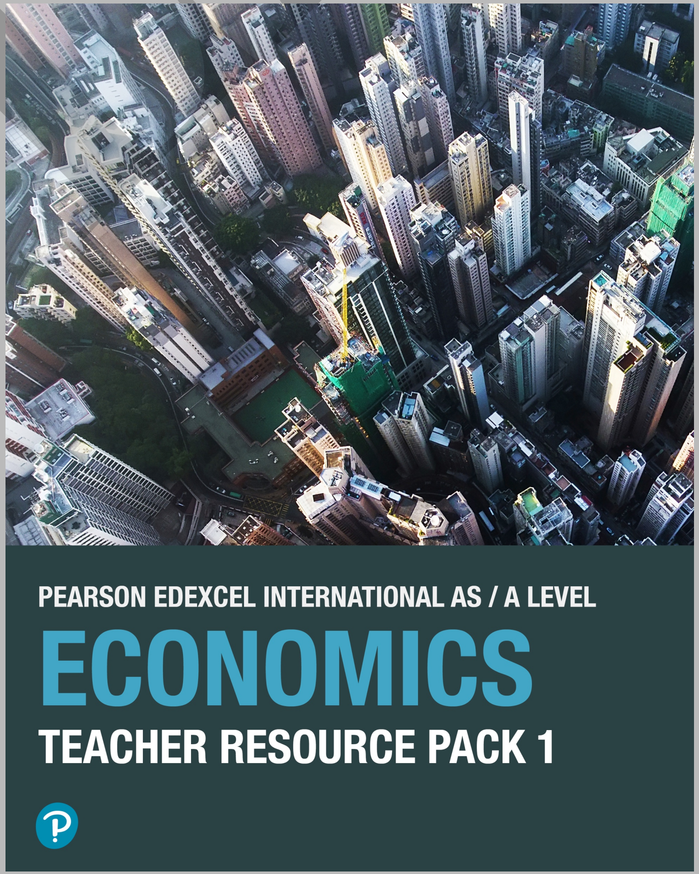
IAS Economics

Paper 2 (Section C style question)

Exam practice

SAMPLE



Exam practice
Section C style question

Exam question

(d) Slovenia's currency has been the Euro since 2007. Slovenia exports to Germany, France, Italy, Croatia and Austria, whilst it mainly imports from Germany, Italy, Austria, China and Croatia. With the exception of Croatia and China, all the other major import/export markets for Slovenia use the Euro.

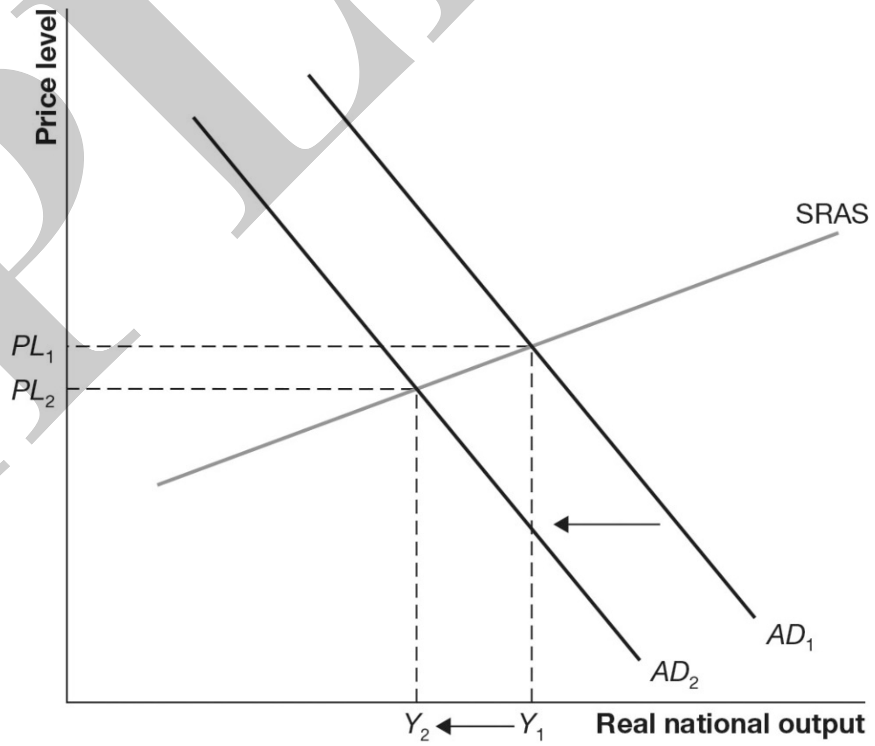
With reference to Figure 6 (p.196 of the Student Book) and the use of an AD/SRAS diagram, discuss the likely effect of an appreciation of Slovenia's exchange rate against the currencies of its major trading partners.

[14 marks]

Mock student response

An exchange rate is the value of a country's currency expressed in terms of another country's currency. An appreciation of Slovenia's exchange rate means that it is worth more than the other currencies it is measured against. This means that more foreign currency can be purchased with each Euro.

The first effect of an appreciation of the Euro will be to make exports more expensive. …



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Mock student response

… This means that consumers will be able to afford fewer goods from Slovenia and therefore the amount exported will fall. Therefore a fall in the value of exports will result in a decrease in AD, moving it inwards from AD_1 to AD_2. This will cause a fall in the output of Slovenia from Y_1 to Y_2.

An appreciation of Slovenia's exchange rate will mean that imports are less expensive; therefore Slovenia's consumers will purchase more imported goods, causing AD to shift further leftwards. This will cause a decrease in Slovenia's real national output (Y_1 to Y_2).

However, the shift of AD will depend on the change in the exchange rate.

Mock student response

Examiner verdict

This answer starts off well, with a definition of an exchange rate, and then takes a general view on an appreciation of the euro, which causes exports to be more expensive and imports cheaper. There is a good diagram, which is linked to the text, but the answer needs more analysis. Evaluation is very limited – just one idea that has not been developed. This answer would reach Level 2 for knowledge, application and analysis, achieving 6 marks. It would reach Level 1 for evaluation, achieving 1 mark (overall ***7 marks****).*

Activity

- Using the information from the previous slides, write your own answer to the question. Remember that this student did not develop their points fully to show their evaluation skills. Make sure you evaluate the likelihood of the effects you mention.

An example of best practice

An exchange rate is the value of a country's currency expressed in terms of another country's currency. An appreciation of Slovenia's exchange rate means that it is worth more than the other currencies it is measured against. This means that more foreign currency can be purchased with each Euro.

From the information above, for many of the economies that Slovenia trades with, an appreciation of the Euro will make no difference as those countries use the Euro as well (such as Germany, France, Italy and Austria). An appreciation of the Euro will only affect trade with China and Croatia …

(Continues on next page)

An example of best practice

… The first effect of an appreciation of the Euro will be to make exports to non-Euro countries, such as Croatia and China, more expensive. This means that consumers in those countries will be able to afford fewer goods from Slovenia and therefore the amount exported will fall.

Aggregate Demand (AD) is the sum of consumption (C), government spending (G), investment (I), exports (X) with the value of imports (M) deducted. ($AD = C + I + G + (X-M)$).

Therefore a fall in the value of exports will result in a decrease in AD, moving it inwards from AD_1 to AD_2. This will cause a fall in the output of Slovenia from Y_1 to Y_2 …

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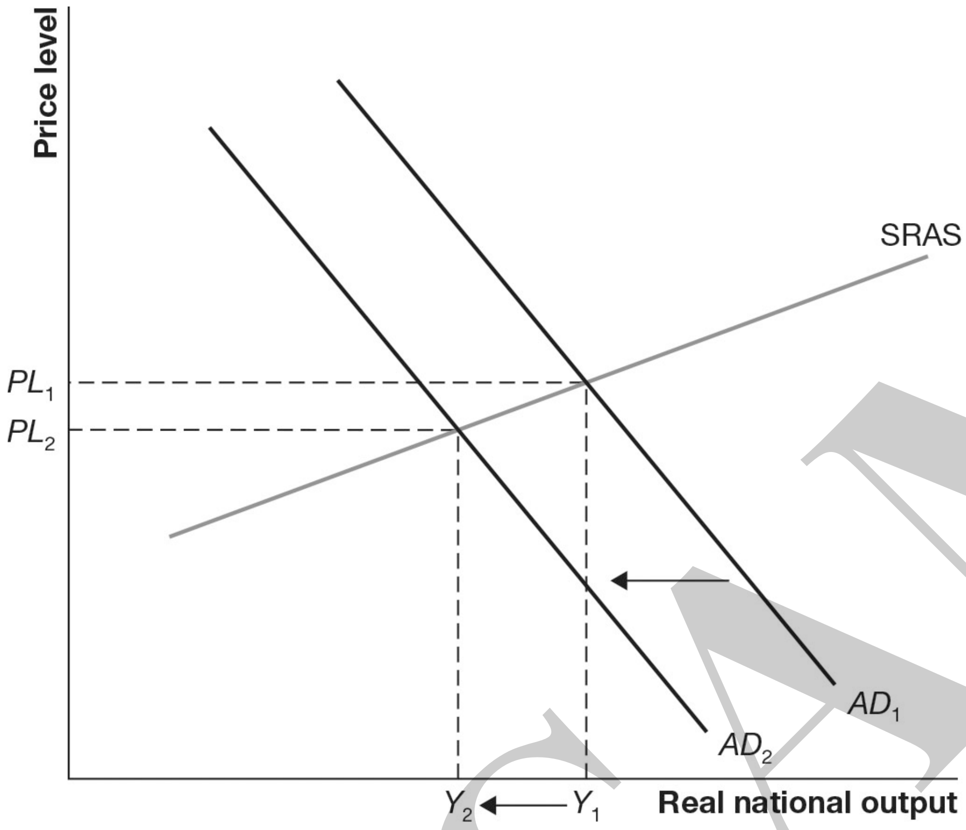
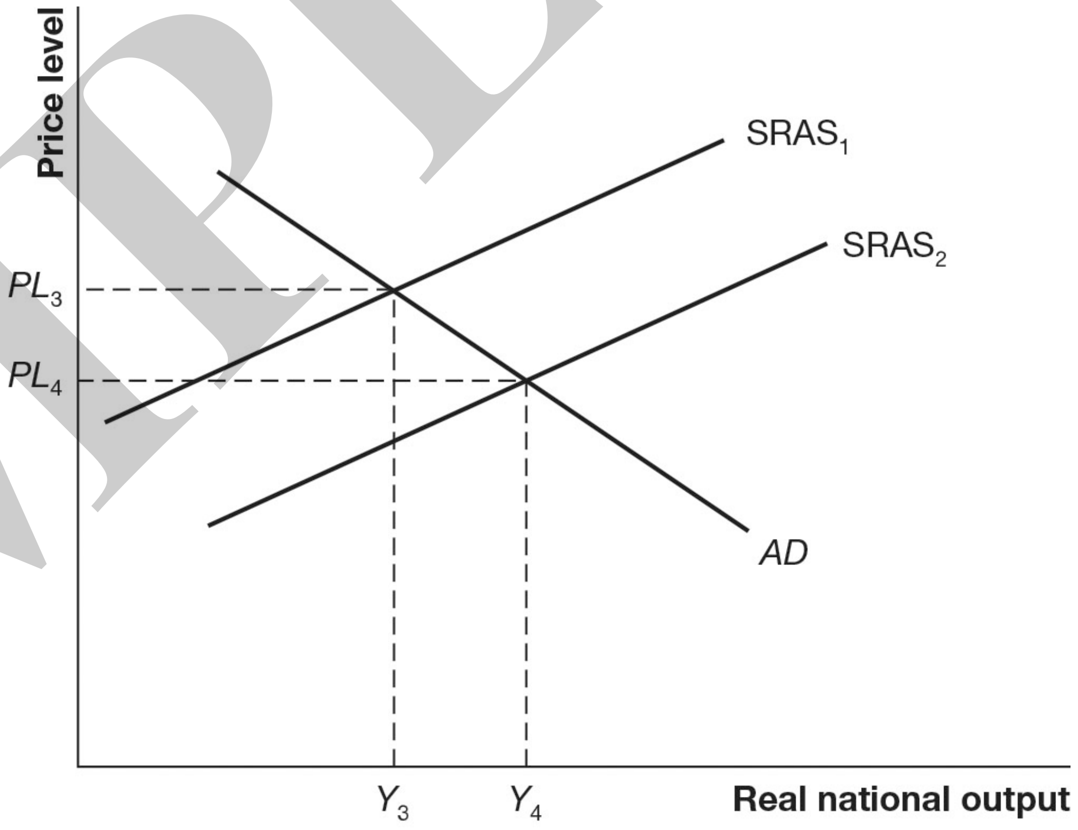
An example of best practice





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An example of best practice

… Depending what Slovenia imports, there may be an impact on SRAS. Cheaper imported materials for use in production will mean that SRAS moves rightwards, causing an increase in real output from Y_3 to Y_4 and this could potentially reduce the price level (PL_3 to PL_4).

However, the size of the shift of AD will depend on the proportion of goods exported to non-Euro countries. This is potentially quite small compared with the overall size of exports. In addition to this, as Slovenia has net exports close to 0 (X-M) this will potentially have no effect whatsoever. Similarly, the change of imports is likely to be only a very small proportion of AD and therefore shift AD very little…

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An example of best practice

… The other factor that needs to be considered here is the change in the exchange rates – they would need to be large to have much impact on either X or M, unless the goods are very price elastic (a small increase in price will cause a disproportionally large decrease in quantity demanded).

An example of best practice

Examiner verdict

This answer has much more analysis and addresses the fact that many of Slovenia's exports are to other countries that use the euro, so a change in the exchange rate will have little effect. There is another point made regarding SRAS, which strengthens the argument. Evaluation, over two paragraphs, is well analysed and explained. This student would be awarded 14 marks.

An example of best practice

Key to assessment objectives: Knowledge and Understanding (K), Application (A), Analysis (AN), Evaluation (E)

An exchange rate is the value of a country's currency expressed in terms of another country's currency. An appreciation of Slovenia's exchange rate means that it is worth more than the other currencies it is measured against. This means that more foreign currency can be purchased with each Euro. (K)

From the information above, for many of the economies that Slovenia trades with, an appreciation of the Euro will make no difference as those countries use the Euro as well (such as Germany, France, Italy and Austria). An appreciation of the Euro will only affect trade with China and Croatia. (A)…

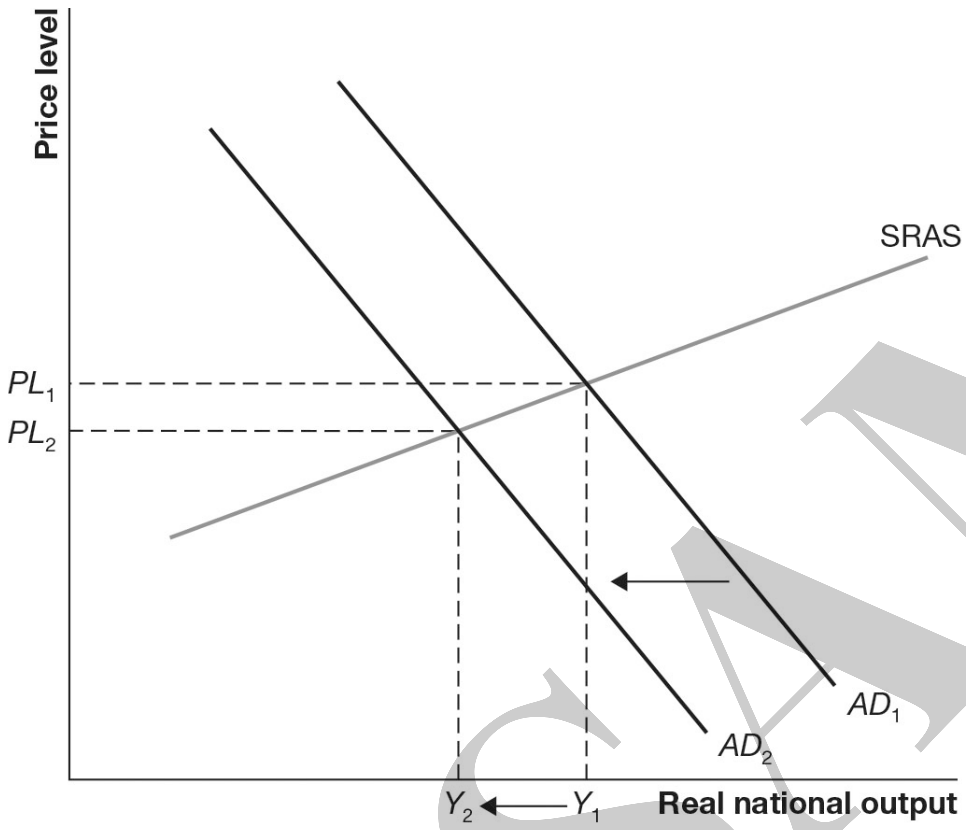
An example of best practice

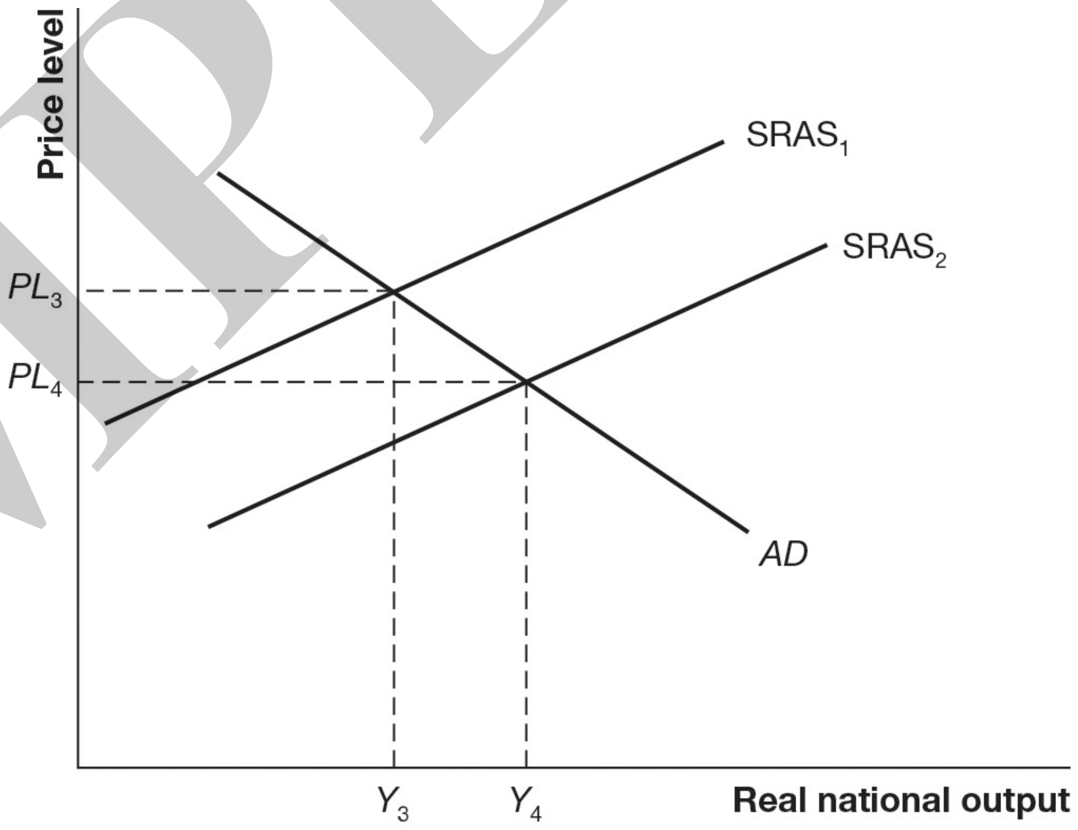
Key to assessment objectives: Knowledge and Understanding (K), Application (A), Analysis (AN), Evaluation (E)

… The first effect of an appreciation of the Euro will be to make exports to non-Euro countries, such as Croatia and China, more expensive. This means that consumers in those countries will be able to afford fewer goods from Slovenia and therefore the amount exported will fall. (AN)

Aggregate Demand (AD) is the sum of consumption (C), government spending (G), investment (I), exports (X) with the value of imports (M) deducted. (AD = C + I + G + (X-M)). (K) Therefore a fall in the value of exports will result in a decrease in AD, moving it inwards from AD_1 to AD_2. This will cause a fall in the output of Slovenia from Y_1 to Y_2. (AN)…

An example of best practice





An example of best practice

Key to assessment objectives: Knowledge and Understanding (K), Application (A), Analysis (AN), Evaluation (E)

… Depending what Slovenia imports, there may be an impact on SRAS. Cheaper imported materials for use in production will mean that SRAS moves rightwards, causing an increase in real output from Y_3 to Y_4 and this could potentially reduce the price level (PL_3 to PL_4). (AN)

However, the size of the shift of AD will depend on the proportion of goods exported to non-Euro countries. This is potentially quite small compared with the overall size of exports. In addition to this, as Slovenia has net exports close to 0 (X-M) this will potentially have no effect whatsoever. Similarly, the change of imports is likely to be only a very small proportion of AD and therefore shift AD very little. (E)

An example of best practice

Key to assessment objectives: Knowledge and Understanding (K), Application (A), Analysis (AN), Evaluation (E)

… The other factor that needs to be considered here is the change in the exchange rates – they would need to be large to have much impact on either X or M, unless the goods are very price elastic (a small increase in price will cause a disproportionally large decrease in quantity demanded). (E)