of aggregate demand) causing a shift in AD to the right (AD1 – AD2). This increases the price level (P1 – P2) as well as the real national output (Y1 – Y2).

In conclusion, investment from MNCs is beneficial to both developed and developing countries. However, it is the negative effect that differentiates the two. In developed countries the Dutch disease can occur due to over specialisation and over reliance on an exporting goods leading to deindustrialisation. In developing countries due to little effect of the trickle down effect and the risk of corrupt governments. **Total marks = 27/50**

Summary examiner comments

The candidate produces good analysis and clearly has a good understanding of the issues raised in the questions and the stimulus material and can draw on both micro and macro material to produce synoptic discussions. But there is still room for more depth of analysis and evaluation.

CANDIDATE STYLE ANSWERS

STRONG ANSWER – UNANNOTATED

Q1 Explain the term 'barriers to entry'. [2]

Barriers to entry are factors that make it impossible or very difficult for a firm to enter a market and compete with existing suppliers. Many barriers to entry can create pure monopolies or are sources of monopoly power in a market.

Q2 Using Fig.1 calculate the three firm concentration ratio for the UK banking market. [2]

27% + 18% + 18% = 63%

Q3 Evaluate, with reference to Extract 1, how a change in ownership of a firm can benefit the consumer. [8]

After the global financial crisis of 2008/09, a number of banks were bailed out by the government such as Lloyds Banking Group and Royal Bank of Scotland. This means that the government (or the tax payer) owns parts of these banks.

If the bank is fully privately owned, it is likely to seek profit maximisation, as the banking sector is an oligopoly. This means that the bank will try to operate at the output where MR=MC. This point of operation is likely to lead to low prices to consumers which is very beneficial as, especially with financial products such as mortgages, it will give them increased discretionary income.

In an oligopoly, there are only a small number of large firms, and in the banking sector this can lead to reduced choice of products for consumers. In addition, a bank may be able to manipulate consumer decision making due to the lack of competition, meaning they complicate decisions on product such as mortgages causing consumers to make confused and biased decisions.

On the other hand, if a bank were to move to public ownership, their business objectives are likely to change, as the government is generally interested in maximising social benefit. This will mean that it is more likely to offer services to the community and will focus more on ethical concerns as opposed to simply maximising revenue or profit. For example, a bank may choose to withdraw investment from firms which are not environmentally friendly. There is however, an issue with high levels of inefficiency when a firms is in public ownership, this is because there is usually a large separation between ownership and control, in the case of a bank between the government and the managers which is known as the principal agent problem and can lead to X-inefficiency. This is because the bank will be shielded from competition if it is state owned by the government, and this could lead to a large rise in average costs as they have no motivation to prevent an increase in costs.

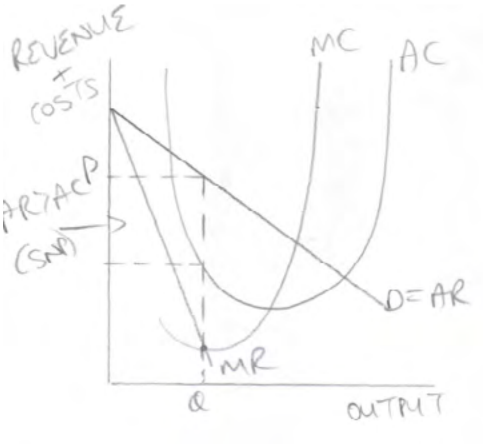
To conclude, there are many advantages and disadvantages to both public and private ownership of a bank but if the government can prevent issues of high inefficiency within a bank then it is probable that state ownership of a bank is more beneficial to consumers.

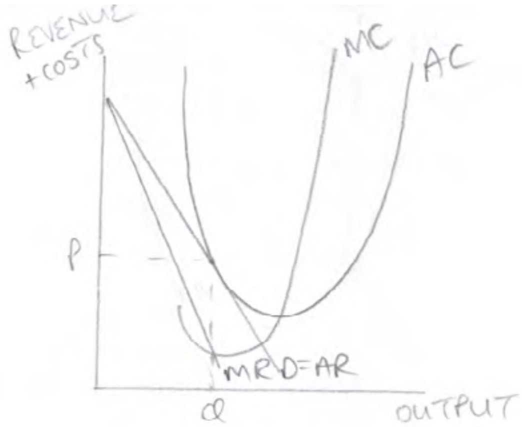
Q4 Evaluate, using an appropriate diagram(s), the extent to which a more competitive market always increases efficiency. [15]

There are three types of efficiency which firms are able to achieve. The first is allocative efficiency; this is where there is optimal distribution of goods and services into account consumer preferences. In other words, it is an output level where marginal cost is equal to price; this point is allocatively efficient as the consumer is paying a price equivalent to the marginal utility that they receive. Firms may also aim to achieve productive efficiency. This is using the optional combination of factor input to produce maximum output for the minimum of cost. A firm is productively efficiency when it is producing at the lowest point on its average cost curve this is where MC = AC. Finally, firms can achieve dynamic efficiency, which is where firms use supernormal profit to invest into the research and development for innovation of their processes and products.

In a monopolistic market there are many producers selling differentiated products to one another. In this market structure firms are short term profit maximisers. However, it is not possible to obtain maximum profits in the long run due to there being no barriers to entry or exit so more firms enter the market to seek the supernormal profits that were being exploited by other producers. In addition, there are many buyers and sellers in a monopolistic market, none of which have significant market power and they produce non-homogenous products, meaning that there is a lot of competition. Due to the high level of price competition firms look for non-price competition such as the quality of their products in order to boost profits.

Q4 Evaluate, using an appropriate diagram(s), the extent to which a more competitive market always increases efficiency. (contd) [15]

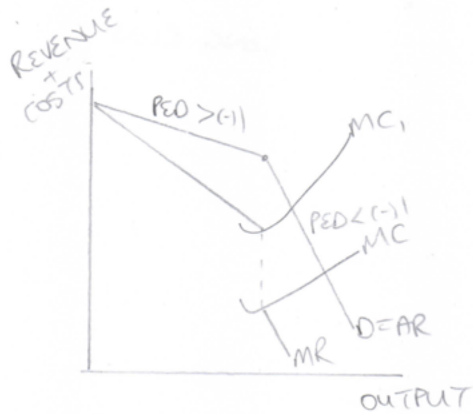




From the diagrams above we can see that in the short run firms make supernormal profits at they are producing at a level where average revenue is greater than average cost. However, firms are not productively or allocatively efficient as the level of output is not where MC=MR or MC= AC, firms only make normal profit at AR=AC.

It is argued by economists that firms are not efficient due to product differentiation as each individual firm is too small to benefit from economies of scale; this gives each individual firm a small amount of pricing power above marginal cost. In contrast, this must be weighed up against the increase in welfare that consumer experience which competes from having more choice, a key characteristic of monopolistic markets. This therefore means that competition does not necessarily mean that firms are more efficient. However, as firms make supernormal profits in the short run there are able to invest into research and development, which allows them to be dynamically efficient.

In an oligopoly there is slightly less competition compared to monopolistic competition there are barriers to entry and exit as well as there being a high concentration ratio with between 3-5 firms dominating the industry. Similarly to monopolist markets however, firms are profit maximisers in the short run. One of the key features of an oligopoly is interdependency between firms, meaning that the actions of one firm impact on another and this had effects on efficiency.



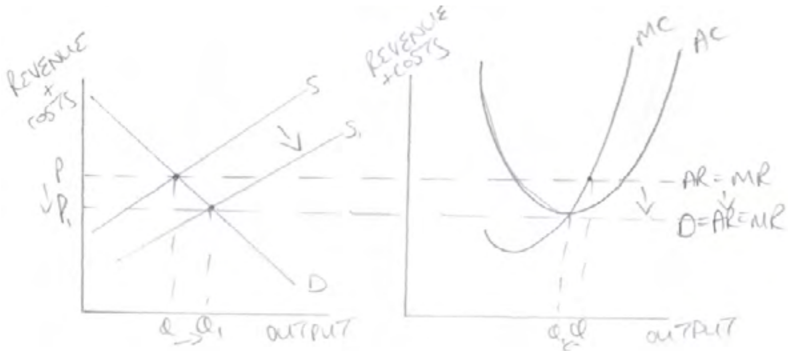
The diagram for an oligopoly (above) shows a kinked demand curve that reflects the behaviour of firms. Due to interdependency and competition, if one firm increases its prices then other firms will keep their prices lower in order to gain greater market share, as rational consumers will choose cheaper product. Price wars can happen in the short-term in oligopolistic markets, therefore as firms are making supernormal profits they are incentivised to lower prices to steal market share from competition and gain even greater profit. However, when a firm does this other firms are likely to react by dropping their prices are well causing prices to fall rapidly to a new equilibrium. Collusion between firms can occur in oligopoly markets as they attempt to raise prices together to maximise their joint profits – this also affects efficiency.

From the diagram it is clear that firms in an oligopoly market are not productively and allocatively efficient. This is evident as the output level shows that MC does not equal AC and MC is not equal to AR either. The downward sloping demand curve means that firms are incentivised to restrict output below the minimum efficiency scale and through collusion prices will be above the MC curve. However, due to non-price competition within the market meaning firms are able to make super-normal profits (AR=AC), firms are able to invest into research and development to improve the quality of their products and this enables them to be dynamically efficient.

Q4 Evaluate, using an appropriate diagram(s), the extent to which a more competitive market always increases efficiency. (contd) [15]

It is again evident from this that in an oligopolistic market where there is competition, allocative and productive efficiency is not created.

In contrast to these two market structures if there is perfect competition then there is likely to be both productive and allocative efficiency. In a perfect market there are many buyers and sellers with no dominant firm making all firms price takers, Firms are able to make maximum profit in the short run however due to no barriers to entry or exit and the fact that there is symmetric information this is not maintained in the long run. Furthermore, in a perfect market all products are homogenous and therefore this is the most competitive structure.



From the diagram above it can be seen that a perfectly competitive firm will be both productively and allocatively efficient in the long run. This is because the firm is operating at the minimum point of its long run average cost curve (productively efficient) and the price is equal to marginal cost (allocatively efficient). This is seen at output Q1 on the diagram. However, it must be noted that due to the lack of supernormal profits in this market structure firms are unable to fund research and development to create innovation processes and products. Firms in perfect competition are therefore said to be dynamically inefficient and are restrained from any long run improvements in products and processes.

In conclusion, it is clear that competition only creates productive and allocative efficiency in a prefect market structure. The competition seen within oligopolistic and monopolistic markets does not create either productive or allocative efficiency due to differentiated products and collusion. However, firms within these two market structures are likely to be dynamically efficient due to their ability to obtain supernormal profits, allowing investment into the research and development of their processes and products.

Q5 Explain, with reference to Fig. 2, two reasons for the slow increase in world trade. [4]

Figure 2 shows that in 2009 there was a severe decrease in world trade volumes as dropped to 10% and 3% the year before. The reason for this was the global economic recession at this time, which damaged companies within countries, preventing their ability to trade. In addition consumer confidence was affected greatly, leading to a decrease in demand for goods and services so trade declined. Following the huge bounce back in trade volumes to 13% in 2010 following the recession, trade has increased relatively slowly, increasing by only 2% between 2010 and 2016. A potential reason for this is the rise in the use of protectionism (such as tariffs) by different countries. This puts a tax on imports in order to protect domestic industries from foreign competition. By doing this the level of imports may decrease, which would suggest why the increase in world trade seems slow. Furthermore, trade may be increasing slowly due to industries restricting supply in order to increase the price of their product. A lack of supply would simply mean that there are fewer goods to be traded so volumes will increase slowly. A current example of this is OPEC, which has reduced the supply of oil in order to increase the price at which it is sold.

Q6 Economists would expect a negative relationship between a nation's HDI and Gini index, using Fig. 5 explain whether the data in the table supports this. [4]

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Q7 Evaluate, using an appropriate diagram, the extent to which an oligopoly market is preferable to a competitive market. [15]

Foreign direct investment is a long term capital flow into a country by a multinational company with the objective of purchasing an asset or setting up production or sales facility. It is an injection into the circular flow of income of the recipient country. FDI from MNCs can bring advantages to both developed and developing countries, however, with this also comes many disadvantages. The reason for FDI is either market seeking or efficiency seeking in order to reduce costs of production.

For both developed and developing countries, one of the main benefits from FDI is an increase in employment opportunities, as the multinational companies need workers in their new facilities. This is shown in extract two which states that Nissan provides 40,000 jobs in the UK. An increase in employment will lead to a rise in national household income in the recipient country. In turn this will cause an increase in GDP per capita followed by higher standard of living as well as an increase in welfare as people can afford more goods that have high income elasticity of demand. Furthermore an increase in consumption will cause AD to rise resulting in an increase in national income. The overall benefit of this for a developing country is that it aids economic growth which is required more by them. It helps the cycle of increase in RNO as both consumption increases as well as an increase in exports from a rise in aggregate supply which in turn would improve their current account position. On top of all this if members of society in a developing country are wealthier they may well be able to increase their consumption of merit goods such as education or healthcare. This overall consequence of this is that labour productivity will increase and unit labour costs would be reduced. In addition, more people earning money means greater tax revenue (fiscal dividends) to the government as well as them having to provide less welfare payments via automatic stabilisers. This would benefit developed countries more as they are more likely to have a welfare state in place. Few welfare payments allows the government to spend money elsewhere in the country on things such as infrastructure which may subsequently through higher corporation tax receipts also have developing nations. They will be able to increase government spending on supply side policy measures such as education and training which will subsequently lead to an increase in peoples wellbeing and higher productivity of labour and capital which will also boost AD as output increases so exports rise.

Another main benefit for a developing county is that poverty may be reduced. This is also due to rising incomes as well as MNCs providing better infrastructure which allows people to access basic human needs and leads fewer people living at the subsistence level. This will inevitably lead to a higher standard of living as well as an increase in HDI. In a developed country there may potentially be a decrease in relative poverty as well.

Finally, FDI provides the necessary investment that is lacking due to a lack of savings in a developing country (Harrod Domar model) and this subsequently plugs the savings gap.

In contrast to all of the above, there are negative consequences for FDI by MNCs to both developed and developing countries. Firstly MNCs may cause a loss of market competition if these foreign firms are allowed to dominate markets. For example extract 2 says that Shell can dominate local markets abusing monopoly power. They do this by undercutting the market with far lower prices which increase barriers to entry (predatory pricing) and prevents entrepreneurs from entering the domestic market. This can harm efficiency of firms as well as the quality of service or quality of products that is provided. It could also cause an increase in prices and create inflationary pressure in the medium term. This is likely to affect developing countries more as they cannot prevent the MNC from doing this, as they don't have the power to do so. In contrast a developed nation is able to prevent monopoly power being abused through regulators such as the CMA.

Furthermore, the recipient country is likely to face a rise in negative externalities in the form of environmental degradation and a loss of environmental capital stock through the operations of MNCS especially if they are not concerned with the consequences of their actions to the home nation. This is likely to happen more in developing countries as often this is a natural resource being exploited as well as the fact that environmental regulation is weaker in developing countries than in developed counties that have pollution permits as well as a carbon tax.

Another problem that developing countries face with MNCs is that they become over reliant on the exports that they provide as well as jobs. This is problematic if the MNC relocates in response to rising relative wage rates or lower corporation tax rates in another nation. MNCs are footloose so can move whenever they want. This is a common problem for many African nations in their race to the bottom regarding corporation tax.

In reflection the extent to which MNCs benefit the recipient country depends on the strengths of the government and how well they manage the activities of the MNC as well as who has ownership of the countries resources. Due to the fact that developing countries tend to have weaker governments they are often at the mercy of the MNC making it more likely that they'll face negative externalities due to the actions of the MNC. On the whole FDI from MNCs is more beneficial for a developing nation as it provides a higher standard of living and helps eradicate poverty as well as crucially providing economic growth which enables a country to develop. A developed country also experiences these benefits but not to as great an extent due to the fact that they have already developed and have less relative poverty and an already higher standard of living and are now growing at a slow and steady rate. However, developed countries experience less of the negative consequences of the MNCs due to the fact that their governments have a greater amount of power of the MCN that in a developing country.

CANDIDATE STYLE ANSWERS

STRONG ANSWER – ANNOTATED

Q1 Explain the term 'barriers to entry'. [2]

Barriers to entry are factors that make it impossible or very difficult for a firm to enter a market and compete with existing suppliers. Many barriers to entry can create pure monopolies or are sources of monopoly power in a market.

One mark for understanding the definition of barriers to entry

One mark for understanding the impact of barriers to entry

2 marks

Q2 Using Fig.1 calculate the three firm concentration ratio for the UK banking market. [2]

27% + 18% + 18% = 63%

One mark for correctly identifying the three firms with the largest market share

One mark for correctly calculating the three firm concentration ratio

2 marks

Q3 Evaluate, with reference to Extract 1, how a change in ownership of a firm can benefit the consumer. [8]

After the global financial crisis of 2008/09, a number of banks were bailed out by the government such as Lloyds Banking Group and Royal Bank of Scotland. This means that the government (or the tax payer) owns parts of these banks.

If the bank is fully privately owned, it is likely to seek profit maximisation, as the banking sector is an oligopoly. This means that the bank will try to operate at the output where MR=MC. This point of operation is likely to lead to low prices to consumers which is very beneficial as, especially with financial products such as mortgages, it will give them increased discretionary income.

In an oligopoly, there are only a small number of large firms, and in the banking sector this can lead to reduced choice of products for consumers. In addition, a bank may be able to manipulate consumer decision making due to the lack of competition, meaning they complicate decisions on product such as mortgages causing consumers to make confused and biased decisions.

On the other hand, if a bank were to move to public ownership, their business objectives are likely to change, as the government is generally interested in maximising social benefit. This will mean that it is more likely to offer services to the community and will focus more on ethical concerns as opposed to simply maximising revenue or profit. For example, a bank may choose to withdraw investment from firms which are not environmentally friendly. There is however, an issue with high levels of inefficiency when a firms is in public ownership, this is because there is usually a large separation between ownership and control, in the case of a bank between the government and the managers which is known as the principal agent problem and can lead to X-inefficiency. This is because the bank will be shielded from competition if it is state owned by the government, and this could lead to a large rise in average costs as they have no motivation to prevent an increase in costs.

To conclude, there are many advantages and disadvantages to both public and private ownership of a bank but if the government can prevent issues of high inefficiency within a bank then it is probable that state ownership of a bank is more beneficial to consumers.

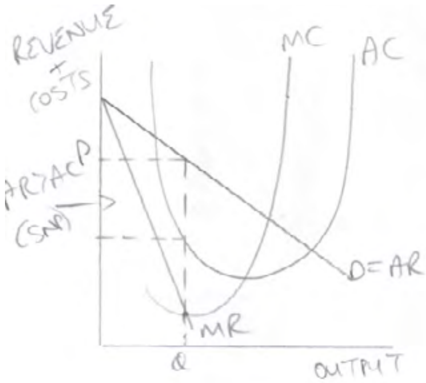
The candidate has a strong understanding of how a change in ownership could benefit the consumer and uses good analysis to lay out a logical coherent chain of reasoning on both sides. The benefits of operating in the private sector could have been explained in more detail. There is a supported judgement that is based on the conclusion that weighs up both sides. However, the candidate does not establish why producing where MR = MC would lead to low prices. In the third paragraph the reference to 'complicate decisions on product' could have been clearer. The candidate suggests that the banks may collude in terms of range of services but does not recognise they could also collude in terms of price.

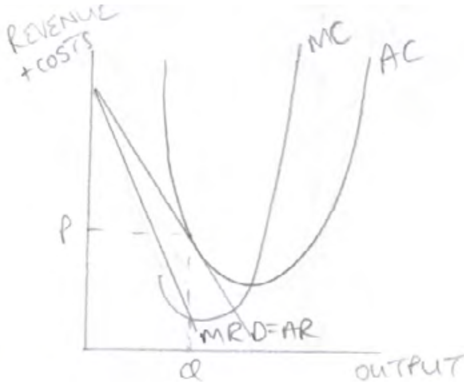
L2 7 marks

Q4 Evaluate, using an appropriate diagram(s), the extent to which a more competitive market always increases efficiency. [15]

There are three types of efficiency which firms are able to achieve. The first is allocative efficiency; this is where there is optimal distribution of goods and services into account consumer preferences. In other words, it is an output level where marginal cost is equal to price; this point is allocatively efficient as the consumer is paying a price equivalent to the marginal utility that they receive. Firms may also aim to achieve productive efficiency. This is using the optional combination of factor input to produce maximum output for the minimum of cost. A firm is productively efficiency when it is producing at the lowest point on its average cost curve this is where MC = AC. Finally, firms can achieve dynamic efficiency, which is where firms use supernormal profit to invest into the research and development for innovation of their processes and products.

In a monopolistic market there are many producers selling differentiated products to one another. In this market structure firms are short term profit maximisers. However, it is not possible to obtain maximum profits in the long run due to there being no barriers to entry or exit so more firms enter the market to seek the supernormal profits that were being exploited by other producers. In addition, there are many buyers and sellers in a monopolistic market, none of which have significant market power and they produce non-homogenous products, meaning that there is a lot of competition. Due to the high level of price competition firms look for non-price competition such as the quality of their products in order to boost profits.





From the diagrams above we can see that in the short run firms make supernormal profits at they are producing at a level where average revenue is greater than average cost. However, firms are not productively or allocatively efficient as the level of output is not where MC=MR or MC= AC, firms only make normal profit at AR=AC.

It is argued by economists that firms are not efficient due to product differentiation as each individual firm is too small to benefit from economies of scale; this gives each individual firm a small amount of pricing power above marginal cost. In contrast, this must be weighed up against the increase in welfare that consumer experience which competes from having more choice, a key characteristic of monopolistic markets. This therefore means that competition does not necessarily mean that firms are more efficient. However, as firms make supernormal profits in the short run there are able to invest into research and development, which allows them to be dynamically efficient.

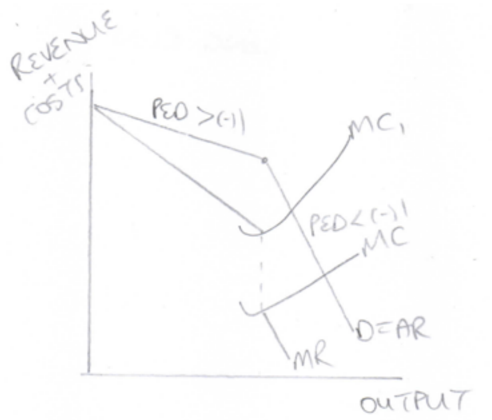
In an oligopoly there is slightly less competition compared to monopolistic competition there are barriers to entry and exit as well as there being a high concentration ratio with between 3-5 firms dominating the industry. Similarly to monopolist markets however, firms are profit maximisers in the short run. One of the key features of an oligopoly is interdependency between firms, meaning that the actions of one firm impact on another and this had effects on efficiency.

The candidate has a clear understanding of the different efficiencies experienced by firms and can confidently analyse how changes in market structures, and therefore the behaviour of firms, can influence the type of efficiencies enjoyed by firms.

The discussion is set out in a logical order and addresses the question of competition and efficiency by tackling the idea of monopolistic competition relative to oligopolistic competition. The candidate then draws on the idea of perfect competition, which in this instance isn't necessary but does continue to reinforce their argument that greater competition will result in greater static but not dynamic efficiency. Diagrams are integral to the analysis and there is a supported judgement justifying the top of level 3.

L3 15 marks

Q4 Evaluate, using an appropriate diagram(s), the extent to which a more competitive market always increases efficiency. [15]

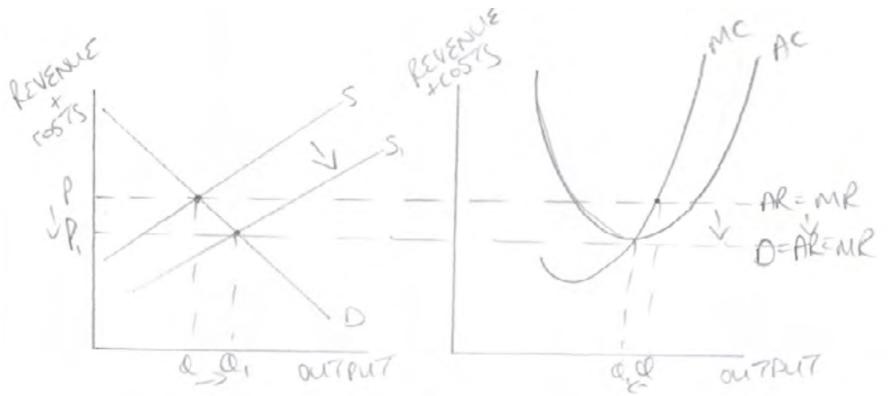


The diagram for an oligopoly (above) shows a kinked demand curve that reflects the behaviour of firms. Due to interdependency and competition, if one firm increases its prices then other firms will keep their prices lower in order to gain greater market share, as rational consumers will choose cheaper product. Price wars can happen in the short-term in oligopolistic markets, therefore as firms are making supernormal profits they are incentivised to lower prices to steal market share from competition and gain even greater profit. However, when a firm does this other firms are likely to react by dropping their prices are well causing prices to fall rapidly to a new equilibrium. Collusion between firms can occur in oligopoly markets as they attempt to raise prices together to maximise their joint profits – this also affects efficiency.

From the diagram it is clear that firms in an oligopoly market are not productively and allocatively efficient. This is evident as the output level shows that MC does not equal AC and MC is not equal to AR either. The downward sloping demand curve means that firms are incentivised to restrict output below the minimum efficiency scale and through collusion prices will be above the MC curve. However, due to non-price competition within the market meaning firms are able to make super-normal profits (AR=AC), firms are able to invest into research and development to improve the quality of their products and this enables them to be dynamically efficient.

It is again evident from this that in an oligopolistic market where there is competition, allocative and productive efficiency is not created.

In contrast to these two market structures if there is perfect competition then there is likely to be both productive and allocative efficiency. In a perfect market there are many buyers and sellers with no dominant firm making all firms price takers, Firms are able to make maximum profit in the short run however due to no barriers to entry or exit and the fact that there is symmetric information this is not maintained in the long run. Furthermore, in a perfect market all products are homogenous and therefore this is the most competitive structure.



Q4 Evaluate, using an appropriate diagram(s), the extent to which a more competitive market always increases efficiency. [15]

From the diagram above it can be seen that a perfectly competitive firm will be both productively and allocatively efficient in the long run. This is because the firm is operating at the minimum point of its long run average cost curve (productively efficient) and the price is equal to marginal cost (allocatively efficient). This is seen at output Q1 on the diagram. However, it must be noted that due to the lack of supernormal profits in this market structure firms are unable to fund research and development to create innovation processes and products. Firms in perfect competition are therefore said to be dynamically inefficient and are restrained from any long run improvements in products and processes.

In conclusion, it is clear that competition only creates productive and allocative efficiency in a prefect market structure. The competition seen within oligopolistic and monopolistic markets does not create either productive or allocative efficiency due to differentiated products and collusion. However, firms within these two market structures are likely to be dynamically efficient due to their ability to obtain supernormal profits, allowing investment into the research and development of their processes and products.

Q5 Explain, with reference to Fig. 2, two reasons for the slow increase in world trade. [4]

Figure 2 shows that in 2009 there was a severe decrease in world trade volumes as dropped to 10% and 3% the year before. The reason for this was the global economic recession at this time, which damaged companies within countries, preventing their ability to trade. In addition consumer confidence was affected greatly, leading to a decrease in demand for goods and services so trade declined. Following the huge bounce back in trade volumes to 13% in 2010 following the recession, trade has increased relatively slowly, increasing by only 2% between 2010 and 2016. A potential reason for this is the rise in the use of protectionism (such as tariffs) by different countries. This puts a tax on imports in order to protect domestic industries from foreign competition. By doing this the level of imports may decrease, which would suggest why the increase in world trade seems slow. Furthermore, trade may be increasing slowly due to industries restricting supply in order to increase the price of their product. A lack of supply would simply mean that there are fewer goods to be traded so volumes will increase slowly. A current example of this is OPEC, which has reduced the supply of oil in order to increase the price at which it is sold.

The candidate marks good use of Fig.2 to support their points and explains two valid reasons for slow growth in world trade.

4 marks

Q6 Economists would expect a negative relationship between a nation's HDI and Gini index, using Fig. 5 explain whether the data in the table supports this. [4]

The gini index is used to display the income inequality within a nation; the lower the index the less inequality there is. In contrast the higher the HDI of a country, the more developed it is. Therefore, the negative relationship that economists would expect to see between the two is that as HDI increases the gini index decreases. This holds true for most of the countries in fig. 4. For example, in Argentina HDI increased by 0.04 from 2005-2012 and the gini index decreased by around 7. Also, in the Netherlands HDI increased over the seven year period and the gini index fell by about 2. However, there are two exceptions, which do not support the relationship that economists would expect. In Austria HDI rose by 0.03 and the gini index increased by 2; also Cyprus HDI rose by 0.03 from 2005-2012 and the gini index rose by 4. Therefore some of the data supports the idea that there is a negative relationship between HDI and gini index and some of the data does not.

The candidate sets out a concise explanation that uses data in support of their explanation. There is a clear understanding of the Gini index, HDI and the relationship expected as well as the evidence provided in Fig. 5.

4 marks

Q7 Evaluate, with reference to the stimulus material, the view that multinational companies are more beneficial for developed countries than developing countries. [15]

Foreign direct investment is a long term capital flow into a country by a multinational company with the objective of purchasing an asset or setting up production or sales facility. It is an injection into the circular flow of income of the recipient country. FDI from MNCs can bring advantages to both developed and developing countries, however, with this also comes many disadvantages. The reason for FDI is either market seeking or efficiency seeking in order to reduce costs of production.

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Furthermore, the recipient country is likely to face a rise in negative externalities in the form of environmental degradation and a loss of environmental capital stock through the operations of MNCS especially if they are not concerned with the consequences of their actions to the home nation. This is likely to happen more in developing countries as often this is a natural resource being exploited as well as the fact that environmental regulation is weaker in developing countries than in developed counties that have pollution permits as well as a carbon tax.

The candidate achieves L4 because the answer demonstrates an excellent knowledge both of this question and the topic area. The candidate demonstrates that they can write as an economist and draw on a wide range of theory to produce a synoptic, logical and balanced discussion that is fully embedded in both relevant macro (and micro) economic concepts. As required by this question, the candidate also makes quite effective use of the stimulus material to support their arguments.

Arguments are consistently expressed as developed links in a chain of reasoning that is coherent. However, the analysis might have been enhanced by the use of a diagram(s) – analysis of a rise in AD and/or rise in LRAS could have been taken further by the use of a diagram.

The final conclusion is underpinned by previous analysis, weighs up the arguments and comes to a final (relatively well supported) judgement.

L4 14 marks

Q7 Evaluate, with reference to the stimulus material, the view that multinational companies are more beneficial for developed countries than developing countries. [15]

Another problem that developing countries face with MNCs is that they become over reliant on the exports that they provide as well as jobs. This is problematic if the MNC relocates in response to rising relative wage rates or lower corporation tax rates in another nation. MNCs are footloose so can move whenever they want. This is a common problem for many African nations in their race to the bottom regarding corporation tax.

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Total marks = 48/50

Summary examiner comments

This is an example of strong knowledge and understanding of the economic issues covered in the stimulus material and the questions. The candidate produces strong analysis using consistently well-developed links forming coherent chains of reasoning that are underpinned by advanced economic terms, models and concepts – when used, diagrams are integral to the analysis. Where appropriate there is also strong evaluation which weighs up both sides of the argument and includes a supported judgement.

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