

Markscheme

November 2016

Economics

Standard level

Paper 2

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Use the question-specific markscheme together with the markbands. Award up to the maximum marks as indicated.

Section A

1. (a) (i) Define the term *depreciation* indicated in bold in the text (paragraph ④). [2]

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>Vague definition.</i> The idea that the exchange rate/value (price) of a currency falls.	1
2 <i>Accurate definition.</i> An explanation that it is a decrease in the value (price/exchange rate) of one currency plus one of the following: <ul style="list-style-type: none"> • due to a change in market forces • in a floating exchange rate system. 	2

(ii) Define the term *monetary policy* indicated in bold in the text (paragraph ⑥). [2]

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>Vague definition.</i> The idea that is to do with interest rates (or money supply).	1
2 <i>Accurate definition.</i> An explanation that it is any two of the following: <ul style="list-style-type: none"> • demand-side policy • changes in interest rates • changes in money supply. 	2

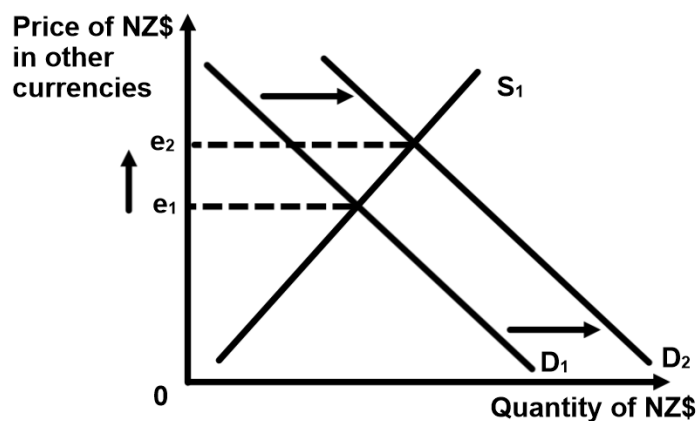
- (b) Using an exchange rate diagram, explain how the increase in the official interest rate to 3.5% is likely to affect the value of the New Zealand dollar (paragraph 9). [4]

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>There is a correct diagram or an accurate written response.</i> For drawing a correctly labelled exchange rate diagram, showing a shift of the demand curve for the New Zealand dollar to the right or for an explanation that when the interest rate rises, people abroad will wish to save more in New Zealand financial institutions, and so demand for the currency will increase and the value of the currency will rise (appreciate).	1–2
2 <i>There is a correct diagram and an accurate written response.</i> For drawing a correctly labelled exchange rate diagram, showing a shift of the demand curve for the New Zealand dollar to the right and for an explanation that when the interest rate rises, people abroad will wish to save more in New Zealand financial institutions, and so demand for the currency will increase and the value of the currency will rise (appreciate).	3–4

Candidates may offer an alternative explanation that, because of the interest rate increase, there might be an increase of “hot money” inflows, leading to the shift in the demand curve. This may be fully rewarded.

Candidates who incorrectly label diagrams can be awarded a maximum of [3].

For an exchange rate diagram, the vertical axis may be exchange rate, price of NZD in other currencies, or other currency per NZD. The horizontal axis should be quantity or quantity of NZD. A title is not necessary.



(c) Using an AD/AS diagram, explain how “monetary policy tightening” may affect a country’s inflation rate (paragraph 6). [4]

Level Marks

0 *The work does not reach a standard described by the descriptors below.* 0

1 *There is a correct diagram **or** an accurate written response.* 1–2

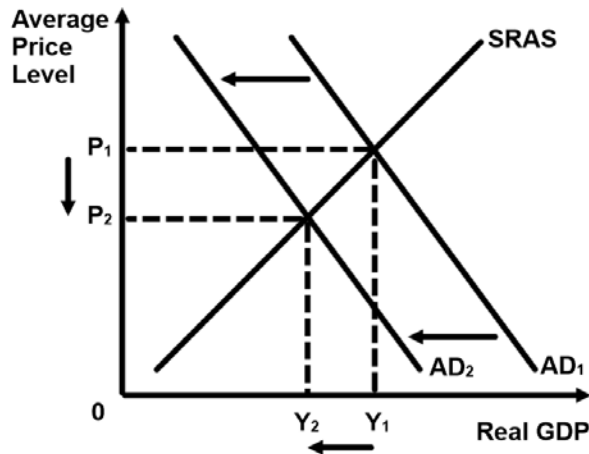
For drawing a correctly labelled AD/AS diagram, showing a shift of the AD curve to the left **or** for an explanation that monetary policy tightening (increasing interest rates and/or reducing the money supply) should reduce consumption and/or investment, components of AD ($C+I+G+[X-M]$), lowering the inflation rate (inflationary pressure) in the economy.

2 *There is a correct diagram **and** an accurate written response.* 3–4

For drawing a correctly labelled AD/AS diagram, showing a shift of the AD curve to the left **and** for an explanation that monetary policy tightening (increasing interest rates and/or reducing the money supply) should reduce consumption and/or investment, components of AD ($C+I+G+[X-M]$), lowering the inflation rate (inflationary pressure) in the economy.

Candidates who incorrectly label diagrams can be awarded a maximum of [3].

For AD/AS, the vertical axis, the label may be Average (General) Price Level, APL or Price level. For the horizontal axis, real output, real national output, real income, real national income, real GDP or real Y. A title is not necessary.



- (d) Using information from the text/data and your knowledge of economics, discuss the possible economic consequences of an overvalued New Zealand dollar on the New Zealand economy. [8]

Examiners should be aware that candidates may take a different approach which, if appropriate, should be rewarded.

Do not award beyond Level 2 if the answer does not contain reference to the information provided.

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>Few relevant concepts are recognized.</i> There is basic knowledge/understanding.	1–2
2 <i>Relevant concepts are recognized and developed in reasonable depth.</i> There is clear knowledge/understanding. There is some attempt at application/analysis.	3–5
3 <i>Relevant concepts are recognized and developed in reasonable depth.</i> There is clear knowledge/understanding. There is effective application/analysis. There is synthesis/evaluation, supported by appropriate theory and evidence.	6–8

Command term

Discuss requires candidates to offer a considered and balanced review that includes a range of arguments, factors, or hypotheses. Opinions or conclusions should be presented clearly and supported by appropriate evidence.

Responses may include:

Inflation rate:

- the current inflation rate seems to be reasonable near 2 % target (paragraph 6)
- a strong dollar will lower the cost of imported raw materials, semi-finished goods, and finished goods, reducing inflationary pressure.

Employment:

- in the short run, export prices will rise and import prices will fall, leading to reduced employment in both export industries, as demand for exports falls, and domestic industries, as people buy more imports
- the export sector is used to high exchange rates and remains competitive, so employment rates may not be as badly affected in export industries (paragraph 5).

Economic growth:

- the expected growth rate is 3.7 % (paragraph 7) – reasonably high for a developed country
- a fall in net exports would lead to lower AD and so a fall in growth rates
- firms are efficient and competitive (paragraph 5), so economic growth may not be so badly affected
- possible intervention by the central bank to depreciate the currency (paragraph 4) to prevent net exports from decreasing and slowing economic growth.

Current account balance:

- a high exchange rate could lead to a fall in net exports and so a movement towards a current account deficit
- exporters seem to be coping with a high exchange rate (paragraph ⑤) and so net exports may not be affected greatly on the export side
- the effect may be greater on the import side
- there is a present trade in goods balance surplus of \$1.2 billion (paragraph ⑦)
- overvalued NZD may begin to harm New Zealand dairy products which is a key export (paragraph ⑧).

Any reasonable discussion.

2. (a) (i) Define the term *interest rates* indicated in bold in the text (paragraph ❶). [2]

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>Vague definition.</i> The idea that it is a payment for a loan.	1
2 <i>Accurate definition.</i> An explanation that it is one of the following: <ul style="list-style-type: none"> • the price or cost of borrowed money • the price of credit (or the percentage paid on borrowed money) • the reward for saving. 	2

(ii) Define the term *inflation* indicated in bold in the text (paragraph ❷). [2]

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>Vague definition.</i> The idea that it is an increase in prices in the economy.	1
2 <i>Accurate definition.</i> An explanation that it is a sustained increase in the average (general) price level in the economy.	2

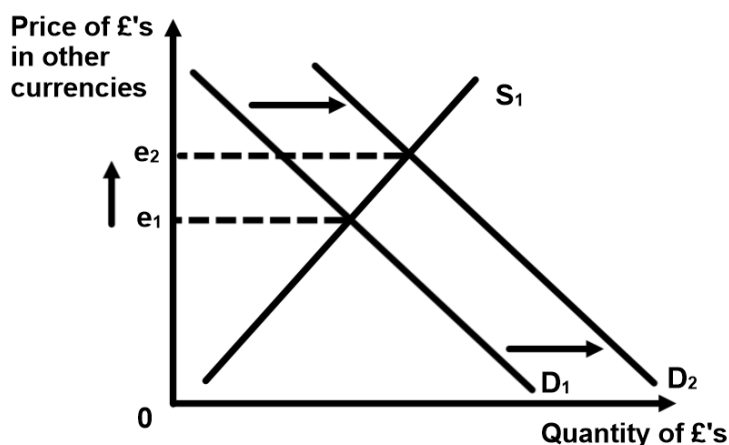
- (b) Using an exchange rate diagram, explain how speculation is contributing to the rising value of the British pound (paragraph 1). [4]

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>There is a correct diagram or an accurate written response.</i> For drawing a correctly labelled exchange rate diagram showing an increase in demand and the appreciation of the British pound or for an explanation that speculators are anticipating that the pound will rise in value in the future and thus have been buying more British pounds, leading to appreciation.	1-2
2 <i>There is a correct diagram and an accurate written response.</i> For drawing a correctly labelled exchange rate diagram showing an increase in demand and the appreciation of the British pound and for an explanation that speculators are anticipating that the pound will rise in value in the future and thus have been buying more British pounds, leading to appreciation.	3-4

Candidates might explain that speculators are anticipating an increase in interest rates in the future, which would give a higher return on future savings, so are demanding British pounds now. This alternative approach should be fully rewarded.

Candidates who incorrectly label diagrams can be awarded a maximum of [3].

For an exchange rate diagram, the vertical axis may be exchange rate, price of British pound in other currencies, or other currency per British pound. The horizontal axis should be quantity or quantity of British pounds. A title is not necessary.



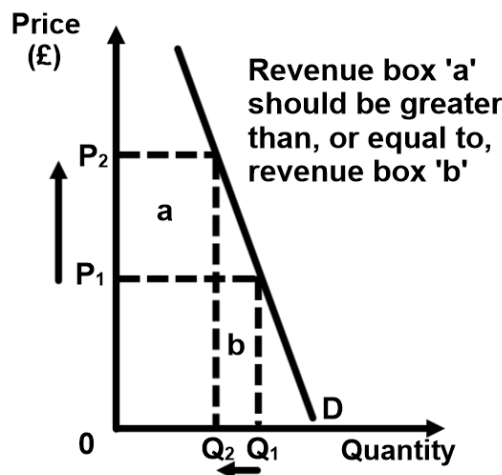
- (c) Using an appropriate diagram, explain why it is possible that “British firms producing exported goods that have few substitutes have reported no reduction in export revenue despite the appreciation” (paragraph ③). [4]

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>There is a correct diagram or an accurate written response.</i> For drawing a correctly labelled diagram showing a demand curve, with a price increase and a decrease in quantity, and revenue boxes showing an increase in export revenue or for an explanation that since these firms produce goods with few substitutes, the demand is inelastic, and so when price increases due to appreciation, the total revenue increases.	1–2
2 <i>There is a correct diagram and an accurate written response.</i> For drawing a correctly labelled diagram showing a demand curve, with a price increase and a decrease in quantity, and revenue boxes showing an increase in export revenue and for an explanation that since these firms produce goods with few substitutes, the demand is inelastic, and so when price increases due to appreciation, the total revenue increases.	3–4

Candidates may explain that the demand is unit elastic and so when the price increases due to appreciation, the total revenue will remain the same (“no reduction in export revenue”). If the diagram is also correct, this approach may be fully rewarded.

Candidates who incorrectly label diagrams can be awarded a maximum of [3].

The use of P and Q is sufficient for a demand and supply diagram. A title is not necessary.



- (d) Using information from the text/data and your knowledge of economics, discuss possible consequences of the appreciation of the British pound. [8]

Examiners should be aware that candidates may take a different approach which, if appropriate, should be rewarded.

Do not award beyond Level 2 if the answer does not contain reference to the information provided.

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>Few relevant concepts are recognized.</i> There is basic knowledge/understanding.	1–2
2 <i>Relevant concepts are recognized and developed in reasonable depth.</i> There is clear knowledge/understanding. There is some attempt at application/analysis.	3–5
3 <i>Relevant concepts are recognized and developed in reasonable depth.</i> There is clear knowledge/understanding. There is effective application/analysis. There is synthesis/evaluation, supported by appropriate theory and evidence.	6–8

Command term

Discuss requires candidates to offer a considered and balanced review that includes a range of arguments, factors, or hypotheses. Opinions or conclusions should be presented clearly and supported by appropriate evidence.

Responses may include:

- a strong British pound will lower the cost of imported raw materials, semi-finished goods, and finished goods, reducing inflationary pressure
- in the short run, export prices will rise and import prices will fall, leading to reduced employment in both export industries, as demand for exports falls, and domestic industries, as people buy more imports
- impact on tourist sector in the UK (paragraph ②)
- impact on British tourists going overseas (paragraph ②)
- in markets where demand is inelastic, export revenue may not fall (part (c)) (paragraph ③)
- British firms are losing out to foreign competitors (paragraph ⑤) as goods and services are relatively more expensive
- a fall in net exports would lead to lower AD and so a fall in growth rates
- impact on British firms' profits
- a high exchange rate could lead to a fall in net exports and have an impact on the current account
- the impact of cheaper fuel on household budgets (paragraph ⑥).

Any reasonable discussion.

Section B

3. (a) (i) Define the term *infant industries* indicated in bold in the text (paragraph 5). [2]

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>Vague definition.</i> An explanation that they are any one of the following: <ul style="list-style-type: none"> • they are new industries • which do not benefit from economies of scale • that need protection to compete with imports. 	1
2 <i>Accurate definition.</i> An explanation that they are any two of the following: <ul style="list-style-type: none"> • they are new industries • which do not benefit from economies of scale • that need protection to compete with imports. 	2

(ii) Define the term *complementary goods* indicated in bold in the text (paragraph 5). [2]

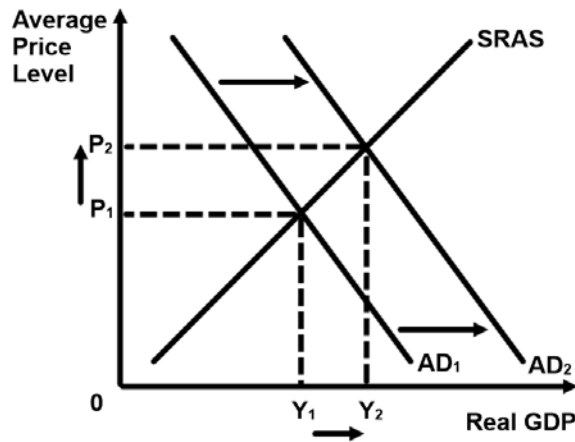
Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>Vague definition.</i> The idea that they are goods that are related to each other.	1
2 <i>Accurate definition.</i> An explanation that they are goods that are consumed with each other (joint demand) or that they are goods that have negative cross price elasticity of demand.	2

(b) Using an AD/AS diagram, explain how moving from a trade deficit to a trade surplus would affect real GDP in Ecuador, *ceteris paribus*. [4]

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>There is a correct diagram or an accurate written response.</i> For drawing a correctly labelled AD/AS diagram showing a shift in aggregate demand to the right and an increase in real GDP or for an explanation that moving from a trade deficit to a trade surplus would involve an increase in net exports, a component of aggregate demand, and thus an increase in AD and an increase in real GDP.	1–2
2 <i>There is a correct diagram and an accurate written response.</i> For drawing a correctly labelled AD/AS diagram showing a shift in aggregate demand to the right and an increase in real GDP and for an explanation that moving from a trade deficit to a trade surplus would involve an increase in net exports, a component of aggregate demand, and thus an increase in AD and an increase in real GDP.	3–4

Candidates who incorrectly label diagrams can be awarded a maximum of [3].

For AD/AS, the vertical axis may be Average (General) Price Level, APL or Price Level. The horizontal axis may be real output, real national output, real income, real national income, real GDP or real Y. A title is not necessary.



- (c) Using a definition of the term *ceteris paribus*, explain why it is necessary to include this assumption in part (b). [4]

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>There is a correct definition or an accurate written response.</i> For an explanation that <i>ceteris paribus</i> means “all other things being equal” (or any other reasonable explanation) or for an explanation that net exports may have increased, but any of the other components of AD may have fallen and so Ecuador’s aggregate demand may not have increased.	1–2
2 <i>There is a correct definition and an accurate written response.</i> For an explanation that <i>ceteris paribus</i> means “all other things being equal” (or any other reasonable explanation) and for an explanation that net exports may have increased, but any of the other components of AD may have fallen and so Ecuador’s aggregate demand may not have increased.	3–4

- (d) Using information from the text/data and your knowledge of economics, evaluate Ecuador’s import-substitution policy as a means of achieving economic growth and development. **[8]**

Examiners should be aware that candidates may take a different approach which, if appropriate, should be rewarded.

Do not award beyond Level 2 if the answer does not contain reference to the information provided.

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>Few relevant concepts are recognized.</i> There is basic knowledge/understanding.	1–2
2 <i>Relevant concepts are recognized and developed in reasonable depth.</i> There is clear knowledge/understanding. There is some attempt at application/analysis.	3–5
3 <i>Relevant concepts are recognized and developed in reasonable depth.</i> There is clear knowledge/understanding. There is effective application/analysis. There is synthesis/evaluation, supported by appropriate theory and evidence.	6–8

Command term

Evaluate requires candidates to make an appraisal by weighing up the strengths and limitations.

Responses **may** include:

- explanation of import-substitution:
- policy to replace imports with domestically produced goods
- elements of an import-substitution policy may include any measures to support domestic producers (eg tariffs, quotas, subsidies, administrative barriers)
- explanation of economic growth
- explanation of economic development.

Possible strengths:

- reduction in imports means a reduction in import spending, which will reduce the trade deficit and contribute to economic growth
- increased real GDP (may refer to diagram in part (b))
- increase employment, which may contribute to economic growth and development
- Ecuador has moved from trade deficit to trade surplus so its policy seems to be effective (paragraph ①)
- Ecuador's exports are largely primary products, and so import-substitution may be necessary for Ecuador to diversify and/or produce products with more value-added such as chocolate (**Table 1** and paragraph ③)
- it is important that countries have the right to set and enforce product standards to protect their people from below-standard products (paragraph ②)
- firms like Pica may be able to increase output, thereby achieving economies of scale; this may allow it to become an exporter and further help Ecuador's trade balance (paragraph ④), thereby resulting in economic growth; possible job creation and breaking of poverty cycle for those with jobs
- any policies to support domestic producers may be seen as interventionist supply-side policies, which will increase long-run aggregate supply (paragraph ④).

Possible weaknesses:

- the government may not be able to correctly identify the industries that will be able to compete with imports
- domestic products are likely to be more expensive than imports, which is harmful to consumers; impact on low income earners will be significant
- producers like Toni Industries will have to buy from more expensive domestic producers, which increase costs of production (paragraph ⑤)
- higher tariffs on capital equipment and raw materials will feed through to higher costs of production leading to (cost-push) inflation (diagram) (paragraph ③)
- allows domestic producers to remain less efficient than foreign producers (paragraph ⑥)
- less choice of consumer goods
- misallocation of resources
- danger of retaliation (paragraph ⑥).

Any reasonable evaluation.

4. (a) (i) Define the term *budget deficit* indicated in bold in the text (paragraph ①). [2]

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>Vague definition.</i> The idea that it is to do with government revenue or spending.	1
2 <i>Accurate definition.</i> An explanation that it is when (planned) government spending is greater than government revenues.	2

(ii) Define the term *economic development* indicated in bold in the text (paragraph ②). [2]

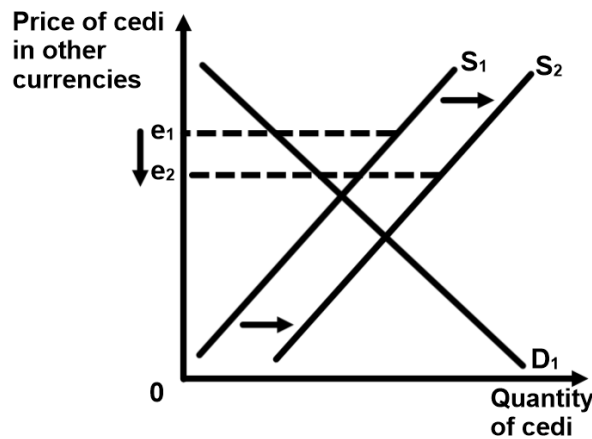
Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>Vague definition.</i> The idea that living standards improve.	1
2 <i>Accurate definition.</i> An explanation that it is a broad concept involving any two of the following: <ul style="list-style-type: none"> • improvement in standards of living • reduction in poverty • improved health • improved education • reduction in unemployment • greater equality in income distribution • environmental protection • increased freedom and economic choice. 	2

(b) Using an exchange rate diagram, explain how the large current account deficit may have affected the value of the Ghanaian cedi. [4]

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>There is a correct diagram or an accurate written response.</i> For drawing a correctly labelled exchange rate diagram for the Ghanaian cedi with the supply curve shifting to the right and a fall in the exchange rate or for providing an explanation that outflows of money on the current account exceed inflows and hence there is increased selling of the Ghanaian cedi that will result in downward pressure on the currency (depreciation of the currency).	1–2
2 <i>There is a correct diagram and an accurate written response.</i> For drawing a correctly labelled exchange rate diagram for the Ghanaian cedi with the supply curve shifting to the right and a fall in the exchange rate and for providing an explanation that outflows of money on the current account exceed inflows and hence there is increased selling of the Ghanaian cedi that will result in downward pressure on the currency (depreciation of the currency).	3–4

Candidates who incorrectly label diagrams can be awarded a maximum of [3].

For an exchange rate diagram, the vertical axis may be exchange rate, price of cedi in other currencies, or other currency per cedi. The horizontal axis should be quantity or quantity of cedi. A title is not necessary.



- (c) Using an AD/AS diagram, explain how the falling value of the Ghanaian cedi may have contributed to inflation. [4]

Level Marks

0 *The work does not reach a standard described by the descriptors below.* 0

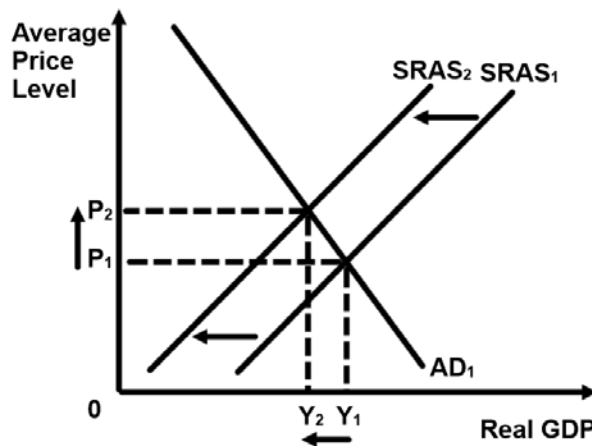
1 *There is a correct diagram **or** an accurate written response.* 1-2
For drawing a correctly labelled AD/AS diagram showing a fall in short-run aggregate supply and an increase in the average price level **or** for explaining that a fall in the value of the cedi will result in an increase in the cost of imported factors of production and therefore a fall in short-run aggregate supply, resulting in (cost-push) inflation.

2 *There is a correct diagram **and** an accurate written response.* 3-4
For drawing a correctly labelled AD/AS diagram showing a fall in short-run aggregate supply and an increase in the average price level **and** for explaining that a fall in the value of the cedi will result in an increase in the cost of imported factors of production and therefore a fall in short-run aggregate supply, resulting in (cost-push) inflation.

Candidates might explain that the falling cedi results in increasing net exports (X-M) due to cheaper exports and more expensive imports, which increases AD causing demand-pull inflation. This alternative approach should be fully rewarded.

Candidates who incorrectly label diagrams can be awarded with a maximum of [3].

For AD/AS, the vertical axis may be Average (General) Price Level, APL or Price level. The horizontal axis may be real output, real national output, real income, real national income, real GDP or real Y. A title is not necessary.



- (d) Using information from the text/data and your knowledge of economics, discuss possible consequences of International Monetary Fund (IMF) financial aid on Ghana's economic growth and development. **[8]**

Examiners should be aware that candidates may take a different approach which, if appropriate, should be rewarded.

Do not award beyond Level 2 if the answer does not contain reference to the information provided.

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>Few relevant concepts are recognized.</i> There is basic knowledge/understanding.	1–2
2 <i>Relevant concepts are recognized and developed in reasonable depth.</i> There is clear knowledge/understanding. There is some attempt at application/analysis.	3–5
3 <i>Relevant concepts are recognized and developed in reasonable depth.</i> There is clear knowledge/understanding. There is effective application/analysis. There is synthesis/evaluation, supported by appropriate theory and evidence.	6–8

Command term

Discuss requires candidates to offer a considered and balanced review that includes a range of arguments, factors, or hypotheses. Opinions or conclusions should be presented clearly and supported by appropriate evidence.

Responses may include:

- an explanation of the differences between economic growth and economic development
- an explanation of the links between growth and development
- an explanation of the sources of economic growth (eg improvements in the quality and quantity of physical and human capital, institutional reform).

Possible positive consequences:

- falling cedi may be limiting economic growth; financial aid from the IMF may be necessary to stop the cedi from falling further (paragraph ❶)
- if the cedi appreciates, it may reduce inflation
- any improvements in the economy may improve investor confidence, which will lead to more investment (FDI and portfolio investment) which will contribute to economic growth (paragraph ❷)
- the financial aid will force the government to reduce the budget deficit which is acting as a deterrent to investment (paragraph ❸)
- the financial aid will force the government to fight inflation which will help economic growth (paragraph ❹)
- if investment and growth pick up, there will be more leeway for the government to be able to afford to finance spending on development objectives, although this may only be possible over the longer term.

Possible negative consequences:

- the impact of IMF conditions of reduced government spending, a reduction in subsidies, privatization and a wage freeze on development (paragraph 5)
- opportunity costs of servicing the debt
- IMF aid may be mismanaged (paragraph 6) which will have no impact on development
- the “sacrifices” (paragraph 6) Ghanaians have to make will be anti-developmental.

Any reasonable discussion.

Discussion **may** include more general consideration of the nature of aid, growth and development and relationships between them.
