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

9708/22 Paper 22 (Data Response and Essay – Core), maximum raw mark 40

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UNIVERSITY of CAMBRIDGE
International Examinations

1 (a) (i) Why are weights used in constructing a CPI? [2]

To give an accurate measure of inflation (1), by reflecting the importance of different products to consumers (1).

(ii) Explain possible reasons why the weights for alcohol and tobacco and transport changed between 1992 and 2008. [4]

Alcohol and tobacco prices may have risen, health issues may have reduced consumption (2), transport costs may have changed or income increases may have allowed more relative expenditure (2) to max.

(b) (i) What is meant by inflation? [2]

A continuous/persistent/sustained rise (1) in the general price level (1). A fall in the value of money (1).

(ii) Using Fig. 1 compare Paraguay's inflation with that of Venezuela. [2]

Higher until approx. 1987, lower from approx. 1987 onwards, accept other valid comparisons, 1 mark per comparison.

(iii) To what extent did Paraguay achieve a low and stable rate of inflation between 1950 and 2005? [4]

Generally unstable over whole period (1), relatively high for most of the period (1), particularly high and unstable at start of period to 1960(1), 1962–1970 most successful in controlling inflation (1), credit other valid comments, evidence required to support conclusions.

(c) Discuss whether all countries should set annual inflation targets of around 3%. [6]

Case for includes e.g. stable and low rate desirable, active policy priority, retention of competitiveness, avoidance of unwanted redistribution, maintenance of confidence and risk taking.
Case against includes e.g. unrealistic (current high inflation), unnecessary (current low inflation), more important priorities, ineffective control (lack of institutional framework) and different circumstances in different economies.
4 marks maximum for one side.

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2 (a) Explain how a country's production possibility curve depends upon its factors of production. [8]

A production possibility curve (ppc) shows the combination of outputs that a country can produce when fully employing its resources. Factors include land, labour, capital and enterprise. Some countries have greater quantities and better quality of factors. Land may include a favourable climate and valuable minerals, labour may be skilled,, capital may embody modern technology and, enterprise may be readily available. The way the factors are combined to work productively will determine the quantities of different outputs produced. This will be reflected in the absolute and relative levels of output, which may be shown as diagrams.

Understanding of the ppc and factors of production	4 marks
Explanation of the different impact of the factors	4 marks

(b) Discuss how well comparative advantage explains the pattern of international trade. [12]

A country has a comparative advantage when it can produce a good at a lower opportunity cost than another country. This would reflect its factor endowment. The result is increased total output when both specialise where they have comparative advantage and trade with one another at an exchange rate between their opportunity cost ratios. This works even if a country possesses no absolute advantage in relation to another country. There are no gains from trade if they have identical opportunity cost ratios. The theory is able to explain much of commodity trade which reflects the strength of countries in different resources. The assumptions of the model restrict its conclusions. These include no transport costs, constant costs, perfect factor mobility, no trade barriers and perfect knowledge. It also does not take account of political influences, obligations of trade agreements and trade in non-homogeneous goods.

Understanding of the operation of comparative advantage	4 marks
Discussion of its validity as an explanation of trade	4 marks
Discussion of its weaknesses as an explanation of trade	4 marks

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3 (a) With the help of a diagram, explain why some goods are produced in quantities greater than is socially desirable. [8]

Overproduction is usually associated with production of goods with negative externalities and demerit goods. Negative externalities, such as pollution, impose a cost on third parties which is not reflected in the market outcome where the price is too low and quantity too great. Demerit goods, such as cigarettes, are demanded in quantities which reflect the consumers' lack of information about the effects of consumption or the failure to act upon that information. As the free market sets an equilibrium that only accounts for the private costs and not the external and therefore social costs the socially desirable outcome will not be achieved.

Understanding of externalities and demerit goods	4 marks
Explanation with diagram showing overproduction	4 marks

(b) Discuss whether national defence or a public park is the better example of a public good. [12]

A public good possesses the properties of non-rivalry and non-excludability. Consumption by one does not reduce the availability to others and it is not possible to restrict the benefit of the good to selected groups. Non-rejectability, that is automatically having to consume the good or service, can also apply. Defence is a classic example of a public good, as increases in population do not reduce the protection for current consumers and it is not possible to prevent consumers in some places from getting the benefit as it applies nationally. Everyone is automatically protected. A public park is non-rival up to the (unlikely) point at which its popularity causes it to become so crowded that others cannot enjoy it and the admission of others would reduce the consumption of other users . While public parks are usually free to enter, so no-one is excluded by price, it is possible to exclude people by admission systems and the enforcement of charges. No-one is forced to enjoy the existence of the public park as they are not compelled to use it. While defence always demonstrates the required qualities, a public park usually does but not always or entirely.

Understanding of the properties of a public good	4 marks
Discussion of national defence as a public good	4 marks
Discussion of a public park as a public good	4 marks

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4 (a) Explain, using a normal demand curve, how consumer surplus occurs. [8]

A normal demand curve slopes downward from left to right and shows a negative relationship between price and quantity demanded. Consumer surplus is the difference between what a consumer is willing to pay for a good and what he actually pays for it. It arises because of the downward sloping nature of the demand curve and the fact that the price paid is that for the last worthwhile purchase. The consumer might be willing to pay $10 for one item of a product but the market price is $2, this gives consumer surplus of $8, for the second he might value it at $7 so consumer surplus is $5 and so on until the surplus disappears. Consumer surplus is zero when the market price matches the buyer's valuation. The more elastic the demand curve, the lower the level of consumer surplus. Price changes will directly affect the level of consumer surplus.

Understanding of consumer surplus and demand curve	4 marks
Explanation of varying levels of consumer surplus	4 marks

(b) With the help of diagrams, discuss whether consumers will benefit from the introduction on a product of (i) an indirect tax and (ii) an effective maximum price. [12]

An indirect tax is a tax on consumption. An effective maximum price sets the highest price at which a good can be sold and is below the market price. An indirect tax shifts the supply curve to the left and raises the price. This reduces the amount of consumer surplus with less consumed and surplus per item reduced. The consumer pays a higher price and consumes less of the product. This does not benefit the consumer although the way the tax is spent may be to their advantage and a tax on a demerit good may raise their welfare. An effective maximum price is set below the market price and results in a smaller quantity supplied, greater quantity demanded and excess demand. Unofficial black markets may develop. The reduced consumption will reduce the consumer surplus as less is consumed, while the lower price will increase consumer surplus for those who continue to consume. Some consumers will benefit while others will lose. Whether the overall effect is an increase or decrease will depend on the level of the maximum price and the elasticities of demand and supply. The maximum price has the potential to raise consumer surplus, an indirect tax does not.

Understanding and diagram of an indirect tax and effective maximum price	4 marks
Discussion of tax impact	4 marks
Discussion of maximum price impact	4 marks

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