

GCE ECONOMICS – EC2

Mark Scheme – January 2014

Question	Answer	Mark	AO1	AO2	AO3	AO4
1 (a) (i)	<p>With the aid of a demand and supply diagram explain why the price of olive oil has been falling in recent years.</p> <p><i>Diagram showing leftward shift in demand and rightward shift in supply (2). Explanation of shifts. Falling demand due to recession or cheaper substitutes (2) and increasing supply due to a bumper crop in Spain (2).</i></p>	6	2	2	2	
1 (a) (ii)	<p>With the aid of a demand and supply diagram explain why the price of agricultural goods such as olive oil fluctuates more than the price of manufactured goods such as cars.</p> <p><i>Supply tends to be very volatile meaning that prices will also be volatile (explained) (2) this is made worse by price inelastic demand (2). Supply is also price inelastic meaning that any change in demand cannot be absorbed, therefore also making prices volatile (2). Speculation (2). Diagram showing this (Cobweb diagram accepted) (2). Max 5 if there is no comparison with manufactured goods.</i></p>	6	2	2	2	
1 (b) (i)	<p>To what extent might the fall in the market price in olive oil to under \$3000 a tonne lead to a fall in the price of olive oil in UK supermarkets?</p> <p><i>A fall in price of olive oil on the commodity markets should be passed on to consumers in lower supermarket prices because it requires no major processing by manufacturers. It represents a major fall in price since 2005 from \$5500 a tonne. (2)</i></p> <p>BUT</p> <p><i>Other costs may be rising eg bottling, wages, distribution etc. Supermarkets may maintain prices in order to make bigger profits. Monopoly power of supermarkets to keep prices high. Exchange rate changes may prevent a price fall (2).</i></p>	4			2	2

Question			Answer	Mark	AO1	AO2	AO3	AO4
1	(b)	(ii)	<p>Define consumer surplus and explain how it will change for UK consumers of olive oil if prices fall in supermarkets</p> <p><i>Definition of consumer surplus (2). Fall in price will increase the consumer surplus because the gap between what consumers will pay and the market price has risen (2). Diagram (1).</i></p>	4	2	2		
1	(c)		<p>Comment on the income elasticity of demand of olive oil</p> <p><i>Definition of Yed/equation (1). Income elasticity of demand is positive/normal good (1) as incomes rise demand rise/as incomes fall demand falls (1). Use of the data (2).</i></p>	4	2	2		
1	(d)		<p>To what extent is the price elasticity of supply of olive oil likely to be inelastic?</p> <p><i>Definition of price elasticity of supply (1). Olive oil takes time to produce- growing time, etc and seen as a perishable product (1). Likely to be price inelastic in the short term (1).</i></p> <p>BUT</p> <p><i>Mention of stockpile in the data indicates that olive oil can be stored so supply may be elastic even in the short run (2). In the long term supply can be increased and becomes more elastic (2).</i></p> <p><i>Maximum 4 without evaluation.</i></p>	6	2	2		2

Question		Answer	Mark	AO1	AO2	AO3	AO4
1	(e)	<p>Using the data evaluate the view that bodies such as the European Union should try to stabilise the price of olive oil.</p> <p><i>Olive oil is an agricultural good and prices and incomes are volatile due to fluctuations in/inelasticity of demand and supply.</i></p> <p><i>Many countries are very dependent on the production and export of olive oil.</i></p> <p><i>Olive oil is an important part of diet in many countries/health benefits.</i></p> <p><i>Need to support/preserve rural communities.</i></p> <p><i>Major EU olive oil producers already have very high unemployment.</i></p> <p><i>Max 6.</i></p> <p><i>Price support leads to overproduction/misallocation of resources.</i></p> <p><i>Costly to EU taxpayers.</i></p> <p><i>Reduces consumer surplus/higher prices for consumers.</i></p> <p><i>Damage to the environment of over-production.</i></p> <p><i>Diagram (2)</i></p> <p><i>Max 6.</i></p> <p><i>Reversible answer.</i></p>	10	2	2	2	4
		Total for Question 1	40	12	12	8	8

Question		Answer	Mark	AO1	AO2	AO3	AO4
2	(a)	<p>Suggest and explain possible policies that the government could introduce to increase the supply of housing in the UK.</p> <p><i>Government builds/renovates more houses/social housing projects.</i> <i>Private builders given tax incentives to build new houses.</i> <i>Simplify the planning process.</i> <i>Regulation-low interest rates for mortgages/smaller deposits.</i> <i>Tax relief on mortgage interest payments.</i> <i>Loans to construction companies backed by government.</i> <i>End affordable housing requirement for new build estates.</i> <i>Up to 3 marks for each point (1 identification + 2 explanation).</i></p>	8	3	3	2	
2	(b)	<p>With the aid of a diagram discuss the view that a maximum rent should be set for all privately rented housing in the UK.</p> <p><i>Maximum rent makes rented property more affordable for tenants.</i> <i>Reduces inequality/poverty/housing is a merit good.</i> <i>Prevents exploitation by profiteering landlords.</i></p> <p><i>Diagram (2)</i></p> <p><i>Creates excess demand for rented property.</i> <i>Fewer private landlords see renting as profitable and rented housing stock falls.</i> <i>Depends how high/low the maximum rent is set.</i> <i>Illegal markets develop in the rented property market.</i></p> <p><i>Max 8 without evaluation.</i></p> <p><i>Reversible answer.</i></p>	12	3	3	2	4
Total for Question 2			20	6	6	4	4

Question		Answer	Mark	AO1	AO2	AO3	AO4
3	(a)	<p>Explain why the government might subsidise vaccinations but heavily tax cigarettes.</p> <p><i>Vaccinations produce external as well as private benefits. Reduced costs on the NHS and wider economy. In a free market vaccinations would be over-priced and under-provided in relation to the social optimum. Thus they should be subsidised to reduce market failure.</i></p> <p><i>Vaccinations are a merit good. Max 4.</i></p> <p><i>Cigarettes impose costs on society via health spending and loss of productivity in the economy. Also there are problems with passive smoking, litter and fires etc. At a free market price cigarettes would be under-priced in relation to their social cost. Smoking is a demerit good. Max 4.</i></p>	8	3	3	2	
3	(b)	<p>With the aid of a diagram evaluate the view that there are better ways to reduce cigarette consumption than to keep raising taxes on tobacco.</p> <p><i>Cigarette taxes raise price by shifting the supply curve to the left.</i></p> <p><i>Demand falls.</i></p> <p><i>Taxation can work if it is high enough so that demand becomes price elastic.</i></p> <p><i>Diagram (2)</i></p> <p><i>BUT</i></p> <p><i>Putting taxes on tobacco does not reduce consumption significantly as demand is price inelastic and smoking is addictive.</i></p> <p><i>Indirect taxes are regressive.</i></p> <p><i>People find ways round higher prices through smuggling/duty free purchases</i></p> <p><i>Better to use regulation/smoking bans/raise the age limit for purchase/negative advertising/bans on promotion.</i></p> <p><i>BUT</i></p> <p><i>Regulations require costly enforcement/some regulations damage the economy ie closure of pubs.</i></p> <p><i>Taxes internalise the consumption externality.</i></p> <p><i>Max 8 without evaluation/10 without a diagram.</i></p> <p><i>Reversible answer.</i></p>	12	3	3	2	4
		Total for Question 3	20	6	6	4	4

Question	Answer	Mark	AO1	AO2	AO3	AO4
4 (a)	<p>Using a diagram, explain why the equilibrium wage might rise or fall in a free market.</p> <p><i>Diagram/s showing the demand and supply of labour and how the equilibrium wage changes when there is a shift in demand and supply (2). Factors which may shift demand: derived demand effects, changes in labour productivity, changes in costs of other factors of production, state of the economy. Factors which may shift supply: changes in wage rates in other occupations, entry qualifications changing, migration/changes in the size of the labour force, power of trade unions.</i></p> <p><i>Max 3 marks for each explained factor. Max 6 without a diagram. Max 5 marks for only one explained shift.</i></p>	8	3	3	2	
4 (b)	<p>Discuss whether the government should stop increasing the minimum wage each year.</p> <p><i>Freezing the NMW: may help to raise the demand for labour, prevent rises in unemployment, help younger workers.</i></p> <p><i>BUT: Could lead to poverty, increases inequality, reduce the number of adults seeking work.</i></p> <p><i>Rises in NMW: raises costs and prices thus fall in demand and profits/less competitive, can cause workers to lose their job/fewer hours if Ped for labour is elastic thus unemployment rises.</i></p> <p><i>BUT: Depends on how much the NMW rises by, proportion of costs which are labour costs, may encourage firms to raise the productivity of workers, some firms don't have any NMW staff. Raising the NMW increases spending power in the economy. A rise in the NMW will reduce government spending on in work benefits.</i></p> <p><i>Max 8 without evaluation. Diagram 2 marks.</i></p>	12	3	3	2	4
Total for Question 4		20	6	6	4	4

Question	Answer	Mark	AO1	AO2	AO3	AO4
5 (a)	<p>Explain with examples what is meant by the term supply side policies.</p> <p><i>Definition of supply side policies (2).</i></p> <p><i>Examples of different types of supply side policies:</i></p> <p><i>Education and training.</i></p> <p><i>Infrastructure (roads/rail/high speed broadband)</i></p> <p><i>Labour market reforms. (Benefit/trade union reform).</i></p> <p><i>Privatisation and deregulation.</i></p> <p><i>Tax reform (cuts in direct taxes)</i></p> <p><i>Max 3 marks for each example (1 mark identification and 2 explanation).</i></p>	8	3	3	2	
5 (b)	<p>To what extent will supply side policies help an economy to recover from a recession? Use a diagram in your answer.</p> <p><i>Supply side policies increase potential output shifting AS to the right.</i></p> <p><i>AD/AS equilibrium at a higher level of GDP thus unemployment falls (2).</i></p> <p><i>Supply side reforms increase competitiveness of the economy and raise the demand for labour (2).</i></p> <p><i>Supply side policies increase the efficiency of product and factor markets causing unemployment to fall (2).</i></p> <p><i>Some supply side policies will also increase AD as well as AS eg infrastructure projects.</i></p> <p>BUT</p> <p><i>The economy may lack AD and thus there is a need for a reflationary policy.</i></p> <p><i>Supply side reforms take a long time to work.</i></p> <p><i>Policies may be ineffective (government policy ill directed).</i></p> <p><i>Supply side policies cannot be afforded when an economy is in recession.</i></p> <p><i>Max 8 without evaluation.</i></p> <p><i>Diagram. (2)</i></p> <p><i>Max 10 without a diagram.</i></p> <p><i>Reversible</i></p>	12	3	3	2	4
	Total for Question 5	20	6	6	4	4

Question	Answer	Mark	AO1	AO2	AO3	AO4
6 (a)	<p>Using appropriate diagrams explain how a rise in (i) interest rates and (ii) imports might affect the exchange rate.</p> <p><i>Rise in interest rates will increase speculative inflows of 'hot money' and increase the demand for domestic currency shifting the demand curve to the right increasing the exchange rate (2). Appropriate diagram (2).</i></p> <p><i>Rise in imports increases the supply of domestic currency and demand for foreign currency shifting the supply curve to the right decreasing the exchange rate (2). Appropriate diagram (2).</i></p>	8	3	3	2	
6 (b)	<p>Discuss the view that a significant rise in the exchange rate of the pound against the Euro is bad for the UK economy.</p> <p><i>Rise in the exchange rate makes exports more expensive and imports cheaper thus demand for exports falls and demand for imports rises (2) worsens trade deficit (2) loss of jobs/rise in unemployment (2). GDP/output falls (2).</i></p> <p>BUT</p> <p><i>Cheaper imports can help to keep inflation down (2). Export demand may be price inelastic (2). Other factors affect the demand for exports/imports (2). High exchange rate encourages firms to reduce costs/raise productivity (2). Pound may be falling against other currencies such as the dollar.</i></p> <p><i>Max 8 without evaluation. Reversible answer.</i></p>	12	3	3	2	4
	Total for Question 6	20	6	6	4	4

Question	Answer	Mark	AO1	AO2	AO3	AO4
7 (a)	<p>Explain why governments have attempted to achieve high economic growth and low inflation.</p> <p><i>Low inflation: international competitiveness (trade balance), better for forward planning in business (investment decisions), saving on menu/shoe leather costs, inflationary expectations low (wage bargaining), lower interest rates, Protection of those on fixed incomes. Max 4.</i></p> <p><i>High economic growth: higher living standards, increased tax revenues, higher levels of employment etc. Max 4.</i></p>	8	3	3	2	
7 (b)	<p>Discuss policies that could be introduced to help reduce the UK's trade deficit.</p> <p><i>Devalue the exchange rate to make exports cheaper but could cause inflation and provoke competitive devaluations.</i></p> <p><i>Use protectionist measures to reduce imports but could cause retaliation/misallocation of resources/not possible as an EU member.</i></p> <p><i>Supply side policies to improve competitiveness but can take years to be effective/costly/potential for government failure.</i></p> <p><i>Reduce domestic demand using higher income tax but could cause unemployment.</i></p> <p><i>Tax breaks/R&D subsidies to exporters but costly and may take year to be effective.</i></p> <p><i>Max 3 for each explained policy. Max 8 without evaluation.</i></p>	12	3	3	2	4
Total for Question 7		20	6	6	4	4

SECTIONS B and C

The following levels should be applied to each question.

Part (a) questions

Level 1 1 - 3	Limited knowledge of relevant economic theory. One or two basic points made.
Level 2 4 - 6	Good understanding of subject matter with some application. Relevant points made and developed using examples/diagrams and appropriate economic theory.
Level 3 7 - 8	The demands of the question are fully understood and relevant economic theory has been fully explained and applied using relevant examples/diagrams throughout the answer.

Part (b) questions

Level 1 1 - 4	Limited knowledge of relevant economic theory with no real engagement with the issue being considered. Likely to focus on just one side of the issue. Information is poorly organised. There is limited use of specialist terminology/vocabulary and frequent errors in SPG.
Level 2 5 - 8	Basic economic theory and principles are explained/applied/analysed. The candidate engages with the issue being considered using appropriate examples/diagrams, but may focus heavily on one side of the issue and evaluation may be limited. Information is well organised and ideas are expressed in a logical manner. There is good use of specialist terms/vocabulary with some errors in SPG, but these are not intrusive.
Level 3 9 - 12	Relevant economic theory and principles are fully understood, applied and analysed. The issue is fully evaluated using a range of appropriate examples/diagrams. Information is very well organised and argument is presented clearly and coherently. There is very good use of specialist terms/vocabulary with few, if any, errors in SPG.



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