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Cambridge International Advanced Subsidiary and Advanced Level

MARK SCHEME for the October/November 2015 series

9708 ECONOMICS

9708/22 Paper 2 (Data Response and Essay – Core), maximum raw mark 40

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Data Response

1 (a) Describe the change in the value of the Indonesian rupiah between July 2009 and July 2013 shown in Fig.1. [2]

The rupiah appreciated from July 2009 to July 2011 **(1 mark)** then depreciated from July 2011 until July 2013. **(1 mark)**

If the answer describes the overall change in this period i.e. the rupiah has appreciated. **(1 mark)**

(b) Explain how the fall in the rupiah could cause the first current account deficit since 1997 as stated in Extract 1. [2]

For clear **understanding** of the impact of a fall in the rupiah on the price of Indonesia's exports and/or the price of Indonesia's imports. **(1 mark)**

For **explanation** of how this would lead to a deficit in the current account in terms of the short-term **impact** on export receipts and expenditure on imports. **(1 mark)**

(c) With the help of a diagram, explain how a cut in fuel subsidies would have contributed to the rise in the price of fuel by 44%. [4]

For an accurate diagram showing the shift to the left of the supply curve and the rise in equilibrium price that results. **(Up to 2 marks)**

For an accompanying **explanation** of the diagram e.g. the reason for the shift in the supply curve in terms of increased costs. **(1 mark)**

For reference to the elasticity of demand to explain the extent of the price rise resulting from the shift. **(1 mark)**

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(d) (i) How could a rise in interest rates in the US affect Indonesia's balance of payments? [2]

Candidates can approach this in a number of ways.

The impact could be assessed through the effect on capital flows or through the impact upon the current account.

Allow approaches that look at the long-run effects, for example as interest rates rise in the US this will push up the value of the dollar.

For example, capital flows out of Indonesia to seek better returns in the US **(1 mark)** this leads to an outflow from Indonesia's Financial Account. **(1 mark)**

Or

Higher interest rates would reduce consumption in the US **(1 mark)** so there would be a fall in Indonesia's exports and the balance on Indonesia's current account would reduce. **(1 mark)**

Or

The rise in interest rates in the US increases the value of the dollar making imports from Indonesia less expensive **(1 mark)** and this will cause a fall (or rise?) in Indonesia's current account balance. **(1 mark)**

The answer must refer to a rise in interest rates in the US and arrive at an assessment of the impact upon Indonesia's balance of payments.

(ii) With the help of a diagram, explain how this rise in US interest rates would be expected to cause a fall in the value of the Indonesian rupiah. [4]

Again the impact could be through the effect upon capital flows or trade.

For an accurate diagram showing an increased supply of rupiah as capital flows from Indonesia to the US and a fall in the exchange rate of the rupiah. **(Up to 2 marks)**

Or

For an accurate diagram showing a fall in the demand for the rupiah as US imports from Indonesia decline. **(Up to 2 marks)**

An 'accurate diagram' will refer to the foreign exchange market and will be fully and appropriately labelled. If the curves are labelled supply and demand, and the axes price and quantity, then the explanation should be examined to ensure that the candidate's answer refers to the foreign exchange market NOT the goods and services market.

For an accompanying **explanation**. **(Up to 2 marks)**

The **analysis** may explain a rise in the value of the dollar. This is only acceptable if it is made clear that this represents a fall in the value of the rupiah.

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(e) Discuss how any <u>two</u> changes described in the data might be expected to affect aggregate demand and aggregate supply in Indonesia and assess how prices and output might be affected. [6]

For an **explanation** of how any one change described in the data would impact upon aggregate demand **(up to 3 marks)** and how this change might affect prices and output in Indonesia. **(1 mark)**

For an **explanation** of how any one change described in the data would impact upon aggregate supply **(up to 3 marks)** and how this change might affect prices and output in Indonesia. **(1 mark)**

There are many changes described in the data that might affect aggregate demand or aggregate supply in Indonesia. These include:

- The fall in the value of the rupiah
- The reduction in fuel subsidies
- Possible rise in Indonesia's interest rates
- The ban on nickel exports
- Economic growth in Indonesia slowing
- The rise in interest rates in the US
- The large outflow of capital from Indonesia

Examples of possible responses:

A fall in the value of the rupiah would reduce the price of Indonesia's exports and increase the price of Indonesia's imports. This might lead to an increase in net exports and a rise in aggregate demand. This could lead to a rise in output and/or prices depending upon the availability of spare resources. **(4 marks)**

The reduction in fuel subsidies would increase the cost of fuel and would increase industry costs. This would lead to a fall in aggregate supply and a fall in output together with a rise in prices. **(4 marks)**

(6 marks maximum)

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Essays

2 (a) A study estimates that dark chocolate has a price elasticity of demand of (–) 0.8 and that white chocolate has a price elasticity of demand of (–) 1.4. Explain how chocolate producers could change price to increase total revenue for each type of chocolate. [8]

For **knowledge and understanding** of price elasticity of demand and the meaning of elastic and inelastic. **(Up to 4 marks)**

What price elasticity of demand measures. **(1 mark)**

For an accurate formula. **(Up to 2 marks)**

For the distinction between elastic and inelastic. **(1 mark)**

For **application** showing how a rise in the price of dark chocolate **(up to 2 marks)** and a fall in the price of white chocolate will increase total revenue. **(Up to 2 marks)**

(b) Explain the factors that might cause a fall in demand for chocolate and discuss the extent to which chocolate producers have the power to stop this fall in demand happening. [12]

The demand for chocolate is subject to a range of factors such as incomes, tastes, the price of chocolate and the price of other goods. These can change and cause a shift in the demand curve or a movement along the demand curve in the case of price changes.

Chocolate producers have the power to influence some of these factors such as price and tastes, but not others such as incomes.

For an **analysis** of the factors that might cause a fall in the demand for chocolate such as a rise in the price of chocolate, a fall in incomes or a change in tastes against chocolate. **(Up to 6 marks)**

For an **analysis** of the ways in which chocolate producers might prevent the fall in demand. **(Up to 6 marks)**

(8 marks maximum)

For **evaluative comment** on the extent to which chocolate producers could stop this happening. **(Up to 4 marks)**

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3 (a) Explain what is meant by the term 'money' and outline its characteristics in a modern economy. [8]

Money is anything generally accepted in payment of debt. In a modern economy money consists of cash, notes and coin, and bank deposits. There are also different types of near money such as savings accounts in banks and building societies.

For **knowledge and understanding** of what is meant by 'money' in a modern economy. **(Up to 4 marks)**

For a valid definition of money: anything generally acceptable in payment of debt. **(Up to 2 marks)**

For recognition that in a modern economy money constitutes cash, notes and coin **(1 mark)**, and various types of bank deposit. **(1 mark)**

(4 marks maximum)

For **application** providing elaboration of the characteristics of money in a modern economy.

Cash is legal tender and is durable, portable, divisible etc. **(Up to 2 marks)**

Bank deposits can be transferred by cheque or electronically, some deposits are types of near money because they are not completely liquid. **(Up to 2 marks)**

(4 marks maximum)

(b) Discuss whether money is able to perform all its functions effectively in an economy that is experiencing a high rate of inflation. [12]

Money is usually said to have four functions. It acts as a medium of exchange, a unit of account, a store of value and a standard of deferred payment. As the rate of inflation increases each of these functions can be affected. The higher the rate of inflation, the more likely that all of the functions will be affected. The function that is likely to be affected only when inflation is at very high levels is the medium of exchange. When money will be replaced by other media as people lose confidence in it. Whether money can perform all its functions depends upon the rate of inflation and the time period over which it persists. Whether the inflation is anticipated or unanticipated is also relevant.

For an **analysis** of how the functions of money are affected by inflation. **(Up to 8 marks)**

For **explanation** of each function **and** how it may be affected by inflation. **(Up to 2 marks per function)**

(8 marks maximum)

For an **evaluative comment** on whether money can perform all of its functions during periods of high inflation. **(Up to 4 marks)**

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4 (a) In a two-country world, one country is more efficient at producing one product and the other country is more efficient at producing another product. Explain why specialisation and trade usually benefit both countries. [8]

For **knowledge and understanding** of the law of reciprocal absolute advantage. **(Up to 4 marks)**

For a statement of the assumptions of the model. **(2 marks)**

For a model that shows the outcome of self-sufficiency. **(2 marks)**

(4 marks maximum)

For **application** showing how both countries can benefit from specialisation and trade. **(Up to 4 marks)**

For a model that shows the benefits of specialisation in terms of total world output **(up to 2 marks)** and demonstrates the benefits of trade to both countries. **(Up to 2 marks)**

(4 marks maximum)

(b) Suppose one country is more efficient at producing both products. Discuss whether it is the case that specialisation and trade will always benefit both countries. [12]

The Law of Comparative Advantage can show how both countries will benefit from specialisation and trade when one country is better at producing both products. The benefits will only exist however if the exchange rate lies between the opportunity cost ratios and in those products that do not have excessive transport costs that can nullify the benefits. In addition, some might suggest that specialisation and trade might benefit both countries if unemployment is created and causes social problems or if there are strategic issues and so on.

For an **analysis** of the law of comparative advantage showing the benefits to each country of specialisation and trade. **(Up to 6 marks)**

For an **analysis** of the reasons why specialisation and trade might not benefit both countries. **(Up to 6 marks)**

For **evaluative** comment on whether specialisation and trade is likely, on balance to benefit both countries. **(Up to 4 marks)**

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