UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS

GCE Advanced Subsidiary Level and GCE Advanced Level

MARK SCHEME for the May/June 2012 question paper

for the guidance of teachers

9708 ECONOMICS

9708/23 Paper 2 (Data Response and Essay – Core), maximum raw mark 40

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1 (a) (i) Use Table 1 to compare the export performance of the three trade groups in 2003. [2]

EU significantly the largest exporter (1), more than the others combined (1), JACIK more exports than NAFTA (1) any 2 points

(ii) How might the differences you have identified be explained? [3]

Up to **two marks** for any **one** explanation with three marks maximum. Examples of explanations for these differences include:

- The relative economic strength of each trade group. (up to 2 marks)
- The relative openness to trade of each trade group (up to 2 marks)
- The degree of self-sufficiency of each trade group (up to 2 marks)
- The composition of imports and exports of each trade group. (up to 2 marks)

Credit other valid explanations not included above.

(b) (i) State three ways in which an economic union differs from a free trade area. [3]

Directive word is **'state',** so no explanation is required.

Greater degree of integration (1), common external tariff (1), freedom of movement (1), monetary union (1), common policies (1) any 3 points

(ii) Explain two problems that might make economic integration difficult. [4]

Economic sovereignty issues (2), different levels of economic development (2), different features of economic system (2), historical influences (2) any two points explained

(c) Use Table 2 to show whether the free movement of capital or the free movement of skilled workers is estimated to be more beneficial for JACIK. [2]

More impact from free movement of workers (1), + US$ 55 billion against + US$ 5 billion (approx)

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(d) Discuss how the rest of the world might view the formation of JACIK. [6]

The formation of JACIK represents a possible benefit to the rest of the world, but also a potential threat.

The benefits are positive in net terms when the free movement of goods and services, capital and labour occurs in JACIK. This might occur as a result of more efficient resource allocation within JACIK leading to greater productivity, and lower prices of goods and services, which if exported will benefit consumers in the rest of the world. Producers in other economies might also benefit from lower component costs. Rising incomes are also likely in the JACIK economies which will expand the market for the exports of other economies.

The threats include those to other economies with export sectors that will face fiercer competition and this might lead to reduced sales, falling profits and probable job losses.

The data shown in the table need to be interpreted and included as part of the discussion.

Up to 4 marks for benefits and up to 4 marks for threats with 6 maximum.

2 (a) Explain whether the factors of production are always of equal importance within and between economies. [8]

Factors of production are land, labour, capital and enterprise. While all are likely to be needed to some degree their relative importance differs within and between economies. Advanced economies may rely more on capital with more emphasis on enterprise, developing economies may focus on land and labour. An economy relying on manufacturing will have a different pattern from those relying on agriculture and services. The nature and productivity of the factors will also differ between economies. They are unlikely to be of equal importance either within or between countries.

- For knowledge and understanding of the factors of production and their role. 4 marks
- For application that explains the relative importance of the factors. 4 marks

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(b) Discuss whether planned economies should always be replaced by free market economies. [12]

A free market economy is based on demand and supply and private activities. A planned economy is based on state ownership and control. Market economies have performed more successfully in terms of living standards. This is attributed to greater efficiency based on consumer sovereignty, incentive and flexibility. Against this can be set greater instability, more unequal distribution of income, higher likelihood of unemployment and the failure of the market to operate effectively. Some of the latter are avoided by the planned economy. The change in eastern European economies supports the preference for the market outcome although it depends upon individual priorities.

- For knowledge and understanding of planned and market economies. 2 marks
- For an analysis of the advantages and disadvantages of replacing planned economies with free market economies. Up to 8 marks. **(One side only 6 max)**
- For evaluative comment on whether planned economies should always be replaced by free market economies. 2 marks

3 (a) Explain how income elasticity of demand and cross elasticity of demand can be used to classify different types of good. [8]

Income elasticity can relate to inferior good where there is a reduction in demand as consumer income rises e.g. bus travel. This would have a negative income elasticity of demand (YED) as Y rises QD falls. Cross elasticity of demand can relate to complementary goods that is consumed in conjunction with another product e.g. bread and butter. There will be a negative cross elasticity of demand (XED) as a rise in the price of one good causes a fall in the demand for the complement. It can also identify substitute or alternative goods e.g. Pepsi-Cola and Coca-Cola where cross elasticity will be positive. Candidates may offer the formulas.

- For knowledge and understanding of income elasticity and cross elasticity. 4 marks
- For application to different types of goods. 4 marks

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(b) Discuss the effectiveness of government use of maximum and minimum prices to help consumers and producers. [12]

A maximum/minimum price intends to keep prices below/above the market level. The former would benefit consumers, the latter producers. Maximum prices will be ignored and ineffective if set above the market price and minimum will not work if below the market price. A maximum price will benefit those consumers who manage to buy the good but will create a shortage at the set price. This will require government intervention to allocate the restricted supply among the would-be consumers but may result in illegal, black markets that favour the richer consumer. A minimum price will cause an excess supply that will require government action such as storage or destruction with its associated costs. It will favour the producer at the expense of the consumer and taxpayer. Both policies conflict with the market outcome.

- For knowledge and understanding of the motives for the setting of government prices. 2 marks
- For an analysis of the outcome of maximum and minimum prices. Up to 8 marks **(Only one type of government controlled price 6 max)**
- For overall evaluative comment on 'effectiveness' of government prices. 2 marks

4 (a) How does aggregate demand and aggregate supply analysis explain the existence of inflation in the short-run? [8]

Aggregate demand is total spending in an economy and it is shown as a curve sloping downward to the right. Aggregate supply is the total amount of output at a given level of prices in the economy and is shown as a curve sloping upward to the right. This may be shown in a diagram. Their interaction sets the equilibrium level of price and real output in the economy. Inflation can be caused by an increase in AD, from increases in its components (C+I+G+(X-M)), or a reduction in AS from influences such as wage rises or more expensive raw materials.

- For knowledge and understanding of AD and AS. 4 marks
- For application to show how changes in AD and AS can result in inflation. 4 marks

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(b) Discuss whether a period of inflation or a period of deflation is more economically desirable. [12]

Inflation is a sustained rise in the general price level. Deflation is a sustained fall in the general price level or a reduction in aggregate economic activity. Inflation has effects on international competitiveness, shoe leather and menu costs, the distribution of income, the ability to plan and the level of confidence. Deflation is linked to rising unemployment, falling economic growth, lower living standards, changing international competitiveness, changing distribution of income (differently to inflation) and loss of confidence. There is some overlap between the effects, and the effects may depend upon the rate of change. Mild inflation is often thought to be desirable. Governments may favour inflation as it reduces the real value of debt and increases income through higher tax revenue. The desirability will depend on the standpoint adopted.

- For knowledge and understanding of 'inflation' and 'deflation'.
  2 marks
- For an analysis of the effects of inflation and deflation.
  Up to 8 marks
  (Only inflation or deflation considered 6 max)
- For an evaluative comment on the relative desirability of inflation and deflation.
  2 marks

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