CAMBRIDGE INTERNATIONAL EXAMINATIONS

Cambridge International Advanced Subsidiary and Advanced Level

MARK SCHEME for the March 2016 series

9708 ECONOMICS

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

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International Examinations

Data Response

1 (a) **Compare the trend in the price of crude oil between April 2014 and June 2014 with that between June 2014 and September 2014. [2]**

The trend is upward from April 2014 to June 2014 **(1 mark)** and downward from June 2014 until September 2014 **(1 mark)**

(b) **Use a demand and supply diagram to show the change in the average price of a unit of solar power referred to in the article. [2]**

For an accurate demand and supply diagram with correctly labelled axes that shows a shift of the supply curve to the right **(1 mark)** and a decline in price **(1 mark)**

(c) (i) **What formula would you use to measure the relationship between the change in the price of solar power and the change in the demand for oil? [1]**

For an accurate formula that shows the calculation of cross elasticity of demand. **(1 mark)**

(ii) **What would you expect this measure to show in this case? Explain your answer. [3]**

- For a statement that the goods are substitutes **(1 mark)**
- and therefore will have a coefficient that is positive or that the relationship will be direct **(1 mark)**
- an explanation that this comes about because a rise in the price of one product will lead to a rise in the demand for the other product or that a fall in the price of one product will lead to a fall in the demand for the other. **(1 mark)**
- for evidence of understanding that the size of the coefficient expresses the extent of the relationship between the two goods. **(1 mark)**

(3 marks maximum)

(d) Using the information and your own knowledge, explain the likely economic effects if the price mechanism were allowed to operate without government interference in Venezuela. [6]

It is clear from the extract that price is not allowed to work freely in Venezuela because gasoline is underpriced and there are shortages caused by restrictions on imports. The outcome of allowing price to work freely would be that prices of petrol would rise to ration the scarce goods. Removing controls on imports would increase the quantity of goods, shortages would be alleviated and prices of imported goods would fall. Allowing the price mechanism to work may create other problems however, such as higher inflation, an increased current account deficit and increased inequality of access to essential goods and services.

- For recognition of the ways in which the price mechanism is prevented from working **(Up to 2 marks)**

  Petrol is sold at a fixed price below market equilibrium **(1 mark)**

  Controls prevent imported goods from entering the country in response to demand, so prices of imported goods will be higher than free market equilibrium. **(1 mark)**

- For an explanation of the impact on prices if the price mechanism was allowed to operate without government interference. **(Up to 2 marks)**

  The price of petrol would rise **(1 mark)** and the price of imports would fall **(1 mark)**

- For explaining the possible disadvantages of allowing price to work freely e.g. an increased current account deficit, inequality of access to some basic goods **(Up to 2 marks)**

(e) Discuss whether a devaluation of the bolivar might be considered a 'dangerous step' or the solution to Venezuela's economic problems. [6]

- For a clear understanding of what is meant by devaluation and the impact upon import prices and export prices **(Up to 2 marks)**

- For an explanation of the possible problems that might arise from devaluation such as cost-push inflation **(Up to 3 marks)**

- For an explanation of the benefits that devaluation might bring to Venezuela's economy. **(Up to 3 marks)**

For a conclusion **(1 mark)**

(6 marks maximum)

Essays

2 (a) Explain, using examples, why the prices charged for merit goods and demerit goods in a free market do not reflect the value to consumers. [8]

For **knowledge and understanding** of merit and demerit goods (award appropriate examples). **(Up to 4 marks)**

For **application,** using the examples, to show how the prices charged for merit goods and demerit goods do not reflect the true value to consumers as a result of imperfect information. **(Up to 4 marks)**

If no examples are included 6 marks maximum.

(b) Discuss the effectiveness of subsidies and indirect taxes in ensuring that the correct price for merit and demerit goods is charged in the market. [12]

For **analysis** of the effects of subsidies applied to merit goods. **(Up to 4 marks)**

- What is meant by a subsidy **(1 mark)**
- The impact of a subsidy upon costs **(1 mark)**
- The impact upon the supply **(1 mark)**
- The impact upon equilibrium price **(1 mark)**

For **analysis** of the effects of indirect taxes applied to demerit goods. **(Up to 4 marks)**

- What is meant by an indirect tax **(1 mark)**
- The impact of an indirect tax upon costs **(1 mark)**
- The impact upon supply **(1 mark)**
- The impact upon equilibrium price **(1 mark)**

For **evaluative comment** on the effectiveness of each method in achieving the correct price.

The application of a subsidy will reduce the price of a merit good and the application of an indirect tax will increase the price of a demerit good. If there was perfect information the price of a merit good would rise and the price of a demerit good would fall. In this sense, the price of each good after government intervention is **not** the correct price. The correct price would be attained through improving information. The demand for merit goods would rise, increasing their price and the demand for demerit goods would fall, reducing their price. **(Up to 4 marks)**

3 (a) Explain <u>two</u> factors that are likely to make the supply of a product relatively price-inelastic. [8]

For **knowledge and understanding** of the concept of elasticity of supply and the meaning of 'relatively price inelastic' **(Up to 4 marks)**

- For what the concept measures i.e. the response of supply to a change in price **(1 mark)**
- For an accurate formula **(Up to 2 marks)**
- For an accurate understanding of what is meant by 'relatively price inelastic' **(1 mark)**

For **application** referring to **two** factors that might make supply relatively price inelastic e.g. Lack of stocks, time period, nature of the product, availability of factors. **(Up to 4 marks)**

- Up to **3 marks** for each of two factors considered

(4 marks maximum)

(b) Discuss the policies that governments might use to increase the price elasticity of supply of essential goods, and assess the likely effectiveness of such policies. [12]

For **analysis** of the ways in which governments might attempt to increase the elasticity of supply of a product for example training programmes to increase the availability of labour with appropriate skills, providing loans for capital investment, etc. Candidates might place these in the context of broad supply side policies. **(Up to 8 marks)**

Two policies are required for full marks. Up to 6 marks for each policy analysed.

For **evaluation** of the likely effectiveness of such policies **(Up to 4 marks)**

The effectiveness of the policies would be affected by a range of factors. These include the cost of training, the time period before the policies take effect and the opportunity cost of implementing the policy.

4 (a) Outline the components of aggregate demand and explain <u>one</u> cause of an increase and <u>one</u> cause of a decrease in aggregate demand in an economy. [8]

For **knowledge and understanding** of each of the four components of the aggregate demand curve **(Up to 4 marks)**

For **application** with one cause of an increase **(Up to 3 marks)** and one cause of a decrease **(Up to 3 marks)** explained.

(4 marks maximum)

(b) Compare two policies that may be considered to solve the problem of demand-pull inflation and evaluate which is likely to be the more effective. [12]

The policies chosen may be set in the context of the interaction of the aggregate demand and aggregate supply curve. Any approach that considers policies that reduce aggregate demand or increase aggregate supply are acceptable.

Accept approaches that focus upon increases in the money supply as the cause of demand-pull inflation.

For **analysis** of any **two** policies that might be adopted to solve demand-pull inflation. Fiscal, monetary and supply-side policies to correct inflation are acceptable. **(Up to 8 marks)**

Allow up to 6 marks for each policy analysed.

(8 marks maximum)

For **evaluative comment** on the most effective policy. **(Up to 4 marks)**

The effectiveness of the policies chosen are varied. Fiscal policy might be difficult to apply because it requires cuts to government spending and increases in tax rates that might be difficult to implement. Monetary policy might prove difficult because the money supply might be difficult to control and supply side policies might be expensive and require increases in government spending that offsets restrictive fiscal policy.