

MARKSCHEME

November 2003

ECONOMICS

Higher Level

Paper 3

Section A — Data Response Questions — Paper Specific Markscheme

Question 1 Over a barrel

	Partial Mark	Maximum Mark
(a) Explain the meaning of the following terms that appear in bold in the article:		
(i) cartel (paragraph 1)		
Award <i>[1 mark]</i> for a definition along the lines of a seller’s organization/monopoly. Award <i>[1 mark]</i> for a definition which also mentions regulating price/output. Both aspects needed for <i>[2 marks]</i> .	1 1	2
(ii) production quotas (paragraph 2).		
• a fixed amount of output allocated to an individual producer	1	
• in a cartel	1	
• in a specified period of time	1	
• with a reference to the text	1	2
(b) Use a supply and demand diagram to show how OPEC might keep prices within its “the target range of \$22 – \$28 per barrel”. (paragraph 2)		
An S & D diagram with a price range of \$22 to \$28 being shown is expected. Diagram should show OPEC shifting supply curve to right in response to increases in demand that threaten to raise the price above \$28 and shifting supply curve to left in response to decreases in demand that threaten to reduce the price below \$22.		
However be open to other possibilities and award marks accordingly.		
Award up to <i>[3 marks]</i> for a clearly drawn and well labelled diagram	3	
Award up to <i>[3 marks]</i> for a good explanation of the diagram up to a maximum of <i>[5 marks]</i> .	3	5

	Partial Mark	Maximum Mark
(c) With reference to the concept of price elasticity of demand, explain the likely consequences of oil price changes on the oil revenues of OPEC countries.		
• For explanation of the inelastic demand for oil	2	
• For observing that a fall in the price will lead to a fall in revenue	2	
• For observing that an increase in the price will lead to an increase in revenue	2	
• For a well drawn diagram showing changes in revenue	3	4
Be prepared also to award up to [3 marks] for responses which argue from the premise that the demand for oil is price elastic.		3
(d) Why are governments generally hostile to cartels? Illustrate your answer with a suitable diagram.		
Responses are expected to use the usual monopoly diagram showing a downward sloping AR and MR and U shaped ATC and MC curves. However be prepared to give credit for other alternatives, <i>e.g.</i> S & D.		
Award up to a maximum of [5 marks] .		
Among possible points that might be made against cartels are:		
• higher prices than competitive markets		
• lower output than competitive markets		
• productive and allocative inefficiency.		
Among possible points that might be made in favour of cartels are:		
• possible advantages of economies of scale		
• encouragement to invention and innovation		
• benefits of price discrimination.		5
A maximum of up to [3 marks] should be awarded for responses which have no diagram.		3

**Partial Maximum
Mark Mark**

(e) Using the information in the article and your knowledge of economic theory, discuss why OPEC might not succeed in stabilizing prices “within that comfortable \$22 – \$28 band”.

Much of the information concerns demand factors, but to obtain maximum marks, both supply and demand factors should be considered. Award up to **[5 marks]** if only supply or demand factors are considered. Award a maximum of **[5 marks]** to responses which do not explicitly use the information from the text.

Among supply factors:

- failure of price/output fixing agreements due to members non-compliance
- behaviour of non-OPEC producers such as Russia or USA
- variations in supply due to political factors such as sanctions on Iraq or civil unrest or war
- weak supply figures - unreliability of data

Reference to text:

“supply figures so weak”

Among demand factors:

- changes in general level of economic activity in consumer countries which affect the demand for oil - *i.e.* When GDP falls, oil consumption decreases
- weather in consuming countries
- exchange rate changes
- energy policies in consuming countries (*e.g.* taxes on oil)

References to text could include:

“global demand so unreliable”

Asian economic crisis

slowing US economy

northern hemisphere winter

Level 0:	No valid points are made.	0
Level 1:	Some valid points are mentioned in terms of either supply or demand	1-3
Level 2:	Either some valid points are made in terms of either supply or demand and there are references to the text Or some valid points are made in terms of both supply and demand but there are no references to the text	4-5
Level 3:	Valid points are discussed concerning both supply and demand and there are references to the text	6-7

Question 2

	Partial Mark	Maximum Mark
(a) Define the following terms highlighted in bold in the text:		
(i) Free Trade Area (paragraph 1)		
• a group of countries which agree to remove tariffs and quotas between themselves	1	
• but which maintain their individual external protectionisms against the rest of the world.	1	2
(ii) subsidies (paragraph 4).		
• payment by government to producer	1	
• for example, to a farmer	1	
• in order to reduce costs of production	1	
• in order to support farmers	1	
• or to lower prices to consumers	1	2
(b) With reference to the table, which country or trade bloc		
(i) subsidises its agricultural producers most heavily?		
Award up to a maximum of <i>[2 marks]</i> .		
• in terms of support per farmer – Japan	1	
• in terms of total producer support – EU	1	
• in terms of proportionate income boost to farmers – Japan.	1	2
(ii) appears to have the most efficient agricultural sector?		
Award up to a maximum of <i>[4 marks]</i> .		
• New Zealand	1	
• because its farmers produce the largest share of GDP even though it is a developed country	2	
• because its farmers manage without subsidy	2	
• absence of subsidy means absence of overproduction	2	
• farmers are used to prices determined by free markets	2	
• but, NZ farmers are confined to a small market; US farmers have a huge domestic and NAFTA market in which economies of scale may promote greater efficiency.	2	4
(c) Support per farmer is the same in the USA and EU (see table, row 2). Why then is the increase in farm income from subsidies so much greater in percentage terms in the EU (see table, row 3)?		
Award up to a maximum of <i>[2 marks]</i> .		
• Relative inefficiency of European farmers causes reliance on subsidies which become a larger part of farm incomes	2	
• European farm incomes are lower than US farm incomes so subsidies make a proportionally larger difference.	2	2

(d) Using the article and your knowledge of tariffs and subsidies, explain why the consumers of the USA, Canada and Mexico are described by the author as “the chief victims” of protectionism.

**Partial Maximum
Mark Mark**

Candidates should note how consumers may be victims of protectionism because they:

- pay higher prices for goods with tariffs
- pay higher taxes to finance government subsidies
- face the possibility of retaliation by foreign producers/governments

- no valid points **0**
- one valid point made **1-3**
- two or more valid points made and well-explained **4-6**

6

A tariff and/or subsidy diagram would be very effective and useful in illustrating this (but is not required). Answers making effective use of diagrams should be given top marks. Reward answers which make effective use of the data. Also reward answers which argue an alternative view.

- (e) **A free trade deal with the USA is described as “one of the few measures that could truly transform the whole New Zealand economy” (paragraph 2). Evaluate this claim.**

This is an invitation to write about the gains through trade for a country which might enjoy comparative or absolute advantage in a sector which is already 7 % of its GDP and is joining a free trade area.

If New Zealand farmers who produce without subsidy are allowed free access to a much bigger market through trade, (and the US, Canadian and Mexican market combined is many times the size of the New Zealand market) then trade creation effects and longer term dynamic changes in the structure of the New Zealand economy will be opened up.

Convincing responses about the trade creation effects of joining a free trade area should be rewarded. This could be illustrated with a diagram. Good responses might also argue that if New Zealand came to specialize in agricultural products for export to North America, its ability to do so could be limited by transport costs, and that such specialization might lead to dependency. Candidates in Australia might have particular views on this as Australia too has considered membership of NAFTA.

7

Level 0:	No valid points are made.	0
Level 1:	Some valid points are mentioned in terms of one aspect of the argument.	1-2
Level 2:	Either some valid points are mentioned and explained in terms of one aspect of the argument. Or some valid points are mentioned in terms of both sides of the argument.	3-4
Level 3:	Valid points are mentioned and discussed in terms of both aspects of the argument.	5-7

N.B. An answer which shows how free trade can both help and hurt the New Zealand economy and is able to explain the reasoning would clearly be in level 3.

Section B — Essays — Paper-Specific Markscheme

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

“National policies and international agreements must be implemented in order to reduce global environmental problems.”

(a) Using the concept of market failure, explain the statement above from an economist’s point of view.

[10 marks]

- good responses should include an accurate definition of market failure and negative externality
- top marks should be reserved for incorporating an accurate diagram into the explanation
- should note that goods whose production/consumption emits greenhouse gases are being overproduced
- example(s) should be given (an obvious one might be the use of automobiles)
- the result, (*e.g* global warming), is an external cost being paid by those not necessarily producing/consuming the goods
- reward responses which note that this is an international problem, as the external costs are often borne by people outside the country.

- (b) **With reference to both national policies and international agreements, discuss *three* solutions that could be recommended by economists.**

[15 marks]

[5 marks] per solution.

National solutions could include:

- taxes to reduce supply
- taxes to reduce demand
- legislative bans
- quotas
- advertising/moral persuasion
- “green” (environmentally friendly) taxes.

International solutions:

- tradable permits
- debt relief (debt for nature swap) to reduce the burning of forests
- internationally negotiated agreements on the production of certain products.

Award up to a maximum of **[10 marks]** if only national or international solutions are discussed.

Examiners should be aware that candidates may take a different approach which if appropriate should be fully rewarded.

Question 4

With the help of diagrams

(a) distinguish between demand-pull and cost-push inflation

[10 marks]

- for cost-push inflation, responses should explain the different causes of increases in factor prices
- for demand-pull inflation, responses should identify the different sources of increased aggregate demand
- reward responses referring to the debate between Keynesian and neo-classical economists
- diagrams should be incorporated into the explanations.

Award up to a maximum of **[6 marks]** if no diagram is attempted.

(b) explain which policies would be appropriate to deal with these two types of inflation.

[15 marks]

- demand management policies: fiscal policy and monetary policy
- supply-side policies to increase AS: restrain monopoly power; reduce power of unions, policies to increase productivity; appreciation of exchange rate
- diagrams should be used.

Award up to a maximum of **[10 marks]** if no diagram is attempted.

*N.B. As implied in the band descriptors, an **evaluation** of the policies is needed in order to reach Band 4.*

Question 5

(a) Explain the factors which cause the value of a currency to change under a floating exchange rate.

[12 marks]

- responses should note that any factors which affect the supply or demand of a currency will cause appreciation or depreciation
- to reach the top bands, responses must address both supply and demand factors

Award up to a maximum of **[7 marks]** if no diagrams are used.

(b) To what extent does an appreciation of the currency harm an economy?

[13 marks]

- because the question is framed in the terms “to what extent”, a balanced approach is expected noting that some people suffer under a higher value of the currency (*e.g.* exporters, workers in the tourism industry) but also that some people benefit from an increased value (*e.g.* Importers / people who want to travel abroad)
- the best responses should be able to say that although domestic producers may be harmed by a higher value of a currency, it will force them to be more efficient, thus leading to a more efficient allocation of resources
- the lower cost of imported inputs may reduce production costs in the domestic industry
- greater ability to consume imports may raise living standards

Question 6

Discuss the view that investment in human capital is the most effective way to provide development.

[25 marks]

Responses should address the different ways in which countries/governments/international organizations can “invest in human capital”.

These might include:

- government spending on
 - education
 - training/skills programmes
 - health care/nutrition
 - sanitation
 - provision of water
- policies to redistribute income
- policies to increase mobility of labour
- specific policies to address inequalities between men and women.

In order to successfully answer this question, students must be able to explain the concept of “development”. They may even make some comparison with growth. However, it is necessary that they not simply define development, but that they show how the policies they describe can actually contribute to development.

The command term “discuss” is one which is designed to elicit evaluation. Therefore, to reach top band, it is necessary that a “critical approach” is adopted. Candidates should evaluate the view that investment in human capital is the most effective way to provide development versus other ways of achieving development.
