



MARKSCHEME

November 2002

ECONOMICS

Higher Level

Paper 3

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Section A — Data Response Questions — Paper Specific Markscheme

Question 1 Iceland’s Economy

**Partial Maximum
Mark Mark**

(a) (i) In Item 1 what is meant by the term “GDP % increase on previous year”?

- for recognising in general terms that it is measuring changes in national income
- for some recognition of what the term GDP is
- for recognising in specific terms that it shows by how much in percentage terms the country’s national income has changed

**1
1
2 2**

(ii) From the information given in Item 2 describe what happened to the price level in Iceland during the period 1996 to 2000.

- for saying that the price level has increased
- for saying that the price level increased at a decreasing rate up to 1998
- and increased at an increasing rate from 1998
- but rate of increase slows again from 2000

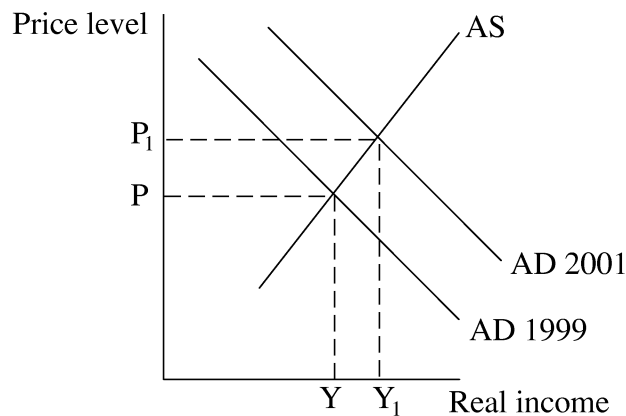
**1
1
1 2**

Please note that this question does ask about the price level: it is the inflation rate that is shown in the chart.

**Partial Maximum
Mark Mark**

- (b) (i) **Draw an aggregate demand / aggregate supply diagram. Shift one of the curves to represent the information given about price and income changes in Items 1 and 2 for Iceland between 1999 and 2001.**

Given that both income and the price level are increasing during the period the simplest appropriate diagram is one showing a shift in the AD line to the right. Expect diagrams with AD curve drawn to left as candidates think that income has fallen.



Alternatively it might be argued that around 99-00 the growth rate falls as the inflation rate rises. This might reflect cost push effects (such as an oil price shock) moving the AS curve to the left, pushing up prices and slowing the economy. Credit should be given to students who argue this in (b) (ii).

for an inaccurate and poorly drawn diagram	0	
for an inaccurate but well drawn diagram	1	
for an accurate but poorly drawn diagram	1	
for an accurate and well drawn diagram	2	2

- (ii) **Explain why you have drawn the diagram in b (i) in the way that you have.**

Marks here should not be based on the correctness of the answer to b (i) as it is not the intention to give a double penalty but rather on the **quality** of their explanation of their diagram.

Level 0 Candidate is unable to explain their diagram.	0	
Level 1 Candidate is able to give some explanation but the explanation has errors / is incomplete.	1	
Level 2 Candidate is able to give a satisfactory explanation.	2	
Level 3 Candidate is able to give a clear and logical explanation.	3-4	4

	Partial Mark	Maximum Mark
(c) For what reasons might an economist be interested in the material given in the three charts?		
The following are points which could possibly be made:		
(i) to obtain information about key macroeconomic objectives such as inflation, unemployment, growth and development	3	
(ii) to provide statistical information for the formulation of government macroeconomic policies	3	
(iii) to identify trends, strengths and weaknesses in Iceland's economy either through time and / or in comparison to other countries	3	
(iv) to test economic theories and relationships	3	3

Candidates should be able to obtain full marks either by making one point well or by making a number of points in less detail.

(d) From the data and from your knowledge of economic theory, explain what you think happened to Iceland's visible trade balance (balance in goods) during the period from 1998 to 2000.

There are good reasons for arguing that the trade balance might have improved or worsened or that it is impossible to determine.

A possible argument for an improvement:

- | | | |
|--|----------|--|
| (i) The table of GDP shows that Iceland's rate of growth is declining compared to that of other OECD countries and so its rate of growth of imports may also be declining. | 3 | |
|--|----------|--|

A possible argument for a worsening:

- | | | |
|---|----------|--|
| (i) Iceland's rate of inflation is shown to be increasing making exports less price competitive and imports more price competitive. | 3 | |
|---|----------|--|

Possible arguments for "impossible to determine" need more information about such things as:

- | | | |
|---|----------|----------|
| (i) Iceland's exchange rate | | |
| (ii) income and price elasticities of demand for exports and imports. | 2 | 5 |

(e) Based on the data in the charts, evaluate the performance of Iceland's economy.

Among the points that candidates might be expected to make are:

- on the favourable side that Iceland

(i) had a low level of unemployment compared to other OECD countries.	2	
(ii) had a higher rate of economic growth up to 1999.	2	

- on the unfavourable side that Iceland's

(i) inflation rate has been higher than that of other OECD countries since 1998.	2	
(ii) growth rate has declined since 1999 to much the same as that of the OECD countries.	2	7

Question 2

	Partial Mark	Maximum Mark
(a) What is the meaning of the following words highlighted in bold in the advertisement and text?		
(i) Manufacturer costs		
<ul style="list-style-type: none"> • the costs of factors of production used by the manufacturer 	2	
<ul style="list-style-type: none"> • equated with price from the factory (but this is not the same thing) 	1	2
(ii) Brands		
<ul style="list-style-type: none"> • a marketing device used by monopolies and oligopolies 	2	
<ul style="list-style-type: none"> • as a means to product differentiation 	2	
<ul style="list-style-type: none"> • and as a feature of non-price competition 	2	2
(b) Use a supply and demand diagram to explain the effect of a sales tax on the price of a 28” Toshiba Widescreen television sold by Intersaver.		
The diagram must be properly labelled and should show the price levels given in the stimulus material:		
<ul style="list-style-type: none"> • a diagram showing two supply curves, with tax as the vertical distance between them, with some explanation 	3	
<ul style="list-style-type: none"> • the diagram properly labelled with the net and full prices shown, with clear explanation 	2	
<ul style="list-style-type: none"> • the diagram, including diverging supply curves to reflect the ad valorem tax, and clear explanation 	1	5
<i>Reward a candidate who realises that elasticity is a factor. Economics teaches us that tax is shared in incidence, so not all the 17.5% would be borne by the consumer in reality.</i>		
(c) Why is Intersaver satisfied with a profit level of 10 % while the traditional High Street Retailer’s profit is 20 %?		
<ul style="list-style-type: none"> • the implication that Intersaver’s profits can be lower because their costs are lower 	2	
<ul style="list-style-type: none"> • an argument which sees Intersaver as accepting normal profit because it is competitive 	2	
<ul style="list-style-type: none"> • an argument which sees the High Street Retailer enjoying large profits through oligopoly, <i>i.e.</i> through exploitation of its market power 	2	
<ul style="list-style-type: none"> • if demand is price elastic, Intersaver might make higher profits through greater sales volumes even though margins are lower 	2	4

	Partial Mark	Maximum Mark
(d) What market structure is represented in a market which contains a number of firms like Intersaver and large established retailers? Justify your answer.		
• for mention of Monopolistic Competition	2	
• for consideration of its main features		
• absence of barriers to entry	1	
• coexistence of large and small firms	1	
• price competition which is to the benefit of the consumer	1	5
But, absence of product differentiations is claimed in this case.	1	

(e) Using the information given in the text and your understanding of business economics, analyse what might happen to the market for domestic electrical goods in the long run.

In the long run we might see the effects of a market which was formerly oligopolistic slowly being transformed into a market in which there is first monopolistic and then movement towards perfect competition. This might be explained by reference to the assumptions of a perfectly competitive market. Candidates might be expected to refer to the progress towards perfect knowledge on the part of consumers which results from the Internet. Online sales also enlarge markets by crossing borders and consumer goods are somewhat homogeneous (though branded) in the sense that they are the same the whole world over. Above all, however, it is the reduction of barriers to entry which is at work here, enabling fairly small business start-ups to compete on price at least with traditional high street retailers. In the long run freedom of entry and exit will force profits down to normal, as the existence of profit attracts new entrants (this is what the advertisement appears to illustrate).

Responses with diagrams should be rewarded as should those which point out the ways in which online companies cannot compete with high street retailers (absence of familiarity of name, absence of personal service *etc.*) Diagrams might be expected to show demand for each individual firm's product shifting left until profits are eliminated.

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

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.

SECTION B

Question 3

(a) **Why is pollution an example of market failure?**

[10 marks]

Candidates should explain that pollution creates negative externalities which is an example of market failure. They should include a standard diagram illustrating that when negative externalities exist, there is a misallocation of resources. Relevant examples should be included.

(b) **To what extent can the market system protect the environment?**

[15 marks]

The following points could be discussed:

- In MDCs, educated consumers are now more aware of environmental problems and are switching to “environmentally-friendly” products and production processes.
- This translates into increased demand for such products (examples could be provided - *e.g.* products which do not use rainforest wood, alternative sources of energy).
- There is also a decrease in demand for products / processes which harm the environment (*e.g.* products which contain CFCs).
- Producers will respond to changes in demand.
- Greater awareness of “sustainable development” may lead to more changes in consumer demand.
- Entrepreneurs seeking to maximise profits will develop more and more environmentally-friendly products.
- Market-based responses to market failure such as taxes / subsidies, tradable permits and the establishment of property rights also illustrate how the market system can protect the environment.
- The market system is based on self-interest and private profit and cannot ultimately protect the environment – incompatibility between private costs and benefits and social costs and benefits.

Question 4

- (a) **What does an economist mean by efficiency in the operation of a firm?** [10 marks]

This calls for basic definitions and requires students to identify and explain **two** key types of efficiency.

- (i) Allocative efficiency occurs where marginal social cost = marginal social benefit;

where $P = MC$.

- (ii) Productive (technical) efficiency occurs

- when firms produce at the lowest cost per unit.
- at the minimum of the average cost curve.

Students may introduce / explain concept of Pareto efficiency but this is not necessary for full marks.

Diagrams should be rewarded.

- (b) **Discuss whether the achievement of efficiency is possible and desirable.** [15 marks]

Students should distinguish between different types of market structure.

- In perfect competition, in the short-run, a firm will be allocatively efficient but not necessarily productively efficient.
- In the long-run, a firm in perfect competition will be productively and allocatively efficient.
- In all the other market structures, neither allocative nor productive efficiency will be achieved.
- *Diagrams are very useful in illustrating these points.*

Allocative efficiency is desirable because welfare is maximised; the economy produces the goods and services most valued by society.

Productive efficiency is desirable because it means that products are being produced at the lowest cost possible; this represents the most efficient allocation of resources.

However, efficiency may not be desirable because:

- firms which **are** efficient (*i.e.* those in perfect competition) may not be able to afford investment in research and development because they cannot earn abnormal profits in the long run.
- such firms do not offer the variety of products because the products are not differentiated.
- although not efficient, a monopolist may produce more than any single firm in perfect competition as a result of economies of scale.

Candidates who write that the whole idea of efficiency is problematic to economists should be rewarded, especially if they substantiate it.

Question 5:

(a) What are the main macroeconomic objectives of government?

[10 marks]

Candidates should identify and explain the goals of

- price stability.
- full employment.
- external viability.
- economic growth.
- (optional) an equitable distribution of income.

(b) Assume the government chooses to pursue *one* of these objectives. Evaluate the possible consequences for the other objectives.

[15 marks]

Candidates should be rewarded for sensible economic arguments which illustrate the trade-offs among policy objectives.

Question 6:

To what extent has the international trading system contributed to economic growth and development in less developed countries?

[25 marks]

- A distinction between economic growth and economic development must be made.
- Some “outward-oriented” countries have experienced high rates of economic growth as a result of their rapidly-expanding exports; however, this has not necessarily contributed to increased development.
- World trade still tends to be dominated by MDCs.
- Many LDCs are heavily reliant on the export of one or two commodities and the importing of manufactured goods; deteriorating terms of trade have harmed both growth and development.
- When LDCs do attempt to industrialise / diversify, they often come up against protectionist barriers in MDCs.
- Increasing liberalisation of trade may lead to problems in terms of “sustainable development”.

*Reward any plausible argument. Candidates might examine a wide range of factors **other** than the international trading system which have contributed to growth and development (e.g. FDI, aid, technology). These should be rewarded.*
