Cambridge International Examinations
Cambridge International Advanced Subsidiary and Advanced Level

ECONOMICS **9708/21**

Paper 2 Data Response and Essay **October/November 2016**

MARK SCHEME

Maximum Mark: 40

Published

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1 (a) (i) Explain one possible reason for the change in the world sugar price between 2011 and 2013. [3]

Accept any one factor/reason that would cause a decrease in demand **or** an increase in supply.

e.g. A fall in incomes leading to a decrease in demand. (Up to 3 marks)

Or

An improvement in technology that would increase supply or more favourable growing conditions in terms of rainfall and sunshine which would raise crop yields, leading to greater supply and lower prices. (Up to 3 marks)

(ii) Explain one possible reason for the difference in the price of sugar in the US and the world price of sugar shown in Table 1. [2]

Accept responses that relate to relative factor endowments in the U.S. compared to other countries (Up to 2 marks)

Other valid responses can be accepted for example government policy in the U.S. that might cause prices in the U.S. to be higher. The higher US price might result from higher costs of production, e.g. resulting from higher labour costs (without a corresponding increase in productivity) or from less fertile growing areas. The higher prices in the US could also be the result of import tariffs which push up prices. (Up to 2 marks)

(b) (i) What is meant by 'dumping'? [2]

Dumping is selling in overseas markets at a price below the (marginal) cost of production (candidates do not need to refer to the marginal cost of production).

Accept the WTO definition of dumping as also applying to a situation when goods are being sold in a market at a price that is lower than the price charged in the producer's domestic market.

Accept any response that states that dumping is selling below costs. (2 marks)

Selling at low prices in an overseas market without elaboration. (1 mark maximum)

(ii) Explain why Mexican producers might choose to dump their sugar in the US market. [2]

The intention is to undercut rivals with low prices in the short-term and prices will then be increased in the long-run once domestic producers have been forced out of the market and competition has been removed (idea of predatory dumping). (Up to 2 marks)

Accept other feasible explanations of the aims of dumping, e.g. to keep prices higher in Mexico.

(iii) Consider how an economist would decide whether the accusation that Mexican producers were dumping sugar in the US was justified. [2]

For an explanation that low prices are because of relative factor endowments, i.e. Mexico is better at producing sugar than the US (Up to 2 marks)

For an explanation that suggests that the costs of production would need to be examined and whether the price is below cost or whether the low prices are a reflection of factor endowment (Up to 2 marks)

(c) With the help of a diagram, explain the likely impact on the US market for raw sugar if a minimum price higher than US$0.21 had been imposed in 2013. [3]

For a diagram showing the imposition of a minimum price above the market price of US$0.21, showing that the quantity supplied exceeds the quantity demanded. (1 mark)

For an explanation of the effects of a minimum price imposed above equilibrium in terms of a lower quantity demanded and a greater quantity supplied, resulting in an excess supply of sugar (Up to 2 marks)

(d) Consider who, if anybody, in the US and Mexico might benefit from a trade war despite the advantages of free trade. [6]

For an explanation of the benefits of free trade based upon comparative advantage. (Up to 2 marks)

For a consideration of those who might benefit from a trade war for example domestic producers, workers and consumers in the short-run. (Up to 3 marks)

Reserve 1 mark for a conclusion. (1 mark)

2 (a) With the help of a supply and demand diagram, explain how the introduction of an indirect tax on a good would affect the surplus enjoyed by the consumers of that good. [8]

For **knowledge and understanding** displayed through a supply and demand diagram of the impact of an indirect tax upon the equilibrium price and quantity of a product, i.e. all four marks are for the diagram.

For an accurately labelled diagram (D,S,P,Q) (1 mark) showing the shift of the supply curve to the left (1 mark), the rise in equilibrium price (1 mark) and the fall in equilibrium quantity (1 mark) (Up to 4 marks)

For **application** showing how the impact of the tax affects consumer surplus. Candidates should define/show an awareness of consumer surplus (1 mark), explain how the impact of an indirect tax would reduce consumer surplus (1 mark) and refer to the significance of price elasticity of demand (up to 2 marks) (Up to 4 marks)

(b) Discuss whether it is better to introduce an indirect tax or to adopt policies to improve consumers' knowledge and understanding to deal with the problem of demerit goods [12]

An indirect tax will increase the price of the product reducing the demand, but the impact depends upon the price elasticity of demand. Improving consumers' knowledge will shift the demand curve to the left, but the success of this policy depends upon the effectiveness of the campaign to improve consumers' knowledge and understanding which might be very expensive and may take a long time to make a difference.

For **analysis** of the problems associated with demerit goods that are under-priced and over-consumed and the two policies designed to reduce the problem. (Up to 8 marks)

For an explanation of the 'problem of demerit goods' in terms of under-pricing and over-consumption (1 mark) that results from imperfect information (1 mark). (Up to 2 marks)

For an explanation of how an indirect tax can deal with the problem of demerit goods. (Up to 3 marks)

For an explanation of how a policy of improving consumers' knowledge can deal with the problem of demerit goods (Up to 3 marks)

For **evaluative comment** on the policies in terms of reducing the problem. Reserve 1 mark for a conclusion on which policy is likely to be the most effective (Up to 4 marks)

3 (a) Explain, with the help of a diagram, what is meant by equilibrium national income, and show how this equilibrium changes when there is an increase in aggregate demand. [8]

Equilibrium national income occurs where aggregate demand and supply are equal. An increase in aggregate demand will shift the aggregate demand curve upwards and result in a higher level of national income. All four marks are for the diagram.

For **knowledge and understanding** of equilibrium national income and where it occurs on an aggregate demand and aggregate supply diagram. (Up to 4 marks)

For **application** showing the impact upon equilibrium national income of an increase in aggregate demand. (Up to 4 marks)

(b) Discuss the factors that determine how much an increase in aggregate demand will affect prices, employment and the balance of payments of an economy. [12]

The impact of an increase in aggregate demand depends upon where the equilibrium occurs. This might be above or below the full employment level of national income. This will determine whether the increase in national income is an increase in real or money national income. The impact upon the balance of payments depends upon a range of factors including whether the economy is relatively open or closed and whether the new equilibrium level of national income generates inflation at a rate in excess of that of the economy's competitors.

For a discussion of prices and employment. (Up to 6 marks)

For a discussion of the balance of payments. (Up to 6 marks)

8 marks maximum

For an **analysis** of the impact of an increase in aggregate demand on prices, employment and balance of payments. (Up to 8 marks)

For **evaluative comment** on the factors that influence the impact, such as the level of employment in the economy and whether it is an open or a closed economy.
(Up to 4 marks)

4 At the end of October 2014, the value of the US dollar on foreign exchange markets rose to a four-year high because it was believed that the US central bank was about to raise interest rates.

(a) With the help of a diagram, explain how exchange rates are determined in a free market and why an expected rise in interest rates in the US would cause the value of the US dollar to rise. [8]

A rise in US interest rates is likely to cause an inflow of funds into the US causing upward pressure on the US exchange rate. It might also cause a fall in US imports as aggregate demand falls causing a fall in outflow of US dollars again creating upward pressure on the dollar.

For **knowledge and understanding** of the factors that determine exchange rates in a free market, with the help of a diagram. (Up to 4 marks)

For **application** showing a diagram with an increase in demand for the dollar as a result of the rise in interest rates in the U.S. (Up to 4 marks)

The diagram can gain up to four marks, two marks under 'knowledge and understanding' and two marks under 'application'.

(b) Discuss the probable impact of this exchange rate rise on the US economy and assess whether it is likely to benefit this economy overall. [12]

There will be an impact upon US imports and exports as imports become cheaper and exports become dearer. This will affect the current account of the balance of payments, but also employment and prices. The significance of this for the US current account of the balance of payments depends upon elasticity. There will be differences in the impact in the long-run and in the short-run.

For **analysis** of the impact of an exchange rate rise upon an economy considering employment, inflation and the balance of payments. (Up to 8 marks)

For **evaluative comment** on the overall effect and the extent to which it might be positive. (Up to 4 marks)