

MARKSCHEME

November 2004

ECONOMICS

Higher Level

Paper 3

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SECTION A

Data Response: Paper-Specific Markscheme

Award up to the maximum marks available.

Question 1 50 yen burger means new price war in Tokyo

	Partial Mark	Maximum Mark
(a) What is meant by the following words printed in bold in the text?		
(i) price war		
• a situation in which companies try to undercut each others prices	2	
• for mention of oligopoly	1	
• for mention of overcapacity or market share	1	2
(ii) recession		
• for the idea that there is a fall in GDP or	1	
• at least two consecutive quarters of negative growth	2	2
(b) Using a supply and demand diagram, explain how the discovery of mad cow disease in Japan affected the market for hamburgers.		
• for a properly labelled diagram, showing a shift of the demand curve to the left	2	
• for an explanation that there will be a fall in demand for hamburgers and so fewer will be demanded and supplied at a lower price	2	4
(c) Given the pricing strategy chosen by McDonald’s what can you conclude about McDonald’s view of the price elasticity of demand? Illustrate your answer with a diagram.		
• for mention that they have cut prices	1	
• for understanding that they expect elasticity to be elastic	2	
• for realizing that if elasticity is elastic, then total revenue will rise when the price is dropped	2	
• for a correctly labelled diagram, showing demand and total revenue	3	5

If no diagram is attempted then the maximum is *[3 marks]*.

(d) (i) Which market structure is most closely represented by the fast food market in Japan?

Oligopoly or monopolistic competition. 1

(ii) Justify your answer using evidence from the text.

Evidence for oligopoly may be:

- a few large firms dominating the market 2
- reference to a price war 2
- elements of price leadership. 2

Evidence for monopolistic competition may be:

- large number of firms 2
 - slightly differentiated products. 2
- 4**

(e) Using information from the text and your knowledge of economics, evaluate the possible outcome of a price war in the Japanese fast food industry.

Points that may be raised could include:

- consumers may gain from lower prices
- consumers may gain from non-price competition
- firms will lose short-run profits
- some firms will be forced out of the industry
- a movement towards monopoly
- government may lose indirect tax revenue from lower prices
- employees may suffer wage cuts or job cuts
- foreign producers will sell more beef, so imports rise
- *any other reasonable answer.*

Level 0:	No valid discussion.	0
Level 1:	Very few relevant issues recognized with little or no valid discussion.	1-2
Level 2:	A few issues recognized with some attempt at discussion or just one issue developed fully.	3-4
Level 3:	A range of issues discussed in reasonable depth. The candidate must also show an awareness of alternative view points and engage in some sensible evaluation.	5-7

Question 2 Consumers need to keep spending or recession could return

	Partial Mark	Maximum Mark
(a) What is meant by the following word printed in bold in the text?		
(i) consumption		
• for the idea that it relates to consumer expenditure	1	
• total expenditure by consumers in an economy over a given period of time	2	
• a component of aggregate demand	1	2
(ii) investment		
• for the idea that it is related to capital	1	
• capital expenditure used to increase productive capacity	2	
• the purchase of capital equipment, such as machinery	1	
• a component of aggregate demand	1	
• references to investment in different forms of capital, such as human, social or productive	2	2
(b) The writer claims that growth of consumption has been faster than growth of GDP in several countries (paragraph ③). In which country has this trend been most evident? Explain your answer.		
• for writing that it is the UK	1	
• for explaining that the annual change in consumer spending has exceeded the annual change in GDP since 1995/96	3	
• for recognizing that the excess has been 2 % since 1999	2	4
(c) The diagrams show the changes in the growth of consumption for the four countries. What can be inferred about changes in the other components of aggregate demand?		
• for identifying the other components (I, G, [X-M])	2	
• for explaining that where annual change in consumption is greater than the annual change in GDP, annual changes in the other components are likely to be lower than the annual changes in GDP	3	
• for linking this to the text, e.g. “until investment revives” or “Japan importing less”; for each link	1	5

(d) Use aggregate demand/aggregate supply analysis to explain how the changes to consumption suggested in *paragraph 4* could be damaging to the economies mentioned.

- | | | |
|--|---|---|
| • for drawing an accurately labelled AD/AS diagram | 1 | |
| • for showing a shift of the AD curve to the right | 1 | |
| • for indicating an increase in real national income | 1 | |
| • for indicating a higher price level | 1 | |
| • for explaining that the shift in AD will cause an increase in GDP | 1 | |
| • for mentioning increased inflation | 1 | |
| • for explaining/showing that increased investment may, in the long run, shift the aggregate supply to the right, increasing GDP and lowering prices | 3 | 5 |

(e) Using information from the text and your knowledge of economics, explain the extent to which a coordinated cut in interest rates might be the best solution to a fall in consumption.

Responses may make the following points:

- cuts in interest rates are part of monetary policy
- they are part of demand management policies
- they should stimulate consumption and investment
- they may have a weakening effect on the value of the currencies
- there is a possible trade-off with inflation
- coordinated cuts will affect a greater proportion of the global economy
- if the cuts are coordinated, the disturbances to exchange rates and trade patterns will be lessened
- responses which concentrate on only the effects of interest rate cuts should not go beyond Level 2
- Keynesian circular flow and multiplier effects may be introduced
- alternative policies may be considered and evaluated.

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

SECTION B

Essays: Paper-Specific Guidance

The following comments are intended to provide extra guidance to Assistant Examiners, but they are not meant to be a “straitjacket”.

They are meant to indicate some of the main points which the question-setter hoped to elicit, and/or indicate sensible approaches; however, it is often possible for candidates to respond to a question in a way which is unanticipated and yet which contains valid economic arguments, so please keep an open mind.

THE GENERAL MARKING CRITERIA REMAIN THE MAIN BASIS FOR AWARDING MARKS.

Question 3

- (a) **Explain the concepts of maximum and minimum price controls.** **[10 marks]**

Responses should explain what maximum prices are, *i.e.* price ceilings set by the government or some other agency. The price is not allowed to rise above this level, although it is allowed to fall below it. Better responses will give examples of when this may be appropriate, *e.g.* for rent controls or for basic goods to keep low for the lower wage earners. The best responses will also include a diagram.

Responses should explain what minimum prices are, *i.e.* price floors set by the government or some other agency. The price is not allowed to fall below this level, although it is allowed to rise above it. Better responses will give examples of when this may be appropriate, *e.g.* for wages or to protect producers’ incomes. The best responses will also include a diagram.

Candidates who only deal with one of the concepts should be limited to a maximum of **[5 marks]**.

- (b) **Evaluate the idea that government intervention in the form of price ceilings and price floors is well intentioned, but often leads to undesirable side effects.**

[15 marks]

This part of the question asks the candidate to assess the effects of the imposition of maximum/minimum prices. It is best approached by taking examples and then evaluating their success in terms of achieving the desired outcome. Candidates might refer to several of the examples in each section but it is equally acceptable to have a well developed discussion on one example only in each section.

Examples and areas for discussion might include:

Minimum prices

- setting minimum prices to protect producers incomes. The aim is usually to provide stability and to give a guaranteed minimum return to important producers. However, the effect is often to create a glut of the product, which the government will then have to buy and possibly store.
- protecting wages leads to an excess supply of labour
- firms with surpluses on their hands may try to evade the price controls and cut their prices
- black markets may evolve to clear the surpluses
- high prices may cushion inefficiency
- high prices may discourage firms from producing alternative goods that they could produce more efficiently.
- the above may be explained and then the candidate may go on to explain how the glut might be used as a buffer stock in future times when production is short.

Maximum prices

- setting a maximum price below the equilibrium price in a market will lead to excess demand. For example setting rent below the equilibrium rent in a market will lead to an excess demand for rented accommodation.
- the government may have to instigate rationing
- black markets may develop
- maximum prices reduce the quantity of an already scarce commodity.
- queues may develop

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

Candidates who only deal with one of the concepts should be limited to a maximum of **[8 marks]**.

Question 4

Evaluate the effectiveness of demand-side and supply-side policies in the short and long run.

[25 marks]

Responses should distinguish between the short run and the long run in some way.

Responses should explain demand-side and cover both fiscal and monetary policies. Better answers will use diagrams.

Responses should explain supply-side policies. Better answers will cover both market-based and interventionist policies, as well as using diagrams.

Better responses may consider the Keynesian/neo-classical debate on the shape of the LRAS curve.

Responses should attempt to evaluate the different policies and better candidates will realize that demand-side policies are effective, to an extent, in the short run, although there are costs because of trade-off. They should also realize that the majority of supply-side policies are long term and take a fair amount of time to take effect.

Better responses may also identify the situations that arise when supply-side policies are also demand-side policies and there may be a clash of outcome. For example, lowering interest rates as a supply-side policy may lead to a shift of AD to the right and inflationary pressures in the short run.

Question 5

(a) Explain the components of the balance of payments.

[10 marks]

Responses should define the components in general terms and should then explain the main elements that make up the balance of payments accounts:

- the balance of trade
- the invisible balance
- balance of payments on current account
- balance of payments on capital account.

Responses which do not introduce all four components should be limited to a maximum of **[6 marks]**.

(b) Evaluate the extent to which the balance of payments may be controlled by the manipulation of interest rates.

[15 marks]

This part of the question asks candidates to evaluate the effect of interest rate changes on the concepts identified in (a).

Responses may consider:

- the effect on exchange rates of altering interest rates
- the role of “hot” money
- the importance of elasticity of demand for exports and imports
- the “short-termism” of hot money
- the internal effects of interest rate changes on the demand for imports
- the internal effects of interest rate changes on the supply of exports
- alternative methods of controlling the balance of payments.

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

Question 6

- (a) **Explain the different forms of aid that may be available to a developing nation.** *[10 marks]*

Candidates should introduce and explain at least three of the following in order to move above Level 2 *i.e.* be awarded more than *[5 marks]*. Three well developed examples can obtain full marks.

- Bilateral aid – aid from one country to another.
- Multilateral aid – aid is given to international aid agencies, who then decide where the need is greatest.
- Grant aid – where money, food aid, or emergency relief is provided as a gift, with no repayment expected.
- Soft loans – loans that are given to LDCs at below-market rates of interest.
- Official aid – aid administered by governments or government agencies.
- Unofficial aid – administered by a non-governmental body, such as a charity.
- Tied aid – the recipient country has to agree to buy goods or services from the donor country.
- Mixed credits – MDCs lend LDCs money for the purchase of MDC exports at below-market prices. In effect, this is a mixture of a loan and an export subsidy.

- (b) **To what extent is aid effective in terms of addressing the problems faced by LDCs?** *[15 marks]*

Responses must show awareness of both the positive and negative effects of aid. Good responses will distinguish between the effect of aid on growth and the effect of aid on development. Better responses will discriminate between the effects of **different** types of aid.

Positive effects might include:

- fill the “savings gap”, “investment gap” “technology gap”, “foreign exchange gap”
- NGO aid is more successful in contributing towards development.

Negative effects might include:

- displaces local producers
 - debt service problems
 - dependency culture
 - corruption – misuse of aid
 - contributes to military struggle
 - tends to focus on urban areas reinforcing income inequalities and worsening rural-urban migration
 - food aid damaging to domestic agriculture.
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