

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**

9708/22	9708 ECONOMICS Paper 22 (Data Response and Essay – Core), maximum raw mark 40
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1 (a) (i) What is meant by nominal prices and real prices? [2]

Nominal relates to the selling/market price (1), real relates to quantities or inflation adjusted value (1)

(ii) Compare what happened to nominal food prices and real food prices before and after the year 2000. [3]

Before: real price index declined, nominal more stable (1), indices moved closer together (1)

After: real and nominal prices moved more closely together (1), real and nominal prices rose (1), indices moved in similar manner (1), three points covering before and after

(b) (i) How might the differences in food weights, shown in Table 1, be explained? [3]

Low income countries have higher weights (1), food necessity taking much of income (1), higher incomes afford non-food, more luxury expenditure (1), food prices may vary between countries (1) Any 3 points

(ii) Contrast the effect on the rate of inflation in Kenya and in the UK if there were a 20% rise in food prices in each country. [2]

Greater effect in Kenya (1), Kenya 5 times as large (2), Kenya 10%, UK 2% rise (2)

(c) Explain one possible reason for the responsiveness of world food supply to changes in price reported by the IFPRI. [4]

PES meaning or formula (1), inelastic supply or 0.1 to 0.2 (1), one from growing period, storage problems, limited resources identification (1), explanation (2)

(d) Discuss the benefits and drawbacks of rising world food prices. [6]

Rising food prices will help producers, farmers and rural areas, will stimulate food production and help those countries which export food. They will hurt low income earners, food importers and food processors and contribute to inflationary pressure. The poorest subsistence farmers who buy additional food will be hurt. The effects differ according to the production pattern and level of income of countries and individuals. One side 4 marks max. Meaningful conclusion (1)

2 (a) With the aid of a diagram, explain how a government subsidy to fuel producers will affect the producers and government expenditure. [8]

A subsidy will lower costs and shift the supply curve to the right and the outcome will be more traded at a lower market price. Producer revenue made up of price and subsidy will increase. Government expenditure will increase by the amount of the subsidy times the new quantity traded.

Diagram of impact on market	4 marks
Explanation of effect on producer	2 marks
Explanation of effect on government expenditure	2 marks

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- (b) Discuss how reduced air fares on low-cost, budget airlines might affect the air travel market and the markets for related goods and services. [12]

Within the air travel market a sub-market may emerge with increased supply of services, lower prices and a restricted service. Former rivals may be able to maintain their position with different customers or may respond by cutting their own price. The size of the market should expand with more people able to afford flying. Rivals such as ferry services or railways may face falling demand, depending upon the elasticity involved. Providers of complementary services e.g. airport parking, travel insurance may face increased demand with upward pressure on their prices. Aircraft manufacturers or leasers may benefit as theirs is a derived demand arising from more flying.

Understanding of the impact on market for air travel	4 marks
Discussion of rival transport market effects	4 marks
Discussion of complementary market effects	4 marks

- 3 (a) Explain why a lighthouse is often given as an example of a public good while a light bulb is not. [8]

Public goods have the characteristics of non-rivalry and non-excludability. The use by one ship of the lighthouse signal does not reduce the consumption of other ships. Once a lighthouse is indicating hazard to one ship it cannot stop other ships from being warned and it is not possible to exclude other ships from gaining the benefit. This means that charging for the service is not possible as free riders would be able to benefit. A light bulb is a private good as it can be charged for when sold (excludable) and its use within one person's home prevents others from benefiting (rival). The concept of non-rejectability may also be applied.

Understanding of non-rival and non-excludable	4 marks
Explanation of lighthouse as public good	2 marks
Explanation of light bulb as private/non public good	2 marks

- (b) Discuss whether it is likely that the private costs and the social costs of production would be identical. [12]

Private costs are borne by the producer who benefits from the action. They may include raw material costs, wages and energy payments. Social costs are the total costs to those directly involved in the activity and to the rest of society (third parties) as well. Social costs include external costs or spillover effects borne by members of society who do not benefit from the action. Various forms of pollution come within this category. Private costs and social costs will only be identical if there are no external costs. Some actions from transport (e.g. road) and production of manufactures (e.g. chemicals) and provision of services (tourism) may have negative externalities. Private cost may be greater than social when there is an external benefit in production such as research and development effects. However while some output may generate few externalities it is unlikely that they produce none and it would not be the case for total production within an economy.

Understanding of the link between private, external and social costs	4 marks
Discussion of the existence of externalities	6 marks
Comment on the existence of zero externalities	2 marks

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- 4 (a) Compare the aims and features of a free trade area with those of an economic union. [8]

A free trade area aims to achieve free trade between its members by the abolition of internal barriers but the retention of individually set barriers to non-members. There is no integration beyond this. An economic union aims at major integration, includes a common external tariff, free movement of factors of production, harmonisation of economic policies and taxes and a common currency. This involves the loss of national sovereignty. The latter is a more comprehensive and ambitious project.

Explanation of a free trade area 4 marks
 Explanation of economic union 4 marks

- (b) Discuss whether an improvement in a country's terms of trade always works to its benefit. [12]

The terms of trade measure the average price of a country's exports against the average price of its imports. This is presented as an index number. A rise in export prices relative to import prices is said to be favourable and may arise from a number of different changes in the two components. This gives the ability to purchase more imports with a given quantity of exports. This may help to raise living standards. The changes in prices may not be favourable from a trade balance perspective. Higher export prices and lower import prices will help more if the goods involved have inelastic demand as net revenue should increase. Elastic demand will worsen the position.

Understanding of measurement of changes in terms of trade 4 marks
 Discussion of favourable outcomes 4 marks
 Discussion of unfavourable outcomes 4 marks