Skoolumy

CAMBRIDGE A LEVEL ECONOMICS TOPICAL ESSAY QUESTIONS

ECONOMIC PROBLEM, BASIC QUESTIONS AND TERMS OF TRADE

PAST QUESTIONS

1. (a) Explain what might cause a favourable movement in an economy's terms of trade. [8]

(b) Discuss whether overall a favourable movement in an economy's terms of trade would be likely to have positive or negative effects on the economy. [12]

2. (a) Explain the three economic questions that all economies face because of the basic economic problem. [8]

(b) Discuss whether the price mechanism is an effective way to solve the basic economic problem. [12]

3. (a) Explain two possible causes of a change in the terms of trade in an economy and consider which of these causes is likely to be more important for low-income countries. [8]

(b) Assess the extent to which different tools of protection can impact on the terms of trade in an economy. [12]

4. (a) Explain the difference between the terms of trade and the balance of trade in goods and consider whether an economy should be more concerned about its terms of trade than its balance of trade in goods. [8]

(b) Assess whether a rise or a fall in the terms of trade will benefit the macroeconomic performance of an open economy that is heavily dependent on international trade. [12]

MARK SCHEME

Table A: AO1 Knowledge and understanding and AO2 Analysis

Level	Description	Marks
3	• A detailed knowledge and understanding of relevant economic concepts is included, using relevant explanations. Explanations are supported by examples, where appropriate. • The response clearly addresses the requirements of the question and explains economic issues, and fully develops these explanations. • Analysis is developed and detailed and makes accurate and relevant use of economic concepts and theories. Where necessary, there is accurate and relevant use of analytical tools such as diagrams and formulae, and these are fully explained. • Responses are well-organised, well-focused and presented in a logical and coherent manner.	6–8
2	• Knowledge and understanding of some relevant economic concepts is included, using explanations and examples that are limited, over-generalised or contain inaccuracies. • The response addresses the general theme of the question and the relevant economic issues, with limited development. • Analysis is generally accurate with some development but little detail. Uses analytical tools such as diagrams and formulae where necessary. Use of these tools is partially accurate or not fully explained. • Responses are generally logical and coherent but are sometimes lacking in focus or organisation.	3–5
1	• A small number of relevant knowledge points are included and the response is limited by significant errors or omissions. • The response has little relevance to the question. • Analysis where provided is largely descriptive. Use of analytical tools such as diagrams and formulae, where necessary, may contain significant errors or be omitted completely. • Responses show limited organisation of economic ideas.	1–2
0	No creditable response.	0

Table B: AO3 Evaluation

Level	Description	Marks
2	• Provides a justified conclusion or judgement that addresses the specific requirements of the question. • Makes developed, reasoned and well-supported evaluative comment(s).	3–4
1	• Provides a vague or general conclusion or judgement in relation to the question. • Makes simple evaluative comment(s) with no development and little supporting evidence.	1–2
0	No creditable response.	0

1. (a) For knowledge and understanding of the terms of trade. [Up to 4 marks]

For application to show how changes in the price of exports relative to the price of imports cause a favourable movement in the terms of trade. [Up to 4 marks]

(b) For analysis of the impact of a favourable change in the terms of trade:

• Up to 6 marks for the possible positive effects.

• Up to 6 marks for the possible negative effects. [8 marks maximum]

For evaluative comment upon the 'overall' aspect of the question. [Up to 4 marks]

2. (a) The basic economic questions are what to produce (the selection), how to produce (the methods) and how to distribute (the consumers). These are the result of scarce resources and unlimited wants. Scarcity exists and makes choices necessary and this is found in all types of economy.

Understanding of the prevalence of scarcity up to 2 marks

Explanation of the basic economic questions up to 6 marks

(b) The price mechanism is a feature of the free market and operates through demand and supply and the self interest of individuals, government action is minimised. This has the benefits of incentive, efficiency, innovation, choice and consumer sovereignty. Against this there may be market failure including inequality, lack of public and merit goods, externalities and instability. Depending upon the degree of failure the mechanism may be more or less effective. The price mechanism does not solve the basic economic problem but is thought to be effective when operating efficiently.

Understanding of the price mechanism up to 4 marks

Analysis of its effectiveness up to 6 marks } to max

Discussion of its limitations up to 6 marks } 10 marks

3. (a) up to 3 marks for AO1 Knowledge and understanding up to 3 marks for AO2 Analysis

up to 2 marks for AO3 Evaluation.

AO1 Knowledge and understanding (max 3 marks)

• Explanation of what is meant by the terms of trade i.e., the ratio of export price index to the import price index. (1)

• It measures the number of exports that have to be sold to buy a given number of imports. (1)

• Terms of trade are said to improve when the ratio increases and / or to deteriorate when the ratio falls. (1)

AO2 Analysis (max 3 marks)

• The two main causes of changes in the terms of trade occur e.g., when there is an increase in export prices and a fall in import prices. Such changes are often the result of changes in the demand for exports and the demand for imports. (1)

• Low-income countries are more likely to export primary goods and to import manufactured goods. The demand for primary goods may be lower than that for manufactured goods when income rises, e.g., for agricultural goods, so import prices may fall and terms of trade deteriorates. (1)

• However, commodity prices such as oil may have an inelastic demand and prices may rise leading to an improvement in terms of trade. (1) .

AO3 Evaluation (max 2 marks)

For evaluation that considers the significance of changes in terms of trade for low-income countries that are producers of food stuffs and similar products compared to the benefits for low-income countries that have exports of products such as minerals that are in high demand in high-income countries. **Reserve 1 mark for a justified conclusion.**

Please use a text box to show the mark split e.g., 3 2 1

AO1 Knowledge and understanding 3

AO2 Analysis 3

AO3 Evaluation 2

(b) AO1 and AO2 out of 8 marks. AO3 out of 4 marks.

Indicative content

Responses may include:

AO1 Knowledge and understanding and AO2 Analysis

• An explanation of what is meant by tools of protection.

• Explanation of the different tools of protection and how they may impact the terms of trade.

• Examples include tariffs which are used to increase import prices which will reduce the terms of trade but may improve them if domestic producers including infant industries are encouraged to invest and build up demand and increase export prices. However, retaliation and inelastic PED for imports may reduce the positive impact.

• Other examples include import quotas, embargoes, exchange rate manipulation etc. At least one additional tool should be explained and analysed in terms of its advantages and disadvantages in relation to its impact on the terms of trade.

Level 1 responses will be assertive and lacking in explanations / mainly descriptive and/or or mainly lacking in relevance to the question.

Level 2 responses may contain some inaccuracies and will be one sided. Analysis will be explained at least in part and will be largely relevant to the question.

Level 3 responses will consider alternative policies / concepts etc. and will be balanced. Explanations of points raised will be offered and will be accurate and relevant to the question.

AO3 Evaluation

Evaluation must focus on the impact of the tools of protection on the terms of trade. This should lead to a justified conclusion.

Accept all valid responses.

A one-sided response cannot gain any marks for evaluation.

Please use a text box to show the mark split e.g., L2 5 L1 2

AO1 Knowledge and understanding and AO2 Analysis 8

AO3 Evaluation 4

4. (a)

up to 3 marks for AO1 Knowledge and understanding.

up to 3 marks for AO2 Analysis

up to 2 marks for AO3 Evaluation.

AO1 Knowledge and Understanding (max 3 marks)

The term of trade is a numerical measure of the relationship/ratio between export and import prices (1) with an accurate formula showing the measure as an index (1) whereas the balance of trade in goods measures the revenue earned from exports of goods minus the expenditure on imports of goods (1)

AO2 Analysis (max 3 marks)

Analysis must consider issues concerning both the terms of trade and the balance of trade in goods. These may include:

• Up to 2 marks for an analysis of the effects of changes to the terms of trade e.g., relative change in competitiveness, increase in cost-push inflation, effects on balance of trade in goods and services.

• Up to 2 marks for an analysis of the effects of changes to the balance of trade e.g., an increase in the demand for exports ceteris paribus may lead to an increase in the balance of trade, impact on employment levels, economic growth, inflation.

MAX 3 marks overall

AO3 Evaluation (max 2 marks)

Evaluation should use relevant analysis to consider the importance of both measures and make a judgement as to which one may be of most concern to an economy (1). Reserve one mark for a justified conclusion (1).

AO1 Knowledge and understanding 3

AO2 Analysis 3

AO3 Evaluation 2

(b)

AO1 and AO2 out of 8 marks. AO3 out of 4 marks.

Indicative content Responses may include:

AO1 Knowledge and understanding and AO2 Analysis

Better answers will examine the impacts on the wider economy i.e., employment, price stability, economic growth as well the on the current account. Reference will also be made to the dependency on international trade.

For a rise in the terms of trade:

- This may lower inflation if raw material import prices are lower.
- Depending on price elasticity of demand, it may lead to economic growth if the income earned from exports increases and a boost to employment.
- It may however lead to lower economic growth if it leads to a current account deficit.

For a fall in the terms of trade:

- Exports may be boosted, and this may lead to higher economic growth.
- It may reduce a current account deficit.
- It may however be a sign of a weak economy with exports that are less in demand and therefore lead to lower economic growth.
- If imports are price inelastic, this may lead to import cost-push inflation if the economy is highly dependent on imported goods.
- **Answers which do not refer to the heavy dependence on international trade cannot gain more than L2.**
- **Answers which only refer to a rise or a fall in the terms of trade cannot gain more than L2.**
- **At least one negative effect in addition to positive effects (either for a rise or a fall in the terms of trade) should be considered within the analysis to gain lower L3.**

AO3 Evaluation

• Evaluation should consider both price elasticity of demand for exports and imports and the dependency on international trade. **N.B. reference to the Marshall-Lerner condition may be rewarded but must not be expected as that is an AL topic.**

• The benefits and drawbacks of both a rise in the terms of trade and a fall in the terms of trade should be carefully considered and compared to form a judgement about their impact on the wider economy.

• This should lead to a considered conclusion about which is **more likely to** be of benefit.

Accept all valid responses.

A one-sided response cannot gain any marks for evaluation.

AO1 Knowledge and understanding and AO2 Analysis 8

AO3 Evaluation 4