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ECONOMICS **9708/23**

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

MARK SCHEME

Maximum Mark: 40

Published

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1 (a) (i) Calculate the price elasticity of demand for meat in Bishkek. [2]

For evidence of correct formula (1 mark) **and** correct calculation = (–) 4.16 (1 mark)

Accept answers within the range 4.1 to 4.2.

Correct calculation with no formula shown (2 marks), correct formula with incorrect calculation (1 mark).

(ii) How does the price elasticity of demand for meat differ from the price elasticity of demand for flour in Bishkek? [2]

Price elasticity of demand for meat exceeds 1 and so is elastic (1 mark), the data indicates that there is an inelastic demand for flour. (1 mark)

(iii) How might an economist explain this difference? [2]

For any explanation that is valid in terms of the factors that influence elasticity

For identification of a valid factor (1 mark) for explanation of this factor (1 mark).

For example, the candidate might explain that the data indicates that meat has many substitutes whereas flour has few substitutes. Or that meat is more expensive and therefore takes up a higher proportion of consumer spending. One factor explained can gain both marks.

(b) With the help of a supply and demand diagram, explain how the Russian central bank is 'attempting to protect the value of the rouble'. [3]

For an explanation of how the sale of foreign exchange reserves by the Russian central bank can increase the demand for the rouble and support its value. (up to 2 marks)

For an accurate supply and demand diagram of the foreign exchange market. (1 mark)

If the candidate only explains an action to support the value of the rouble that does not involve the sale of foreign exchange reserves, for example an increase in interest rate. (1 mark maximum)

(c) Consider the extent to which the economic performance of Kyrgyzstan would be affected by the fall in remittances from Russia. [5]

The data indicates that the fall in remittances from Russia will have serious consequences for the Kyrgystan economy. This is because of the scale of these remittances and the extent of the fall. In addition the remitted roubles will purchase fewer US dollars. The outcome would be reduced aggregate demand and possibly cost-push inflation.

For analysis of the effects of the fall in remittances upon other macro indicators such as the national income, employment and prices. (up to 4 marks)

For evaluative comment on the scale of the impact. (1 mark)
Allow approaches that focus on a narrow range of indicators, but also those that consider a wider range of indicators in less detail as long as there is explanation of the effects.

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(d) Discuss whether the actions of the Russian and Kyrgyzstan governments in protecting the value of their currencies are likely, on balance, to have benefited their economies. [6]

Protecting the value of a currency has advantages and disadvantages. Advantages include the fact that importers and exporters will be more sure of the value of their transactions and this will enhance trading conditions, there is less opportunity for speculators to create a run on the currency and so on.

The disadvantages include the cost of the intervention in terms of foreign exchange reserves and the fact that changes in the exchange rate that are determined by market forces cannot offset differences in inflation rates between trading nations.

For explaining the negative effects of protecting the value of their currencies.
(up to 3 marks)

For explaining the positive effects of protecting the value of their currencies. (up to 3 marks)
(up to 5 maximum)

For a conclusion based upon the evidence offered. (1 mark)

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2 (a) Distinguish between the concepts of market equilibrium and disequilibrium and show what happens in a free market for a good when disequilibrium exists. [8]

Market equilibrium means that there is no tendency for price and quantity to change. Dis equilibrium means that excess demand or excess supply exists and as a result price and quantity will change as a result of market forces.

For clear **knowledge and understanding** of the terms equilibrium and disequilibrium. (up to 4 marks)

For knowledge and understanding of the meaning of equilibrium in a free market. (up to 2 marks)

For knowledge and understanding of the meaning of disequilibrium in a free market. (up to 2 marks)

If the candidate shows where equilibrium and/or disequilibrium occurs, but does not explain what this means. (1 mark maximum)

For **application** showing how equilibrium is re-established in a free market when disequilibrium exists. (up to 4 marks)

For showing how market forces operate to re-establish equilibrium when an excess demand exists. (up to 3 marks)

For showing how market forces operate to re-establish equilibrium when an excess supply exists (up to 3 marks) (4 marks maximum)

(b) Discuss whether subsidies or improved information is the more effective policy to deal with the problems raised by the under-consumption of merit goods. [12]

For **analysis** of the problems associated with the under-consumption of merit goods and the two policies designed to reduce the problem. (up to 8 marks)

For an explanation of the problems of merit goods in terms of under-consumption (1 mark) that results from imperfect information (1 mark) (up to 2 marks)

For an explanation of how a subsidy can deal with the problem of merit goods. (up to 4 marks)

For an explanation of how a policy of improving information can deal with the problem of under-consumption of merit goods. (up to 4 marks) (8 marks maximum)

For **evaluative comment** on the policies in terms of reducing the problems. A concluding comment on which policy is likely to be most effective is essential for full marks. (up to 4 marks)

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3 (a) Explain with the help of a diagram why production possibility curves are usually drawn with increasing opportunity costs, and show how they can be used to illustrate scarcity. [8]

For **knowledge and understanding** of production possibility curves and why they are usually drawn with increasing costs. (up to 4 marks)

For a production possibility curve accurately drawn with appropriate axes (1 mark) and displaying increasing opportunity costs (1 mark) (up to 2 marks)

For an explanation of why increasing opportunity costs arise as a movement along the opportunity cost curve takes place. (up to 2 marks)

For **application** showing how production possibility curves can be used to illustrate scarcity with due reference to choice and opportunity cost and that points outside the curve are unattainable. (up to 4 marks)

(b) Discuss whether it is likely that economies that have an increase in labour and a high rate of technological innovation will come nearer to solving the economic problem. [12]

For **analysis** of the impact of an increase in the labour supply and a high rate of technological innovation upon the goods and services produced. This could be illustrated with a diagram showing an outward shift in the production possibility curve. (up to 8 marks)

For explanation of the 'economic problem' in terms of unlimited wants and scarce resources. (up to 2 marks)

For explanation of the impact of an increase in the labour supply on the capacity of an economy to produce goods and services. (up to 4 marks)

For explanation of the impact of a high rate of technological innovation on the capacity of an economy to produce goods and services. (up to 4 marks)

For **evaluative comment** on whether the economic problem can be solved. (up to 4 marks)
(8 marks maximum)

4 (a) Using diagrams, explain how rising raw material prices and a fall in the rate of interest might cause different types of inflation. [8]

For **knowledge and unbderstanding and application** of how rising raw material prices can cause cost-push inflation. (No diagram 3 max) (up to 4 marks)

For **knowledge and understanding and application** of how a fall in the rate of interest can cause demand-pull inflation. (No diagram 3 max) (up to 4 marks)

(Allow 2 marks maximum for answers that show understanding of the way in which a fall in the rate of interest could cause cost-push inflation through the impact upon the exchange rate)

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(b) Discuss how the policy chosen to reduce the rate of inflation will be influenced by the cause of the inflation. Consider which type of inflation is most difficult to reduce and why. [12]

The most appropriate policy to reduce inflation depends upon the type of inflation that exists. Demand-pull inflation is best approached through contractionary monetary or fiscal policy or through supply side policies. The most appropriate policy to reduce cost-push inflation depends upon the source of the rise in costs. For example, a rise in raw material costs might be off-set by new sources of supply. Increasing costs through a declining exchange rate can be offset by support for the exchange rate and so on. Which type of inflation is most difficult to reduce depends upon a number of factors. For example, if the inflation is demand-pull then policy might have a considerable time lag. If inflation is caused by a shortage of raw materials, it might take a long time before new sources of supply are found.

For **analysis** that explains how demand-pull inflation can be reduced through:

- Contractionary monetary policy i.e. through a decrease in the quantity of money and a rise in the rate of interest
- Contractionary fiscal policy i.e. through a decrease in government spending and a rise in taxation.
- Supply side policies i.e. through an increase in aggregate supply that offsets the excess aggregate demand. (up to 6 marks)

For **analysis** that explains cost-push inflation can be reduced through:

- Support for the exchange rate
- A range of supply-side policies aiming to reduce costs etc.

(up to 6 marks) (8 marks maximum)

For **evaluative comment** on the most 'difficult to reduce' aspect of the question. A concluding comment on which policy is likely to be most effective is essential for full marks. (up to 4 marks)

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