UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS

GCE Advanced Subsidiary Level and GCE Advanced Level

MARK SCHEME for the October/November 2009 question paper

for the guidance of teachers

9708 ECONOMICS

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

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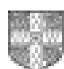

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1 (a) (i) State the formula used to calculate income elasticity of demand. [2]

Proportionate (%) change in quantity demanded/proportionate (%) change in income, exact (2), no proportionate element or price rather than income or inverted (1)

(ii) What can be concluded about air travel from Fig. 1? [2]

It is a normal good (1) it is income elastic or a change in income causes a more than proportionate increase in demand (1)

(b) Using Fig. 2, explain a likely reason for the different price elasticity values for

(i) business flights compared with leisure flights [3]

Business flights are more inelastic than leisure flights (1), no choice/substitutes exist in time or destinations (2), price rises are borne by the traveller's firm rather than the traveller. (2)

(ii) long-distance flights compared with short-distance flights. [3]

Long-distance flights are less elastic than same purpose short-distance (1), fewer substitutes exist for long-distance than short-distance flights (2), long-distance involves longer time periods and higher costs making price rises less significant in total cost (2)

(c) Explain the significance of the price elasticity values in Fig. 2 for an airline considering a policy of fare cutting. [4]

Cutting fares will raise revenue when demand is elastic but not when it is inelastic or unit elastic (1). Comment on motive e.g. revenue or profit or sales maximisation (1)
It will raise revenue with short-distance leisure flights (1) but not with long distance leisure flights (unchanged) (1) nor the 2 types of business flights (1).

(d) Discuss the costs and benefits of an increased demand for air travel. [6]

Benefits will affect business (expansion, profit, new markets), individuals (mobility, leisure, employment), economies (growth, balance of payments)
Costs include externalities (pollution, noise, visual intrusion), resource depletion, effects on rivals and balance of payments effects. Meaningful conclusion on overall effect.
One side max. (4), identification max. (2), explanation (4)

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2 (a) Explain, with the help of a diagram, how the price of a product moves to a new equilibrium following a decrease in its supply. [8]

A decrease in supply results from rising costs, unfavourable natural influences, higher taxes etc. and causes supply to shift to the left. This will result in a rise in the price of the product. Equilibrium, the tendency not to change when D=S, is restored as the higher price discourages the quantity demanded as consumers adjust their spending levels. Price will continue to rise until the balance is restored.

Knowledge of equilibrium and of decrease in supply	up to 2 marks
Diagram showing original and new equilibrium	up to 3 marks
Explanation of the process of change	up to 3 marks

(b) Discuss whether government intervention always improves the operation of the market. [12]

Government may intervene to correct market failures or for non-economic reasons. It may use regulation, price control and taxes and subsidies. It may succeed with the provision of public and merit goods or the discouragement of external costs and demerit goods or subsidies to increase provision and so increase welfare. It may fail because of poor information, costs of administration and misjudgement of policy impacts. There may be interference with the efficiency of the market. Non-economic motivation may cause undesirable side effects.

For understanding of government intervention and market	up to 4 marks
For analysis of the success of intervention	up to 4 marks
For discussion of the limitations of intervention	up to 4 marks

3 (a) Explain why it is usually more difficult to trade internationally than domestically. [8]

International trade is usually over greater distance which raises transport costs. The use of different currencies involves transaction costs and risks in exchange. Obstacles to trade such as tariffs, quotas, subsidies and the existence of trade areas reduce free and fair competition. The larger size of the market attracts a wide range of competitors which may undercut domestic producers. Different cultures, languages and tastes may make judgment of the market more difficult.

For knowledge of the differences between international and domestic trade	up to 2 marks
For understanding of the differences	up to 3 marks
For explanation of the significance of the differences	up to 3 marks

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(b) Discuss, with examples, how far the global distribution of factors of production determines what a country imports and exports. [12]

Factors of production are land, labour, capital and enterprise and they occur irregularly around the world. Examples are oil and mineral reserves, technology, skilled labour. Factor endowment is the basis of international trade theory, which suggests specialisation in line with lower opportunity cost so reflecting factor distribution. In some cases it may be absolute rather than comparative advantage at work. Other influences such as trade agreements, unequal bargaining power, political issues and the unrealistic assumptions of C A theory may mean that trade does not reflect factor distribution.

For understanding of the diverse distribution of factors	up to 4 marks
For application of comparative advantage	up to 4 marks
For discussion of comparative advantage and alternative explanations	up to 4 marks

4 (a) Explain how a rapid rate of inflation in a country will affect its floating exchange rate. [8]

A rapid rate suggests an undesirable rate. A floating exchange rate is fixed by market forces. Assuming other countries have lower rates of inflation the country will lose competitiveness as exports become relatively expensive and imports become relatively cheap. Lack of confidence will deter investment flows. Demand for the currency will fall while supply will rise causing a depreciation.

Knowledge of rapid inflation rate and floating system	up to 2 marks
Link of inflation to direction of flows	up to 3 marks
Explanation of depreciation	up to 3 marks

(b) Discuss whether a government should operate a fixed exchange rate system. [12]

A fixed exchange rate is set by the government's use of currency reserves, buying on the prospect of depreciation and selling with a prospective appreciation. There are variations in which systems have an element of fixing e.g. the adjustable peg. A fixed rate, such as the gold standard, brings stability and certainty which should encourage trade. It brings discipline to the government's internal economic policy (particularly inflationary pressure) and forces firms to control costs to remain competitive. It should discourage destabilising speculation.
Against this is the need to keep large currency reserves, the need to introduce deflationary policies which may harm other economic aims, the tendency to maintain an overvalued rate and the limits on using monetary policy. Fixed rates have become less common because of the lack of an automatic adjustment and the move to a more robust market system.

For understanding of the operation of a fixed system	up to 4 marks
For analysis of the benefits of fixed rates	up to 4 marks
For discussion of the drawbacks of fixed rates	up to 4 marks

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