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

9708/23 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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1 (a) **Compare the exchange rate of the S$ against the US$ from the beginning of 1980 to the beginning of 2010. [2]**

It appreciated/rose (1), by approx 50% or US$0.24 (1)

(b) **Analyse the possible changes in the demand for and the supply of the S$ that could account for the trends in its exchange rate between 1997 and 2007. [4]**

A depreciation between 1997 and 2001(1) may be the result of a fall in demand and/ or a rise in the supply of S$ (1), the appreciation between 2002 and 2007 (1) may be the result of a rise in demand and/or a fall in supply of S$ (1)

(c) **Explain <u>two</u> ways in which an appreciating exchange rate can help to reduce inflation. [4]**

Appreciation will reduce the price of imports (1), lessening cost-push pressure (1)
Exports are more expensive (1), reducing demand-pull pressure (1)

(d) **Using the extract, consider whether Singapore has both a floating and a fixed exchange rate system. [4]**

Elements of floating include movement within trading band (1), fluctuation of exchange rate shown in data (1)
Fixed includes MAS intervention (1), set limits to movement (1)

(e) **Discuss whether an economy will benefit from a fall in its exchange rate. [6]**

Benefits: improved balance of trade; more competitive industry; higher employment and income; increased growth
Drawbacks: only works with Marshall-Lerner condition and elasticity of supply; generates inflationary pressure; undermined by retaliation; reduced purchasing power of currency
Max. 4 marks for one side only

2 (a) **Explain how resources are allocated in a free market system.** **[8]**

A free market system relies on demand and supply without government intervention. Resources are the factors of production. Consumer and producer behaviour results in demand and supply changes leading to price changes. Higher prices, profits and rewards draw more resources to that use. Price falls do the opposite.

Understanding of the free market and resources	4 marks
Explanation of the operation of the price mechanism	4 marks

(b) **Discuss how the market system might be influenced by government intervention to provide appropriate quantities of goods and services.** **[12]**

Markets may fail by under-provision, over-provision or non-provision of goods and services. This relates to merit goods, demerit goods and public goods. The government can undertake state provision, subsidisation, taxation and product bans and regulation. Each method can be judged by its cost, effectiveness and side effects. State provision will make the goods available but may be costly and inefficient. Subsidisation will reduce the cost of the good but will interfere with the market mechanism and be a burden to taxpayers. Taxation regulates consumption and raises revenue but imposes burdens on producers and consumers. Bans and regulation prevent production but may lose some benefits and create unemployment and enforcement costs.

Understanding of the failings of market provision	4 marks
Analysis of the nature of intervention	4 marks
Discussion of the problems of intervention	4 marks

3 (a) **Explain how and why the price elasticity of supply of agricultural goods differs from that of manufactured goods. [8]**

Price elasticity of supply measures the responsiveness of supply to changes in price. Agricultural goods tend to be more price inelastic (PES<1) than manufactured goods. The influences at work are perishability of product, specialised storage, growing period, capacity availability, ability to switch products, nature of additional costs etc.

Understanding of PES in these cases	4 marks
Explanation of influences in the two cases.	4 marks

(b) **Discuss whether the payment of government subsidies to farmers is a beneficial policy. [12]**

Subsidies are payments to producers which reduce costs. They shift the supply curve to the right, lowering price and increasing quantity. This will raise farm incomes if PED is elastic but not if it is inelastic. Subsidies will lower prices for consumers and help make domestic farmers competitive with foreign producers so helping the balance of trade. They will enable farmers to stay in business with effects on employment and the environment. The benefit will be split between the consumer and farmer depending upon the elasticities involved. Against this, subsidies may undermine the operation of the market, keep resources in an inefficient use, raise the tax burden, reduce government expenditure on other groups and may be ineffective in raising farm incomes.

Understanding of the meaning and effect of subsidies	4 marks
Discussion of the benefits of subsidies	4 marks
Discussion of the drawbacks of subsidies	4 marks

4 (a) Explain the limitations of the theory of comparative advantage in accounting for of a country's pattern of trade. [8]

Comparative advantage is found when a country can produce at a lower opportunity cost than another. This reflects the country's factor endowment. It is the basis for specialisation, increased output and the benefits of trade. The theory is based on some restrictive assumptions which limit its explanatory value. These include bilateral rather than multilateral trade, absence of transport costs, mobility of factors, constant returns, full employment and reciprocal demand. These assumptions may not exist in practice.

Understanding of comparative advantage	4 marks
Explanation of the limitations of the theory of comparative advantage	4 marks

(b) Discuss whether the introduction of trade barriers to imports can be justified. [12]

Trade barriers include tariffs, quotas, export subsidies, misaligned exchange rates, administrative restrictions, exchange control etc. These are intended to reduce imports and the corresponding outflow of currency. Barriers can be justified in terms of protection of infant industries, prevention of dumping, raising revenue, short-run employment protection, improving the terms of trade and avoiding overspecialisation. On the other hand, barriers will prevent the benefits of international trade which include lower prices, more choice, more efficiency and higher living standards. Barriers may face retaliation and breach international obligations e.g. those of the World Trade Organisation.

Understanding of the types and purpose of trade barriers	4 marks
Discussion of the benefits of trade barriers	4 marks
Discussion of the drawbacks of trade barriers	4 marks