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UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS

GCE Advanced Level and GCE Advanced Subsidiary Level

MARK SCHEME for the November 2005 question paper

9708 ECONOMICS

9708/02 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*.

The minimum marks in these components needed for various grades were previously published with these mark schemes, but are now instead included in the Report on the Examination for this session.

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

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UNIVERSITY of CAMBRIDGE
International Examinations

1 (a) State one way in which a customs union and a free trade area are the same and one way in which they differ. [2]

They have no internal trade barriers (1), CU has CET, FTA individual tariffs (1)

(b) (i) Compare the behaviour of the Mexican and Argentine exchange rates against the US$ in the period shown in Fig 1. [2]

Mexican unstable (1), Argentine steady (1)

(ii) Explain one possible reason for the trend in the Mexican exchange rate during 1999. [2]

Increased demand or reduced supply of peso (1), change in competitiveness, interest rates etc (1).

(iii) Explain how the fixed level of the Argentine exchange rate would have been achieved. [3]

Government action (1), sale of peso when above target rate (1), sale of $ when below target rate (1)

(c) (i) Compare Mexico's and Argentina's experience of inflation in the period shown in Fig 2. [2]

Mexico continuous inflation/ price rises (1), Argentina price stability/no inflation (1)

(ii) Explain how Mexico's inflation rate may have influenced the behaviour of its exchange rate. [3]

High Mexican inflation harms trade position or causes outflow of funds (1), reduced demand or increased supply of pesos (1), causes fall in exchange rate (1), comment on 1999 reverse acceptable(1)

(d) Discuss whether the devaluation of a country's exchange rate will always improve its balance of trade position. [6]

Operation of devaluation (2), consideration of elasticities of demand (Marshall-Lerner) and supply, time lags(J curve) and the reactions of producers and other governments. (4)

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2 (a) Explain the effects of externalities on the allocation of resources. [8]

Externalities may be positive or negative. They include e.g. the supply of trained workers to the economy and pollution. Positive externalities result in the underproduction of the product and its sale at an excessive price. Negative externalities result in overproduction and sale at too low a price. In both cases the allocation of resources is not optimal as it is based on private rather than social considerations. This may be explained with the support of diagrams.

Knowledge of externalities	up to 3 marks
Explanation of outcomes	up to 3 marks
Explanation linked to allocation of resources	up to 2 marks

(b) Discuss the use of indirect taxes and subsidies by governments to deal with externalities. [12]

Indirect taxes can be used to counter negative externalities, while subsidies can be used to encourage positive externalities. Each will affect the position of the supply curve and move it towards the optimal position reflecting social costs and benefits. This can be shown by diagrams. While theoretically this may be straightforward, practice may be different. The costs/benefits may be hard to value so the appropriate level of tax and subsidy may be difficult to calculate and it might be too complicated to have individual rates for each case. There may be other side effects of raising tax and paying subsidies.

Understanding of the relevance of taxes and subsidies	up to 4 marks
Analysis of the operation of taxes and subsidies	up to 6 marks} to max of
Discussion of the use of taxes and subsidies	up to 6 marks} 8 marks

3 (a) Explain the meaning of the equilibrium price of a good and how it is set in a free market. [8]

Equilibrium price means no tendency to change and is when D=S. A free market implies no government intervention. Demand and supply operate to set price.

Changes in demand and supply cause price changes. Any disequilibrium is corrected by reactions to the price level. The process can be shown by the use of diagrams.

Knowledge of the terms	up to 3 marks
Explanation of the operation of the market	up to 3 marks
Explanation of moves from disequilibrium	up to 2 marks

(b) Discuss whether free international trade in goods should be encouraged. [12]

Free trade means a lack of obstacles such as tariffs and quotas. Free trade is thought to bring benefits of higher living standards, more employment and greater choice at lower cost. The world's factors of production should be employed more efficiently. This is based on the principle of comparative advantage. In reality free trade may have harmful effects in some circumstances and this may apply particularly to developing economies. Unequal bargaining strength may prevent a fair sharing of the benefits, unfair trading practices such as dumping may undermine a country's industries, dominant market positions may prevent the growth of infant industries and there may be high short-term costs in terms of unemployment and disruption. Globalisation has not shared benefits equally and there may be a case for a slow transition towards freer trade.

Knowledge of the theoretical benefits of free trade	up to 4 marks
Analysis of the operation of free trade	up to 6 marks} to max of

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Discussion of the case for free trade up to 6 marks} 8 marks

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4 (a) Explain why it is difficult to measure unemployment accurately. [8]

Unemployment may be measured by the claimant count or the ILO job seekers survey method. Problems involve inadequate data collection methods, costs of data collection, inadequate sampling techniques, unemployed people excluded from benefits, those claiming illegally and problems of defining the unemployed.

Knowledge of the methods of measuring unemployment	up to 3 marks
Recognition of the difficulties involved	up to 3 marks
Explanation of the difficulties	up to 2 marks

(b) Discuss the view that 'labour is the most important factor of production and therefore the division of labour should be applied to its maximum extent'. [12]

The traditional fourfold classification should be recognised with clarification of division of labour at an individual and national level. While labour may be relatively more important, depending on comparative advantage and production choices, there needs to be understanding of the need to combine factors. Contrasts between countries will illustrate this. Division of labour should increase efficiency but has limits and may result in dependency and vulnerability.

Knowledge of the factors and division of labour	up to 4 marks
Analysis of the importance of labour and division of labour	up to 6 marks} to max of
Discussion of the limitations of the view	up to 6 marks} 8 marks

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