

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

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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

