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Cambridge International Advanced Subsidiary and Advanced Level

MARK SCHEME for the May/June 2015 series

9708 ECONOMICS

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

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1 (a) Use production possibility curves to compare Brazil's economy in 2013 with its economy in 2003. [2]

The Brazilian economy has grown between 2003 and 2013. Candidates should provide a diagram of a production possibility curve shifting outwards.

For a diagram of the ppc with appropriate axes, accurately labeled (1).

For an indication of the outward shift of the ppc as the Brazilian economy has grown (1).

(b) (i) Using Fig.1, explain what has happened to the value of the Brazilian Real in 2013 compared with 2004? [2]

It has appreciated/risen/increased/is higher etc. (1)
by approximately 25%(23%-27%) Accept answers in the region of 50% (46%-51%) (1)

Do not award the second mark for confused attempts that calculate the change using invalid units.

(ii) Explain <u>one</u> possible reason for the stability of the Mexican Peso from 2004 to 2008 shown in Fig. 1. [2]

A number of reasons are acceptable. For example intervention by the Mexican authorities in the foreign exchange market. Or answers could be based upon the information provided in the extract i.e. the small trade deficit that can be financed easily…. For maximum marks there must be some reference to the supply and demand for the Mexican currency. (up to 2 marks)

(iii) With the help of diagrams, explain how the different economic experiences of Brazil and Mexico after 2011 mentioned in the text could explain the changes in the currency values shown in Fig. 1. [4]

The changes in the currency values are a reflection of changes in the supply and demand for the Brazilian Real and the Mexican Peso.

For an explanation of the reasons for the depreciation of the Brazilian currency with due reference to the text. (Up to 2 marks (no diagram 1 max))

A number of approaches are acceptable:
There has been a decline in China's demand for Brazil's raw materials and as a result a decline in the demand for the Real.
There has been a rapid rise in imports of luxuries from the US into Brazil and therefore an increase in the supply of the Real.
A significant trade deficit in goods and services has developed that means that the supply of Real exceeds its demand.
If reference is made to 'the waste of the boom years' the candidate needs to go on to show how this affects the value of the Real through the impact upon the supply and the demand for the currency.
For an explanation of why Mexico's currency is relatively more stable or one that explains the rise in the Peso after 2012 with due reference to the text.
(Up to 2 marks (no diagram 1 max))
A number of approaches are acceptable:
A 'relatively small trade deficit that can easily be financed…….' means that there is not

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a great excess supply or demand for the Peso.
If reference is made to the Mexican government's policy that has 'significantly strengthened its economy' the candidate needs to go on to show how this would prevent a large trade deficit from arising.

(c) Explain how the approach of the Mexican government 'during the past decade' is more likely to generate an expansion of the economy than the approach of the Brazilian government during this period. [4]

In Mexico improving the education system and making the various sectors mentioned more efficient has improved the productivity of the factors of production and lead to an expansion of the economy. In Brazil, the government 'wasted the boom years' failing to invest in infrastructure. Candidates need to show understanding of the link between the actions of the two governments and the supply side of their economies. A further acceptable approach is to analyse the impact of the Mexican government's policy on aggregate demand in Mexico.
For an explanation of the way in which the policies of the Mexican government would lead to an expansion of the Mexican economy through an improvement in the quality of Mexico's factors of production **or** for an explanation of the impact upon aggregate demand of increased Mexican government spending. (up to 3 marks)

For a comparative statement referring to the Brazilian government's failure to invest in its resources and/or fail to boost aggregate demand. (1)

(d) Identify and evaluate the usefulness of any further information that might be helpful in assessing the future prospects of the Brazilian and Mexican economies. [6]

Further information that might be useful includes demographic factors, inflation and unemployment rates and the policies of the two governments. Good answers might use the information on each economy included in the data. For example, it is clear that Mexico's prospects are linked to the United States so information on the US economy would be useful. Also, in the past, Brazil has been dependent upon demand for raw materials from China. The future prospects of Brazil therefore will depend upon economic activity in China.
Candidates might suggest a wide range of factors that would be helpful or alternatively might provide a detailed explanation of only one factor. Either approach is acceptable, but it is insufficient to simply identify further information without explaining why it might be helpful. If further information that might be useful is identified but not explained then this can be awarded a maximum of 1 mark.

For **identification (1 mark), explanation (up to 3 marks) and evaluation (up to 2 marks)** of the factors that would be helpful in assessing the future prospects of these economies.
(6 marks maximum)

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Essays

2 (a) Explain how economists measure the way in which demand for a good changes when income changes and, with the help of a diagram, show why some goods are classified as 'inferior goods'. [8]

For **knowledge and understanding** of income elasticity of demand (up to 4 marks)

Definition of income elasticity: (1)

Formula: Up to 2 marks (Some inaccuracy e.g. no reference to %: 1 mark)

For some development of the concept e.g. explanation of elastic/inelastic or meaning of normal good: (1)

For **application** using a diagram to show how goods are classified as inferior.
(up to 4 marks)

For clear explanation of inferior good (definition 1 mark, negative value of yed 1 mark)

For an accurate, correctly labelled diagram illustrating an inferior good (up to 2 marks).

(b) Discuss how useful governments might find the concepts of price and income elasticity of demand when setting economic policy. **[12]**

Price elasticity is useful to governments because it measures the change in demand when price changes. This helps governments in a number of ways. For example, it helps to predict revenues from indirect taxes, it can be used to estimate the change in the consumption of demerit goods when taxes are imposed and also the extent of any price fall when a good is subsidised. Income elasticity of demand can be used by governments to predict the impact on regions that specialise in goods or services that are sensitive to income changes. It can also be used to assess the impact of changes in income tax.

Which is most useful might depend upon the policy aims of the government or whether incomes are stable or changing**.**

For **analysis** of the usefulness of both price and income elasticity to governments when setting economic policy (up to 8 marks).

For **analysis** of the usefulness of price elasticity of demand (up to 6 marks).

For **analysis** of the usefulness of income elasticity of demand (up to 6 marks).

If the candidate discusses the usefulness of these concepts to firms with no reference to governments then no marks will be awarded for analysis. (Up to a maximum of 8 marks for analysis)

For **evaluative comment** on which concept might be most useful (up to 4 marks).

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3 (a) Using examples, explain the difference between merit goods and public goods and show why it is possible for profit to be made in the supply of one of these types of good but not the other. [8]

For **knowledge and understanding** of both merit goods and public goods with appropriate examples (up to 4 marks).

For an accurate definition of merit goods in terms of under-consumption through information failure (accept positive externalities), with an appropriate example. No example or incorrect example, 1 maximum (2).

For an accurate definition of public goods in terms of non-excludability and non-rivalry, with an appropriate example. No example or incorrect example, 1 maximum (2).

For **application** to show why profit could be made in supplying merit goods, but not public goods (up to 4 marks).

The answer should be based upon the fact that public goods are non-excludable and this gives rise to the free rider problem meaning that no price can be charged. As result entrepreneurs cannot make a profit in the supply of public goods (up to 2 marks).

Merit goods are excludable and as a result a price can be charged so that entrepreneurs will produce the good in pursuit of profit (up to 2 marks).

(b) Discuss why merit goods are under supplied in a free market economy and consider the effectiveness of <u>one</u> policy to deal with this problem. [12]

Merit goods are undersupplied in a free market economy because of information failure. They are undervalued by consumers so the demand for them is less than it would be if the value was fully understood. Policies include subsidies, educational campaigns and state provision. Each has disadvantages such as cost and the length of the time period before the impact is felt.

For **analysis** of the under-provision of merit goods and an appropriate policy to deal with the problem (up to 8 marks).

Explaining why they are undersupplied and why a policy is needed (up to 4 marks).

Explanation of any one policy to deal with this (up to 4 marks).

For **evaluation** of the effectiveness of the policy analysed**.** (up to 4 marks)

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4 (a) Explain how a declining exchange rate and a high rate of inflation in an economy might affect that economy's terms of trade. [8]

For **knowledge and understanding** of the terms of trade, a declining exchange rate and a high rate of inflation (up to 4 marks).

Terms of trade. Definition 1 mark, formula 1 mark (up to 2 marks).

A declining exchange rate. Candidates might demonstrate understanding of this through application. (1)

A high rate of inflation. Candidates might demonstrate understanding of this through application. (1)

For **application** showing how both a declining exchange rate and a high rate of inflation would affect the terms of trade of an economy (up to 4 marks).

Impact of a declining exchange rate (up to 2 marks).

Impact of a high rate of inflation (up to 2 marks).

(b) Discuss the advantages and disadvantages to an economy of a fall in that economy's terms of trade and consider whether the overall effects are likely to be beneficial. [12]

A fall in an economy's terms of trade can result from a number of changes in the price of exports and imports. The effect is that the price of exports has fallen relative to the price of imports. This has advantages, such as the fact that exports are now more competitive and this might boost exports and increase employment in export reliant industries. Similarly, imports are now more expensive and this should see a fall in imports and an impact upon domestic industries. Disadvantages include the fact that demand-pull and cost-push pressures on prices might be experienced. The overall effects depend upon a range of factors such as the price elasticity of demand for exports and imports and the price elasticity of supply of exports.

For **analysis** of the advantages of a fall in the terms of trade (up to 6 marks).

For **analysis** of the disadvantages of a fall in the terms of trade (up to 6 marks).
(Up to a maximum of 8 marks for analysis)

For an **evaluation** of whether an unfavourable movement would, on balance be beneficial (up to 4 marks).

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