CAMBRIDGE INTERNATIONAL EXAMINATIONS

GCE Advanced Subsidiary Level and GCE Advanced Level

MARK SCHEME for the May/June 2014 series

9708 ECONOMICS

9708/22 Paper 2 (Data Response and Essay – Core), maximum raw mark 40

This mark scheme is published as an aid to teachers and candidates, to indicate the requirements of the examination. It shows the basis on which Examiners were instructed to award marks. It does not indicate the details of the discussions that took place at an Examiners' meeting before marking began, which would have considered the acceptability of alternative answers.

Mark schemes should be read in conjunction with the question paper and the Principal Examiner Report for Teachers.

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Cambridge is publishing the mark schemes for the May/June 2014 series for most IGCSE, GCE Advanced Level and Advanced Subsidiary Level components and some Ordinary Level components.

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1 (a) (i) Describe the change in New Zealand's terms of trade from June 2011 until September 2012. [1]

The terms of trade have moved in an unfavourable direction or have deteriorated or declined (1).

(ii) With reference to Fig. 1, account for the change that you have described. [2]

Allow flexible interpretation of the data in the diagram as long as the route to the outcome is valid.

E.g. (1) Export prices have fallen and import prices have remained stable.

(2) Export prices have fallen more than import prices.

2 marks available for valid account of relative change in export prices and import prices. If only export or import prices explained then a maximum of 1 mark may be expected.

The answer must refer to the information in Fig. 1 to receive marks.

(b) (i) Given the information in Extract 1, calculate the price elasticity of demand for New Zealand meat from June to September if all other factors were equal. [2]

Evidence of correct formula (1 mark), correct outcome (–) 2.5 (2).

The sign is not essential for answers to receive both marks.

(ii) Explain why receipts from meat exports rose despite the fall in price of meat. [2]

Sales of meat rose by a greater proportion than the fall in price (2).

If the candidate refers to absolute rather than proportionate changes then 1 mark may be awarded.

If the candidate states that the reason is that the price elasticity of demand is elastic with no further explanation then 1 mark may be awarded.

(c) Using the information provided in the extracts, explain why New Zealand's terms of trade were expected to 'stabilise through 2013'. [3]

Information in the data suggests that key export commodity prices were showing signs of improvement (1) and international inflationary pressures remained weak meaning that import prices were not expected to rise (1).

Reserve 1 mark for further interpretation of the data in the extract. For example, 'demand in Australia is expected to recover', which should lead to increased prices for New Zealand's exports (1).

Must have reference to both export prices and import prices for full marks.

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(d) Use economic theory to explain why New Zealand specialises in exports of dairy products and meat and imports machinery and consumer goods. [4]

For identification of comparative advantage as the relevant economic theory (1).

For recognition that New Zealand has lower opportunity costs in the production of dairy products and meat (1).

For recognition that New Zealand has higher opportunity costs in the production of machinery and consumer goods (1).

For linking New Zealand's comparative advantage to resource endowment (1).

If absolute advantage rather than comparative advantage (2 marks maximum).

(e) Discuss whether the rising deficit in New Zealand's balance of trade is what would be expected, given the change in the terms of trade after June 2011. [6]

For explaining that a declining deficit or a surplus might be expected given the impact of a declining terms of trade upon export prices and import prices (up to 2 marks).

For analysis of the factors that might result in the rising deficit that actually occurred, e.g. J-curve effect, elasticities, Marshall-Lerner, changing factors in export markets, etc. (up to 4 marks).

Reward a conclusion based on the analysis offered if one is provided.

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Essays

2 (a) Explain the meaning of the term 'equilibrium price and quantity' in the market for a good or service and show how a new equilibrium is established when there is an increase in demand. [8]

For **knowledge and understanding** of equilibrium price and quantity (up to 4 marks).

Candidates need to show a good understanding of equilibrium price and quantity as that where there is 'no tendency to change'. This can be illustrated and explained with the use of a supply and demand diagram.

If the candidate recognises where equilibrium occurs but fails to explain what is meant by 'equilibrium', reward a maximum of 2 marks, e.g. 'It is where supply is equal to demand' (1), shown on a diagram (1).

For **application** showing the process through which equilibrium is re-established when there is an increase in demand (up to 4 marks).

Candidates will provide a supply and demand diagram showing a shift in the demand curve to the right, the consequent excess demand that this will cause together with the upward movement of price and quantity to re-establish equilibrium.

An accurate diagram with no explanation of the process that results in a new equilibrium (2 marks maximum).

For full marks for this part of the question there should be reference to issues of excess demand or shortage.

(b) Discuss the view that attempts to help poorer consumers through the imposition of a maximum price for food items will always fail. [12]

For an **analysis** of the effects imposition of a price maximum below the equilibrium (up to 8 marks).

The analysis will illustrate the impact of a maximum price below the equilibrium, and will explain how this will lead to an excess demand. The answer will go on to explain how a system of allocation will need to be established such as rationing, queuing, etc.

For an **evaluative comment** on the 'will always fail' aspect of the question (up to 4 marks).

Marks will be awarded for a consideration of the likely success of a maximum price in terms of helping the poor given the arrangements made to allocate food when an excess demand exists. For example, can rationing be successful or will a black market arise? For full marks for evaluation, a conclusion must be provided.

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3 (a) Distinguish between income elasticity of demand and cross elasticity of demand and explain how each is used to identify different types of product. [8]

For **knowledge and understanding** of both types of elasticity (up to 4 marks).

Candidates are expected to show a good understanding of the relevant concepts, demonstrated by means of an accurate explanation of each type of elasticity mentioned in the question. The distinction between types of elasticity can be implicit.

For each type of elasticity: definition/description (1 mark), formula (1 mark).

For **application** showing how goods are identified using each type of elasticity (up to 4 marks).

Marks for application will be awarded for an explanation of the values of the coefficients and the classification of products into normal, inferior and necessary categories in the case of income elasticity and substitutes and complementary products in the case of cross elasticity.

(Allow 3/1 split here if one type of elasticity is particularly well answered.)

(b) Discuss which of these two types of elasticity would be most useful when predicting how a firm's revenues would change as demand factors change in a market economy. [12]

For **analysis** showing how each type of elasticity could be used to predict changes in sales revenues as demand factors changed (up to 8 marks).

The analysis will explain how changes in income will affect the revenue of firms in the case of normal, inferior and necessary goods, and how the revenue of firms will be affected by a change in the price of substitutes and complements.

If only one type of elasticity is analysed 6 maximum.

For **evaluative comment** on the 'most useful' aspect of the question (up to 4 marks).

Marks for evaluative comments will be awarded if candidates examine the relative usefulness of the two measures. For example, they might consider the reliability of the measures, the likelihood of the change in the relevant conditions of demand, the actions of competitors etc.

Some candidates may successfully argue that the changes that might occur will depend on upon the circumstances. For full marks for an evaluation, a conclusion must be provided.

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4 (a) Using diagrams, explain the difference between demand-pull and cost-push causes of inflation. [8]

For **knowledge and understanding** of demand-pull and cost-push causes of inflation (up to 4 marks).

For stating that demand-pull inflation is caused by an increase in aggregate demand (1).

For explaining the possible cause of an increase in aggregate demand such as an increase in consumption, investment, government expenditure or net exports (1).

For stating that cost push inflation is caused by an increase in costs (1).

For explaining the possible cause of an increase in costs such as an increase in wage rates, raw materials etc. (1).

For **application** using appropriate diagrams to distinguish between the two types of inflation (up to 4 marks).

Diagrams showing how changes in aggregate supply and aggregate demand may lead to inflation.

Award marks for diagrams as follows:

- A 'micro' diagram should be awarded 0 marks.
- A 'macro' diagram that is not fully accurate may gain 1 mark.
- An accurate 'macro' diagram is required for 2 marks.

One accurate diagram showing both demand pull (AD) and cost push (AS) causes could gain 4 marks (8 marks total).

(b) Distinguish between the domestic and external consequences of inflation and discuss which is most damaging to an economy. [12]

For **an analysis** of the internal and the external consequences (up to 8 marks).

The analysis must make clear the distinction between the internal and external consequences of inflation. The analysis must also explain the consequences of each. Internal consequences include the impact on savings and investment, the re-distribution of income, menu costs and shoe-leather costs. External consequences include the impact on trade and the exchange rate and international investment flows. For full marks for evaluation, a conclusion must be provided.

(Allow up to 6 marks if only the internal or external are considered).

If the candidate explains the consequences of inflation but fails to distinguish between internal and external, then a maximum of 6 marks may be awarded.

For **evaluative comment** on 'the most damaging' element of the question (up to 4 marks).

Relevant evaluative comment, might include the extent to which an economy engages in trade, whether an economy has a fixed, floating or managed floating exchange rate and so on.

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