



MARKSCHEME

May 2001

ECONOMICS

Standard Level

Paper 2

Question 1: Farmers to Plant Record Soybean Acres Despite Drop in Price

Partial Mark Maximum Mark

(a) (i) Define the term ‘subsidy’.

- For accurately defining subsidy as a payment by the government to producers or consumers, or expressed in terms of a negative tax 2
- For mentioning that the income received by the producer is greater than the market price charged 2 2

(ii) Using appropriate demand and supply diagrams, briefly explain the difference between a subsidy and a price support scheme (paragraph 2).

- For stating that subsidies have the effect of shifting the supply curve to the right 2
- For including a correctly labelled diagram illustrating the above point 2
- For explaining price support schemes in terms of floors 2
- For illustrating this in a diagram 2 4

Note: Appropriate credit should be given to candidates who

- describe the various effects of floors
 - such as distortion of market
 - creation of surplus
 - storage problem
 - high profits which over-encourage investment in the industry
- mention how consumers are affected by the two different prices

**Partial Maximum
Mark Mark**

(b) Use a separate supply and demand diagram to explain the effects on price and output of each of the following:

(i) the increased soybean planting (paragraph 2);

- For correctly drawing and labelling a diagram which shifts the supply curve to the right 2
- For identifying greater output at a lower market price 2 4

Note: Candidates who do not present a diagram should not be awarded full marks, even though their response is correct.

(ii) the ‘big downturn of US farm exports’ (paragraph 1).

- For correctly drawing and labelling a diagram which shifts the demand curve to the left 2
- For identifying a subsequent reduction in output at a lower price 2 4

Note: Candidates who do not present a diagram should not be awarded full marks, even though their response is correct.

(c) Using evidence from the passage, explain the decision by farmers to plant more soybeans despite collapsing prices.

As part of the explanation, the following points from the extract should be cited:

- farmers are sticking with soybeans because of the federal government loan subsidy 2
- distorted market signals 2 4

**Partial Maximum
Mark Mark**

- (d) **“The market’s signals to farmers are still being distorted; farmers are planting more soybeans than we need.”**

Using the passage and your knowledge of economics, evaluate the effects of government intervention in agricultural markets.

Effects of subsidies

- lower costs for producers
- lower prices for consumers
- increased output of food
- possible effects on government budgets
- price distortions
- misallocation of resources
- subsidies as a protectionist measure

Effect of intervention

- higher prices for consumers
- higher output
- unsold stocks
- costs to the government of purchasing / storing unsold stocks
- possible effect of above on government expenditure and taxation
- misallocation of resources / price signals distorted
- encourages over-production of food
- maintains agricultural supplies
- price stability / reduces price fluctuations

Level 0:	No valid discussion	0
Level 1:	Very few relevant issues recognised with little or no valid discussion or basic understanding	1-2
Level 2:	A few relevant issues recognised with some attempt at discussion or just one issue developed well	3-4
Level 3:	A range of issues developed in reasonable depth. Must also show an awareness of alternative viewpoints and engage in some sensible evaluation	5-7

Question 2: Crisis in Africa

	Partial Mark	Maximum Mark
(a) With reference to Item 1, briefly explain the following terms (in paragraph 2):		
(i) strict deflationary targets;		
• For a brief explanation in terms of reduction of aggregate demand	1	
• For a brief explanation in terms of constraining price levels	1	
• For a fuller explanation in terms of pre-determined targets	2	
• For a development along the lines that this would involve	1	
- a reduction in government spending	1	
- the size of the budget deficit	1	
- and consumption	1	2
(ii) trade liberalisation.		
• For a statement along the lines of allowing the forces of demand and supply to operate to a greater extent in determining the pattern of international trade	1	
• For a more precise explanation related to the systematic removal of all barriers to international trade	2	2
(b) With reference to Item 2,		
(i) briefly describe the debt situation of Guinea Bissau and Sierra Leone in 1995;		
• For stating the relevant figures to describe the debt situation	1	
• For a more developed explanation of what the figures mean	2	2
(ii) explain why their level of debt service ratio might hinder economic development.		
<i>Allow up to [4 marks] for any well developed, relevant explanation, e.g.</i>		
• diversion of export earnings into debt repayment		
• opportunity costs of debt repayment		
• loss of freedom to determine national economic and social policies		
• effects on domestic resource allocation, e.g. need for cash cropping		
• cumulative, non-reducing nature of international debt	4	6

**Partial Maximum
Mark Mark**

- (c) **The data provided indicates various economic problems faced by Guinea Bissau and Sierra Leone. Use your knowledge of economics to examine *two* of these problems (other than the debt service problem).**

Candidates could discuss **two** of the following economic problems

- low adult literacy
- low per capita income
- high percentage of workforce in agriculture
- adverse terms of trade
- current account deficits

Allow up to [3 marks] for each of the two problems examined.

3 6

- (d) **Evaluate the view that to solve the problems of less developed countries such as Guinea Bissau and Sierra Leone, it is necessary to abandon ‘the almost religious faith in the powers of market forces to generate development and reduce poverty’.**

Issues and areas for discussion might include

- distinction between growth and development
- role of foreign aid
- aid versus trade
- impact of foreign investment
- policies designed to redistribute income, land and wealth versus ‘trickle down’
- inward versus outward orientated strategies
- role of the state, *e.g.* in providing health and education
- importance of comparative advantage
- free markets versus planning

Allow appropriate credit for candidates who take a more applied approach in terms of reference to particular countries or other data.

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Level 3:	A range of issues developed in reasonable depth. Must also show an awareness of alternative viewpoints and engage in some sensible evaluation	5-7

Question 3

- (a) **Explain how, in a market economy, the price mechanism assists in the allocation of resources.**

[15 marks]

Possible areas for discussion

- what is meant by the terms
 - market economy
 - price mechanism
 - resource allocation

- demand and supply analysis to explain how the price mechanism allocates resources

- explanation of
 - the rationing function
 - the incentive function
 - the signalling function

Note: *appropriate credit should be given to students who compare the price mechanism with command and mixed economies.*

- (b) **Critically evaluate how the price mechanism deals with the problem of non-renewable resources.**

[10 marks]

Possible areas for discussion

- what is meant by non-renewable resources
- the use of properly labelled diagrams to
 - explain how the price of non-renewable resources is determined by the interaction of supply and demand
 - explain that as population and income increase demand will shift rightwards
 - explain that as the stocks of non-renewable resources decline the supply curve of these goods will shift to the left
 - explain how the price for these products will increase
- a discussion of the role of income and price elasticity of demand in determining the extent of the price increase
- the incentive to develop substitutes
- a discussion of the rationing/conserving effect of the increases in prices
- a discussion of how the burden of conservation is passed on to the least able to pay
- a discussion of how present prices might reflect the value of these resources for present generations but not for future generations
- problem of depletion where it's impossible to find substitutes *e.g.* water
- limits of pricing in general when seeking to assess environmental worth or value, *e.g.* concepts like 'the commons'

Note: *appropriate credit should be given to any other relevant points.*

Question 4

- (a) **With the help of examples, explain the purpose of the various supply-side policies.**

[15 marks]

Issues that could be mentioned include:

- general macroeconomic objectives of government
- general definition of supply-side policies
- the central focus of supply-side policies

Policy examples that could be raised include

- lower personal income tax rates
- reduced taxes on income from savings
- reduction in corporate income tax
- reduced government regulation of markets
- reduction in transfer payments
- measures designed to reduce labour union activities and lower minimum wage
- privatisation
- retraining programs
- any measures to increase labour mobility - both occupational and geographic

Candidates should be able to explain in each one of the above cases how that particular measure would (at least in theory) have the effect of raising the aggregate supply curve.

Appropriated credit should be given to students who discuss demand side measures which have secondary supply-side implications.

- (b) **Evaluate the success of these measures in countries where they have been implemented.**

[10 marks]

Reference should be made to indicators such as

- unemployment rates
- price stability
- productivity
- external equilibrium
- growth rates / development

Other points that could be mentioned include

- distribution gap - the difference between the wealthy and the poor
- effects on fiscal budgets of reduced public expenditure and taxation
- possible environmental effects
- the possible rundown of publicly owned infrastructure and services provided by the government

Note: *Additional credit can be awarded where it is argued that in some cases supply-side policies tend to be introduced as part of a package which also may include tightened monetary policy.*

Question 5

Critically assess the arguments for and against the increased liberalisation of international trade. Refer in your answer to both less developed and more developed countries.

[25 marks]

Possible areas for discussion include:

- meaning of liberalisation of international trade
- types of protectionism
- infant industry argument
- importance of diversification
- impact on employment
- balance of payments effects
- impact on comparative advantage and resource allocation
- effect on consumers in terms of price, variety and quality
- general effects on competitiveness
- significance of trading blocs
- the growing income gap between rich and poor nations
- social / cultural consequences of withdrawing protection to traditional industries

Question 6

(a) Describe the main barriers to economic development.

[12 marks]

Points that could be included:

- a distinction could be made between growth and development
- low per capita GDP
- poverty
- malnutrition
- inadequate health provision
- short life expectancy
- low savings
- low investment levels (in both physical and human terms)
- predominance of primary sector activity
- adverse terms of trade
- access to markets / increased protectionism in the developed world
- instability in export earnings
- unequal income distribution
- external debt levels - role of IMF, WTO and World Bank along with restructuring packages
- brain drain
- role of the state and institutional framework
- inadequate markets
- high population growth rates
- urban-rural divide
- role of MNC investment
- high dependency burdens
- capital flight
- inappropriate use of aid

(b) Is rapid population growth a cause or an effect of poverty?

[13 marks]

If the response focuses on population growth as a cause of poverty, points that may be discussed include

- lower per capita GDP figures
- more wants and needs to be satisfied
- resource depletion
- environmental degradation
- possibility of educating all children becomes more remote
- exacerbation of other indicators of underdevelopment

If the candidate's response focuses on population growth as an effect of poverty

- low opportunity costs of having children for the poor
- the inverse relationship between education levels and fertility

Note: *Appropriate credit should be given to candidates who argue that the central issue is not a question of population growth but one of income distribution at a global and domestic level.*
