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Economics

Specimen Papers and Markschemes

For examinations 2005 onwards

Economics
Specimen Papers and Markschemes
September 2003

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Contents

- 1 Introduction**
- 2 Specimen Papers and Markschemes**
 - Higher Level**
 - Paper 1**
 - Paper 1 Markscheme**
 - Paper 2**
 - Paper 2 Markscheme**
 - Paper 3**
 - Paper 3 Markscheme**
 - Standard Level**
 - Paper 1**
 - Paper 1 Markscheme**
 - Paper 2**
 - Paper 2 Markscheme**
- 3 Glossary of Command Terms**

Introduction

This booklet contains higher level (HL) and standard level (SL) specimen papers for the Diploma Programme economics course published in February 2003. It also contains markschemes and a glossary of command terms.

The assessment criteria for these question papers are published in the *Economics* guide. Paper-specific markschemes are published in this booklet.

Specimen Papers and Markschemes

Higher Level

Paper 1 (20%)

This paper consists of four extended-response questions based on all five sections of the syllabus. Each question is divided into two parts: part (a) is worth 10 marks and part (b) is worth 15 marks. Candidates must answer one question.

Paper 2 (20%)

This is a short-answer question paper based on all five sections of the syllabus. There are six questions, each worth 10 marks, and candidates must answer three questions.

Paper 3 (40%)

This is a data-response paper based on all five sections of the syllabus. There are five structured questions each worth 20 marks. All questions are divided into four parts: (a) (i) and (ii), each worth 2 marks; (b) worth 4 marks; (c) worth 4 marks and (d) worth 8 marks. Candidates must answer three questions.

Standard Level

Paper 1 (25%)

This paper consists of four extended-response questions based on all five sections of the syllabus. Each question is divided into two parts: part (a) is worth 10 marks and part (b) is worth 15 marks. Candidates must answer one question.

Paper 2 (50%)

This is a data-response paper based on all five sections of the syllabus. There are five structured questions each worth 20 marks. All questions are divided into four parts: (a) (i) and (ii), each worth 2 marks; (b) worth 4 marks; (c) worth 4 marks and (d) worth 8 marks. Candidates must answer three questions.

Glossary of Command Terms

A glossary of command terms commonly used in the examination papers is included for information.

**ECONOMICS
HIGHER LEVEL
PAPER 1**

SPECIMEN PAPER

1 hour

INSTRUCTIONS TO CANDIDATES

- Do not turn over this examination paper until instructed to do so.
- Answer one question.
- Use diagrams and real-world examples where appropriate.

Answer one question. Each question is worth [25 marks].

1. (a) Explain how a monopolist may be able to earn supernormal (abnormal) profits in the long run. *[10 marks]*
(b) "Production by a monopolist will always be against the interests of consumers." Discuss. *[15 marks]*

 2. (a) What are the possible causes of unemployment? *[10 marks]*
(b) Evaluate possible policies that may be used to lower the natural rate of unemployment. *[15 marks]*

 3. (a) Explain the theory of comparative advantage. *[10 marks]*
(b) Given the benefits of specialization, evaluate reasons why countries might choose not to specialize. *[15 marks]*

 4. (a) Using examples, describe various sources of funds available to developing countries through trade and aid. *[10 marks]*
(b) Evaluate trade and aid as means of achieving economic growth and development. *[15 marks]*
-

MARKSCHEME

SPECIMEN PAPER

ECONOMICS

Higher Level

Paper 1

Extended-response questions

The assessment criteria apply to all questions. Each question is worth [25 marks].

Part (a)		[10 marks]
level		
0	Inappropriate answer.	0
1	Limited knowledge but some basic points made. There may be significant errors and/or omission of important points.	1–4
2	Evidence of familiarity with basic economic principles. Some ability to apply relevant theory and/or to analyse using relevant theory.	5–6
3	Evidence of familiarity with basic economic principles. Clear ability to apply relevant theory or to analyse using relevant theory.	7–8
4	Evidence of familiarity with basic economic principles. Clear ability to apply relevant theory and to analyse using relevant theory.	9–10
Part (b)		[15 marks]
level		
0	Inappropriate answer.	0
1	Limited knowledge but some basic points made. There may be significant errors and/or omission of important points.	1–3
2	Evidence of familiarity with basic economic principles. Some ability to apply relevant theory and/or to analyse using relevant theory.	4–7
3	Evidence of familiarity with basic economic principles. Clear ability to apply relevant theory and/or to analyse using relevant theory.	8–12
4	Evidence of familiarity with basic economic principles. Clear ability to apply relevant theory and to analyse using relevant theory. Evidence of ability to evaluate.	13–15

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

1. (a) Explain how a monopolist may be able to earn supernormal (abnormal) profits in the long run.

[10 marks]

- definition of monopoly
- definition of supernormal (abnormal) profits
- diagram to show supernormal (abnormal) profits
- supernormal (abnormal) profits would normally be competed away in a more competitive industry
- discussion of barriers to entry
- awareness of contestable markets

(b) “Production by a monopolist will always be against the interests of consumers.” Discuss.

[15 marks]

On the negative side, a monopolist may:

- charge a higher price for a lower level of output
- be productively and allocatively inefficient
- not produce at the socially optimal level of output
- have excessive political influence
- act as monopsonist.

A lack of competition may:

- result in complacency
- result in lack of innovation
- result in high unit costs.

On the positive side, a monopolist may:

- have lower unit costs because of economies of scale
- as a natural monopolist, exist in the public interest
- price discriminate to the benefit of some consumers
- invest in research and development (eg pharmaceuticals) leading to important innovations
- use predatory pricing, which will temporarily benefit the consumer.

2. (a) What are the possible causes of unemployment? **[10 marks]**

Causes of unemployment could include:

- fall in demand for a particular type of labour
- fall in demand for a particular type of product
- fall in AD
- changes in seasonal patterns
- labour immobility
- minimum wage
- labour union power
- unemployment/welfare benefits.

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

(b) Evaluate possible policies that may be used to lower the natural rate of unemployment. **[15 marks]**

An explanation of the meaning of natural rate of unemployment.

Possible policies would be supply side policies which promote:

- increased labour mobility
- occupational mobility/geographical mobility
- deregulation
- privatization tax incentives/Laffer curve
- improved information flows.

Better responses will use a diagram.

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

3. (a) Explain the theory of comparative advantage. **[10 marks]**

An explanation of comparative advantage in terms of factor endowment and opportunity cost. Better responses may use numerical examples or diagrams to illustrate the concept.

(b) Given the benefits of specialization, evaluate reasons why countries might choose not to specialize. **[15 marks]**

Reasons why countries might not specialize may include:

- weaknesses of comparative advantage theory
- protection of workforce/unemployment
- diseconomies of scale
- strategic reasons
- deteriorating terms of trade
- danger of overdependence on one product
- desire to diversify.

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

4. (a) **Using examples, describe various sources of funds available to developing countries through trade and aid.**

[10 marks]

Sources of funds include:

- export revenue
- foreign direct investment
- all types of aid
- commercial loans.

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

- (b) **Evaluate trade and aid as means of achieving economic growth and development.**

[15 marks]

- definition of economic growth
- definition of development
- an awareness of a distinction between the two
- advantages and disadvantages of trade related to growth and/or development
- advantages and disadvantages of aid related to growth and/or development

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

**ECONOMICS
HIGHER LEVEL
PAPER 2**

SPECIMEN PAPER

1 hour

INSTRUCTIONS TO CANDIDATES

- Do not turn over this examination paper until instructed to do so.
- Answer three questions.
- Use diagrams and real-world examples where appropriate.

Answer **three** questions. Each question is worth [10 marks].

1. Explain why Veblen goods are an exception to the law of demand. *[10 marks]*

 2. To what extent can a firm in monopolistic competition earn supernormal (abnormal) profits? *[10 marks]*

 3. Compare the impact of an indirect tax on the market for cigarettes with the impact of an indirect tax on the market for holidays. *[10 marks]*

 4. Using an appropriate diagram, explain how economists measure income distribution. *[10 marks]*

 5. Why are the concepts of trade creation and trade diversion important for a country that is considering joining a customs union? *[10 marks]*

 6. Use the Harrod-Domar model to explain the barriers to growth that may be faced by developing countries. *[10 marks]*
-

MARKSCHEME

SPECIMEN PAPER

ECONOMICS

Higher Level

Paper 2

Short-answer questions

The assessment criteria apply to all questions. Each question is worth [10 marks].

level		[10 marks]
0	Inappropriate answer.	0
1	Limited knowledge but some basic points made. There may be significant errors and/or omission of important points.	1–3
2	Evidence of familiarity with basic economic principles. Some ability to apply relevant theory and/or to analyse using relevant theory.	4–6
3	Evidence of familiarity with basic economic principles. Clear ability to apply relevant theory or to analyse using relevant theory.	7–8
4	Evidence of familiarity with basic economic principles. Clear ability to apply relevant theory and to analyse using relevant theory.	9–10

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

1. Explain why Veblen goods are an exception to the law of demand.

[10 marks]

- definition of the law of demand with reference to a time period and including the *ceteris paribus* clause
- definition of Veblen goods with example(s)
- diagram or explanation indicating an upward-sloping demand curve and/or a direct relationship between price and quantity demanded

Some responses may also refer to the concept of elasticity of demand.

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

2. To what extent can a firm in monopolistic competition earn supernormal (abnormal) profits?

[10 marks]

- definition of monopolistic competition.
- definition of supernormal (abnormal) profits
- diagram showing a firm in monopolistic competition earning supernormal (abnormal) profits in the short run
- supernormal (abnormal) profits are eroded away in the long run because of a lack of barriers to entry
- diagram with an explanation showing the long run equilibrium of a firm in monopolistic competition

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

3. Compare the impact of an indirect tax on the market for cigarettes with the impact of an indirect tax on the market for holidays.

[10 marks]

- definition of indirect tax
- diagram and/or explanation to indicate that demand for cigarettes is generally acknowledged to be inelastic, so that the incidence of an indirect tax falls largely on consumers; prices will rise and demand will fall less than proportionately
- diagram and/or explanation to explain that demand for holidays is generally acknowledged to be elastic, so that the incidence of an indirect tax falls largely on producers; prices will rise and demand will fall more than proportionately
- explanations can imply either *ad valorem* or percentage taxes

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

4. Using an appropriate diagram, explain how economists measure income distribution.

[10 marks]

- illustration with explanation of the Lorenz curve
- reference to the fact that the further away from the line of perfect equality of income, the more unequal the distribution of income
- comparison of countries with different Lorenz curves

Some responses may make reference to the Gini coefficient, noting that the higher the coefficient, the more unequal the distribution of income.

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

5. Why are the concepts of trade creation and trade diversion important for a country that is considering joining a customs union?

[10 marks]

- definition of a customs union
- trade creation is where, upon entering a customs union, production of a good moves from a relatively high-cost producer to a relatively low-cost producer
- trade diversion is where, upon entering a customs union, production of a good moves from a relatively low-cost producer to a relatively high-cost producer
- a country would consider changes in trading patterns in light of the above
- comparative advantage would be altered by entering a customs union

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

6. Use the Harrod-Domar model to explain the barriers to growth that may be faced by developing countries.

[10 marks]

- explanation of the Harrod-Domar model
- definition of developing countries
- lack of saving to finance investment in physical capital
- lack of tax revenues to finance supply-side improvements to the quality of labour

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

**ECONOMICS
HIGHER LEVEL
PAPER 3**

SPECIMEN PAPER

2 hours

INSTRUCTIONS TO CANDIDATES

- Do not open this examination paper until instructed to do so.
- Answer three questions.
- Use diagrams and real-world examples where appropriate.

Answer **three** questions. Each question is worth [20 marks].

1. Study the extract below and answer the questions that follow.

Australian regulator raids top oil companies

Australia's competition regulator (The Australian Competition and Consumer Commission) has seized hundreds of documents and computer records from the offices of the country's biggest oil companies, staging the largest raid on any industry in the history of the Commission. The raids came after complaints were made that the oil companies were fixing the price of petrol, thus operating a **minimum price scheme**.

The Commission announced that it was investigating whether Caltex, Mobil, Shell and other distributors had acted together to price competitors out of the market, and had engaged in price-fixing and market-sharing.

The move followed complaints from motoring organizations that oil companies in Australia have tended to raise petrol prices before holiday weekends and also have been slow to adjust them to reflect the falling price of oil.

The Commission said that it had acted after receiving an anonymous letter from an informant who had since come forward with further information. From the information, it appears that there may have been a breaking of the Trade Practices Act. This wrong doing principally applies to a section of the Act about collusion. It may well be that there are some questions for some oil companies to answer. There may well have been illegal communications between some oil companies concerning certain price rises.

Caltex, Mobil and Shell, Australia's biggest refiners and distributors of petrol, have rejected the allegations and said that they have agreed to co-operate with the inquiry. Spokesmen for all three companies denied price-fixing or market-sharing and stressed that **non-price competition** was the most common form of promotion in their industry.

A representative of the Service Station Association, a body representing the owners of petrol stations, said that it had been complaining about predatory practices within the oil industry for a number of years. The representative doubted that the raids would find any evidence of collusion, but said that they were welcome and felt that they would provide a wake-up call for the major oil companies. It would show the oil companies that their commercial behaviour was no longer acceptable to the authorities, or to consumers.

If the allegations are upheld, the companies could face fines of up to A\$10 million each. In addition, there were calls on the government to strengthen the punishment for price-fixing and collusion to include jail sentences for any company executives involved.

[Source: © *Financial Times*, April 25th 2002 (adapted with permission)]

(This question continues on the following page)

(Question 1 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) minimum price scheme *[2 marks]*
 - (ii) non-price competition. *[2 marks]*
- (b) What type of market form do you think exists in the Australian oil industry? Explain your answer. *[4 marks]*
- (c) Explain, using a supply and demand diagram, why the oil companies may have tended to raise their prices before holiday weekends. *[4 marks]*
- (d) Using information from the text and your knowledge of economics, evaluate the possible effects on consumers and on the Australian economy of increased competition in the oil industry. *[8 marks]*

2. Study the extract below and answer the questions that follow.

Hire clean taxis, citizens urged

Campaigners against air pollution in Mumbai, India, suggested that citizens could contribute to preserving the environment by using only taxis running on clean compressed natural gas (CNG). Although the taxis are slightly more expensive, the increased **opportunity cost** involved would be well worth it, if the local environment could be improved.

“Such conscious choices would help the campaign against air pollution and put pressure on the government,” said lawyer-activist Shiraz Rustomjee. He was speaking at an Earth Day Event organized by Clean Air, an environmental NGO. He is presently representing citizens and environmental groups in the continuing case in the Mumbai high court against the **negative externalities** caused by vehicles.

The court has already ordered public transport companies to replace their old, polluting vehicles or to convert them to clean fuels like CNG. Already, about half of the city’s 55,000 taxis have been converted. In addition, Clean Air have started an advertising campaign, urging people to use the clean taxis, which they expect to be a very positive factor in the battle for a less polluted atmosphere.

It would appear that the campaign for clean air has managed to stop the increase in pollution levels by forcing the conversion of the taxis to cleaner fuels. Data suggests that pollution levels have actually come down very slightly, although it does not feel that way on the streets.

More importantly, perhaps, the transport operators’ attitudes appear to have changed considerably. In the past, taxi drivers would go on strike and refuse to comply with the law. Today, they only ask for more time. They seem to understand that the issue has to be addressed.

Mr Rustomjee admitted that the public interest lawsuit, which was started in 1999, was taking a long time to get rules in place to reduce pollution. The VM Lal committee on pollution submitted its report in early 2000 and yet the first 15 recommendations were only just beginning to be implemented.

The Earth Day event also saw the introduction of NETRA (Networking for Transport Alternatives), a group that is lobbying for better public transport. NETRA member, Nikhil Anand, said it aimed to pressurise the government to implement the World Bank-backed Mumbai Urban Transport Project II, to upgrade the local railways, as early as possible.

[Source: *The Times of India*, April 25th 2003]

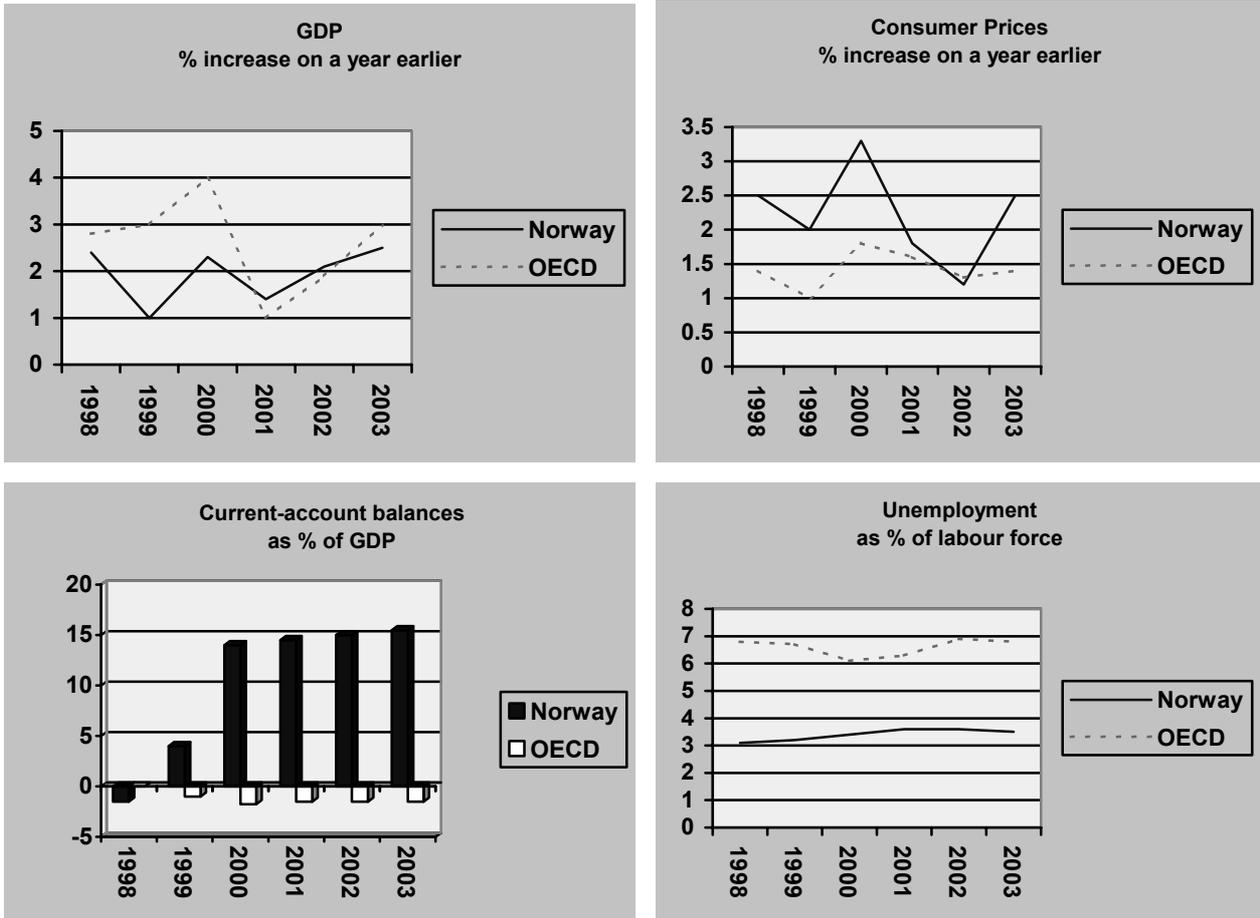
(This question continues on the following page)

(Question 2 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) opportunity cost *[2 marks]*
 - (ii) negative externalities. *[2 marks]*
- (b) Using an appropriate diagram, explain how air pollution created by the taxis in Mumbai is an example of market failure. *[4 marks]*
- (c) Explain in economic terms, how the advertising campaign is expected to help to cure the market failure. *[4 marks]*
- (d) Using information from the text and your knowledge of economics, evaluate the advantages and disadvantages for the Indian government of improving the quality and quantity of public transport in Mumbai. *[8 marks]*

3. Study the extract below and answer the questions that follow.

Data on Norway



OECD is the Organization for Economic Cooperation and Development (formed in 1961). The figures given represent an average for the members of the OECD (the EU countries, USA, Canada, Japan, New Zealand and Australia).

High oil prices have contributed to Norway's huge **current account surplus**. However, Norway's oil wealth complicates the management of the economy and the oil-related rise in the Norwegian currency, the *kroner*, is discouraging competitiveness. The government is loosening **fiscal policy** after the budget surplus reached 14 % of Gross Domestic Product last year. But with the economy near capacity, looser fiscal policy means that monetary policy has to be tight.

[Source: © *The Economist Newspaper Limited, London, September 14th 2002* (adapted with permission)]

(This question continues on the following page)

(Question 3 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) current account surplus *[2 marks]*
 - (ii) fiscal policy. *[2 marks]*
- (b) Using an appropriate diagram, explain why Norway might have to tighten its monetary policy. *[4 marks]*
- (c) Using supply and demand analysis, explain why there may have been a rise in the value of the currency, the *krone*. *[4 marks]*
- (d) Using information from the text, the diagrams, and your knowledge of economics, evaluate the performance of the Norwegian economy in comparison with the OECD countries. *[8 marks]*

4. Study the extract below and answer the questions that follow.

Devaluation's Downbeat Start

"If Argentina falls one more step, there will be a disaster," said Eduardo Duhalde, its new president, urging Congress to grant him emergency powers to cope with the country's economic collapse. Congress duly granted those powers. Mr Duhalde promptly used them to order a **devaluation** and launched Argentina into the unknown.

After a decade in which the Argentinean *peso* has been fixed to the US dollar, many of the emergency measures unveiled are designed to cushion the impact of the devaluation on ordinary Argentines. Instead of a free float, the government has set an official exchange rate of 1.4 *pesos* to the dollar (*i.e.* a 29 % devaluation) for exports, those imports judged to be essential, and most capital transactions.

In a move to make the public less upset, the prices charged by privatized telephone, water and energy companies will not change. These had been pegged to the dollar and indexed to **inflation** in the US. Now, they will be switched to *pesos* at par and the link to US prices will be scrapped. Congress has also given official powers to impose price controls, but they say that they will only use them on sensitive products, such as fuels and medicines.

In a country with a history of hyperinflation, the government is clearly scared that an uncontrolled devaluation would lead to massive price rises. In fact, though some prices have already gone up, the economy's deep recession may restrain inflation.

If inflation and the exchange rate are to be restrained, Congress will have to approve a convincingly balanced budget. Last year, as the economy collapsed, the government's deep spending cuts failed to keep up with plunging tax revenues, causing a deficit of \$9 billion. Now the government will save money by not servicing most of its debt, but in order to balance the books further, deeper cuts will be required.

[Source: © *The Economist Newspaper Limited, London, January 12th 2002* (adapted with permission)]

(This question continues on the following page)

(Question 4 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) devaluation *[2 marks]*
 - (ii) inflation. *[2 marks]*
- (b) Using an appropriate diagram, explain why “an uncontrolled devaluation would lead to massive price rises” (*paragraph 4*). *[4 marks]*
- (c) Using an appropriate diagram, explain the likely impact of imposing price controls on “sensitive products” (*paragraph 3*). *[4 marks]*
- (d) Using information from the text and your knowledge of economics, evaluate the advantages and disadvantages of Argentina adopting a contractionary fiscal policy. *[8 marks]*

5. Study the extract below and answer the questions that follow.

“Cut in farm subsidies necessary” says World Bank

Efforts by institutions such as the World Bank to help developing countries are useless unless wealthy countries cut farm subsidies, said James Wolfensohn, the World Bank president. Wolfensohn warned that the \$50 billion spent worldwide each year on development assistance as **multilateral aid**, was nothing compared with the \$350 billion put into agricultural subsidies every year.

“To have seven times the amount going into agricultural subsidies than development assistance makes no economic sense at all. It prevents developing countries from exploiting their **comparative advantage** in agricultural products,” according to Wolfensohn.

Farm subsidies in rich countries certainly hit developing countries hard. According to a report by the International Monetary Fund (IMF), if rich countries eliminated their farm subsidies, the main agricultural exporters of Latin America and sub-Saharan Africa would see their economic growth climb between 0.3 % and 0.6 %. Countries that are experiencing severe economic crises, such as Argentina would benefit greatly from a cut in agricultural subsidies, as Argentina’s agricultural commodities account for 52 % of its exports.

The World Trade Organization (WTO) has so far been unable to come up with any agreement from the more developed countries to cut subsidies, and Wolfensohn admitted that he had no power to change countries’ trade policies. However, there has been increasing pressure on the WTO to give preferential treatment to developing countries hard hit by the trading system. Although increased trade liberalization is the main goal of the WTO, it has been suggested that developing countries should be given permission to raise tariffs to protect small farmers from being swamped by imports. Such an inward-looking strategy may seem to go against current popular view, but may be necessary given the fact that more than half of the world’s poorest people depend on farming.

As Wolfensohn claims, “Someone will have to recognize some time that what happens in developing countries is in the full interests of the developed countries. You will not have peace, you will not have stability, unless you have development.”

[Source: adapted from various sources]

(This question continues on the following page)

(Question 5 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) multilateral aid *[2 marks]*
 - (ii) comparative advantage. *[2 marks]*
- (b) Using an appropriate diagram, explain how subsidies in rich countries harm farmers in Latin America and sub-Saharan Africa. *[4 marks]*
- (c) Using an appropriate diagram, explain how import tariffs could help farmers in developing countries. *[4 marks]*
- (d) Using information from the text and your knowledge of economics, evaluate the proposition that inward-looking strategies may be necessary in order to achieve growth. *[8 marks]*
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MARKSCHEME

SPECIMEN PAPER

ECONOMICS

Higher Level

Paper 3

Data-response questions

The assessment criteria apply to all questions. Each question is worth [20 marks].

Part (a) (i)		[2 marks]
level		
0	Wrong definition.	0
1	Vague definition.	1
2	Precise definition, or vague definition with appropriate example.	2
Part (a) (ii)		[2 marks]
level		
0	Wrong definition.	0
1	Vague definition.	1
2	Precise definition, or vague definition with appropriate example.	2
Part (b)		[4 marks]
level		
0	Inappropriate answer.	0
1	Identification of appropriate theory.	1–2
2	Correct application of appropriate theory.	3–4
Part (c)		[4 marks]
level		
0	Inappropriate answer.	0
1	Identification of appropriate theory.	1–2
2	Correct application of appropriate theory.	3–4
Part (d)		[8 marks]
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

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

Question 1

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

(i) minimum price scheme
The idea that it is a price floor or the charging of a high price. **1**

An explanation that it is a price set above the equilibrium or for an accurate diagram showing the same. **2**

(ii) non-price competition. **[2 marks]**
The idea that it is simply competition that is not in terms of price. **1**

An explanation that it exists where competition is not in terms of price, but rather in terms of non-price activities designed to differentiate the products. This may be shown by means of examples. **2**

(b) What type of market form do you think exists in the Australian oil industry? Explain your answer. **[4 marks]**

For identifying oligopoly and for explaining that the oil market is dominated by a few firms. **1–2**

For explaining oligopoly, using the data in the text, and offering examples from the text to support the answer. A diagram may be offered and should be rewarded. **3–4**

(c) Explain, using a supply and demand diagram, why the oil companies may have tended to raise their prices before holiday weekends. **[4 marks]**

For drawing a supply and demand diagram **or** providing an explanation of how the elasticity of demand for petrol would be more inelastic coming up to a holiday weekend and so higher prices could be charged with a relatively small fall in the quantity demanded. Drawing or explaining a shift in the demand curve to the right and an increase in both price and quantity would be sufficient. **1–2**

For drawing a supply and demand diagram **and** providing an explanation of how the elasticity of demand for petrol would be more inelastic coming up to a holiday weekend and so higher prices could be charged with a relatively small fall in the quantity demanded. Drawing and explaining a shift in the demand curve to the right and an increase in both price and quality would be sufficient. **3–4**

(Question 1 continued)

- (d) Using information from the text and your knowledge of economics, evaluate the possible effects on consumers and on the Australian economy of increased competition in the oil industry.**

[8 marks]

Responses may include:

- the lowering of petrol prices
- increases in demand and quantity sold, depending upon price elasticity
- consideration of efficiency, both productive and allocative
- increasing negative externalities.

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

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

Question 2

(a) Define the following terms indicated in bold in the text:

(i) opportunity cost **[2 marks]**

The idea that it is something given up or an alternative.

1

An explanation that it is the value of the next best alternative forgone, preferably with an example.

2

(ii) negative externalities. **[2 marks]**

The idea that they are a cost to society.

1

An explanation that they are costs borne by society resulting from acts of consumption or production, where the consumers or producers in question do not bear the cost themselves. A situation where social cost is greater than private cost.

2

(b) Using an appropriate diagram, explain how air pollution created by the taxis in Mumbai is an example of market failure. **[4 marks]**

For drawing a marginal social cost/marginal social benefit diagram **or** providing an explanation of how air pollution is created by the taxi drivers, but is not reflected in their private costs, and as a result making social costs greater than private costs and creating a negative externality.

1–2

For drawing a marginal social cost/marginal social benefit diagram **and** providing an explanation of how the pollution is created by the taxi drivers, but is not reflected in their private costs, and as a result making social costs greater than private costs and creating a negative externality.

3–4

(c) Explain in economic terms, how the advertising campaign is expected to help to cure the market failure. **[4 marks]**

For identifying that effective advertising will affect the demand for clean taxis, by shifting the demand curve to the right (*i.e.* increasing demand).

1–2

For identifying that effective advertising will affect the demand for clean taxis, by shifting the demand curve to the right (*i.e.* increasing demand) and for then taking this further, either into reduced price elasticity values, or acceptance of higher prices.

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

3–4

(Question 2 continued)

- (d) Using information from the text and your knowledge of economics, evaluate the advantages and disadvantages for the Indian government of improving the quality and quantity of public transport in Mumbai.**

[8 marks]

Responses may include:

Advantages

- reduction in social costs
- improvements in health
- consequent reductions in the costs of providing health care
- increases in the demand for public transport
- possible increases in income from the above
- improvements in the quality of life and sustainable development.

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

Disadvantages

- “crowding out” caused by increased government borrowing
- possible opportunity costs of a reduction in expenditure in other areas
- possible increases in taxation
- pressure from private industry.

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

level

- | | | |
|----------|---|------------|
| 0 | No valid discussion | |
| 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 |

Question 3

(a) Define the following terms indicated in bold in the text:

(i) current account surplus [2 marks]

The idea that it is where the value of exports is greater than the value of imports.

1

An explanation that it is where the value of the exports of visibles and invisibles is greater than the value of the imports of visibles and invisibles.

2

(ii) fiscal policy. [2 marks]

The idea that it relates to government income (taxation) or expenditure.

1

An explanation that it relates to government income (taxation) and expenditure.

2

(b) Using an appropriate diagram, explain why Norway might have to tighten its monetary policy. [4 marks]

For drawing an AD and AS diagram or providing an explanation of how looser fiscal policy will lead to increased demand in the economy and inflationary pressures, which may need tighter monetary policy to act as a counter measure.

1–2

For drawing an AD and AS diagram and providing an explanation of how looser fiscal policy will lead to increased demand in the economy and inflationary pressures, which may need tighter monetary policy to act as a counter measure.

3–4

(c) Using supply and demand analysis, explain why there may have been a rise in the value of the currency, the *kroner*. [4 marks]

For drawing a supply and demand diagram or providing an explanation of how the increased demand for the *kroner* will lead to an increase in its exchange rate.

1–2

For drawing a supply and demand diagram and providing an explanation of how the increased demand for the *kroner* will lead to an increase in its exchange rate.

3–4

(Question 3 continued)

- (d) Using information from the text, the diagrams, and your knowledge of economics, evaluate the performance of the Norwegian economy in comparison with the OECD countries.**

[8 marks]

Responses may include:

- Norway has less volatility in terms of GDP changes
- comment on relative growth rates
- the fact that Norway has a current account surplus and that the OECD has not
- Norwegian inflation rates tend to be higher than those in the OECD
- unemployment levels are lower in Norway than the OECD
- possibility of long-run changes if oil supplies fall.

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

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 |

Question 4

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

(i) devaluation

The idea that it is a reduction in the value of a currency.

1

An explanation that it is a reduction in the value of a currency, conducted by the central bank, in a fixed exchange rate system.

2

(ii) inflation.

The idea that it relates to a rise in prices.

[2 marks]

1

An explanation that it is a **sustained** increase in the general level of prices over a given time period.

2

(b) Using an appropriate diagram, explain why an “uncontrolled devaluation would lead to massive price rises” (paragraph 4). **[4 marks]**

For drawing an AD and AS diagram **or** providing an explanation of how there would be imported inflation, raising factor costs for domestic producers who use imported resources and the prices of final goods for domestic consumers of imports. Explanations may also look at increased demand for exports, causing shortages in the domestic economy and consequent higher prices.

1–2

For drawing an AD and AS diagram **and** providing an explanation of how there would be imported inflation, raising factor costs for domestic producers who use imported resources and the prices of final goods for domestic consumers of imports. Explanations may also look at increased demand for exports, causing shortages in the domestic economy and consequent higher prices.

3–4

(c) Using an appropriate diagram, explain the likely impact of imposing price controls on “sensitive products” (paragraph 3). **[4 marks]**

For drawing a price-ceiling diagram **or** providing an explanation of how the imposition of price controls will keep prices low, but will probably lead to excess demand and the appearance of black/parallel/grey markets.

1–2

For drawing a price-ceiling diagram **and** providing an explanation of how the imposition of price controls will keep prices low, but will probably lead to excess demand and the appearance of black/parallel/grey markets.

3–4

(Question 4 continued)

- (d) Using information from the text and your knowledge of economics, evaluate the advantages and disadvantages of Argentina adopting a contractionary fiscal policy.**

[8 marks]

Responses may include:

- definition of fiscal policy
- definition of a contractionary fiscal policy.

Advantages

- reduction in inflationary pressures
- improvements in foreign confidence (eg from the IMF)
- impact on exchange rate
- less “crowding out”
- lower government interest payments.

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

Disadvantages

- increasing unemployment
- less provision of public services
- reduced AD in the economy
- reduction in public confidence.

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

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

Question 5

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

(i) multilateral aid **1**

The idea that it is aid provided to developing countries by other countries.

An explanation that it is aid provided by an agency representing more than one country. **2**

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

The idea that comparative advantage exists when one country can produce more of a product than another country. **1**

An explanation including the concept of opportunity cost and/or a suitable example. **2**

(b) Using an appropriate diagram, explain how subsidies in rich countries harm farmers in Latin America and sub-Saharan Africa. **[4 marks]**

For drawing a supply and demand diagram indicating an increase in supply **or** for explaining how subsidies in rich countries force prices downwards, and as a result harming incomes of farmers in developing countries. **1–2**

For drawing a supply and demand diagram indicating an increase in supply **and** for explaining how subsidies in rich countries force prices downwards, and as a result harming incomes of farmers in developing countries. **3–4**

(c) Using an appropriate diagram, explain how import tariffs could help farmers in developing countries. **[4 marks]**

For drawing a supply and demand diagram **or** providing an explanation of how import tariffs raise domestic prices and reduce the level of imports, as a result aiding developing country farmers. **1–2**

For drawing a supply and demand diagram **and** providing an explanation of how import tariffs raise domestic prices and reduce the level of imports, as a result aiding developing country farmers. **3–4**

(Question 5 continued)

- (d) Using information from the text and your knowledge of economics, evaluate the proposition that inward-looking strategies may be necessary in order to achieve growth.**

[8 marks]

Responses may include:

- an explanation of inward-looking strategies
- the need for developing countries to use protectionist policies to promote their own industries or to protect their industries from subsidized goods from developed countries
- the idea that such subsidies in developed countries force down prices of the products which developing countries export, thus affecting their export revenues and potential for growth
- the idea that inward-looking strategies are often viewed as inappropriate as a means of achieving growth because they may lead to less competition, inefficiency, complacency, higher prices, lower levels of invention and innovation.

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

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

**ECONOMICS
STANDARD LEVEL
PAPER 1**

SPECIMEN PAPER

1 hour

INSTRUCTIONS TO CANDIDATES

- Do not turn over this examination paper until instructed to do so.
- Answer one question.
- Use diagrams and real-world examples where appropriate.

*Answer **one** question. Each question is worth [25 marks].*

1. (a) Explain the concept of elasticity of demand. *[10 marks]*
(b) Evaluate the significance of elasticity of demand to businesses and government. *[15 marks]*

 2. (a) Describe the various types of taxation used by governments. *[10 marks]*
(b) Evaluate the effectiveness of taxation as a means of redistributing income. *[15 marks]*

 3. (a) Describe **three** types of protectionism used to limit international trade. *[10 marks]*
(b) To what extent can protectionism in developed countries be justified? *[15 marks]*

 4. (a) Using examples, describe various sources of funds available to developing countries through trade and aid. *[10 marks]*
(b) Evaluate trade and aid as means of achieving economic growth and development. *[15 marks]*
-

MARKSCHEME

SPECIMEN PAPER

ECONOMICS

Standard Level

Paper 1

Extended-response questions

The assessment criteria apply to all questions. Each question is worth [25 marks].

Part (a)		[10 marks]
level		
0	Inappropriate answer.	0
1	Limited knowledge but some basic points made. There may be significant errors and/or omission of important points.	1–4
2	Evidence of familiarity with basic economic principles. Some ability to apply relevant theory and/or to analyse using relevant theory.	5–6
3	Evidence of familiarity with basic economic principles. Clear ability to apply relevant theory or to analyse using relevant theory.	7–8
4	Evidence of familiarity with basic economic principles. Clear ability to apply relevant theory and to analyse using relevant theory.	9–10
 Part (b)		 [15 marks]
level		
0	Inappropriate answer.	0
1	Limited knowledge but some basic points made. There may be significant errors and/or omission of important points.	1–3
2	Evidence of familiarity with basic economic principles. Some ability to apply relevant theory and/or to analyse using relevant theory.	4–7
3	Evidence of familiarity with basic economic principles. Clear ability to apply relevant theory and/or to analyse using relevant theory.	8–12
4	Evidence of familiarity with basic economic principles. Clear ability to apply relevant theory and to analyse using relevant theory. Evidence of ability to evaluate.	13–15

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

1. (a) Explain the concept of elasticity of demand. [10 marks]

- definition of elasticity as a measurement of responsiveness of one variable to a change in another variable
- definition(s) of PED, cross elasticity of demand, income elasticity of demand
- formula and values

Responses would not be expected to cover all types of elasticity but they should show awareness that more than one type exists.

(b) Evaluate the significance of elasticity of demand to businesses and government. [15 marks]

- Businesses make pricing decisions based on total revenue and this is determined by price elasticity of demand.
- Businesses make pricing, advertising and marketing decisions with an awareness of income elasticity of demand and cross elasticity of demand.
- Governments base decisions about indirect taxes on the price elasticity of demand for products.
- Governments might consider price elasticity of demand in decisions about tariffs and depreciations/devaluations.

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

2. (a) Describe the various types of taxation used by governments. [10 marks]

Types of taxation used by government include:

- direct taxation: income tax, wealth tax, death duties, corporate/business tax, any reasonable examples
- indirect taxation: sales tax (eg VAT/GST), any reasonable examples
- tariffs: progressive/regressive/proportional taxes.

Responses would not be expected to cover all types of taxation but they should show an awareness that more than one type exists.

(b) Evaluate the effectiveness of taxation as a means of redistributing income. [15 marks]

- taxation as a tool of fiscal policy, effects of taxation on aggregate demand
- taxation as a tool of supply-side policies, effects on aggregate supply
- a comparison of progressive, regressive and proportional taxes in terms of redistributing income

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

3. (a) Describe *three* types of protectionism used to limit international trade.

[10 marks]

Types of protectionism could include:

- tariffs
- quotas
- subsidies
- VERs
- administrative delays
- health and safety standards
- environmental standards and regulations.

- (b) To what extent can protectionism in developed countries be justified?

[15 marks]

Arguments in favour of protectionism could include:

- protection of domestic employment
- source of government revenue
- to achieve economies of scale
- sunrise industries (infant-industry argument)
- sunset industries (senile industries)
- strategic reasons
- to reduce dependency on imports
- political lobbying
- to be consistent with domestic health, safety and/or environmental standards.

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

Arguments against protectionism could include:

- increased costs of goods and services to consumers
- reduction in world output
- distortion of comparative advantage
- opportunity costs of subsidizing industries
- effect of higher costs on export competitiveness
- danger of retaliation and trade wars
- welfare loss
- political implications.

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

4. (a) **Using examples, describe various sources of funds available to developing countries through trade and aid.**

[10 marks]

Sources of funds include:

- export revenue
- foreign direct investment
- all types of aid
- commercial loans.

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

- (b) **Evaluate trade and aid as means of achieving economic growth and development.**

[15 marks]

- definition of economic growth
- definition of development
- an awareness of a distinction between the two
- advantages and disadvantages of trade related to growth and/or development
- advantages and disadvantages of aid related to growth and/or development

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

**ECONOMICS
STANDARD LEVEL
PAPER 2**

SPECIMEN PAPER

2 hours

INSTRUCTIONS TO CANDIDATES

- Do not open this examination paper until instructed to do so.
- Answer three questions.
- Use diagrams and real-world examples where appropriate.

Answer **three** questions. Each question is worth [20 marks].

1. Study the extract below and answer the questions that follow.

Hire clean taxis, citizens urged

Campaigners against air pollution in Mumbai, India, suggested that citizens could contribute to preserving the environment by only using taxis running on clean compressed natural gas (CNG). Although the taxis are slightly more expensive, the increased **opportunity cost** involved would be well worth it, if the local environment could be improved.

“Such conscious choices would help the campaign against air pollution and put pressure on the government,” said lawyer-activist Shiraz Rustomjee. He was speaking at an Earth Day Event organised by Clean Air, an environmental NGO. He is presently representing citizens and environmental groups in the continuing case in the Mumbai high court against the **negative externalities** caused by vehicles.

The court has already ordered public transport companies to replace their old, polluting vehicles or to convert them to clean fuels like CNG. Already, about half of the city’s 55,000 taxis have been converted. In addition, Clean Air have started an advertising campaign, urging people to use the clean taxis, which they expect to be a very positive factor in the battle for a less polluted atmosphere.

It would appear that the campaign for clean air has managed to stop the increase in pollution levels by forcing the conversion of the taxis to cleaner fuels. Data suggests that pollution levels have actually come down very slightly, although it does not feel that way on the streets.

More importantly, perhaps, the transport operators’ attitudes appear to have changed considerably. In the past, taxi drivers would go on strike and refuse to comply with the law. Today, they only ask for more time. They seem to understand that the issue has to be addressed.

Mr Rustomjee admitted that the public interest lawsuit, which was started in 1999, was taking a long time to get rules in place to reduce pollution. The V.M. Lal committee on pollution submitted its report in early 2000 and yet the first 15 recommendations were only just beginning to be implemented.

The Earth Day event also saw the introduction of NETRA (Networking for Transport Alternatives), a group that is lobbying for better public transport. NETRA member, Nikhil Anand, said it aimed to pressurize the government to implement the World Bank-backed Mumbai Urban Transport Project II, to upgrade the local railways, as early as possible.

[Source: *The Times of India*, April 25th 2003]

(This question continues on the following page)

(Question 1 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) opportunity cost *[2 marks]*
 - (ii) negative externalities. *[2 marks]*
- (b) Using an appropriate diagram, explain how air pollution created by the taxis in Mumbai is an example of market failure. *[4 marks]*
- (c) Explain in economic terms, how the advertising campaign is expected to help to cure the market failure. *[4 marks]*
- (d) Using information from the text and your knowledge of economics, evaluate the advantages and disadvantages for the Indian government of improving the quality and quantity of public transport in Mumbai. *[8 marks]*

2. Study the extract below and answer the questions that follow.

Brazil – Economic information

Economic reforms have improved Brazil's growth prospects, argues the Organisation for Economic Cooperation and Development (OECD). However, a big current account deficit means that the economy is vulnerable to external shocks. The OECD calls for more tax and public pension reforms. It also recommends that the central bank be made independent to keep **inflation** in check.

The *real*, Brazil's currency, has suffered a **depreciation** of 40 % in 2002, sending the public debt—much of which is linked to the exchange rate—spiralling upwards. The president has agreed to a tightening of Brazil's fiscal policy.

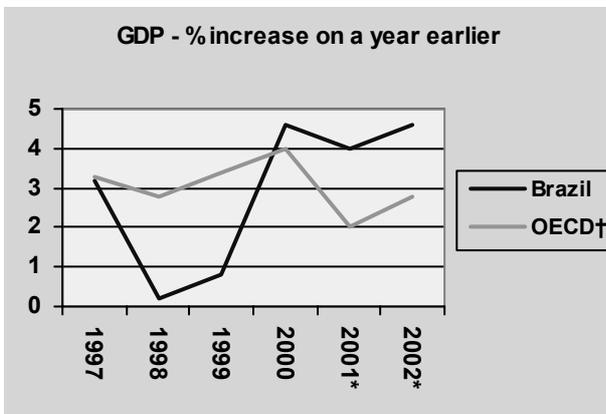


Diagram 1

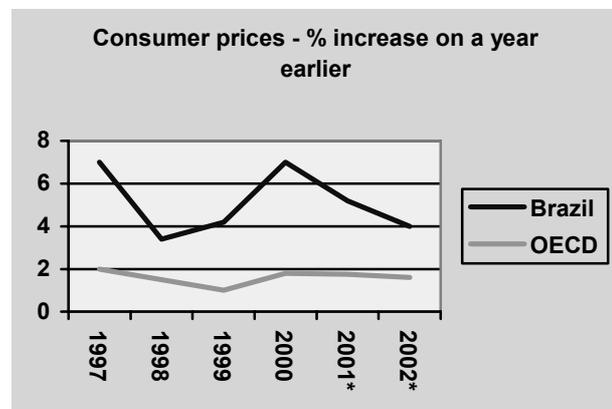


Diagram 2

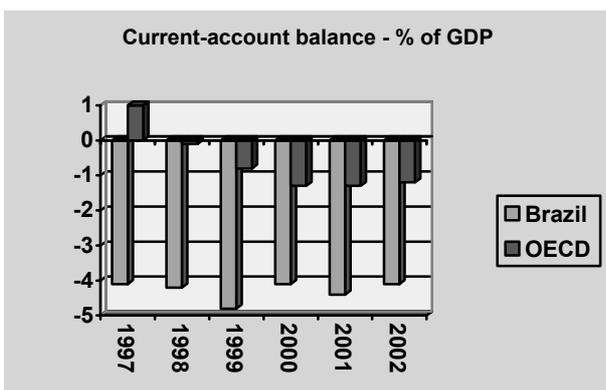


Diagram 3

* Forecast
† Private consumption deflator, excluding Hungary, Mexico, Poland and Turkey

(This question continues on the following page)

(Question 2 continued)

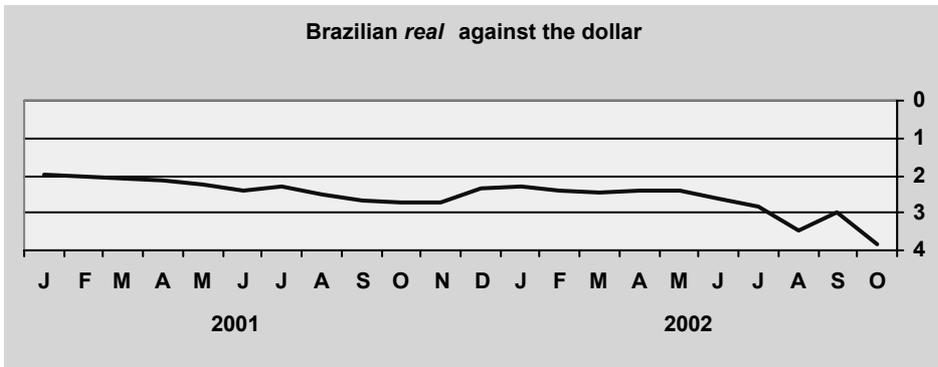
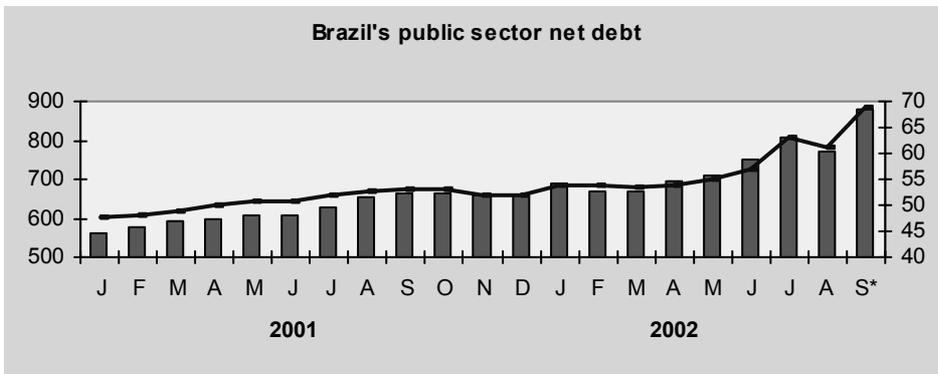


Diagram 4



Source: Thomson Datastream; Central Bank of Brazil; Citibank

*Estimate

Diagram 5

[Source: © *The Economist Newspaper Limited, London, June 14th 2001* (adapted with permission)]

(a) Define the following terms indicated in bold in the text:

(i) inflation [2 marks]

(ii) depreciation. [2 marks]

(b) Using an appropriate diagram, explain the change in consumer prices in Brazil between 2000 and 2002 shown in **Diagram 2**. [4 marks]

(c) Using an appropriate diagram, explain the possible link between **Diagrams 4 and 5**, that is, why a depreciating *real* might contribute to increasing public sector net debt. [4 marks]

(d) Using information from the text and diagrams, and your knowledge of economics, evaluate the economic situation in Brazil at the end of 2002. [8 marks]

3. Study the extract below and answer the questions that follow.

Jump in unemployment drives down shares and dollars

News of a surprise sharp rise in unemployment in the United States drove the exchange rate of the US dollar and share prices down, ending a difficult and uncertain week for the US currency. For the second month in a row, official data showed that expectations of a turnaround in the US labour market had been too optimistic.

The **unemployment rate** rose by 0.3 percentage points to a seven-year high of 6 %. Economists had been predicting that the rate would rise by a smaller amount to 5.8 %. Analysts note that the unemployment rate was affected by an increase in numbers of previously inactive workers, who recorded themselves as unemployed as a result of more generous unemployment benefit.

The news caused the dollar to slide against all large currencies. The dollar fell by a cent to a six-month low of \$0.917 against the Euro. The dollar has been under pressure this week as market participants have begun to focus on the large size of the US **current account deficit** and the obvious signs of sluggishness in the economic recovery. Traders have seized any opportunity to sell the currency.

The Federal Reserve would like to raise interest rates to prop up the dollar, but they are worried that this would increase the level of unemployment.

The disappointing unemployment news was followed by suggestions that the recovery in the service sector was also weakening. The regular survey issued by the Institute of Supply Management showed that overall activity in the service sector grew at a slower rate in April than it had in March. Government officials have played down the unemployment figures, saying that the economy was poised to grow. But the markets continue to have a pessimistic view of the prospects for US profit growth and the currency.

[Source: © *Financial Times*, May 14th 2002 (adapted with permission)]

(This question continues on the following page)

(Question 3 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) unemployment rate *[2 marks]*
 - (ii) current account deficit. *[2 marks]*
- (b) Using an appropriate diagram, explain why higher interest rates might increase unemployment. *[4 marks]*
- (c) Using an appropriate diagram, explain why more generous unemployment benefits may have caused the unemployment rate to rise. *[4 marks]*
- (d) Using information from the text and your knowledge of economics, evaluate the possible effects of the fall in the value of the US dollar on the American economy. *[8 marks]*

4. *Study the extract below and answer the questions that follow.*

Free Trade is a Grand Illusion Conjured up by the West

George Bush did us all a favour when he placed **tariffs** on imported steel. The duties were evidence that the United States, like the European Union, Japan and Canada, are avid supporters of free trade, but only when it means liberalizing the markets of smaller and weaker countries, not their own. Why? Because the strong are interested in free trade only when it suits them.

There is no question that Europe has a strong case over steel. European producers have accepted the pain of restructuring, but will now be frozen out of the US market by the decision to subsidize inefficient plants. But we must remember that it is the EU that operates the biggest protection scheme of all, the common agricultural policy, which uses colossal subsidies to keep lower-cost producers out of the European agricultural markets.

What then is to be done? Western governments would argue that developing countries have benefited from trade, and they are right. Countries that have been integrated into the global economy over the past 50 years have performed considerably better than those that have followed an **import-substitution** route.

Where the West is wrong is in its insistence that poor countries open themselves up immediately to the full blast of global competition. The World Bank and the International Monetary Fund have made opening up markets in poor countries a condition for loans, confident in the belief that this will lead to greater efficiency, higher growth and less poverty. They say that those countries that have given up on protectionism and become more export-driven have grown much faster than those nations that have maintained barriers to trade. But this argument needs to be turned around.

Successful countries develop industrial strength before they fully open up their markets. This is what America did. If the early Americans had listened to Adam Smith, they would still be tilling the fields, leaving manufacturing to Britain. Instead, the US industrialized in the 19th century protected by large tariff barriers. America's route was followed by Germany, Japan and the Asian tigers.

Trade restrictions cost poor nations \$100bn a year – twice as much as they receive in aid. A 1 % increase in export share for each developing region would reduce poverty by 12 %, with the biggest reductions in sub-Saharan Africa. We need to realize that, as a global community, we sink or swim together.

[Source: © *The Guardian* adapted with permission from an article entitled "Morals of a brothel" by Larry Elliot published in *The Guardian Weekly*, April 15th 2002.]

(This question continues on the following page)

(Question 4 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) tariffs *[2 marks]*
 - (ii) import-substitution. *[2 marks]*
- (b) Using a demand and supply diagram, explain the effects of the United States imposing tariffs upon imported steel. *[4 marks]*
- (c) Using an appropriate diagram, explain how the imposition of farm subsidies in the European Union will affect foreign producers. *[4 marks]*
- (d) Using information from the text and your knowledge of economics, evaluate the arguments for and against protectionism. *[8 marks]*

Question 5

Study the extract below and answer the questions that follow.

Release the Poor from Debtors' Prison

The West's big economies are in trouble. Growth is coming to a halt, **budget deficits** are rising; financial markets are full of doom and gloom. Freeing the poorest countries from their debtors' prison was supposed to be guaranteed, but from the start, it was obvious that there were potential problems with the debt relief formula because of optimistic estimates for export growth.

Not all heavily-indebted countries have been hurt because the prices of some **commodities**, such as cocoa, have been rising. However, the World Bank and the IMF know that there is a real problem and accept that some of the weakest commodity prices are unlikely to recover soon. Also, the tendency for commodity prices to experience extreme fluctuations means that predicting income for commodity producers is almost impossible.

Where debt relief is freeing resources for poor countries, there are signs that it is having an impact. Mozambique has introduced a free immunisation programme for children. User fees for primary education have been abolished in Uganda, Malawi and Tanzania. But there is a long way to go. In Mozambique, the government estimates that 17 % of children will die of Aids by the end of the decade. The World Bank estimates that combating HIV/Aids will cost low income countries at least 1 %–2 % of GDP.

So what needs to be done? One answer is to tackle low commodity prices by ending the large subsidies that Western governments give to their farmers, which lead to over-production and low prices. A report this week said that the subsidy for a cow under the European Union's common agricultural policy is \$2.20 a day, higher than the income of more than half the world's population. The IMF's economic model shows that removal of support on rice, refined sugar and wheat would result in an increase in the world price of these goods by 2 %–8 %. These would be substantial net gains for a few countries, including some poor countries that are big exporters, as well as some relatively rich ones.

However, part of the problem for indebted countries is that the prices of tropical commodities, not produced in the West, are also falling. Here, there is a need for producers to take supply out of the world market. Only by doing so will they bring supply into line with demand, and as a result push up prices. Sadly however, poor countries are so desperate to boost exports that there is a temptation to produce more, condemning themselves to continued low prices.

[Source: © *The Guardian* adapted with permission from an article entitled "Stop treating debtors as poor cows" by Larry Elliot published in *The Guardian Weekly*, September 23rd 2002]

(This question continues on the following page)

(Question 5 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) budget deficits *[2 marks]*
 - (ii) commodities. *[2 marks]*
- (b) Explain why many commodity prices tend to experience **extreme** price fluctuations. *[4 marks]*
- (c) Using an appropriate diagram, explain how the subsidies given to farmers lead to “over-production and low prices”. *[4 marks]*
- (d) Using information from the text and your knowledge of economics, evaluate the effectiveness of debt relief in terms of alleviating poverty in developing countries. *[8 marks]*
-

MARKSCHEME

SPECIMEN PAPER

ECONOMICS

Standard Level

Paper 2

Data-response questions

The assessment criteria apply to all questions. Each question is worth [20 marks].

Part (a) (i)		[2 marks]
level		
0	Wrong definition.	0
1	Vague definition.	1
2	Precise definition, or vague definition with appropriate example.	2
Part (a) (ii)		[2 marks]
level		
0	Wrong definition.	0
1	Vague definition.	1
2	Precise definition, or vague definition with appropriate example.	2
Part (b)		[4 marks]
level		
0	Inappropriate answer.	0
1	Identification of appropriate theory.	1–2
2	Correct application of appropriate theory.	3–4
Part (c)		[4 marks]
level		
0	Inappropriate answer.	0
1	Identification of appropriate theory.	1–2
2	Correct application of appropriate theory.	3–4
Part (d)		[8 marks]
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

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

Question 1.

(a) Define the following terms indicated in bold in the text:

(i) opportunity cost [2 marks]
The idea that it is something given up or an alternative. 1

An explanation that it is the value of the next best alternative forgone, preferably with an example. 2

(ii) negative externalities. [2 marks]
The idea that they are a cost to society. 1

An explanation that they are costs borne by society resulting from acts of consumption or production, where the consumers or producers in question do not bear the cost themselves. A situation where social cost is greater than private cost. 2

(b) Using an appropriate diagram, explain how air pollution created by the taxis in Mumbai is an example of market failure. [4 marks]

For drawing a marginal social cost/marginal social benefit diagram **or** providing an explanation of how air pollution is created by the taxi drivers, but is not reflected in their private costs, as a result making social costs greater than private costs and creating a negative externality. 1–2

For drawing a marginal social cost/marginal social benefit diagram **and** providing an explanation of how air pollution is created by the taxi drivers, but is not reflected in their private costs, as a result making social costs greater than private costs and creating a negative externality. 3–4

(c) Explain in economic terms, how the advertising campaign is expected to help to cure the market failure. [4 marks]

For identifying that effective advertising will affect the demand for clean taxis, by shifting the demand curve to the right (*i.e.* increasing demand). 1–2

For identifying that effective advertising will affect the demand for clean taxis, by shifting the demand curve to the right (*i.e.* increasing demand) and for then taking this further, either into reduced price elasticity values, or acceptance of higher prices.

Examiners should be aware that candidates may take a different approach, which if appropriate should be fully rewarded. 3–4

(Question 1 continued)

- (d) Using information from the text and your knowledge of economics, evaluate the advantages and disadvantages for the Indian government of improving the quality and quantity of public transport in Mumbai.**

[8 marks]

Responses may include:

Advantages

- reduction in social costs
- improvements in health
- consequent reductions in the costs of providing health care
- increases in the demand for public transport
- possible increases in income from the above
- improvements in the quality of life and sustainable development.

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

Disadvantages

- crowding out caused by increased government borrowing
- possible opportunity costs of a reduction in expenditure in other areas
- possible increases in taxation
- pressure from private industry.

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

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

Question 2.

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

(i) inflation

The idea that it relates to a rise in prices.

1

2

An explanation that it is a **sustained** increase in the general level of prices over a given period of time.

(ii) depreciation.

The idea that it is a reduction in the value of a currency.

[2 marks]

1

An explanation that it is a reduction in the value of a currency, in a floating exchange rate system.

2

(b) Using an appropriate diagram, explain the change in consumer prices in Brazil between 2000 and 2002 shown in *Diagram 2*.

[4 marks]

For drawing an appropriate AD/AS diagram showing inflation **or** for explaining that inflation has fallen from 7% to 4%, but prices are still rising. Causes may be given for the continuing inflation, such as high public sector spending and the depreciation of the currency leading to imported inflation.

1–2

For drawing an appropriate AD/AS diagram showing inflation **and** for explaining that inflation has fallen from 7% to 4%, but prices are still rising. Causes may be given for the continuing inflation, such as high public sector spending and the depreciation of the currency leading to imported inflation.

3–4

Responses may simply graph the fall in inflation against time and this should be rewarded as an appropriate diagram.

(Question 2 continued)

- (c) Using an appropriate diagram, explain the possible link between Diagrams 4 and 5, that is, why a depreciating real might contribute to increasing public sector net debt.** **[4 marks]**

For drawing an appropriate diagram **or** for explaining that presumably much of the debt is owed overseas and needs to be repaid in whichever currency the lender country deals. As a result, servicing the debt will require more *reals* as the value of the currency depreciates. **1–2**

For drawing an appropriate diagram **and** for explaining that presumably much of the debt is owed overseas and needs to be repaid in whichever currency the lender country deals. As a result, servicing the debt will require more *reals* as the value of the currency depreciates. **3–4**

Responses may offer diagrams showing the depreciation of the real, in terms of demand and supply, or may use AD/AS curves and illustrate the changes in government debt caused by the depreciation. Any appropriate diagram should be rewarded, so long as it fits in with the explanation given.

(Question 2 continued)

(d) Using information from the text and the diagrams, and your knowledge of economics, evaluate the economic situation in Brazil at the end of 2002.

[8 marks]

Responses may include:

- Brazil seems to have a healthy growth rate, 4.5% in 2002. (However, we do not know if it is real GDP).
- Growth rate seems to have stabilised over the last three years.
- Inflation has fallen over the last three years, although it is still relatively high and is above OECD averages.
- The current account balance is in continual deficit and must be a strain on the economy.
- The falling value of the *real* does not seem to have helped exports and slowed down imports. This may indicate that the demand for Brazilian exports and imports is relatively inelastic.
- Increasing public sector net debt is very worrying for the economy and may lead to high interest rates and have negative implications for economic growth.
- The threat of tighter fiscal policy has a number of implications.

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

Question 3.

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

(i) unemployment rate
The idea that it is the number of people claiming benefit or who are out of a job. **1**

An explanation that it is the number of people claiming benefit, divided by the number in the labour force $\times 100$, *i.e.* that it is expressed as a percentage. **2**

(ii) current account deficit. **[2 marks]**
The idea that it is where the value of exports is less than the value of imports. **1**

An explanation that it is where the value of the exports of visible and invisibles is less than the value of the imports of visible and invisibles. **2**

(b) Using an appropriate diagram, explain why higher interest rates might increase unemployment. **[4 marks]**

For drawing an AD and AS diagram **or** providing an explanation of how there would be a demand side shift to the left, reducing demand in the economy and so increasing unemployment. Better candidates may make a case for a leftward shift of the AS curve as well. **1–2**

For drawing an AD and AS diagram **and** providing an explanation of how there would be a demand side shift to the left, reducing demand in the economy and so increasing unemployment. Better candidates may make a case for a leftward shift of the AS curve as well. **3–4**

(c) Using an appropriate diagram, explain why more generous unemployment benefits may have caused the unemployment rate to rise. **[4 marks]**

For drawing a demand and supply of labour diagram **or** providing an explanation of how an increase in unemployment benefits will increase the number available for work and decrease the number willing to work, *i.e.* increase voluntary unemployment. **1–2**

For drawing a demand and supply of labour diagram **and** providing an explanation of how an increase in unemployment benefits will increase the number available for work and decrease the number willing to work, *i.e.* increase voluntary unemployment. **3–4**

(Question 3 continued)

(d) Using information from the text and your knowledge of economics, evaluate the possible effects of the fall in the value of the US dollar on the American economy.

[8 marks]

Responses may include:

- an increase in the price of US imports and consequent possible imported inflation
- a fall in the demand for US imports, depending upon elasticity
- domestic products possibly replacing imported goods and thus higher employment in these industries
- a fall in the price of US exports, and as a result, an improvement in competitiveness
- an increase in demand for US exports, depending upon elasticity
- a possible increase in employment in the US export industries
- an increase in tourism from abroad
- concern that higher interest rates used to prop up the dollar might worsen unemployment (*paragraph 4*).

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

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

Question 4.

(a) Define the following terms indicated in bold in the text:

(i) tariffs *[2 marks]*
The idea that they are taxes placed upon imports. **1**

An explanation that they are taxes placed upon imports in order to reduce imports or to raise revenue. **2**

(ii) import-substitution. *[2 marks]*
The idea that it relates to a reduction in imports. **1**

An explanation that it is a policy aimed to replace imported products with domestically produced goods. **2**

(b) Using a demand and supply diagram, explain the effects of the United States imposing tariffs upon imported steel. *[4 marks]*

For drawing a demand and supply diagram **or** providing an explanation of how a tariff will increase the prices charged by foreign producers, and as a result increasing domestic supply and reducing the level of imports. **1–2**

For drawing a demand and supply diagram **and** providing an explanation of how a tariff will increase the prices charged by foreign producers, and as a result increasing domestic supply and reducing the level of imports. **3–4**

(c) Using an appropriate diagram, explain how the imposition of farm subsidies in the European Union will affect foreign producers. *[4 marks]*

For drawing a demand and supply diagram **or** providing an explanation of how a subsidy will increase the amount received by domestic producers, shifting the domestic supply curve downwards thus increasing domestic supply and reducing the levels of imports. **1–2**

For drawing a demand and supply diagram **and** providing an explanation of how a subsidy will increase the amount received by domestic producers, shifting the domestic supply curve downwards thus increasing domestic supply and reducing the levels of imports. **3–4**

(Question 4 continued)

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

[8 marks]

Responses may include:

- definition of protectionism.

Arguments for

- infant industry argument
- strategic reasons
- retaliation
- protecting employment
- safety reasons, *e.g.* drugs, harmful or dangerous products
- trade diversion
- gaining government revenue through tariffs.

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

Arguments against

- lack of opportunities for economies of scale
- increased efficiency through competition
- the ability to gain from comparative advantage
- elimination of dead-weight losses
- trade creation.

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

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

Question 5.

(a) Define the following terms indicated in bold in the text:

(i) budget deficits **[2 marks]**

The idea that it is related to government expenditure or income. **1**

An explanation that it is where government expenditure exceeds government income. **2**

(ii) commodities. **[2 marks]**

The idea that it is a primary product. **1**

An explanation that it is a product extracted from (*i.e.* hard commodity) or grown on (*i.e.* soft commodity) the land. **2**

(b) Explain why many commodity prices tend to experience *extreme* price fluctuations. **[4 marks]**

The concept of inelastic demand and/or inelastic supply must be mentioned. **1–2**

An explanation that relatively inelastic demand and supply curves will lead to large price fluctuations when demand and/or supply shifts. This will probably be achieved by the use of a diagram, but a full explanation would be enough. **3–4**

(c) Using an appropriate diagram, explain how the subsidies given to farmers lead to “over-production and low prices”. **[4 marks]**

For drawing a demand and supply diagram **or** providing an explanation of how a subsidy will increase the price received by domestic producers, shifting their supply curve downwards, and as a result leading to over-production and reducing the level of prices. **1–2**

For drawing a demand and supply diagram **and** providing an explanation of how a subsidy will increase the price received by domestic producers, shifting their supply curve downwards, and as a result leading to over-production and reducing the level of prices. **3–4**

(Question 5 continued)

- (d) Using information from the text and your knowledge of economics, evaluate the effectiveness of debt relief in terms of alleviating poverty in developing countries.**

[8 marks]

Responses may include:

- an explanation of the concept of debt relief
- definition of poverty.

Positive consequences of debt relief

- freeing of resources
- opportunities for greater investment in human capital
- opportunities for greater investment in technology.

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

Negative consequences of debt relief

- tendency towards fiscal irresponsibility
- corruption
- loss of income/profits for developed countries.

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

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

Glossary of Command Terms

Introduction

Candidates need to be familiar with these key terms and phrases used in economics examination questions, which are to be understood as described in the glossary. Although these terms are used frequently in examination questions, other terms may also be used to direct candidates to present an answer in a specific way.

Glossary

Account for

Asks candidates to explain a particular situation or a particular outcome. Candidates are expected to present a reasoned case for the existence of something. For example:

Account for the rise in unemployment shown in the table of data.

Analyse

Asks candidates to respond with a closely argued and detailed examination of a particular topic or event. A clearly written analysis will indicate the relevant interrelationships between important variables and any relevant assumptions involved, and will also include a critical view of the significance of the account as presented. If this key word is augmented by the phrase “the extent to which”, then candidates should be clear that judgment is also sought. For example:

Analyse the extent to which foreign aid promotes economic development.

Assess

Asks candidates to measure and judge the magnitude or quality of something. Candidates may offer differing assessments as long as they present the reasoning for their conclusion. For example:

Assess the economic implications of the movement of many eastern and central European countries from planned economies to market economies.

Calculate

Asks candidates to give a precise answer, meaning there is only one acceptable answer. For example:

Calculate the PED for a price change of \$2.00 to \$2.20.

Compare/Compare and contrast

Asks candidates to describe two situations and present the similarities and differences between them. A description of the two situations does not on its own meet the requirements of this key term. For example:

Compare the effectiveness of demand-side policies to supply-side policies in reducing the level of unemployment.

Define	<p>Asks candidates to give a clear and precise account of a given word or concept. For example:</p> <p>Define what is meant by a free-trade area.</p>
Describe	<p>Asks candidates to provide a description of a given situation. It is a neutral request to present a detailed picture. For example:</p> <p>Describe the main roles of the IMF and the World Bank.</p>
Discuss	<p>Asks candidates to consider a statement or to offer a considered review of or balanced argument about a particular topic. For example:</p> <p>Discuss the view that trade is more effective than aid in promoting economic development.</p>
Distinguish	<p>Asks candidates to make clear their understanding of similar terms. For example:</p> <p>Distinguish between normal and supernormal profit.</p>
Evaluate*	<p>Invites candidates to make an appraisal of a situation. Candidates should weigh the nature of the evidence available and discuss the convincing aspects of an argument as well as its implications and limitations, and the less convincing elements within an argument. For example:</p> <p>Evaluate alternative policies designed to reduce inflation.</p>
Explain	<p>Directs candidates to describe clearly, make intelligible and give reasons for a concept or idea. For example:</p> <p>Explain why a monopolist may charge different prices to different customers for the same service.</p>
To what extent?	<p>Asks candidates to evaluate the success or otherwise of one argument or concept over another. Candidates should present a conclusion, supported by arguments. For example:</p> <p>To what extent should LDCs adopt outward-oriented strategies rather than inward-oriented strategies to promote economic development?</p>
What?	<p>Asks candidates to clarify the nature of something, in contrast to either a temporal dimension (when?) or a spatial dimension (where?) For example:</p> <p>What is the difference between a tariff and a quota?</p>

Why?

Invites candidates to present reasons for the existence of something. This command word implies a powerful requirement to present a judgment. It is similar to the invitation “account for”. For example:

Why do prices tend to be stable in an oligopolistic industry?

*** Evaluation**

Evaluation occurs when a judgment is made. It is the weighing or measuring of factors followed by an attempt to give relative weight to those factors. Questions that begin “evaluate”, “assess”, “critically assess”, “discuss” or “to what extent” require candidates to show their skills of evaluation in order to reach the highest achievement levels.

There are many ways that candidates can be encouraged to improve their skills of evaluation.

- When factors such as causes, consequences or remedies are asked for, candidates should attempt to identify the most important ones and then to justify the reason for the choice.
- When advantages and disadvantages are asked for, candidates should attempt to identify the most important advantage (or disadvantage) and then justify the reason for the choice.
- When strategies are asked for, candidates should attempt to assess the short term and long term implications.
- When data is offered, candidates may question its validity, in terms of whether it is appropriate, whether it is reliable, or whether it is still relevant.
- When summarizing a theory, candidates may question its validity, in terms of whether it is appropriate, whether it is reliable, or whether it is still relevant.