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UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS

GCE Advanced Subsidiary and Advanced Level

MARK SCHEME for the June 2005 question paper

9708 ECONOMICS

9708/02 Paper 2 Data Response and Essay (Core), maximum raw mark 40

This mark scheme is published as an aid to teachers and students, to indicate the requirements of the examination. It shows the basis on which Examiners were initially instructed to award marks. It does not indicate the details of the discussions that took place at an Examiners' meeting before marking began. Any substantial changes to the mark scheme that arose from these discussions will be recorded in the published *Report on the Examination*.

All Examiners are instructed that alternative correct answers and unexpected approaches in candidates' scripts must be given marks that fairly reflect the relevant knowledge and skills demonstrated.

Mark schemes must be read in conjunction with the question papers and the *Report on the Examination*.

- CIE will not enter into discussion or correspondence in connection with these mark schemes.

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Grade thresholds for Syllabus 9708 (Economics) in the June 2005 examination.

	maximum mark available	minimum mark required for grade:		
		A	B	E
Component 2	40	28	25	16

The thresholds (minimum marks) for Grades C and D are normally set by dividing the mark range between the B and the E thresholds into three. For example, if the difference between the B and the E threshold is 24 marks, the C threshold is set 8 marks below the B threshold and the D threshold is set another 8 marks down. If dividing the interval by three results in a fraction of a mark, then the threshold is normally rounded down.

June 2005

GCE AS/A LEVEL

MARK SCHEME

MAXIMUM MARK: 40

SYLLABUS/COMPONENT: 9708/02

ECONOMICS
Paper 2
Data Response and Essay (Core)

UNIVERSITY of CAMBRIDGE
International Examinations

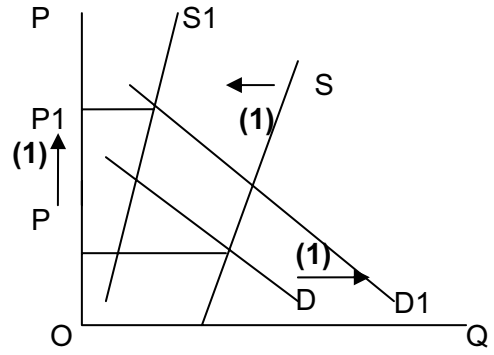
1 (a) Show how Fig 1 supports the view that the prices of precious metals change dramatically. [2]

Wide variation in price per time period **(1)**, supporting use of data **(2)**

(b) Explain one reason for the increased demand for gold in 2002. [2]

Uncertainty/stock market collapse-safer investment **(2)**, low interest rates-better return **(2)**
Recognition **(1)** + explanation **(1)**

(c) Draw a diagram to show why the price of platinum rose in 2002. [3]



(d) (i) Define price elasticity of supply. [2]

A measure of the responsiveness of quantity supplied to a change in price
Exact **(2)**, less precise or formula **(1)**

(ii) What does the data suggest about the nature of the elasticity of supply of precious metals? [2]

With stocks **(1)** relatively elastic **(1)**,
or without stocks **(1)** relatively inelastic **(1)**

(e) How may the price behaviour of palladium and platinum, shown in Table 1, have been linked? [3]

Recognition of price divergence or substitutes **(1)**, high relative palladium price caused replacement by platinum **(1)** and demand for palladium fell leading to price fall **(1)**, switch to platinum raised its demand and price **(1)**

An alternative linkage is through changing nature of demand for vehicles, i.e. rise in D for diesel – rise in D for platinum **(1)** leading to rise in P **(1)** (inferred) fall in D for petrol vehicles – fall in demand for palladium **(1)** plus substitution effect leads to fall in P **(1)**

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(f) Discuss the possible effects on the South African economy of the rise in the prices of gold and platinum. [6]

Benefits: export revenue, balance of trade, employment, improved terms of trade, purchasing power for imports, attract investment

problems: higher ER, export price rise, switch to other suppliers, external costs of increased mining, sustainability
Up to 4 for each side (max 2 for list)

2 (a) Explain the differences in the features of a market economy and a planned economy. [8]

Individual actions and consumer sovereignty dominate in the market economy. Motivation is self interest. Private ownership, the profit motive and the operation of market forces are central features. In a planned economy there are government ownership, planning bodies and the state direction of resources. Motivation is public interest. Decisions by the government dominate economic activity.

Explanation of the features of a market economy up to 4 marks
Explanation of features of a planned economy up to 4 marks

(b) Discuss the desirability of the direct provision of goods and services by the government. [12]

The desirability depends upon the nature of the goods and services. Private goods and services may be most efficiently supplied by the market. However in cases of market failure the government may intervene. Public goods and merit goods may not be provided or be under-provided by the market. This would include defence and education and would justify the direct provision by the government. Intervention in the provision of private goods however may result in inefficiency and reduced welfare. Governments may also use this as a way to tackle monopoly, fair prices and essential goods.

Discussion of merit and public goods up to 6 marks
Discussion of private goods up to 4 marks}to max
Discussion of other government motives for provision up to 4 marks}of 6 marks

3 (a) Explain why economies make use of money. [8]

Money avoids the use of barter and the need for a double coincidence of wants. This makes trade more efficient. Acting as a unit of account and a medium of exchange also simplifies the trading process. The store of value and standard of deferred payment functions encourage saving and investment. Trade and investment raise welfare and economic efficiency.

Knowledge of the functions of money up to 4 marks}to max
Explanation of the functions of money up to 6 marks}of 8 marks

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(b) Discuss whether stability in the value of money is essential for a country's economic well-being. [12]

Stability in value would be upset by inflation. This causes problems with the efficient working of the price mechanism, international competitiveness and aspects of redistribution. Price stability can dent expectations and profits and lead to lack of confidence and stagnation. These effects would harm economic well-being. This may be shown by inefficiency, unemployment, lower living standards etc. However the level of harm depends upon the actual rate of change, whether or not it has been anticipated and the comparative rate internationally. If these are relatively favourable the effects may not cause significant instability. A low and stable level of inflation is thought to encourage production and growth so absolute stability is not necessary.

Understanding of inflation	up to 2 marks
Discussion of harm done by inflation	up to 6 marks}to max of
Discussion of circumstances when inflation may be benign/beneficial	up to 6 marks}10 marks

4 (a) Explain how a country's balance of payments is organised to account for all of its international transactions. [8]

The accounts are arranged to show the total international transactions, arranged by their differing nature and debit or credit effects. The current account deals with the exports and imports of goods (visibles) and services (invisibles). It also includes income from investments (inflow and outflow) and transfers of income. Its final element is current transfers such as payments to international institutions. The capital account records the transfer of ownership of fixed assets. The financial account relates to short-term and long-term investment, both portfolio and real, and the movement of reserves. A balancing item is included to account for the errors and omissions in collecting the data.

Knowledge of the nature of the current account	up to 3 marks
Knowledge of the non-current sections	up to 3 marks
Explanation of the organisation of the account	up to 2 marks

(b) A country has a deficit on the current account of its balance of payments. Discuss whether this is necessarily harmful to the country. [12]

Deficit occurs when outflow of various current items exceed inflows. The cause of the deficit, its size and its likely duration decide whether it will be harmful. On the current account a deficit on goods may be bad if long-running and the result of a lack of competitiveness. On the other hand it may just reflect rising standards of living and be covered by other inflows. If the goods are capital rather than consumption later benefits may offset a current outflow. Weakness in services may simply reflect comparative advantage. Strong foreign reserves may be able to finance a temporary deficit. However if a deficit is long-term and cannot be financed without excessive international borrowing, the depletion of international reserves or exceptional policy measures the position is an undesirable disequilibrium.

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Understanding of the nature of deficit	up to 2 marks
Discussion of a non-harmful deficit	up to 6 marks} to a max
Discussion of the harmful effects of a deficit	up to 6 marks} of 10 marks

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