UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS

GCE Advanced Subsidiary Level and GCE Advanced Level

MARK SCHEME for the May/June 2011 question paper

for the guidance of teachers

9708 ECONOMICS

9708/21 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 must be read in conjunction with the question papers and the report on the examination.

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Cambridge is publishing the mark schemes for the May/June 2011 question papers for most IGCSE, GCE Advanced Level and Advanced Subsidiary Level syllabuses and some Ordinary Level syllabuses.

1 (a) (i) Compare the average milk price paid to farmers in the US in August 2008 with that in August 2009? [2]

Fell (1), by €9 or 33% approx (1)
Allow range of figures €8.7–9.5 or 32%–35%

(ii) How far does Fig. 1 suggest that the price of milk is subject to regular seasonal influences? [2]

No / Very little (1), supporting reference to data (1)

(b) (i) Compare the changes in milk prices in the US and in New Zealand between 2007 and 2009. [2]

Both fell overall (1), US price fell continuously, NZ price rose then fell (1), US price fell more in % and absolute terms. NZ prices fell more rapidly 2008–9.
Any two points

(ii) Explain two possible reasons for the different level of milk prices in the US and New Zealand. [4]

Allow two interpretations of the question

1. Why US prices are higher than those in NZ
   The price difference may reflect productivity, costs of production / efficiency, government action, € exchange rate, comparative advantage, demand and supply conditions etc.
   Identified reason (1), explained reason (2).
2. Why are prices falling in US and NZ, as above.

(c) Explain how one group, other than dairy farmers, would lose from lower milk prices and how another group would gain from lower milk prices. [4]

Losers: Government (increased farm support expenditure, reduced tax income); associated activities e.g. farm suppliers (lower sales); local retailers (less demand from farmers); banks (loan defaults); farm workers (wages, employment), producers of substitutes.
Gainers: Consumers (lower prices); producers of milk-based goods (lower costs)

(d) Discuss the case for the use of government subsidies for the production of milk. [6]

Benefits: increase exports, reduce imports, support essential industry and employment, lower prices for basic foodstuff for low incomes, promotion of merit good etc. to max. (4)
Problems: financial cost (taxation), opportunity cost, misdirection of resources, inefficiency, dependence, etc. to max. (4)

2 (a) **Explain the functions of an economic system.** **[8]**

An economic system is the means by which a country answers the basic economic problem. Limited resources and unlimited wants result in scarcity and choices have to be made. The system allows the questions of what?, how?, and for whom? to be answered. It arranges for resources to be employed to meet demands and for producers and consumers to be satisfied. This may be done by the price system, state planning or a mixture of the two.

Understanding of the economic problem	2 marks
Explanation of the role of the economic system	6 marks

(b) **Discuss possible reasons why mixed economic systems have replaced most of the former planned economic systems.** **[12]**

Planned economies are based on state control and direction while a mixed economy uses the market system supported by appropriate government intervention. Recent history illustrates the failure of the planned economy to raise living standards and perform as well as mixed economies. Mixed economies proved more efficient, more innovative, more flexible and provided greater choice and higher living standards. Planned economies were unable to coordinate economic decision making, lacked incentives, lacked quality control, were slow to change and caused considerable environmental damage. Despite the attempts of planned economies to provide citizens with security and a minimum standard of living, the advantages of the mixed economy were more highly valued.

Understanding of the two types of system		2 marks	
Analysis of the performance of the planned system	up to	6 marks	max. 10
Discussion of the relative merits of the two systems	up to	6 marks	

3 (a) Explain how the effects of a devaluation on the level economic activity differ from those of a deflation. [8]

Devaluation is the lowering by the government of a currency's international value under a fixed exchange rate system. Deflation refers to a persistent fall in the general price level or a lower level of economic activity possibly resulting from government policy. Devaluation should improve the current account and boost the economy with higher demand, employment and growth. Deflation harms confidence, reduces spending and increases unemployment.

Understanding of devaluation and deflation	4 marks
Explanation of the different effects	4 marks

(b) Discuss whether inflation can be both the cause and the result of fluctuations in an economy's exchange rate. [12]

Higher inflation than trading partners may mean a fall in the exchange rate because of increased supply and reduced demand for the currency. This will result from fewer exports, more imports, reduced confidence and outflows of investment. Overall it would mean a worsening of the balance of payments.
A fall in the exchange rate will increase the cost of imports (cost push inflation) and increase the demand for exports (demand pull inflation). A rise in the exchange rate would reduce inflationary pressure.
Whether these effects occur will depend upon the rate of inflation, the relative rates of inflation, the government's ability to control inflation, the nature of the exchange rate system and the direction of the change in the exchange rate.

Understanding of inflation and the exchange rate		2 marks	
Analysis of the impact of the changes	up to	6 marks	max. 10
Discussion of the conditions affecting the process	up to	6 marks	

4 (a) Explain how the different international transactions of a country are recorded in its balance of payments accounts. [8]

The transactions involve trade in goods and services, incomes from work and investment, profits and dividends (IPD), government and private transfers (remittances), direct investment, portfolio investment and short term capital flows. The items are recorded as inflows (+) or outflows (-) and divided between the current account (goods and services, income and transfers) and the capital and financial accounts.

Understanding nature of international transactions	up to 3 marks
Explanation of the recording of the items in the balance of payments	up to 5 marks

(b) Discuss the use of tariffs and quotas as policies to reduce a current account deficit. [12]

Current account deficit means more outflows than inflows on trade, transfers and income. Tariffs are a tax on imports while quotas are a limit on quantity of imports. A tariff will raise revenue and be more effective the higher the price elasticity of demand and will operate through the market system. A quota will be effective when demand and supply are inelastic, will work with more certainty and benefit is more likely to accrue to the importer. Both methods involve intervention in the free market and may attract retaliation, there may be difficulty in setting the right level, they will have administrative costs and will be ineffective if the cause of the deficit is the performance in the income or transfer sections.

Understanding of current deficit, tariff and quota	up to	3 marks	max. 12
Analysis of the operation of tariffs and quotas	up to	4 marks	
Discussion of their merits and drawbacks	up to	6 marks	