# MARKSCHEME

## November 2002

## ECONOMICS

## Standard Level

## Paper 2

## SECTION A

**Question 1: Coffee Growers find Grounds for Protest**

| | | Partial Mark | Maximum Mark |
|---|---|---|---|
| **(a)** | **Define briefly the following terms highlighted in bold in the text:** | | |
| | **(i) real prices (paragraph 2);** | | |
| | • real prices are the nominal / current price adjusted for inflation. | **2** | **2** |
| | **(ii) commodity agreements (paragraph 5).** | | |
| | • a group made up of producers and consumers | **1** | |
| | • organised to stabilise prices | **1** | |
| | • in the interest of both producers and consumers | **1** | |
| | • by manipulating supply | **1** | |
| | • or maintaining a buffer stock. | **1** | **2** |
| **(b)** | **Explain how a rise in commodity prices might damage "sustainable, inflation-free growth" in Western economies (paragraph 4, last line).** | | |
| | • Western economies tend to import commodities | **1** | |
| | • as factors of production | **1** | |
| | • increased prices = increased costs of production | **1** | |
| | • which may be fed through to higher prices | **1** | |
| | • increased costs - decreased aggregate supply | **1** | |
| | • which results in a higher price level. | **1** | **5** |
| | *Reward other plausible suggestions.* | | |
| **(c)** | **Using supply and demand analysis, show and explain how the ACPC price support system is expected to work.** | | |
| | • basic supply and demand diagram | **2** | |
| | • axes labelled accurately (price per pound, pounds of coffee) | **1** | |
| | • an indication that such a scheme involves a price floor and ceiling | **1** | |
| | • floor price (95 cents per pound) and ceiling price (105 cents per pound) noted on y-axis | **1** | |
| | • a decrease in supply to keep price within "band", leading to higher prices | **2** | **5** |
| | *An explanation **without** an accompanying diagram should receive a maximum of **[3 marks]**.* | | |

| | Partial Mark | Maximum Mark |
|---|---|---|
| **(d) Suggest *two* problems which could threaten the success of the ACPC plan.** | | |
| • An explanation that non-member countries could increase supply and bring down the price. | **3** | |
| • Member countries might cheat by increasing supply. | **3** | |
| • Demand for coffee in the western economies might be price elastic leading to a proportionately larger fall in quantity demanded and a fall in revenues. | **3** | |
| • Falling demand in Western economies. | **3** | **4** |
| *Reward other plausible suggestions.* | | |
| **(e) If it is successful, how can the strategy proposed by the ACPC contribute to economic growth and development in the countries referred to in the text?** | | |
| Candidates should distinguish between economic growth and development, noting that a successful commodity scheme is likely to lead to increased economic growth as increased export earnings are a component of GDP. Better answers will note that this will not necessarily lead to development. | | |
| Economic development will be improved if such countries use their increased earnings in areas of the economy which will lead to development - *i.e.* health, education, investment in human capital *etc.* | | |
| Candidates might refer specifically to the Sub-Saharan countries and note that development is dependent on governments making better use of revenues, cutting back on corruption and reducing spending which may be used to finance civil wars. | | |
| *Reward any plausible argument.* | | |
| **Level 0** No valid discussion | | **0** |
| **Level 1** Very few relevant issues recognised with little or no valid discussion | | **1-2** |
| **Level 2** A few issues recognised 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** |

**Question 2**

| | Partial Mark | Maximum Mark |
|---|---|---|
| **(a) Define the following measurements used in Table I:** | | |
| **(i) GNP per capita** | | |
| • GNP per capita is the value of output from nationally owned capital over a period... | 1 | |
| ...divided by the population | 1 | |
| ...not allowing for depreciation. | 1 | 2 |
| **(ii) purchasing power parity exchange rates.** | | |
| • Purchasing Power Parity exchange rates are used to adapt nominal GNP to allow for local purchasing power. | 3 | 3 |
| **(b) Using the data in Table 1 explain** | | |
| **(i) the difference between the two columns of measurements of GNP per capita.** | | |
| • for noting that GNP per capita PPP is greater than nominal in some countries and less than nominal in others | 1 | |
| • for noting that the disparity is between LDCs and MDCs | 1 | 2 |
| **(ii) what factors might explain these differences?** | | |
| • Local purchasing power is greater in LDCs because prices are lower... | 2 | |
| • perhaps due to lack of demand in an economy which is not fully monetised. | 1 | |
| • Local purchasing power is less in MDCs because prices are higher... | 2 | |
| • perhaps because of taxes and what the market will bear in a developed economy. | 1 | |
| • Nominal exchange rates differ from PPP exchange rates. | 1 | 6 |

**(c) Using the data shown in the first two columns of Table 2, account for the differences in annual growth rates of the selected countries.**

| | | |
|---|---|---|
| • for noting that the difference is between growth and growth per capita | **1** | |
| • for understanding that population growth can affect nominal growth rates over time | **1** | |
| • for realising the implication that population growth rates vary in the selected countries | **1** | |
| • for realising that LDCs have a tendency towards having the highest nominal / lowest per capita growth rates, but MDCs have the lowest nominal / highest per capita growth rates due to population growth | **4** | **5** |

**(d) From your own knowledge of economic theory and the data in Table II, discuss the influence of income distribution on rates of growth and development.**

**Growth**

The implication of the table is that slower per capita growth rates are found in LDCs, where income distribution is least equal, and that faster per capita growth rates are found in MDCs, where income distribution is more equal.
This could be explained with reference to the multiplier (the poor lack the ability to consume sufficiently to generate income flow in an unequal society, while in a more equal society all participate in markets).

Reference could also be made to absence of trickle-down effects in the least equal societies where it might be expected to occur.

**Development**

Unequal distribution of income may be a barrier to development but it is not the only one. Candidates should refer to institutional, trade and political barriers to development, as well as problems of infrastructure and underemployment. Development may depend on the ability of the population to save and stimulate capital markets. An equal distribution of income, especially in the middle of the income range, is helpful.

Reference might also be made to the tendency for wealthy elites in LDCs to import luxuries, diverting demand away from the domestic economy, with consequent lower growth.

| | | |
|---|---|---|
| **Level 0:** | No valid discussion | **0** |
| **Level 1:** | Very few relevant issues recognised with little or no valid discussion | **1-2** |
| **Level 2:** | A few issues recognised 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

### Question 3

**(a) What are positive externalities and how do they arise? Illustrate your answer with examples.** ***[10 marks]***

Candidates should fully explain the term positive externalities showing they understand that they will arise when the social benefits are not reflected in the market price of goods. Better answers will use standard MSB / MSC diagrams to illustrate their parts and will explain that positive externalities may arise from productions and consumption.

**(b) To what extent should governments attempt to influence markets where positive externalities exist?** ***[15 marks]***

Issues and areas for discussion might include:

- different forms of government intervention (*e.g. subsidies, direct provision)*
- explanation of resource misallocation through under consumption / production
- importance of merit goods *e.g.* health and education
- income distribution considerations
- general arguments against government intervention, *e.g.* in terms of consumer choice, competition, efficiency, opportunity costs, impact on government finances, *etc*.

**Question 4**

**(a) Explain the factors which influence the price elasticity of supply. Illustrate your answer with reference to the market for a commodity or raw material.** ***[13 marks]***

Candidates should define price elasticity of supply. Some factors which influence the PES of commodities are:

- the number of producers and barrier to entry into the industry *e.g.* oligopolistic oil industry
- the relationship between producers, *e.g.* cartels, commodity agreements *etc.*
- the availability of producer substitutes
- the time period (distinction between very short, short and long run)
- storage of stocks – possible with minerals but not with foodstuffs
- elasticity of supply of factor inputs – factor endowments, lead times *etc.*

**N.B.** *Candidates who explain the factors which influence PES without any reference to a commodity or raw material should be restricted to a maximum of* ***[6 marks]****.*

*Candidates who confuse PED with PES should be limited to a* ***maximum*** *of* ***[4 marks]****, providing there is something of relevance.*

**(b) Discuss the importance of price elasticity of supply and price elasticity of demand for producers of primary commodities in less developed countries.** ***[12 marks]***

*This part of the question asks the candidate to apply the knowledge provided in response to (a) using the problems of LDCs as commodity producers. Reference to real world examples should be rewarded.*

Candidates might be expected to consider the effects of degrees of inelasticity of supply and demand on:

- export revenues and the external balance
- the exchange rate
- fluctuating effects on local employment and investment

*Reward any other reasonable argument or example.*

**N.B.** *Particular credit should be given to those candidates who are able to relate the importance of PED and PES to primary commodity producers in LDCs, rather than just discussing the importance of the concepts in general terms.*

*Also give credit to those candidates who widen their answer by examining the importance of PED and PES for the economy at large for LDCs, e.g. in relation to the terms of trade, balance of payments, depreciation, government revenues etc.*

## Question 5

**(a) What macroeconomic polices would a government adopt if it wished to reduce aggregate demand in an economy?** ***[12 marks]***

Candidates might be expected to write about such policies as:

(i) restrictive fiscal policy involving decreases in government spending and / or increase in taxation.
(ii) restrictive monetary policies involving such things as increases in interest rate and reduction in the money supply.
(iii) price and incomes policy.

**(b) Should a government attempt to manage the level of aggregate demand to influence unemployment and inflation rates?** ***[13 marks]***

*The intention is to give candidates an opportunity to write about Keynesian / Monetarist controversies using demand management policies in this area.*

Possible points candidates might make relate to:

(i) the nature of the inflation / unemployment trade off.
(ii) the shape of the aggregate supply curve.
(iii) the effectiveness of demand management policies.
(iv) the effectiveness of supply side policies.
(v) the limitations of demand management policies.

*Candidates may score well by covering one aspect in detail or several aspect in less detail.*

**Question 6**

**(a) Why do countries practise protectionism?** *[12 marks]*

Candidates should explain the arguments in favour of protectionism which could include:

- infant industry argument
- protection of domestic jobs
- raising government revenue
- helping diversity (prevent over specialisation)
- correcting a balance of payments deficit
- "uneven playing ground" argument
- strategic reasons
- political reasons
- health, safety and environmental standards.

**(b) Discuss the likely problems associated with such a policy.** *[13 marks]*

Issues and areas for discussion might include:

- a diagram showing the effect of a tariff to illustrate the inefficiency area;
- higher prices for consumers
- lower levels of consumption
- "infant industries" not "growing up" but remaining uncompetitive and dependent on protection
- potential retaliation by trading partners
- a reduction in worldwide output
- costs of protecting jobs outweighing the benefits
- comparative advantage arguments.