

AS Economics Unit 1 05 Jan mark scheme

Q.9 (a) Using a supply and demand diagram, explain why 'the price of the Mexican drink tequila has risen more than a third over the past year'.

Up to 4 marks for the diagram . an increase in demand (1) . a decrease in supply (1)
Candidates need to show the original price (1) and new equilibrium price (1).

Up to 2 marks for providing reasons for the price increase: an increase in demand for tequila among American consumers or an increase in demand for the finer brands of tequila which are made from 100% blue agave (1) a fungus which has destroyed many blue agave plants, the main ingredient in the production of tequila or an increase in costs of 6 production of tequila (1)
(2 Knowledge, 2 Application, 2 Analysis marks)

(b) Examine why the price of tequila rose by less than the the price of blue agave.
(4)

The passage refers to tequila rising in price by more than a third whereas blue agave increased in price by twenty times over the year. Reasons may include: (1)

Blue agave is just one of the costs involved in producing tequila. Therefore an increase in blue agave prices will lead to a smaller percentage increase in price of tequila. (2 marks including 1 evaluation mark here). Other production costs for tequila include labour, power, rent of factory premises, bottling, transport, insurance, marketing (2 marks).

There are more substitutes for the demand for tequila than the demand for blue agave. Discussion of the different price elasticities of demand for tequila and blue agave (2 marks including 1 evaluation mark here).

Tequila is likely to be subject to an indirect tax which adds to the overall price of the good whereas blue agave is less likely to be subject to an indirect tax (2 marks) . Tequila producer may have stocks of agave so do not need to 4 raise price immediately (1) (2 Analysis and 2 Evaluation marks)

(c) To what extent does the price of elasticity of supply of tequila seem likely to vary over time? (5)

Explicit definition of price elasticity of supply or the formula (1) .

In the short run the extract suggests supply will be inelastic due to the long period of time for blue agave to mature (seven to ten years) (1) .

In the long run the extract suggests supply will be price elastic due to the vast blue

agave plantations covering Mexico's tequila producing region (1) .

(1 mark for Knowledge, 1 mark for Analysis, 1 mark for Application)

Evaluation 'Some evaluation is required here, for example, the price 5 elasticity of supply of blue agave may be quite unpredictable, due to possible problems with a cactus fungus or climate. Be prepared to award any genuine candidate attempt at evaluation. (Up to 2 Evaluation marks.)

9 (d) Examine the likely short run and long run effects of the increase in blue agave prices on tequila producers (5)

There may be some overlap in candidate answers between possible short run and long run effects, however, some attempt should be made to distinguish between the two.

Possible short run effects: an increase in production costs and decrease in profits; some tequila producers may even make a loss an attempt may be made to pass on the increased production costs to tequila consumers in the form of higher prices in order to restore profit margins. This seems likely since demand for tequila is increasing rapidly discussion on the ability to raise tequila prices which depends on price elasticity of demand for tequila, e.g. substitutes producers may attempt to reduce other input costs, for example, labour costs or packaging producers may cut costs by reducing the quality of tequila e.g. mixing other cactus plants in the drink

Possible long run effects bankruptcy may occur (line 13) if tequila producers are unable to secure sufficient supplies of blue agave or because they cannot afford the increase in production costs diversification into other drinks (line 14) may occur if supplies of other raw materials are easier to obtain. Also, the tequila producers may have suitable plant and machinery to be able to switch production quite easily increase efficiency by investing in new machinery or making labour more productive mergers between tequila producers to increase efficiency
(2 Analysis marks and 3 Evaluation marks)

To gain full marks, both the short run and the long run effects should be considered - otherwise award a maximum of 3 marks.

To obtain full marks, one short run effect (1) and one long run effect (1) required, plus one good evaluation comment (3). 5

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Q.10 (a) Using a supply and demand diagram, explain why according to the Royal Institute of Chartered Surveyors house prices in London and the South -East fell in the last quarter of 2002 and early 2003. (4)

Award 2 marks (Application) for a correct diagram which shows a decrease in the demand for housing (1), including the original and new equilibrium price levels (1).
Award a further 2 marks (Knowledge) for worries over the war with Iraq (1) and the economic slowdown (1)

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(b) Examine the likely economic impact of falling house prices on

(i) Home owners (3)

(ii) The market for rented accommodation (3)

(bi) Homeowners

Wealth effect: Home owners are likely to experience a fall in housing equity and so become less wealthy and reduce their spending and borrowing on other goods and services. Also obtaining loans will become more difficult:

Expectation: Some home owners may panic into selling their property quickly by dropping the asking price, especially if they fear a continued fall in price.

Some home owners may remove their house for the property market and wait for the housing market to pick up before trying to sell.

Since many home owners are less likely to move, they spend more on existing property improvements, for example building extensions, adding conservatories or window replacements. It could also boost to the DIY market. .

There may be little effect for some homeowners who have no intention of moving property for some considerable period of time.

(bii) The market for rented accommodation

Buying a property and renting a property are substitutes and so there is a positive cross elasticity of demand. A fall in property prices may lead to a decrease in demand for private rented accommodation or council accommodation as some tenants switch into first time buyers.

Also accept people defer house purchase in expectation of further price falls and instead rent accommodation. .

Candidates may show a diagram for rented accommodation where demand decreases, pushing down rental values.

Summary of (bi) and (bit) Up to 3 marks for Analysis and 3 marks for Evaluation:

NOTE: one good evaluation point could achieve the 3 marks

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(c) With reference to figure 1, select two regions and examine two likely reasons why average house prices differ between them. (6)

Candidates may select any two regions but most are likely to choose Greater London or the South East to compare with one other region.

Reference to house price data from the table (1 Application mark).

Candidates may select two from the following reasons to explain regional house price differentials.

The demand for housing relative to supply varies between regions

Regional variation in income and wealth levels

Regional variations in employment levels

Inter regional migration flows, for example, a net migration outflow from the North and net migration inflow to Greater London, the South East and the South West

Housing supply restrictions for example, green belt land in Greater London and the South East which are likely to be tighter than in other regions

Expansion of EU and access to London and South East. (Up to 3 marks for Analysis)

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Evaluation in (c) Some consideration of the relative importance of the two reasons chosen to explain regional house price differentials (up to 2 Evaluation marks).

(d) To what extent might there be scope for house price rises in some regions? (4)

The extract points the way for house price rises, particularly in the North where homes were more affordable (lines 13 and 14), 'because prices were low relative to incomes' (1). Employment prospects in a region (1).

Speculation of future house price increases may take hold in a region (1).

Incomes rising faster than property prices in a region (1). (1 mark for Knowledge and 1 mark for Analysis)

Evaluation in (d) Candidate discussion on the extent to which house prices could rise is required, for example: The ripple effect of house price increases may take hold as more people are forced to look for property away from the South East. House prices might not be able to increase much if mortgage interest rates start to rise or employment prospects look bleak. Property may appear to be a good, long term investment, especially compared to the stock market. Differential changes to the structure of population. (Up to 2 marks for Evaluation)