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Cambridge International Advanced Subsidiary and Advanced Level

MARK SCHEME for the October/November 2014 series

9708 ECONOMICS

9708/21 Paper 2 (Data Response and Essay – Core), maximum raw mark 40

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Data Response Questions

1 (a) Describe the overall trend in coffee prices between 2007 and 2012 and identify one year in which supply was likely to have exceeded demand in the market for coffee. [2]

The trend is upward, rising or increasing.
The candidates need to recognise the upward trend. Do not accept a summary of year-on-year changes that do not make the overall trend clear. **(1)**

Supply is likely to have exceeded demand in 2009 or 2012. The candidates only need to identify a year; they do not need to provide any further elaboration in terms of a year in which supply was likely to have exceeded demand in the market for coffee. If candidates write 2008 or 2011, but offer an explanation of the idea of a time-lag, this can be accepted. **(1)**

(b) Explain how coffee exports and a thriving tourism sector would contribute to Nepal's current account in the balance of payments. [4]

Coffee: Positive contribution to balance of trade in relation to visibles or goods. **(2)**
Tourism: Positive contribution to invisibles or services. **(2)**

Instead of 'positive', candidates can refer to 'increase' or 'benefit'. The idea of 'more inflows than outflows' can be accepted, as can a reference to the idea of a current account surplus, although we do not know if there is a surplus or not.

(c) With reference to Extract 2, explain how you would classify coffee using the concept of income elasticity of demand. [2]

For explanation that coffee is a normal good **(1)** with positive income elasticity of demand **(1)**. **(up to 2 marks)**

Do not allow 'Demand increases when income increases' for the first mark (i.e. they need to specify that it would be classified as a 'normal good'), but this could be accepted for the second mark.

There is no mark for the income elasticity of demand formula and no mark for references to elastic or inelastic income elasticity of demand.

(d) Using diagrams, explain how changes in demand and supply have affected the coffee market in Colombia and in Nepal. [6]

Colombia: Has faced a decrease in supply whilst supply has increased from competitors. This has resulted in Colombia's share of the market falling. The reference to increased competition also suggests the demand side, so candidates can be credited for shifting the demand curve to the left or for shifting the supply curve to the left or both. **(Up to 4 marks)**

Nepal: Has faced an increase in demand, leading to an increase in price and an increase in quantity. **(Up to 4 marks)**
(6 marks maximum)

In each case, there are up to 2 marks for the diagram (1 mark for a shift and 1 mark for clearly showing the change in equilibrium price and equilibrium quantity) and up to 2 marks for the explanation.

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(e) Discuss the view that Nepal should specialise in the production of coffee and Colombia should specialise in some other product given the changes in costs that have occurred. **[6]**

The discussion should be based upon the Law of Comparative Advantage. It could be argued that because the opportunity cost of producing coffee has fallen in Nepal and risen in Colombia, specialisation and trade in coffee should shift from Colombia and move to Nepal. This view could be challenged.

For the argument supporting production of coffee shifting to Nepal **(up to 4 marks)**
For the argument supporting the production of coffee remaining in Colombia. **(up to 4 marks)**
(6 marks maximum)

For further guidance:
An answer which contains very general comments with no economic theory at all: **(up to 2 marks)**

An answer which contains appropriate application to economics and some economic theory, such as in relation to the maintenance of employment, but no reference to either opportunity cost or comparative advantage: **(up to 4 marks)**

An answer which contains within the discussion references to comparative advantage and opportunity cost: **(up to 6 marks)**

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Essay Questions

2 (a) Using a supply and demand diagram, explain how the imposition of a subsidy on a good would affect the surplus enjoyed by the producers of that good. [8]

For knowledge and understanding of subsidy. **(up to 4 marks)**

The candidate needs to provide a clear explanation of what is meant by a 'subsidy'. This might be successfully achieved with the provision of a diagram to support the explanation, showing the supply curve shifting to the right.

For application using a supply and demand diagram to show how a subsidy affects producer surplus. **(up to 4 marks)**

To score here candidates need to provide a diagram that shows how the producer surplus is affected by the imposition of a subsidy. This should show a shift of the supply curve to the right, a fall in price and an increase in quantity. Although the subsidy will reduce the price to the consumer, the producer benefits because they will receive the price plus the subsidy. This will increase the producer surplus. The benefits of the subsidy will be shared between the consumer and the producer according to the price elasticity of demand**.**

Candidates can be given some marks for showing that they have an understanding of producer surplus before the subsidy:
Explanation of what is meant by a producer surplus **(1)**
Diagram of producer surplus before the subsidy **(1)**
Explanation of producer surplus after the subsidy (including the subsidy) **(up to 2 marks)**

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(b) Discuss whether minimum price legislation or the imposition of an indirect tax is more effective in improving resource allocation when the consumption of a good causes negative externalities. [12]

For analysis explaining how minimum price legislation and indirect taxes affect resource allocation when negative externalities arise from the consumption of a good. **(up to 8 marks)**

Analysis should include an explanation of how negative externalities arising from consumption result in the sub-optimal allocation of resources. The impact of minimum prices and indirect taxes on resource allocation in this case then needs to be explained.

For evaluation of the 'more effective' aspect of the question. **(up to 4 marks)**

Evaluation marks can be awarded for explaining the advantages and disadvantages of each policy, including a consideration of how you measure it, and arriving at a conclusion on which is best or 'more effective'.

NOTE: If a candidate only discusses one, i.e. either minimum price legislation or an indirect tax, they can gain a maximum of 6/8 in the analysis section, but cannot be given any marks in the evaluation section.

3 (a) Explain the factors that determine whether the price elasticity of demand for a product has a high value or a low value. [8]

For knowledge and understanding of price elasticity of demand and the meaning of a 'high value' (elastic) and a 'low value' (inelastic). **(Up to 4 marks)**

The candidate needs to show a firm and accurate understanding of price elasticity of demand. The formula is not essential for full marks, but an accurate explanation will make clear that the concept measures the % change in quantity relative to the % change in price. This is also essential when the candidate is explaining the difference between 'high' and 'low' values (or elastic and inelastic).

For application showing the factors that lead to a high or low value of price elasticity of demand. **(Up to 4 marks)**

Application marks will be awarded for explaining the link between high and low values and for e.g. the availability of substitutes, the proportion of income spent on the product and so on. At least two factors well explained are needed for full marks here.

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(b) Discuss whether it is both possible and beneficial for a business to change the price elasticity of demand for its product. [12]

For analysis explaining how it is worthwhile for a business to change the price elasticity of demand for its product. **(Up to 8 marks)**

Candidates need to explain how and why businesses might attempt to change the price elasticity of demand for their products.

'How' – The price elasticity of demand could be changed through advertising. This aims to make consumers more or less sensitive to price changes. We should also credit explanations based upon the removal of substitutes.

'Why' – Candidates might argue that with a lower price elasticity of demand businesses can raise prices in order to increase sales revenue. With a higher price elasticity of demand businesses might cut prices to increase sales by a larger % (and increase revenues).

For evaluation of whether it is possible and beneficial to change the price elasticity of demand for a product from the perspective of a business. **(Up to 4 marks)**

Evaluation marks will be awarded for any comment that questions either aspect. For example, 'possible' might question the effectiveness of advertising; 'beneficial' might suggest that attempts to shift the curve might achieve aims more effectively than changing the elasticity. Award credit for attempts to reach a conclusion.

NOTE: Candidates can write about either reducing or increasing the PED or both. If elasticity is reduced, this will make it more possible to increase price and, because of the inelastic demand, to increase revenue. On the other hand, the PED could be made more elastic so that a reduction in price would bring in more revenue.

4 (a) Explain how tariffs and an undervalued exchange rate can operate to protect a domestic market from foreign competition. [8]

For knowledge and understanding **(up to 2 marks)** of tariffs and application **(up to 2 marks)** explaining how a tariff operates to protect a domestic market. **(Up to 4 marks)**

Candidates need to show a clear understanding of the meaning of tariffs. Application marks will be awarded for explaining how tariffs protect the home market, raising the price of imports through taxation.

For knowledge and understanding **(up to 2 marks)** of an undervalued exchange rate and application **(up to 2 marks)** explaining how an undervalued exchange rate operates to protect the domestic market. **(Up to 4 marks)**

Application marks will be awarded for explaining the mechanism that protects the home market in the case of an undervalued exchange rate. An undervalued exchange rate raises the price of imports through the foreign exchange rate.

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(b) Discuss whether protectionism disadvantages most people in the protected country. **[12]**

For analysis of the advantages and disadvantages of protectionism. **(Up to 8 marks)**

The analysis should be balanced with reference to both advantages and disadvantages.

Advantages include safeguarding employment in vulnerable industries, protecting infant industries and preventing dumping.

Disadvantages include the prevention of the benefits gained through comparative advantage, reduced choice and so on.

For evaluation of the 'disadvantageous to most people' aspect of the question**. (Up to 4 marks)**

Candidates need to consider the overall impact of protectionism in order to reach a conclusion to score full marks for evaluation. Credit reference to comparative advantage in the candidate's judgement.

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