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UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS

GCE Advanced Subsidiary Level and GCE Advanced Level

MARK SCHEME for the October/November 2008 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 candidates, to indicate the requirements of the examination. It shows the basis on which Examiners were instructed to award marks. It does not indicate the details of the discussions that took place at an Examiners' meeting before marking began.

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.

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UNIVERSITY of CAMBRIDGE International Examinations

1 (a) Why can the demand for OTR tyres be described as a derived demand? [2]

Demand is derived when a product is wanted for its input to another product (1) + tyres are needed to equip trucks or contribute to mined output (1)

(b) Explain why the supply of OTR tyres was highly inelastic in 2006. [4]

Inelastic = relatively unresponsive to price change or < 1 (1)
+ explain 3 from no stocks (1), full capacity (1), high cost new investment (1), inability to switch lines (1), no new factories (1) etc.
but copied list = (1) only max of 4

(c) Analyse, with a demand and supply diagram, the change in the market for OTR tyres during 2006. [5]

Major demand increase (1), pressure for significant price rise (1),
+ diagram showing supply is inelastic (1), increase in D (1), new equilibrium with higher price and higher/same output (1)

(d) How might a shortage of OTR tyres affect the productivity of mining companies? [3]

Reduce productivity (1), less output per unit input (1),
+ vehicle breakdown or vehicle check/repair or less mineral production (1),

(e) Discuss whether the shortage of OTR tyres required government intervention. [6]

The focus is whether intervention is desirable not what form it should take.

Intervention might be justified to maintain growth, employment, productivity, balance of trade, market stability and reduce inflationary pressure, It might be particularly important for countries reliant on mining.
However, the problem is short term, in the long run extra production is planned, the market is not a particularly significant one for many countries, intervention might be ineffective with unwelcome side effects, government may not have the expertise to manage the market, may result in government failure. Which government should intervene? (1),
(1) mark per explained element with (4) max for each side of argument.

2 (a) Explain the characteristics required by money if it is to carry out its functions effectively. [8]

Money functions as a medium of exchange, a unit of account, a store of value and a means of deferred payment. It must be acceptable, recognisable, durable, divisible, uniform, scarce, convenient and stable in value. The characteristics are needed to make it operate effectively.

Knowledge of functions	up to 2 marks
Knowledge of characteristics	up to 2 marks
Explanation of links	up to 4 marks

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(b) Discuss whether a country should welcome a period of deflation (negative inflation). [12]

Price deflation is a reduction in the general price level and may occur when economic activity is depressed or the economy is in a slump/recession. The benefits from it go to creditors and fixed income earners who gain in real terms. It will also help with international price competitiveness and may improve the balance of trade position. Against this confidence and profit levels may reduce, leading to lower output and more unemployment. The real burden of government debt will increase and economic growth may be checked. Government interest rate policy measures may become ineffective. Japan's experience has shown a number of these drawbacks. Generally mild inflation is thought best.

Understanding of deflation	up to 4 marks
Analysis of the effects of deflation	up to 6 marks} to max of
Discussion of the desirability of the effects	up to 6 marks} 10 marks

3 (a) Explain the market failure which arises from the characteristics of public goods. [8]

Public goods are non-excludable and non-rival and include defence and street lighting. The problem is that they cannot be supplied by the market mechanism as a price cannot be set because of free riders. They will be underprovided if a non market organisation does not intervene to reflect the needs of society.

Knowledge of the nature of public goods	up to 4 marks
Explanation of the resulting problem for provision	up to 4 marks

(b) Discuss whether the use of cost benefit analysis helps to improve economic decision making. [12]

Cost benefit analysis (CBA) attempts to evaluate the social costs and social benefits of investment in deciding whether an investment is worthwhile. It involves identifying, valuing and judging relevant costs and benefits. It takes a wider view than investment appraisal which concentrates on private profit. The decision is more comprehensive and should be a more accurate representation of society's welfare. It may however not be accurate since, the decisions are subjective, it is difficult to value the savings and costs and to decide which are to be included. It should however provide better information to help improve the decision making.

Understanding of the method of CBA	up to 4 marks
Analysis of the effectiveness of CBA	up to 6 marks} to max
Discussion of the usefulness of CBA	up to 6 marks} 10 marks

4 (a) How might opportunity cost help to explain the pattern of international trade? [8]

Opportunity cost is the sacrifice of the next best outcome in taking a decision. International trade is based on comparative advantage and is determined by specialisation in the product with the lower opportunity cost. Trade is then at an exchange rate between the opportunity costs of the countries involved. This results in greater production, trade and consumption, which reflects differing opportunity costs.

Knowledge of opportunity cost	up to 2 marks
Understanding of the basis of trade	up to 2 marks
Explanation of the link to opportunity cost	up to 4 marks

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(b) Discuss whether the formation of regional trading groups, such as ASEAN and NAFTA, is desirable. [12]

Regional blocs may be free trade areas, customs unions ior economic unions. They encourage free trade between member states and can be bilateral or multilateral. The benefits should be more trade, more choice, lower costs and higher living standards. However small scale agreements may have limited impact, may prevent more beneficial, large scale agreements and cause trade diversion. Smaller members may be at a disadvantage, as may infant industries, to more powerful members and there may be problems with complicated regulations. While these agreements may be better than facing global barriers they may be inferior to wider global agreements.

Understanding of regional trade blocs	up to 4 marks
Analysis of the effects of agreements	up to 6 marks} max of
Discussion of the overall impact of agreements	up to 6 marks} 10 marks

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