

Mark Scheme (Results)

Summer 2014

Pearson Edexcel
International Advanced Level (IAL)
Economics (WEC03) Unit 3

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General Marking Guidance

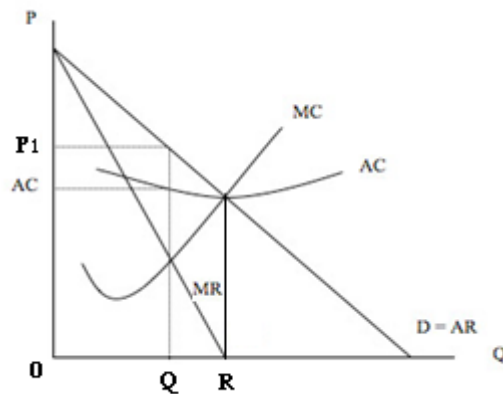
- All candidates must receive the same treatment. Examiners must mark the first candidate in exactly the same way as they mark the last.
- Mark schemes should be applied positively. Candidates must be rewarded for what they have shown they can do rather than penalised for omissions.
- Examiners should 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

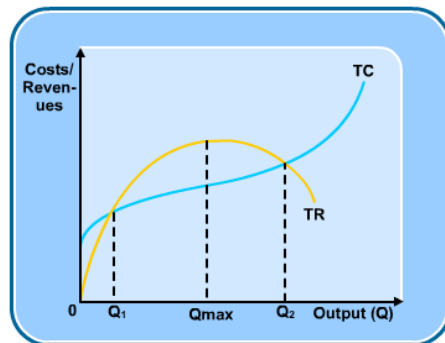
NB: Use levels based mark scheme (20 marks) to mark this section.

Question Number	Answer	Mark
1	<p>Indicative content</p> <p>Define: private sector businesses, short run & long run</p> <p>Explanation of profit maximisation, may include:</p> <ul style="list-style-type: none"> • MC = MR defined and explained (Accept TR – TC at maximum value) • Profits will be lower at any other output level • Distinction between normal and supernormal profit • Diagram to show equilibrium price and output (can be perfect competition or monopolistic competition or monopoly – short or long run) • A possible diagram may show: MC = MR for a perfectly competitive firm (short or long run) <p>e.g. long run perfect competition – firm makes normal profit where MC = MR</p> <div data-bbox="550 1265 1109 1892" style="text-align: center;"> <p>In the long run the firm operating under perfect competition is allocatively and productively efficient at point A, where $P = MC$, and $ATC = MC$</p> <p>Copyright: www.economicsonline.co.uk</p> </div>	(20)

OR: for a monopolist – a choice of outputs is possible. OQ shows profit max. but OR shows sales max making normal profit ($AC = AR$)



OR: a TR,TC diagram to show profit maximisation where $TR - TC$ is maximised



A business may seek to gain market share by using branding, limit pricing, predatory pricing – may be at the expense of profit maximisation

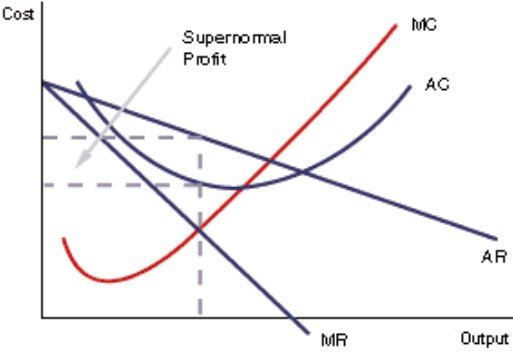
Evaluation:

- Other business objectives – e.g. revenue maximisation, sales maximisation, behavioural – may be more important
Reasons why – sales or revenue maximisation to gain market share and limit opportunities for competitors (see monopoly diagram above)
behavioural – divorce between ownership and control, goals of managers vs shareholders
- Distinction between short and long run – under perfect competition or monopolistic competition firms can only make normal profit in the long run (profit max.) so this **must** be a long term objective – may be shown on the diagram

	<ul style="list-style-type: none">• For a monopolist/oligopolist other objectives may be as important – e.g. sales maximisation where $AR = AC$. Use of predatory pricing to achieve this objective• The business may be receiving financial support from the government• High profits may attract government attention – so an incentive to keep profits lower. The market may be contestable so a monopolist can choose to earn normal profit to deter potential entrants• Difficulty in determining profit maximising price and output values in the real world	
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Question Number	Answer	Mark
2	<p>Indicative content</p> <ul style="list-style-type: none"> • Definition of conglomerate – firm expands into different markets/industries • Explanation of the term demerger – selling off a part of the business • Possible impact : <ul style="list-style-type: none"> - Lower LRAC as the business was previously experiencing diseconomies of scale - The business becomes more efficient – less x-inefficiency - Increase in profits as a result of lower LRAC - Increase in funds through the sale of assets - The firm avoids intervention from the competition authorities - The firm uses funds raised to invest in more R & D and becomes more dynamically efficient • Diagram to show impact of the decision. The firm is currently experiencing diseconomies of scale - output OQ on LRAC curve. Following demerger output falls to OR – movement along LRAC and to the left. Therefore a fall in LRAC – with a move towards MES. AC falls from OB to OC <div data-bbox="571 1115 1104 1594" style="text-align: center;"> <p>Copyright: www.economicsonline.co.uk</p> </div>	(20)

	<p>Evaluation</p> <ul style="list-style-type: none">• The impact on economies/diseconomies of scale – may be the most important factor as it affects the business in the long run• Raising of funds through sale- the impact depends on how the funds are used – e.g pay outstanding costs or debts (more short term) compared with used for further investment (more long term)• Firm may regret decision (in long run) – demerged component performs well under new ownership, undervalued market price at time of sale• May result in the firm no longer being large enough to fully exploit benefit from economies of scale – it is now smaller than MES• The firm is no longer spreading the risk so it is more vulnerable to changing demand and the success of its competitors	
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Question Number	Answer	Mark
3	<p>Indicative content</p> <p>Definition of collusion – where firms agree to co-operate in their pricing and output policies. Applies where the market is an oligopoly.</p> <p>Collusion provides firms with the ability to fix prices and limit output</p> <p>Impact on firms may include:</p> <ul style="list-style-type: none"> • Ability to each earn higher supernormal profits  <ul style="list-style-type: none"> • Barriers enable firms to restrict competition • Reduces unpredictability and uncertainty in the market • RESPONSES MAY EXPLORE THE IMPACT ON FIRMS WHICH ARE NOT PART OF THE COLLUSIVE AGREEMENT – lower market share, potential losses, leave the market etc. <p>Impact on consumers may include:</p> <ul style="list-style-type: none"> • Higher prices • Less choice • Fall in consumer surplus <p>NB: The likely impact on BOTH firms AND consumers must be considered</p>	(20)

	<p>Evaluation</p> <ul style="list-style-type: none">• Increased profits to firms and greater certainty may encourage firms to increase R and D leading to improved products for consumers• Firms may compete using non-price methods – special offers, loyalty schemes etc.• Prices may be less volatile making it easier to plan future consumer expenditure• Impact on consumers depends on value of PED – e.g. availability of substitutes• Benefits are more likely to apply to firms than consumers – rise in producer surplus at the expense of consumers• Benefits to firms may be short-lived if one or more colluding firms break away from the agreement• Falling demand creates tension between firms e.g. during an economic downturn• The entry of new firms into the industry may break existing collusive agreements• Exposure of illegal price fixing by the government or other regulatory agencies causes agreements to end• Any consumer benefits from R & D are likely to apply mainly in the long run	
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Question Number	Answer	Mark
4	<p>Indicative content</p> <ul style="list-style-type: none"> • Types of government intervention may include <ul style="list-style-type: none"> - Local sourcing - Joint ventures with local businesses - barriers to entry to foreign firms - subsidies to domestic firms - improvements to the infrastructure - limits on monopsony power – e.g. minimum price for suppliers • Reasons for government intervention may include: <ul style="list-style-type: none"> - to stimulate growth and employment in the local economy - to promote competition - to reduce the power of monopsonists • Effects may include: <ul style="list-style-type: none"> - “fairer” prices for suppliers (supermarkets, fair trade) - employment opportunities due to higher returns and more trade for suppliers - reduced power of monopsonies - prevents suppliers from leaving the market - reduces exploitation of employees of the suppliers <p>Evaluation</p> <ul style="list-style-type: none"> • Positive benefits to the economy in terms of growth, competition and employment • Distinction between SR and LR – is the support for suppliers 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? • Might be perceived as a form of protectionism and provoke retaliation • May result in higher prices for domestic consumers • Monopsonists decide to buy from other sources • The possibilities of government failure – costs outweigh benefits 	(20)

Section A Questions: Performance Criteria for Mark base 20

Level 0	0	<ul style="list-style-type: none"> • No rewardable material
Level 1	1-4	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none"> • 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	<ul style="list-style-type: none">• 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.
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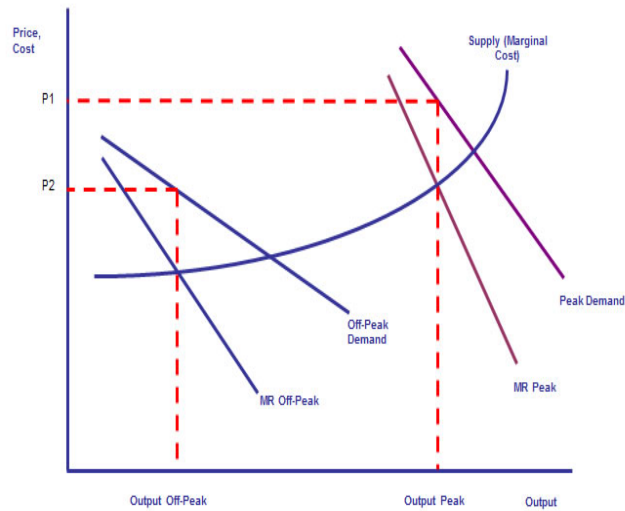
Section B: Data response

Question Number	Answer	Mark
5(a)	<p>Knowledge and Application (up to 4 marks)</p> <p>Knowledge – up to 2 marks Define profit: – the difference between total revenue and total cost (2); the value of what is left once all costs have been paid for (2) Imprecise definition will score 1 mark A fall in profit occurs if the gap between revenue & costs widens - falling revenue/rising costs (2) Inverse relationship between price and quantity demanded PED and the effects on revenue</p> <p>Application – up to 2 marks: Fall in demand for car insurance due to higher prices – fewer young people willing to drive especially young female drivers The lower premiums for young male drivers may have adversely affected LV's profits The car insurance market may have become more competitive – new entrants, price wars, LV not able to compete effectively LV may have experienced rising costs More competition may lower profit levels for LV</p>	(4)

Question Number		Mark
5(b)		(12)
Knowledge, Application and Analysis – Indicative content		
	<p>Extract 1 refers to a wide range of fares for this journey.</p> <p>Many candidates will answer this question by looking at price discrimination. However, a product differentiation approach is equally valid – the distinction between first class and second class journeys, choice of route etc. Either approach is likely to develop an answer based on different demand conditions/price elasticities</p> <ul style="list-style-type: none"> - The effect on revenue depends on how demand responds to the different prices -price elasticity of demand • Conditions necessary for Price Discrimination – monopoly power; different PED's of consumer groups; supplier able to split, and maintain separation of, the distinct consumer groups (no switching between consumers). • Apply to the data -the company is charging higher prices to those consumers whose demand is relatively inelastic and lower prices to those consumers whose demand is relatively elastic e.g. Blackpool –London £16.50. • Diagram <div data-bbox="507 1339 1177 1832" style="text-align: center;"> <p>Costs & Revenue</p> <p>Copyright: www.economicsonline.co.uk</p> </div>	

An alternative approach – using marginal cost – upward sloping supply curve)

- lower marginal cost where lots of spare capacity (off peak and elastic demand) – charging P2, higher MC at peak times (and inelastic demand) – adding more coaches or additional trains to meet demand – charging P1



Level	Marks	Descriptor
0	0	A completely inaccurate response.
1	1-3	Shows some awareness of the concept(s) of demand/price discrimination/product differentiation. 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 concept(s) of demand/price discrimination/product differentiation, 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 concept(s) of demand/price discrimination/product differentiation 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		
	<p>An increase in revenue will depend on:</p> <ul style="list-style-type: none"> • The extent to which it can maintain the 3 conditions necessary for price discrimination to apply • Whether other train operators/coach companies enter the market and provide a similar service <p>The company's ability to price discriminate will be diminished where: -</p> <ul style="list-style-type: none"> • There are price controls set by regulatory bodies • There is public/media/consumer group/government pressure opposing the large number of prices for the same journey 	
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	Answer	Mark
5(c)		(12)
Knowledge, Application and Analysis – Indicative content		
	<p>Appropriate forms of government intervention – for example: maximum price, legislation, deregulation.</p> <ul style="list-style-type: none"> • Maximum price – restricts the ability of firms to charge very high prices to some consumers • Legislation – direct intervention to prevent firms from “discriminating” (as in the car insurance case – Extract 2) • Deregulation – allowing more firms to compete in the market, restricting the power of a firm to price discriminate <p>Benefits to consumers –</p> <ul style="list-style-type: none"> • lower prices for some consumer groups and a gain in welfare – a rise in consumer surplus for those groups e.g peak time rail users • simplified pricing structures – evidence from Fig. 1 & extracts 1 & 2 • may result in a greater choice of providers if powers of existing providers are restricted 	
Level	Marks	Descriptor
0	0	A completely inaccurate response.
1	1-3	Shows some awareness of the positive effects of government intervention to restrict the practice of price discrimination. 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 positive effects of government intervention to restrict the practice of price discrimination, 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 positive effects of government intervention to restrict the practice of price discrimination 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		
	<ul style="list-style-type: none"> • May increase prices for some consumer groups – e.g women drivers in the European Union (Extract 2) • May discourage the firm from offering low price deals to consumers with elastic demand • May result in a fall in supply and in the long run discourage investment which may have lead to lower costs and prices • Legislation may be difficult to monitor and enforce leading to high administration costs 	
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	Answer	Mark
5(d)		(12)
Knowledge, Application and Analysis – Indicative content		
	<p>Nature of market structure – railways display features of a <u>natural monopoly</u>. Factors limiting competition may include:</p> <ul style="list-style-type: none"> -Very high capital (sunk) costs – deter entry & exit - Duplication of resources – trains, track, stations etc. is unnecessary and wasteful - MES occurs at a very high level of output (from extract -long trains carrying a lot of passengers) – productive efficiency. More efficient to have one producer. <p>Diagram of natural monopoly</p>	
Level	Marks	Descriptor
0	0	A completely inaccurate response.
1	1-3	Shows some awareness of the factors restricting the possibilities of competition. 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 factors restricting the possibilities of competition, 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 factors restricting the possibilities of competition 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		
	<ul style="list-style-type: none"> • A method of competition exists in the form of franchising. The degree of competition depends on: <ul style="list-style-type: none"> – the number of bidders - how long the franchise lasts for – a shorter time span would increase competitive pressure -the extent of government controls (regulatory powers) of the franchisee. • Competition applies to the running of the service (e.g. trains) but would be allocatively inefficient if applied to the infrastructure (track, signalling etc). • Price and quality of other transport services (eg road (bus, private car) and air travel, can exert competitive pressures on rail services. Competitive demand and the degree of substitutability. 	
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	Answer	Mark
6(a)	<p>Knowledge and Application (up to 4 marks)</p> <p>Knowledge: up to 2 marks Definition of FDI – overseas capital investment into an economy (2) Imprecise definition for 1 mark e.g. refers to buying shares (portfolio investment) Reasons – e.g. a means of expanding; to take advantage of lower cost locations 1 mark per reason given</p> <p>Application: up to 2 marks FDI growing in China but falling in India (1) A more detailed comparison of the 2 trends - e.g. both FDI's fell in 2009 followed by a subsequent sharp rise for China whilst further decline for India FDI into China has risen by \$78.3b or 44.7% whereas FDI into India has fallen by \$18.1b or -41.7%. India's FDI was 24.8% of China's in 2008 and 10% of China's in 2013. Any other valid calculations for 2 marks China's emergence as a major economy; significant market opportunities for international businesses with a growing market of Chinese consumers - more so than in India 2 marks for any applied reason</p>	(4)

Question Number	Answer	Mark
6(b)		(12)
Knowledge, Application and Analysis – Indicative content Benefits – <ul style="list-style-type: none"> • Ikea can increase profits/revenues • Ikea can expand into economies where costs are lower – examples from Extract 1 • Opens up access to more markets – emerging markets from Extract 1 • Spreads risk of failure • Less vulnerable to trade barriers – fewer imports • Locate nearer to markets – lower transport costs • More scope for economies of scale & competitive advantage • May operate transfer pricing to reduce tax liabilities • Avoids tougher legislation in other economies • Increases its brand identity 		
Level	Marks	Descriptor
0	0	A completely inaccurate response.
1	1-3	Shows some awareness of the potential benefits of growing as a TNC. 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 growing as a TNC, 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 growing as a TNC, 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		
		<ul style="list-style-type: none"> • Initial high costs • Short term losses – only started to make profit after making big price cuts • Unfamiliarity with markets/economies – laws, customs, tastes etc • Potential diseconomies of scale • Resistance from local consumers • Having to contend with bureaucracy – paperwork etc.
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	Answer	Mark
6(c)		(12)
Knowledge, Application and Analysis – Indicative content		
	<p>Measures to attract FDI (TNCs) may include domestic governments:</p> <ul style="list-style-type: none"> • Offering tax advantages – exemptions, lower rates • Providing other financial incentives (grants, subsidies etc.), especially for exports and R & D • Removing excessive paperwork and administrative barriers • Funding improved infrastructure • Removing trade barriers • Increasing flexibility in markets (including labour markets) • Loan guarantees and lower interest rates 	
Level	Marks	Descriptor
0	0	A completely inaccurate response.
1	1-3	Shows some awareness of measures used to attract FDI (TNCs) into an economy 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 measures used to attract FDI into an economy 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 measures used to attract FDI into an economy with effective application. 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		
	<p>Ranking of measures – some measures may be implemented quickly – financial incentives, tax advantages but others may be more effective longer term – e.g. supply side measures such as improved infrastructure, labour flexibility</p> <p>Many measures have cost implications for the government</p> <p>Effectiveness of measures depends on:</p> <ul style="list-style-type: none"> -The relative level of incentives on offer – how they compare with “rival” economies -The level of confidence in the economy - present and future -The pace of economic reform and development– e.g. China, India -Political and economic stability -Degree of opposition to TNC activity from pressure groups 	
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	Answer	Mark
6(d)		(12)
Knowledge, Application and Analysis – Indicative content		
	<p>Methods of government control:</p> <ul style="list-style-type: none"> • Tightening up on tax laws – making it more difficult for TNCs to avoid taxes, reducing opportunities for transfer pricing – refer to Extract 3 • Tighter legislation and regulation of TNCs' activities – employment laws, health & safety • Competition policy – encouraging domestic firms to compete or restricting market powers of TNCs • Price controls <p>Role of pressure groups –trade unions, charities and faith groups (Extract 3), Greenpeace (e.g. BP oil spills)</p> <ul style="list-style-type: none"> • Campaigns, TU action, protests, consumer campaigns e.g. Fair Trade • Public pressure, adverse media coverage- Nike changing suppliers following "sweatshop" disclosure <p>TNCs may alter behaviour as a result – public image, longer term economic benefits, ethics.</p>	
Level	Marks	Descriptor
0	0	A completely inaccurate response.
1	1-3	Shows some awareness of the effects of government control and/or pressure groups. 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 government control and/or pressure groups, 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 government control and pressure groups 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		
	<ul style="list-style-type: none"> • Some TNC's are very powerful – will often require concerted joint international action (Extract 3) • Governments may be concerned of the threat of TNCs pulling out of the economy – negative consequences on jobs, incomes etc. • Difficulties of imposing <i>national</i> laws and regulations on <i>transnational</i> organisations • Ability of pressure groups to influence depends on different factors including: - size of group, local, national or international influence, media coverage, TU strength, government support (national/international) • Willingness of TNCs to comply 	
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.

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