

MARKSCHEME

November 2001

ECONOMICS

Standard Level

Paper 2

Question 1: The Buses are Free - for Everyone

	Partial Mark	Maximum Mark
(a) Explain the meaning of the following terms used in the passage:		
(i) externalities;		
<ul style="list-style-type: none"> • Give one mark for a good definition in terms of costs and benefits that affect a third party. 	2	
<i>Award [1 mark] for candidates who mention either costs or benefits and [2 marks] for candidates who refer to both.</i>		
(ii) subsidy.		
<ul style="list-style-type: none"> • Give one mark for a general definition in terms of a payment to a producer. 	1	
<ul style="list-style-type: none"> • Give a second mark for the realisation that the aim is to reduce costs or decrease price or increase supply. 	1	2
(b) What is the price elasticity of demand for bus travel in Kristinehamn?		
<ul style="list-style-type: none"> • For a correct definition of price elasticity of demand 	1	
<ul style="list-style-type: none"> • For claiming that price elasticity is elastic 	2	
<ul style="list-style-type: none"> • For explaining that the number of passengers has increased by 160 % whereas price has decreased by 100 % 	2	
<ul style="list-style-type: none"> • For the exact answer, <i>i.e.</i> -1.6 but also give [4 marks] if the candidates give 1.6 rather than -1.6. 	4	4
(c) Compare Carl Soneson's use of the term 'free good' (paragraph 4) with that of an economist.		
<ul style="list-style-type: none"> • For Soneson using the term to mean no charge 	1	
<ul style="list-style-type: none"> • For an economist using it to mean no opportunity cost 	1	
<ul style="list-style-type: none"> • For giving other economic examples of a free good 	1	
<ul style="list-style-type: none"> • For commenting that for an economist there is an opportunity cost in this case and so the economist, unlike Soneson, would not regard this as a free good 	2	4

**Partial Maximum
Mark Mark**

(d) Why might other local authorities be reducing their support to state supplied services? Refer to paragraph 4 in your answer.

The intention is for the candidate to make a link between the quotation and supply side policies.

Points that could possibly be made relate to the

- benefits of making the consumer pay the full cost of the service **3**
- increased incentives due to tax cuts **3**
- effect on efficiency of providing services without a subsidy **3**
- general idea of the increased use of the market mechanism and the reduced role of the government **4**

6

Be prepared to reward any other relevant points in the same manner.

(e) Using the information in the article and your own knowledge of economic theory, how would an economist judge whether the experiment of free bus travel in Kristinehamn was a success?

The candidate is being invited to write about cost - benefit analysis.

Possible points that could be made are:

- private costs - zero since fares are free (mentioned in the article)
- private benefits - greater travel opportunities and financial savings for travellers (mentioned in the article)
- external benefits - reduced congestion and accidents. Savings in time and effort for the drivers (mentioned in the article)
- external costs - cost to taxpayers in Kristinehamn (not mentioned in the article). Greater congestion on the buses (mentioned in the article). The need to calculate social costs and benefits in order to judge whether it is a success.

Be prepared to reward other relevant costs and benefits which are not mentioned in the article.

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

Question 2: Finland, OECD Report

	Partial Mark	Maximum Mark
(a) With reference to the Balance of Payments table, explain the meaning of the following terms:		
(i) trade surplus;		
• Visible exports exceed visible imports	2	2
(ii) current account surplus.		
• Exports of goods and services (visible and invisible) are greater than imported goods and services	2	2
(b) Explain the relationship between the current account surplus and the trade surplus over the period 1995 to 2000.		
• Trade surplus greater than current account surplus in each year	1	
• Invisible trade must have been negative, in deficit in each year to account for the difference	2	
• No consistent correlation between changes in the two	1	
<i>Give credit for inclusion of relevant data.</i>	1	3
(c) With reference to the tables, suggest how the Finnish government was able to ‘turn a budget deficit of 7% of GDP in 1993 into a surplus of 1.5 % in 1998’.		
• Lower unemployment means more government revenue from taxation	2	
• Same evidence also implies that government pays less in unemployment benefits	2	
• Healthy trade surplus implies employment growth	2	
• GDP growth rate above that of OECD, therefore government revenues will be healthy	2	
• Inflation below OECD average, hence growing competitiveness	2	4

		Partial Mark	Maximum Mark
(d)	Explain how loose monetary policy in Europe might harm the Finnish economy? (See final sentence of the article.)		
	• Understanding that loose monetary policy means lower interest rates and greater money supply	2	
	• Note that Finland is committed to the same monetary policy as Europe	1	
	• Loose monetary policy leads to increased consumption and investment, which can be inflationary if the economy is near full employment	2	
	• Use of an appropriate diagrams, <i>e.g.</i> AD/AS	3	4
(e) (i)	State why the OECD feels that labour-market and tax reforms are needed.		
	• Unemployment still too high, though it has fallen	2	
	• Unemployment might be due to labour market rigidities	2	
	• Requires reform which provides incentives for people to work	1	
	• Increases in aggregate demand, such as the loose monetary policy will be inflationary	1	3
(ii)	Discuss the types of policies which could be adopted to carry out such reforms.		
	• Candidates should interpret this as a question about supply-side policies and discuss any policies which encourage people to work. These are likely to include changes to minimum wage legislation, reduction of union power, decreased marginal tax rates, reduction in benefits, <i>etc.</i>		
	• Answers should address how these actually work		
	<i>For the highest marks candidates should make use of a diagram.</i>		
Level 0:	No valid discussion		0
Level 1:	Very few relevant issues recognised with little discussion or basic understanding		1-2
Level 2:	A few issues recognised with some attempt at discussion or just one issue developed well		3-4
Level 3:	A range of issues developed in reasonable depth with some sensible evaluation		5-7

Question 3

- (a) Explain why and how a buffer stock scheme might be used to stabilise prices in a market economy. [12 marks]**

Reasons for the creation of a buffer stock scheme could include:

- buffer stock schemes are intended to provide a stable framework of prices to benefit both producers and consumers
- buffer stock schemes are generally used in the case of commodities where the price is very volatile
- because many developing countries are dependent on the export of commodities, they are therefore very vulnerable to such volatility

To explain how the scheme would work:

- a graph should be drawn to illustrate the maximum and minimum range of prices set by the scheme
- should also note what might occur to cause the price to move out of the acceptable range and then explain what an organisation would have to do to bring it back
- a buffer stock manager and suitable resources would have to be established

- (b) Evaluate the difficulties involved in the operation of such a scheme. [13 marks]**

Possible areas for discussion include:

- the high costs of storing the goods
- the necessity of holding large amounts of financial reserves
- the difficulty of choosing an appropriate price range which can be sustained
- the possibility of cheating by individual members who might seek to sell a larger amount by reducing the price
- the growing availability of synthetic substitutes for many commodities causing downward pressure on prices
- the increasing supply of many commodities as a result of improved technologies causing downward pressure on prices

Question 4

- (a) **To what extent is GNP per capita an appropriate measurement to use to compare living standards in different countries?** **[12 marks]**

Possible areas for discussion include:

- increases in GNP often associated with improvements in living standards but this is not necessarily the case; economic growth is not the same as economic development
- GNP alone not a good statistic to use to measure living standards, let alone compare countries
- statistic does not indicate the distribution of income
- statistics may not be accurate; degree of accuracy will vary from country to country
- different countries have different conventions for calculations
- extent of 'black', hidden, informal economy may differ, leading to varying levels of underestimation in different countries
- work at home/subsistence agriculture not included - amounts will vary, leading to varying levels of underestimation
- the type of output / spending not clear - some types of spending are more likely to improve living standards than others
- statistics may be converted at official exchange rates which will not necessarily reflect purchasing power

- (b) **Discuss other measures which might be used to compare living standards.** **[13 marks]**

The following could be mentioned:

- composite indicators such as: Human Development Index, Human Suffering Index, Physical Quality of Life Index, Index of Sustainable Economic Welfare, Human Poverty Index
- GNP per capita refined to take account of purchasing power parity rates
- the need to look at other indicators of living standards: *e.g.* life expectancy, infant mortality, literacy rates, access to safe water, daily calorie supply, number of doctors per 100 people, number of televisions *etc.*
- the desirability of being able to value the more 'intangible' indicators such as gender equality, political freedom, freedom of speech, civil rights. However, answers based entirely on non economic indicators and which ignore HDI, HPI *etc.* should not score more than **[6 marks]**
- the need to account for the negative aspects of growth such as resource depletion, externalities

Question 5

- (a) **What are the costs of a high level of unemployment in a developed economy?** **[10 marks]**

Candidates should be aware of both economic and social cost of unemployment.

Economic cost might include:

- reduced tax revenue to government / greater spending on benefits
- actual output falls short of potential output
- excess supply of labour might depress wages among those in employment

Social costs might include:

- crime and social unrest, poor health and social dislocation - all of which may have significant economic costs to government

*Candidates should be rewarded for reference to real world examples. Candidates who write solely about social **or** economic cost should score no more than [6 marks].*

- (b) **Suggest and evaluate measures to deal with high unemployment.** **[15 marks]**

While the wider Keynesian and Monetarist debate is a higher level extension only, standard level candidates are expected to have a critical awareness of current macroeconomic debate.

Candidates might be expect to recognise that

- solution depends on the type of unemployment
- solution depends on the school of thought - some recognition of Keynesian versus neo-classical perspectives should be mentioned
- a description of supply-side polices - *e.g.* policies which increase aggregate supply by increasing the incentives to work
- supply-side policies are supported generally by the neo-classical school of thought/monetarist who view structural, frictional, seasonal and real-wage unemployment as being essentially ‘voluntary’
- supply-side policies appropriate for ‘voluntary’ unemployment include: reducing/removing the minimum wage, reducing the power of trade unions, reducing government unemployment benefits, reduction in marginal tax rates
- a description of demand-management policies - *e.g.* fiscal and monetary policies designed to adjust the level of aggregate demand
- expansionary fiscal and monetary policies are useful in correcting demand-deficient unemployment (Keynesian model)

Question 6

Evaluate the consequences for developing countries of relying on market forces and outward orientated strategies to achieve economic growth.

[25 marks]

The implication of the question is that candidates can respond in terms of positive or negative consequences or both. Some likely arguments are:

Consequences of the use of market forces:

- possible increase in income inequality as growth occurs first in a modern sector
- lack of regulation may lead to presence of negative externalities
- greater access to international capital markets
- smaller size of the state sector

Reward any other reasonable example, especially if backed by real world awareness.

Consequences of outward orientated strategy:

- openness to world markets may lead to greater FDI and presence of multinationals and to economic activities which may result in air pollution, soil erosion, deforestation, *etc.*
- improved access to foreign exchange, technology and foreign markets
- greater exposure to fluctuation in the world economy
- dependence on a narrow range of export markets, leading to resource reallocation and possible structural unemployment

Reward any other reasonable example especially if backed by real world examples.

The best answers will relate the chosen strategies to the outcome in terms of growth and growth rates.
