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UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS

GCE Advanced Subsidiary Level and GCE Advanced Level

MARK SCHEME for the May/June 2008 question paper

9708 ECONOMICS

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

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UNIVERSITY of CAMBRIDGE
International Examinations

1 (a) Identify from Fig.1 the greatest monthly appreciation of the Kwacha.

(i) In which month did this take place?
November [1]

(ii) By how much did it appreciate?
20–25% or 900–1100 Kwacha [1]

(b) Explain what Fig.1 suggests about the type of exchange rate system used by Zambia.
Floating/free (1), meaning of floating (1), fluctuations in rate (1) [3]

(c) Explain how the change in the value of the Kwacha between September 2005 and January 2006 might have been influenced by

(i) the improved export performance and
Buyers use foreign currency to pay for exports (1), more demand for Kwachas (1), pushes up price (1), diagram (1), up to 3 marks

(ii) the reduction in foreign debt.
Less need for Zambia to repay debt or interest in foreign currency (1), reduced supply of Kwachas (1), pushes up price (1), diagram (1), up to 3 marks [6]

(d) How would the appreciation of the Kwacha affect Zambia's terms of trade?
T of T improve (1) plus two from: terms of trade = price of exports /price of imports (1), export prices rise (1), import prices fall (1) [3]

(e) Discuss whether an appreciation of its exchange rate always benefits a country.
Benefits: greater confidence, lower inflation, higher purchasing power, more financial inflows (confidence), lower debt burden etc (up to 4 marks)

Disadvantages: worsening trade performance, higher unemployment, lower growth, reduced FDI (costs) etc (up to 4 marks)
Credit consideration of elasticity relevance [max of 6]

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2 (a) Explain the three economic questions that all economies face because of the basic economic problem.

The basic economic questions are what to produce (the selection), how to produce (the methods) and how to distribute (the consumers). These are the result of scarce resources and unlimited wants. Scarcity exists and makes choices necessary and this is found in all types of economy.

Understanding of the prevalence of scarcity	up to 2 marks	
Explanation of the basic economic questions	up to 6 marks	[8]

(b) Discuss whether the price mechanism is an effective way to solve the basic economic problem.

The price mechanism is a feature of the free market and operates through demand and supply and the self interest of individuals, government action is minimised. This has the benefits of incentive, efficiency, innovation, choice and consumer sovereignty. Against this there may be market failure including inequality, lack of public and merit goods, externalities and instability. Depending upon the degree of failure the mechanism may be more or less effective. The price mechanism does not solve the basic economic problem but is thought to be effective when operating efficiently.

Understanding of the price mechanism	up to 4 marks	
Analysis of its effectiveness	up to 6 marks] to max	
Discussion of its limitations	up to 6 marks] 10 marks	[12]

3 (a) Explain what determines the size of a country's labour force.

The labour force is the part of the population employed or available for work. It includes the unemployed. Its level is influenced by total population (birth rate, death rate, migration), age distribution, school leaving age, retirement age, attitudes towards women working, higher education opportunities, post retirement employment, part time opportunities, etc.

Understanding of the labour force	up to 2 marks	
Explanation of the influences on the labour force	up to 6 marks	[8]

(b) Discuss whether a widespread shortage of labour might be a major cause of inflation.

Inflation is a sustained rise in the general price level and is caused by cost push, demand pull and monetary influences. A shortage of workers might mean rising wages, which would push up costs over a large number of industries and generate more spending power. Both could contribute to inflation. The impact will be less where there is the ability to use machinery or migrant labour. However, other factors such as money supply increases, raw material price rises, increases in aggregate demand, overheating in the economy etc might be more important.

Understanding of inflation and its types	up to 4 marks	
Analysis of the inflationary effect of labour shortage	up to 6 marks] max of	
Discussion of limits to its impact on inflation	up to 6 marks] 10 marks	[12]

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4 (a) Explain what is meant by a current account deficit.

The current account involves the trade in goods (visible) and services (invisible), flows of income and current transfers. A deficit results when total outflows exceed total inflows.

Understanding of deficit	up to 2 marks	
Explanation of the elements of the current account	up to 6 marks	[8]

(b) Discuss the effectiveness and desirability of imposing tariffs to correct a current account deficit.

Tariffs are a tax, specific or ad valorem on imported goods and may be targeted. They push up the price of the good and reduce the quantity demanded of imports, so helping domestic producers and reducing the outflow of currency. They allow a breathing space for structural adjustment. Dumping can be prevented. They raise revenue for the government. Tariffs might not be effective in reducing quantity demanded when demand is inelastic and they will not be relevant to dealing with a deficit resulting from income and transfer flows. They interfere with the operation of the market, reduce the benefits of trade, may breach international obligations and may provoke retaliation. The impact of a tariff can be shown in a diagram.

Understanding of a tariff	up to 4 marks	
Analysis of the benefits of a tariff	up to 6 marks] max of	
Discussion of the problems of a tariff	up to 6 marks] 10 marks	[12]

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