

## **EC2 GENERAL MARKING GUIDANCE**

### **Positive Marking**

It should be remembered that candidates are writing under examination conditions and credit should be given for what the candidate writes, rather than adopting the approach of penalising him/her for any omissions. It should be possible for a very good candidate to achieve full marks and a very poor one to achieve zero marks. Marks should not be deducted for a less than perfect answer if it satisfies the criteria of the mark scheme, nor should marks be added as a consolation where they are not merited.

### **Quality of Written Communication**

QWC is assessed in Section B part (b) and Section C part (b).

**GCE ECONOMICS - EC2**

**Summer 2012**

**SECTION A**

- Q.1 (a) Distinguish a :**
- |  |             |                                |            |
|--|-------------|--------------------------------|------------|
|  | <b>(i)</b>  | tariff from a quota;           | <b>[2]</b> |
|  | <b>(ii)</b> | trade war from a currency war. | <b>[2]</b> |
- (i) Tariff - a tax on imported goods. (1)  
Quota - limit on the quantity of goods imported or by market share. (1)
- (ii) Trade war-countries retaliating against each others protectionist policies. (1)  
Currency war-countries devaluing their currencies to try to gain price advantage. (1)
- (b) Explain the effects of (i) a budget deficit and (ii) a trade deficit on aggregate demand.** **[4]**
- (i) Budget deficit - will increase AD (1) because  $G > T$  (1)  
(ii) Trade deficit - will decrease AD (1) because  $M > X$  (1)
- (c) Why does an artificially low yuan contribute to a 'flood of Chinese imports and rising unemployment in the USA?' **[6]****
- Low yuan makes Chinese exports to the US Cheap (1) thus there is an increasing demand for them (1) causing them to displace US made goods (1) resulting in US firms cutting their output and employment. (1) Makes it harder for the US to sell exports to China. Resulting in US job losses (2).
- (d) Governments, such as those in Japan and Brazil, have intervened to reduce the value of their currencies. Using a diagram, explain how governments can intervene in this way.** **[6]**
- Appropriate diagram showing shifts in the D/S of currency resulting in a lower exchange rate. (2)
- Identification (1) and explanation (3) of policies:  
Interest rates.  
Buying and selling currency.  
Use of foreign exchange reserves.
- (e) With the aid of a diagram and the data, discuss the possible effects on the US economy of the imposition by the USA of import tariffs on Chinese goods.** **[10]**
- Tariff diagram or AD/AS diagram explained max 4.  
Beneficial effects - domestic employment/output/profits/tax revenue/trade balance. (max 4)  
Negative effects - retaliation/welfare loss/WTO.  
rising costs/inflation, size/extent of tariffs, Ped of imports, alternative import sources used. (max 4)
- Evaluation 4 marks. (max 6 without evaluation)  
Max 6 with no diagram.  
Max 8 no data reference.

- (f) Evaluate the case for the use of supply-side policies as a means of reducing the US trade deficit. [10]**

Definition of supply-side policies.

Explanation of how supply-side policies will reduce trade deficit through increased competitiveness (price/quality).

Tax/benefit reform, training, education, grants for R&D, infrastructure tax breaks for entrepreneurs, etc

Evaluation:

Time lags.

Government failure.

Cost of policies - large US budget deficit.

Other factors important i.e. exchange rate.

Max 6 without evaluation.

Reversible answer.

## 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	<p>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.</p> <p>Information is poorly organised. There is limited use of specialist terminology/vocabulary and frequent errors in SPG.</p>
Level 2 5 - 8	<p>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.</p> <p>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.</p>
Level 3 9 - 12	<p>Relevant economic theory and principles are fully understood, applied and analysed. The issue is fully evaluated using a range of appropriate examples/diagrams.</p> <p>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.</p>

**Q.2 World production of rare earth metals fails to keep up with soaring demand.**

- (a) Define price elasticity of supply and explain the factors that determine it. [8]**

Indicative content

Definition of Pes or equation. (2)

- Factors affecting Pes:
- Time.
- Complexity of the production process.
- Nature of the product
- Availability of the product.
- Perishability of the product.

Max 3 for each factor.

- (b) Many everyday products such as iphones use rare earth metals; discuss the measures which governments could introduce to increase the supply and reduce the demand for these metals. [12]**

Indicative content

Subsidies to mining companies to search for these metals - but subsidies are costly/not a government problem.

Use substitutes - other metals - but this may not be possible in the short term.

Recycling of laptops/mobiles etc - but costly to be set up and takes time.

Reduce demand - taxation of products using these metals - but not popular with customers.

Use of some form of buffer stock scheme - but these have problems. (Like the International Tin Council)/Minimum price scheme.

Up to 4 marks for each fully evaluated point.

Max 8 with no evaluation.

**Q.3 Employers criticise rise in minimum wage to £6.08 per hour.**

- (a) With the aid of a diagram, explain the factors which might cause a change in the equilibrium wage in a free market. [8]**

Indicative content.

Diagram/s showing the demand and supply of labour and how the equilibrium wage changes when there is a shift in demand/supply. Max 2

Factors which may shift demand: derived demand effects, changes in labour productivity, changes in the 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.

2 marks for each explained factor.

- (b) To what extent would an increase in the minimum wage be beneficial for firms, workers and consumers? [12]**

Indicative content

Rise in NMW on firms: raises costs and prices thus fall in demand and profits/less competitive BUT depends how much the NMW rises by, proportion of costs which are labour costs, may encourage firms to raise productivity of workers, some firms don't have any NMW staff. Max 4

Rise in NMW on workers: rise in wage/living standards, more incentive to look for work/work harder BUT can cause them to lose their job/fewer hours if Ped for labour is elastic, some workers unaffected. Max 4

Rise in NMW on consumers: rise in costs thus prices of goods/services rise (reduced consumer surplus) BUT depends how big the rise in the NMW is, many prices of goods/services not affected by the NMW. Max 4

2 marks for a diagram.

Max 8 without evaluation.

All economic agents to be covered to gain full marks.

**Q.4 European emissions trading scheme temporarily suspended.**

- (a) Explain with the use of examples what is meant by market failure. [8]**

Indicative content

Define market failure. (2)

Examples showing why they illustrate market failure:

Public goods, merit goods, demerit goods, absence of property rights, asymmetry of information, external costs/benefits/monopoly..

Max 4 for each example explained. Two examples minimum.

- (b) Consider the view that the use of tradable pollution permits is the best way of reducing greenhouse gas emissions. [12]**

Indicative content

Explanation of the how tradable permit schemes reduce emissions and correct market failure. Focus on the advantages of these schemes not merely how they work.

Market based system designed to reduce emissions over time. All firms are incentivised to clean up pollution using the price mechanism. Pollution is reduced in the most efficient way.

A good basic understanding of a pollution permits scheme. (4)

BUT.

Scheme is open to abuse/corruption: number of permits issued by governments/computer hacking. Permits raise costs for firms, effects on competitiveness. Firms shift production to parts of the world where there are no controls on pollution. Candidates can refer to problems with the ETS.

Max 4 for referring to other policies that could be used to reduce emissions i.e. carbon taxes, regulations etc

Max 8 without evaluation (reversible answer).

## SECTION C

## Q.5 UK economy needs to be rebalanced.

- (a) **Using a diagram, explain the shape of the aggregate demand and aggregate supply curves.** [8]

Indicative content

Diagram/s showing the shape of the AD and AS curves. (2)

Candidate explains shape of AD curve. (Max 4)

Candidate explains shape of AS curve. (Max 4)

- (b) **Evaluate the view that the UK economy would benefit from a greater proportion of aggregate demand coming from investment and exports rather than consumption and government spending.** [12]

Indicative content

Yes: Investment increases productivity/competitiveness/economic growth/employment/trade balance.

Exports help pay for imports/reduce trade deficit/employment effects/economic growth etc

BUT: Consumption contributes to AD benefits from employment/GDP.

Government spending corrects market failure and reduces inequality/needed to support the private sector (training/education/infrastructure).

Candidates may take a different approach by explained the problems of high consumption (inflation) and government spending (budget deficits).

Max 8 without evaluation.

**Q.6 Government tackles huge budget deficit.**

- (a) Explain using examples the main categories of government spending and taxation. [8]**

Indicative content

Government spending: Current spending and capital spending (examples) (4)  
Taxation: Direct and Indirect taxes (examples) (4)

- (b) Discuss the view that in order to reduce the budget deficit the government should increase taxes rather than cut government spending. [12]**

Higher VAT: No real effect on incentives, avoidable to an extent, hard to evade/easy to collect, will raise more revenue than raising top tax rates **but** is regressive/raises prices/unpopular with retailers.

Raising income tax: effect on incentives (Laffer Curve) impact on AD/more evasion/exit of top managers/entrepreneurs **but** higher income tax can reduce inequality/progressive

Tax maximum 8.

Cutting government spending: Can have direct effect on employment, hits lower income groups hardest, **but** less effect on incentives, scope to reduce waste, need to rebalance the economy.

Government spending maximum 8.

Neither policy will reduce the deficit as economic growth will fall. Austerity will worsen the deficit. Max 4 if explained fully.

Max 8 without evaluation.

**Q.7 Inflation and trade deficit worsen whilst economic growth and unemployment disappoint.**

- (a) Explain why governments have attempted to achieve low inflation and a low level of unemployment. [8]**

Indicative content

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).  
means low interest rates.  
protects those on fixed incomes.

(max 4 2x2 points)

Low unemployment: higher living standards.  
reduced benefit payments.  
higher economic growth.  
Fewer social problems.

(max 4 2x2 points)

- (b) Discuss whether it is possible for a government to achieve all its macroeconomic policies at the same time. [12]**

Indicative content

Identification of macroeconomic objectives (2)

Not possible to achieve all at the same time:

Inflation unemployment trade-off explained max 4  
Economic growth and environmental depletion and degradation max 4  
Economic growth and trade deficit max 4.

Max 8 without evaluation.

BUT:

Possible to achieve all objectives with the successful implementation of supply-side policies - explained with the use of AD/AS analysis.  
Use of evidence from the NICE decade.

Max 4.

Reversible.