Cambridge International AS & A Level

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Cambridge International Advanced Subsidiary and Advanced Level

ECONOMICS **9708/21**

Paper 2 Data Response and Essay **May/June 2016**

MARK SCHEME

Maximum Mark: 40

Published

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SECTION A

1 (a) How and where would revenue from tourist arrivals in Fiji be recorded in Fiji's balance of payments? [2]

A credit **[1 mark]** in the services section of invisibles/the trade in services/the current account (accept any one of these) **[1 mark]**.

(b) Use a supply and demand diagram to show how the government investment referred to in the article affected the price of sugar produced in Fiji. [2]

For a supply and demand diagram showing a shift in the supply curve to the right **[1 mark]** and the subsequent fall in price **[1 mark]. [Up to 2 marks]**

(c) Explain what the changes in sugar's contribution to visible export earnings and in the price of sugar might suggest about the price elasticity of demand for sugar. [3]

For a clear understanding of the concept of price elasticity of demand **[1 mark].**

The price elasticity of demand for sugar must be elastic **[1 mark]** because a fall in price has resulted in an increase in demand by a greater % resulting in a rise in expenditure **[1 mark].**

(d) Using aggregate demand and aggregate supply analysis, explain why inflationary pressures remained subdued in Fiji despite higher growth. [3]

For aggregate demand analysis that explains the potential impact of economic growth upon prices through increasing aggregate demand. **[Up to 2 marks]**

For aggregate supply analysis that explains how declining international commodity prices would increase aggregate supply to prevent price rises. **[Up to 2 marks] [3 marks maximum]**

(e) Explain how increased investment could address supply-side capacity constraints in the Fiji economy. [4]

For a clear understanding of the meaning of the supply-side of the economy **[1 mark]**.

For explanation of the link between investment and an increase in supply-side capacity **[1 mark]** with appropriate examples of supply-side policies **[1 mark]**.

For comment on the strength of the link **[1 mark].**

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(f) Discuss any economic factors that would help to explain the changes in visitor arrivals to Fiji from Australia and Japan. [6]

At least **two** factors must be identified and discussed. For example:

- differences in relative exchange rates
- differences in income changes
- differences in price of related goods, for example travel.

For full marks some evaluative comment is required on the likely impact of each factor identified. For example the impact of income changes depends upon the income elasticity of demand.

Up to **4** marks for each factor discussed. If no evaluative comment, **2** marks maximum on each factor discussed. **[6 marks maximum]**

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SECTION B

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 position is established when there is a decrease in demand. [8]

For **knowledge and understanding** of equilibrium price and equilibrium quantity. **[Up to 4 marks]**

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

For **application** showing the process through which equilibrium is established when there is a decrease in demand. **(Up to 4 marks)**

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

(b) Discuss whether attempts to help poorer consumers through the introduction of a maximum price for necessities can ever be successful. [12]

For **analysis** showing the impact of a maximum price below equilibrium, the consequent shortage and the likely emergence of black markets. **(Up to 8 marks)**

In this case, there will need to be an alternative system of resource allocation, such as rationing.

For **evaluative comment** making a judgement about whether this can ever be successful. **(Up to 4 marks)**

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3 (a) Outline the functions of the factor enterprise in a modern economy, and explain how enterprise responds to a rise in the demand for a good. [8]

For **knowledge and understanding** of the functions of enterprise.

For the organisation function **[Up to 3 marks]**

For risk taking **[Up to 3 marks] [4 marks maximum]**

For **application** showing how enterprise responds to an increase in demand and the consequent rise in price. **[Up to 4 marks]**

(b) Discuss why some goods and services are provided by private enterprise and others are provided by the government in a mixed economy. [12]

For **analysis** explaining how governments and private enterprise produce:
- private
- merit
- demerit and
- public goods. **[Up to 8 marks]**

For **evaluative comment** that considers the effectiveness of government provision and provision by private enterprise. **[Up to 4 marks]**

4 (a) Explain what might cause a favourable movement in an economy's terms of trade. [8]

For **knowledge and understanding** of the terms of trade. **[Up to 4 marks]**

For **application** to show how changes in the price of exports relative to the price of imports cause a favourable movement in the terms of trade. **[Up to 4 marks]**

(b) Discuss whether overall a favourable movement in an economy's terms of trade would be likely to have positive or negative effects on the economy. [12]

For analysis of the impact of a favourable change in the terms of trade:

- **Up to 6 marks** for the possible positive effects.

- **Up to 6 marks** for the possible negative effects. **[8 marks maximum]**

For **evaluative comment** upon the 'overall' aspect of the question. **[Up to 4 marks]**

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Data Response

1 (a) What happened to the balance on Turkey's current account between 2012 and 2013? [2]

Recognition of deficit in both years (1 mark) and this has increased or worsened (1 mark)

No calculation needed although the figures can be used to illustrate the growing deficit.

If the candidate produces a calculation that has a negative figure for the balance but there is no clear recognition that this is a deficit, then no marks.

(b) Use a production possibility curve diagram to show the intended outcome of the structural reforms in Turkey. [2]

For a diagram showing a movement of a ppc outward from the origin (Up to 2 marks)

Shift outward of the curve (1 mark)

Appropriate axes that show that suggest that a ppc represents choice in production e.g. consumer or capital goods, guns or butter, good A or good B (1 mark)

The wording of the question means that an accompanying explanation is not required. An explanation could make it clear however that the candidate understands what a ppc represents. So an explanation could be awarded a mark if the candidate has not been awarded the second mark for appropriate axes.

No diagram, no marks

(c) With the help of a demand and supply diagram, show how the expected change in US interest rates was likely to cause the US dollar 'to continue to rise'. [2]

The demand for US$ on the foreign exchange market is likely to increase as foreign investors seek dollars to deposit in US banks as the returns rise. In addition, the supply of dollars might fall as those with investment funds in the US decline to move them abroad because of the higher US interest rates.

For an accurate diagram showing the supply and demand for the US$ in the foreign exchange market and a shift in the demand curve to the right or a shift in the supply of the US$ to the left and the resulting appreciation of the dollar. (1 mark)

For a brief explanation of one underlying cause of an increased demand for or reduced supply of US dollars on the foreign exchange market based upon the higher return on investment funds in the US (1 mark)

No diagram, 1 mark maximum

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(d) Consider whether the outcome of the interest rate changes in the US was likely to be 'harmful for Turkey's economy'. [4]

The rise in interest rates in the US and the rise in the US dollar might be harmful for Turkey's economy for a number of reasons. There might be an outflow of investment funds from Turkey to the US creating a deficit on Turkey's Financial Account of the Balance of Payments. In addition, the rise in the US dollar would affect the price of Turkey's exports to and imports from the US affecting the current account. This might create a deficit on the current account. In addition, there might be an impact upon employment and the rate of inflation in Turkey. It could be argued however that the rise in interest rates in the US would have a beneficial effect upon Turkey's economy. The rise in interest rates in the US and the appreciation of the dollar would mean that Turkey's exports to the US are cheaper and Turkey's imports from the US are more expensive. If the Marshall-Lerner condition is satisfied this will lead to an improvement in Turkey's balance of payments on current account and possibly a fall in unemployment in Turkey.

For explaining potential harmful effects on Turkey of the interest rate changes.
(Up to 3 marks)

For explaining potential beneficial effects on Turkey of the interest rate changes.
(Up to 3 marks)

3 marks maximum

For evaluative comment (on whether the explained effect would in fact be harmful or beneficial. (1 mark)

(e) Explain two factors that determine how the increase in consumer prices between 2013 and 2014 shown in Figure 1 might affect the total value of Turkey's exports. [4]

This question requires an explanation of the factors that determine the outcome, not an explanation of how an increase in consumer prices will affect exports.

A range of factors might be explained. One factor, for example is the price elasticity of demand for Turkey's exports. If the demand is price inelastic then the total value of Turkey's exports will rise. If the demand is price elastic then the total value will fall. The demand is likely to become more elastic in the long run. A second factor is the Turkey's rate of inflation compared to the rate of inflation of Turkey's competitors in international trade. Although Turkey's rate of inflation has increased in 2014 compared to 2013, whether this makes Turkey's goods and services uncompetitive in international trade depends upon the rate of inflation of Turkey's competitors. Other factors include whether there have been off-setting changes in Turkey's exchange rate and whether the rate of inflation has affected both the prices of internationally traded goods or goods that Turkey consumes domestically.

For explanation of any one factor that determines how an increase in consumer prices will affect exports. (Up to 3 marks)

4 marks maximum

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(f) Discuss how 'tight fiscal policy' could be expected to help Turkey achieve the first priority of the MTP, and consider how effective this is likely to be. [6]

The term 'tight fiscal policy' refers to policies that aim for a budget surplus or a reduction in the budget deficit through either tax rises and/or government spending cuts. The first priority of the MTP is solving the problem of inflation. A tight fiscal policy will do this through a reduction in spending on consumption and investment that will reduce aggregate demand.

The effectiveness of the policy depends upon factors such as the ability of the Turkish government to implement the policy and whether there are other factors that cause inflation such as cost-push pressures.

For understanding of 'fiscal policy' (1 mark)

For an example of what is meant by a 'tight fiscal policy' e.g. an increase in taxation or a decrease in government expenditure or a budget surplus or reduced budget deficit (1 mark)

For a clear explanation of the way in which a tight fiscal policy might control inflation. (Up to 3 marks)

For evaluative judgement on how effective a tight fiscal policy is likely to be. (Up to 2 marks)

6 marks maximum

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Essays

2 (a) Use examples to illustrate the difference between private goods and public goods and explain why only private goods will be supplied in a free market economy. [8]

For knowledge and understanding of the characteristics of private goods with examples and application to show why they will be supplied in a free economy. (4)

For knowledge and understanding of the characteristics of public goods with examples and application to show why they will not be supplied in a free economy. (4)

(b) 'The factor enterprise and the free working of the price mechanism always ensure a satisfactory outcome for consumers even when imperfect information exists.' Discuss this view. [12]

Please note that the new syllabus does not require candidates to have knowledge of the technical framework formerly used to analyse merit and demerit goods. Analysis of these concepts now focuses upon 'imperfect information'. Reference to private and social costs and benefits can be credited here, but is not necessary for full marks.

For analysis showing how the price mechanism and the factor enterprise respond to signals from consumers to allocate resources in line with consumer preferences. (up to 2 marks)

and the impact of imperfect information in terms of merit goods (up to 4 marks)

and demerit goods. (up to 4 marks)

8 maximum

For evaluative comment on whether this will always result in better outcomes. (4)

3 (a) Explain the meaning of price elasticity of demand and, using examples, outline the factors that would cause the demand for a good to be relatively price elastic. [8]

For knowledge and understanding of price elasticity of demand and the meaning of 'price elastic'. (4)

For a clear definition of what is meant by price elasticity of demand or an accurate formula (Up to 2 marks)

For elaboration that explains why a coefficient that is greater than one is considered 'elastic' i.e. the % change in quantity is greater than the % change in price. (Up to 2 marks)

For application in terms of the factors that cause a good to be price elastic. (4)

For example, the proportion of income, the availability of substitutes etc.
(Up to 3 marks for each factor explained)

4 marks maximum

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(b) Discuss why entrepreneurs might want to change the price elasticity demand for their product and consider the extent to which this is achievable. [12]

For analysis explaining the motives for changing the price elasticity of a good. This should include the reason for making a good more elastic (Up to 4 marks)

and more inelastic (Up to 4 marks)

Up to 6 marks maximum

For analysis explaining how the change in elasticity might be achieved (Up to 4 marks)

8 marks maximum

For evaluative comment on whether this is achievable. (4)

4 (a) Using examples, explain the instruments of monetary policy and supply-side policy. [8]

Monetary policy refers to changes in the money supply, interest rates and the exchange rate. It also includes changes to credit regulation. An increase in the money supply and a fall in the rate of interest for example might be used to stimulate the economy and bring unemployment down.

Supply side policy refers to any policy that attempts to increase the aggregate supply of goods and services to an economy. There are many instruments of supply side policy such as reductions in tax rates to increase the supply of factors of production, schemes to improve the training of labour to enhance skills and re-location grants to improve the geographic mobility of labour. There is a wide range of other instruments.

Please note that supply-side policy has been expanded on the new syllabus.

For knowledge and understanding of the instruments of monetary policy (up to 2 marks)

and application with an example of how these instruments might be used in an economy (up to 2 marks)

4 maximum

For knowledge and understanding of the instruments of supply-side policy (up to 2 marks)

and application with an example of how these instruments might be used in an economy (up to 2 marks)

4 maximum

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(b) Discuss the advantages and disadvantages of supply-side policy and consider its effectiveness in an economy that is facing a labour shortage. [12]

Supply-side policy works through achieving increases in aggregate supply. The advantages include the fact that non-inflationary growth can be achieved together with improvements in the productivity of the factors of production. The disadvantages include the opportunity cost of the funds needed to improve the supply–side and the fact that many improvements take a long time to take effect.

For analysis showing how supply side policy might be used to solve a labour shortage (up to 6 marks)

For the advantages of supply-side policy (up to 4 marks)
and disadvantages of supply-side policy (up to 4 marks)

6 marks maximum

8 marks maximum for analysis

For evaluative comment on 'effectiveness' in an economy facing a labour shortage. (4)

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Data Response

1 (a) (i) Calculate the approximate change in Australia's trade balance between August 2010 and August 2014. [2]

It is acceptable to make the calculation using the seasonally adjusted figures or the trend.

In August 2010 it is in surplus by just over $1000, (or $1500) million in August 2014 it is in deficit by just under $1000, (or $1500) million**.**

So the change is a magnitude of –$2000 (or –$3000) **(1 mark)**

In addition, candidates must show understanding that the change that has occurred is that the balance changes from a surplus to a deficit. **(1 mark)**

2 marks maximum.

(ii) Use a supply and demand diagram to show how the trend in Australia's trade balance over this period would be expected to influence the value of Australia's exchange rate. [2]

For an accurate diagram showing a fall in the demand (or an increase in the supply) for Au$ **(1 mark)** which would result in a decline in the exchange rate **(1 mark)**

(iii) What other information would be required to measure the change in Australia's current account on the balance of payments over this period? [2]

The two other components are net income flows **(1 mark)** and current transfers **(1 mark)**

Note that some candidates might use the latest terms for these entries i.e. primary and secondary incomes. This is acceptable.

(b) Suggest a change in the prices of exports and imports that might account for the change in the Australian terms of trade between 2011 quarter 3 and 2014 quarter 2 [2]

Any combination of price changes that would cause a fall in the terms of trade is acceptable. Reference must be made to the price of exports and the price of imports.

For example, export prices may have fallen **(1 mark)** and import prices may have risen. **(1 mark)**

Accept answers that explain that it is not just the direction of the change in export and import prices that affect the terms of trade. It is also possible that they could change in the same direction but there might be a difference in the relative size of the change.

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(c) Explain who in China would lose and who in China would benefit if China's exchange rate were allowed to rise. [6]

If China's exchange rate were allowed to rise those who would lose include Chinese exporters, those employed in Chinese firms facing increased competition from abroad and those employed in export-orientated firms in China. Those who would benefit would include Chinese consumers and Chinese producers who import raw materials from overseas. The impact however is heavily dependent on the elasticity of demand for Chinese imports and exports.

For identifying and explaining who might lose, for example Chinese exporters, and those employed in Chinese export orientated firms. **(Up to 4 marks)**

For identifying and explaining who might benefit, for example Chinese consumers and Chinese importers of raw materials. **(Up to 4 marks)**

Reward those answers that recognise the importance of price elasticity in influencing who would lose and who would benefit from the rise of the exchange rate in the short-run and the long-run.

(d) Discuss whether lower interest rates in China or a rise in China's exchange rate is more likely to help solve Australia's balance of payments problems. [6]

For explaining the impact of lower interest rates upon Australia's balance of payments **(Up to 3 marks)**

For explaining the impact of a higher Chinese exchange rate upon Australia's balance of payments **(Up to 3 marks)**

5 marks maximum.

Reserve 1 mark for providing a conclusion on whether lower interest rates or a rise in China's exchange rate is more likely to help solve Australia's balance of payments problems.

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Essays

2 (a) Explain how economists use the concept of elasticity to distinguish between normal and inferior goods and between substitutes and complements. [8]

For **knowledge and understanding** of income elasticity of demand and **application** showing how the concept can be used to distinguish between normal and inferior goods. **(Up to 4 marks)**

For **knowledge and understanding** of cross elasticity of demand and **application** showing how the concept can be used to distinguish between substitutes and complements. **(Up to 4 marks)**

(b) Discuss how knowledge of the differences between these types of goods would help government policy makers and entrepreneurs to make decisions. [12]

For **analysis** explaining how understanding of the concepts can help government to make decisions for example which goods to tax, how tax revenues will rise or fall in recessions or growth periods. **(Up to 6 marks)**

For **analysis** explaining how understanding of the concepts can help entrepreneurs make decisions for example when to vary price to increase revenues. **(Up to 6 marks)**

8 marks maximum

For **evaluative comment** on the value of these concepts. This might include reference to the difficulty of calculating the coefficients and the influence of 'other factors' in influencing their values. **(Up to 4 marks)**

3 (a) Use aggregate demand and aggregate supply analysis to distinguish between cost-push and demand-pull causes of inflation. [8]

For **knowledge and understanding** of cost-push inflation and **application** showing how aggregate demand and aggregate supply analysis can be used to explain this and distinguish this type of inflation from demand-pull inflation**.** **(Up to 4 marks)**

For **knowledge and understanding** of demand-pull inflation and **application** showing how aggregate demand and aggregate supply analysis can be used to explain this and distinguish this type of inflation from cost-push inflation**.** **(Up to 4 marks)**

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(b) Distinguish between the domestic and the external consequences of inflation, and consider which you think is more serious for an economy. [12]

For **analysis** of the domestic consequences such as the impact upon savings and productive investment and the re-distributive effects together with the shoe-leather and menu costs of inflation. **(Up to 6 marks)**

For **analysis** of the external consequences of inflation such as the likely impact upon the trade balance and investment flows and the resulting effect upon the exchange rate. **(Up to 6 marks)**

8 marks maximum

For **evaluative comment** on which is more serious which might include reference to the extent to which the economy is open or closed. **(Up to 4 marks)**

4 (a) Use production possibility diagrams to explain how specialisation and international trade can improve the standard of living of consumers in a country. [8]

For **knowledge and understanding** of production possibility curves and the trade-off that this illustrates. **(Up to 4 marks)**

For **application** showing how specialisation leads to an improvement in the standard of living with due reference to the law of comparative advantage. **(Up to 4 marks)**

(b) Discuss whether protection of domestic industries can ever be justified, given the benefits of specialisation and trade. [12]

For **analysis** of the reasons advanced to justify protection of domestic industries such as to protect employment, to protect infant industries, to protect against dumping, to solve a balance of payment problem etc. **(Up to 8 marks)**

For **evaluative comment** on whether any of these reasons can be justified. Reward appropriate reference to the law of comparative advantage. **(Up to 4 marks)**

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