

Question 1

The New Normal for China: Internal and External Shifts

Suggested Answers

(a)	Using Figure 1, describe the trend in real Gross Domestic Product for China from 2010 to 2012. [2]
	The real Gross Domestic Product (GDP) increased from 2010 to 2012. [1m] It increased at a decreasing rate. [1m]
(b)	Use AD/AS analysis to explain the views that
(i)	‘anything below 8 percent would put job creation in jeopardy’ (Extract 1) in China. [2]
	The rise in AD leads to actual growth in the economy. As output increases, firms would demand for more factors of production including labour. [1m] According to the Chinese leadership, with an economic growth of at least eight percent, the increase in output in the economy would be able to create enough jobs sufficiently for an expanding labour force in China that leads to an increase in AS. [1m]
(ii)	there is ‘less urgency for the Chinese government to subsidise the cost of electricity, water and oil for producers’ (Extract 1). [3]
	<u>Higher cost of production affect output and general price level</u> A higher cost of production at all levels of output in the economy will result in a fall in the SRAS, causing a rise in general price level and a fall in real national output. The rise in general price level will lead to inflation while the fall in real national output will lead to lower growth rate. [1m] <u>This is less urgency for the Chinese government to subsidise cost of electricity, water and oil for producers.</u> Since the Chinese government is allowing for a slower growth rate and higher inflation rate of around 5 percent [1m], there is no urgent need for the government to subsidise the cost of electricity, water and oil to reduce the fall in SRAS. [1m]
(c) (i)	Explain the meaning of labour force. [1]
	Labour force refers to the number of people of legal working age, who are willing and able to work.
(ii)	Account for the ‘barely growing’ (Extract 1) labour force in China. [2]
	Reason with reference to Extract 1: Demographic change in China – As the population starts to age, more people in the labour force are reaching the retirement age. With the one-child policy, the number of people entering the labour force is increasing at a slower rate than the people leaving the labour force, hence there is a slow growth in the labour force in China. Reason with reference to Extract 2: The people in China could have abandoned the hope of finding jobs, especially the college graduates. As the number of people who are actively looking for work decreased, it could possibly lead to a slow growth in the labour force in China. Either one reason – 2 marks

(d)	(i)	Using AD/AS analysis, explain the possible trade-off between inflation and unemployment. [2]
		An increase in AD will lead to a rise in both real national output and general price level. As the level of output increases, firms would employ more factors of production, including labour. [1m] Hence during periods of economic growth, cyclical unemployment rate decreases, while demand-pull inflation rate increases, and vice versa. Hence, a higher rate of inflation will result in a lower unemployment rate. [1m]
	(ii)	Comment on whether Table 1 shows such a trade-off in China. [2]
		<p><u>Table 1 did not show a trade-off between inflation and unemployment</u> Table 1 shows that the unemployment rate does not seem to change much over the period 2008-2014 while the inflation rate ranges from -0.7% to 5.9%. Hence it suggests that inflation and unemployment are unrelated. [1m]</p> <p><i>[Note: Do not accept inverse relationship that holds for one year. It should be for the entire time frame. Candidates should realise that unemployment had barely changed over the period]</i></p> <p><u>Comment on possible explanation of the data</u> Eg. Fall in SRAS will lead to a rise in both inflation and unemployment hence Table 1 did not demonstrate an inverse relationship between inflation and unemployment. [1m]</p>
(e)		Discuss whether China should be concerned about unemployment as she enters the 'new normal' growth stage. [6]
		<p><u>Introduction</u> This essay will discuss China should be concerned about unemployment as she enters the 'new normal' growth stage.</p> <p><u>Thesis 1: Unemployment (in general) might be a concern in China</u> With the 'new normal' growth stage, AD will be rising slower. There might be a chance that AD will not be rising at least in tandem of LRAS due to changing size of labour force. As such, there might still be issues with unemployment.</p> <p>Economic Implication: It means that the economy will be performing below full employment.</p> <p><u>Thesis 2: Structural unemployment might be a concern in China</u> However there could be structural unemployment in China as the skills of the graduates may not be relevant to the needs of the industries in China. The number of college-educated (or university graduates) labours has increased tremendously from 1998 to 2012 due to the government decision to expand the higher-education system in 1999. However these university courses may not produce the necessary knowledge and skills that are specific to the industries, leading to high unemployment among them.</p> <p>In addition, structural unemployment due to geographical immobility also present in China.</p> <p>There could be government failure in identifying the relevant courses to meet the industry needs. If this is not resolved structural unemployment could persist and become a major issue.</p> <p>Evidence: "A full quarter of recent college graduates in China are unemployed... And many of those who are employed end up working in jobs that are nothing near what they have studied in their undergraduate days."</p> <p>Economic Implication : There will issue with underemployment.</p> <p><u>Thesis 3: Frictional unemployment might be a concern in China</u> Furthermore, with more jobs being created in the economy, it does not mean that most of the workers would be employed. This is due to imperfect information, leading to frictional unemployment in China.</p> <p>Evidence: "being a large country like China, it is common that some graduates are unwilling or do not possess the necessary information to land them their first job in other parts of the country."</p>

Economic Implication: This is because having a large number of unemployed graduates would mean that **resources are not being utilised, leading to a loss in output**. In addition, if these workers are not employed for a long period of time, they will need to seek help from the government for financial assistance, which is a **strain on the Chinese government's budget**. Besides, there could be **social problems** associated with the high level of unemployment among the graduates. The structural unemployment could be worsened in view that China is a very big country and there is geographical immobility of labours. Therefore a high level of structural unemployment might be a concern for China

Anti- thesis: Unemployment (in general) might not be a concern in China

Unemployment as a whole may not be a major issue. Table 1 shows that unemployment rate is around 4% from 2008-2012 and is also projected to be around 4% in 2013 and 2014. Moreover, there is a shortage of labour in some provinces in China. This implies that the labour market in general could be very tight and unemployment may not be a major issue. Furthermore, as the Chinese economy achieves actual growth due to the rise in AD, more jobs would be created, leading to a rise in demand for labours, hence maintaining a low unemployment rate of around 4%. This imply that majority of the labour force are being employed and are able to maintain a minimum standard of living. Therefore unemployment might not be a concern in China.

Mark Scheme

L3	5 - 6m	Good discussion on the types of unemployment with sufficient or good implications to the economy. Provided good evaluations and sound judgment. Excellent use of data.
L2	3 - 4m	Able to explain the types of unemployment in the data with little implications to the Chinese economy. Little or no attempt at evaluating the material. Max 3m for a lopsided answer
L1	1 - 2m	Only identifying the types of unemployment with no implications to the Chinese economy to show illustrate the concerns. Weak attempt in answering the question requirement. Major conceptual errors might be evident. Descriptive answer without economic concepts or answer that is mostly irrelevant or has little or no reference to data.

(f) (i) **Using Figure 2, describe the trends in China monthly trade balance from 2009 to early 2012. [2]**

The trade balance with US had been in a increasing surplus throughout

Trade balance with the rest of world was in a surplus from 2009 to 2010 before experiencing deficit for most months from 2010 onwards.

(ii) **Discuss whether the alleged undervaluation of the Yuan is the major reason behind China's growing trade imbalance with the United States. [8]**

Introduction

China has enjoyed a trade surplus against the United States (US) from 2005 to 2012, with reference to Figure 4.

Thesis: The alleged undervaluation of the Chinese yuan is the reason behind China's growing trade imbalance with the United States

There is a common sentiment among the producers in the US to request for a major revaluation of the Yuan. This suggests that the Yuan could be undervalued against the US dollar. This would make Chinese exports relatively cheaper in terms of US dollar, while US imports relatively more expensive in terms of Chinese Yuan. Therefore a cheaper Yuan against the US dollar will allow China to enjoy a balance of trade surplus against the US. This is evident as shown in Figure 2, China's trade surplus against US would continue to increase.

Anti-thesis 1: The Chinese Yuan has appreciated since 2006 hence this is not the reason behind China's growing trade imbalance with the United States

However the Yuan had appreciated against the US dollar by almost 30 percent since 2006. This implies that the Yuan may not be too undervalued against the US dollar. Instead, Chinese exports have increasingly become more expensive in terms of US dollar hence the exchange rate movement is not the reason behind China's growing trade surplus against the US.

In addition, Figure 2 shows that China's balance of trade deficit with the world excluding US has increased from 2005 to 2012. This shows that China's Yuan may not be undervalued and the growing trade imbalance with the US may not be due to the exchange rate movement.

Other reasons to explain China's growing trade imbalance with the United States – US's high level of consumption of imported goods

There could be other reasons for China's growing trade imbalance with the US. The trade imbalance could be caused by US's high level of consumption and the use of China as a production base.

The US government has implemented expansionary fiscal policy and monetary policy through Quantitative Easing (QE). The expansionary fiscal policy is implemented via a rise in government's expenditure, leading to a rise in AD, resulting in a rise in real national output in the US. The rise in the output has increased the demand for factors of production including labour, leading to a fall in the level of unemployment. As mentioned in Extract 3, the US economy has grown for more than three years and unemployment rates had been falling. The consumers in US are very optimistic that the economy would continue to grow and thus the level of consumer expenditure is likely to rise.

This might lead to a rise in import expenditure from other countries such as China. The two rounds of QE would also encourage the US consumers to purchase more consumer durable goods such as cars, electronic goods and household appliances which are imported from China. Hence this will increase the export revenue of China, at the expense of US, creating China's growing trade imbalance with the US.

Evaluation: However the US government may decide to scale back the fiscal expansion, halt further QE policies and possibly raise the interest rates in the latter half of 2012. This would slow down the rise in the income level of the US consumers, and reduce the consumption of imported goods from China. Hence this might reduce US's trade deficit with China.

Other reasons to explain China's growing trade imbalance with the United States – China as an export centre

China entered the World Trade Organisation in 2001 and soon became the assembly plant for the world. With abundant supply of labour that process high level of productivity, China has a comparative advantage in the production of manufactured goods, especially goods which are labour intensive. Hence many multinational companies have moved their production plants to China and use China as an export centre to export goods to the rest of the world such as the US. As China exports more goods to US, the trade surplus against US would rise, resulting in China's growing trade imbalance with the US.

Evaluation: As wages rises in China, its role as a production base for East Asia might diminish if firms decide to move another place in Asia such as Vietnam or Indonesia.

Conclusion

In conclusion, it is unlikely that the external value of the Yuan is the major reason behind China's growing trade imbalance with the United States as the Yuan has appreciated against the US dollar since 2006. The trade imbalance is more likely to be caused by the rising import expenditure by the US residents and the establishment of production plants in China due to her comparative advantage.

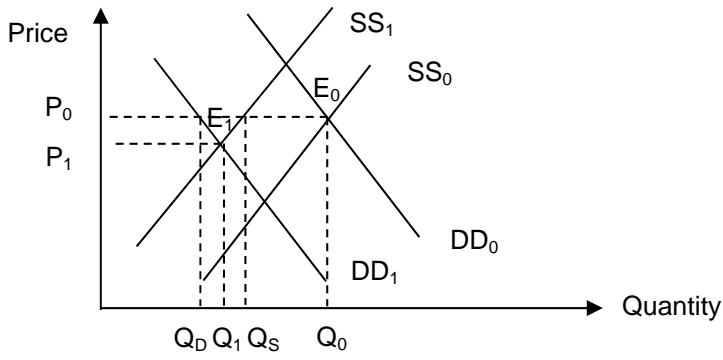
Mark Scheme

L3	Balanced and well developed economic analysis, based on the case material. Good economic analysis of how the 3 factors attribute to the changes in trade imbalance.	6-8
L2	Some balance in answer. Able to give some economic analysis in the 3 factors to explain the trade imbalance between China and US.	4-5
L1	Descriptive answer without much reference to economic analysis. Good explanation centered on exchange rate alone, max 3 marks	1-3

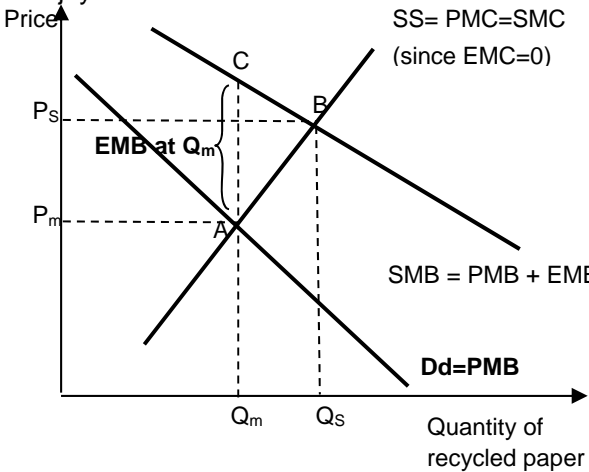
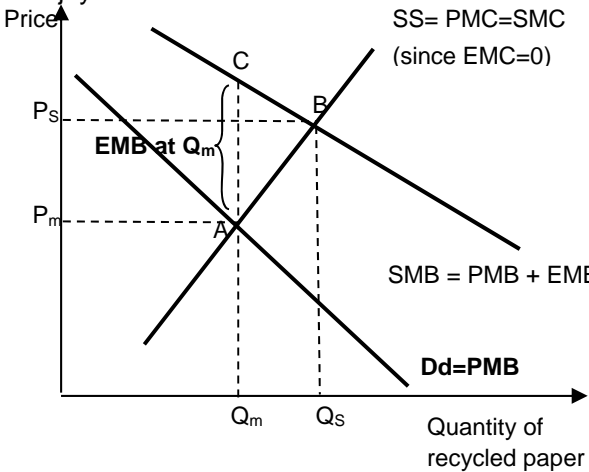
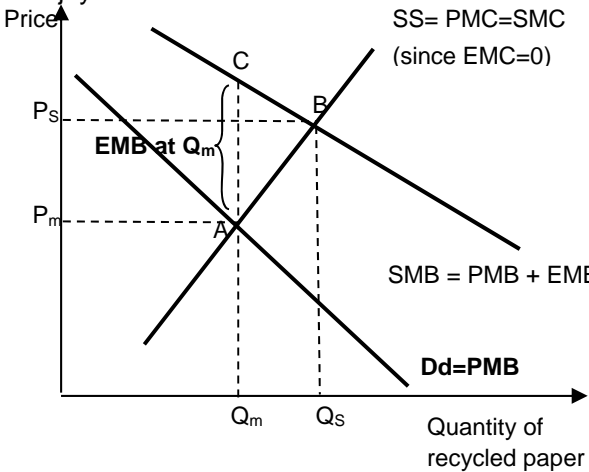
Question 2

Paper Industry and Paper Recycling

Suggested Answers

(a)	(i)	Compare China's and the world's consumption of paper and paperboard between 2008 and 2012 in Table 3. [2]
		<p>Similarity: <u>Both</u> China's and the world's consumption of paper and paperboard between 2008 and 2012 <u>increased</u>. [1m]</p> <p>Difference: <u>However</u>, China's consumption increased at a <u>faster rate</u> (25.14%) than that of the world's (2.33%). [1m]</p> <p>OR: <u>However</u>, China's consumption <u>consistently increased</u> while the world's consumption <u>fell</u> in 2009 and 2012. [1m]</p>
	(ii)	Account for China's trend in part (a)(i). [2]
		<p>China's demand for paper and paperboard increases due to rising exports/ greater domestic consumption that require packaging. Hence as demand for exports/ domestic goods increases, <u>derived demand</u> for packaging increases, leading to increasing consumption of paper and paperboard. Evidence: Extract 1 "China, as one of the world's largest exporters, has seen a surge in demand for packaging paper" or "greater domestic consumption".</p> <p>OR: Evidence: Extract 1 "rises in per capita demand" or "rising incomes and the burgeoning middle class". When income increases, demand for paper and paperboard increases as they are <u>normal goods</u>, hence consumption increases.</p>
(b)		With reference to Tables 2 and 3,
	(i)	explain whether China is a net importer or exporter of paper in 2012. [1]
		In 2012, China is a net exporter of paper and paperboard as production of paper and paperboard is <u>more</u> than consumption.
	(ii)	use a diagram to explain how world price of paper and paperboard might have changed between 2008 and 2009. [4]
		 <p>1m for diagram</p> <p>Between 2008 and 2009, world production (supply) decreased by 19.2 million tonnes, shown by a leftward shift in supply curve from S_0 to S_1 [1m] while world consumption (demand) decreased by 21.7 million tons, shown by a leftward shift in demand curve from D_0 to D_1. [1m] The decrease in demand is more than the decrease in supply hence price would likely decrease to P_1. [1m]</p>

(c)	Extract 4 says that Chinese producers are facing stiff resistance in the form of rules in developed countries to control the flow of paper from cheaper producers.							
	(i)	Comment on whether the protectionist measure by the developed countries is justified. [3]						
		<p>The above action is a form of protectionism to prevent the Chinese producers from exporting papers to developed countries, probably via the imposition of quotas.</p> <p>The action is justified if it can be proven that China is guilty of ‘dumping’. Define Dumping. [1]</p> <p>However, the low prices of Chinese papers might actually be due to the abundance of land and labour in China, which means that China has comparative advantage, i.e. lower opportunity cost, in paper production and is hence not guilty of dumping. [1]</p> <p>There is insufficient evidence provided in the data to suggest whether the above action in the developed countries is justified. [1]</p>						
	(ii)	Using AD/AS analysis, consider the impact of the above actions on the developed countries. [6]						
		<p>The imposition of quotas on paper will restrict the level of imports into the developed countries by making imported papers more expensive. Hence, import expenditure on final goods (i.e. printing and writing papers) will fall. $AD = C+I+G+X-M$ will increase. As firms face an unplanned fall in stocks when AD falls, they will increase production by hiring more factors of production (e.g. labour), leading to a fall in cyclical unemployment. There will be a multiple rise in national income from Y0 to Y1 via the multiplier effect, hence leading to actual economic growth. However, the general price level will increase if the country is approaching full employment, leading to demand-pull inflation.</p> <p>Moreover, the costs of production may increase as corrugated boxes are needed by most firms for packaging. Hence, when prices of paperboard increases, costs of production increase, leading to a fall in SRAS. This will cause a fall in real national income from Y0 to Y2, slowing down actual growth and increasing unemployment. The general price level will also increase from P0 to P2, resulting in cost-push inflation.</p> <p>The overall impact on the economy depends on the extent of the shift in AD and AS. If AD increases more than AS falls, there will be beneficial effects on economic growth and employment level. Conversely, if AD increases less than AS falls, there will be adverse effects.</p> <p>There will definitely be greater inflationary pressures when AD rises and AS falls.</p> <p>Externally, $BOP = CA + FA$ will improve as BOT improves, assuming ceteris paribus.</p> <p>Mark Scheme</p> <table><tr><td>L3 (5-6)</td><td>Excellent explanation with economic analysis using diagram(s) Considered impact on both AD and AS Considered impact on the macroeconomic aims (at least 3) of developed countries</td></tr><tr><td>L2 (3-4)</td><td>Explained using economic analysis but explanation might not be detailed enough. Considered impact on AD and/or AS. Considered impact on the macroeconomic aims (at least 2) of developed countries</td></tr><tr><td>L1 (1-2)</td><td>Weak attempt in answering the question requirement. Major conceptual errors might be evident. Descriptive answer without economic concepts or answer that is mostly irrelevant or has little or no reference to data.</td></tr></table>	L3 (5-6)	Excellent explanation with economic analysis using diagram(s) Considered impact on both AD and AS Considered impact on the macroeconomic aims (at least 3) of developed countries	L2 (3-4)	Explained using economic analysis but explanation might not be detailed enough. Considered impact on AD and/or AS. Considered impact on the macroeconomic aims (at least 2) of developed countries	L1 (1-2)	Weak attempt in answering the question requirement. Major conceptual errors might be evident. Descriptive answer without economic concepts or answer that is mostly irrelevant or has little or no reference to data.
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(d)	To what extent would the change in price of rice in Figure 3 affect the production of paper in Thailand? [4]				
	<p>The price of rice has shown an increasing trend over the years. Rice and paper-tree are competitive in supply as they use the same resources in production (e.g. land and labour) such that when the resources are used to produce rice, they cannot be used to produce trees (Extract 5: convert farm lands ... to tree plantations). This means that when the price of rice increases, the quantity supplied increases. Hence, to increase rice production, farmers might divert resources used in tree production to the production of rice. Therefore the production of tree might fall. [2m]</p> <p>However, according to Extract 5, Double A Paper-Trees are planted “along KHAN-Na, the unused space between rice paddies” hence rice and paper-tree are not competitive in supply as they might not use the same resources in production – the land is unused space while the farmers only cut the matured trees during off peak season. Also, there is no statistics on what proportion of paper production in Thailand is actually produced from trees using land that were previously designated for planting rice. Hence, to a large extent, the increase in price of rice might not affect the production of paper in Thailand. [2m]</p>				
(e)	In the light of the data provided, if you were an economic advisor to the Thai government, would you recommend that it should intervene in the market for recycled paper. [8]				
	<p>Introduction Government should only intervene if there is market failure and/or when it wants to achieve certain macroeconomic goals. I shall now assess whether the Thailand government should or should not intervene in the market for recycled paper.</p> <table border="1"> <thead> <tr> <th data-bbox="177 907 837 974">Thesis – Should intervene in the market for recycled paper</th><th data-bbox="837 907 1476 974">Anti-thesis – Should not intervene in the market for recycled paper.</th></tr> </thead> <tbody> <tr> <td data-bbox="177 974 837 2130"> <p>1. The consumption of recycled paper generates external benefits to third parties who are not part of the production or consumption process. Hence, this is a case of a positive consumption externality. As mentioned in Extract 6, the external benefits includes less energy and water consumption, and less trees being felled to produce virgin papers leading to better biodiversity. However, the third parties do not compensate the users of recycled papers for the environmental/ external benefits (EMB) they enjoy.</p>  <p>Explain how the market equilibrium quantity Q_m, will be less than the socially efficient quantity Q_s, leading to underconsumption of recycled papers by $Q_s - Q_m$ and DWL, hence social welfare is not maximized and there is a need for government intervention.</p> </td><td data-bbox="837 974 1476 2130"> <p>1. It is difficult to estimate the size of the EMB correctly so as to achieve Q_s. Given that “most major pulp and paper producers are implementing more environmentally friendly business practices” (Extract 5), the extent of the EMB might not be as significant as what the environmentalists are suggesting.</p> <p>By intervening in the market for recycled paper, there might be a case of overconsumption if the EMB is estimated overly high and resources would still be misallocated. To show using diagram (high vs low EMB).</p> <p>Evaluation: Given that the recycling rate in Thailand is only 22% compared to Singapore’s 60%, it is unlikely that Thailand has done enough to encourage recycling and the use of recycled paper. So even if EMB is not as high as estimated, it is unlikely that the current effort will increase demand and consumption beyond the socially efficient level.</p> </td></tr> </tbody> </table>	Thesis – Should intervene in the market for recycled paper	Anti-thesis – Should not intervene in the market for recycled paper.	<p>1. The consumption of recycled paper generates external benefits to third parties who are not part of the production or consumption process. Hence, this is a case of a positive consumption externality. As mentioned in Extract 6, the external benefits includes less energy and water consumption, and less trees being felled to produce virgin papers leading to better biodiversity. However, the third parties do not compensate the users of recycled papers for the environmental/ external benefits (EMB) they enjoy.</p>  <p>Explain how the market equilibrium quantity Q_m, will be less than the socially efficient quantity Q_s, leading to underconsumption of recycled papers by $Q_s - Q_m$ and DWL, hence social welfare is not maximized and there is a need for government intervention.</p>	<p>1. It is difficult to estimate the size of the EMB correctly so as to achieve Q_s. Given that “most major pulp and paper producers are implementing more environmentally friendly business practices” (Extract 5), the extent of the EMB might not be as significant as what the environmentalists are suggesting.</p> <p>By intervening in the market for recycled paper, there might be a case of overconsumption if the EMB is estimated overly high and resources would still be misallocated. To show using diagram (high vs low EMB).</p> <p>Evaluation: Given that the recycling rate in Thailand is only 22% compared to Singapore’s 60%, it is unlikely that Thailand has done enough to encourage recycling and the use of recycled paper. So even if EMB is not as high as estimated, it is unlikely that the current effort will increase demand and consumption beyond the socially efficient level.</p>
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<p>2. It was mentioned in Extract 6 that “recycling is an economically attractive option... raising living standards... and creating skilled employment”, hence the government can opt to develop the recycled paper industry as an alternative that would damage the environment to a lesser degree, Steps can be taken via “education and awareness raising campaigns”, to encourage the use of recycled papers, raising demand for recycled papers and shifting the PMB to the right. The government could also take steps to encourage recycling in order to increase the quantity of paper waste collected which would help to lower the cost of production for recycled papers, increasing supply. Hence, by intervening in the market for recycled paper, this would lead to more recycled papers being consumed/ produced, creating skilled jobs, generating higher incomes and improving the living standards of the citizens.</p> <p><u>Evaluation:</u> Thailand may be able to develop CA in the production of recycled paper industry if the industry is able to buy enough paper waste either domestically or by importing from the neighbouring countries at relatively low cost.</p>	<p>2. If the intention of the government is to create jobs and raise living standards, it might need to consider the kind of jobs it intends to create. According to Extract 6 the type of jobs created from recycling are “skilled employment”,</p> <p>However, in Extract 5, Double A’s KHAN-NA program has already “helped to improve the living conditions of more than 1.5 million farmers (low/ unskilled workers) by supplementing their income during off peak season. Any intervention in the market for the domestic industry to produce recycled paper may result in further of widening income gap as more skilled workers (from the production of recycled paper industry) gained employment at the expense of unskilled workers.</p> <p><u>Evaluation:</u> If it is developed successfully, the production of recycled paper industry as a sunrise industry will contribute to economic growth. Any widening of income gap between workers in sunrise and sunset industry might require further government actions.</p>
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Conclusion
It is important that the Thai government helps the paper production industry to improve from its standing as “one long criticised by environmentalists”. In the short run, it is important to encourage production and use of recycled papers and for more firms to practise environmentally friendly programme such as KHAN-NA. In the long run, government intervention may need to involve carrot and sticks to regulate the amount of pollutants release by the paper industry and to reward firms that find ways to decrease the amount of byproducts such as chlorine and dioxin being generated while producing virgin papers.

Mark Scheme

L3 (7-8)	Excellent explanation with economic analysis using data and diagrams Considered both positive externality and macro aims. Judgement based on analysis given
L2 (4-6)	Show understanding of how government interventions in the recycled paper market can be grounded on economics analysis. Considered positive externality but the analysis on macro aims may be underdeveloped or not considered. Answer must be balanced.
L1 (1-3)	Able to give descriptive link between recycled papers and positive externality or impact on macroeconomic aims. Lopsided analysis