GradeMax



Mark Scheme (Results)

January 2015

Pearson Edexcel IAL
WEC03
Paper 03 Business Behaviour

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General Marking Guidance

- All candidates must receive the same treatment. Examiners must mark the first candidate in exactly the same way as they mark the last.

- Mark schemes should be applied positively. Candidates must be rewarded for what they have shown they can do rather than penalised for omissions.

- Examiners should mark according to the mark scheme not according to their perception of where the grade boundaries may lie.

- There is no ceiling on achievement. All marks on the mark scheme should be used appropriately.

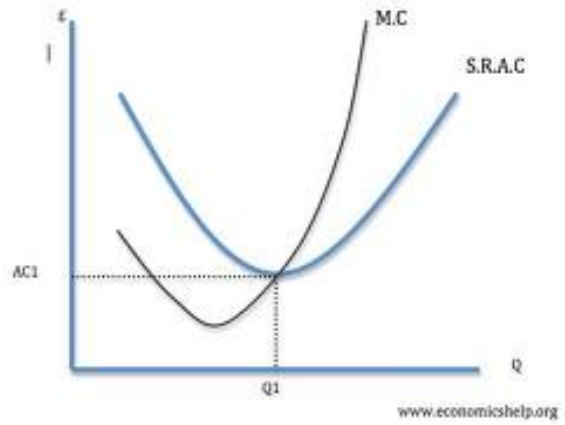
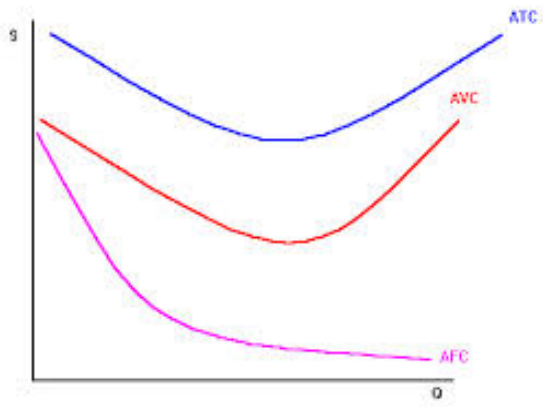
- All the marks on the mark scheme are designed to be awarded. Examiners should always award full marks if deserved, i.e. if the answer matches the mark scheme. Examiners should also be prepared to award zero marks if the candidate's response is not worthy of credit according to the mark scheme.

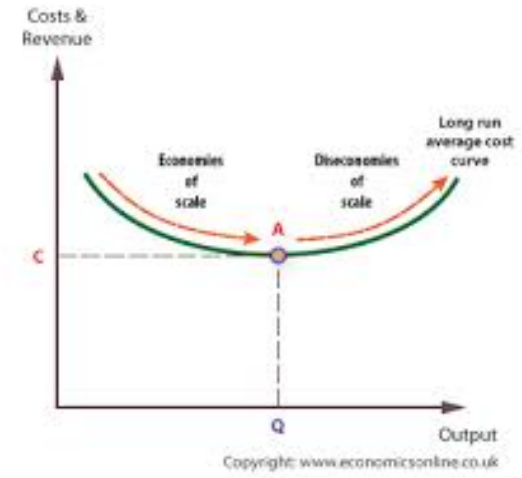
- Where some judgement is required, mark schemes will provide the principles by which marks will be awarded and exemplification may be limited.

- When examiners are in doubt regarding the application of the mark scheme to a candidate's response, the team leader must be consulted.

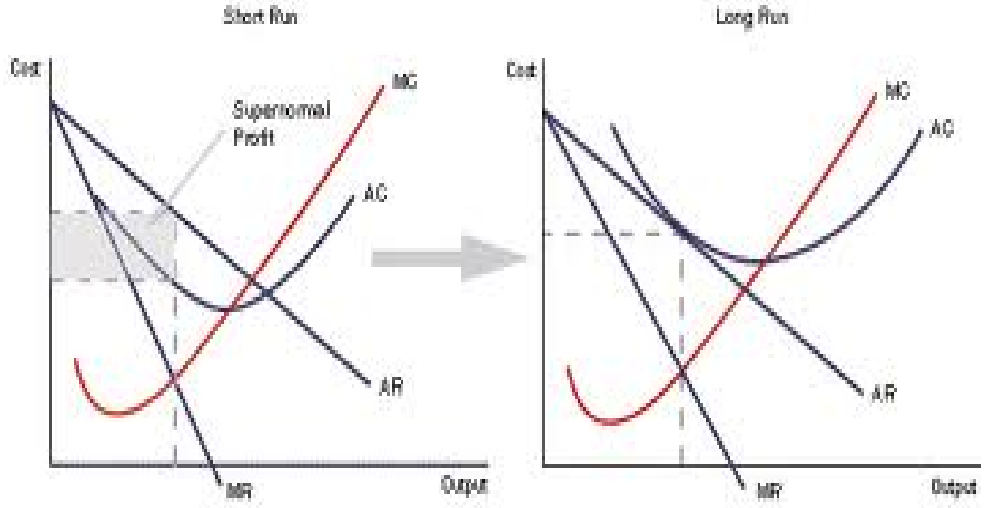
- Crossed out work should be marked UNLESS the candidate has replaced it with an alternative response.

Section A: Essay questions
NB: Use levels based mark scheme (20 marks) to mark this section.

Question Number	Answer	Mark
1	**Indicative content** • Definition of average cost – cost per unit of output, total cost/output • Definition and distinction between AFC (fixed cost/output) & AVC (variable cost/output) • Definition of short run and long run – at least one fixed factor of production and one or more variable factors (SR); all factors are variable (LR) <u>SHORT RUN</u> • Typical short run behaviour of AC –falling (spreading of fixed costs over more units of output); then rising (assuming diminishing marginal productivity – define & explain) • Diagram of 'U-shaped' curve OR all 3 short run average cost curves (AFC, AVC & ATC)   	

	LONG RUN • Long run – typically falling LRAC arising from economies of scale -define and discuss various factors - Types of economy of scale – technical, financial, marketing, managerial, purchasing • Diagram of LRAC  Effects of **external** economies and **external** diseconomies of scale – explanation of terms and their impact – shift in LRAC downwards or upwards respectively. Applied to LRAC diagram **Evaluation**: Short run SRAC may continue to fall for longer where fixed costs are being spread over more and more units of output and/or where diminishing returns are not arising (falling or constant AVC) Long run • Causes and impact of diseconomies of scale • At what point is MES reached on LRAC? – varies according to market/industry/time - In some industries/markets smaller firms may be more productively efficient. Examples – hairdressing, plumbing, gardening etc. - In other industries/markets diseconomies may only arise at very high levels of output. Up to this point AC is falling (or is constant) 'L-shaped' curve. Examples – cars, engineering, pharmaceuticals etc. - Possible use of diagram(s) to illustrate these points	**(20)**

Question Number	Answer	Mark
2	**Indicative content** • Conditions for monopolistic competition – large number of buyers & sellers, perfect information, no barriers to entry or exit, differentiated product • Conditions for perfect competition – as above, but homogeneous product (not differentiated) • Benefits to firms: - Facing a downward sloping AR curve – demand curve (not perfectly elastic), so not a price taker. Hence firms are able to raise price above that which would apply under perfectly competitive conditions - Firms have a certain degree of market power due to product differentiation – customer loyalty - Likely to be able earn a larger supernormal profit in the short run compared with perfect competition - More chance of R&D may lead to more product innovation and possible dynamic efficiency gains • Benefits to consumers: - Differentiated products can provide more choice/variety - Offers more convenience (based on location) - No barriers will lower prices in the long run (but still higher than perfect competition) - May benefit from more product innovation **Short run monopolistic competition** Firms can make supernormal profits where MC =MR **Long run monopolistic competition** No barriers means AR shifts downwards until only normal profits are earned and price is lower at profit max level of output <u>Candidates may contrast this analysis with diagram(s) for perfect competition</u>	



Evaluation

- Firms earn normal profits in long run
- Firms are small and have very limited market power due to large number of close substitutes
- Costs are likely to be higher due to the need for advertising and promotion
- Monopolistic competition results in neither allocative efficiency nor productive efficiency, (SR & LR), whereas perfectly competitive firms are both in the long run and allocatively efficient in SR. Labelling of diagrams to show this.
- Price is likely to be higher and output lower than under conditions of perfect competition
- Proliferation of brands may lead to confusion for consumers

(20)

Question Number	Answer	Mark
3	**Indicative content** • Explanation of a contestable market – where there are few, if any, barriers to entry and exit. • The number of firms can vary from one (a monopoly) to many • Examples of entry/exit barriers may include brand loyalty, high start- up costs, patents, advertising & marketing costs. • Some (or all) of these may be sunk costs – define & explain IMPACT ON A FIRM'S BEHAVIOUR A <u>more contestable</u> market may cause a firm to, for example: - Lower its prices - Increase its output - Improve quality of product/service - Innovate (dynamic efficiency) - Decide to earn normal profits to deter potential entrants (threat of new firms) - Exit the market A new firm may decide to enter the market for short term gains and then exit the market – hit and run entry A <u>less contestable</u> market may cause a firm to, for example: - Keep prices high - Restrict output - Be complacent – lack of R & D, X-inefficiency - Collude It may provide existing firm(s) in the market with monopoly power and may result in supernormal profits being gained	

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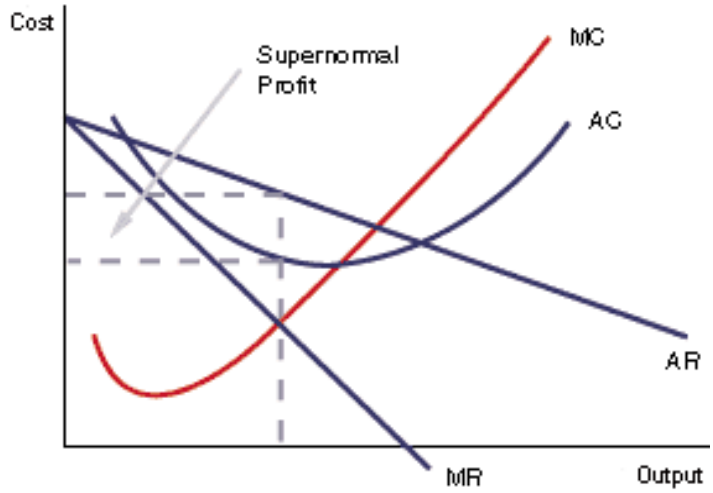
Diagram to show supernormal profit at MC = MR



Evaluation

- A highly contestable market may result in incumbent firms attempting to raise artificial barriers e.g. limit pricing, more advertising. Increased focus on non-price barriers. Reward real life examples
- Distinction between short run and long run – hit and run entry may mean that contestability is unsustainable in the long run
- Dynamic nature of the market may make markets more contestable in the long run e.g. the impact of the internet in making markets more accessible for smaller firms, technological change reducing capital costs
- Depends on the size of the firm – contrast behaviour of small and large firms when faced with more contestability
- Impact may vary according to new entrant's reputation (the firm may have diversified into a new market)
- A firm's response is likely to be influenced by government competition policies. Fear of reprisals as a consequence of limit pricing, predatory pricing, collusive strategies

(20)

Question Number	Answer	Mark
4	**Indicative content** • Define international competitiveness • Measures to promote international competitiveness may include: - improving labour productivity – education, training, investment incentives - reducing unit labour costs – subsidies to employers, low cost borrowing terms for employers - lowering the exchange rate – a depreciation of the domestic currency to reduce relative export prices - deregulation – removing/lowering entry barriers, privatisation - more incentives for investment – tax allowances/tax cuts, regional assistance, direct financial support - funding for developments to the infrastructure - local sourcing - increasing the flexibility of labour markets **Evaluation** • Positive benefits to the economy in terms of growth, competition and employment • Limits to how effective and influential intervention can be e.g. government's ability to manipulate exchange rates may be highly constrained • Impact on employment rights – employees may be more prone to exploitation • Which measures might be more effective and why – prioritisation • Short term & long term impact – possible time lags before effective e.g. infrastructure developments • Distinction between SR and LR – is the support financially sustainable in the long run? • Costs of intervention – both financial and opportunity cost. Can the costs be justified? What are the implications for taxpayers and other recipients of government finance? • The possibilities of government failure – costs outweigh benefits	**(20)**

Section A Questions: Performance Criteria for Mark base 20		
Level 0	0	• No rewardable material
Level 1	1-4	• Displays knowledge presented as facts without awareness of other viewpoints • Demonstrates limited understanding with little or no analysis • Attempts at selecting and applying different economic ideas are unsuccessful • Material presented is often irrelevant and lacks organisation. Frequent punctuation and/or grammar errors are likely to be present and the writing is generally unclear.
Level 2	5-8	• Displays elementary knowledge of well learnt economic facts showing a generalised understanding together with limited analysis i.e. identification of points or a very limited discussion • Displays a limited ability to select and apply different economic ideas • Material presented has a basic relevance but lacks organisation, but is generally comprehensible. Frequent punctuation and/or grammar errors are likely to be present which affects the clarity and coherence of the writing overall.
Level 3	9-12	• Displays knowledge and understanding of economic principles, concepts and theories as well as some analysis of issues i.e. answer might lack sufficient breadth and depth to be worthy of a higher mark • Shows some ability to apply economic ideas and relate them to economic problems • Employs different approaches to reach conclusions • Material is presented with some relevance but there are likely to be passages which lack proper organisation. Punctuation and/or grammar errors are likely to be present which affect the clarity and coherence.
Level 4	13-16	• Displays a good knowledge of economic principles, concepts and theories together with an analysis of the issues involved • Demonstrates an ability to select and apply economic ideas and to relate them to economic problems • Evidence of some evaluation of alternative approaches leading to conclusions • Material is presented in a generally relevant and logical way, but this may not be sustained throughout. Some punctuation and/or grammar errors may be found which cause some passages to lack clarity or coherence.
Level 5	17-20	• Displays a wide range of knowledge of economic principles, concepts and theories together with a rigorous analysis of issues • Demonstrates an outstanding ability to select and apply economic ideas to economic problems • Evaluation is well balanced and critical leading to valid conclusions • Material is presented in a relevant and logical way. Some punctuation and/or grammar errors may be found, but the writing has overall clarity and coherence.

Section B: Data response

Question Number	Answer	Mark
5(a)	**Knowledge and Application (up to 4 marks)** **Knowledge** – up to 2 marks Oligopoly (1) with **one** characteristic of oligopoly e.g. small number of dominant large firms (1), interdependency between firms (1) **Application –** up to 2 marks 4 dominant firms in the industry (1) Calculation of concentration ratio – e.g. 2 firm (47%), 3 firm (66%), 4 firm (83%), 5 firm (90%). (2 marks for one accurate calculation) Any other valid application point – up to 2 marks	**(4)**

Question Number		Mark
5(b)		**(12)**

Knowledge, Application and Analysis – Indicative content

Explain meaning of price war – a series of price reductions by firms (airlines) in the market. Call and response to rivals' price cuts

More shut downs are likely as:

- Large airline price discounts by as much as 58%
- Average prices are at or below break-even level
- Evidence of a small airline already leaving industry
- Evidence of slow economic recovery in the Indian economy so less growth in demand
- Some firms gain market share at the expense of rival airlines – possibly Jet Airways and Air India plus the 2 other large airlines benefit whilst others suffer.
- Other rival airlines may be forced out of the market through predatory pricing – e.g. smaller companies, such as Jet Konnect and/or Go Air, may be particularly vulnerable
- A price war results in some airlines failing to survive and a rise in the concentration ratio – some airlines lose revenue especially if demand is price inelastic
- Small airlines lack economies of scale compared to large airlines
- Small airlines may have less cash reserves / access to loans than large airlines

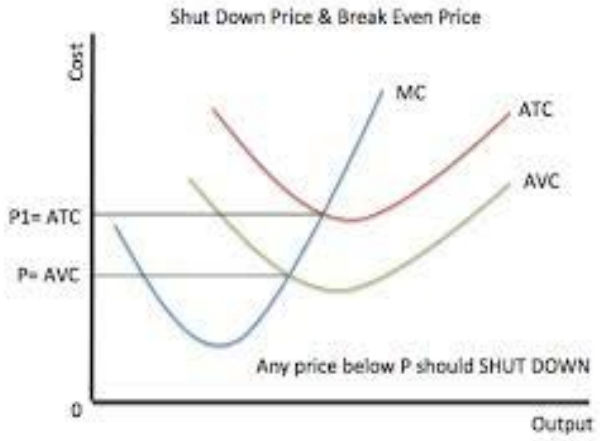
  If price is below AVC the firm will shut down in the short run (SEE DIAGRAM on next page)

More shut downs are unlikely because:

- Economic recovery could accelerate
- Costs could fall e.g. air fuel
- Increased efficiency of airlines
- Possibility of non-price competition – advertising, promotional techniques (e.g. competitions)
- Possibility of collusion e.g. price fixing
- Price war may not be sustainable beyond the short run and has little long lasting impact
- Price war may provoke a reaction from the Indian government which moves to stop further price cuts
- Consumer groups may be highly critical- concerned with possible loss of competitors and future lack of choice/monopoly power.
- Airlines remain in production in short run as long as variable costs are covered by revenue - AVC<AR (SEE DIAGRAM on next page)

ACCEPT ONE LINE OF ARGUMENT FOR KAA MARKS (THE COUNTER-ARGUMENT REPRESENTS EVALUATION)

(contd…)



In the long run price must be at least equal to ATC (normal profit)

Level	Marks	Descriptor
0	0	A completely inaccurate response.
1	1-3	Shows some awareness of the possible effects of a price war. Material presented is often irrelevant and lacks organisation. Frequent punctuation and/or grammar errors are likely to be present and the writing is generally unclear.
2	4-6	Understanding of the effects of a price war, with some application to context. Material is presented with some relevance but there are likely to be passages which lack proper organisation. Punctuation and/or grammar errors are likely to be present which affect the clarity and coherence.
3	7-8	Clear understanding of the effects of a price war, with effective application to context. Material is presented in a relevant and logical way. Some punctuation and/or grammar errors may be found, but the writing has overall clarity and coherence.

Evaluation – Indicative content

Candidates may answer either that more shut downs are likely or unlikely. The counter-arguments represent evaluation points

Other evaluation points:

- Much depends on the impact of price cuts on a firm's revenue and how that relates to the firm's costs (relative size of price cuts)
- Potential revenue and profit gains depend on values of PED
- Short run/long run impact

Level	Marks	Descriptor
0	0	No evaluative comments.
1	1-2	For identifying evaluative comments without explanation.
2	3-4	For evaluative comments supported by relevant reasoning.

Question		Mark
5(c)		**(12)**

Knowledge, Application and Analysis – Indicative content

- Definition of collusion – incumbent firms agreeing to restrict competition (formally or informally)
- Collusion can be tacit (e.g. price leadership) or overt (e.g. price fixing). Extract 2 suggests price fixing
- Firms may collude to:
  - Avoid price competition
  - restrict output and artificially raising price
  - divide the market geographically
  - share market information
  - influence government policy
- May be a rational strategy for firms as the reasons for collusion are to:
  - Achieve joint-profit maximisation within a market
  - Prevent price and revenue instability
  - Raise entry barriers
  - Profit satisfice – provide an easy life for firms
  - Achieve a more secure market share
- Application & analysis of information from Extract 2 may include; collusion has led to - artificially high diesel fuel prices, exchange of market information to reduce risks, influencing of regulations affecting the SA fuel market for the firms' benefit. There may have been weak competition laws if collusion has been occurring since 1980s

NOTE: Candidates may approach this question from the alternative viewpoint, in which case evaluation marks will be gained from considering why collusive behaviour **is** rational

Level	Marks	Descriptor
0	0	A completely inaccurate response.
1	1-3	Shows some awareness of the reasons for collusive behaviour. Material presented is often irrelevant and lacks organisation. Frequent punctuation and/or grammar errors are likely to be present and the writing is generally unclear.
2	4-6	Understanding of the reasons for collusive behaviour with some application. Material is presented with some relevance but there are likely to be passages which lack proper organisation. Punctuation and/or grammar errors are likely to be present which affect the clarity and coherence.
3	7-8	Clear understanding of the reasons for collusive behaviour with effective application to context. Material is presented in a relevant and logical way. Some punctuation and/or grammar errors may be found, but the writing has overall clarity and coherence.

(evaluation on next page)

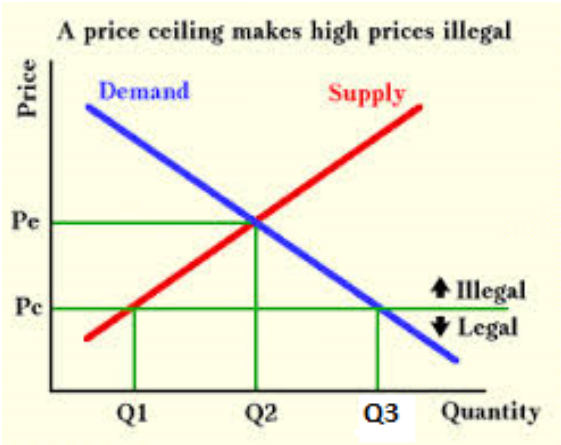
Evaluation – Indicative content		
	• Strong competition authorities • Firms may not collude due to negative consequences of government action e.g. fines recommended to be 10% of turnover • Collusion may be difficult to sustain in the long run – firms break away and charge lower prices. Although evidence found information sharing since 1980s • Many oligopolies undertake non-collusive behaviour in the form of non-price competition – advertising, sales promotions, quality of service etc. • Other forms of oligopoly behaviour – predatory pricing and price wars	

Level	Marks	Descriptor
0	0	No evaluative comments.
1	1-2	For identifying evaluative comments without explanation.
2	3-4	For evaluative comments supported by relevant reasoning.

Question Number		Mark
5(d)		**(12)**
Knowledge, Application and Analysis – Indicative content		

Methods of government control: Various forms of competition policy may include;

- Laws against collusion – with bans and fines imposed
- Deregulating the industry – lowering barriers by allowing new companies to enter the industry
- Regulating prices –e.g. price controls, setting a maximum fuel price



Possible <u>impact</u> of a range of measures may include:
A more competitive market:

- Fewer barriers to entry so more contestable and an incentive for new entrants (deregulation, anti-collusion)
- Fewer businesses leave the market, (no predatory pricing) so more consumer choice
- Increase in consumer surplus and lower producer surplus or consumers gain from lower prices (price ceiling and greater competition)
- Increased economic efficiency of firms e.g. productive, allocative and dynamic; reduced x-inefficiency of firms.
- Measures may have a damaging effect on firms' profits and cause some businesses to exit the market
- Maximum prices may create shortages in the market (see diagram where shortage = Q1Q3

(contd...)

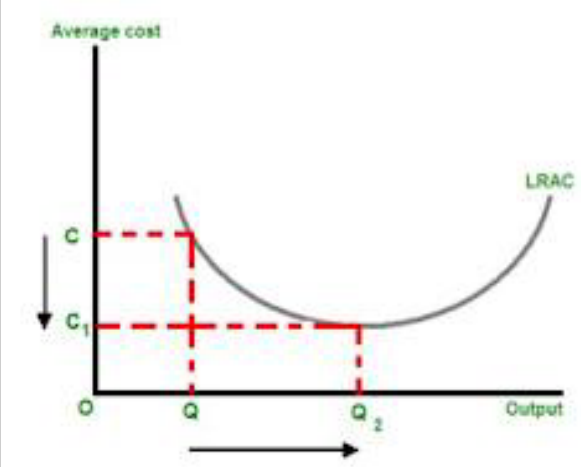
Level	Marks	Descriptor
0	0	A completely inaccurate response.
1	1-3	Shows some awareness of the likely impact of government competition policies. Material presented is often irrelevant and lacks organisation. Frequent punctuation and/or grammar errors are likely to be present and the writing is generally unclear.
2	4-6	Understanding of the likely impact of government competition policies, with some application to context. Material is presented with some relevance but there are likely to be passages which lack proper organisation. Punctuation and/or grammar errors are likely to be present which affect the clarity and coherence.
3	7-8	Clear understanding of the likely impact of government competition policies, with effective application to context. Material is presented in a relevant and logical way. Some punctuation and/or grammar errors may be found, but the writing has overall clarity and coherence

Evaluation – Indicative content

- Measures can stimulate competition and restrict powers of existing firms in the market
- Impact will depend on how extensive government measures are and how businesses respond to those measures, e.g. what maximum price is set, what level of fines is imposed?
- Costs of enforcing regulations and laws
- Difficulty in proving cases of predatory pricing and collusion (especially tacit)
- Length of time taken to correct business behaviour – e.g. oil companies in Extract 2 - high prices since 2009 and information sharing since 1980's
- Large TNCs are more able to avoid detection and may threaten to pull out of the economy
- Encouraging new firms to enter the market may have little impact where incumbent firms are large and powerful (e.g. the oil companies).
- Regulatory capture

Level	Marks	Description
0	0	No evaluative comments.
1	1-2	For identifying evaluative comments without explanation.
2	3-4	For evaluative comments supported by relevant reasoning.

Question Number	Answer	Mark
6(a)	**Knowledge and Application (up to 4 marks)** **Knowledge** – up to 2 marks: Organic growth – a business grows without acquiring (or not joining up with) another business (1) Takeover – a firm grows by acquiring (buying out) another business (1) **OR** a firm grows by buying another business in the same industry at the same stage of production – horizontal; at a different stage – vertical; or in an unrelated industry – conglomerate. 1 mark for identifying one (or more) of the different forms of integration **Application** - up to 2 marks: Kroger's purchase of Harris Teeter (1) and Cerberus Capital Management's purchase of grocery chains (1) are both examples of takeovers (= total of 2 marks). OR Kroger is a horizontal takeover (1), CCM is a conglomerate (1) Any other valid application point – up to 2 marks	**(4)**

Question Number		Mark
6(b)		**(12)**
Knowledge, Application and Analysis – Indicative content		
	Definition of horizontal merger – integration at the same stage of production in the same industry (e.g. supermarket/grocery industry) Benefits to the firms: • A means of inorganic (external) growth – quicker method than organic growth • Achieves a bigger market share • Gains from shared knowledge/understanding of the market from the other firm • A means of being more able to compete against the largest firms e.g. Wal-Mart • More funds available for capital investment • A means of growth when market demand is low • Achieves economies of scale – examples such as bulk buying of foodstuffs/groceries and financial economies (see diagram) • Increases profits • Reduce competition • A way of coping with the recent recession • Increases monopsony power  Firm's output rises from OQ to OQ2 following merger and LRAC falls Benefits to the consumers: • Lower prices as a result of passing on gains from lower LRAC • May be a means of stopping stores from closing – hence retains a degree of choice • Efficiency gains may lead to an improved quality of service – e.g. supermarkets investing in faster checkout systems • Increases consumer surplus	

Level	Marks	Descriptor
0	0	A completely inaccurate response.
1	1-3	Shows some awareness of the benefits of horizontal mergers for firms OR consumers. Material presented is often irrelevant and lacks organisation. Frequent punctuation and/or grammar errors are likely to be present and the writing is generally unclear.
2	4-6	Understanding of the benefits of horizontal mergers for firms AND/OR consumers with some application to context. Material is presented with some relevance but there are likely to be passages which lack proper organisation. Punctuation and/or grammar errors are likely to be present which affect the clarity and coherence.
3	7-8	Clear understanding of the benefits of mergers for firms AND consumers with effective application to context. Material is presented in a relevant and logical way. Some punctuation and/or grammar errors may be found, but the writing has overall clarity and coherence.

Evaluation – Indicative content

Mergers may be more beneficial to firms than consumers

- For consumers the merger may
  - lead to more market power and higher prices for consumers
  - lead to less competition -fewer offers and promotions
  - lead to having to spend more time shopping around
  - Less choice

- For firms the merger may
  - lead to diseconomies of scale
  - have high set up costs
  - be ineffective in preventing larger firms from controlling the market
  - result in a conflict of business objectives
  - result in a competition authority investigation with negative consequences for the firm

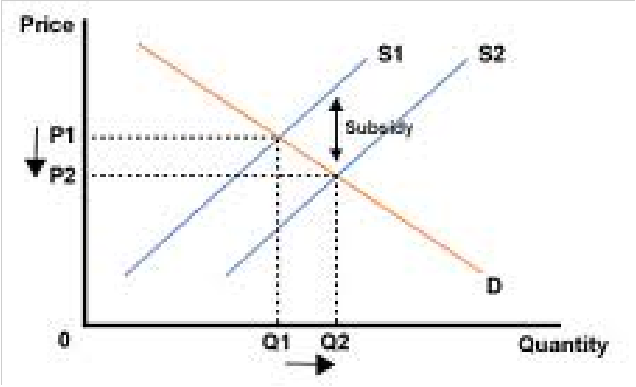
Level	Marks	Descriptor
0	0	No evaluative comments.
1	1-2	For identifying evaluative comments without explanation.
2	3-4	For evaluative comments supported by relevant reasoning.

Question Number		Mark
6(c)		**(12)**
Knowledge, Application and Analysis – Indicative content		
	Identification and explanation of monopsony – where a buyer has significant market power over its suppliers Impact on suppliers may include: • forced to sell at very low prices – leading to lower profits margins/lower incomes/losses (Extract 2) • Tough conditions imposed by monopsonist e.g. discounts, delayed payments, threats of switching to new suppliers (Extract 2) • Some suppliers may leave the market due to the above (unable to make a profit or insufficient profit margin) • Risk of supply chains to supermarkets in long term as supply firms exit market • Suppliers respond by cutting production costs e.g. lower wages and worsen working conditions for workers/ignore environmental protection measures (so increase spraying of pesticides / use intensive farming methods) • Suppliers may seek mergers to offer counter-veiling power	

Level	Marks	Descriptor
0	0	A completely inaccurate response.
1	1-3	Shows some awareness of the impact of supermarket buyer power on suppliers. Material presented is often irrelevant and lacks organisation. Frequent punctuation and/or grammar errors are likely to be present and the writing is generally unclear.
2	4-6	Understanding of the impact of supermarket buyer power on suppliers, with some application to context. Material is presented with some relevance but there are likely to be passages which lack proper organisation. Punctuation and/or grammar errors are likely to be present which affect the clarity and coherence.
3	7-8	Clear understanding of the impact of supermarket buyer power on suppliers with effective application to context. Material is presented in a relevant and logical way. Some punctuation and/or grammar errors may be found, but the writing has overall clarity and coherence.

(evaluation on next page)

Evaluation – Indicative content			
	• Other suppliers may benefit in the form of longer term contracts leading to potentially higher revenue and profits • May remove a degree of uncertainty for suppliers where contracts are longer term • Do the costs outweigh the benefits for suppliers? • Which specific benefits and costs are likely to exert more influence? Prioritisation • Depends on the terms and conditions of the buyer and seller relationship • Short term/long term impact • Depends on how governments (national/international), respond - if at all		
Level	Marks	Descriptor	
0	0	No evaluative comments.	
1	1-2	For identifying evaluative comments without explanation.	
2	3-4	For evaluative comments supported by relevant reasoning.	

Question Number		Mark
6(d)		**(12)**
Knowledge, Application and Analysis – Indicative content		
	Types of government intervention may include • limits on monopsony power • support for domestic suppliers e.g. subsidies for substitute goods  Lowers price from OP1 to OP2, raising QD from OQ1 to OQ2 • setting minimum prices for fruit growers and fruit companies to charge supermarkets • employee protection - minimum wage legislation - health & safety laws • support for pressure groups (e.g. Make Fruit Fair campaign) • encourage buyers to improve their global buying behaviour (e.g. EU and a Code of Practice) Reasons FOR government intervention may include: • can result in 'fairer' prices for domestic suppliers • improved pay and conditions for employees to combat exploitation • reduced power of monopsonists • improved economic performance – higher revenues/profit for suppliers, higher wages for workers may stimulate the economy (contd…)	

Level	Marks	Descriptor
0	0	A completely inaccurate response.
1	1-3	Shows some awareness of the potential benefits of government intervention to protect suppliers OR employees. Material presented is often irrelevant and lacks organisation. Frequent punctuation and/or grammar errors are likely to be present and the writing is generally unclear.
2	4-6	Understanding of the potential benefits of government intervention to protect suppliers AND/OR employees with some application to context. Material is presented with some relevance but there are likely to be passages which lack proper organisation. Punctuation and/or grammar errors are likely to be present which affect the clarity and coherence.
3	7-8	Clear understanding of the potential benefits of government intervention to protect suppliers AND employees with effective application to context. Material is presented in a relevant and logical way. Some punctuation and/or grammar errors may be found, but the writing has overall clarity and coherence.

Evaluation – Indicative content

- How might monopsonists react? May source supplies from other countries and have serious negative effects
- Limits to the powers of national governments – may need international co-operation. However, EU competition policy does not cover non EU suppliers
- Distinction between SR and LR - e.g. is the support for suppliers, in the case of subsidies, sustainable in the long run; is international co-operation viable in the long run?
- Cost implications for governments – may be even more significant in poorer economies
- Should the government intervene at all?
- Some of the suppliers are big companies themselves – Del Monte, Dole etc. which are imposing poor working conditions on the workers in developing countries
- Risks of government failure

Level	Marks	Descriptor
0	0	No evaluative comments.
1	1-2	For identifying evaluative comments without explanation.
2	3-4	For evaluative comments supported by relevant reasoning.

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