

CAMBRIDGE INTERNATIONAL EXAMINATIONS

Pre–U Certificate

MARK SCHEME for the May/June 2014 series

9772 ECONOMICS

9772/01

Paper 1, maximum raw mark 80

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, which would have considered the acceptability of alternative answers.

Mark schemes should be read in conjunction with the question paper and the Principal Examiner Report for Teachers.

Cambridge will not enter into discussions about these mark schemes.

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**Section A
Multiple Choice
Answer Key**

<i>Question Number</i>	<i>Key</i>	<i>Question Number</i>	<i>Key</i>
1	B	16	A
2	B	17	B
3	C	18	B
4	A	19	D
5	B	20	B
6	D	21	A
7	D	22	C
8	C	23	B
9	D	24	B
10	C	25	A
11	B	26	C
12	C	27	C
13	C	28	C
14	B	29	D
15	A	30	C

Section B

- 1 (a)** The value of the output produced in an economy [1] in a given time period. [1]

Obviously more rigorous definitions e.g. the value of all newly produced final goods and services produced in an economy within a given time period, will also get the marks to a maximum of 2 marks.

- (b) (i)** Net Property Income from abroad. [1]

Again, if candidates differentiate between GDP being a territorial measure and GNI being a measure of the output of a nation's factors of production, irrespective of location, this gets 1 mark.

- (ii)** Candidates should identify one relevant factor, such as the repatriated profits of foreign owned firms. Thus BP refineries located overseas, who repatriate their profit to the UK, would be one such example.

[2]

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2 (a) For an accurate explanation:

The International Labour Organisation (ILO) measure of unemployment defines someone as unemployed if they are out of work but have been looking for a job in the past month, and are ready, willing and available to start work in the next fortnight. [2]

Only 1 mark will be awarded for definitions that make no reference to the time periods.

(b) (i) ILO Measure: $2,500,000 / (29,000,000 + 2,500,000) \times 100 = 7.94\%$ [2]

(ii) Any valid point: it allows for easier international comparability; it might be a more accurate reflection of the natural rate of unemployment; it gives a 'truer' picture of the amount of slack in the labour market. [1]

3 (a) One mark for each example: tariffs, non-tariff barriers, reducing domestic inflation below that of a nation's trading partners. Award one mark for each valid example to a maximum of two marks. [2]

(b) Because in the short-run, the elasticities of demand for exports and imports are likely to be considerably less elastic than they are in the long-term. Candidates need to demonstrate an understanding that in the short-run, the quantity of exports and imports demanded does not change or highlight how price elasticity of demand figures show this [2]. For explaining why this might be the case, because of pre-agreed contracts, forward buying, and difficulties in locating new sources of supply [1]. If candidates mention that the statement will only be true if the Marshall-Lerner condition holds, then award [1]. Identification of the J-curve effect and illustration via a clearly explained diagram can get 3 marks. [3]

4 (a) A definition of comparative advantage, provided that the candidate mentions that a country can produce a given good at a lower opportunity cost than another country [1]. Calculation of the respective opportunity costs – in Country A, 1 unit of X costs 1 unit of Y; Country B, 1 unit of X costs 4 units of Y [1]. Identification that Country A has a comparative advantage in the production of Good X [1].

[Maximum of 3]

(b) Award a mark for any valid point which draws upon the 'unrealistic' nature of the theory of comparative advantage and which may negate the ability of a nation to exploit it: imperfect factor mobility within an economy; protectionism; transport costs, non-homogenous products; imperfect information.

[Maximum of 2]

[Total: 20 marks]

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Section C

Answers should be primarily assessed on the basis of good economics, clearly explained and/or illustrated.

- 5 (a) What is meant by the term ‘transition economies’ (Extract 1 line 13)?

[2]

	Knowledge
2 marks	Good understanding of ‘transition’ relating to moving from one market system to another, perhaps with reference to the move from a centrally planned economy to a free market economy.
1 mark	Partial understanding that a ‘transition economy’ involves a shift of emphasis, but perhaps looking from a perspective of industrial policy to shift production from one sector to another or to switch the mix between public and private sector activity.
0 mark	No relevant understanding.

Candidates should be rewarded for reference to appropriate examples of ‘transition economies’.

- (b) Using Table A, calculate the total percentage increase in the number of entrepreneurs in the Cuban economy as a proportion of the workforce between 2007 and 2012. Briefly comment on the implications of this for the productivity of the Cuban economy.

[3]

	Application	Analysis
2 marks		Good explanation of the role of entrepreneurs as risk-takers and innovators with an incentive to increase productivity.
1 mark	Accurate use of the data to identify that the number of entrepreneurs as a proportion of the total workforce has increased from 3% (2007) to 8% (2012).	Partial explanation of the role of entrepreneurs.
0 mark	Failure to reach correct answer, irrespective of any accurate intermediate working.	No relevant or very limited explanation.

Candidates should be capable of calculating the percentage change in the proportion of entrepreneurs, and should go on to consider why this is likely to boost productivity.

Answers which relate the incentive to innovate to the profit motive and compare this with the lack of incentive for state-owned firms and individual state employees to innovate to the same degree, should be rewarded.

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An answer which suggests that in the short-term, productivity might fall because of a lack of entrepreneurial experience or a lack of the appropriate institutions but that it is likely to improve in the medium-term, should also be awarded 2 marks for analysis.

- (c) Extract 1 states that ‘Gone are the days of the state fixing prices...’ (lines 15–16). Using a supply and demand diagram, explain the likely effects of removing a price ceiling and allowing the market to determine the price of a good.

[5]

	Knowledge	Application	Analysis
2 marks		Good, accurate application to price liberalisation. Must be aware how excess demand at the previous price will lead consumers to bid up price.	Good explanation of the effects of removing a price ceiling through a diagram and clear quantification of the price increase.
1 mark	Understanding of the term price ceiling.	Some awareness that price liberalisation is likely to bid up price, will not identify what causes this.	Partial explanation, but there may be errors and omissions and the price increase might not be quantified.
0 mark	No or limited understanding of the term price ceiling.	No identification of how the removal of a price control will affect the market.	No meaningful analysis of how the removal of the price ceiling will affect the market.

Candidates might consider issues such as:

- The implication that the term ‘an effective price ceiling’ means that the maximum price has been fixed below the price that would exist in the free market.
- The fact that it is excess demand that is responsible for bidding up the price of the good.
- The fact that if the good in question is a factor input, any rise in its price has implications for the price of consumer goods and services.
- The fact that it is possible that some firms might be capable of cutting costs thus defraying some of the price rise that might be likely to occur.

Candidates who draw and explain a price floor will score a maximum of two marks.

- (d) Using the information provided and your own knowledge, evaluate which of the disadvantages of centrally planned economies highlighted in Table 1, in your view, is the most significant.

[10]

	Analysis	Application
6 marks		Clear evidence of evaluation and excellent awareness of the relative strengths of the arguments given.

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5 marks		Clear evidence of evaluation and very good awareness of the relative strengths of the arguments given.
4 marks	Good explanation of a suitable range of relevant issues within a clear structure.	Clear evidence of evaluation and good awareness of the relative strengths of the arguments given.
3 marks	Reasonable explanation of a limited range of relevant issues: some structure to the answer.	Some evidence of evaluation and/or limited awareness of the relative strengths of the arguments given; may well have no final summary.
2 marks	Partial explanation given: a limited or unstructured answer.	Some evidence of evaluation but no clear conclusion.
1 mark	Partial explanation given; a very limited answer.	Limited evaluation.
0 mark	No relevant explanation.	No evaluation.

Analysis

Answers without direct reference to the issues raised in Table 1, will be awarded a maximum of 2 marks.

Candidates are permitted to choose any of the disadvantages listed in Table 1: the opportunity cost of bureaucracy, the absence of the price mechanism, the lack of incentives, the lack of consumer sovereignty and explain why it is such a disadvantage relative to the others. Although it is likely that most candidates will choose the absence of the price mechanism and might suggest that the lack of incentives and the consumer sovereignty largely stem from this, this is not required to get 4 marks. As long as it is clear that the candidate is aware of many of the adverse implications of the factor they highlight, they will get credit for this.

Evaluation

Issues discussed in evaluating the relative importance of the disadvantages of centrally planned economies may include:

- The bureaucratic costs of central planning – the extent to which being the sole employer is unfeasible, the petty officialdom associated with regulating sales of mobile phones, computers and DVDs and so on might be cited as examples.
- Difficulties involved in the pricing of goods and services – candidates might highlight the difficulties involved in this, perhaps with reference to the price of bread in Russia or the scale of the shadow economy.
- The degree to which the lack of incentives for workers and firms to be efficient is apparent in the difficulty with which the public sector was able to employ the efficient quantity of labour, and the implication that there are a large number of unprofitable state-owned businesses.
- Whether limiting consumer choice – e.g. to have a mobile phone or not – is a significant detriment of centrally planned economies.

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For each of the areas mentioned above, a clear and full appreciation of the relative merits of at least two of the issues mentioned above or similar, is needed for an award of all 6 evaluation marks.

Further issues discussed in evaluating which disadvantage of centrally planned economies is the most significant may include:

- What is 'overall' welfare; isn't aggregate welfare simply the sum of individual welfare, and why the state isn't best placed to judge what maximises welfare?
- The issue of taking account of social costs and benefits – subsidising food might imply that governments attempt to do this, but candidates might highlight the difficulties involved in this, perhaps with reference to the price of bread in Russia or the scale of the shadow economy.

Candidates do not need to refer to both disadvantages and advantages but may choose to look to the latter two, highlighting why the disadvantages may stop centrally planned economies from experiencing their 'supposed' advantages.

It is likely that the best candidates will steer away from highlighting one disadvantage and will instead highlight the fact that many of them are interlinked. They might suggest that the transition from central planning to the free market is indicative of this or that different disadvantages are more/less important dependent upon the prevailing circumstances.

- (e) 'Teachers, accountants and doctors are now working as waiters in Havana' (lines 47–48). With reference to the Extracts and your own knowledge, evaluate the effects on the labour market of movement towards a free market in Cuba.

[10]

	Analysis	Evaluation
6 marks		Clear evidence of evaluation and excellent awareness of the relative strengths of the arguments given.
5 marks		Clear evidence of evaluation and very good awareness of the relative strengths of the arguments given.
4 marks	Good explanation of a suitable range of relevant issues within a clear structure.	Clear evidence of evaluation and good awareness of the relative strengths of the arguments given.
3 marks	Reasonable explanation of a limited range of relevant issues: some structure to the answer.	Some evidence of evaluation and/or limited awareness of the relative strengths of the arguments given; may well have no final summary.
2 marks	Partial explanation given: a limited or unstructured answer.	Some evidence of evaluation but no clear conclusion.
1 mark	Partial explanation given; a very limited answer.	Limited evaluation.
0 mark	No relevant explanation.	No evaluation.

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Analysis

There are a number of ways to score four marks on this question.

For example, drawing a monopsony diagram, explaining that in a centrally planned economy the state is the dominant employer, and comparing this to a competitive market, will go a long way towards gaining full marks.

Candidates should also be aware that the fact that ‘Teachers, accountants and doctors are now working as waiters in Havana’ reflects the fact that these people, who in free market economies would earn more in their existing occupations than waiters, have chosen to work in the private sector because the pay and working conditions are better. This implies that wages in the state sector have been held below the equilibrium level, and they might infer that given the lack of state revenues, this is unlikely to change in the near future.

However, if people are increasingly free to choose their occupation, then many state sector workers might seek jobs as waiters thus driving wages down in this sector. However, it will also be the case that other areas where private enterprise is prevalent will seek to offer higher wages to attract the most qualified/skilled candidates rather than be compelled to have state-determined wages.

In short, wages will increasingly become determined by the marginal revenue product of the individual worker, and workers will become increasingly aware that their labour has a market-determined value.

Some candidates might go as far as to suggest that if wages are increasingly determined by market forces, there might be a number of other effects: more people might opt for self-employment, employers might initially be advantaged relative to employees, and that whilst this might initially create imperfectly competitive labour markets it could also encourage the formation of trade unions in the longer term. Further, if average wages rise, then there might be less migration from Cuba to the United States and, indeed, some Cubans might return to their homeland.

In short, the answer should focus on the fact that allowing the movement towards the free market will allow the functions of price to help allocate resources in the most efficient fashion, and that there are a number of consequences of this. This is a very open-ended question and candidates should be rewarded for good economics.

Evaluation

Issues likely to be discussed are likely to include:

- The extent to which the reintroduction of the free market will alter the labour market: this depends upon the extent to which the state previously regulated Cuban wages and whether any wage ceilings were significantly below the equilibrium wage.
- Whether the public sector wages will rise under these circumstances: the state is likely to be relatively poor but under the free market, and according to the passage, the number of public sector employees is going to fall and thus, some state employees may now receive higher wages.
- The fact that the initial move to the free market may see a period of dislocation where firms/workers struggle to adjust to market norms; under these circumstances there might be short-run unemployment.
- Whether the market reacts so that workers are redeployed in the most profitable sectors, as economic theory would suggest, or reasons why this might not take place – e.g. the relative occupational immobility of labour.

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- The various implications of movement to a free market on individual labour markets – what is going to happen to the market for waiters in relation to the market for teachers? Some candidates might suggest that decisions to work in a particular sector depend upon more than the salary being offered.
- Recognition of the fact that some firms will try to avoid the risk of high levels of staff turnover and look to incentivise its workers by offering efficiency wages which might be above the free market equilibrium.

A clear and full explanation of any two of the above or similar issues is needed to award all 6 evaluation marks.

Candidates should be rewarded for engaging directly with the question – the impact of the free market is likely to have a variety of consequences for firms, workers and the economy as a whole. Thus, candidates should be rewarded for the quality of their argument in support of either case rather than for adopting a particular position.