



Mock Exam M1

ECONOMICS

9708

Paper 2 Data Response and Essay

MARK SCHEME

Maximum Mark: 40

Published

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Section A

Answer 1

Answer	Marks	Guidance
<p>For a clear diagram(s) showing understanding of the concept of a production possibility curve with correctly labelled axes and appropriate output choices (1 mark)</p> <p>For an appropriate representation of the change in Iceland (1 mark)</p> <p>For an appropriate representation of the change in Ireland (1 mark)</p>	3	<p>Figure 1 shows a rise in the GDP of Iceland and a fall in the GDP of Ireland. One way in which this could be shown would be a shift outwards of Iceland's PPC and a shift inwards of Ireland's PPC. Alternatively, this could be represented as a movement from within the curve towards the frontier in Iceland or a movement from the frontier to a point inside the frontier in Ireland. Either representation is acceptable.</p>
<p>The price level is higher in 2015 than in 2007 (1 mark)</p>	1	
<p>For recognition that a fall in the value of the Krona will lead to a rise in the price of Iceland's import (1 mark) and an explanation of how this could cause cost-push inflation in Iceland. (Up to 3 marks) 4 maximum</p> <p>For recognition that a fall in the value of the Krona will lead to a fall in the price of Iceland's exports (1 mark) and an explanation of how this could cause demand-pull inflation in Iceland. (Up to 3 marks). 4 maximum</p> <p>(6 marks maximum)</p>	6	<p>The collapse of the Krona could cause cost-push and/or demand-pull inflation. As the Krona collapses this makes imports more expensive. This might feed into increased costs for Icelandic companies as they import raw materials and components. In addition, there might be increases in the cost of living as imports might comprise foodstuffs and so on. In addition, the fall in the Krona would reduce the price of Iceland's exports and increase the price of her imports that would lead to a rise in net exports and aggregate expenditure causing inflationary pressures.</p> <p>Give due credit to those answers that make good, appropriate use of the aggregate demand and aggregate supply framework although this is not essential for full marks.</p>
<p>At least two factors must be explained for full marks.</p> <p>∞ For an explanation of any factor that might determine whether a devaluation would turn a deficit into a surplus (Up to 3 marks)</p> <p>(4 marks maximum)</p>	4	<p>The fall in the value of the Krona has resulted in a change in the price of Iceland's exports and imports. Exports have fallen in price and imports have increased in price. The impact of this Upon the current account depends Upon factors such as the time period under consideration, the price elasticity of demand for Iceland's imports and exports and the price elasticity of supply of Iceland's exports. Also relevant is whether the currencies of other countries lose value against the Krona. Candidates need to explain at least two factors for full marks. Marks will be awarded for development of each factor. The J-curve, the Marshall-Lerner condition and whether Iceland has the capacity to expand exports will be developed in high scoring answers.</p> <p>Identification of relevant factors with no explanation (1 mark only)</p> <p>Please note that this question concerns the factors that determine the impact of devaluation Upon a country's current account. There are no marks for explaining that export prices fall and import prices rise after devaluation.</p>
<p>∞ For an explanation of the costs of managing an exchange rate (Up to 4 marks)</p> <p>∞ For an explanation of the benefits of managing an exchange rate (Up to 4 marks)</p> <p>(5 marks maximum for costs and benefits)</p> <p>∞ For a reasoned conclusion on whether the costs outweigh the benefits. (1 mark)</p>	6	<p>Iceland's exchange rate system is under the control of the Icelandic authorities. It is a managed exchange rate system. This means that Iceland has the option to vary the exchange rate to suit economic circumstances. The devaluation of the Krona has resulted in a current account surplus, falling unemployment and a budget surplus. These are the benefits of a managed exchange rate, but there are also costs. In order to manage the exchange rate, it is necessary to hold large quantities of foreign exchange reserves and these may not be sufficient to manage the exchange rate. In addition, in order to maintain a particular exchange rate it might be necessary to sacrifice other economic objectives. Iceland had to raise interest rates to very high levels and this would have resulted in some costs to consumers and businesses.</p> <p>This question does not require specific reference to Iceland. More general explanations of the costs and benefits of managing an economy's exchange rate are acceptable.</p> <p>Identification of a cost with no explanation (1 mark only)</p> <p>Identification of a benefit with no explanation (1 mark only)</p>

Section B

Answer **one** question

Answer 2 (a & b)

Answer	Marks	Guidance
<p>Distinguish between regressive and progressive taxes and explain whether you would use an income tax or a specific indirect tax to make post-tax incomes more equal.</p> <p>Knowledge and understanding:</p> <ul style="list-style-type: none"> ∞ For a definition of a regressive tax 1 mark ∞ For a definition of a progressive tax 1 mark <p style="text-align: right;">(KU: up to 2 marks)</p> <p>Application:</p> <p>Explains that specific indirect taxes are regressive (Up to 2 marks) and their impact upon the equality of post-tax incomes (1 mark)</p> <p>Explains that income taxes can be progressive (Up to 2 marks) and their impact upon the equality of post-tax incomes (1 mark)</p> <p style="text-align: right;">(APP: up to 6 marks)</p>	8	<p>Candidates need to have a clear understanding of the difference between a regressive and progressive tax and that specific indirect taxes will be regressive and income taxes can be designed to be progressive.</p>

Answer	Marks
<p>For analysis of the importance of income elasticity of demand (YED) to a firm.</p> <p>Comment on whether YED is useful. Comment on whether it is positive, which will be the case with normal goods, or whether it is negative, which will be the case with inferior goods.</p> <p>YED is important to the decisions of a firm, enabling it to estimate the effect on the demand for its products of a change in incomes. For example, if incomes are rising in an economy, a firm would be expected to increase the production of normal goods and decrease the production of inferior goods. Candidates need to consider that the extent to which YED is likely to be important to a firm will depend on a number of factors, such as the proportion of income that is spend on a particular product. The demand for some products will not be very sensitive to a change in income because they are not very expensive, whereas the demand for other more expensive products will be much more sensitive to a change in income.</p> <p>(Up to 4 marks)</p> <p>Candidates could then discuss other elasticities of demand, such as PED or XED. One of these done very well could gain all 4 marks, or two done reasonably well. (Up to 4 marks)</p> <p>Note: Accept PES as a possible answer</p> <p style="text-align: right;">(AN: up to 8 marks total)</p> <p>For evaluative comment on whether YED is likely to be the most important measure of elasticity to a firm.</p> <p style="text-align: right;">(EV: up to 4 marks, reserve one mark for a conclusion)</p>	12

Answer 3 (a & b)

Answer	Marks	Guidance
<p>In some countries vaccinations against infectious diseases are offered at a price and payment has to be made.</p> <p>Use a diagram to explain how a subsidy given to producers in the market for vaccinations will affect the market price and explain the impact of this subsidy upon the consumer surplus in this market.</p> <p>For knowledge and understanding of the meaning of consumer surplus (2 marks)</p> <p style="text-align: center;">Up to 2 marks</p> <p>For application using an accurately labelled diagram that shows the shift to the right of the supply curve (1 mark) and the fall in equilibrium price and rise in equilibrium quantity of vaccinations (1 mark). For the consumer surplus before the subsidy (1 mark) and the rise in consumer surplus after the subsidy (1 mark)</p> <p>For application that explains one other factor that determines the fall in price for e.g. the price elasticity of demand, the price elasticity of supply or the size of the subsidy (1 mark)</p> <p>that explains one other factor that determines the change in the consumer surplus for e.g. the price elasticity of demand, the price elasticity of supply or the size of the subsidy. (1 mark)</p> <p style="text-align: center;">Up to 6 marks</p>	8	<p>The imposition of a subsidy will shift the supply curve to the right reducing price and increasing quantity. The price will fall and the consumer surplus will increase. The impact on each will be determined by factors such as the price elasticity of demand and the price elasticity of supply vaccinations.</p>

Answer	Marks	Guidance
<p>AO3: analysis of the advantages and disadvantages that arise when resources are allocated through central planning. (Up to 4 marks)</p> <p>Analysis of advantages and disadvantages that arise when resources are allocated through the free market. (Up to 4 marks)</p> <p style="text-align: center;">AO3: maximum 8 marks</p> <p>For evaluation of the strengths and weaknesses of the two systems (Up to 3 marks)</p> <p>Conclusion on which system is most effective. (1 mark)</p> <p style="text-align: center;">AO4: maximum 4 marks</p>	12	<p>In a planned economy national, regional and local planning committees undertake decision-making. Decision-making in this system lacks signals transmitted through the price mechanism to express consumer wants.</p> <p>In a free market economy the factor enterprise allocates resources in response to signals from consumers through the price mechanism.</p>

Section C

Answer 4 (a & b)

Answer	Marks
<p><i>Structural unemployment arises from changes in the pattern of demand in an economy and is usually focused upon specific industries or geographical areas. It can also be caused by the introduction of new technology acting as a substitute for labour. Frictional (or search) unemployment arises due to imperfect information in the labour market. Workers are unemployed primarily due to the time taken to find a new job. Both types have a negative impact on an economy but it is generally assumed that structural unemployment will have a long-term impact and impose higher costs on society compared with frictional unemployment which normally lasts a relatively short time. Hence, it may be concluded that structural unemployment is likely to cause the greater negative impact.</i></p> <p>L4 (9–12): for a clear explanation of both types of unemployment and their main differences. A conclusion as to which type has the greater negative effect, supported by an appropriate rationale</p> <p>L3 (7–8): for a clear explanation of the differences between both types of unemployment and a conclusion which is stated rather than supported by an appropriate rationale</p> <p>L2 (5–6): for a clear distinction between both types of unemployment but no comment on the effect on the economy</p> <p>L1 (1–4): for an answer that shows some knowledge but does not indicate that the question has been fully grasped or where the answer is mostly irrelevant</p>	12

<p><i>A discussion of the benefits of economic growth e.g. rising GDP, improving standard of living, better health, longer lifespans.</i></p> <p><i>A discussion of the costs of economic growth e.g., pollution, congestion, increase in working hours.</i></p> <p>L4 (9–13 marks) For a thorough discussion of both sides of the issue. Maximum 11 if no conclusion.</p> <p>L3 (7–8 marks) For a competent comment which does not fully analyse both sides. An analysis of one side and limited analysis of the other.</p> <p>L2 (5–6 marks) For an accurate though undeveloped comment concentrating on one side.</p> <p>L1 (1–4 marks) For an answer which shows some knowledge but does not indicate that the question has been fully grasped. The answer will have some correct facts but include irrelevancies. Errors of theory or omissions of analysis will be substantial.</p>	<p>13</p>
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Answer 5 (a & b)

<p>For Knowledge and Understanding:</p> <p>For an explanation of how the exchange rate is determined in a freely floating exchange rate system. (Up to 2 marks)</p> <p>For a diagram showing a depreciation of the currency as the demand falls and/or the supply rises as a result of the inflation. (Up to 2 marks)</p> <p>4 marks maximum</p> <p>For Application:</p> <p>For an explanation of the causes of a fall in the demand and/or a rise in the supply of a currency due to high inflation (Up to 4 marks)</p> <p>4 marks maximum</p>	<p>8 A freely floating exchange rate is determined by the free forces of the supply and demand for the currency in the foreign exchange market. A high rate of inflation could lead to a decline in the exchange rate because the goods and services produced by an economy become uncompetitive. The demand for the currency falls as the demand for exports fall and the supply of the currency rises as imports rise as their relative price falls.</p>
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<p>For analysis containing:</p> <ul style="list-style-type: none"> ∞ an explanation of the way in which monetary policy can be used to solve the problem of inflation with due reference to the effectiveness of such a policy (Up to 4 marks) ∞ an explanation of the way in which monetary policy can be used to solve the problem of deflation with due reference to the effectiveness of such a policy (Up to 4 marks) <p style="text-align: right;">(8 marks maximum)</p> <p>For evaluation that assesses and compares</p> <ul style="list-style-type: none"> ∞ the likely effectiveness of monetary policy in solving inflation with its likely effectiveness in solving deflation (3 marks) ∞ and reaches a conclusion on whether it is likely to be effective in solving only one or both problems (1 mark) <p style="text-align: right;">(4 marks maximum)</p>	<p>12 Monetary policy is any action taken by the monetary authorities to change the quantity of money, the rate of interest or credit terms. It is usually operated by the central bank of an economy.</p> <p>When faced with inflation it is likely that the central bank will limit the money supply, raise the rate of interest and tighten credit controls.</p> <p>When faced with deflation these measures would be reversed.</p> <p>Whether the policy is likely to be effective depends upon the extent to which spending is sensitive to changes in the money supply, the rate of interest and credit terms.</p> <p>If only inflation or deflation considered then 4 maximum.</p>
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