

MARKSCHEME

November 2003

ECONOMICS

Standard Level

Paper 2

Section A — Data Response Questions — Paper-Specific Markscheme

Question 1: Karnataka Tourism set to gain from admissions fever.

**Partial Maximum
Mark Mark**

(a) Explain the meaning of the following terms that appear in bold text in the passage:

(i) excess demand (paragraph 2)

- demand > supply
- demand > supply at existing market price.
- accurate diagram

1
2
2 2

(ii) social benefits (paragraph 4).

- benefits to the different human stakeholders in the state of Karnataka *e.g.* businessmen, employees *etc.*
- benefits of production and/or consumption, benefits include both private and external benefits.

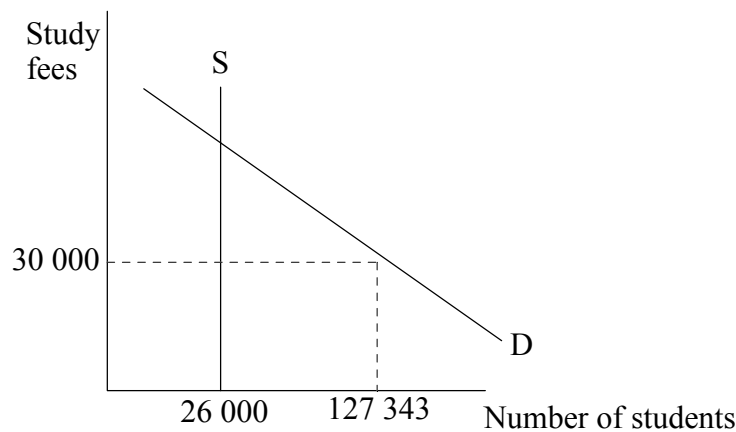
1
1 2

(b) (i) Use the information in paragraph 2 to draw a supply and demand diagram to illustrate the admissions' problem at the I.I.T.

Award up to a maximum of **[4 marks]**.

- for a well drawn and labelled diagram
- wrong diagram equilibrium at R 30 000
- for showing supply curve as perfectly inelastic
- for representing excess demand at 30 000 rupees.

2
1
2
2 4



**Partial Maximum
Mark Mark**

(ii) With the aid of supply and demand theory suggest proposals to deal with this problem of excess demand for places at I.I.T.

Award up to a maximum of *[5 marks]*.

Proposals might involve increases in supply, decreases in demand, use of price mechanism, *e.g.*

- increase in supply – expand I.I.T 3
 - decrease in demand – build universities elsewhere 3
 - raise entrance requirements 3
 - use price mechanism – raise fees from R30 000. 3
- 5**

(c) Using the information in the article and your knowledge of economic theory, describe and explain the possible social benefits to which the KTDC spokesperson refers in *paragraph 4*.

The key intention is for responses to include the benefits to both tourism and industry from the admissions procedure, the private benefits to the university and students as well as the longer term benefits from students living near the university for several years while they study.

Award up to a maximum of *[5 marks]*.

- little relevance 0
- few points, briefly mentioned 1-2
- relevant points, well explained 3-5

Information in the text relates to the business opportunities for hotels, lodgings and travel operators. Applicants to I.I.T can be seen as either an external benefit of production or consumption with appropriate diagram.

5

(d) Critically assess the role of I.I.T in promoting development in the Karnataka region.

This is a question which can be answered in a number of ways. Possible approaches may include

- appropriateness of developing higher education in an LDC
- use of AD/AS approach. Increase in AD lending to higher incomes and employment
- but possible higher prices
- cost-benefit analysis approach
- increase in the ratio of health professionals and engineers to the general population.

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 well-developed.	3-4
Level 3:	A range of issues developed in reasonable depth. Must also show an awareness of alternative viewpoints and engage in some sensible evaluation.	5-7

Question 2: OECD Survey, Czech Republic

**Partial Maximum
Mark Mark**

(a) Explain the meaning of the following terms that appear in bold in the text:

(i) recession (*line 3*)

Award up to a maximum of **[2 marks]**.

- | | | |
|-----------------------------------------------|----------|----------|
| • where output in the economy falls | 1 | |
| • growth becomes negative | 1 | |
| • two consecutive quarters of negative growth | 2 | |
| • as in the years 1997-1999 on graph. | 1 | 2 |

(ii) current account deficit (*line 4*).

Award up to a maximum of **[2 marks]**.

- | | | |
|--------------------------------------------------------------------------------------------------------------------------------------|----------|----------|
| • current account is a part of a country's Balance of Payments account | 1 | |
| • measures trade in goods (visibles) and services (invisibles) | 1 | |
| • in deficit, the outflow of money for imports of goods and services exceeds the amount earned from the export of goods and services | 2 | 2 |
- (Allow alternative terminology for countries using it e.g. non merchandise trade.)*

(b) (i) Describe the relationship between the change in GDP and the current account balance between 1999 and 2001.

Award up to a maximum of **[2 marks]**.

- | | | |
|----------------------------------------------------------------------------------------------------------------------------------------------|----------|----------|
| • as the GDP begins to grow in 1999, the current account deficit grows quite substantially | 2 | |
| • growth rate increases from 0 % to approximately 3.7 % while current account deficit increases from approximately 3 % of GDP to 6 % of GDP. | 2 | 2 |

(ii) What might account for this relationship?

Award up to a maximum of **[3 marks]**.

- | | | |
|-----------------------------------------------------------------------------|----------|----------|
| • as GDP increases, incomes rise | 1 | |
| • imports generally rise as incomes rise | 1 | |
| • extra demand "sucks in" a larger amount of imports | 1 | |
| • as inflation accompanies the growth, exports can become less competitive. | 1 | 3 |

**Partial Maximum
Mark Mark**

(c) (i) Describe the change in the Czech Republic’s consumer price level over the years 1998 to 2000.

Award up to a maximum of *[2 marks]*.

- inflation rate fell from 1998-2000 1
- from approximately 9 % in the 1998 to approximately 3 % in 2000 1
- inflation fell more rapidly (from 9 % to 4 %) in the first year 1
- than it did in the second year (4 % to 3 %). 1

(ii) How might monetary policy be responsible for the change from 1998 to 2000?

Award up to a maximum of *[4 marks]*.

- Text states that inflation was fought quite successfully with monetary measures 1
- monetary policy is the deliberate attempt by government to control interest rates and/or control the supply of money 2
- in this case, the government may have increased interest rates or lowered the supply of money to fight inflation 2
- higher interest rates can lead to lower consumption and/or investment 2
- resulting in lower aggregate demand 1
- and a lower price level 1
- reasonable diagrams (*e.g.* AD/AS or interest rates and investment) should be credited
- as interest rates rose, exchange rate may have risen making imports cheaper and thus reducing consumer prices. 4

(d) Explain why “the large current account deficit is putting downward pressure on the exchange rate and this may be inflationary”.

Award up to a maximum of *[3 marks]*.

- current account deficit implies that imports are greater than exports 1
- so that supply of currency will be greater than demand for currency 1
- which results in a falling exchange rate 1
- this leads to an increase in import prices 1
- which may stimulate cost-push inflation. 1

**Partial Maximum
Mark Mark**

(e) Use aggregate demand/aggregate supply analysis to explain why it is recommended that the Czech Republic continue using supply-side measures along with fiscal tightening.

- A diagram is essential in this question. Responses should list a few supply-side measures and show how they will increase aggregate supply. They should note that fiscal tightening means either increasing taxes or decreasing government spending and that such measures will reduce aggregate demand. Such measures will allow the Czech Republic to meet its inflation targets. Responses should address both demand and supply side to earn full marks.

Level 0:	No valid discussion.	0
Level 1:	Very few points recognised or just points developed.	1-2
Level 2:	A few points recognised with some attempt to use a diagram correctly in the discussion.	3-4
Level 3:	Several points addressed correctly. Diagram effectively used to illustrate the theory.	5-7

Section B — Essays — Paper-Specific Markscheme

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) Why do markets sometimes fail to set socially acceptable prices? [12 marks]

Among the factors responses are expected to consider are:

- the presence of externalities, especially negative externalities, which lead to overconsumption at undesirably low prices. Better responses will illustrate this with a diagram illustrating equilibrium at prices and quantities lower and greater than is socially desirable.
- the difficulty of providing merit goods through free markets: these would be underconsumed because of higher-than-desirable market price, though not all societies or people would agree on what should be considered a merit good.
- the abuse of monopoly power. Monopoly power gives the firm greater sovereignty leading to a deadweight loss of output at higher price and lower efficiency. Again, good responses might be expected to draw a diagram illustrating this.
- less important points (because the question is wider than plain market failure) might include difficulties that markets themselves experience in finding equilibrium or market-clearing price due to time-lags, supply inelasticities, *etc.*; the distorting influence of government intervention through taxes and subsidies, *etc.*

(b) To what extent can governments overcome this form of market failure? Illustrate your answer with examples. [13 marks]

To some extent the answer to (b) will depend on what has been written in response to (a). Bearing in mind this is a Standard Level question, responses might include:

- the use of taxes and subsidies to adjust levels of price and output into line with social costs. Better responses will again illustrate this with a diagram. Examples might be drawn from goods with consumption externalities such as cigarettes, or environmental externalities such as petrol.
- tradable permits. Explaining this is challenging and examples are relatively rare, so responses covering this clearly should be well-rewarded.
- anti-monopoly/anti-trust legislation to reallocate sovereignty in markets from producers to consumers. Examples here could be from the airline, oil or telecoms industries, among many others.
- adjustments to the legal framework in which markets operate, such as the establishment of property rights.

N.B. To reach bands 4 and 5 there must be some evaluation of the arguments and an analytical approach overall.

Question 4

Assess the impact of an increase in interest rates on:

(a) the balance of payments

[10 marks]

The **external** effects of an increase in interest rates might bear on the exchange rate. Higher interest rates relative to those of other countries should lead to an appreciation of the exchange rate. This might be caused by movements of money into the country on the capital account.

The effects on the balance of trade will be less predictable, depending on import and export elasticities. Where there is a high degree of elasticity in demand for imports and exports, the currency appreciation will lead to a deterioration in the balance of trade which could even reverse the currency appreciation.

(b) the domestic economy.

[15 marks]

The syllabus indicates that Standard Level candidates are likely to use the basic AD/AS model to deal with the effects of an increase in interest rates on the **domestic** side of the economy.

An increase in interest rates might encourage savings at the expense of consumption, causing the AD curve to move to the left. (The increased cost of investment might also have a longer term and more indirect effect on the AS curve, also shifting it to the left.)

The effects on the economy would depend on the shape of the AS curve, reducing the rate of inflation if it is vertical, or output if it is more horizontal. Good responses will refer to this controversy and illustrate the answer with a diagram.

Also, reward responses which set interest rates against the background of monetary policy, and express suitable opinions on its effectiveness as a tool of economic policy.

The important aspect of examining this question is to judge how far the candidate applies knowledge of the economic concepts and theories. Reward any references to real-world events and consequences.

***N.B.** To reach bands 4 and 5 there must be some evaluation of the arguments and an analytical approach overall.*

Question 5

(a) What are the benefits (gains) from international trade?

[10 marks]

The possible benefits might include the following:

- international trade and efficient resource allocation
- international trade and specialization
- the benefits of specialisation in terms of the principle of comparative advantage
- international trade and the enlargement of markets for producers
- the link between trade, specialization, economics of scale and lower unit costs
- greater variety of products for consumers
- international trade, competition and the challenge to monopoly power.

(b) To what extent is it justifiable for governments to resort to protectionism?

[15 marks]

Reward responses which critically assess the arguments for protectionism and provide an overall evaluation.

Credits should also be given to those responses which show good current awareness of the importance of trading blocs and the role of the WTO.

Issues and areas for discussion might include:

- inward and outward orientated growth strategies
- protection as a way of overcoming balance of payment problems
- the infant industry argument/sunset industries argument
- employment arguments
- strategic arguments
- possibility of retaliation
- misallocation of measures and inefficiency
- higher prices/less choice for consumers.

***N.B.** To reach bands 4 and 5 there must be some evaluation of the arguments for protectionism and an analytical approach overall.*

Question 6

Evaluate the role of Foreign Direct Investment (FDI) in contributing to growth and development in Less Developed Countries.

[25 marks]

A balanced response is required and must include:

- a good definition of FDI and the connection with Multinational Companies (MNCs)
- the advantages and disadvantages of FDI
- distinguish between growth and development
- note that the benefits of MNC investment tend to contribute to economic growth while the disadvantages tend to be in terms of a challenge to meeting development objectives.

***N.B.** To reach bands 4 and 5 there must be some evaluation of the arguments and an analytical approach overall.*
