



Mark Scheme (Results)

January 2012

GCE Economics (6EC01)
Paper 01

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General Marking Guidance

- All candidates must receive the same treatment. Examiners must mark the first candidate in exactly the same way as they mark the last.
- Mark schemes should be applied positively. Candidates must be rewarded for what they have shown they can do rather than penalised for omissions.
- Examiners should mark according to the mark scheme not according to their perception of where the grade boundaries may lie.
- There is no ceiling on achievement. All marks on the mark scheme should be used appropriately.
- All the marks on the mark scheme are designed to be awarded. Examiners should always award full marks if deserved, i.e. if the answer matches the mark scheme. Examiners should also be prepared to award zero marks if the candidate's response is not worthy of credit according to the mark scheme.
- Where some judgement is required, mark schemes will provide the principles by which marks will be awarded and exemplification may be limited.
- When examiners are in doubt regarding the application of the mark scheme to a candidate's response, the team leader must be consulted.
- Crossed out work should be marked UNLESS the candidate has replaced it with an alternative response.

NB candidates may achieve up to 3 explanation marks even if incorrect option key is selected.

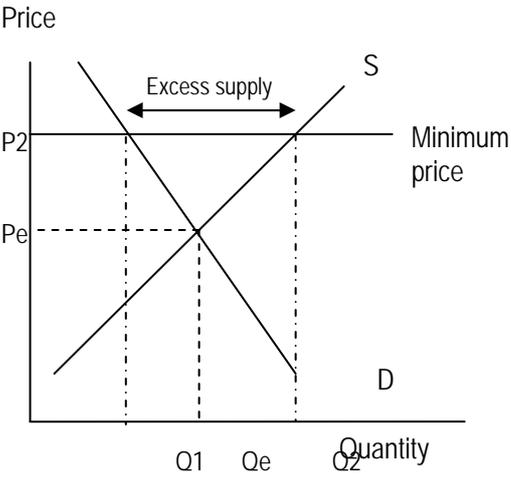
NB candidates may achieve up to 3 marks for explaining three incorrect options (provided three different reasons are offered and each option key should be explicitly rejected).

Question Number	Answer	Mark
1	<p>C (1 mark)</p> <ul style="list-style-type: none"> • Definition of production possibility frontier (PPF) (the maximum output combinations of two goods an economy can achieve when all its resources are fully / efficiently employed). (1 mark) • Position Z currently unobtainable since it is beyond the production possibility frontier / only positions on or within the frontier can be achieved / economic growth is required. (1 mark) <p>Note: this may be annotated on to the diagram by an outward shift of the PPF.</p> <ul style="list-style-type: none"> • Position Z can be achieved with more resources / new technology and this will take time. (1 mark). <p>Note: No marks are available for definition of opportunity cost as this is not relevant to the question.</p> <p>Rejection marks</p> <ul style="list-style-type: none"> • Option A incorrect since position W has unemployed resources / there is an inefficient allocation resources / it is not on the production possibility frontier / it is possible to increase output of both goods. (1 mark). • Option B incorrect since relatively fewer capital goods at position X compared to Y. capital goods are a major determinant of economic growth. (1 mark). • Option D incorrect since the production possibility frontier is curved - not constant or opportunity cost is increasing due to the curve. (1 mark). 	(4)

Question Number	Answer	Mark
2	<p>B (1 mark)</p> <ul style="list-style-type: none"> • Definition of consumer surplus (the difference between the price one is prepared to pay and the actual market price or the area below the demand curve and above the equilibrium price line). (1 mark). • Definition of producer surplus (the difference between the price a firm is willing to sell a good for and the actual market price or the area above the supply curve and below the equilibrium price) (1 mark). • Consumer surplus is RXP_e and producer surplus is WXP_e or annotation of diagram showing both areas. (1 mark). • Supply is relatively price elastic compared to demand so producer surplus is lower (1 mark). <p>Rejection marks</p> <ul style="list-style-type: none"> • Option A incorrect since supply is price elastic since the curve comes from the vertical (price) axis. (1 mark) • Option C incorrect since elasticity of demand varies along its length / from highly price elastic at the top left through to very price inelastic at bottom right of demand curve. (1 mark). • Option D incorrect since there is a direct relationship between price and quantity supply - as price rises so will supply rise / the gradient is positive. (1 mark) 	(4)

Question Number	Answer	Mark
3	<p>A (1 mark)</p> <ul style="list-style-type: none"> • Definition or formula of price elasticity of demand (PED): (the responsiveness or sensitivity of demand for a good due to a change in its price) or $(\% \Delta QD \div \% \Delta P)$ • OR definition of price elastic demand (the percentage change in demand exceeds the percentage change in price) depicting an elastic demand curve and showing how an increase in price will reduce total revenue. (1 mark). • Correct answer for PED of fresh fruit -1.1 (1 mark) • Correct answer for PED of fresh vegetables -1.2 (1mark) • The greater the numerical value of PED, the more price elastic is the demand. (1 mark). <p>Note: accept answers without the minus sign.</p> <p>Note: award no mark for the method in this question.</p> <p>Rejection marks</p> <ul style="list-style-type: none"> • Option B incorrect since demand for fruit and vegetables are price elastic - so an increase in price will reduce total revenue. (1 mark). • Option C is incorrect since demand for fruit and vegetable is price elastic since the percentage change in demand exceeds the percentage change in price (1 mark). • Option D incorrect since we do not have information on the responsiveness of demand for fresh fruit and vegetables to a change in income. (1 mark) 	(4)

Question Number	Answer	Mark
4	<p>D (1 mark)</p> <ul style="list-style-type: none"> • Definition or formula for income elasticity of demand (YED): (The responsiveness or sensitivity of demand for a good due to a change in income) or $(\% \Delta QD \div \% \Delta Y)$. (1 mark). • Cars and taxis are a normal good / since when income rose so did demand for cars and taxis (this could be shown by diagram) (1+1 marks). • Explicit use of data on cars and taxis, for example, weekly real household income has risen from £552 to £604 and demand for cars and taxis has risen from 393 to 402 billion passenger kilometres (1 mark). • NB: award 2 marks for correct calculation of income elasticity of demand: $2.29\% \div 9.4\% = 0.24$ (Note: accept 0.2) <p>Rejection marks</p> <ul style="list-style-type: none"> • Option A incorrect since buses and coaches had an income elasticity of demand of 0. (1 mark). • Option B incorrect since bicycles had a positive income elasticity of demand, shown by demand rising as income rises. (1 mark). • Option C incorrect since the data only shows how demand responds to changes in income; there is no information on the price elasticity of demand for rail travel. (1 mark). 	(4)

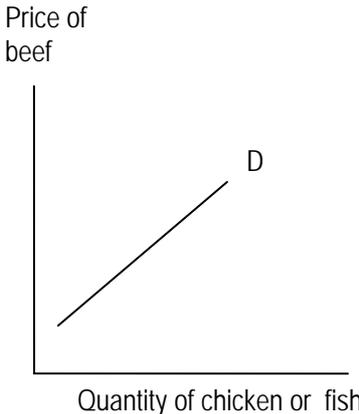
Question Number	Answer	Mark
5	<p>A (1 mark)</p> <ul style="list-style-type: none"> • Reward a comment on government intervention to correct a market failure (1 mark). • Definition of minimum price (the lowest price a good is allowed to be sold for or it is a floor price) (1 mark). • Explanation of excess supply (surplus): where the quantity supplied exceeds the quantity demanded (1 mark). • Written explanation of the process of excess supply: as price rises then supply extends or rises / demand contracts (falls) or consumption falls (1+1 marks). <p>OR diagram depicting the minimum price above the free market price / showing excess supply ($Q_1 - Q_2$) (2 marks).</p>  <p>Note: no marks available for a response stating that the excess supply is purchased by government.</p> <p>Note: no marks available for a diagram depicting just a demand and supply curve without the minimum price.</p> <p>Rejection marks</p> <ul style="list-style-type: none"> • Option B is incorrect since the minimum price is set above the market price and so price will have to rise. (1 mark) • Option C is incorrect since a rise in price will lead to a contraction in demand - (not enough to just reverse key with 'a decrease in consumption'. (1 mark) • Option D is incorrect since only if a minimum price is set below the market price will there be no effect in the market. (1 mark) 	(4)

Question Number	Answer	Mark
6	<p>B (1 mark)</p> <ul style="list-style-type: none"> • Definition of public goods (non-rivalry and non-excludability) Also accept non-rejectable as one of these characteristics. (1 mark). • Definition of a free market economy (the price mechanism is used to allocate resources) (1 mark). • Explanation of free rider problem: it is possible for people to consume a good without paying for it once it is provided / so little incentive for producers to provide sufficient quantities or there is under-provision (1+1 marks). • Example of a public good, for example, defence, street lighting, lighthouses, flood defence schemes. (1 mark). <p>Rejection marks</p> <ul style="list-style-type: none"> • Option A incorrect since the resources used to produce public goods could have been used to produce other goods. (1 mark). • Option C incorrect since there is little incentive for private enterprise to provide public goods due to the difficulty in making consumers pay - so the government often finances them (accept provides them). (1 mark). <p>Note: do not double award if already credited in the explanation.</p> <ul style="list-style-type: none"> • Option D incorrect since people can consume public goods without paying for them so 'price' is irrelevant here. (1 mark). 	(4)

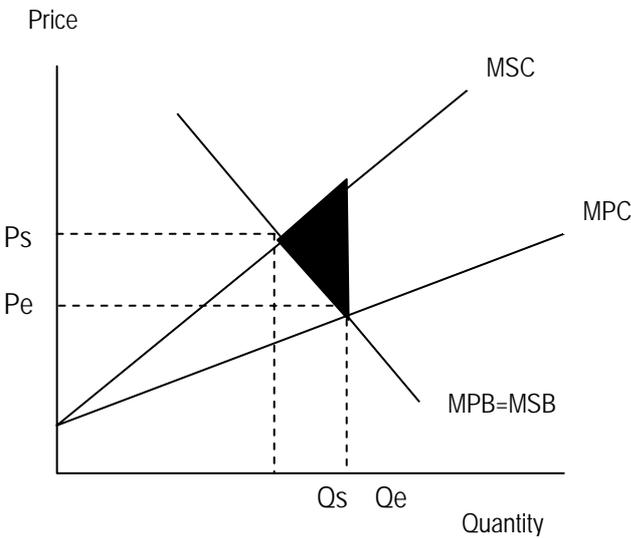
Question Number	Answer	Mark
7	<p>D (1 mark)</p> <ul style="list-style-type: none"> • Understanding or explanation of buffer stock scheme (for example: agency sells from buffer stock in times of poor harvest and buys or adds to it in times of good harvest. (1 mark). <p>Note this explanation must consider both the buying and selling function of the buffer stock to secure a mark).</p> <ul style="list-style-type: none"> • Identification that in 2010 there is a bad harvest / or supply has decreased (1 mark). • Without intervention the price would rise to P3 or point Z (1 mark) • Government agency sells Q3-Q2 or XY of wheat from its stockpile to establish a price of P2 (this may be shown by annotation of the diagram) (1 mark). • Government agency revenue from the sale is Q3Q2XY (this may be shown by annotation of diagram but needs to be labelled or referred to in answer) (1 mark). <p>Rejection marks</p> <ul style="list-style-type: none"> • Option A incorrect since there is a poor harvest that could lead to an excess demand for wheat (1 mark). • Option B incorrect since the agency will sell Q2Q3XY from its stockpile - not buy. (1 mark) Note: do not double award if already credited in the explanation. • Option C incorrect since price would increase to P3 in a free market or to a maximum of P2 under the buffer stock scheme. (1 mark). 	(4)

Question Number	Answer	Mark
8	<p>C (1 mark)</p> <ul style="list-style-type: none"> • Definition of welfare gain (the excess of social benefit over social cost for a given quantity) (1 mark). • Identification or annotation of diagram to identify welfare gain as area XZY (accept welfare loss) (1 mark). • Identification of the free market equilibrium as point X or quantity Q_e and the social optimum as point Y or quantity Q_1 (1 mark). • Definition of external benefits: (positive third party effects / benefits external to an exchange/ benefits the price mechanism ignores / benefits outside the market transaction / difference between social benefits and private benefits / positive spillover effects) (1 mark). • Application to vaccinations: welfare gain or external benefits include a reduction in the spread of diseases since more people vaccinated. (1 mark). <p>Rejection marks</p> <ul style="list-style-type: none"> • Option A incorrect since the social optimum quantity is Q_1 or Y which is greater than the free market quantity Q_e or X. (1 mark) Note: do not double award if already credited in the explanation • Option B incorrect since welfare gain is area XZY Note: do not double award if this area has already been credited in the explanation) (1 mark). • Option D incorrect since marginal social cost (X or P_e) is less than marginal social benefit (Z) (must state the letters) (1 mark). 	(4)

Question Number	Answer	Mark
9(a)	<ul style="list-style-type: none"> • Explicit reference to Figure 1 to show price increase of beef e.g. from 125 cents to 170 cents or a 45 cents rise or from 50 cents to 100 cents (Accept approximate figures here). These figures may be stated on the diagram. (1 mark) • Increase in price of beef caused by: <ul style="list-style-type: none"> ➤ Rise in price of cattle feed (1 mark) ➤ Drought in Australia and New Zealand (1 mark) <p>Note: award for development of either of these points e.g. an increase in production costs. (1 mark)</p> <ul style="list-style-type: none"> • Diagram (up to 3 marks) <div data-bbox="486 1025 1002 1489" style="text-align: center;"> </div> <ul style="list-style-type: none"> ➤ Original demand and supply diagram (must include equilibrium price) (1 mark) ➤ A decrease in supply curve (accept a double inward shift of the supply curve) (1 mark) ➤ The original and new equilibrium price (1 mark) <p>NB: Award a maximum of 4 marks if no diagram.</p> <p>NB: Award a maximum of 5 marks if incorrect diagram depicting a shift in demand as well as supply.</p>	(6)

Question Number	Answer	Mark
9(b)	<p>KAA = 4 marks</p> <ul style="list-style-type: none"> • Definition or formula for cross elasticity of demand (XED): (The responsiveness in demand for good B due to a change in price of good A) or $(\% \Delta QD \text{ good B} \div \% \Delta P \text{ good A})$. (1 mark). • Reference to the goods being substitutes or in competitive demand (1 mark). • Reference to the goods having a positive cross elasticity of demand (1 mark). • Application: e.g. the rise in price of beef is likely to cause an increase in demand for chicken or fish (1 mark). • Numerical example of substitutes (1 mark). • Correctly labelled diagram depicting price of beef / demand for chicken or fish. This may be shown in two separate diagrams (1 mark). <div style="text-align: center;">  </div> <p>Evaluation (2 marks or 1+1 marks)</p> <ul style="list-style-type: none"> ➤ Discussion of how close beef and chicken & fish are as substitutes / beef is a red meat whereas chicken is a white meat / people may eat fish but not beef / weak substitutes. ➤ Figure 1 shows stable chicken prices, suggesting no change in demand - so evaluative use of the data. ➤ Once the sauces put on then not much difference in a beef burger and chicken burger at fast food restaurants. ➤ Big distinction at high quality restaurants. ➤ Other factors may affect the relationship e.g. health warnings on salmonella in chicken. ➤ The demand for beef may be price inelastic so weak substitutes. 	(6)

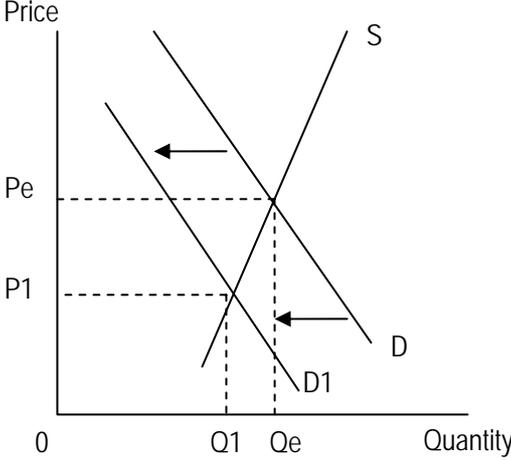
Question Number	Answer	Mark
9(c)	<p>KAA = 6 marks</p> <ul style="list-style-type: none"> • Definition or formula for income elasticity of demand (YED): (The responsiveness or sensitivity of demand for a good due to a change in income) or $(\% \Delta QD \div \% \Delta Y)$. (1 mark). • Reference to Extract 1 which suggests beef burgers might be inferior goods (e.g.) fast food restaurants have benefited from recession as consumers switch to burger places (2 marks). NB: this point could be considered as KAA or evaluation. • Explanation of inferior good (as income rises the demand for a good falls) (1 mark). • Inferior goods have a negative YED (1 mark). • Explanation of normal good (as income rises so too will demand for a good) (1 mark). • Normal goods have a positive YED (1 mark). • Numerical example of either normal or inferior good (1 mark). • Correctly labelled diagram depicting a normal good or inferior good (1 mark). <p>Evaluation (2 marks)</p> <ul style="list-style-type: none"> ➤ Discussion of different types of beef such as high quality beef - some parts are very expensive and so are normal goods; some beef burgers may be considered as inferior goods. Figure 1 refers to 'high quality beef' and 'standard quality beef'. ➤ Discussion of differences in income elasticity of demand e.g. due to different income levels of consumers / consumers in developed and developing countries. ➤ For some consumers this is irrelevant as they do not eat beef e.g. vegetarians. 	(8)

Question Number	Answer	Mark
9(d)*	<p>KAA = 8 marks</p> <ul style="list-style-type: none"> • Definition of external cost: (cost external to an exchange / negative third party effect / spillover from production or consumption / cost which the price mechanism fails to take into account / difference between private costs and social costs) (1+1 marks). • Examples of external costs associated with destroying rainforest to convert to cattle ranching and crop growing. e.g. increase in carbon dioxide emissions or global warming / effects in terms of crop failure / rising sea levels / wildlife destruction / damage to tourism (up to 3 marks for a well developed point or 1+1+1 marks). • Definition of market failure: (the price mechanism fails to allocate resources efficiently / price mechanism leads to a misallocation of resources) (1 mark). • Market failure is due to over-production and under-pricing / social costs exceeding social benefits at output Q_e, or, market failure occurs since marginal social costs exceed marginal social benefits at output Q_e (1+1 marks). <p>Diagram (up to 4 marks)</p>  <p>➤ MPC and MB curves (1 mark).</p> <p>➤ MSC curve (accept a parallel MSC line here) (1 mark)</p> <p>➤ Social optimum and market equilibrium positions labelled or explained in text (1 mark).</p> <p>➤ Welfare loss area shaded in (black triangle above) and named (1 mark).</p>	(14)

	<p>NB: Award maximum of 6 KAA marks if no relevant diagram offered.</p> <p>Evaluation: (2+2+2 or 3+3 marks)</p> <ul style="list-style-type: none">➤ Magnitude of destruction: - seems huge as extract 2 refers to 7,330 square miles of forest lost each year / 400 million tonnes of carbon dioxide into the atmosphere.➤ Discussion of the difficulty in quantifying and attaching a monetary value on external costs.➤ Time period: in the short run there may be little impact but more serious in the long run / destruction has been going on for many years and problem seems to be accelerating / a tipping point may come in terms of irreversible climate change.➤ Discussion of possible benefits e.g. employment and income for local communities / increase availability of food / reduction in beef and other commodity prices / reduction in poverty and hunger.➤ Government might be forced to take action, for example, subsidies to create sustainable development or an increase in policing to protect rainforest / but problems with these such as opportunity cost of the subsidies and difficulty in protecting such a vast area of land.	
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Question Number	Answer	Mark
9(e)*	<p>KAA = 8 marks</p> <ul style="list-style-type: none"> • Definition or understanding of sustainable development (development which enables future generations to access resources for further development) (1 mark) • Definition of government subsidy (grant to increase production or reduce price) (1 mark) • A subsidy has the effect of reducing production costs (1 mark) <p>Diagram of subsidy (up to 3 marks) or written explanation that supply increases resulting in an increase in production and this lowers price (1+1 marks).</p> <p>The diagram is a supply and demand graph. The vertical axis is labeled 'Price' and the horizontal axis is labeled 'Quantity'. A downward-sloping demand curve 'D' starts at point 'A' on the price axis. Two upward-sloping supply curves, 'S' and 'S2', are shown, with 'S2' shifted to the right of 'S'. The original equilibrium point 'E' is at the intersection of 'S' and 'D', corresponding to price 'Pe' and quantity 'Qe'. The new equilibrium point 'R' is at the intersection of 'S2' and 'D', corresponding to price 'P2' and quantity 'Q2'. A vertical dashed line is drawn at quantity 'Q2', intersecting supply curve 'S' at point 'L' and supply curve 'S2' at point 'T'. A horizontal dashed line is drawn from 'L' to the price axis at point 'G'. A horizontal dashed line is drawn from 'R' to the price axis at point 'P2'. A horizontal dashed line is drawn from 'E' to the quantity axis at point 'Qe'. A horizontal dashed line is drawn from 'T' to the quantity axis at point 'Q2'. A rightward-pointing arrow is shown between 'S' and 'S2'. A rightward-pointing arrow is shown between 'Qe' and 'Q2' on the quantity axis. The area bounded by points G, L, R, and P2 is shaded, representing the subsidy area.</p> <ul style="list-style-type: none"> ➤ Increase in supply curve to S2 (1 mark) ➤ Original and new equilibrium price (1 mark) ➤ Subsidy area identified (GLRP2) (1 mark) <ul style="list-style-type: none"> • Benefit to local communities e.g. increase in employment and income / replanting forest and tourism is labour intensive / positive multiplier effects (1+1 marks). • Benefits to local communities e.g. maintain way of life / 	(14)

	<p>secure lifestyle or forest for future generations (1+1 marks).</p> <ul style="list-style-type: none"> • Benefit to environment: reduction in deforestation and thus carbon emissions / so less external costs. (1+1 marks). • Increase in consumer surplus and / or producer surplus (1 mark) • Accept macro arguments e.g. improve Balance of Payments on current account due to attracting more overseas visitors / increase foreign investment (1+1 marks). <p>Evaluation (2+2+2 or 3+3 or 2+2+1+1 marks)</p> <ul style="list-style-type: none"> ➤ Extract 2 mentions that the amount of funds available for sustainable development projects has yet to be announced by the government - it may be a very small amount and so little beneficial impact for protecting rainforest and so reducing global warming. ➤ Brazilian government might be able to obtain some funding of the project from overseas e.g. European Commission / World Bank, / International Monetary Fund. Protecting the rainforest could become part of the carbon trading scheme. ➤ Opportunity cost to government / higher taxes or borrowing or less spending elsewhere / affordability of scheme in time of slow global economic recovery. ➤ Discussion of the difficulty in quantifying and attaching a monetary value on the externality. ➤ There may be significant corruption which undermines the effectiveness of government subsidies to support sustainable development. ➤ Time period issue: the subsidies may be required for a very long time - raises issue of affordability. ➤ There may be a decrease in supply of beef and other crops, leading to higher prices / job losses and lower income / poverty and hunger. ➤ Government subsidies may lead to inefficiency and create a dependency culture. ➤ Discussion of price elasticity of demand of the sustainable development projects. 	
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Question Number	Answer	Mark
10(a)	<p>Explicit reference to Extract 1 to show September price decrease of housing e.g. £6000 or 3.6% / accept a fall of 10% in 2011. Note the figures may be shown on the diagram (1 mark)</p> <ul style="list-style-type: none"> • Identification of causes of decrease in house prices: High and rising unemployment / limited wage growth / deteriorating consumer confidence / difficulties in getting a mortgage (award any two points 1+1 marks) • Development of either or both points (up to 2 marks) <p>Diagram (up to 3 marks)</p>  <ul style="list-style-type: none"> ➤ Original demand and supply diagram (1 mark) ➤ A decrease in demand curve to D1 (accept a double inward shift of the demand curve) (1 mark) ➤ The original and new equilibrium price (1 mark) <p>NB: Award a maximum of 4 marks if no diagram.</p> <p>NB: Award a maximum of 5 marks if incorrect diagram depicting a shift in supply as well as demand.</p>	(6)

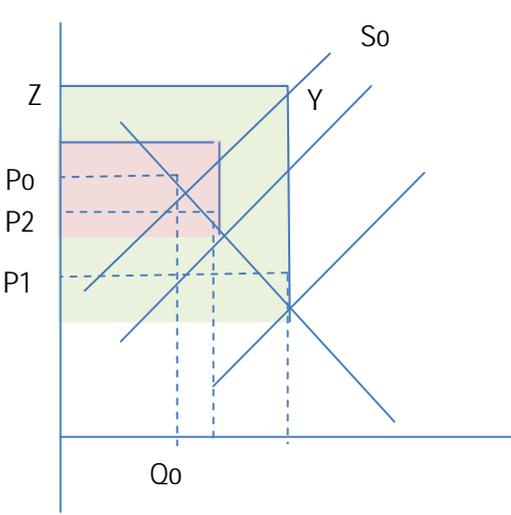
Question Number	Answer	Mark
10(b)	<p>KAA (6 marks) Extract 1 and / or Figure 2 data reference (1+1 marks) for example:</p> <ul style="list-style-type: none"> ➤ Share prices have fallen in 6 of the 7 companies. ➤ Barratt developments and Taylor Wimpey have recorded biggest fall in share price at 32.9% ➤ House building companies have lost more than £1 billion in share value. ➤ Builders' profits and employment has suffered. <p>➤ Development of point(s) for example, lower supply of new houses / lower employment as labour is a derived demand / less funds available for investment / possible losses and exit from industry / difficulty raising finance / lower dividends or no dividends available for shareholders / merger activity. (2+2 or 3+1 or 1+1+1+1 marks)</p> <p>Evaluation (2 marks)</p> <ul style="list-style-type: none"> ➤ Discussion of magnitude of the fall in house prices (3.6% in just one month) and so major impact on house builders. ➤ Discussion of possible reasons for marked difference in performance of house builder shares - e.g. comparing Berkeley with Taylor Wimpey. ➤ Companies might use previous profits to continue in business despite making current losses. ➤ Firms may cut production costs such as wages / increase efficiency. ➤ Time period - house prices expected to continue to fall in 2011 and so damaging the revenue and profits of the house builders. 	(8)

Question Number	Answer	Mark
10(c)	<p>NB: Candidates may develop either point of view on elasticity of supply; be prepared to accept one view as KAA (4 marks) and the other view as evaluation (2 marks).</p> <p>KAA (up to 4 marks) Definition or formula of price elasticity of supply (1 mark).</p> <p>Supply of housing tends to be inelastic in the short run but more elastic in the long run (this may be shown by a diagram - but do not double award) (1 mark)</p> <p>Supply may be inelastic since:</p> <ul style="list-style-type: none"> ➤ some inputs fixed in the short run / examples such as building development land (1+1 marks). ➤ limited availability of land to build on / time taken to gain planning permission. (1+1 marks) ➤ different stages in building a house (1 mark). ➤ shortages of skilled labour / examples include plumbers and bricklayers (1+1 marks). <p>Evaluation (2 marks)</p> <p>Supply may be more elastic in the long run since:</p> <ul style="list-style-type: none"> ➤ Extract 1 refers to the sharp fall in supply of new housing due to the fall in house prices / this suggests supply is price elastic in relation to a price fall. ➤ It might be easy for building firms to lay off workers as many are self-employed / on short term contracts. ➤ Spare capacity exists in the building industry / unemployed workers so supply is price elastic. ➤ Discussion of the number of building firms in the industry / ease of entry and exit. ➤ More land allocated to build on / training of skilled labour for building industry. ➤ Changes in planning regulations / make it easier to build housing. 	(6)

Question Number	Answer	Mark
10(d)*	<p data-bbox="427 331 1203 398">NB: If candidates refer to both points view then accept one side as KAA and the other as evaluation.</p> <p data-bbox="427 432 1038 465">Note KAA = 8 marks and Evaluation 6 marks</p> <p data-bbox="427 499 1177 566">Falling house prices may not help first-time buyers to purchase property since (2+2+2+2 or 3+3+2 marks):</p> <ul data-bbox="435 600 1203 2004" style="list-style-type: none"> <li data-bbox="435 600 1203 712">• Higher cash deposit required / so need more time to save up the funds / the cash deposits involved are huge e.g. 40% of property value. <li data-bbox="435 745 1203 857">• Lenders have not passed on interest rate cuts to first-time buyers / so monthly repayments are high / interest rates set to increase in future as economy recovers. <li data-bbox="435 913 1203 1025">• Rising unemployment / mean banks might be reluctant to offer mortgages to new borrowers / increased risk of default. <li data-bbox="435 1059 1203 1171">• High student debts / mean first-time buyers have less funds each month to pay for mortgage / student loans set to increase in the future. <li data-bbox="435 1205 1203 1317">• Low business confidence / so banks extremely cautious over mortgage lending / Extract 1 mentions mortgage approvals at their lowest for more than a decade. <li data-bbox="435 1350 1203 1462">• House prices predicted to fall by 10% in 2011 / so banks reluctant to offer mortgage on an asset falling in value. <li data-bbox="435 1496 1203 1608">• Extract 2 refers to 30% cut in government subsidies to new-build homes / these are typically the type of homes which first-time buyers might seek. <li data-bbox="435 1641 1203 1753">• The RIC indicates that there has been an increase in demand for rental property and rents / suggesting that people are forced to look to the rental property market / a substitute to private ownership. <li data-bbox="435 1809 1203 1921">• Problem of falling house prices mean that first-time buyers might delay purchase / concern over negative equity / existing house owners reluctant to sell. <li data-bbox="435 1955 1203 2004">• Less house put up for sale as vendors reluctant to sell when house prices are falling. 	(14)

Falling house prices may help first-time buyers to purchase property since: (up to 2+2+2 or 3+3 marks)

- As house prices fall it becomes more affordable to get on property ladder / plus some development.
- A lower mortgage is required as house prices fall / cash deposit will automatically rise as percentage of house price.
- House prices expected to fall by 10% in 2011 (some £16,000) / if the trend continues then property becomes more affordable in long run.
- More likely to help those first-time buyers who are able to receive parental financial support / through payment of cash deposit or guarantee of loan.
- Figure 3 shows that monthly mortgage payments as a percentage of average take home pay for first time buyers has decreased from around 50% in 2007 to 35% in 2010.
- Interest rates likely to remain low in foreseeable future / so more affordable monthly repayments.
- First-time buyers more likely to look for flats or studio apartments which are more affordable than houses.
- Recent government initiatives to help first-time buyers.
- Discussion on the price elasticity of demand for housing among first-time buyers / if inelastic then little impact.

Question Number	Answer	Mark
10(e)*	<p>KAA (Up to 8 marks)</p> <ul style="list-style-type: none"> • Definition of subsidy (government grant to increase production / lower price) (1 mark). • Reduction in the subsidy has the effect of increasing production costs (1 mark). <p>Diagram (up to 4 marks)</p> <ul style="list-style-type: none"> ➤ Original demand and supply curve before any subsidy (So) (1 mark) ➤ The supply curve with the full subsidy (S1) (1 mark) ➤ The new supply curve after a cut in the subsidy (S2) (1 mark) ➤ Any correct area of subsidy identified or shaded in e.g. (XYZP1) (1 mark) <p>Price</p>  <p>NB: If no diagram provided then award a maximum of 6 KAA marks from the 8 available.</p> <ul style="list-style-type: none"> • It becomes harder for first-time buyers to get on property ladder / with development (1+1 marks). • The supply or quantity of affordable housing will be reduced / with development e.g. impact on low income families or inequality (1+1 marks). • It may reduce the consumer surplus or producer surplus / with development (1+1 marks). • Government finances may not improve if it is forced to 	(14)

	<p>spend more on housing benefits / Job Seeker's Allowance as builders become unemployed.</p> <ul style="list-style-type: none"> • It may lead to a decrease in economic activity in the house building sector / such as falling employment or wages or profits and revenue. (1+1 marks). • It may increase demand for substitute accommodation / such as council or private rented properties (1+1 marks). • It may reduce the geographical mobility of labour / especially for areas where property prices are very high (1+1 marks). <p>Evaluation (2+2+2 or 3+3 marks)</p> <ul style="list-style-type: none"> ➤ Discussion of magnitude of the cut - 30% reduction (but 70% of funding for affordable new builds still exist. It also depends upon the size of government subsidy here in relation to overall new build housing market. ➤ Discussion of the time period in which the spending cut occurs - it may be prolonged over several years given the state of government finances. ➤ Private sector firms or charities may be able to fill the gap left by government funding cuts to new build housing. ➤ Some homeowners may benefit due to possibility of house prices rising / wealth effect. ➤ Opportunity cost: it may improve government finances / reduce budget deficit or national debt / provides funds for other uses e.g. healthcare. ➤ Substitute accommodation e.g. council housing is simply not available in the quantities needed. Private rental housing is too expensive. ➤ Discussion of cross elasticity of demand between private new builds and rental property. ➤ Discussion on economic efficiency among building firms as they become less reliant upon government subsidies. 	
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