

MARKSCHEME

May 2001

ECONOMICS

Higher Level

Paper 3

Section A — Data Response Questions — Paper Specific Markscheme

Question 1: Why the world’s economies are suffering a glut reaction

		Partial Mark	Maximum Mark
(a)	(i) Explain what is meant by the phrase <i>chronic global overcapacity</i> (paragraph 2).		
	• For a superficial statement only in terms of too much output	1	
	• For noting this is a world-wide phenomenon	1	
	• For a more expanded explanation in terms of excess supply / supply in relation to demand	2	2
	(ii) How would you explain the author’s claim that <i>there is too much of everything</i> (paragraph 2) in the world when widespread global poverty exists?		
	• For pointing out that there is not too much in relation to human needs	1	
	• For an expansion of the above in terms of effective demand versus human demand / exclusion of the poor from markets	4	
	• For a suitable discussion in terms of luxury goods / necessities / merit goods / demerit goods / distribution of income within countries / between countries	4	4
(b)	Use the data (paragraph 3) and a separate supply and demand diagram to explain the change in the price of oil from		
	(i) the supply side.		
	• For correctly identifying one or more supply side factors, <i>e.g.</i> new sources of supply, technological improvements	1	
	• For correctly drawing and labelling a diagram showing supply shifting to the right	2	
	• For explaining the shift to the right	1	3
	(Maximum of 1 point if no diagram)		
	(ii) the demand side.		
	• For correctly identifying one or more demand side factors, <i>e.g.</i> low growth in Europe, diversification programmes	1	
	• For correctly drawing and labelling a diagram showing demand shifting to the left	2	
	• For briefly explaining the shift to the left	1	3
	(Maximum of one point if no diagram)		

	Partial Mark	Maximum Mark
(c) Explain how the changing price of oil is <i>destabilising country after country</i> (paragraph 4) in the terms of its effect on the		
(i) balance of payments on current account.		
• For an accurate definition of the current account	1	
• For explaining that		
- a falling oil price will adversely affect the current account of countries which are net oil exporters	1	
- and reduce export earnings	1	
• For explaining that exporting countries will see a deterioration in their terms of trade	2	
• For explaining how the above would be compounded by		
- a relatively inelastic demand for oil	2	
- a falling exchange rate	2	3
(ii) budget deficit.		
• For accurately defining a budget deficit	1	
• For explaining how falling oil prices may adversely affect the revenues and profits of the oil companies and consequently the amount of tax revenue that the government can collect	3	
(Maximum of <i>[2 marks]</i> if discussion is not related to falling oil prices)		
• For explaining the effects in terms of declining public expenditure and consequent effects on the economy	3	3

(d) “Price movements have an important influence on the decision of producers and consumers.”

With reference to the article evaluate the possible impact of changes in oil prices on the allocation of resources within an economy.

Points for discussion might include:

- discussion of the signalling function of prices, *e.g.* through demand switching from oil to other fuels and vice versa as oil prices fall
- discussion of the incentive function of prices, *e.g.* through a rising price of oil and the opening up new sources of supply
- discussion of the rationing function
- possible structural changes as oil exporting countries switch resources to other industries
- impact on related markets, *e.g.* petrol
- significance of taxes on oil
- importance of price elasticity of demand / elasticity of supply / the short and long run
- the differing impacts on oil exporting and oil importing countries

Candidates who use issues from part (c) and relate them to the issue of resources allocation should be given appropriate credit.

Level 0:	No valid discussion.	0
Level 1:	Very few relevant issues recognised with little discussion or basic understanding.	1-2
Level 2:	A few issues recognised with some attempt at discussion or just one issue well-developed.	3-4
Level 3:	Issues well developed with some reference to the data and with sensible evaluation.	5-7

Question 2: Africa in the Aftermath of the Asian Crisis.

		Partial Mark	Maximum Mark
2.	(a) With reference to Item 1, define the following concepts:		
	(i) terms of trade.		
	• For a vague statement saying that it refers to the price of exports and imports	1	
	• For a fuller definition along the lines of ‘the price index of exports divided by the price index of imports, itself expressed as an index	2	
	• For a good intuitive explanation, <i>e.g.</i> How many units of imports can be bought with one unit of exports	2	2
	(ii) trade balance.		
	• For a vague statement that says it refers to trade in goods	1	
	• For a definition along the lines of ‘it is the section of the Balance of Payments that records the balance of tangible/visible imports and exports of physical merchandise/goods	2	2
	<i>Note: No marks should be given to candidates who simply state that it is a section of the balance of payments.</i>		
	(b) Use Item 1 to describe		
	(i) the possible relationship between the terms of trade and the trade balance.		
	• For a vague statement simply saying that both move in the same direction or that there is a positive correlation?	1	
	• For remarking that there could be an inverse or positive relationship depending on price elasticity	2	2
	(ii) what has happened to the debt burden over the period shown.		
	• For merely stating that there has not been a significant change in the debt burden	1	
	• For defining debt service	1	
	• For reference to interest rates	1	
	• For justifying the answer by referring to the debt service ratio	2	2

		Partial Mark	Maximum Mark
(c) Use the data and your knowledge of economics to			
(i) give reasons for recent changes in Africa's terms of trade.			
• For recognising that the value of the ratio has fallen		1	
• For recognising an adverse movement in the terms of trade		2	
• For explaining that this could be due to			
- Africa's heavy dependence on primary commodities which have low income elasticity of demand in MDCs		3	
- lower commodity prices as a result of the global slowdown following the Asian financial crisis		3	4
(ii) explain <i>two</i> possible consequences for Africa arising from the changes in its terms of trade.			
Any two meaningful explanations based on			
• the impact on the balance of payments		2	
• the need to export an ever greater amount in order to buy a given quantity of imports		2	
• Increased export volumes		2	
• Environmental degradation		2	
• Export revenues insufficient to pay for capital goods, medicines, food and other essential imports		2	
• The debt burden could increase, leading to possible IMF intervention or greater debt servicing		2	6
(Award two marks for mention of any one of these bullet points plus up to a further two marks based on the quality of response)			

**Partial Maximum
Mark Mark**

(d) Use the data provided and your knowledge of economics to evaluate future prospects for economic growth in Africa.

Issues that could be raised include:

- evidence of greater macroeconomic stability during the 1990s
 - declining inflation
 - positive trend in the reduction of fiscal balances during the 1990s (unfortunately reversed during 1998 due to the financial crisis in East Asia)
 - reductions in the growth of the money supply
 - positive per capita growth since the mid 1990s
 - FDI increased in 1998 (although there are fears of a reversal)
- economic growth slowed as a result of the slowdown in the global economy
- Africa's heavy dependence on the export of primary products
- the income elasticity of demand for primary products and its effects on commodity prices and terms of trade
- after the rapid growth of the mid 1990s, export expansion lost momentum in 1998
- the burden of external debt, IMF intervention and the HIPC initiative
- the adverse effect of climate *e.g.* El Nino and its effects on agriculture
- civil conflicts and social strife
- The impact of AIDS
- environmental degradation
- recognition of considerable regional variation: Africa is by no means homogeneous, *e.g.* the prospects for South Africa are not the same as for Ethiopia
- role of aid

Reward any other valid points.

Level 0:	No valid discussion	0
Level 1:	Very few relevant issues recognised with little discussion or basic understanding	1-2
Level 2:	A few issues recognised with some attempt at discussion or just one issue well-developed	3-4
Level 3:	Issues well developed with reference to the data and Africa with a sensible evaluation	5-7

Section B Essays: Paper-Specific Guidance

The following comments are intended to provide extra guidance to Assistant Examiners, but they are not meant to be a ‘straitjacket’.

They are meant to indicate some of the main points which the question-setter hoped to elicit, and/or indicate sensible approaches; however, it is often possible for candidates to respond to a question in a way which is unanticipated and yet which contains valid economic arguments, so please keep an open mind.

THE GENERAL MARKING CRITERIA REMAIN THE MAIN BASIS FOR AWARDING MARKS.

Question 3

- (a) **Using suitable diagrams, explain why there is likely to be an absence of long run economic profits in perfect competition.** *[12 marks]*

The explanation might include the following:

- definitions of perfect competition (including its assumptions), economic profit and the long run
- absence of barriers to entry as the principal feature in the elimination of long run economic profits
- short run economic profit is possible within this model, while long run economic profit is not
- description of the process by which long run profits are eliminated
- correctly used and labelled diagrams, incorporated into the response.

If no appropriate diagrams, no more than five marks should be awarded

(b) To what extent might consumers benefit from increased competition between firms?

[13 marks]

Issues that could be raised include:

- factors that influence competition (*e.g.* barriers to entry, number and size of firms *etc.*)
- model of perfect competition and its outcome
 - productive efficiency
 - allocative efficiency
 - lower prices and higher output
 - consumer sovereignty

- general benefits from increased competition
 - lower prices
 - lower production costs
 - a more diverse range of products
 - improvements in quality
 - greater responsiveness to consumers
 - potential for greater innovation and technical change

Note: *Appropriate credit should be given to students who elaborate on the limits of competition, e.g. distribution of income, pollution etc.* Recognise the value of the candidate's critical awareness

Question 4

- (a) Explain how governments can use fiscal policy to redistribute income. [12 marks]**

Possible areas for discussion include:

- explain what is meant by fiscal policy
- explain what is meant by ‘redistribute income’
- a description of the main types of taxes *i.e.* taxes on income, expenditure, inheritance, capital gains *etc.*
- progressive, proportional and regressive taxation
- how income taxes affect the distribution of income
- how taxes on expenditure affect the distribution of income
- how other taxes affect the distribution of income
- role of subsidies and transfer payments
- role of other types of public expenditure, *e.g.* on merit goods

- (b) Evaluate the advantages and disadvantages of policies aimed at reducing income inequalities. [13 marks]**

Candidates’ responses should be organised coherently into advantages and disadvantages.

Possible areas for discussion include:

- effect on resource allocation
- effect on aggregate demand, employment growth and macroeconomic stability
- effect on poverty
- effect on crime, health and social welfare
- issues of justice and fairness
- poverty leading to potential talents being lost
- issues of political stability
- tax evasion and tax avoidance
- impact on tax base and tax revenues
- disincentives of higher taxes on certain groups
 - may lead to less employment
 - may reduce interest in promotion and better qualifications
 - loss of enterprise
- the backward bending supply curve
- taxation and the poverty trap
- higher taxes for certain groups could lead to higher wage demands
- tax cuts for lower paid groups may allow employers to cut their wages
- alternatives such as subsidies, minimum wage, transfer payments

Question 5

“Whether the exchange rate rises or falls there are always losers.”

Evaluate this statement from a domestic and / or a global perspective.

[25 marks]

Candidates can receive full credit for answers based only on domestic perspectives

Definitions that should be included:

- exchange rate
- Appreciation/depreciation; revaluation/devaluation

For currency **appreciation** the following issues could be addressed:

- loss of domestic and international markets as the price of exports increases and the price of imports falls
- the resulting impact on the Balance of Payments
- the Marshall-Lerner condition
- possible falls in domestic output and employment
- possible effects of policies to deal with Balance of Payments deficits
- hot money / capital flows
- effects of cheaper imports on inflation
- de-industrialisation

For currency **depreciation**, the following issues could be addressed:

- effect on domestic and international market shares
- the Marshall-Lerner condition, the J-curve and the Balance of Payments
- possible effects on inflation (cost push and demand pull)
- hot money and capital flight
- terms of trade
- debt repayments / debt servicing ratios and the effect of these on public expenditure and investment
- loss of confidence in the currency
- competitors may devalue to restore competitiveness / possible global instability
- Environmental issues

Question 6

(a) Why have multi-national corporations grown so rapidly in recent decades? [10 marks]

Factors responsible might include some of the following:

- growth of international trade
- pyramidal international division of labour
- profit maximisation strategies, *e.g.* economies of scale, transfer pricing *etc.*
- growth of free trade areas, *e.g.* EU and NAFTA
- advances in communications and information technology
- the marketisation of former communist economies
- the trend towards globalisation
- multinationals and development strategies such as import substitution and export orientated growth

(b) Do multinational corporations help or hinder the less developed countries? [15 marks]

Possible areas for discussion include some of the following:

- providing LDCs with capital and thus stimulating growth
 - diffusion of technological know-how and managerial skills
 - provision of employment and income to areas of absolute and relative poverty, particularly for women
 - the breakdown of economic distortions caused by political frontiers
 - balance of payments effects
 - government tax revenues
 - problems of capital intensive investment
 - outward directed growth and stifling of domestic competition
 - profits outflow
 - widening inequalities between rural and urban sectors
 - exploitation of local labour
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