

EC2

- Q.1 (a) With reference to the first paragraph of the data, identify the injections and withdrawals into and from the circular flow of income resulting from the government's policy announcements. [4]**

Injections - government spending (G) on Investment (I) Withdrawals - higher taxes (T) and less welfare spending (G) and private sector investment(I)

2 x 2 marks. (4)

Max 2 Marks for good understanding of circular flow

- (b) (i) Explain the private costs and private benefits to the train operating companies which will run services on the new high speed rail network. [4]**

Private costs: wages, maintenance, network access charges, purchasing/leasing rolling stock.

Private benefits: revenues, profits resulting from ticket sales

2 x 2 marks.

Max 1 mark for definition of private costs and benefits

- (ii) Define external costs and discuss whether the building of the London to Birmingham rail link will increase or reduce external costs. [6]**

Definition of external costs (2)

External costs: damage to countryside/areas of outstanding natural beauty/falling house prices. (2)

BUT:

more passengers and freight on rail means less road congestion/pollution. (2)

Max 4 without evaluation

- (c) How could projects, such as, building improved rail and telecommunications infrastructure help the UK achieve its macroeconomic objectives? [10]**

Identification of the macroeconomic objectives. (2)

Increased employment (1) explained i.e. construction/rail workers (1).

Increased output (1) explained i.e. construction of new lines (1)

Lower inflation (1) explained i.e. productivity/lower costs. (1)

Improved B of P (1) explained i.e. more competitive economy (1)

Reduction in inequality (reduced north/south divide) (2)

Reduced emissions/external costs (2).

Deficit reduction(2)

- (d) With the aid of a diagram, use the concept of price elasticity of demand to evaluate the effects of a government subsidy designed to reduce rail fares. [6]**

Definition of Ped (2)

Diagram showing the effect of a producer subsidy. (2)

Explanation of diagram (2)

Evaluation: fares will drop most if demand is price inelastic. Changes in passenger numbers depends on Ped (2)

Max 4 without evaluation

- (e) Discuss whether rail subsidies or the introduction of road tolls are the best way to reduce road congestion. [10]**

Tolls internalise the negative externalities (2)

Tolls raise the price of road travel thus demand falls. (1)

Tolls may persuade people to use other forms of transport i.e. rail (2)

Tolls raise revenue for the government.

Rail subsidies reduce rail fares and increase rail passenger numbers(1)

BUT: Effects depend on the price elasticity of demand for road travel.

Tolls are regressive.

Set up and administrative costs are high.

Motorway tolls will increase congestion on other roads.

Tolls are inflationary/raise costs etc.

Burden on the taxpayer of rail subsidies

Rail network is already congested itself. 2 x 2 marks.

Rail subsidies – transfer to higher incomes

Max 6 without evaluation.

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.

SECTION B**Q.2 New Car Sales Drop 22% in October 2010 as petrol prices hit record levels.**

- (a) **Define cross price elasticity of demand and explain why a firm needs to be aware of the cross elasticity relationships between different products.** [8]

Indicative content

Candidate defines Xed/shows the equation. (2)

Substitute relationships - awareness of effects price changes depending upon how close the substitutes are. Max 3.

Complementary relationships - awareness of effects price and demand changes of complementary product Max 3.

Reference required to positive and negative Xed to gain 8

- (b) **Using demand and supply diagrams, discuss whether the increase in petrol prices is likely to be the main factor causing a fall in the sales of new cars.** [12]

Petrol and cars are complements thus a rise in petrol prices will affect demand for cars. Negative Xed.

Use of diagrams showing rise in petrol prices (supply shifting left) and another diagram for cars (showing demand shifting left).

BUT.

New car sales depend upon other factors: availability and cost of credit/state of the economy/consumer expectations. Incomes.

Demand for high mpg cars may rise.

Max 8 without evaluation.

Max 10 without appropriate diagram

Max for diagrams 4 marks

Q.3 Internet access give the patient an edge over doctors.

- (a) **With the use of examples, explain why asymmetry of information might lead to market failure.** [8]

Indicative content.

Definition/understanding of asymmetry of information (2).

Candidate explains how asymmetry of information exists between doctor and patient. Max 4.

Candidate explains how internet access has increased in knowledge of patients and reduced the asymmetry. Max 4.

Other plausible examples are acceptable.

- (b) Evaluate the view that health care should be free at the point of consumption. [12]**

In favour:
Private benefits
External benefits/merit good.
Reduces inequality.

Against:
Costly - higher taxes/opportunity cost of expenditure.
Excess demand/queuing.
Need for rationing.

Max 8 without evaluation.

Q.4 Venezuela imposes maximum prices as food prices rise rapidly.

- (a) Explain why food prices might have increased rapidly in recent years. [8]**

Indicative content:
Demand increases: rising population/rising incomes/tastes changing. Max 5.
Supply decreases: weather/natural disasters/pests/civil conflict. Max 5
Appropriate diagram (2)

- (b) Discuss, with the aid of a diagram, whether government imposed maximum price schemes, such as those in Venezuela, are likely to be beneficial to consumers and producers. [12]**

Low price benefit poorer groups in society/keep inflation down/prevent civil unrest/increases the consumer surplus.

BUT
Causes excess demand (shortages)/less incentive to supply/profits of producers fall/reduced producer surplus/reduced investment.
Depends how high the maximum price is set.
Government may subsidise producers.
Rationing/black markets
Appropriate diagram. (2)

Max 8 without evaluation.
Max 10 without appropriate diagram.

SECTION C**Q.5 Consumer spending rises ahead of increase in VAT.**

- (a) Explain the main factors that affect the level of consumption in an economy.** **[8]**

Indicative content.

Definition of consumption (1)

Factors which could be considered:

Income growth.

Interest rates.

Wealth/house prices.

Taxation.

Expectations/of changes in the price level, job security.

Exchange rate.

Personal debt levels.

Cost and availability of credit.

2 marks for each point explained.

Max 2 for diagram

- (b) Discuss the view that investment is more important to an economy than consumption.** **[12]**

Definition of investment/consumption.

Investment increases productive capacity/LRAS. (Diagram).

Investment improves productivity/competitiveness.

Investment can increase employment/can lead to higher wages.

Investment needed to replace depreciated assets/Investment improves quality of goods and services.

Consumption can cause inflation via high AD.

2 marks for each point explained.

2 marks for a relevant diagram or definition. Max 8

Investment can be badly directed/have unintended consequences.

Investment can lead to unemployment.

Increased consumption boots AD and can thus create output and employment. (Diagram)

High consumption can direct goods away from the export market.

2 marks for each point explained.

2 marks for a relevant diagram.

Max 8.

Reversible answer

Q.6 Taxes rise and government spending is cut to reduce budget deficit.

- (a) Define fiscal policy and explain, with examples, the main categories of government spending. [8]**

Indicative content.

Definition of fiscal policy (2)

Categories of government spending: current v capital spending (examples)
OR public goods v merit goods (examples) OR social security, defence, health, education etc Max 6.

- (b) Should the government raise a greater proportion of its revenue from indirect taxes such as VAT and less from direct taxes such as income tax? [12]**

More from indirect taxes: little effect on incentives/easier to collect/harder to avoid and evade/consumers don't notice it as much as income tax/can be used to reduce consumption of demerit goods/internalise external costs.

Less from direct taxes: increased incentives/Laffer Curve/increased choice for consumers how to spend their income/more saving if tax is reduced.

Max 8

BUT:

Increased indirect taxes are regressive and push up costs/prices.

Higher indirect taxes distort the signalling function of price.

Cutting direct taxes can make the system less progressive.

Higher indirect taxes can lead to lower consumption.

Max 8

Reversible answer

Q.7 World trade organisation warns against protectionism.

- (a) Explain, with the aid of a diagram, how tariffs reduce imports. [8]**

Indicative content.

Tariffs defined max 2 (more than "tax on imports")

Tariff diagram max 4

Diagram explained how tariffs reduce imports. max 4

- (b) Discuss whether the imposition of tariffs is the best way to protect domestic markets. [12]**

Increased domestic employment.

Tariff revenue.

Increased domestic producer surplus/profits.

Reduced imports.

Increased incomes/GDP.

BUT:

Higher prices/reduced consumer surplus.

Welfare loss/resource misallocation.

Retaliation by trading partners.

Discussion of the relative advantages of other forms of protection. Max 6 for discussing and evaluating other forms of protection.

Max 8 without evaluation.



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