CAMBRIDGE INTERNATIONAL EXAMINATIONS

GCE Advanced Subsidiary Level and GCE Advanced Level

MARK SCHEME for the May/June 2014 series

9708 ECONOMICS

9708/21 Paper 2 (Data Response and Essay – Core), maximum raw mark 40

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Data Response Questions

1 (a) (i) Calculate the rate of inflation in India between 2001 and 2011. [1]

91.5% **(1 mark)**

Accept no other answer
There is no need to refer to %

(ii) Calculate the expected rate of inflation in India between 2011 and 2013. [1]

20.9% **(1 mark)**

Accept any answer between 20.8 and 21.0
There is no need to refer to %

(b) With the use of a production possibility curve explain the opportunity cost to India of choosing to produce transport facilities rather than education services. [4]

For a correctly constructed PPC with axes labelled appropriately. **(up to 2 marks)**

Accept a straight line PPC.

For accurate illustration of opportunity cost with a definition of concept. **(up to 2 marks)**

It is not necessary to show a movement along the PPC, as long as the understanding of the underlying concept is clear.

(No diagram, a maximum of 2 marks)

(c) Explain how the provision of improved transport facilities and education services might develop the potential of the economy in India. [4]

Both enhanced transport and education facilities will improve productive capacity in India. This might be illustrated with a shift outwards in the PPC. Transport will improve the market as supply constraints are removed. Enhanced skills provided through education will improve productivity and increase total output.

Reward key Economics concepts such as skills, productivity, output, resources, infrastructure, shift outwards of PPC, productive/allocative efficiency. Do not reward very general answers which do not bring in relevant Economics concepts. **(up to 4 marks)**

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(d) India's exchange rate depreciated between 2010 and 2011.

With reference to the data explain, using supply and demand analysis, what might have contributed to this change in India's exchange rate. [4]

The explanation should be based upon the current account deficit, slowing exports and higher imports. In addition, credit should be awarded for reference to India's external debts**.** It should make reference to how these factors affect the supply and demand for the rupee and how a depreciation will result. **(up to 4 marks)**

For an explanation in relation to demand. **(up to 2 marks)**
For an explanation in relation to supply. **(up to 2 marks)**
Other factors to refer to could include a relatively high rate of inflation and a deficit in the current account balance

NB A diagram is not actually required.

(e) Given the changes in the exchange rate shown in Table 1 between 2010 and 2011, discuss whether the changes in the current account balance over this period is what economic theory predicts. [6]

The data shows that the exchange rate has declined, and it would be expected that this would lead to a fall in the price of India's exports and a rise in the price of India's imports. This would result in a decrease in the Current Account deficit that is expected to rise by 2013. This depends upon certain factors being present, such as the elasticity of demand for exports and imports being sufficiently elastic to reduce the expected deficit. Reference to the Marshall-Lerner condition and the J-curve effect should be credited here. Other evaluative comment should be awarded with due credit.

For the expected impact upon the current account balance. **(up to 4 marks)**

For a discussion indicating why the expected outcome might not occur. **(up to 4 marks)**

(6 marks max)

In the marking of Section B answers, please use the T (Text Box) at the end of (a) and (b) to show the mark splits. You can include a comment if you think that it would be helpful.

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2 (a) Explain whether you would expect the price elasticity of supply of a product, such as rice in a market to be elastic or inelastic. [8]

For knowledge and understanding of price elasticity of supply including elastic and inelastic outcomes. **(up to 4 marks)**

Candidates need to show a firm grasp of the concept of price elasticity of supply. The formula is not required, but it is essential that an accurate explanation refers to the formula. The meaning of elastic and inelastic must be accurate for full marks.

For application of the factors that determine the coefficient, giving both elastic and inelastic outcomes. **(up to 4 marks)**

Application marks require candidates to demonstrate an understanding of the factors that lead to elastic and inelastic outcomes. These might include a reference to the time period under consideration, the availability of stocks, the availability of surplus capacity and the nature of the good. A good explanation of relevant factors is more important than an explanation of a range of factors. **(8 marks total)**

NB The question refers to 'a product, such as rice', but it is not necessary to refer to rice.

(b) Discuss the extent to which a government can increase the supply of an agricultural product to an economy in the short-run and in the long-run. [12]

For an analysis of the factors that might increase the supply of an agricultural product to an economy in the short-run and in the long-run. **(up to 8 marks)**

The government can adopt a number of policies to increase the supply of agricultural products. These include subsidies, increasing imports through, for example, exchange rate depreciation or bi-lateral trade agreements, increasing factors devoted to agricultural production and so on.

For evaluative comment on 'the extent to which' element of the question. **(up to 4 marks)**

A number of points can be raised to score evaluative marks. For example, candidates might refer to the inelasticity of supply of agricultural products when appropriate resources in terms of land and labour are absent, so that the extent to which supplies can increase is limited. Accept any attempt to question the effectiveness of policies suggested in the analysis. **(max 12 marks)**

NB The question explicitly refers to the role of a government in increasing the supply of an agricultural product.

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3 (a) Explain the difference between private goods and public goods, and why it is possible for a business to make a profit in the supply of private goods but not in the supply of a public good. [8]

For **knowledge and understanding** of the distinction between private and public goods. **(up to 4 marks)**

Candidates need to show a firm grasp of the difference between the types of good in terms of excludability, rejectability and non-rivalry in consumption.

A maximum of 2 marks for a list of distinctions that are not explained.

For **application** to explain how it is possible to make a profit providing private goods, but not public goods based upon the free rider problem. **(up to 4 marks)**

Application marks will be awarded for a clear explanation of the free rider problem and why this undermines the ability to make a profit through the fact that no one can be excluded from the consumption of public goods.

(b) Discuss the view that a market economy is always preferable to a planned economy because of the existence of the price mechanism. [12]

For an analysis of the two types of economy and the role of the profit motive in the free market economy. **(up to 8 marks)**

Candidates should explain the difference between the two types of economy in terms of resource allocation. The role of the factor enterprise in responding to the wants of the consumer through the price mechanism in the market economy should be explained and the role of profit made clear.

NB Up to a maximum of 4 marks for a general answer that does not focus on the existence of the price mechanism.

For evaluative comment on the 'always preferable' aspect of the question. **(up to 4 marks)**

Candidates can score for evaluative comment through an examination of the advantages and disadvantages of the free market economy and the role of the price mechanism in such an economy. Advantages include consumer sovereignty. Disadvantages include the non-provision of public goods and the over provision of demerit goods.

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4 (a) Explain is meant by the term 'money' and outline its characteristics in a modern 21st century economy. [8]

For knowledge and understanding of the meaning of the term 'money' **(up to 4 marks)**

Candidates need to show a good understanding of what is meant by 'money'.

A definition is expected for a good mark.

For application explaining the characteristics of money in a modern economy.
(up to 4 marks)

Candidates need to focus on what acts as money in a modern economy, and it is essential that reference be made to forms of money other than cash. It is also essential that bank deposits and the transfer of these deposits in a modern society, for example cheques and debit cards, are explained, for a good mark.

Up to a maximum of 4 marks if there is no reference to bank deposits and the role of electronic money, given explicit reference to modern 21st century economy in question.

(b) Discuss whether money is able to perform all its functions in an economy that is experiencing a high rate of inflation. [12]

For analysis showing how the functions of money are affected by a high rate of inflation.
(up to 8 marks).

The analysis will include an explanation of the functions and the impact of high inflation on each. For example, medium of exchange, store of value and so on.

For evaluative comment on the 'all its functions' aspect of the question. **(up to 4 marks)**

Evaluative comment will distinguish how each function is affected by high inflation and whether some functions might continue successfully. For example, the store of value function will be affected by high inflation before the medium of exchange function. But during hyperinflation the medium of exchange function is also affected. So whether functions are affected depends upon the rate of inflation.

NB One mark for reference to each of the four functions of money. One additional mark for reference to the effect of inflation on each of these four functions.

Some candidates may refer to the functions of money in (a), so be prepared to credit this in the mark given to part (b).

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1 (a) (i) Describe the change in New Zealand's terms of trade from June 2011 until September 2012. [1]

The terms of trade have moved in an unfavourable direction or have deteriorated or declined (1).

(ii) With reference to Fig. 1, account for the change that you have described. [2]

Allow flexible interpretation of the data in the diagram as long as the route to the outcome is valid.

E.g. (1) Export prices have fallen and import prices have remained stable.

(2) Export prices have fallen more than import prices.

2 marks available for valid account of relative change in export prices and import prices. If only export or import prices explained then a maximum of 1 mark may be expected.

The answer must refer to the information in Fig. 1 to receive marks.

(b) (i) Given the information in Extract 1, calculate the price elasticity of demand for New Zealand meat from June to September if all other factors were equal. [2]

Evidence of correct formula (1 mark), correct outcome (–) 2.5 (2).

The sign is not essential for answers to receive both marks.

(ii) Explain why receipts from meat exports rose despite the fall in price of meat. [2]

Sales of meat rose by a greater proportion than the fall in price (2).

If the candidate refers to absolute rather than proportionate changes then 1 mark may be awarded.

If the candidate states that the reason is that the price elasticity of demand is elastic with no further explanation then 1 mark may be awarded.

(c) Using the information provided in the extracts, explain why New Zealand's terms of trade were expected to 'stabilise through 2013'. [3]

Information in the data suggests that key export commodity prices were showing signs of improvement (1) and international inflationary pressures remained weak meaning that import prices were not expected to rise (1).

Reserve 1 mark for further interpretation of the data in the extract. For example, 'demand in Australia is expected to recover', which should lead to increased prices for New Zealand's exports (1).

Must have reference to both export prices and import prices for full marks.

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(d) Use economic theory to explain why New Zealand specialises in exports of dairy products and meat and imports machinery and consumer goods. [4]

For identification of comparative advantage as the relevant economic theory (1).

For recognition that New Zealand has lower opportunity costs in the production of dairy products and meat (1).

For recognition that New Zealand has higher opportunity costs in the production of machinery and consumer goods (1).

For linking New Zealand's comparative advantage to resource endowment (1).

If absolute advantage rather than comparative advantage (2 marks maximum).

(e) Discuss whether the rising deficit in New Zealand's balance of trade is what would be expected, given the change in the terms of trade after June 2011. [6]

For explaining that a declining deficit or a surplus might be expected given the impact of a declining terms of trade upon export prices and import prices (up to 2 marks).

For analysis of the factors that might result in the rising deficit that actually occurred, e.g. J-curve effect, elasticities, Marshall-Lerner, changing factors in export markets, etc. (up to 4 marks).

Reward a conclusion based on the analysis offered if one is provided.

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Essays

2 (a) Explain the meaning of the term 'equilibrium price and quantity' in the market for a good or service and show how a new equilibrium is established when there is an increase in demand. [8]

For **knowledge and understanding** of equilibrium price and quantity (up to 4 marks).

Candidates need to show a good understanding of equilibrium price and quantity as that where there is 'no tendency to change'. This can be illustrated and explained with the use of a supply and demand diagram.

If the candidate recognises where equilibrium occurs but fails to explain what is meant by 'equilibrium', reward a maximum of 2 marks, e.g. 'It is where supply is equal to demand' (1), shown on a diagram (1).

For **application** showing the process through which equilibrium is re-established when there is an increase in demand (up to 4 marks).

Candidates will provide a supply and demand diagram showing a shift in the demand curve to the right, the consequent excess demand that this will cause together with the upward movement of price and quantity to re-establish equilibrium.

An accurate diagram with no explanation of the process that results in a new equilibrium (2 marks maximum).

For full marks for this part of the question there should be reference to issues of excess demand or shortage.

(b) Discuss the view that attempts to help poorer consumers through the imposition of a maximum price for food items will always fail. [12]

For an **analysis** of the effects imposition of a price maximum below the equilibrium (up to 8 marks).

The analysis will illustrate the impact of a maximum price below the equilibrium, and will explain how this will lead to an excess demand. The answer will go on to explain how a system of allocation will need to be established such as rationing, queuing, etc.

For an **evaluative comment** on the 'will always fail' aspect of the question (up to 4 marks).

Marks will be awarded for a consideration of the likely success of a maximum price in terms of helping the poor given the arrangements made to allocate food when an excess demand exists. For example, can rationing be successful or will a black market arise? For full marks for evaluation, a conclusion must be provided.

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3 (a) Distinguish between income elasticity of demand and cross elasticity of demand and explain how each is used to identify different types of product. [8]

For **knowledge and understanding** of both types of elasticity (up to 4 marks).

Candidates are expected to show a good understanding of the relevant concepts, demonstrated by means of an accurate explanation of each type of elasticity mentioned in the question. The distinction between types of elasticity can be implicit.

For each type of elasticity: definition/description (1 mark), formula (1 mark).

For **application** showing how goods are identified using each type of elasticity (up to 4 marks).

Marks for application will be awarded for an explanation of the values of the coefficients and the classification of products into normal, inferior and necessary categories in the case of income elasticity and substitutes and complementary products in the case of cross elasticity.

(Allow 3/1 split here if one type of elasticity is particularly well answered.)

(b) Discuss which of these two types of elasticity would be most useful when predicting how a firm's revenues would change as demand factors change in a market economy. [12]

For **analysis** showing how each type of elasticity could be used to predict changes in sales revenues as demand factors changed (up to 8 marks).

The analysis will explain how changes in income will affect the revenue of firms in the case of normal, inferior and necessary goods, and how the revenue of firms will be affected by a change in the price of substitutes and complements.

If only one type of elasticity is analysed 6 maximum.

For **evaluative comment** on the 'most useful' aspect of the question (up to 4 marks).

Marks for evaluative comments will be awarded if candidates examine the relative usefulness of the two measures. For example, they might consider the reliability of the measures, the likelihood of the change in the relevant conditions of demand, the actions of competitors etc.

Some candidates may successfully argue that the changes that might occur will depend on upon the circumstances. For full marks for an evaluation, a conclusion must be provided.

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4 (a) Using diagrams, explain the difference between demand-pull and cost-push causes of inflation. [8]

For **knowledge and understanding** of demand-pull and cost-push causes of inflation (up to 4 marks).

For stating that demand-pull inflation is caused by an increase in aggregate demand (1).

For explaining the possible cause of an increase in aggregate demand such as an increase in consumption, investment, government expenditure or net exports (1).

For stating that cost push inflation is caused by an increase in costs (1).

For explaining the possible cause of an increase in costs such as an increase in wage rates, raw materials etc. (1).

For **application** using appropriate diagrams to distinguish between the two types of inflation (up to 4 marks).

Diagrams showing how changes in aggregate supply and aggregate demand may lead to inflation.

Award marks for diagrams as follows:

- A 'micro' diagram should be awarded 0 marks.
- A 'macro' diagram that is not fully accurate may gain 1 mark.
- An accurate 'macro' diagram is required for 2 marks.

One accurate diagram showing both demand pull (AD) and cost push (AS) causes could gain 4 marks (8 marks total).

(b) Distinguish between the domestic and external consequences of inflation and discuss which is most damaging to an economy. [12]

For **an analysis** of the internal and the external consequences (up to 8 marks).

The analysis must make clear the distinction between the internal and external consequences of inflation. The analysis must also explain the consequences of each. Internal consequences include the impact on savings and investment, the re-distribution of income, menu costs and shoe-leather costs. External consequences include the impact on trade and the exchange rate and international investment flows. For full marks for evaluation, a conclusion must be provided.

(Allow up to 6 marks if only the internal or external are considered).

If the candidate explains the consequences of inflation but fails to distinguish between internal and external, then a maximum of 6 marks may be awarded.

For **evaluative comment** on 'the most damaging' element of the question (up to 4 marks).

Relevant evaluative comment, might include the extent to which an economy engages in trade, whether an economy has a fixed, floating or managed floating exchange rate and so on.

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1 (a) (i) Calculate the rate of food price inflation from 2003 to 2009. [1]

57% (1 mark)

(ii) Calculate the rate of food price inflation from 2009 to 2012. [1]

35.66% (1 mark)

(b) What evidence is contained in Table 1 to suggest that the adoption of biofuel targets in the EU had an impact on food prices? [2]

Candidates are expected to use the data in Table 1 to provide evidence that biofuel targets had an impact on food prices. A number of approaches are acceptable.

e.g. 1. Cereal prices and/or sugar prices, both of which are used in biofuel production, have risen more than the overall food price index **(up to 2 marks).**

e.g. 2. The rate of inflation of cereal prices increases after 2009 when the targets began. **(up to 2 marks).**

(c) Using diagrams explain how the removal of the subsidy for biofuel production in the United States would be likely to affect the market for biofuels. [3]

(i) biofuels.

For an appropriate diagram showing how the removal of the subsidy will increase price and reduce quantity of biofuels**. No diagram 1 mark maximum. (up to 3 marks).**

(ii) fossil fuels. [3]

For an appropriate diagram showing a shift to the right of the demand curve for fossil fuels as biofuels become more expensive and the resulting rise in price and rise in quantity demanded. **No diagram 1 mark maximum (up to 3 marks).**

(d) (i) Use a production possibility curve to show the trade-off between the production of crops for biofuels and the production of food crops. [2]

For an accurate ppc diagram showing the trade-off with production of biofuel and food on the axes. **If the diagram is provided, but the trade-off is not indicated 1 mark maximum** (**up to 2 marks).**

(ii) Explain why the cost of food production is increasing as more land is used to grow crops for biofuels. [2]

As resources are not homogeneous, the opportunity cost will increase, as less suitable resources are used to produce food **(up to 2 marks).**

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(e) Carbon emissions are believed to contribute to global warming.

Discuss whether indirect taxes on fossil fuels might be a more effective way of preventing global warming than government commitments to biofuel targets. [6]

For an analysis of the impact of indirect taxes upon global warming **(up to 3 marks).**

For an evaluative comment on which is most effective **(up to 3 marks).**

Essays

2 (a) Explain what is meant by the term 'money' and outline its characteristics in a modern 21st century economy. [8]

For **knowledge and understanding** of the meaning of the term 'money' **(up to 4 marks).** Candidates are expected to demonstrate a good understanding of what is meant by 'money' and its functions in society. A definition is expected for a good mark.

For **application** explaining the characteristics of money in a modern economy. **(Up to 4 marks).**

Candidates need to focus on what acts as money in a modern economy, and it is essential that a reference is made to forms of money other than cash. It is essential that bank deposits and the transfer of these deposits in a modern society (e.g, cheques and debit cards) is explained for a good mark.

(b) Discuss whether money is able to perform all its functions in an economy that is experiencing a high rate of inflation. [12]

For **analysis** showing how the functions of money are affected by a high rate of inflation **(up to 8 marks).**

The analysis will include an explanation of the functions and the impact of high inflation on each. For example, the medium of exchange, the store of value and so on.

For **evaluative comment** on the 'all its functions' aspect of the question **(up to 4 marks).**

Evaluative comment will distinguish how each function is affected by high inflation, and whether some functions might continue successfully. For example, the store of value function will be affected by high inflation before the medium of exchange function is affected. But during hyperinflation, the medium of exchange function is also affected. So whether functions are affected primarily depends upon the rate of inflation.

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3 (a) Explain the factors that might make the price elasticity of demand for a good highly inelastic. [8]

For **knowledge and understanding** of 'price elasticity of demand' and 'highly inelastic' **(up to 4 marks).**

Candidates are expected to demonstrate good understanding of price elasticity and should provide an accurate explanation of highly inelastic.

For **application** explaining factors that cause the demand for a good to be inelastic **(up to 4 marks).**

The application will focus on an explanation of the factors that influence price elasticity such as the availability of substitutes, proportion of income spent upon a product and so on.

(b) Discuss why businesses might attempt to change the price elasticity of demand for their products and consider whether it is likely that they will be successful in their attempt. [12]

For **analysis** showing why businesses would want to change the price elasticity of demand **(up to 8 marks).**

The analysis will explain the link between inelastic demand and changes in total revenue. It will also include an explanation of the way in which the elasticity can be influenced, such as through the means of advertising, removal of rivals and so on.

For **evaluative comment** on the 'likely to be successful' aspect of the question **(up to 4 marks).**

Evaluative comment will assess the likely success of attempts by businesses to make demand for their product more inelastic. Such comment might include the view that it depends upon the number of rivals that makes it difficult to increase inelasticity and might question the effectiveness of advertising.

4 (a) Explain the factors that might cause an economy to experience a current account deficit. [8]

For **knowledge and understanding** of the meaning of current account deficit **(up to 4 marks).**

Candidates are expected to show an accurate understanding of the components of the current account and what is meant by a deficit.

For **application** explaining why current account deficits might arise **(up to 4 marks).**

A number of possible causes may be identified and explained. Credit quality of explanation rather than, for example, the number of causes identified. An overvalued exchange rate, loss of comparative advantage, high relative rates of inflation etc.

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(b) Discuss the policies available to a government faced with a current account deficit and consider which policy has the fewest disadvantages for the consumers in that economy. [12]

For **analysis** showing how at least two policies are designed to deal with a current account deficit **(up to 8 marks).**

The analysis may refer to expenditure switching and expenditure dampening policies. Credit accuracy and quality of explanation.

For **evaluative comment** on the 'fewest disadvantages' aspect of the question **(up to 4 marks).**

Examples of evaluative comment include the impact on consumer choice when expenditure-switching policies are adopted, and the impact on living standards when expenditure-dampening policies are deployed.

Candidates need to make some assessment of 'fewest disadvantages' to receive full evaluative marks.

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