UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS

GCE Advanced Subsidiary Level and GCE Advanced Level

MARK SCHEME for the October/November 2007 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.

Mark schemes must be read in conjunction with the question papers and the report on the examination.

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

CIE is publishing the mark schemes for the October/November 2007 question papers for most IGCSE, GCE Advanced Level and Advanced Subsidiary Level syllabuses and some Ordinary Level syllabuses.

1 (a) (i) **Summarise the performance of the US current account balance between 1980 and 2002. [2]**

Mostly in deficit (1), only 3 surplus years (1), cyclical/volatile pattern (1), detail of cycle (1), any 2 points.

(ii) **Explain how the US might have been able to finance the current account position it faced between 1992 and 2002. [3]**

A worsening deficit needs extra funds (1), can come from capital, financial inflows (1), borrowing (1), use of reserves (1) – recognition of position (1), explanation of sources (2).

(b) **Suppose a country has a surplus on its current account. Explain how this may affect its exchange rate. [3]**

Fall in supply of domestic currency to buy imports (1), rise in demand for domestic currency from sale of exports (1), S and D changes cause exchange rate to appreciate (1).

(c) (i) **Outline how a depreciation of a country's exchange rate may affect its current account balance. [3]**

Cheaper exports raise revenue (1), dearer imports cut expenditure (1), current account improves (1), credit Marshall Lerner (1) and J curve (1), to max 3 marks.

(ii) **Use Fig 1 and Fig 2 to analyse whether this expected effect of an exchange rate depreciation occurred for the US between 1980 and 2002. [3]**

Support: broadly weaker $ coincided with improving current account 1987-91 (2), weak values gave surplus 1980/1 and 1991 (2) but possible time lag (1), exceptions e.g. 1985-7, 1992, 2002 (1), to max 3 marks.

(c) **Discuss whether a government should try to fix its foreign exchange rate. [6]**

for: e.g. stability to encourage trade and investment, own priorities e.g. exports from undervaluation, encourages responsible domestic policy.
against: e.g. resists market pressures, requires reserves, deflationary policies, inappropriate value set.
1 side to max 4 marks, a well explained argument up to 2 marks.

2 (a) Explain how an equilibrium price for a product is established in the market and how it may change. [8]

Equilibrium is when D=S and there is no tendency to change. Disequilibrium positions (QD more or less than QS) are corrected by responses of consumer and producer, which alter price. New equilibriums are created when changes in conditions cause shifts in D and S. This may be shown with diagrams.

Knowledge of equilibrium	2 marks
Correction of disequilibriums	3 marks
Setting of new equilibriums	3 marks

(b) Discuss whether or not a firm's revenue would increase, in response to price and income changes, if the price elasticity and income elasticity of demand for its product became highly elastic. [12]

PED and YED measure the responsiveness of demand to changes in those variables. Highly elastic means a significantly more than proportionate response (greater than 1). Highly elastic PED means increased revenue with price cuts and decreased revenue with price rises. The outcome depends upon pricing policy and the nature of the product e.g. substitutes. Highly elastic YED means more than proportionate increase when incomes rise (prosperity) but more than proportionate fall with falling incomes (recession). The nature of the product, normal/inferior and economic conditions will determine YED outcome.

Understanding of PED, YED and highly elastic	4 marks
Discussion of PED case	4 marks
Discussion of YED case	4 marks

3 (a) Explain how resources are allocated in a market economy. [8]

Market economy means free market forces and limited government. Resources are the factors of production. The actions of producers, consumers and factor owners influence operation of market as they follow maximising behaviour. Demand and supply set price so influencing profits and affordability, which determines the employment of factors between alternative activities.

Knowledge of market and factors of production	3 marks
Understanding of motives	2 marks
Explanation of link to factors	3 marks

(b) Discuss, with the aid of a demand and supply diagram, the effects on consumers and producers when the government introduces an indirect tax on a good. [12]

An indirect tax e.g. VAT, GST shifts the S curve to the left with the tax incidence split between the consumer and producer, depending on the PED and PES. The consumer will pay a higher price and purchase less, the producer will receive less company income and supply less. Different elasticities of demand and supply will cause the burden to split differently between the consumer and producer.

Meaning and diagram effect of indirect tax	4 marks
Analysis of the impact on two groups	4 marks
Discussion of the different share of tax burden	4 marks

4 (a) Explain, with examples, why labour productivity might vary between countries. [8]

Labour productivity is output per worker (total output/workers) or per hour. It depends upon the amount and quality of capital, skill, education, supporting infrastructure, technology and attitudes. More developed economies e.g. Japan, with skilled labour forces, automated systems and efficient equipment will be more productive than developing economies e.g. Bangladesh relying on manpower with limited quantities of other productive factors.

Meaning of productivity	2 marks
Understanding of influences on productivity	3 marks
Explanation of examples	3 marks

(b) Unemployment can be measured by the claimant count or the labour force survey. Discuss the relative reliability of these two measures. [12]

Claimant count identifies those who receive unemployment benefit. The labour force survey is a return from a sample of those who are available for and seeking work while currently without work. This is the ILO definition. Claimant may include those not unemployed (fraudulent) and miss those unemployed (not entitled to benefits) and would give an unreliable result, although it is cheap and quick to calculate. Benefits may not be equally available between countries. LFS may include some of the groups missed by the claimant and gives international comparability. It is more expensive if done properly and may be subject to sampling errors but is thought to be more accurate.

Understanding of the two methods	4 marks
Discussion of claimant method	4 marks
Discussion of LFS	4 marks