

MARKSCHEME

November 2005

ECONOMICS

Higher Level

Paper 3

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Paper Specific Markscheme

In addition to the assessment criteria use the paper-specific markscheme below. Award up to the maximum marks as indicated.

1. (a) Define the following terms indicated in bold in the text: **[2 marks]**

(i) **maximum price (paragraph 5)**

level

0 *Wrong definition* **0**

1 *Vague definition* **1**

The idea that it is a price above which the market is not allowed to go.

2 *Precise definition* **2**

An explanation that a maximum price is imposed by an authority and is set below the equilibrium price. An appropriate diagram is enough.

(ii) **cross elasticity of demand (paragraph 6).** **[2 marks]**

level

0 *Wrong definition* **0**

1 *Vague definition* **1**

The idea that it is the relationship between the demand for one good when there is a change in the price of another good.

2 *Precise definition* **2**

The responsiveness of the demand for one good to a change in the price of another good. A correct formula is enough.

(b) Using a supply and demand diagram, explain why there was an “excess supply of chicken in the market” (paragraph 4). [4 marks]

level

0 *Inappropriate answer* 0

1 *Identification of appropriate theory* 1-2

For drawing a correctly labelled demand and supply diagram, where demand has shifted to the left and there is now an excess of supply (or any other suitable diagram) **or** for providing an explanation of how demand for chicken has fallen because of the avian flu and that now, more will be supplied than demanded.

2 *Correct application of appropriate theory* 3-4

For drawing a correctly labelled demand and supply diagram, where demand has shifted to the left and there is now an excess of supply (or any other suitable diagram) **and** for providing an explanation of how demand for chicken has fallen because of the avian flu and that now, more will be supplied than demanded.

Better candidates may refer to the imposed price or may use figures from the text and a perfectly inelastic supply curve set at 1.1 million chickens, but this is not necessary for full marks.

(c) Using an appropriate diagram, explain the likely effect of importing higher priced baby chicks from Australia and the EU on the market for chickens. [4 marks]

level

0 *Inappropriate answer* 0

1 *Identification of appropriate theory* 1-2

For drawing a correctly labelled supply and demand diagram, with supply shifting to the left and so a higher price and lower quantity demanded and supplied (but any suitable diagram should be rewarded) **or** for explaining that an increase in the price of baby chicks is an increase in a raw material cost, which should lead to fewer chickens being supplied at a higher price.

2 *Correct application of appropriate theory* 3-4

For drawing a correctly labelled supply and demand diagram, with supply shifting to the left and so a higher price and lower quantity demanded and supplied (but any suitable diagram should be rewarded) **and** for explaining that an increase in the price of baby chicks is an increase in a raw material cost, which should lead to fewer chickens being supplied at a higher price.

(d) Using information from the text and your knowledge of economics, especially elasticity of demand, evaluate the economic situation facing the chicken farmers and consumers of chicken.

[8 marks]

There is a lot of information in the text, some of which may be included in the answer:

- chicken farmers may be vulnerable to demand and supply-side shocks
- the elasticity of demand for processed chicken may be calculated and is $10\%/20.00\% = 0.5$
- the elasticity of demand for live chickens may be calculated and is $10\%/20\% = 0.5$
- in both cases, the demand is inelastic
- this means that if producers wish to increase their revenue, then it would be better to raise their prices rather than lower them
- the farmers are acting as a cartel and so should be able to control supply and thus price
- there may be competition from imports, especially if price rises
- the reaction of the 20 % of the non-cartel suppliers may be important
- the imposition of the maximum price poses some interesting problems
- aggressive marketing may be necessary and this may be costly
- cross elasticity of demand and suppliers of substitutes may be a factor
- consumers benefit from lower prices
- consumers gain an increase in real income
- consumers' demand for beef and lamb may be affected
- any reasonable answer.

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

Effective evaluation may be to:

- consider short run versus long run consequences
- examine the impact on different stakeholders
- discuss advantages and disadvantages
- prioritize the arguments

Level

0	No valid discussion.	0
1	Few relevant concepts recognized. Little discussion or only basic understanding.	1-2
2	Relevant concepts recognized and developed in reasonable depth. Some attempt at application and analysis.	3-5
3	Relevant concepts developed in reasonable depth, demonstrating effective evaluation, supported by appropriate evidence or theory.	6-8

2. (a) Define the following terms indicated in bold in the text: [2 marks]

(i) **current account**

level

0 *Wrong definition* 0

1 *Vague definition* 1
The idea that it is exports minus imports.

2 *Precise definition* 2
An explanation that it is a measure of the revenues earned from the export of goods and services minus the expenditure on imports of goods and services. (Allow alternative terminology. Some candidates may add interest, dividends and profits, but this is not necessary for full marks.)

(ii) **GDP per capita (Figure 1).** [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1
The idea that it is a measure of a country's product.

2 *Precise definition* 2
An explanation that it is a measure of output in the economy in one year per head of the population. (Candidates may express their answers in income or expenditure terms and, if so, these responses should be fully rewarded.)

(b) Using a supply and demand diagram, explain why Chile may suffer because of its overdependence on copper for earning export revenues. **[4 marks]**

level

- 0 *Inappropriate answer* **0**

- 1 *Identification of appropriate theory* **1-2**
For drawing a correctly labelled demand and supply diagram, where demand and supply are relatively inelastic, possibly showing that price fluctuations will be large **or** for providing an explanation of how inelastic demand and supply will cause fluctuating prices, which are not good for stable export earnings. (Income inelasticity of demand for commodities may also be introduced here and may be rewarded.) Some students may draw or explain a relatively elastic supply curve. This is acceptable.

- 2 *Correct application of appropriate theory* **3-4**
For drawing a correctly labelled demand and supply diagram, where demand and supply are relatively inelastic, possibly showing that price fluctuations will be large **and** for providing an explanation of how inelastic demand and supply will cause fluctuating prices, which are not good for stable export earnings. (Income inelasticity of demand for commodities may also be introduced here and may be rewarded.) Some students may draw and explain a relatively elastic supply curve. This is acceptable.

(c) Using an appropriate diagram, explain the phrase, “... the Gini coefficient still stands at approximately 0.57, one of the highest figures in the world”. **[4 marks]**

level

- 0 *Inappropriate answer* **0**

- 1 *Identification of appropriate theory* **1-2**
For drawing a correctly labelled Lorenz curve with the areas below and above the curve identified **or** for explaining that the Gini coefficient measures the area between the 45° line and the Lorenz Curve as a proportion of the entire area under the 45° line, and that a figure of 0.57 is a relatively large area, indicating a high level of inequality.

- 2 *Correct application of appropriate theory* **3-4**
For drawing a correctly labelled Lorenz curve with the areas below and above the curve identified **and** for explaining that the Gini coefficient measures the area between the 45° line and the Lorenz Curve as a proportion of the entire area under the 45° line, and that a figure of 0.57 is a relatively large area, indicating a high level of inequality.

- (d) **Using information from the text, the figures, and your knowledge of economics, evaluate the situation facing the Chilean economy.** **[8 marks]**

Discussion points may include:

- the improvement in poverty levels
- the implications of high urban occupancy
- the implications of high income inequality
- the implications of overdependence on commodity exports
- the implications of deteriorating terms of trade
- the implications of a persistent current account deficit
- the implications of the low size of the manufacturing sector
- the implications of the development diamond – high in terms of GDP *per capita*, but standard in terms of the non-monetary factors, implying that they are better in terms of growth rather than development
- any reasonable answer.

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

Effective evaluation may be to:

- consider short run versus long run consequences
- examine the impact on different stakeholders
- discuss advantages and disadvantages
- prioritize the arguments

Level

0	No valid discussion.	0
1	Few relevant concepts recognized. Little discussion or only basic understanding.	1-2
2	Relevant concepts recognized and developed in reasonable depth. Some attempt at application and analysis.	3-5
3	Relevant concepts developed in reasonable depth, demonstrating effective evaluation, supported by appropriate evidence or theory.	6-8

3. (a) Define the following terms indicated in bold in the text: [2 marks]

(i) investment

level

0 *Wrong definition* 0

1 *Vague definition* 1
The idea that it is spending by firms.

2 *Precise definition* 2
An explanation that it is expenditure by firms on capital equipment and is an injection into the economy (or any other reasonable second point).

(ii) inflation. [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1
The idea that it is rising prices.

2 *Precise definition* 2
An explanation that it is a sustained increase in the general or average level of prices.

(b) Using an appropriate diagram, explain what is meant by the economy “operating below capacity”. [4 marks]

level

0 *Inappropriate answer* 0

1 *Identification of appropriate theory* 1-2
For drawing a correctly labelled AD/AS diagram, or production possibility curve (PPC), where output is below the full employment level **or** for providing an explanation of how the economy is not producing at its potential level of output.

2 *Correct application of appropriate theory* 3-4
For drawing a correctly labelled AD/AS diagram, or production possibility curve (PPC), where output is below the full employment level **and** for providing an explanation of how the economy is not producing at its potential level of output.

(c) Using an appropriate diagram, explain how the Swiss National Bank may be able to bring about the desired change for the Swiss franc.

[4 marks]

level

0 *Inappropriate answer*

0

1 *Identification of appropriate theory*

1-2

For drawing a correctly labelled demand and supply diagram, showing a shift in the demand curve for the Swiss franc to the left or a shift in supply to the right **or** for explaining a method which the Swiss National Bank could use to reduce the value of the Swiss franc.

2 *Correct application of appropriate theory*

3-4

For drawing a correctly labelled demand and supply diagram, showing a shift in the demand curve for the Swiss franc to the left or a shift in supply to the right **and** for explaining a method which the Swiss National Bank could use to reduce the value of the Swiss franc.

- (d) Using information from the text, the diagrams, and your knowledge of economics, evaluate the performance of the Swiss economy. [8 marks]**

Responses may include:

- Switzerland’s GDP growth has generally been below OECD levels and was in recession for a period
- comment on relative growth rates
- current account balances are positive, but not high enough
- Swiss inflation rates are well below the OECD
- unemployment levels are much lower in Switzerland
- country depends upon trade and there has been a downturn in the world economy
- the Swiss franc may be over-valued
- economy is below capacity
- any reasonable answer.

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4. (a) Define the following terms indicated in bold in the text: [2 marks]

(i) recession (paragraph 1)

level

0 Wrong definition 0

1 Vague definition 1
The idea that it is a fall in economic activity.

2 Precise definition 2
An explanation that it is at least two consecutive quarters of negative economic growth.

(ii) economies of scale (paragraph 7). [2 marks]

level

0 Wrong definition 0

1 Vague definition 1
The idea that goods are cheaper to produce when a firm gets bigger.

2 Precise definition 2
An explanation that they are a fall in long run unit costs that comes about as a result of a firm increasing its scale of operations.

(b) Using an appropriate diagram, explain how the establishment of a Woolworths store in Kempsey has created external costs. [4 marks]

level

0 Inappropriate answer 0

1 Identification of appropriate theory 1-2
For drawing a correctly labelled diagram, showing that the marginal social cost of Woolworths is greater than their marginal private cost and so there is a loss of welfare **or** for providing an explanation of how the introduction of Woolworths has led to an external cost, because the town centre has become run-down and deserted.

2 Correct application of appropriate theory 3-4
For drawing a correctly labelled diagram, showing that the marginal social cost of Woolworths is greater than their marginal private cost and so there is a loss of welfare **and** for providing an explanation of how the introduction of Woolworths has led to an external cost, because the town centre has become run-down and deserted.

(c) **Using an appropriate diagram, explain why Woolworths is able to sell its products at lower prices than the local stores.** **[4 marks]**

level

0 *Inappropriate answer* **0**

1 *Identification of appropriate theory* **1-2**

For drawing a correctly labelled diagram showing Woolworths' unit costs to be lower than those of the local stores and thus showing that they can charge lower prices and still be profitable **or** for providing an explanation of how Woolworths gains from economies of scale and so can undercut the local stores and still make profits.

2 *Correct application of appropriate theory* **3-4**

For drawing a correctly labelled diagram showing Woolworths' unit costs to be lower than those of the local stores and thus showing that they can charge lower prices and still be profitable **and** for providing an explanation of how Woolworths gains from economies of scale and so can undercut the local stores and still make profits.

(d) Using information from the text and your knowledge of economics, evaluate the view that the Australian government should regulate the behaviour of Woolworths.

[8 marks]

Responses may include:

- discussion of external costs and benefits
- discussion of economies of scale
- effects on employment
- short term versus long term effects
- discussion of consequences of less competition
- any reasonable answer.

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

Effective evaluation may be to:

- consider short run versus long run consequences
- examine the impact on different stakeholders
- discuss advantages and disadvantages
- prioritize the arguments

Level

0	No valid discussion.	0
1	Few relevant concepts recognized. Little discussion or only basic understanding.	1-2
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5. (a) Define the following terms indicated in bold in the text: [2 marks]

(i) **dumping (paragraph 1)**

level

0 *Wrong definition* 0

1 *Vague definition* 1

The idea that it is the cheap selling of goods in another country.

2 *Precise definition* 2

An explanation that it is the selling of a good in another country at a price below its cost of production.

(ii) **comparative advantage (paragraph 2).** [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1

The idea that one country is able to produce a good more cheaply than another.

2 *Precise definition* 2

An explanation that one country is able to produce a good at a lower opportunity cost than another.

(b) With the help of a supply and demand diagram, show the effects of the US tariff on imported steel. [4 marks]

level

0 *Inappropriate answer* **0**

1 *Identification of appropriate theory* **1-2**

For drawing a correctly labelled diagram, showing the effect of a tariff on imported steel **or** for providing an explanation of how a tariff will lead to greater domestic production and a fall in the level of imported steel.

2 *Correct application of appropriate theory* **3-4**

For drawing a correctly labelled diagram, showing the effect of a tariff on imported steel **and** for providing an explanation of how a tariff will lead to greater domestic production and a fall in the level of imported steel.

(c) With the help of an appropriate diagram, explain one other protectionist policy (other than a tariff), which the American government might use to support the domestic steel industry. [4 marks]

level

0 *Inappropriate answer* **0**

1 *Identification of appropriate theory* **1-2**

For drawing a correctly labelled diagram, showing the effect of a protectionist policy (other than a tariff) on the steel industry **or** for providing an explanation of how a protectionist policy (other than a tariff) will lead to greater domestic production and a fall in the level of imported steel.

2 *Correct application of appropriate theory* **3-4**

For drawing a correctly labelled diagram, showing the effect of a protectionist policy (other than a tariff) on the steel industry **and** for providing an explanation of how a protectionist policy (other than a tariff) will lead to greater domestic production and a fall in the level of imported steel.

(d) Using information from the text and your knowledge of economics, evaluate the arguments for and against the protectionism in the steel industry.

[8 marks]

Responses may include:

- discussion of dumping
- discussion of “unfair” foreign trade
- effects on employment
- short term versus long term effects
- discussion of comparative advantage
- discussion of efficiency
- any reasonable answer.

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

Effective evaluation may be to:

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- examine the impact on different stakeholders
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- prioritize the arguments

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