

MARKSCHEME

May 2007

ECONOMICS

Higher Level

Paper 3

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

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

(i)	centrally planned economy (<i>paragraph ①</i>)	[2 marks]
	level	
	0 <i>Wrong definition</i>	0
	1 <i>Vague definition</i> The idea that the government makes all the economic decisions.	1
	2 <i>Precise definition</i> An explanation that it is an economic system where resources are allocated by the government or a central planning authority OR resources are not allocated by the forces of demand and supply.	2
(ii)	foreign direct investment (<i>paragraph ③</i>).	[2 marks]
	level	
	0 <i>Wrong definition</i>	0
	1 <i>Vague definition</i> The idea that a company invests in another country.	1
	2 <i>Precise definition</i> An explanation that it is the establishment of production units by multinational companies in other countries.	2

(b) Using an appropriate diagram, explain why China is experiencing “increasingly rapid economic growth and expansion” (paragraph 4). [4 marks]

level

- | | | |
|---|---|-----|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
For drawing a correctly labelled production possibility curve for China, showing an expansion in the PPC or an explanation that efficiency improvements are improving the quality of resources and driving economic growth and expansion. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing a correctly labelled production possibility curve for China, showing an expansion in the PPC and an explanation that efficiency improvements are improving the quality of resources and driving economic growth and expansion. | 3-4 |

Candidates may use an AD/AS diagram showing a shift to the right in the SRAS or LRAS curve.

Alternatively, candidates may use AD/AS analysis to explain that there has been an increase in AD due to an increase in investment (par. 4 entrepreneurs, joint venture and multinational companies are contributing to rapid economic growth”. There has also been an implied increase in consumption (par. 4 – “businesses are manufacturing cars for transport and mobile phones for communication”).

Using a PPC analysis, candidates might also show a shift outwards in the PPC combined with two points, one inside the initial curve and one to the right of the original PPC but to the left of the new one, with more of both “goods” at the second point.

Candidates do **not** have to make the distinction between actual growth and potential growth.

Candidates who incorrectly label diagrams cannot be rewarded with full marks. For a PPC, anything with two competing goods, such as capital goods and consumer goods (even Good X and Good Y) is acceptable on the axes (not price and quantity).

(c) “The increased domestic demand, along with the push to make more goods for the international market, has increased China’s consumption of just about everything” (*paragraph 5*). Using an appropriate diagram, explain how increased domestic demand in China may impact upon prices and output in China.

[4 marks]

level

0 *Inappropriate answer*

0

1 *Identification of theory*

1-2

For drawing a correctly labelled AD/AS diagram showing a shift in the AD curve **or** for providing an explanation of how increased domestic demand could increase the components of AD (*e.g.* private consumption and private investment) causing AD to rise, contributing to rising output and prices.

2 *Correct application of appropriate theory*

3-4

For drawing a correctly labelled AD/AS diagram showing a shift in the AD curve **and** for providing an explanation of how increased domestic demand could increase the components of AD (*e.g.* private consumption and private investment) causing AD to rise, contributing to rising output and prices.

Candidates who incorrectly label diagrams cannot be rewarded with full marks. For AD/AS, the vertical axis may be price level or average price level. The horizontal axis may be output, national output, real output, real national output, national income, GDP or real GDP.

(If candidates used incorrect labels on an AD/AS in (c) above, then they should not be penalised twice. That is, if the answer is otherwise correct, they may receive full marks.)

It is possible that the answers to (b) and (c) are very similar. Candidates are not to be penalised for this.

- (d) **Using information from the text and your knowledge of economics, evaluate the economic consequences resulting from the transition of an economy from central planning to a market economy.**

[8 marks]

Answers **may** include:

Favourable consequences:

- greater domestic ability to spend on domestic goods (*e.g.* cars and mobile phones par. 4)
- rapid economic growth is resulting in new suburbs being built
- efficiency gains (par. 3 – closing of state-owned enterprises)
- increases in investment and efficiency gains through joint ventures and multinational corporations (par 4)
- multiplier effect of increased investment
- increased standards of living (*e.g.* “developing suburbs for the growing middle class”)

Unfavourable consequences

- increasing inequality in the distribution of income (par 6 – “growing gap between the wealthy cities and poor rural communities”)
- possible negative effects associated with increase in FDI by multinationals
- possible unemployment as a result of privatisation
- negative consequences of increased MNC activity
- Market failure – negative externalities associated with rapid economic growth. Environmental concerns/issues (par. 6)
- inflation risks (demand pull and cost push) as prices are liberalised (par. 5)

Economic consequences might also relate to the consequences to the “rest of the world” – *e.g.* lower priced consumer goods due to the rapid growth of Chinese industry, higher commodity prices (oil, copper, steel and cement) due to Chinese demand.

Do not award more than *[5 marks]* if the answer does not contain references to the information provided in the text.

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

Effective evaluation may be to:

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

Level

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

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

(i) price discrimination (paragraph 5) *[2 marks]*

level

0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that different prices are charged for a product.	1
2	<i>Precise definition</i> An explanation that it occurs when a producer charges a different price to customers for an identical good or service.	2

(ii) income elasticity of demand (paragraph 7). *[2 marks]*

level

0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that YED is about how much demand changes when income changes.	1
2	<i>Precise definition</i> An explanation that YED is the measure of the responsiveness of quantity demanded (OR demand) of a good to a change in income.	2

An alternative approach that may be given full marks is to state the formula. (either “demand” or “quantity demanded” may be used.

(b) **With reference to paragraph 2, use an appropriate diagram to explain why the new road system does not reflect the true cost to society.** [4 marks]

level

0 *Inappropriate answer* 0

1 *Identification of theory* 1-2

For drawing a correctly labelled diagram of a negative externality showing MSC is greater than MPC (or MPB is greater than MSB) or for providing an explanation that despite the new road system MSC is still greater than MPC (or MPB greater than MSB) as evidenced by the external costs of continued traffic congestion, delays, pollution and general wear and tear on the roads. There should be some mention of the external costs to show awareness that the “true cost” is not reflected.

2 *Correct application of appropriate theory* 3-4

For drawing a correctly labelled diagram of a negative externality showing MSC is greater than MPC (or MPB is greater than MSB) and for providing an explanation that despite the new road system MSC is still greater than MPC (or MPB greater than MSB) as evidenced by the external costs of continued traffic congestion, delays, pollution and general wear and tear on the roads. There should be some mention of the external costs to show awareness that the “true cost” is not reflected.

Some candidates may argue that the problem is not that the new road system is imposing external costs on non-users, but rather that the new road is under-consumed. Examiners should reward any plausible answer.

Candidates who incorrectly label diagrams cannot be rewarded with full marks. The use of P and Q is sufficient. Alternatively, the vertical axis could be “costs and benefits”.

(c) **Using at least *one* appropriate diagram, explain why the price elasticity of demand (PED) is different for the two main users of the road system.** [4 marks]

level

0 *Inappropriate answer* **0**

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

For drawing a correctly labelled diagram showing the different PED for the two main users with the PED for producers being steeper than the PED for households **or** for providing an explanation that the PED for producers is inelastic because the benefits gained by producers make them more willing to pay higher tolls. The consumers have more choice in using the non-toll roads and do not need the faster roads as much, so their demand is elastic.

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

For drawing a correctly labelled diagram showing the different PED for the two main users with the PED for producers being steeper than the PED for households **and** for providing an explanation that the PED for producers is inelastic because the benefits gained by producers make them more willing to pay higher tolls. The consumers have more choice in using the non-toll roads and do not need the faster roads as much, so their demand is elastic.

Candidates might show the different elasticities on two separate diagrams.

Candidates who incorrectly label diagrams cannot be rewarded with full marks. The use of price and quantity on the axes is sufficient.

- (d) **Using information from the text and your knowledge of economics, evaluate the arguments for and against charging for the use of roads.** **[8 marks]**

Answers **may** include:

Arguments for:

- for producers/industry that use them, greater efficiency (par. 6 – “cutting costs)
- possible economies of scale for business/industry (par. 6 – “allowing the use of larger trucks”)
- if people are willing to pay for it, there is quicker travel time (par. 3 = “reduced travel times for motorists that use it”)
- increased demand for environmentally-friendly public transport, a substitute
- if the roads are produced and “sold” by the public sector, the money raised could be used to make further improvements in infrastructure
- the ability to charge for a road will increase the incentive for private firms to build roads
- par 1 – “added significantly to the overall stock of infrastructure”
- macroeconomic supply side benefits

Arguments against:

- could encourage more people to use alternative cheaper roads leading to external costs of greater “traffic congestion, delays, pollution and general wear and tear on the roads” (par. 2)
- difficulty of pricing the road. If the price is too high, it will create the problems of external costs on non-toll roads, as suggested in text. If the price is too low, it will not solve the problems.
- disadvantages for low income earners
- politically unpopular if people think that roads should be provided free of charge

Do not award more than **[5 marks]** if the answer does not contain references to the information provided in the text.

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

Effective evaluation may be to:

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

Level

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

3. (a) Define the following terms indicated in bold in the text and data:

(i) Gini Coefficient (*graph heading*) [2 marks]

level

0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that it measures the distribution of income.	1
2	<i>Precise definition</i> An explanation that it is a measure of inequality in the distribution of income. The candidates may well add more, but this is sufficient for full marks.	2

(ii) progressive tax (*text 1*).

level

0	<i>Wrong definition</i>	[2 marks]
1	<i>Vague definition</i> The idea that as someone earns more income, they pay more tax.	0
2	<i>Precise definition</i> An explanation that it is where the higher the level of income, the higher the percentage of taxation that is paid, OR the higher the level of income the higher the average rate of taxation.	1 2

(b) Using a Lorenz Curve diagram, explain what happened to the distribution of income in the UK between 1984 and 1988. **[4 marks]**

- | | | |
|-------|--|------------|
| level | | 0 |
| 0 | <i>Inappropriate answer</i> | |
| 1 | <i>Identification of theory</i>
For drawing a correctly labelled Lorenz Curve diagram showing a shift in the Lorenz Curve away from the diagonal 45 degree line or for providing an explanation that the Gini coefficient increased indicating that income distribution became less equal between 1984 and 1988. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing a correctly labelled Lorenz Curve diagram showing a shift in the Lorenz Curve away from the diagonal 45 degree line and for providing an explanation that the Gini coefficient increased indicating that income distribution became less equal between 1984 and 1988. | 3-4 |

Candidates who incorrectly label diagrams cannot be rewarded with full marks. The vertical axis should be “income” or “% of income” or “% of Y”. The horizontal axis should be “population” or “% of population” or “quintiles”. It is not necessary to include the word “cumulative”. It is not necessary to label the 45 degree line as the line of absolute equality as long as the explanation shows some understanding of this point.

(c) Using an appropriate diagram, explain how the introduction of an indirect tax on a good or service will affect its price. **[4 marks]**

- | | | |
|-------|--|------------|
| level | | 0 |
| 0 | <i>Inappropriate answer</i> | |
| 1 | <i>Identification of appropriate theory</i>
For drawing a correctly labelled diagram showing a shift to the left in the supply curve for a good or service or for providing an explanation that the indirect tax increases effectively the cost of production and decreases supply thus raising price. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing a correctly labelled diagram showing a shift to the left in the supply curve for a good or service and for providing an explanation that the indirect tax effectively increases the cost of production and decreases supply thus raising price. | 3-4 |

Candidates who incorrectly label diagrams cannot be rewarded with full marks. The use of price and quantity on the axes is sufficient.

- (d) **Using information provided and your knowledge of economics, evaluate the use of progressive tax systems to provide a more equitable distribution of income.**

[8 marks]

Answers **may** include:

- considered equitable/fair as the burden of the tax falls mainly on high income earners
- reduction in poverty (Text 1 – “alter the distribution of income in favour of the less well-off, thereby reducing absolute and relative poverty”)
- the revenue can be used to increase government spending on merit goods and public goods
- Text 1 – “those who can most afford to pay should take a higher share of the burden of financing public spending”

However:

- “economists worry about the impact of progressive taxes on efficiency and output”
- Overall, higher average taxes may have negative supply side effects
- Disincentive effect of higher taxes – people may not be inclined to work harder if their tax rates will rise. This can help to explain the effect on efficiency and output
- Progressive taxes might discourage entrepreneurial activity
- Laffer curve effect – if people work less hard, then government revenues might fall
- firms may move to countries with lower taxes
- lowers investment and potential economic growth.

Do not award more than *[5 marks]* if the answer does not contain references to the information provided.

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

Effective evaluation may be to:

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

Level

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

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

(i) free trade area (text 2)

level		0
0	<i>Wrong definition</i>	
1	<i>Vague definition</i> The idea that countries make an agreement to have free trade with each other	1
2	<i>Precise definition</i> An explanation that it is an agreement whereby there is free trade among member countries, but each member can maintain its own trade barriers in trade with non-member countries	2

(ii) subsidies (text 3).

level		0
0	<i>Wrong definition</i>	
1	<i>Vague definition</i> The idea that it is government financial assistance to businesses.	1
2	<i>Precise definition</i> An explanation referring to government financial assistance to producers to reduce the costs of production OR to reduce the price of necessity goods to consumers OR to give domestic producers assistance in international markets.	2

(b) Using an appropriate tariff diagram, explain how the USA-Australian trade agreement, and the removal of US tariffs on Australian goods, could boost Australian exports to the USA.

[4 marks]

level

0 *Inappropriate answer*

0

1 *Identification of theory*

1-2

For drawing a correctly labelled tariff diagram showing a fall in the world plus tariff line **or** for providing an explanation that a lower US tariff on Australian goods will cause the amount of imports in the US market to rise which would mean an increase in Australian exports sold in the US market.

2 *Correct application of appropriate theory*

3-4

For drawing a correctly labelled tariff diagram showing a fall in the world plus tariff line **and** for providing an explanation that a lower US tariff on Australian goods will cause the amount of imports in the US market to rise which would mean an increase in Australian exports sold in the US market.

Candidates who incorrectly label diagrams cannot be rewarded with full marks. The use of price and quantity on the axes is sufficient.

(c) Using an appropriate diagram, explain how “freer market access” (text 4) could lead to a strengthening of the Australian dollar. [4 marks]

level

- 0 *Inappropriate answer* **0**

- 1 *Identification of appropriate theory* **1-2**
For drawing a correctly labelled exchange rate diagram showing an increase in demand for the Australian dollar and a rise in the exchange rate **or** for providing an explanation that freer market access will increase the demand for Australian exports and so the demand for the Australian dollar rises, resulting in a strengthening of the Australian dollar.

- 2 *Correct application of appropriate theory* **3-4**
For drawing a correctly labelled exchange rate diagram showing an increase in demand for the Australian dollar and a rise in the exchange rate **and** for providing an explanation that freer market access will increase the demand for Australian exports and so the demand for the Australian dollar rises, resulting in a strengthening of the Australian dollar.

Some candidates may recognise that this may be countered through an increase in imports.

Candidates who incorrectly label diagrams cannot be rewarded with full marks. It is not sufficient to simply write “price” on the vertical axis. The following are acceptable: “price of AUS \$ in US \$” “price of AU\$ in other currencies”, “US\$/AU\$”, “price of AU\$”, “exchange rate”. It is sufficient to write “quantity” on the horizontal axis.

- (d) **Using information provided and your knowledge of economics, evaluate the consequences of WTO trade negotiations aimed at reducing protectionism.**

[8 marks]

Answers **may** include:

- a description of the WTO
- an explanation of protectionism

The answer might be framed in terms of positive and negative outcomes:

Positive outcomes:

- increased world output and other benefits of free trade – comparative advantage theory
- better allocation of the world’s scarce resources
- job creation (Text 4 – more than 250 000 jobs created in Australia)
- increased size of market for exporters– economies of scale
- benefits to consumers in developed countries (lower prices) of greater access to developed markets for developing countries (Text 3 – “the removal of barriers will, hopefully, improve the access of developing nations into the markets of developed nations”)
- benefits in terms of growth (and possibly development) to developing countries from having greater access to developed country markets
- benefits to developing countries should there be a reduction in agricultural subsidies in developed countries

Negative outcomes

- consequences for industries that have lost comparative advantage
- falling real wages or unemployment in “sunset industries”
- adjustment costs in both developed and developing countries (short run costs versus long run advantages)
- nationalistic sentiments and/or fears
- concerns about dumping
- Text 4 – “nationalistic fears of job losses, dumping”
- loss of tariff revenues as a source of government income and the resulting “therefore need to raise (other) taxes
- prices of some food products may rise if agricultural subsidies are eliminated. This may be a problem for developing countries that are net importers of food
- concerns about poor working conditions in developing countries
- concerns about health, environment or safety standards

Do not award more than *[5 marks]* if the answer does not contain references to the information provided.

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

Effective evaluation may be to:

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

Level

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

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

(i) informal markets (paragraph ③)

level

0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that informal markets are parallel or black markets.	1
2	<i>Precise definition</i> An explanation that informal markets refer to markets in which economic activity is not officially measured/recorded. The answer may include examples of informal markets or reasons why activity may be un-recorded, but this is not necessary for full marks.	2

(ii) property rights (paragraph ④). *[2 marks]*

level

0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that it is the private ownership of property.	1
2	<i>Precise definition</i> An explanation that property rights give people a legal right to own property/assets.	2

(b) Using an appropriate diagram explain how removing the “regulatory problems” (*table heading*) would impact on an economy. [4 marks]

level

- | | | |
|---|--|-----|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of theory</i>
For drawing a correctly labelled AD/AS or PPC diagram showing the impact of removing these regulatory problems (an increase in SR OR LR aggregate supply or an outward shift in the PPC) or for providing an explanation that removing the regulations will cut costs and improve efficiency and so increase aggregate supply in the economy. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing a correctly labelled AD/AS or PPC diagram showing the impact of removing these regulatory problems (an increase in SR OR LR aggregate supply or an outward shift in the PPC) and for providing an explanation that removing the regulations will cut costs and improve efficiency and so increase aggregate supply in the economy. | 3-4 |

Alternatively, candidates might be able to use a business cycle diagram showing a change in the long run growth trend line. This would also be acceptable, if correctly explained.

Candidates who incorrectly label diagrams cannot be rewarded with full marks. For AD/AS, the vertical axis may be price level or average price level. The horizontal axis may be output, national output, real output, real national output, national income, GDP or real GDP. For a PPC, anything with two competing goods, such as capital goods and consumer goods (even Good X and Good Y) is acceptable on the axes (not price and quantity). For a business diagram showing an upward trend in GDP, the vertical axis would be along the lines of “GDP”.

(c) **Identify and explain two possible consequences of an “ineffective taxation structure” (paragraph 3).** **[4 marks]**

level

- | | | |
|---|---|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
Candidates just identify the consequences or explain only one in detail. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
Two consequences are identified and explained in detail. | 3-4 |

An explanation of the possible consequences of an ineffective taxation structure **may** include:

- loss of government revenue from an inability to tax economic activity in informal markets
- inability of a government to provide merit and public goods
- higher taxes charged to the formal sector to compensate for forgone taxes in the informal markets
- increased tendency towards tax avoidance/evasion
- the negative effect on income distribution due to the reliance on indirect taxes which are regressive
- an inefficient tax structure is likely to enhance the opportunity for corruption/bribery
- excessive regulatory/administrative costs – inefficiency

Alternative arguments might be made, which, if plausible, may be fully rewarded. *The two consequences explained by candidates might well be inter-related as in the first two points above. If they are well explained, they should be fully rewarded, as it is not easy for candidates to separate the reasons.*

- (d) **Using information from the text and your knowledge of economics, evaluate how institutional and political factors can impact upon economic development.**

[8 marks]

Institutional and political factors mentioned in the text include:

- under-use of formal banking system may prevent saving
- lack of property rights may inhibit entrepreneurial activity
- excessive bureaucracy/red tape may increase costs of doing business
- corruption may increase costs of doing business
- ineffective tax system limits ability of governments to generate revenue.

Candidates must show an understanding of how the factors impact upon development. Many of the points are more obviously linked to economic growth, so this distinction should be made.

There may well be overlap between this question and the previous question. Candidates should not be penalised for this.

Do not award more than **[5 marks]** if the answer does not contain references to the extract provided in the text.

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

Effective evaluation may be to:

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

Level

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