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Cambridge International Advanced Subsidiary and Advanced Level

MARK SCHEME for the May/June 2015 series

9708 ECONOMICS

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

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Data Response

1 (a) With reference to Fig. 1, explain the trend in US net imports of oil after 2005. [3]

The trend is downward **(1 mark)** because consumption is falling [1 mark] and production is rising. **(1 mark)**

If the explanation is not clearly linked to Fig. 1, even if it is a valid explanation, then there is a maximum mark of 2.

(b) (i) With the help of a diagram(s), explain how the new sources of crude oil from hydraulic fracturing and the 'falling enthusiasm for cars among younger Americans' might be expected to cause a fall in the price of gasoline (petrol) in the US. [4]

For a diagram with an explanation showing the increased supply of crude oil and the fall in equilibrium price of gasoline. **(Up to 2 marks)**

For a diagram with an explanation showing the decreased demand for gasoline as a result of the falling enthusiasm for cars and the fall in the price of gasoline. **(Up to 2 marks)**

Accept one diagram showing both changes. **(Up to 4 marks)**

Use the text box to show the mark out of 2 in each case, i.e. each part should be marked out of 2.

If the candidate has not included a diagram, or diagrams, then there is a maximum mark of 1 out of 2 for each part, i.e. a maximum mark of 2/4.

(ii) Suggest and explain one factor that might have caused the price of gasoline (petrol) to rise in the US after 2009 despite these changes. [3]

Accept any valid suggestion. This could be contained in the data or be independent of the data, such as an increase in the price of oil on world markets.

E.G. 'Suggest': A rise in tax on gasoline or an increase in the costs of production **(1 mark)**.
'Explanation': Example of a shift in the supply curve to the left and the resulting rise in price. **(Up to 2 marks)**

Or 'Suggest': A rise in incomes or an increase in advertising campaigns for cars **(1 mark)**.
'Explanation': Example of a shift in the demand curve to the right and the resulting rise in price. **(Up to 2 marks)**

There needs to be an explicit reference to demand and/or supply in order to gain all 3 marks.

Diagrams are NOT essential in order to gain full marks, as long as the explanation is good.

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(c) Explain the value that you would expect to find if you measured the relationship between gasoline (petrol) and biofuel using the concept of cross elasticity of demand. [4]

For knowledge and understanding of the cross elasticity of demand: either through a definition of the term or the formula, but making it clear what is being measured. **(1 mark)**

For recognition that the two goods are substitutes. **(1 mark)**

For recognition that the coefficient would be positive. **(1 mark)**

For explanation of why the coefficient is positive. **(1 mark)**

(d) Discuss how reducing dependence on foreign oil might affect aggregate demand in the US economy and the impact of this on prices and on employment in the US. [6]

For knowledge and understanding of AD=C+I+G+(X-M). **(1 mark)**

For knowledge and understanding of AD equally consumption + investment + government expenditure – net exports. **(1 mark)**

For analysis showing that 'reducing dependence on foreign oil' would increase aggregate expenditure through an increase in net exports'. **(Up to 2 marks)**

For evaluation showing judgment about how the impact upon prices and employment depends upon the interaction of aggregate demand and aggregate supply in the U.S. economy. **(Up to 2 marks)**

Essays

2 (a) Explain two factors that are likely to make the supply of a product relatively price inelastic. [8]

For knowledge and understanding of the concept of elasticity of supply and the meaning of 'relatively price inelastic'. **(Up to 4 marks)**

For application with two factors that might make supply relatively price inelastic e.g. the lack of stocks, the time period, the nature of the product, the availability of factors of production, the number of producers, the existence of spare capacity, the ease of storing stocks, the length of the production period and factor mobility. **(Up to 4 marks)**

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(b) Discuss how governments might attempt to make the supply of an essential good more responsive to a change in its price and assess the likely effectiveness of such attempts. [12]

For **analysis** of the ways in which governments might attempt to increase the elasticity of supply of a product for example buffer stock schemes to ensure the availability of stocks during shortages, training programs to increase the availability of labour with appropriate skills, providing loans for capital investment and financial incentives to promote research and development etc.

A subsidy on training will increase supply, i.e. shift the supply curve to the right, but will not necessarily increase supply elasticity. In order to make supply more elastic, candidates need to comment on how a subsidy would change the resources. (**Up to 8 marks)**

For **evaluation** of the likely effectiveness of such policies, such as cost issues.
(Up to 4 marks)

3 (a) Explain how the contribution of each factor of production differs in an agricultural economy from that in an industrialised economy. [8]

For **knowledge and understanding** of the contribution of each factor of production in the production process. **(Up to 4 marks)**

For **application** showing the how the different factors of production might contribute to the different types of economies described. **(Up to 4 marks)**

(b) Discuss whether entrepreneurs or governments are more likely to cause economic growth in a mixed economy. [12]

In a mixed economy it is expected that both entrepreneurs and the government would contribute to economic growth. Entrepreneurs would respond to consumer wants by investing in capital goods and expanding production in pursuit of profit. Governments would invest in public goods and merit goods to ensure that these goods are sufficiently provided. Which contributes most depends upon a wide range of factors including the availability of funds for private investment, the number of entrepreneurs with the necessary skills and government budgets.

For **analysis** of the ways in which both entrepreneurs and the government can generate economic growth (up to 2 marks can be given for an understanding of what is meant by a mixed economy). **(Up to 8 marks)**

For **evaluation** of the 'more likely' issue. **(Up to 4 marks)**

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4 (a) Explain what acts as money in a modern economy and what is likely to happen to the price level if the quantity of money increases significantly. [8]

For **knowledge and understanding** of money in a modern economy. **(Up to 4 marks)**

(Up to 2 marks can be given for a traditional approach to what acts as money without recognising what may act as money in a modern economy).

For **application** showing the impact of an increase of the money supply upon the general price level in an economy. **(Up to 4 marks)**

(Up to 2 marks can be given for a general comment on inflation being caused by the growth of the money supply; up to 2 marks are reserved for explicit reference to the Fisher equation of MV=PT).

(b) Explain how a significant rise in the general price level will affect the current account of the balance of payments of an economy and discuss whether this is likely to turn a deficit into a surplus. [12]

For analysis of the fact that a significant rise in the general price level will make export prices rise and import prices fall. The impact on the current account depends upon the price elasticity of demand for exports and imports and candidates should refer to the Marshall-Lerner condition. Candidates may also refer to how capital flows are influenced with the effect on interest payments and so on.

For **analysis** of the impact of a rise in the general price level upon the deficit.
(Up to 8 marks)

For evaluation of the effect upon the deficit being affected by factors such as the relative inflation rate, the time period and the J-curve effect.

For **evaluation** of whether this is likely to turn the deficit into a surplus. **(Up to 4 marks)**

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1 (a) Use production possibility curves to compare Brazil's economy in 2013 with its economy in 2003. [2]

The Brazilian economy has grown between 2003 and 2013. Candidates should provide a diagram of a production possibility curve shifting outwards.

For a diagram of the ppc with appropriate axes, accurately labeled (1).

For an indication of the outward shift of the ppc as the Brazilian economy has grown (1).

(b) (i) Using Fig.1, explain what has happened to the value of the Brazilian Real in 2013 compared with 2004? [2]

It has appreciated/risen/increased/is higher etc. (1)
by approximately 25%(23%-27%) Accept answers in the region of 50% (46%-51%) (1)

Do not award the second mark for confused attempts that calculate the change using invalid units.

(ii) Explain <u>one</u> possible reason for the stability of the Mexican Peso from 2004 to 2008 shown in Fig. 1. [2]

A number of reasons are acceptable. For example intervention by the Mexican authorities in the foreign exchange market. Or answers could be based upon the information provided in the extract i.e. the small trade deficit that can be financed easily…. For maximum marks there must be some reference to the supply and demand for the Mexican currency. (up to 2 marks)

(iii) With the help of diagrams, explain how the different economic experiences of Brazil and Mexico after 2011 mentioned in the text could explain the changes in the currency values shown in Fig. 1. [4]

The changes in the currency values are a reflection of changes in the supply and demand for the Brazilian Real and the Mexican Peso.

For an explanation of the reasons for the depreciation of the Brazilian currency with due reference to the text. (Up to 2 marks (no diagram 1 max))

A number of approaches are acceptable:
There has been a decline in China's demand for Brazil's raw materials and as a result a decline in the demand for the Real.
There has been a rapid rise in imports of luxuries from the US into Brazil and therefore an increase in the supply of the Real.
A significant trade deficit in goods and services has developed that means that the supply of Real exceeds its demand.
If reference is made to 'the waste of the boom years' the candidate needs to go on to show how this affects the value of the Real through the impact upon the supply and the demand for the currency.
For an explanation of why Mexico's currency is relatively more stable or one that explains the rise in the Peso after 2012 with due reference to the text.
(Up to 2 marks (no diagram 1 max))
A number of approaches are acceptable:
A 'relatively small trade deficit that can easily be financed…….' means that there is not

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a great excess supply or demand for the Peso.
If reference is made to the Mexican government's policy that has 'significantly strengthened its economy' the candidate needs to go on to show how this would prevent a large trade deficit from arising.

(c) Explain how the approach of the Mexican government 'during the past decade' is more likely to generate an expansion of the economy than the approach of the Brazilian government during this period. [4]

In Mexico improving the education system and making the various sectors mentioned more efficient has improved the productivity of the factors of production and lead to an expansion of the economy. In Brazil, the government 'wasted the boom years' failing to invest in infrastructure. Candidates need to show understanding of the link between the actions of the two governments and the supply side of their economies. A further acceptable approach is to analyse the impact of the Mexican government's policy on aggregate demand in Mexico.
For an explanation of the way in which the policies of the Mexican government would lead to an expansion of the Mexican economy through an improvement in the quality of Mexico's factors of production **or** for an explanation of the impact upon aggregate demand of increased Mexican government spending. (up to 3 marks)

For a comparative statement referring to the Brazilian government's failure to invest in its resources and/or fail to boost aggregate demand. (1)

(d) Identify and evaluate the usefulness of any further information that might be helpful in assessing the future prospects of the Brazilian and Mexican economies. [6]

Further information that might be useful includes demographic factors, inflation and unemployment rates and the policies of the two governments. Good answers might use the information on each economy included in the data. For example, it is clear that Mexico's prospects are linked to the United States so information on the US economy would be useful. Also, in the past, Brazil has been dependent upon demand for raw materials from China. The future prospects of Brazil therefore will depend upon economic activity in China.
Candidates might suggest a wide range of factors that would be helpful or alternatively might provide a detailed explanation of only one factor. Either approach is acceptable, but it is insufficient to simply identify further information without explaining why it might be helpful. If further information that might be useful is identified but not explained then this can be awarded a maximum of 1 mark.

For **identification (1 mark), explanation (up to 3 marks) and evaluation (up to 2 marks)** of the factors that would be helpful in assessing the future prospects of these economies.
(6 marks maximum)

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Essays

2 (a) Explain how economists measure the way in which demand for a good changes when income changes and, with the help of a diagram, show why some goods are classified as 'inferior goods'. [8]

For **knowledge and understanding** of income elasticity of demand (up to 4 marks)

Definition of income elasticity: (1)

Formula: Up to 2 marks (Some inaccuracy e.g. no reference to %: 1 mark)

For some development of the concept e.g. explanation of elastic/inelastic or meaning of normal good: (1)

For **application** using a diagram to show how goods are classified as inferior.
(up to 4 marks)

For clear explanation of inferior good (definition 1 mark, negative value of yed 1 mark)

For an accurate, correctly labelled diagram illustrating an inferior good (up to 2 marks).

(b) Discuss how useful governments might find the concepts of price and income elasticity of demand when setting economic policy. **[12]**

Price elasticity is useful to governments because it measures the change in demand when price changes. This helps governments in a number of ways. For example, it helps to predict revenues from indirect taxes, it can be used to estimate the change in the consumption of demerit goods when taxes are imposed and also the extent of any price fall when a good is subsidised. Income elasticity of demand can be used by governments to predict the impact on regions that specialise in goods or services that are sensitive to income changes. It can also be used to assess the impact of changes in income tax.

Which is most useful might depend upon the policy aims of the government or whether incomes are stable or changing**.**

For **analysis** of the usefulness of both price and income elasticity to governments when setting economic policy (up to 8 marks).

For **analysis** of the usefulness of price elasticity of demand (up to 6 marks).

For **analysis** of the usefulness of income elasticity of demand (up to 6 marks).

If the candidate discusses the usefulness of these concepts to firms with no reference to governments then no marks will be awarded for analysis. (Up to a maximum of 8 marks for analysis)

For **evaluative comment** on which concept might be most useful (up to 4 marks).

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3 (a) Using examples, explain the difference between merit goods and public goods and show why it is possible for profit to be made in the supply of one of these types of good but not the other. [8]

For **knowledge and understanding** of both merit goods and public goods with appropriate examples (up to 4 marks).

For an accurate definition of merit goods in terms of under-consumption through information failure (accept positive externalities), with an appropriate example. No example or incorrect example, 1 maximum (2).

For an accurate definition of public goods in terms of non-excludability and non-rivalry, with an appropriate example. No example or incorrect example, 1 maximum (2).

For **application** to show why profit could be made in supplying merit goods, but not public goods (up to 4 marks).

The answer should be based upon the fact that public goods are non-excludable and this gives rise to the free rider problem meaning that no price can be charged. As result entrepreneurs cannot make a profit in the supply of public goods (up to 2 marks).

Merit goods are excludable and as a result a price can be charged so that entrepreneurs will produce the good in pursuit of profit (up to 2 marks).

(b) Discuss why merit goods are under supplied in a free market economy and consider the effectiveness of <u>one</u> policy to deal with this problem. [12]

Merit goods are undersupplied in a free market economy because of information failure. They are undervalued by consumers so the demand for them is less than it would be if the value was fully understood. Policies include subsidies, educational campaigns and state provision. Each has disadvantages such as cost and the length of the time period before the impact is felt.

For **analysis** of the under-provision of merit goods and an appropriate policy to deal with the problem (up to 8 marks).

Explaining why they are undersupplied and why a policy is needed (up to 4 marks).

Explanation of any one policy to deal with this (up to 4 marks).

For **evaluation** of the effectiveness of the policy analysed**.** (up to 4 marks)

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4 (a) Explain how a declining exchange rate and a high rate of inflation in an economy might affect that economy's terms of trade. [8]

For **knowledge and understanding** of the terms of trade, a declining exchange rate and a high rate of inflation (up to 4 marks).

Terms of trade. Definition 1 mark, formula 1 mark (up to 2 marks).

A declining exchange rate. Candidates might demonstrate understanding of this through application. (1)

A high rate of inflation. Candidates might demonstrate understanding of this through application. (1)

For **application** showing how both a declining exchange rate and a high rate of inflation would affect the terms of trade of an economy (up to 4 marks).

Impact of a declining exchange rate (up to 2 marks).

Impact of a high rate of inflation (up to 2 marks).

(b) Discuss the advantages and disadvantages to an economy of a fall in that economy's terms of trade and consider whether the overall effects are likely to be beneficial. [12]

A fall in an economy's terms of trade can result from a number of changes in the price of exports and imports. The effect is that the price of exports has fallen relative to the price of imports. This has advantages, such as the fact that exports are now more competitive and this might boost exports and increase employment in export reliant industries. Similarly, imports are now more expensive and this should see a fall in imports and an impact upon domestic industries. Disadvantages include the fact that demand-pull and cost-push pressures on prices might be experienced. The overall effects depend upon a range of factors such as the price elasticity of demand for exports and imports and the price elasticity of supply of exports.

For **analysis** of the advantages of a fall in the terms of trade (up to 6 marks).

For **analysis** of the disadvantages of a fall in the terms of trade (up to 6 marks).
(Up to a maximum of 8 marks for analysis)

For an **evaluation** of whether an unfavourable movement would, on balance be beneficial (up to 4 marks).

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1 (a) (i) Showing your calculation, determine the category of spending that has shown the biggest rise in price from January to September 2013 [2]

Recreation and Culture **(1 mark),** for calculation showing biggest rise in price of 17.1%. **(1 mark)**

(ii) Why do the categories of spending have different weights in Table 1? [2]

The categories have different weights to reflect the importance or proportion of expenditure on different categories **(1 mark)** in the household budget **(1 mark)**.

(b) (i) Explain how the fact that Malawi has the highest inflation rate in the southern African region might be expected to affect Malawi's terms of trade [2]

For knowledge of the meaning of 'terms of trade' **(1 mark)**.

For application to show that the highest inflation in Southern Africa might be expected to cause a rise in the terms of trade through the impact on the price of exports and imports. **(1 mark)**.

(ii) With the help of a diagram, explain how increasing exports could provide a solution to Malawi's weak currency [3]

For a diagram of the foreign currency market showing an increase in the demand for the kwacha **(1 mark)** and a rise in the exchange rate of the kwacha **(1 mark)**. Accompanying explanation **(1 mark)**.

(c) (i) Draw a diagram to show the choice that Malawi faces when allocating its scarce resources between the production of tobacco and tourism [2]

For a diagram of a production possibility curve showing the choice between tobacco and tourism services. **(up to 2 marks)**

For full marks the axes must be correctly labelled. Accept either constant or increasing opportunity costs.

(ii) Explain one difficulty that Malawi might face in reallocating resources from the production of tobacco to tourism [3]

Difficulties include lack of skilled labour, lack of available resources such as hotels, lack of infrastructure etc. Explanation might refer to the geographic and occupational immobility of factors, the cost of re-training etc.

For identifying one difficulty **(1 mark)** and for explaining that difficulty **(up to 2 marks)**.

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(d) Discuss the factors that should be considered by the Malawian Government in deciding if it should develop its tourist industry and allow its tobacco industry to decline [6]

A range of factors may be considered. These include the impact upon employment, the cost of developing resources required for a successful tourism industry, whether the decline in tobacco use is temporary or permanent etc. Credit should be awarded to those candidates who include a consideration of Malawi's comparative advantage.

For explanation of the factors that should be considered. **(Up to 4 marks)**

For evaluative comment on the importance of the explained factors. **(Up to 2 marks)**

2 (a) With the help of diagrams, explain how economists use the concept of income elasticity of demand to distinguish between inferior goods and necessity goods [8]

For **knowledge and understanding** of the concept of income elasticity of demand **(Up to 4 marks)**
Definition of income elasticity: **(1 mark)**

Formula: **Up to 2 marks** (Some inaccuracy e.g. no reference to % change: 1 mark)

For some development of the concept e.g. explanation of elastic/inelastic. **(1 mark)**

For **application** of the concept of income elasticity to distinguish necessary goods from inferior goods using appropriate diagrams. **(Up to 4 marks)**

For explanation of classification of goods as normal using an appropriate diagram. **(Up to 2 marks)**

For explanation of classification of goods as inferior using an appropriate diagram. **(Up to 2 marks)**

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(b) Discuss how, during a world-wide recession when incomes in most countries are falling, economists might use the concept of income elasticity of demand to assess the impact of this recession [12]

A world-wide recession will affect countries through the fall in income and this will lead to falling aggregate demand as consumption, investment, government spending and net exports fall. This will cause falling employment. The concept of income elasticity can be used to assess the effects of this upon various industries as those businesses producing normal goods see a fall in sales. On the other hand, those industries that produce inferior goods will see a rise in sales. If countries export normal goods they will see a fall in export revenue, whereas if they produce a large quantity of inferior goods they may see a rise in export revenue. The concept of income elasticity by assessing the extent of any fall in employment could indicate the fall in income tax revenues. Whether the information is useful largely depends upon the accuracy of the calculations and whether the ceteris paribus condition holds.

For **analysis** of the impact of falling incomes with reference to the concept of income elasticity. **(Up to 8 marks)**

For **evaluation** of the extent to which the concept can be used to assess the impact. **(Up to 4 marks)**

3 (a) Explain what economists mean when they describe a good as a 'demerit good' and, using a diagram, show why such goods will be overconsumed in a free market [8]

For **knowledge and understanding** of a demerit good. **(Up to 4 marks)**

For **application** showing a diagram that shows why demerit goods are overconsumed. **(Up to 4 marks)**

(b) Discuss any two policies that might be used to deal with the problems caused by the consumption of demerit goods and consider which might be the more effective policy [12]

Demerit goods are over-consumed in a market because of incomplete information about their ill-effects. Policies that might be applied include indirect taxation, legislation to prohibit or restrict consumption or education campaigns. Each has problems that limit effectiveness. For example, indirect taxes have the problem that it is difficult to measure the extent of the overconsumption. Education campaigns are costly and take time to take effect and so on.

For **analysis** of the problems caused by the consumption of demerit goods and two policies to deal with these problems. **(Up to 8 marks)**

For **evaluation** of the effectiveness of each policy analysed. **(Up to 4 marks)**

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4 (a) Define each component of aggregate demand and, using a diagram, show how a reduction in one of these components might reduce inflationary pressure in an economy [8]

For **knowledge and understanding** of the meaning of aggregate demand with each component defined. **(Up to 4 marks)**
If the components of AMD are listed, but not defined, 2 maximum.

For **application** showing a diagram with a fall in aggregate demand and the impact upon the general price level. **(Up to 4 marks)**

(b) Discuss the impact of a high rate of inflation on the consumers and producers in an economy and assess whether consumers or producers would suffer more [12]

A high rate of inflation has both internal and external effects on an economy. The internal effects include the re-distributive impact on incomes and the reduction in productive investment together with shoe-leather and menu costs. The external effects are largely through the impact upon exports and imports. Consumers and producers are affected as these effects have an impact upon them. Which is affected most depends upon factors such as whether the rate of inflation in an economy is higher than the rate in a competing economy.

For **analysis** of the impact of inflation upon consumers. **(Up to 6 marks)**

For **analysis** of the impact of inflation upon producers. **(Up to 6 marks)**

8 marks maximum

For **evaluation** of whether consumers or producers are likely to suffer more. **(Up to 4 marks)**

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