Cambridge International AS & A Level

Cambridge Assessment International Education
Cambridge International Advanced Subsidiary and Advanced Level

ECONOMICS **9708/21**

Paper 2 Data Response and Essay **May/June 2018**

MARK SCHEME

Maximum Mark: 40

Published

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Question	Answer	Marks	Guidance
1(a)(i)	2013: 38.4 RUB against the US dollar 2015: 61.3 RUB against the US dollar A fall of 22.9 compared with initial value of 38.4 = a fall of 59.63541% Accept a fall of 59.6% or 59.64%	**2**	1 mark for correct calculation method, but wrong answer 2 marks for correct answer, even if no calculation method shown
1(a)(ii)	• A nominal exchange rate is one that is expressed in money terms without taking into account the effects of inflation (1) • A real exchange rate is one where a nominal exchange rate has been adjusted, taking into account the effects of inflation on the value of a currency in terms of its purchasing power / reflects the purchasing power of money at constant prices (1)	**2**	
1(b)	Diagram: • P, Q, D and S all correctly shown and labelled (1) • Shift of the demand curve for roubles to the left (1) Explanation: • Russia's exports are heavily dependent on oil; the oil price has tumbled from its mid-2014 peak of over US$100 a barrel to only about US$40 a barrel (1) • This has meant that other countries needed fewer roubles to buy oil from Russia, causing a shift of the demand curve to the left with a resulting fall in the price and in the quantity traded (1)	**4**	

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Question	Answer	Marks	Guidance
1(c)	Analysis of positive effects **Up to 4 marks** Analysis of negative effects **Up to 4 marks** Maximum of 6 marks	**6**	A depreciation of the Russian rouble would make exports cheaper, making them more price competitive on the international market, and this could lead to an increase in the demand for them. It would also make imports dearer, making them less price competitive on the international market, and this could lead to a decrease in the demand for them. The overall effect could therefore be an improvement in the current account balance, which would be advantageous to the Russian economy. The actual effect of the depreciation will depend on the extent to which the demand for both exports and imports is price elastic. Candidates could refer to the Marshall-Lerner condition which states that the depreciation will only lead to an improvement in the current account balance if the sum of the price elasticity of demand for exports and the price elasticity of demand for imports is greater than 1. Candidates could also refer to the J-curve effect which states that the current account balance will get worse before it gets better. Candidates could also refer to the fact that the imported goods could include imported raw materials and components, leading to an increase in the cost of production which would not be advantageous to the Russian economy. In addition to the balance of payments effects, candidates may also consider possible inflation, employment and growth effects.

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Question	Answer	Marks	Guidance
1(d)	For **identification** and **explanation** of the possible benefits of privatisation (Up to 3 marks) For **identification** and **explanation** of the possible costs of privatisation (Up to 3 marks) **(5 marks maximum for explanation)** For **evaluative conclusion** on the factors identified in relation to whether the privatisation of some state assets would be of overall benefit for the Russian economy. **(1 mark for evaluation)**	**6**	Definition of privatisation: the transfer of the ownership of a firm or an industry from the state or public sector to the private sector. The sale of some state assets would bring revenue in. The sale of some state assets would reduce public expenditure on such assets. The overall effect of increasing public revenue and reducing public expenditure would be to contribute positively to a reduction in the size of the budget deficit in Russia, although it is uncertain whether this would be sufficient to bring down the size of the budget deficit from 7% of GDP to 3% of GDP. The privatisation of some state assets could also lead to an improvement in efficiency. However, privatisation will lead to firms aiming for profit maximisation and this could lead to detrimental effects on the Russian economy, such as an increase in unemployment.

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Question	Answer	Marks	Guidance
2(a)	For **knowledge and understanding** of merit goods and demerit goods. Knowledge and understanding of merit goods as an example of a product that is under-consumed as a result of information failure. (Up to 3 marks) **Knowledge and understanding** of demerit goods as an example of a product that is over-consumed as a result of information failure. (Up to 3 marks) **(KU total: Up to 4 marks)** For **application** showing how merit goods and demerit goods are examples of a private good. Application to examples of merit goods, such as education and health care. (Up to 3 marks) Application to examples of demerit goods, such as cigarettes and alcohol. (Up to 3 marks) **(APP total: Up to 4 marks)**	**8**	Reward appropriate reference to information failure in relation to both merit goods and demerit goods. Both merit goods and demerit goods are examples of a private good because: There is rivalry in consumption, i.e. once a product has been consumed by one person, it cannot be consumed by another person. There is excludability in consumption, i.e. it is possible to exclude a person from consuming a product if another person has consumed it and they have not paid for it.

Question	Answer	Marks	Guidance
2(b)	For **analysis** of the provision of merit goods through a market economy. (Up to 4 marks) For **analysis** of the provision of demerit goods through a market economy. (Up to 4 marks) **(AN total: Up to 8 marks)** For **evaluative comment** on whether the provision of merit goods and demerit goods through a market economy will always be the best form of provision. (1 mark for a conclusion) **(EV total: Up to 4 marks)**	**12**	Advantages of a market economy: Possible advantages of a market economy, such as decisions taken by individual consumers, who aim to maximise utility/satisfaction, and by individual producers, who aim to maximise profits. Important role of a price mechanism to allocate resources efficiently, with prices acting as a signalling device. There is likely to be greater efficiency arising from the existence of a profit motive and of competition, with no government intervention. Disadvantages of a market economy: A market economy, as well as having potential benefits, can also have potential drawbacks, such as the under-production of merit goods and the over-production of demerit goods.

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Question	Answer	Marks	Guidance
3(a)	For **knowledge and understanding** of the concept of price elasticity of demand as the percentage change in the quantity demanded of a product divided by the percentage change in the price of the product. **(KU total: Up to 2 marks)** For **application** of factors to the determination of the PED of a product. The question does refer to factors, i.e. a minimum of two factors need to be explained. Up to 3 marks for one factor that is very well explained. A candidate needs to explain a minimum of two factors to gain all 6 marks. **(APP total: Up to 6 marks)**	**8**	Candidates should refer to the possible factors that can affect the PED for a product: • the period of time • the number and availability of substitutes • the degree of necessity • the durability of a product • the proportion of income taken by a product • the width of definition of a product • the amount of money spent on a product
3(b)	For **analysis** of the importance of XED to a firm. **Analysis** of a positive XED. (Up to 4 marks) **Analysis** of a negative XED. (Up to 4 marks) **(AN total: Up to 8 marks)** For **evaluative** comment on the extent to which XED is likely to be important to a firm supplying that product (1 mark for a conclusion) Candidates need to consider that the extent to which XED is likely to be important to a firm supplying a particular product will depend on a number of factors, such as how close a substitute or a complement is to the firm's product and so how significant a change in a competitor's price will be, and how large the original price change was. XED is likely to be more important when the relationship between two products is a close one. Candidates could evaluate whether XED is likely to be more or less useful than PED or YED. Candidates could also bring zero cross elasticity of demand into the discussion. **(EV total: Up to 4 marks)**	**12**	Candidates can comment on whether XED is positive, which will be the case if the two products are substitutes, giving rise to competitive demand, or whether it is negative, which will be the case if the two products are complements, giving rise to joint demand. XED is important to the decisions of a firm, enabling it to estimate the effect on the demand for one of its products of a change in the price of a substitute or a complement in the market.

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Question	Answer	Marks	Guidance
4(a)	For **knowledge** and **understanding** of the characteristics of money. **(KU total: Up to 4 marks)** For **application** showing how the characteristics of money are necessary in order for money to perform its functions effectively, e.g. money needs to be divided into smaller units so that products at various prices can be bought and sold and money needs to be portable if it is going to be convenient for the users of it. Application to at least three characteristics and three functions required for full marks. **(APP total: Up to 4 marks)**	**8**	Characteristics of money, such as: • acceptability • portability • scarcity • recognisability • relative stability of value • divisibility • durability • uniformity • stability of supply. Four functions of money: • a medium of exchange • a measure of value/unit of account • a standard for deferred payment • a store of value or wealth.
4(b)	For **analysis** of the likely consequences for an economy of an increase in the money supply. Candidates need to refer to the impact that an increase in the money supply can have in an economy, especially in relation to the existence of inflation. An increase in the money supply can lead to demand-pull inflation, especially if AD is in excess of AS. Accept an answer that focuses on the consequences of inflation. **(AN total: Up to 8 marks)** For **evaluative** comment on the extent to which an increase in the money supply in an economy is likely to be inflationary (1 mark for a conclusion). Candidates need to consider that the extent to which an increase in the money supply will lead to inflation will depend on whether AD is in excess of AS. If there is an increase in AS which matches the increase in AD, then the effect of the increase in the money supply will not necessarily be inflationary. The consequences will also depend on the extent of the size of the increase in the money supply and the state of an economy at the time of the increase. **(EV total: Up to 4 marks)**	**12**	

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Question	Answer	Marks	Guidance
1(a)(i)	$US 437 billion	**1**	Must have $ and billions. No need to indicate US.
1(a)(ii)	Capital goods **(1 mark)**	**1**	
1(b)(i)	For recognition that consumption will increase **(1 mark)** For an explanation. Candidates can **either** identify one reason and provide a developed explanation of this e.g. the fall in the interest rate means that loans are cheaper **(1 mark)** and therefore spending on consumer goods that are sensitive to interest rate changes for example 'big ticket' items will increase **(1 mark)** **OR** Identify a second reason for a likely rise in consumption such as the disincentive to save **(1 mark)**	**3**	Consumption is likely to increase. Two approaches are expected. One relates to the impact of the fall in the rate of interest upon the cost of loans. The other upon the impact upon savings. Candidates can either give a developed explanation of one approach or give a brief explanation of the two approaches.
1b(ii)	For a developed explanation of the chosen outcome. For example the fall in interest rates will reduce the value of the baht **(1 mark)** and as a result export prices will fall **(1 mark)** and export expenditure will rise/fall if demand for exports is price elastic/inelastic **(1 mark)** **(Up to 3 marks)**	**3**	The impact on export expenditure depends upon a number of factors and there are a number of possible outcomes. • The fall in interest rates will decrease the value of the baht and this could lead to a rise or fall in export earnings depending upon the price elasticity of exports • The fall in interest rates might result in more spending in Thailand and as a result Thai exports might be diverted to the home market and export earnings could fall. • The fall in the rate of interest might lead to more investment in Thailand that results in more productivity in export industries and export earnings might rise.

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Question	Answer	Marks	Guidance
1(c)	For each demand factor explained **(Up to 2 marks)** For the identification of a factor that will increase the number of visitors from China **(1 mark)** for the second mark it is necessary to compare this change with other countries **(1 mark)** If two demand factors explained can be categorised as **a 'change in tastes'** then this can only be accepted for two of the three demand factors. **6 marks maximum**	**6**	Any three demand factors can be developed to explain the differences. For example, differences in changes in income, changes in tastes, price and so on. If the candidate identifies changes in factors that are changes in tastes then the maximum marks awarded should not be greater than 2.
1(d)	For an explanation of the benefits of a high proportion of income stemming from the external balance. **(Up to 3 marks)** For an explanation on the dangers of reliance upon the external balance**.** **(Up to 3 marks)** **5 marks maximum for explanation** **1 mark reserved** for a reasoned conclusion **6 marks maximum**	**6**	Thailand is a very open economy that depends upon tourism for its export income. This allows for the import of many goods that are not produced efficiently in Thailand. This is effectively a reflection of comparative advantage and allows for an improved standard of living in Thailand. The danger is that the external balance can be influenced by world events and changes in export earnings can have serious consequences.

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2(a)	**Up to 4 marks** for **knowledge and understanding** and **application** of how resources are allocated in a free market economy. • Resources are allocated through the price mechanism **(1 mark)** • Elaboration in terms of features such as supply and demand, consumer sovereignty, enterprise and the profit motive **(Up to 3 marks)**. **Up to 4 marks** for **knowledge and understanding** and **application** of how resources are allocated in a mixed economy. • Resources are allocated through the price mechanism **and** the government (1 mark) • Elaboration in terms of the provision of public and merit goods, intervention in markets such as indirect taxes on demerit goods and so on (Up to 3 marks).	**8**	
2(b)	**Up to 8 marks** for **analysis** of supply side policies and their impact on the supply of enterprise: • For an explanation of how any supply side policies can increase the supply of enterprise to the economy (Up to 4 marks) • For an explanation of the difficulties associated with the application of these policies. (Up to 4 marks) **Up to 4 marks** for **evaluative** comment with **1 mark reserved** for a reasoned conclusion on the overall effectiveness of the policies.	**8 + 4**	To answer this effectively, candidates must have a good knowledge of the role of enterprise and the ways in which supply side policies operate to encourage enterprise. These include reducing business taxes, improving the economic environment and providing training for prospective entrepreneurs. Accept a broad idea of 'enterprise'. This could refer to the number of entrepreneurs in the market or the expansion of existing firms that necessitates an increase in risk and organisation. If the policies introduced do not refer to the supply of enterprise but are very general descriptions of supply side policies then no credit should be awarded.

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Question	Answer	Marks	Guidance
3(a)	**Up to 4 marks** for **knowledge and understanding:** Of the meaning of an indirect tax (1 mark) For a clear understanding of a price-elastic demand (1 mark) For a clear understanding of price-inelastic demand (1 mark) For a clear understanding of the meaning of the incidence of taxation (1 mark) **Up to 4 marks** for **application** using a diagram: • to show that if a good is price elastic the incidence of an indirect tax will fall mainly on the producer (2 marks) • and if it is price inelastic the incidence it will fall mainly on the consumer (2 marks)	**8**	An indirect tax will shift the supply curve to the left. This will raise the price of the product. The incidence depends upon price elasticity. If the demand is inelastic, the consumer bears most of the incidence. If the demand is elastic most of the incidence falls upon the producer. The candidate is NOT required to define elastic or inelastic. They need to demonstrate that they understand the concepts through their application in answer to the question.
3(b)	**Up to 8 marks** for **analysis** • Of the negative impact of the imposition of an indirect tax upon consumer surplus; higher prices and lower consumer surplus and lower consumption of the good overall. Also allow broader considerations such as the fact that the tax is regressive and could contribute to cost-push inflation (up to 4 marks) • Of the positive effects of imposing indirect taxes such as discouraging the consumption of demerit goods, raising revenue, tariffs are indirect taxes that discourage imports and so on (up to 4 marks) **Up to 4 marks** for **evaluative** comment with **1 mark reserved** for a reasoned conclusion on whether indirect taxes should ever be imposed.	**8 + 4**	The imposition of an indirect tax distorts the market in the sense that the price signals from the consumer do not reflect the value that consumers place upon the good. In addition, consumer surplus and producer surplus are reduced. In the case of demerit goods however indirect taxes adjust demand to overcome the problem of imperfect information. Candidates can be rewarded for discussion of the revenue raising motive for imposing taxes.

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Question	Answer	Marks	Guidance
4(a)	**Up to 4 marks** for **knowledge and understanding** and **application** to show how inflation can cause a deficit. • For a recognition of the impact of a high rate of inflation upon the relative price of exports and the price of imports (1 mark) • and the total expenditures on exports and imports (1 mark) • given the price elasticity of demand for exports (1 mark) • For understanding that it is the relative rate of inflation that is relevant (1 mark) **Up to 4 marks** for **knowledge and understanding** and **application** to show how a rise in the exchange rate can cause a deficit. • For a recognition of the impact of a rise in the exchange rate on the relative price of exports and the price of imports (1 mark) • and the total expenditures on exports and imports (1 mark) • given the combined price elasticity of demand for exports and imports greater than one (Marshall-Lerner) (1 mark) • Reference to the J-curve or long/short run distinction (1 mark)	**8**	Both inflation and a rise in an economy's exchange rate will raise the price of exports and reduce the relative price of imports. As a result both can cause a current account deficit.
4(b)	**Up to 8 marks** for **analysis**: • Of the problems that are created through a high rate of inflation. Possible problems could include: menu costs/shoe leather costs (count as one), haphazard redistribution of income, loss of business confidence, debtors/creditors, flight of FDI, lack competitiveness, fiscal drag and so on. Must be explained for all the marks. **(Up to 4 marks)** • Of the problems that are created through a deficit in the current account. Possible problems could include: decline in the exchange rate, accumulating foreign debt, impact on domestic policies, unemployment and so on. **(Up to 4 marks)** **Up to 4 marks** for **evaluative** comment with **1 mark reserved** for a reasoned conclusion on which poses the most serious problem.	**8 + 4**	Candidates need to show a good grasp of the difficulties that are associated with a high rate of inflation such as the re-distribution of incomes and the impact on the external balance and the problems created through a deficit on the current account such as pressure on the exchange rate and currency reserves. Acceptable evaluative comment could be that it depends upon the rate of the inflation and whether the economy is open to international trade or is a closed economy.

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1(a)(i)	Malaysia **(1 mark)** NZ$895 million **(1 mark)**	**2**	The answer must have correct figures and denominations i.e. NZ$ and millions units.
1(a)(ii)	Trade in services is NZ$2400m + NZ$429m = NZ$2829m **(2 marks)**	**2**	There is no requirement to show the calculation, but if there is a correct calculation that arrives at the wrong answer 1 mark can be awarded.
1(a)(iii)	Primary income **(1 mark)** Secondary income **(1 mark)**	**2**	'Old' terminology is an acceptable alternative i.e. net transfers and investment income.
1(b)	For a clear idea that comparative advantage relates to the lowest opportunity cost of production **(1 mark)** For recognition that comparative advantage is determined by factor endowment **(1 mark)** For an explanation of how New Zealand's membership of the TPP will lead to the exploitation of comparative advantage and a better allocation of resources through specialisation and trade **(Up to 2 marks)**	**4**	New Zealand has a comparative advantage in lamb and dairy products. Entry into the TPP will allow New Zealand access to a bigger market and through specialisation and trade it will be able to export more of these products and import those goods that it can only produce at higher opportunity cost.
1(c)	For explanation of how there might be negative effects upon Canadian farmers incomes **(Up to 2 marks)** For explanation of how there might be beneficial effects upon Canadian farmers incomes **(Up to 2 marks)**	**4**	The most likely outcome is that the Canadian market will be flooded with cheap food imports from other members of the TPP, especially New Zealand. If so, this will reduce prices and the incomes of those farmers who produce similar products. It could also be argued that membership of the TPP provides new opportunities for Canada's farmers with tariff and quota free access to new markets within the TPP. This could have a positive effect on certain farm incomes. Overall outcome though is uncertain.

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Question	Answer	Marks	Guidance
1(d)	For an **explanation** of the possible costs: **(Up to 3 marks)** For an **explanation** of the possible benefits: **(Up to 3 marks)** **Reserve 1 mark** for a reasoned conclusion	**6**	There are both costs and benefits that could result if China joined the TPP: Possible costs include : the domestic market could be flooded with cheap imports; there might be increased balance of trade deficits, infant industries might be prevented from development and so on. Possible benefits include : tariff free access to the massive Chinese market; increase in scale of production of exporting industries leading to economies of scale and so on.
2(a)	For **knowledge and understanding** and **application** in the case of direct, progressive taxes **(Up to 4 marks)** **1 mark** for a valid example **1 mark** for a clear idea of meaning of 'direct' **Up to 2 marks** for an explanation of a progressive tax For **knowledge and understanding** and **application** in the case of indirect, regressive taxes **(Up to 4 marks)** **1 mark** for a valid example **1 mark** for a clear idea of meaning of 'indirect' **Up to 2 marks** for an explanation of a regressive tax	**8**	Candidates need to display good knowledge and understanding of the distinction between direct and indirect taxes and taxes that are progressive and regressive. They then need to apply these concepts o provide an example of each type of tax.

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Question	Answer	Marks	Guidance
2(b)	For **analysis** of the impact of a sugar tax **(Up to 4 marks)** This should explain the impact of the tax upon supply and make due reference to the significance of the price elasticity of demand. Credit accurate diagrams. For **analysis** of the impact of an educational campaign **(Up to 4 marks)** This should explain the impact of the campaign upon the demand curve for 'fizzy soft drinks' or similar products. Credit accurate diagrams. **(AN: Up to 8 marks maximum)** For **evaluation** as to whether the new tax or an educational campaign is more likely to reduce child obesity with **1 mark** reserved for a reasoned conclusion **(EV: Up to 4 marks maximum)**	**12**	The imposition of an indirect tax will shift the supply curve to the left raising price and reducing quantity demanded. The impact depends upon the price elasticity of demand for the product. An educational campaign will shift the demand curve for the product to the left. This will reduce price and result in a fall in the quantity demanded. The impact depends upon the effectiveness of the campaign.

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Question	Answer	Marks	Guidance
3(a)	For **knowledge and understanding** of two relevant factors of production in the manufacture of chocolate. Award **1 mark** for identification and 1 mark for explanation of how this contributes to the production process. **(KU: Up to 4 marks maximum)** For an understanding of specialisation and its **application** to the manufacture of chocolate. For an understanding of specialisation **(1 mark)** and the division of labour **(1 mark)** For the benefits of specialisation and the division of labour **(Up to 2 marks)** **(APP: Up to 4 marks maximum)**	**8**	The factors of production are land, labour, capital and enterprise. Each has a distinct role in the production process. Specialisation occurs when workers are assigned specific tasks within a production process. This is usually called the division of labour. Workers will require less training to be an efficient worker. Therefore this will lead to an increase in labour productivity and firms will be able to benefit from economies of scale and increased efficiency. No knowledge of chocolate manufacture is required for full marks on this question.
3(b)	For an **analysis** of the impact of the increase in demand and the likely fixed supply on the market for chocolate in terms of price and quantity traded **(Up to 2 marks)** For an **analysis** of how the price may be stabilised with reference to the difficulties. **(Up to 6 marks)** **(AN: Up to 8 marks maximum)** For an **evaluation** of the most effective way of stabilising the price of chocolate with **1 mark** reserved for a reasoned conclusion. **(EV: Up to 4 marks maximum)**	**12**	An increase in demand with a relatively fixed supply will result in a rise in price with no or little extension in supply. The supply will be highly inelastic or perfectly inelastic. Price can be stabilised through a maximum price that might be made effective through buffer stocks. This has several problems including cost and problems of storage.

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Question	Answer	Marks	Guidance
4(a)	For an **knowledge** and **understanding** and **application** of cost-push inflation **(Up to 6 marks)** For an **knowledge and understanding and application** of demand-pull inflation **(Up to 6 marks)** **(8 marks maximum)**	**8**	The question refers to 'causes' so we should expect candidates to make reference to at least two causes. If, however, the candidate provides application to one country and explains that there is only one cause of inflation in that country then up to 6 marks are available.
4(b)	For **analysis** of how monetary policies might be used to correct inflation with due reference to the advantages and disadvantages of this approach. **(Up to 4 marks)** For **analysis** of how at least **one** other policy might be used to correct inflation with due reference to the advantages and disadvantages of this approach. **(Up to 4 marks)** **(AN: Up to 8 marks maximum)** Up to 4 marks for an **evaluation** as to whether monetary policy is the best way to correct inflation with 1 mark reserved for a reasoned conclusion. **(EV: Up to 4 marks maximum)**	**12**	Candidates need to explain how governments might use monetary policy to cure inflation and the difficulties associated with this. They can then compare this policy with fiscal and or supply side methods.

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