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UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS

GCE Advanced Subsidiary Level and GCE Advanced Level

MARK SCHEME for the October/November 2011 question paper for the guidance of teachers

9708 ECONOMICS

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

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1 (a) Compare the price behaviour of the three sizes of diamond between July 2004 and December 2008.

0.5 carat diamonds changed least, almost steady (1), 4.0 carat diamonds changed most (1), tripled at one point then fell back (1), 3.0 carat diamonds followed pattern of 4.0 carats (1), doubled before falling back (1). Any 3 points
Answers dealing only with the period shown on the graph can earn full marks
Max. 2 marks if no comparison [3]

(b) Explain <u>two</u> possible influences on the demand for diamonds.

Price (1), affordability/consumer surplus (1) advertising (1),
Persuades consumer to buy ('diamonds are for ever') (1)
Income (1), rising income makes diamonds more affordable (less luxury) (1)
Tastes (1), diamonds become more desirable in light of fashion trends (1)
Prices of other goods (1), e.g. substitute prices change (1)
Any two valid influences, for each identify (1), explanation (1) [4]

(c) Show, with the help of a diagram, how the introduction of the 5% luxury tax would have affected the supply of diamonds.

No effect at prices below $20 000 Reserve 1 mark (1), acts as an additional cost (1) reduced supply (1) diagram: show shift to left (1) (above $20 000) will diverge by an increasing absolute amount (1) [4]

(d) Using an example from the data, explain the meaning of external cost.

External cost is the harmful side effect borne by those not directly involved in an economic transaction (third parties) (1), e.g. mining in Canada spoils the environment for others (1), tourists and locals disadvantaged (1) [3]

(e) Discuss how well diamonds might serve as money if people lose confidence in paper currency.

Functions of money – medium of exchange, store of value, unit of account, standard… (1)
Characteristics of money – portable, scarce, durable, and divisible, acceptable etc. (1)

Application of functions and characteristics (4)
e.g. they are not uniform, are not easily recognisable and would not be generally acceptable so would not act as a medium of exchange, the high basic value of the lowest unit might make it difficult to serve as a unit of account, problems with these functions would make it difficult to be a standard of deferred payment

Diamonds are durable, portable and retain their value and so could serve as a good store of value.
Reasoned conclusion (1)
Max. of 6 [6]

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2 (a) Explain how a government's approach to making a decision about a construction project might differ from that of a private firm.

Government can take a wider view of social welfare than a firm concerned with profit maximisation. External costs and benefits in addition to private costs and benefits may be considered. Cost benefit analysis (CBA) can be used to establish the balance of social costs and benefits. The decision on whether a project is worthwhile may differ between the two parties.

Understanding of private and external costs/benefits of construction	4 marks	
Explanation of different purpose (2) and method of CBA (2)	4 marks	[8]

(b) Discuss whether an economist would classify healthcare and national defence in the same way.

Usual classifications are private, merit, public and normal goods. Healthcare is a private good as it has excludability and rival, national defence is a public good being non-excludable and non-rival. Health care is a merit good based on inadequate information of the consumer and under-provision by the market and it has external benefits. Defence is not considered a merit good. While healthcare is a clearly a normal good national defence could also be considered a normal good. They might be considered the same in that government provision may be needed to obtain the appropriate level of provision. Both could be classified as services rather than goods.

Understanding of the possible classifications	Up to 2 marks	
Application of the classifications to healthcare and defence	Up to 6 marks	
Discussion of the similarities and dissimilarities	Up to 6 marks	
Reasoned conclusion (1)		
Max. of 12		[12]

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3 (a) Explain what determines a country's comparative advantage in production.

Comparative advantage occurs when a country has a lower opportunity cost in the production of a good than another country. This may be based on the quality and nature of its factors of production, production methods, technology, transport costs, exchange rates, government policies etc

Understanding of comparative advantage and opportunity cost	4 marks	
Explanation of the influences on comparative advantage	4 marks	[8]

(b) Discuss the effectiveness of expenditure-switching policies in reducing a current account deficit on the balance of payments.

Current account deficit means a net outflow on goods and services, transfers and income. Expenditure-switching involves encouraging domestic consumers to move from imports to domestic products and foreign consumers to buy more imports to replace their own products. Methods include devaluation, tariffs and subsidies. These may be effective in improving the trade position and boosting domestic employment but have drawbacks. They may draw retaliation, reduce specialisation, lower choice, and raise prices. They may not be effective, depending upon elasticities and reactions of trading partners.

Understanding of current account deficit and expenditure-switching	4 marks	
Analysis of the operation and benefits of expenditure-switching	4 marks	
Discussion of the drawbacks of expenditure-switching	4 marks	
Reasoned conclusion (1)		
Max. of 12		[12]

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4 (a) Explain the factors which determine the size and productivity of a country's labour force.

The labour force is the proportion of the population in employment or available for work. Productivity is the output per worker. The size depends upon the population's size and age distribution, rules about retirement and school-leaving, cultural attitudes etc. Productivity will depend upon health, training, capital equipment etc.

Meaning of labour force and productivity 4 marks
Explanation of influences on size (2) and productivity (2) 4 marks [8]

(b) Discuss the problems that governments face in trying to produce accurate unemployment statistics.

Unemployment is measured by the labour force survey (ILO method) and the claimant (those claiming benefits) methods. The unemployed are those without paid work, available for work and seeking work. The LFS is thought more accurate because of regular (3 monthly), valid sampling techniques. The claimant count ignores those not entitled to benefits or who do not claim them and rules for eligibility are changeable. Governments may lack resources to collect accurate data, an informal economy may exist, fraudulent data may be supplied, some may be 'unemployable', and there may be political reasons to massage the data.

Understanding of unemployment
and recognition of measurement methods
Up to 4 marks) 6
Analysis of the accuracy of the two methods Up to 4 marks) max.
Discussion of the problems faced in the calculation 6 marks
Reasoned conclusion (1)
Max. of 12 [12]

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1 (a) Calculate the approximate world price of rice in January 2002. [2]

Approx. $200 per tonne (2), correct understanding of method but calculation error (1).

(b) With reference to Fig 1, analyse the different causes of the price movements of rice from November 2007 to April 2008 and then after May 2008. [4]

Restrictions (India, Vietnam) reduced supply to the world market (1) resulting in a higher price (1) release of stocks (Japan) increased supply (1) resulted in a price fall (1).

(c) Explain <u>two</u> possible economic reasons for India's introduction of export restrictions. [4]

Reasons include:
To transfer supply to the home market (1) to improve living standards (1)
To help lower income families in India (1) as rice is an important part of their diet (1)
To reduce inflationary pressure in India (1) as rice has a large weight in the CPI (1).

(d) (i) How might an effective minimum price for exports have helped India's position? [2]

Price set above world equilibrium to be effective (credit diagram) (1) then possible elaboration might include that the higher price would reduce the amount exported and increase the availability of rice to the home market (1) or that there might be a possible revenue gain for producers (1).

(ii) Why might India have changed from the use of a minimum export price to an export ban? [2]

This is likely to be because the minimum price is ineffective (1) because the price is set at the wrong level (1) or because the demand for exports is inelastic and there is no significant decrease in exports (1) or because the demand for exports is elastic and there is no increased revenue (1).

(e) Discuss the potentially harmful effects of India's protectionist trade policy for both its own economy and that of the rest of the world. [6]

For a definition of protectionism (1)
Harmful effects for India might include: may face retaliation, trade position may worsen through loss of export revenue, reduced flows of foreign currency, may lose markets in the long-run etc. (up to 4 marks).
Harmful effects for the rest of the world might include: higher prices for imports, reduced choice of product, reduced welfare, trade diversion to less efficient producers (up to 4 marks).

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2 (a) Show how production possibility curves may be used to explain any <u>two</u> economic ideas. [8]

A production possibility curve (ppc) shows the alternative combinations of two goods that can be produced when an economy fully uses its resources. Likely economic ideas are scarcity (contrast within and without curve) and opportunity cost (movement between points on curve) although unemployment and growth may also be considered.
Meaning of PPC (2) and choice of two valid concepts (2)
Explanation of use of PPC to illustrate each economic idea. Up to 3 marks for one idea explained well, but 4 maximum for this part of the question.

(b) Discuss whether the combination of improved technology and globalisation will result in solving the basic economic problem. [12]

The basic economic problem is the allocation of limited resources between unlimited wants and the existence of scarcity. The need for choice and the operation of opportunity cost follow from this. Improved technology increases output by raising productivity. Globalisation brings many advantages including the benefits of specialisation. These result in a rise in the standard of living and may reduce poverty and hardship. Some groups may be harmed by the two influences. Scarcity will continue as new wants will arise and benefits may not be spread equitably. The position may improve as a result of the changes but the economic problem will continue to exist.
Understanding of the basic economic problem (2 marks)
Analysis of the impact of improved technology (up to 4 marks) **and** globalisation (up to 4 marks)
6 maximum for this part of the question
Discussion of the continued existence of the economic problem. (Up to 4 marks)
Reserve 1 mark for a reasoned conclusion.

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3 (a) Explain the influences which determine the level of demand for healthcare in an economy. [8]

Demand will depend on price, population size and age distribution, health needs, income levels (income elasticity), balance between public and private provision, attitudes to health, awareness of availability of services, government policy (charging) etc.
Identification of relevant demand factors (up to 4 marks)
Explanation of relevant demand factors (up 4 marks per explanation with 6 maximum).

(b) Discuss whether healthcare can and should be provided by the free market. [12]

Healthcare is provided by both the private sector (free market) and the public sector. It has the properties of a private good. Within the private sector standards are often thought to be better (shorter waiting times, better conditions, efficient use of resources, little time wasting, etc.). The profit motive means that patients have to pay and it does not reflect need. This limits the availability of the healthcare and is considered inequitable. It may lead to the provision of non-essential services e.g. cosmetic surgery. Healthcare is a merit good (imperfect information) and generates positive information. This justifies free or subsidised provision by the state when the private sector does not meet the need or provides insufficient levels. Private healthcare is possible but will provide limited availability so justifying government provision.
Understanding of the nature of healthcare (2)
Discussion of the benefits of free market provision (up to 6 marks)
Discussion of the limits of free market provision (up to 6 marks)
Reserve 1 mark for a reasoned conclusion.

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4 (a) Explain what might cause an improvement in a country's terms of trade. [8]

The terms of trade are a ratio of the index of export prices to an index of import prices. The terms of trade may become more favourable, depending upon the relative movement of the two indices. An export price rise and import price fall can contribute to an improvement, although relative changes are most important. Price changes may result from changes in exchange rates, tariffs and subsidies, demand and supply conditions, costs of production, profit margins etc.
Basic idea of terms of trade (2) and a favourable movement (2)
Explanation of underlying influences that cause an improvement in the terms of trade (4).

(b) Discuss whether a country should be more concerned by a fall in its terms of trade or a fall in its domestic price level. [12]

A fall in the terms of trade may be associated with cheaper exports or dearer imports. This will reduce the international purchasing power of a country but may, depending upon elasticities, improve the balance of trade position and the level of employment. A fall in the domestic price level is deflation. This may recruit economic activity, harm business confidence, raise unemployment, reduce spending etc. However it may make the country more competitive internationally. The impact of falling terms of trade has been experienced by many countries over a long period and some have managed to cope with it. Deflation has more harmful effects on an economy and is likely to be more serious.
Understanding of a fall in terms of trade and a fall in domestic price level (4)
Analysis of the impact of the fall in terms of trade (up to 4 marks)
Analysis of the impact of the fall in domestic price level (up to 4 marks)
(6 maximum for this part of the question)
Discussion of the relative extent and impact of each occurrence (up to 4 marks)
Reserve 1 mark for a reasoned conclusion.

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1 (a) Use Table 1 to identify the main changes in world potato production between 1991 and 2007. [3]

World production increased (1), production in developed economies fell while production in developing economies rose (1), developing overtook developed (1), greater change in developing economies production than in developed (1).

Use of data to support (1 mark)

(b) With reference to Table 2, what might explain the different production per hectare in North America and Africa? [3]

For a general comment that North America is more efficient/productive that could be explicit or implicit (1), reasons such as more equipment, more fertiliser, better infrastructure, more suitable climate (up to 2). This could be one point developed or two distinct points.

(c) Explain <u>two</u> possible reasons for the different levels of potato consumption. [4]

Tastes, custom, availability, relative price, income level, substitutes etc.
Identification of factor (1) plus explanation (1) x two reasons.

(d) Consider the likely cross elasticity of demand between fresh potatoes and processed potatoes. [4]

XED meaning or formula (1), substitutes have positive value (1), good substitutes have a high value
or poor substitutes have a low value (1), reasoning applied to this case (1)

(e) Discuss the effect on world trade and welfare of the spread of 'tariff escalation'. [6]

General tariff case.
Tariff harm: raises price, reduces trade, choice and welfare (the technical definition of welfare is **not** required. Consider welfare as general well-being). (Up to 3 marks)

Tariff benefits: protects domestic producers and helps independence and security. Protects domestic consumers from demerit goods. (Up to 3 marks)

4 marks maximum for general tariff discussion.

Tariff escalation.
This prevents changes in production patterns by protecting higher value added goods produced in developed countries and keeps developing countries in raw material production. This benefits developed countries. (Up to 2 marks)

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2 (a) Explain, with the help of a diagram, how an economy can in the short-run and long run enjoy consumption beyond its current production possibility curve. [8]

A production possibility curve (ppc) shows the maximum possible combination of two goods that can be produced using all its resources. Points outside of the ppc are unattainable by the economy itself. In the short run international trade enables a country to enjoy more than it can produce by running a trade deficit. In the long run technical progress and additional resources can move the ppc out beyond its current position as it achieves economic growth.
Understanding of ppc and short-run limitation on production (4 marks).

Short-run (up to 3 marks) and
Long-run (up to 3 marks) ability to increase production possibility.

4 marks maximum for consideration of short run and long run. (4 marks)

(b) Discuss the effectiveness of free market economies in raising the level of welfare. [12]

Free market economies are based on the market system and have restricted government intervention. Their strength is in efficiency, competition and incentive which should result in lower prices, good quality and choice. Individuals are able to become wealthy and average living standards are generally high. The system has its drawbacks as the profit motive may prevent the supply of public goods and restrict the supply of merit goods. It ignores imperfect information and the existence of externalities so preventing socially optimal output. It does not guarantee employment and economic security and may result in a highly uneven distribution of income and wealth.

Understanding of market economies and welfare indicators. (The technical definition of welfare is **not** required. Consider welfare as general well-being). (4 marks).

For a discussion of how market economies might result in a rise in the level of welfare (up to 5 marks).
For a discussion of how market economies might result in a lowering of the level of welfare (up to 5 marks).

8 marks maximum for consideration of impact of market economies.

(1 mark should be reserved within this for a reasoned conclusion)

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3 (a) Explain the significance of a rise in the terms of trade for a country. [8]

The terms of trade relate the price of exports to the price of imports. They are measured by the price of exports/price of imports and expressed as an index. A rise may result if export prices rise relative to import prices. The significance of a favourable move is that a given quantity of exports will be able to buy a greater quantity of imports and raise living standards. However, the same rise in the terms of trade may reduce a country's international price competitiveness and harm the balance of trade.
Understanding of a rise in the terms of trade (4 marks).
(Definition 1 mark)
(Formula or calculation 1 mark)
(Explanation/illustration of 'rise in terms of trade' 2 marks.)

Explanation of favourable outcomes up to 2 marks
Explanation of unfavourable outcomes up to 2 marks (4 marks).

(b) Discuss whether government action is the most likely cause of a current surplus on the balance of payments. [12]

A current account surplus occurs when inflows from trade, transfers and income are greater than outflows. Government may influence trade by trade protection policies, industrial support and by intervening in the exchange rate. The government involvement in transfers may mean receipt of aid, international contributions and grants. Income is more likely to link to the private sector. Other causes of surplus are based on private activity in efficient production and innovation. Income is likely to be from previous private overseas investment and loans and transfers can result from private remittances. For some economies the main factor may be resource endowment, national attitudes, political relationships and geography. The role and impact of the government will also vary with the nature of the economic system. Examples may be given.

Understanding of current account surplus (2 marks)
Discussion of government influences up to (6 marks).
Discussion of non-government influences up to (6 marks).
(10 marks maximum for discussion element of question)

1 mark should be reserved within this for a reasoned conclusion

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4 (a) Explain with the help of a diagram, the effect of a depreciation of a country's exchange rate on that country's rate of inflation. [8]

Depreciation under a floating exchange rate can lower export prices and raise import prices. Lower export prices will raise aggregate demand and contribute to demand pull inflation. Higher import prices may contribute to higher costs (cost push inflation) and deflect demand to local products (demand pull inflation). All of these factors would raise the rate of inflation. This would be shown in an aggregate demand and supply diagram with a left shift in AS and a right shift in AD.

Understanding of price changes (2) as a result of depreciation (2). (Up to 4 marks)

Explanation of links between depreciation price change and inflation through diagram showing AS shift (2) and AD shift (2). (Up to 4 marks)

(b) Inflation affects an economy both domestically and internationally. Discuss which effect is likely to be more significant. [12]

Inflation is a persistent rise in the price level. The domestic consequences affect real values, the distribution of income, employment levels, production costs and planning. The international consequences stem from the loss of competitiveness with a trade imbalance that affects the exchange rate and employment levels. In both cases the seriousness of the impact depends upon the level of inflation, whether it is anticipated and the importance of trade to an economy. There will be less impact domestically if there is indexation and internationally if other countries also experience inflation. For most economies the domestic effects are liable to be felt by more of the population.
For a definition of inflation. (Up to 2 marks).

For a discussion of the domestic effects of inflation. (Up to 6 marks).
For a discussion of the international effects of inflation. (Up to 6 marks).
(10 marks maximum for discussion element of question)

1 mark should be reserved within this for a reasoned conclusion

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