Cambridge Assessment International Education

Cambridge International AS & A Level

ECONOMICS **9708/21**

Paper 2 Data Response and Essay **October/November 2020**

MARK SCHEME

Maximum Mark: 40

Published

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GENERIC MARKING PRINCIPLE 2:

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GENERIC MARKING PRINCIPLE 5: Marks should be awarded using the full range of marks defined in the mark scheme for the question (however; the use of the full mark range may be limited according to the quality of the candidate responses seen).
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Question	Answer	Marks	Guidance
1(a)	**Describe the functions of an entrepreneur in the production process.** • For a reference to taking decisions/organising, combining or coordinating the factors of production **(1 mark)** • For a reference to taking a risk **(1 mark)**	**2**	Candidates need to have both of these functions to gain 2 marks
1(b)	**How does a customs union differ from a free trade area?** • For clear explanation of a customs union **(1 mark)** • For a clear explanation of a free trade area **(1 mark)** The key difference between them is the common external tariff; this is part of a customs union, but not part of a free trade area. This difference needs to be made explicit to gain both marks, e.g. through words such as 'whereas' or 'however'.	**2**	Customs union: • an agreement between two or more countries to remove trade barriers and reduce or eliminate customs duties on mutual trade • a customs union has a common external tariff against non-member countries Free trade area: • an agreement between two or more countries that allows the countries to freely trade with each other • a free trade area does not have a common external tariff; the countries are allowed to charge whatever tariffs they want against non-member countries
1(c)	**Use a supply and demand diagram to explain how the exchange rate against the euro was maintained as shown in Fig. 1.1.** • For a supply and demand diagram showing the equilibrium at 0.7 Latvian Lats per euro **(Up to 2 marks)** • For an explanation of how a government can intervene in a market to maintain a particular price/exchange rate throughout the period from 2007 to 2013 **(Up to 2 marks)** **4 marks maximum**	**4**	A government can intervene in a market to maintain this particular exchange rate on a regular basis through: • sales of foreign reserves • buying/selling of currency on the foreign exchange market

Question	Answer	Marks	Guidance
1(d)(i)	**Explain what is meant by a 'budget deficit'.** • A budget shows the details of government expenditure and government revenue **(1 mark)** • A budget deficit is the amount by which government expenditure exceeds government revenue **(1 mark)**	**2**	
1(d)(ii)	**Analyse, using a diagram, how fiscal measures to reduce the budget deficit could be used by the Latvian government to lower the relatively high rate of inflation.** • Analysis of the impact of fiscal measures of reducing government expenditure and increasing government taxation to lower the relatively high rate of inflation in Latvia **(Up to 2 marks)** • For an AD/AS diagram showing the shift of the AD curve to the left and a lowering of the general price level **(Up to 2 marks)**	**4**	Measures to reduce government expenditure: • deflationary fiscal policy to reduce public expenditure • policy of government to move from a budget deficit to a balanced budget Measures to increase government taxation: • increases in direct taxes, e.g. taxes on income • increases in indirect taxes, e.g. taxes on expenditure Impact on inflation: • the impact of reduced government expenditure and increased government taxation will be to reduce inflationary pressure in the economy

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Question	Answer	Marks	Guidance
1(e)	**Discuss whether it is better for Latvia to specialise in banking services rather than having a more diversified economy** • For a discussion of the advantages of Latvia specialising in banking services **(Up to 3 marks)** • For a discussion of the advantages of Latvia having a more diversified economy **(Up to 3 marks)** • **5 marks maximum** **Reserve 1 mark for a conclusion** **6 marks maximum**	**6**	Advantages of Latvia specialising in banking services: • advantages of specialisation, such as in relation to comparative advantage and the existence of a lower opportunity cost ratio • builds up expertise • further establishes its reputation as a banking centre • banking services do not have significant transport costs, especially online banking Advantages of Latvia having a more diversified economy: • avoids over-specialisation • this could be advantageous if there is a reduced demand for financial services • spreads risks

Question	Answer	Marks	Guidance
2(a)	**Explain, with the help of examples, how imperfect information among consumers affects their consumption of merit goods and demerit goods.** **Up to 2 marks for Knowledge and Understanding** • Knowledge and understanding of imperfect information in relation to a merit good and a demerit good, with the help of suitable examples **(Up to 2 marks)** **2 marks maximum** **Up to 6 marks for Application** • Application of the idea of imperfect information to the under-consumption of a merit good **(Up to 3 marks)** • Application of the idea of imperfect information to the over-consumption of a demerit good **(Up to 3 marks)** **6 marks maximum**	**8**	**Merit good:** • a particular type of private good • it is rival and excludable • it has intrinsic benefits for an individual • examples include education or health care **Demerit good:** • a particular type of private good • it is rival and excludable • it is potentially damaging for an individual • examples include alcohol or tobacco **Imperfect information and a merit good:** • problem of information failure • merit goods are likely to be under-consumed and under-produced • consumers do not fully appreciate the value of a merit good **Imperfect information and a demerit good:** • problem of information failure • demerit goods are likely to be over-consumed and over-produced • consumers do not fully understand the potential dangers of a demerit good

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Question	Answer	Marks	Guidance
2(b)	**Discuss why in most mixed economies, resources are mainly allocated using market forces and the price mechanism**. **Up to 8 marks for Analysis** • Analysis of market forces/price mechanism element **(Up to 4 marks)** • Analysis of government intervention element (the use of the word 'mainly' makes it clear that market forces/price mechanism is not the exclusive method of resource allocation) **(Up to 4 marks)** **8 marks maximum** **Up to 4 marks for Evaluation** For exercising some judgement on why in most mixed economies, resources are mainly, but not exclusively, allocated using market forces and the price mechanism **Reserve 1 mark for a conclusion** **4 marks maximum**	**12**	**Features of market forces:** • existence of price mechanism • prices operate as signals to indicate consumer preferences • private sector ownership/decision-making with no or very little government intervention **Features of government intervention:** • existence of public sector • public goods and merit goods can be provided by the government

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Question	Answer	Marks	Guidance
3(a)	**Cross elasticity of demand for bread with respect to the price of rice is +1.4 while the cross elasticity of demand for bread with respect to the price of butter is -0.7. Explain why the cross elasticity of demand figures for bread differ.** **Up to 2 marks for Knowledge and Understanding** • What is meant by XED **(1 mark)** • The formula for XED **(1 mark)** **2 marks maximum** **Up to 6 marks for Application** • Application to goods as substitutes/positive XED **(1 mark)** • Application to bread and rice as substitutes **(1 mark)** • Application to figure and strong relationship **(1 mark)** • Application to goods as complements/negative XED **(1 mark)** • Application to bread and butter as complements **(1 mark)** • Application to figure and weak relationship **(1 mark)** **6 marks maximum**	**8**	**Cross elasticity of demand:** • the percentage/proportionate change in the quantity demanded of Good A divided by the percentage/proportionate change in the price of Good B

Question	Answer	Marks	Guidance
3(b)	**Explain the implications of price elasticity of demand and income elasticity of demand for business decisions. Discuss which measure is likely to be more useful to a business.** **Up to 8 marks for Analysis** • Analysis of the usefulness of price elasticity of demand to a business **(Up to 4 marks)** • Analysis of the usefulness of income elasticity of demand to a business **(Up to 4 marks)** **8 marks maximum** **Up to 4 marks for Evaluation** For exercising some judgement on the relative extent to which price elasticity of demand and income elasticity of demand can be of use to a business **Reserve 1 mark for a conclusion** **4 marks maximum**	**12**	**Potential usefulness of PED:** • it can be helpful in giving a business an indication of the extent to which a change in price may affect revenue • this will show that to increase revenue, the price of an elastic good should be reduced and the price of an inelastic good should be increased • however, to be able to make appropriate calculations, a businessman will need to take into account the availability of substitutes, the width of the definition of the product, the amount spent on the product and the time period under consideration **Potential usefulness of YED:** • it can be helpful in giving a business an indication of the extent to which a change in income may affect revenue • however, to be able to make appropriate calculations, a businessman will need to take into account whether a good is a normal or an inferior good, the proportion of income that is spent on a particular good, the width of the definition of the product and the level of economic development of the particular economy

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Question	Answer	Marks	Guidance
4(a)	**Explain, with the aid of a diagram, the impact of a subsidy to domestic producers of a product on the export revenue from that product.** **Up to 2 marks for Knowledge and Understanding** For correct diagram: • Vertical axis correctly labelled: P/Price Horizontal axis correctly labelled: Q/Quantity **(1 mark)** • Shift of the supply curve to the right and new equilibrium price and equilibrium quantity shown **(1 mark)** **2 marks maximum** **Up to 6 marks for Application** • Explanation in relation to the impact of a subsidy to domestic producers of a product on the export revenue from that product. **(Up to 3 marks)** • Explanation in relation to the effect of PED/PES on export revenue **(Up to 3 marks)** **6 marks maximum**	**8**	Both knowledge and understanding marks are for the diagram **Impact of a subsidy in a market:** • government payment of a subsidy to a firm will reduce the costs of production • this will encourage firms to supply more output at any given price • this will cause the supply curve to shift to the right • the equilibrium price in the market will be lower • the equilibrium quantity in the market will be higher • the effect on change in revenue will depend on PED/PES

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Question	Answer	Marks	Guidance
4(b)	**Discuss whether supply-side policies are an effective way of correcting a deficit on an economy's current account of the balance of payments.** **Up to 8 marks for Analysis** • The potential advantages of supply-side policies **(Up to 4 marks)** • The potential disadvantages of supply-side policies **(Up to 4 marks)** **8 marks maximum** **Up to 4 marks for Evaluation** For exercising some judgement on whether supply-side policies are an effective way of correcting a deficit on an economy's current account of the balance of payments **Reserve 1 mark for a conclusion** **4 marks maximum**	**12**	**Supply-side policies could include:** • increasing incentives to work by lowering income tax and unemployment benefits, but this will not necessarily lead to an increase in the supply of labour, especially if there are no jobs • increasing expenditure on education and training, but this will not necessarily lead to an increase in labour productivity or to an increase in the occupational mobility of labour, and its effect can take a long time to show • reducing the power of trade unions, but this will not necessarily lead to a reduction in the number of days lost through industrial action • encouraging the privatisation of firms, but this will not necessarily lead to an increase in the efficiency of firms and a way of correcting such a deficit • encouraging deregulation, e.g. through reducing the barriers of entry into an industry, but this will not necessarily lead to an increase in the number of firms entering an industry • providing more information about job vacancies in different parts of a country, but this will not necessarily lead to the correction of a current account deficit

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1(a)	**With reference to the extract and Fig. 1.1, use supply and demand diagrams to explain the change in the price of natural vanilla**		
1(a)(i)	**from 2004 to 2009** For an accurately labelled diagram showing a decrease in the demand for vanilla **(1 mark)** and the fall in price of vanilla **(1 mark)** For an accompanying explanation of the cause of this decrease in demand for vanilla. The extract indicates that this was a fall in the price of vanillin. **(1 mark)**	**3**	The extract makes it clear that the fall in price of vanilla from 2004 to 2009 is because of a decrease in the demand for vanilla caused by a fall in the price of vanillin that is more reliable in supply.
1(a)(ii)	**from 2015 to 2018** For an accurately labelled diagram showing an increase in the demand for vanilla **(1 mark) OR** a decrease in the supply of vanilla **(1mark)** each to show a rise in price of vanilla **(1 mark)** For an accompanying explanation of a valid cause of the change identified in the extract • In the case of an increase in demand for vanilla concerns about possible health risks of vanillin **(1 mark).** • In the case of a decrease in supply the 'poor harvests' or the cyclone which hit Madagascar **(1mark)**	**3**	The rise in the price of vanilla from 2015 to 2018 was caused by • a decrease in the demand for vanillin as a result of concern about the health risks which caused an increase in the demand for vanilla. • a decrease in supply of vanilla caused by 'poor harvests' and the cyclone A decrease in supply as vanilla farmers withdrew from the industry is not an acceptable explanation because of the time period. Some candidates are providing an explanation of both a decrease in supply and a rise in demand. This is acceptable, but only one reason is required for the mark available.

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Question	Answer	Marks	Guidance
1(b)	**Ice cream producers can use natural vanilla or vanillin to produce ice cream.**		
1(b)(i)	**State the concept that an economist would use to measure the responsiveness of the demand for natural vanilla to a change in the price of vanillin.** The relationship would be measured using the concept of cross elasticity of demand **(1 mark)**	**1**	Accept the formula as sufficient knowledge of the concept if it is clear that the candidate knows the concept underlying the formula.
1(b)(ii)	**Explain the value that you would expect for this measurement.** For stating that the value would be positive because these goods are substitutes **(1 mark)** For an explanation of why a positive relationship would be expected i.e. a fall in the price of vanillin has caused a fall in the demand for vanilla **(1 mark)** For an explanation that the higher the size of the coefficient the stronger will be the relationship **(1 mark)**	**3**	Accept answers where the candidate refers to the text and explains that since the two products are close substitutes you would expect the value to be high.

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Question	Answer	Marks	Guidance
1(c)	**Explain why the price elasticity of supply of ice cream made with vanillin is likely to be relatively more elastic than the price elasticity of supply of ice cream made with natural vanilla.** For a **clear understanding** of the concept of price elasticity of supply (this could be shown through an accurate formula for PES) **(1 mark)** And the distinction between elastic and less elastic in terms of the extent to which the quantity of ice cream supplied can respond to a change in price **(1 mark)** For an explanation of why the price elasticity of supply of ice cream made with vanillin is likely to be higher than the price elasticity of supply of ice cream made with vanilla (or why the price elasticity of supply of ice cream made with vanilla is likely to be lower than the price elasticity of supply ice cream made with vanillin. **(Up to 2 marks)**	**4**	The most important factors that influence the price elasticity of supply are the ease with which production can be increased or decreased and the availability of stocks. The former is determined for e.g. by the nature of the product, the availability of required factors of production any stocks held and the existence of spare capacity. It is likely that the price elasticity of supply of ice cream made with vanilla is less elastic than that made with vanillin because the text makes it clear that it takes a long time to produce new vanilla plants (3 years) and many farmers left the industry in the years that vanilla prices were falling meaning that there is unlikely to be any spare capacity. So even though vanilla prices are rising rapidly the quantity of natural vanilla supplied may be slow to rise. Vanillin on the other hand is made from 'more reliable sources of plentiful raw materials' that indicates that an increase in the quantity supplied can be made much more easily and the price elasticity of supply is likely to be more elastic.

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Question	Answer	Marks	Guidance
1(d)	**Discuss whether the recent rise in the price of vanilla is on balance likely to have a positive or negative impact upon Madagascar's economy.** For analysis of the likely positive impact in terms of the current account of the balance of payments and the possible impact on output, prices and employment. **(Up to 3 marks)** For analysis of the likely negative impact in terms of the current account of the balance of payments and the possible impact on output, prices and employment. **(Up to 3 marks)** Reserve 1 mark for a reasoned conclusion on whether the rise in price is likely to have a positive or negative impact upon Madagascar's economy. So 5 marks maximum if no conclusion provided.	**6**	The rise in the price of vanilla could be expected to have a positive effect on Madagascar's economy. There is expected to be an increase in the value of exports that would increase aggregate demand and stimulate output and employment. Much depends however upon the price elasticity of demand for vanilla. If the demand is price elastic then export revenues will fall and aggregate demand will contract. The current account of the balance of payments might become a deficit. The shortage of natural vanilla and the rise in its price might result in a movement to the use of cheaper vanillin and Madagascar's exports might fall with a negative impact upon output and employment. In addition a negative impact might arise if export revenues increase, but because of lack of capacity in the economy demand pull inflation is created. Some might argue that Madagascar has a clear comparative advantage in production of vanilla so the impact might be positive as resources are re-allocated back into vanilla production, but some might use the text to question whether it is a good idea to be over reliant upon one crop.

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1(d)			Candidates need to give a balanced answer that considers both the positive and negative impact before arriving at a reasoned conclusion. Price elasticity of demand could be relevant, but is not essential for full marks.

Question	Answer	Marks	Guidance
2(a)	**In some countries vaccinations against infectious diseases are offered at a price and payment has to be made.** **Use a diagram to explain how a subsidy given to producers in the market for vaccinations will affect the market price and explain the impact of this subsidy upon the consumer surplus in this market.** For **knowledge and understanding** of the meaning of consumer surplus **(2 marks)** **Up to 2 marks** For **application** using an accurately labelled diagram that shows the shift to the right of the supply curve **(1 mark)** and the fall in equilibrium price and rise in equilibrium quantity of vaccinations **(1 mark).** For the consumer surplus before the subsidy **(1 mark)** and the rise in consumer surplus after the subsidy **(1 mark)** For **application** that explains one other factor that determines the fall in price for e.g. the price elasticity of demand, the price elasticity of supply or the size of the subsidy **(1 mark)** that explains one other factor that determines the change in the consumer surplus for e.g. the price elasticity of demand, the price elasticity of supply or the size of the subsidy. **(1 mark)** **Up to 6 marks**	**8**	The imposition of a subsidy will shift the supply curve to the right reducing price and increasing quantity. The price will fall and the consumer surplus will increase. The impact on each will be determined by factors such as the price elasticity of demand and the price elasticity of supply vaccinations.

Question	Answer	Marks	Guidance
2(b)	**If the cost of the subsidy is to be paid from tax revenues, discuss whether the revenue should be raised through direct taxes or indirect taxes.** For **analysis** considering the advantages **(Up to 3 marks)** and disadvantages **(Up to 3 marks)** of raising the revenue through direct taxes **(4 marks maximum)** For **analysis** considering the advantages **(Up to 3 marks)** and disadvantages **(Up to 3 marks)** of raising the revenue through indirect taxes **(4 marks maximum)** For **evaluative comment** with **1 mark** reserved for a reasoned conclusion on which type of tax should be used. **(Up to 4 marks)**	**12**	Direct taxes include income tax and corporation tax. They have the disadvantage that there is widespread tax evasion especially in less developed economies. On the other hand they can be used to promote equity. Indirect taxes are less easy to avoid, but they are regressive and are potentially inflationary. Very often high indirect taxes can lead to the development of black markets.

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Question	Answer	Marks	Guidance
3(a)	**Explain how the factor of production enterprise contributes to aggregate supply in a modern economy and how it differs from the other factors of production in terms of the reward for its services.** For **knowledge and understanding** of the role of enterprise in the production process in a modern economy: Enterprise undertakes the organisation of the other factors of production **(1 mark)** It also bears the risk of production **(1 mark)** **(2 marks)** **For application**: Profit is the reward to enterprise for its services **(1 mark)** In order to produce goods and services enterprise needs to hire **labour** which is rewarded with wages **(1 mark), land** which is the natural resource rewarded with rent **(1 mark)** and **capital** which is rewarded with interest **(1 mark)** Enterprise will utilise the other factors of production to produce goods and services that increase aggregate supply **(1 mark).** Aggregate supply will increase through an increase in productive potential or a fall in unused resources. **(1 mark)** **(Up to 6 marks)**	**8**	Enterprise takes the risk of production and organises the other factors. In a modern economy this often leads to the divorce of ownership (shareholders) from control (management). Profit is the reward for enterprise, but profit is the reward for risk and in loss making firms there will be no profit. This contrasts with the rewards to labour, land and capital. Aggregate supply, also known as total output, is the total supply of goods and services produced within an economy in a given time period. In order to contribute to aggregate supply enterprise organises the other factors of production and takes the risk that costs will not exceed revenue leading to negative profit.

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Question	Answer	Marks	Guidance
3(b)	**Explain how aggregate demand is likely to be affected by an increase in the money supply and consider whether the impact of such an increase will be on employment or on the general price level.** For **analysis** of the way in which aggregate demand will be affected by an increase in the money supply through an explanation of the impact on at least **two** components (**Up to 4 marks** for each component considered) **8 marks maximum** For **evaluative comment** on whether the impact is likely to be on employment or the general price level with **1 mark** reserved for a reasoned conclusion **(Up to 4 marks)**	**12**	Candidates need to explain how the increase in the money supply will affect the selected component. For example, if consumption is considered it is expected that candidates will explain that the increase in money supply will reduce interest rates and make loans cheaper and the reward for saving lower with the result that consumption will increase.

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Question	Answer	Marks	Guidance
4(a)	**China's terms of trade index fell from 102.1 in March 2018 to 99.7 in April 2018.** **State how the terms of trade are measured, and explain three possible causes of the fall in China's terms of trade shown above.** For **knowledge and understanding** that the terms of trade is a measure of the relationship between export prices and import prices **(1 mark)** and for an accurate formula that measures changes in the terms of trade index **(1 mark)** **(2 marks)** For **application** explaining **three** possible causes of a fall in the terms of trade **(Up to 2 marks for each cause explained)** **(Up to 6 marks)**	**8**	Possible causes of a fall in the terms of trade include a fall in the price of China's exports or a rise in the price of China's imports. Candidates need to identify a possible cause and then provide a brief explanation of what might cause this. For example: • a fall in the value of China's currency will lead to a rise in the price of imports (1 mark) the fall in the exchange rate could be caused by falling interest rates in China (1 mark) • a reduction in the costs of production in China's export industries would lead to a fall in the price of China's exports (1 mark) this reduction in costs could be caused by an increase in export subsidies (1 mark) • a higher rate of inflation in China's trading partners would lead to the relative price of China's exports falling (1 mark) this higher rate of inflation in other countries could be caused by excess government spending in those countries (1 mark)

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Question	Answer	Marks	Guidance
4(b)	**Discuss whether a rise in the terms of trade or a fall in the terms of trade is more likely to be of benefit for an economy.** For an **analysis** of the advantages and disadvantages to an economy of a rise in the terms of trade **(Up to 4 marks)** For an **analysis** of the advantages and disadvantages to an economy of a fall in the terms of trade **(Up to 4 marks)** For **evaluative comment** with **1 mark** reserved for a reasoned conclusion	**12**	A rise in the terms of trade means that a given quantity of exports can purchase a greater quantity of imports and the opposite is true for a fall in the terms of trade. If the terms of trade rise exports might become uncompetitive however there is a potential rise in living standards. If there is a fall in the terms of trade exports become competitive, but inflation might rise as imports become expensive giving rise to cost-push inflation.

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Question	Answer	Marks	Guidance
1(a)	**State whether the Malaysian ringgit depreciated or appreciated against the US dollar over the period July 2013 to July 2017. Justify your answer.** The Malaysian ringgit depreciated (**1 mark)** So the Malaysian ringgit is worth less dollars (or the US dollar is worth more ringgits) **(1 mark)** **Max 2 marks**	**2**	The ringgit has depreciated from 3.1RM to 4.2RM per US dollar**.** It is necessary to state that the ringgit has depreciated for the first mark. The candidate does not need to provide precise figures. Figure 1.2 makes it clear that the Malaysian ringgit is now worth less dollars or the US dollar is worth more ringgit. A clear statement along these lines is sufficient for the second mark.
1(b)(i)	**Describe the relationship you would expect between a change in the foreign exchange rate of a country and its balance of trade in goods and services.** For description of a **fall** in the exchange rate and an increasing surplus or a decreasing deficit **(1 mark)** **And** For description of a **rise** in the exchange rate and a decreasing surplus or an increasing deficit **(1 mark)** **Max 2 marks**	**2**	In general, a depreciation of a foreign exchange rate should lead to a positive change in the balance of trade e.g. a deficit becomes a surplus. An appreciation should lead to a negative change in the balance of trade e.g. a surplus becomes a deficit. How the change in the foreign exchange rate actually affects the balance of trade is determined by the price elasticity of demand for exports and imports, but this is not required.
1(b)(ii)	**Explain whether the evidence in Fig. 1.1 and Fig. 1.2 confirms this relationship.** In general the information in the two figures does not confirm this relationship because the two graphs do not appear to be closely related (**1 mark)** for reference to the data to illustrate a time period when the relationship is not confirmed or they can refer to a time period when the relationship is confirmed (**1 mark)** **Max 2 marks**	**2**	If a candidate reverses the direction of causation this can be allowed if explained well.

Question	Answer	Marks	Guidance
1(c)	**In July 2017, Malaysia's balance of trade in goods and services was RM22045 million and its current account balance was RM9642 million.** **Explain the reason for this difference.** The difference can be attributed to the absence of Primary and Secondary income balances. **(1 mark)** For an explanation that the sum of these two missing balances must be negative. (**1 mark)** **Max 2 marks**	**2**	Accept older terms to describe the components of the current account balance of trade. For example, the income account or current transfers. If the candidate states that 'other parts' of the current account might be absent then allow 1 mark.
1(d)	**Other than exchange rate changes, explain two possible reasons for Malaysia's increasing balance of trade in goods and services surplus from July 2016 to July 2017.** For identification of a valid reason **(1 mark)** and for accompanying explanation **(2 marks)**	**6**	There are many possible reasons for Malaysia's increasing surplus on the balance of trade. Candidates should identify a possible reason and then explain why the factor identified could lead to an increasing surplus. For example, government intervention such as subsidies to export industries **(1 mark)** this will reduce the price of exports **(1 mark)** and make Malaysian goods and services more competitive in world markets **(1 mark)** An increase in the rate of direct taxes in Malaysia **(1 mark)** will reduce disposable incomes **(1 mark)** and make imports less affordable **(1 mark)** **Allow any valid reason.**

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Question	Answer	Marks	Guidance
1(e)	**Discuss whether the Malaysian government should be concerned about persistent surpluses in its balance of trade in goods and services.** Award **up to 3 marks** for analysis of the advantages of a surplus. Award **up to 3 marks** for analysis of the disadvantages of a surplus. **5 marks maximum** Reserve **1 mark** for an evaluative comment that makes clear whether the Malaysian government should or should not be concerned.	**6**	Persistent surpluses on the balance of trade in goods and services could increase aggregate demand in Malaysia leading to high employment and a rise in real GDP. This is a positive outcome, but it could generate demand-pull inflation if the economy is operating at full capacity. In addition, if the surpluses are maintained through government intervention there might be tension with trading partners and competitors. This might lead to retaliation.

Question	Answer	Marks	Guidance
2(a)	**Using diagrams, explain what might cause a market to be in disequilibrium, and how market forces would lead to equilibrium being restored.** **For knowledge and understanding**: using a diagram to show equilibrium in a market **(1 mark)** with a clear statement of what is meant by 'equilibrium' **(1 mark)** **2 marks** **For application:** that shows disequilibrium in a market and why it might arise. A shift in the demand or supply curve **(1 mark)** with a cause of this shift **(1 mark)** and the disequilibrium in terms of an excess demand or excess supply **(1 mark)** and the new equilibrium price and quantity indicated **(1 mark)** And application that explains how the new equilibrium is restored by market forces **(Up to 2 marks)**	**8**	A market is in equilibrium when, given present circumstances, there is no tendency for change. In other words demand and supply are equal with an equilibrium price and quantity. The market clears at this point. Disequilibrium will occur when either the demand curve or supply curve shifts. Change will have to come about to restore equilibrium. Equilibrium is restored through price changes or changes in demand and/or supply in the market. Accept maximum or minimum prices as a cause of disequilibrium.

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Question	Answer	Marks	Guidance
2(b)	**Discuss whether the incidence of an indirect tax on a product always affects its consumers more than its producers.** **Analysis:** Up to **4 marks** for an explanation of the incidence of an indirect tax and how it affects consumers in terms of the price paid and the consumer surplus with due reference to the price elasticity of demand and supply. Up to **4 marks** for an explanation of the incidence of an indirect tax and how it affects producers in terms of the price received and the producer surplus with due reference to the price elasticity of demand and supply. **8 marks max** Up to **4 marks** for **evaluation**. Reserve 1 mark for a clear conclusion of whether it is always consumers rather than producers who are most affected. **Up to 4 marks maximum**	**12**	Incidence refers to the relative impact of an indirect tax on consumers and producers. The extent of the incidence depends on the price elasticity of demand and supply of the product. The more inelastic the PED, the greater the burden of the tax on consumers and so on. Evaluative comment might consider those goods that are habit forming and often considered as demerit goods in terms of the impact of an indirect tax on incidence and consumption.

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Question	Answer	Marks	Guidance
3(a)	**Explain what is meant by income elasticity of demand and, with the help of examples, show how it can be used to determine whether a good is normal or inferior.** For **knowledge and understanding**: up to **2 marks** for an explanation of the concept. What it measures **(1 mark)** and the formula **(1 mark)** For **application** to different types of good. Normal goods have a positive sign **(1 mark),** and why this comes about **(1 mark).** This should be justified with an appropriate example to illustrate the case **(1 mark)** **3 marks** Inferior goods have a negative sign **(1 mark),** and why this comes about **(1 mark).** This should be justified with an appropriate example to illustrate the case **(1 mark)** **3 marks** **8 marks max**	**8**	Income elasticity of demand is a numerical measure of the responsiveness of demand following a change in income. A formula is equally acceptable. The sign and size are important when determining whether a good is normal or inferior.

Question	Answer	Marks	Guidance
3(b)	**Discuss whether knowledge of price elasticity of demand or price elasticity of supply is more useful to a car manufacturer.** For **analysis**: Up to **4 marks** for an explanation of the usefulness of PED to a car manufacturer. Up to **4 marks** for an explanation of the usefulness of PES to a car manufacturer. **8 marks max** For **evaluation**; that compares the usefulness of the two measures **(up to 3 marks)** to arrive at a reasoned conclusion **(1 mark)** **Up to 4 marks maximum**	**12**	The idea behind this question is for candidates to consider the two elasticities and say which one provides the best information in this context. Each measure should be analysed. Re-PES, it is relevant to explain that this will show whether the manufacturer has the capacity to produce more or less as price changes. Reference to the ability to produce vehicles for stock is relevant. PED is most useful when the manufacturer is looking at whether to change the price of vehicles.

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Question	Answer	Marks	Guidance
4(a)	**A government embarks on a supply-side policy involving substantial additional funding for new road schemes and for new training schemes designed to raise labour productivity.** **Use an AD/AS diagram to explain the effects of this funding on the level of output in the economy.** For **knowledge and understanding**: For an accurate AD/AS diagram that shows national output in equilibrium **(2 marks)** **For application:** For a clear understanding of aggregate demand **(1 mark)** using an accurate diagram to show that the AD curve will shift to the right because of the increase in government spending **(1 mark)** and that this will increase the level of national output **(1 mark)** For a clear understanding of aggregate supply **(1 mark)** using an accurate diagram to show that the AS curve will shift to the right because of the increase in productivity **(1 mark)** and that this will increase the level of national output **(1 mark)** **8 marks max**	**8**	In the short run there will be an increase in Aggregate Demand. This can be shown by a shift of the AD function to the right. Longer term, the AS function may also shift to the right as the quality of the labour force increases.

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Question	Answer	Marks	Guidance
4(b)	**Discuss the extent to which a supply-side policy involving new road schemes and new training schemes will increase the rate of inflation in the economy.** For **analysis** of supply side policies with reference to the aims and why the rate of inflation might not increase (**up to 4 marks)** For analysis of the impact upon AD and why the rate of inflation might increase. (**up to 4 marks)** **8 marks max** For **evaluation**: that considers whether the overall effect will be to increase the rate of inflation with **1 mark** reserved for a reasoned conclusion. **4 marks max**	**12**	An increase in the rate of inflation is likely to occur in the short run, if following the increase in AD, there is no spare capacity in the economy. The increase in the rate of inflation may be reduced if the increase in AS provides more capacity. Evaluative comment might refer to the scale of additional funding and how these resources have been funded. Or it might refer to the distinction between the short-run and long-run impact.

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