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UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS

GCE Advanced Subsidiary Level and GCE Advanced Level

MARK SCHEME for the October/November 2010 question paper for the guidance of teachers

9708 ECONOMICS

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

This mark scheme is published as an aid to teachers and candidates, to indicate the requirements of the examination. It shows the basis on which Examiners were instructed to award marks. It does not indicate the details of the discussions that took place at an Examiners' meeting before marking began, which would have considered the acceptability of alternative answers.

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UNIVERSITY of CAMBRIDGE International Examinations

Section A

1 (a) In Swaziland's current account between 2003 and 2007,

(i) which component showed a continuous improvement, and

services (1)

(ii) which component showed a continuous worsening? [2]

goods (1)

(b) How did the current account balance change between 2003 and 2007? [3]

Worsened (1), surplus (1), to deficit (1), supporting data (1), use of 2005 (1)
Any three points

(c) (i) What is comparative advantage? [2]

Where a country has a lower opportunity cost than another in production of a good or service (2), general statement on relative efficiency (1).

(ii) In the light of the Central Bank of Swaziland's report what might be concluded about the nature of Swaziland's comparative advantage and the factors on which it is based? [4]

The main exports are agricultural products, processed agricultural products or basic manufactured goods (textiles) any 2 cases (2), the basis might be suitable growing conditions (land), simple technology (capital) and cheap labour, 2 linked factors (2).

(d) Explain the conditions necessary for the depreciation of a country's currency to increase its export revenue. [3]

Price must be reduced (1), demand must be elastic (1), supply must expand (1), no parallel depreciation (1), no retaliation (1).
Any three points

(e) Discuss the case for and against the use of tariffs by Swaziland to retaliate when the EU banned imports of Swaziland's beef. [6]

Benefits include: exert pressure on EU to remove protection, raise revenue, promote infant industries, encourage import substitution, improve the balance of trade and help employment in the short run.
Drawbacks include: retaliation by EU, it may be an ineffective policy, it may be limited by trade obligations, it may be inflationary, EU may be too important a trading partner, lower levels of trade may harm growth.
4 marks max for one side of the argument.

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Section B

2 (a) Explain how microeconomic and macroeconomic issues may be represented using production possibility curves. [8]

Microeconomics studies individual units while macroeconomic issues involve aggregates for the economy. The production possibility curve (ppc) can show the possible combinations of two outputs that can be produced with full employment of resources. Economic growth, unemployment are macro representations while opportunity cost and scarcity can be micro applications. Some aspects can be shown either for an economy an individual firm.

Understanding of micro/macro distinction and ppc 4 marks
Use of ppc to show macro and micro issues 4 marks

(b) Discuss whether money or the division of labour is likely to have contributed more to economic progress. [12]

Money is anything which is generally acceptable as a means of payment. Division of labour is the subdivision of economic activity and may apply to individuals, firms and economies. Money fosters production and exchange through its four functions. Division of labour increases the efficiency of production and output by specialisation. It is more likely that money will be justified as the more fundamental step forward but either conclusion is acceptable if it is supported by logical argument. Full marks require some attempt at judgment.

Meaning of money and division of labour 4 marks
Discussion of impact of money 4 marks
Discussion of impact of division of labour 4 marks

3 (a) With reference to the relevant type of elasticity of demand, explain the terms

(i) inferior good, and

(ii) complementary good. [8]

Elasticity of demand concerns the responsiveness of demand to a change in a variable. An inferior good is one that is bought in smaller quantities as income rises, as it is replaced by a superior good. It involves income elasticity which has a negative value. An example might be motor cycles replaced by cars.
Complementary goods are ones that are jointly demanded, such as coffee and cream. Cross price elasticity of demand is relevant and is negative as the rise in price of one good reduces the quantity demanded of a complement.

Understanding of the two types of good 4 marks
Explanation of the relevant elasticities 4 marks

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(b) Discuss the importance of price in the effective operation of a mixed economy. [12]

The mixed economy combines market and planned features. Prices are set by the operation of demand and supply and by government action. Price is central to the private sector where it acts to ration out goods and allocate resources. It does this efficiently by using the profit motive to create incentive. This should result in choice and low cost for consumers. However price does not always work well. Goods with externalities will be sold at the wrong price and in the wrong quantities, as are merit and demerit goods. There are also public goods which do not attract a price and will not be provided. Prices may fluctuate excessively or be at an undesirable level. This requires government intervention to help consumers and producers. The effect of price is more important in the private sector but does not necessarily work efficiently overall.

Understanding of the mixed economy and price	4 marks
Discussion of the efficient role of price	4 marks
Discussion of the failings of price	4 marks

4 (a) Explain why it is important to have an accurate measure of inflation. [8]

Inflation is a sustained rise in the general price level. Inflation statistics form the basis of government policy, affect firms' and individuals' planning and are used to set index linked wages, welfare benefits and interest rates. They are a means by which the success of current policy can be judged and are of interest to citizens, investors, trade unions, and official bodies. Inflation is a central economic target. If the statistics are inaccurate the direction and level of action may be inappropriate and may worsen the position. Lack of trust of the statistics may undermine the acceptance of policies and their effectiveness. Errors may be made in planning and real values may not be maintained.

Understanding of inflation and recognition of the uses of a measure	4 marks
Explanation of the need for accuracy/problems of inaccuracy	4 marks

(b) Discuss the methods and problems involved in constructing an accurate measure of the rate of inflation. [12]

Inflation is measured by a weighted price index. This may be the consumer price index, the retail price index or a variation of these. Each of the stages of construction has problems. Choosing the base year needs a year with 'normal' conditions. The selection of a basket of goods needs to reflect average consumption patterns and allow for the introduction of new products. Weighting the individual contents has to reflect up to date spending patterns. Sampling sales outlets must cover a wide enough range of types and locations. Even if these are achieved the average picture may not accurately reflect the position of groups e.g. pensioners; it may not reflect changes in quality of goods; it may lag behind events and it may be based on inaccurate statistics and invalid sampling. International conventions set standards for participating countries.

Understanding of the means of measurement of inflation	4 marks
Discussion of the method of construction	4 marks
Discussion of problems of stages and final outcome	4 marks

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9708 ECONOMICS

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Any three points

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Section B

2 (a) Explain how microeconomic and macroeconomic issues may be represented using production possibility curves. [8]

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Meaning of money and division of labour 4 marks
Discussion of impact of money 4 marks
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3 (a) With reference to the relevant type of elasticity of demand, explain the terms

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Understanding of the two types of good 4 marks
Explanation of the relevant elasticities 4 marks

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(b) Discuss the importance of price in the effective operation of a mixed economy. [12]

The mixed economy combines market and planned features. Prices are set by the operation of demand and supply and by government action. Price is central to the private sector where it acts to ration out goods and allocate resources. It does this efficiently by using the profit motive to create incentive. This should result in choice and low cost for consumers. However price does not always work well. Goods with externalities will be sold at the wrong price and in the wrong quantities, as are merit and demerit goods. There are also public goods which do not attract a price and will not be provided. Prices may fluctuate excessively or be at an undesirable level. This requires government intervention to help consumers and producers. The effect of price is more important in the private sector but does not necessarily work efficiently overall.

Understanding of the mixed economy and price	4 marks
Discussion of the efficient role of price	4 marks
Discussion of the failings of price	4 marks

4 (a) Explain why it is important to have an accurate measure of inflation. [8]

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Understanding of inflation and recognition of the uses of a measure	4 marks
Explanation of the need for accuracy/problems of inaccuracy	4 marks

(b) Discuss the methods and problems involved in constructing an accurate measure of the rate of inflation. [12]

Inflation is measured by a weighted price index. This may be the consumer price index, the retail price index or a variation of these. Each of the stages of construction has problems. Choosing the base year needs a year with 'normal' conditions. The selection of a basket of goods needs to reflect average consumption patterns and allow for the introduction of new products. Weighting the individual contents has to reflect up to date spending patterns. Sampling sales outlets must cover a wide enough range of types and locations. Even if these are achieved the average picture may not accurately reflect the position of groups e.g. pensioners; it may not reflect changes in quality of goods; it may lag behind events and it may be based on inaccurate statistics and invalid sampling. International conventions set standards for participating countries.

Understanding of the means of measurement of inflation	4 marks
Discussion of the method of construction	4 marks
Discussion of problems of stages and final outcome	4 marks

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9708 ECONOMICS

9708/23 Paper 23 (Data Response and Essay (Core)), maximum raw mark 40

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1 (a) Suggest the likely opportunity cost to Ghanaian children of time spent fetching water. Explain your answer [2]

Meaning of opportunity cost (1), education, leisure or acceptable alternative e.g. working on a farm (1)

(b) Use Table 1 to compare the change in Ghana's cocoa output with that of the other main producers. [3]

Greater % growth than 3 others (1), less % growth than Indonesia (1), largest absolute increase (1) supporting calculation (1), retained second position (1), any three valid points

(c) With the use of a diagram, analyse the effect on the market for Cadbury's chocolate of the problems reported in the first paragraph. [6]

Commentary: higher raw material prices reduce supply (1), health warnings reduce demand (1), price may rise or fall or remain unchanged (1)
Diagram: correct shift in D (1) and S (1), new lower quantity from change in D and S (1)

(d) Explain how the Cadbury Cocoa Partnership hoped to affect the productivity of cocoa farmers? [3]

Define labour productivity as output per worker, and increase it (1), higher yielding crops (1), use of fertilisers (1), co-operative working (1) any 3 points

(e) Discuss the consequences for countries such as Cote D'Ivoire and Ghana of relying heavily on the production of one crop. [6]

Merits: benefits of specialisation, lower costs, exploitation of comparative advantage, ability to export, market power.
Problems: risk of loss of demand, emergence of rivals, limited job opportunities, natural hazards, need to import, seasonality of agriculture. Boredom as a factor is not to be rewarded.
Up to 4 marks for one side
Reasoned conclusion e.g. the importance of diversification 1 mark max.

2 (a) Explain the difficulties of carrying out a cost-benefit analysis. [8]

Cost benefit analysis is a technique to evaluate the social costs and social benefits of an investment project and to decide if it is worthwhile. Each stage has potential problems. Identifying the costs and benefits (how wide can the external elements be?), putting a monetary value on the costs and benefits (no market value available), forecasting and discounting future values (level of uncertainty and appropriate rate), deciding to proceed (political interference)

Understanding of cost-benefit analysis	2 marks
Explanation of process	2 marks
Explanation of difficulties	4 marks

2 Stages 1 mark; 4 stages 2 marks

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(b) Discuss the economic consequences of externalities associated with production and consumption. [12]

Externalities can be positive (beneficial) and negative (harmful), they affect third parties not involved in the transaction. They can result from consumption and production, are not reflected in the price of output and result in inefficiency. Negative externalities arise from industrial production and include pollution and environmental damage. Transport, energy supply and agriculture also contribute. At an individual level smoking, driving and tourism can have harmful effects. Industry can produce external benefits such as technology spillover and the training of workers who go to other firms. In consumption maintaining a garden and taking medication may benefit neighbours. Negative externalities are more common than positive ones.

Understanding of externalities	4 marks
Discussion of negative externalities with examples	4 marks
Discussion of positive externalities with examples	4 marks

If only discuss production **or** consumption 8 marks max.

3 (a) Explain why a low and stable rate of inflation may be beneficial to an economy. [8]

Inflation is a persistent/sustained rise in the general price level. A stable rate will bring certainty, raise confidence and minimise menu and shoe leather costs. Firms, individuals and governments will be able to plan effectively. Overseas investors are more likely to invest in the economy. A low rate will encourage production and employment and allow the economy to remain competitive in international markets.

Understanding of inflation	2 marks
Explanation of the benefits of stable rate	3 marks
Explanation of the benefits of a low rate	3 marks

(b) Discuss whether rapid inflation can be caused only by government actions. [12]

Inflation may be caused by monetary, demand pull and cost push factors. Monetary may result from government increases in money supply and lax regulation of the banking system or unsound banking practices. Demand pull may be caused by expansionary government policies and consumer incomes and attitudes to spending. Cost push may occur because of trade unions achieving wage rises in excess of productivity gains, tax rises, raw material costs and the actions of monopoly suppliers. All of these can affect the rate of inflation depending upon the scale of their impact.

Understanding of the different types of inflation	4 marks
Discussion of the government's role in causing inflation	4 marks
Discussion of the role of non-government causes of inflation	4 marks

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4 (a) Explain

(i) the difference between trade creation and trade diversion, and

Both result from establishing a trading area. Creation means shifting consumption from high cost to lower cost producers because of fewer trade barriers and more specialisation. Diversion means switching consumption from lower cost producers outside of the area to higher cost producers within. This results from the external tariff.

Understanding terms 2 marks
Explaining terms 2 marks

(ii) the difference between expenditure-dampening and expenditure-switching trade policies. [8]

Expenditure-dampening intends to lower the total level of spending within an economy by raising taxes and interest rates to reduce imports and raise exports. Expenditure-switching attempts to get foreign and domestic consumers to purchase the country's goods rather than rival countries by tariffs, quotas and devaluation.

Understanding terms 2 marks
Explaining terms 2 marks

(b) Discuss whether a balance of payments current account deficit necessarily indicates a weak economy. [12]

The balance of payments current account includes balances of goods, services, transfers and income. A deficit means outflows exceed inflows. Whether a deficit is a serious matter and indicates weakness depends upon its size (minimal or excessive), its continuity (how long has it run? is it continuous?), the cause of the deficit (buying consumer or investment goods?), its affordability (level of reserves, ease of borrowing), the effect it is having on the economy (running up debt, need for restrictive policies) and the nature of the deficit (which part of the account is causing the problem?), whether the deficit is structural or cyclical.

Depending which of these conditions apply, it may or may not indicate a weak economy. Examples can support the judgment.

Understanding of a current account deficit 4 marks
Discussion of conditions showing weakness 4 marks
Discussion of conditions showing ability to cope 4 marks

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