UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS

GCE Advanced Subsidiary Level and GCE Advanced Level

MARK SCHEME for the May/June 2010 question paper

for the guidance of teachers

9708 ECONOMICS

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

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UNIVERSITY of CAMBRIDGE
International Examinations

Section A

1 (a) How far does the data in Fig.1 confirm that the normal demand curve relationship exists between the price and the quantity demanded of cigarettes? [3]

Normally price and quantity are inversely related (1), true in majority of years in both directions (1), clear exceptions 1992/3 and 2002 onward (1)

(b) (i) What do the three elasticity values in Table 1 tell us about the elasticity of demand for cigarettes? [3]

Short-run (SR) Price elasticity of demand (PED) very inelastic (1), Long-run (LR) PED inelastic but less than SR (1), Income elasticity of demand (YED) elastic (1), PED negative or YED positive with meanings (1) any 3 points

(ii) What might explain these different elasticity values? [4]

Habit/inadequate substitutes makes PED inelastic (1), SR no time to change behaviour (1), LR time for some to give up or find alternatives (1), PED negative-normal inverse relationship (1) Maximum of 3 on PED

YED elastic as cigarettes are a high status/luxury good in Malaysia (1) YED positive – normal good (1)

(c) Explain *two* possible economic reasons why cigarettes are heavily taxed. [4]

To raise revenue (1) based on inelastic demand for cigarettes (1)
or to cover costs of externalities – "polluter pays" principle (1)
To discourage consumption (1), to reduce negative externalities and demerit goods (1)
or to discourage production (1), as above or to improve resource allocation (1)

(d) Discuss the possible economic consequences of making cigarette smoking illegal. [6]

Arguments may include:
Benefits from: reduced death rates, less hospital treatment, less sickness absence, healthier workforce, greater safety (less fires), better environment, reduced Government (G) expenditure
Costs from: enforcement costs, reduced tax revenue, welfare losses, tobacco job losses, growth of illegal activities, more G expenditure on longer lives and pensions.
Maximum of 4 marks for one side of discussion

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Section B

2 (a) Explain how division of labour can affect labour productivity. [8]

Productivity is output per worker. Specialisation involves sub-dividing working processes and concentration on one aspect to raise efficiency. Workers can undertake tasks which match their natural abilities, can become more adept through practice, waste less time through reduced movement and make greater use of machinery which itself is more effective. Lack of division of labour may hold back productivity growth. However, division of labour may create problems which may reduce productivity or limit its growth e.g. boredom.

For understanding of productivity (1) and division of labour (1) 2 marks

For explanation of the effects on labour productivity 6 marks

(b) Discuss how the operation of a barter economy would be affected by the introduction of money. [12]

Barter is the exchange of goods without the use of money and requires a double coincidence of wants. Money is anything generally acceptable as a means of payment and settlement of debt. It has four functions: a medium of exchange, a unit of account, a store of value and a standard of deferred payment. An effective money will have properties such as durability, divisibility etc. Trade will be easier, quicker and more widespread. Specialisation and exchange will become common and can extend to the international level. Credit can be introduced. Economic activity and standards of living will be much higher when money works effectively. However, it may lead to problems such as inflation and counterfeiting.

For understanding of barter and money 4 marks

For analysis of the effects of the introduction of money 4 marks

For discussion of the differences in operation of an economy 4 marks

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3 (a) 'A free market price operates as a rationing and allocating mechanism'. Explain how it does this. [8]

A free market sets price by the operation of demand and supply. The price of a product determines who has the purchasing power to afford the good. A higher income means greater ability to purchase so the price system favours the richer in society. It rations the restricted quantity available between those who might wish to buy. The price also allocates resources between competing uses. The higher the price the greater the potential reward to factor owners. This will attract resources to those activities which pay the highest price so determining the employment of factors.

For understanding of free market price — 2 marks

For explanation of the rationing function — 3 marks

For explanation of the allocating function — 3 marks

(b) Discuss why certain goods and services are usually supplied directly by the government rather than through the market. [12]

Private goods can be supplied by the market system because of excludability and rivalry. Certain other goods will not be supplied in sufficient quantities or not at all if left to the market. Public goods, such as defence, are non-excludable and non-rival so it is not possible to charge for them and 'free riders' can gain benefit without paying. In this case the government provides the good or service and pays for it out of general taxation. Another case is merit goods. These provide a greater benefit than is recognised by the consumer and so will be under-consumed from society's viewpoint. Health and education fall into this category. The government will provide the goods or services from taxation and offer them at a subsidised or at no price. In both cases the government is making the judgement that providing these will raise welfare levels in society. There will be a range of other motives for supply by the government such as prevent exploitation, natural monopolies and reduce unemployment.

For understanding the nature and a discussion of public goods — Max 4 marks

For understanding the nature and a discussion of merit goods — Max 4 marks

For understanding the nature and a discussion of other cases — Max 4 marks

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4 (a) With the aid of a diagram, explain why an economy's floating exchange rate may depreciate. [8]

Depreciation is a fall in the value of a currency which is fixed by market forces. The fall may have been the result of a fall in demand or an increase in supply of the currency. Possible causes include a loss of international competitiveness, loss of foreign confidence and changes in international investment flows. Reference to both supply and demand needed for full marks.

For understanding of a depreciating floating exchange rate 2 marks

For diagram illustrating the depreciation 2 marks

For explanation of the factors behind the depreciation 4 marks

(b) Discuss whether a current account deficit is always a serious economic problem for a country. [12]

A current account deficit occurs when financial outflows from goods, services, income and transfers outweigh inflows. This may be a serious problem if it is the result of a fundamental disequilibrium, if it requires unusual policy measures, if it is long term and if it is not possible to finance it without excessive borrowing or rundown of reserves. However, it may not be significant if it alternates with surplus years, there are sufficient reserves to cover it, if it will enable longer term development (via the importing of capital goods) and if it is a small percentage of GDP. Other economic problems (inflation or unemployment) may be more significant depending upon economic conditions.

For understanding of a current account deficit 4 marks

For discussion of circumstances when it is serious 4 marks

For discussion of circumstances when it is not serious 4 marks

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