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Cambridge International Advanced Subsidiary and Advanced Level

MARK SCHEME for the May/June 2015 series

9708 ECONOMICS

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

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1 (a) (i) Showing your calculation, determine the category of spending that has shown the biggest rise in price from January to September 2013 [2]

Recreation and Culture **(1 mark),** for calculation showing biggest rise in price of 17.1%. **(1 mark)**

(ii) Why do the categories of spending have different weights in Table 1? [2]

The categories have different weights to reflect the importance or proportion of expenditure on different categories **(1 mark)** in the household budget **(1 mark)**.

(b) (i) Explain how the fact that Malawi has the highest inflation rate in the southern African region might be expected to affect Malawi's terms of trade [2]

For knowledge of the meaning of 'terms of trade' **(1 mark)**.

For application to show that the highest inflation in Southern Africa might be expected to cause a rise in the terms of trade through the impact on the price of exports and imports. **(1 mark)**.

(ii) With the help of a diagram, explain how increasing exports could provide a solution to Malawi's weak currency [3]

For a diagram of the foreign currency market showing an increase in the demand for the kwacha **(1 mark)** and a rise in the exchange rate of the kwacha **(1 mark)**. Accompanying explanation **(1 mark)**.

(c) (i) Draw a diagram to show the choice that Malawi faces when allocating its scarce resources between the production of tobacco and tourism [2]

For a diagram of a production possibility curve showing the choice between tobacco and tourism services. **(up to 2 marks)**

For full marks the axes must be correctly labelled. Accept either constant or increasing opportunity costs.

(ii) Explain one difficulty that Malawi might face in reallocating resources from the production of tobacco to tourism [3]

Difficulties include lack of skilled labour, lack of available resources such as hotels, lack of infrastructure etc. Explanation might refer to the geographic and occupational immobility of factors, the cost of re-training etc.

For identifying one difficulty **(1 mark)** and for explaining that difficulty **(up to 2 marks)**.

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(d) Discuss the factors that should be considered by the Malawian Government in deciding if it should develop its tourist industry and allow its tobacco industry to decline [6]

A range of factors may be considered. These include the impact upon employment, the cost of developing resources required for a successful tourism industry, whether the decline in tobacco use is temporary or permanent etc. Credit should be awarded to those candidates who include a consideration of Malawi's comparative advantage.

For explanation of the factors that should be considered. **(Up to 4 marks)**

For evaluative comment on the importance of the explained factors. **(Up to 2 marks)**

2 (a) With the help of diagrams, explain how economists use the concept of income elasticity of demand to distinguish between inferior goods and necessity goods [8]

For **knowledge and understanding** of the concept of income elasticity of demand **(Up to 4 marks)**
Definition of income elasticity: **(1 mark)**

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

For some development of the concept e.g. explanation of elastic/inelastic. **(1 mark)**

For **application** of the concept of income elasticity to distinguish necessary goods from inferior goods using appropriate diagrams. **(Up to 4 marks)**

For explanation of classification of goods as normal using an appropriate diagram. **(Up to 2 marks)**

For explanation of classification of goods as inferior using an appropriate diagram. **(Up to 2 marks)**

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(b) Discuss how, during a world-wide recession when incomes in most countries are falling, economists might use the concept of income elasticity of demand to assess the impact of this recession [12]

A world-wide recession will affect countries through the fall in income and this will lead to falling aggregate demand as consumption, investment, government spending and net exports fall. This will cause falling employment. The concept of income elasticity can be used to assess the effects of this upon various industries as those businesses producing normal goods see a fall in sales. On the other hand, those industries that produce inferior goods will see a rise in sales. If countries export normal goods they will see a fall in export revenue, whereas if they produce a large quantity of inferior goods they may see a rise in export revenue. The concept of income elasticity by assessing the extent of any fall in employment could indicate the fall in income tax revenues. Whether the information is useful largely depends upon the accuracy of the calculations and whether the ceteris paribus condition holds.

For **analysis** of the impact of falling incomes with reference to the concept of income elasticity. **(Up to 8 marks)**

For **evaluation** of the extent to which the concept can be used to assess the impact. **(Up to 4 marks)**

3 (a) Explain what economists mean when they describe a good as a 'demerit good' and, using a diagram, show why such goods will be overconsumed in a free market [8]

For **knowledge and understanding** of a demerit good. **(Up to 4 marks)**

For **application** showing a diagram that shows why demerit goods are overconsumed. **(Up to 4 marks)**

(b) Discuss any two policies that might be used to deal with the problems caused by the consumption of demerit goods and consider which might be the more effective policy [12]

Demerit goods are over-consumed in a market because of incomplete information about their ill-effects. Policies that might be applied include indirect taxation, legislation to prohibit or restrict consumption or education campaigns. Each has problems that limit effectiveness. For example, indirect taxes have the problem that it is difficult to measure the extent of the overconsumption. Education campaigns are costly and take time to take effect and so on.

For **analysis** of the problems caused by the consumption of demerit goods and two policies to deal with these problems. **(Up to 8 marks)**

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

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4 (a) Define each component of aggregate demand and, using a diagram, show how a reduction in one of these components might reduce inflationary pressure in an economy [8]

For **knowledge and understanding** of the meaning of aggregate demand with each component defined. **(Up to 4 marks)**
If the components of AMD are listed, but not defined, 2 maximum.

For **application** showing a diagram with a fall in aggregate demand and the impact upon the general price level. **(Up to 4 marks)**

(b) Discuss the impact of a high rate of inflation on the consumers and producers in an economy and assess whether consumers or producers would suffer more [12]

A high rate of inflation has both internal and external effects on an economy. The internal effects include the re-distributive impact on incomes and the reduction in productive investment together with shoe-leather and menu costs. The external effects are largely through the impact upon exports and imports. Consumers and producers are affected as these effects have an impact upon them. Which is affected most depends upon factors such as whether the rate of inflation in an economy is higher than the rate in a competing economy.

For **analysis** of the impact of inflation upon consumers. **(Up to 6 marks)**

For **analysis** of the impact of inflation upon producers. **(Up to 6 marks)**

8 marks maximum

For **evaluation** of whether consumers or producers are likely to suffer more. **(Up to 4 marks)**

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