



MARKSCHEME

May 2012

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) minimum price (paragraph ❶) [2 marks]

level

0 *Wrong definition* **0**

1 *Vague definition* **1**

The idea that it is a price set by the government (or an authority).

2 *Precise definition* **2**

An explanation that it is any two of the following:

- imposed by the government (or an authority)
- set above the equilibrium (market) price
- price cannot fall below this price.

(ii) free market (paragraph ❷). [2 marks]

level

0 *Wrong definition* **0**

1 *Vague definition* **1**

The idea that it is a market without government intervention.

2 *Precise definition* **2**

An explanation that it is a market in which resource allocation (or price and/or output) is determined by one of the following:

- demand and supply
- price mechanism
- producers and consumers.

(b) Using an appropriate diagram, explain the possible effect on the market for cigarettes of the ban on tobacco advertising in Ireland. [4 marks]

level

- | | | |
|---|--|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
For drawing a demand/supply diagram of the cigarette market showing a decrease in demand and a resulting decrease in price and fall in the equilibrium quantity or for providing an explanation that a ban on advertising would lead to a decrease in demand, leading to a decrease in price and fall in the equilibrium quantity. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing a demand/supply diagram of the cigarette market showing a decrease in demand and a resulting decrease in price and fall in the equilibrium quantity and for providing an explanation that a ban on advertising would lead to a decrease in demand, leading to a decrease in price and fall in the equilibrium quantity. | 3-4 |

Candidates who incorrectly label diagrams can be rewarded with a maximum of **[3 marks]**.

Candidates who interpret this as a market failure question may use MSB/MSC analysis. MPB shifts left towards MSB as a result of the ban on advertising. The effect on the market could be a reduction in the welfare loss. A candidate who selects this approach and does not refer to the change in price may nevertheless be fully rewarded.

The use of P and Q on the axes is sufficient for a demand and supply diagram. A title is not necessary.

For a market failure diagram, the vertical axis may be price, but could be costs or benefits. The horizontal axis is quantity. A title is not necessary.

- (c) **Using an appropriate diagram, explain why, if the demand for cigarettes is inelastic, raising the price may not be effective.** [4 marks]

level

- | | | |
|---|--|-----|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
For drawing a demand diagram of the cigarette market showing that an increase in price has a proportionately small effect on the quantity demanded or for an explanation that with inelastic demand an increase in price will cause a proportionately lower change in quantity demanded, thus not working to effectively discourage smoking. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing a demand diagram of the cigarette market showing that an increase in price has a proportionately small effect on the quantity demanded and for an explanation that with inelastic demand an increase in price will cause a proportionately lower change in quantity demanded, thus not working to effectively discourage smoking. | 3-4 |

Candidates who incorrectly label diagrams can be rewarded with a maximum of [3 marks].

The use of P and Q on the axes is sufficient for a demand and supply diagram. A title is not necessary.

For full marks, candidates must make it clear that the change in quantity demanded is relatively (proportionately) smaller than the change in price. It is not enough to explain in terms of small changes in quantity demanded with no comparison to the change in price.

A maximum of [2 marks] may be awarded for an answer which rests on the assumption that the demand for cigarettes is perfectly inelastic.

If a candidate has incorrectly labelled the diagram in part (b) and been awarded a maximum of [3 marks], then they may achieve full marks in this part of the question, if the labelling mistake has been repeated.

- (d) **Using information from the text/data and your knowledge of economics, evaluate the economic effects of the imposition of a minimum price for cigarettes.**

[8 marks]

Responses **may** include:

- an explanation and/or a diagram of minimum prices
- an observation that minimum prices are usually set to protect producers, but in this case it is being used to solve a market failure.

Arguments for:

- cigarettes are a demerit good and so their consumption should be reduced
- a higher price could discourage people from smoking (paragraph ④)
- the imposition of a minimum price could save lives (paragraph ③)
- the costs of health care could be reduced
- negative externalities such as passive smoking will be reduced
- a higher price will particularly discourage young people (paragraph ④), whose demand is likely to be more elastic because they earn lower incomes.

Arguments against:

- informal (parallel/underground/black) markets may appear, reducing the effectiveness of the minimum price
- demand for cigarettes is inelastic, so relatively few consumers will be discouraged from smoking (paragraph ⑤)
- retailers may suffer through fewer sales
- a minimum price may be difficult to enforce
- the option of increasing indirect tax on tobacco may be more effective and adds to state resources for implementing alternative policies (paragraph ①)
- state financing of education campaigns, persuasion through further advertising, provision of medical advice and counselling support may be better than minimum price
- price controls reduce freedom of choice for consumers and producers
- the cost of living will increase for consumers who buy cigarettes
- distributional effects because lower income households' real incomes will fall more.

Effective evaluation may be to:

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

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

If there is no direct reference to the text/data, then candidates may not be rewarded beyond level 2.

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) **negative externalities** (*paragraph ②*) [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1
The idea that they are “bad” effects of an economic transaction.

2 *Precise definition* 2
An explanation that they are costs that are suffered by third parties when a product is produced (or consumed).

OR

An explanation that they are the spillover costs when a product is produced (or consumed).

OR

An explanation that they are the external costs of production (or consumption) that are not reflected in the market price.

(ii) **structural unemployment** (*paragraph ③*). [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1
The idea that it is unemployment due to a change in the structure of the economy.

2 *Precise definition* 2
Any one of the following would be appropriate:
• unemployment that is caused as a result of a fall in the demand for a particular type of labour
• unemployment that occurs as a result of the changing structure of an economy resulting from changes in demand/supply and/or technology
• unemployment that occurs when there is a mismatch between the skills of unemployed workers and the jobs available
• unemployment that exists as a result of rigidities in the labour market.

(b) Using an appropriate diagram, explain why the Emissions Trading Scheme (ETS) could lead to higher prices for electricity. [4 marks]

level

- | | | |
|---|--|-----|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
For drawing a demand/supply diagram for the electricity market showing a decrease in supply and a resulting increase in price and fall in the equilibrium quantity or for providing an explanation that the ETS will increase costs for a polluting firm, causing the supply of electricity to decrease, leading to an increase in price and fall in the equilibrium quantity. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing a demand/supply diagram for the electricity market showing a decrease in supply and a resulting increase in price and fall in the equilibrium quantity and for providing an explanation that the ETS will increase costs for a polluting firm, causing the supply of electricity to decrease, leading to an increase in price and fall in the equilibrium quantity. | 3-4 |

Candidates may draw the market for carbon permits (perfectly inelastic supply curve) with either a leftward shift of supply or an increase in the demand for permits and therefore an increase in the price of permits, leading to an increase in the costs of production and higher prices for electricity.

Candidates who incorrectly label diagrams can be rewarded with a maximum of [3 marks].

The use of P and Q on the axes is sufficient for a demand and supply diagram. A title is not necessary.

(c) **With the aid of a diagram, explain how carbon emissions are a form of market failure.** **[4 marks]**

level

- | | | |
|---|--|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <p><i>Identification of appropriate theory</i></p> <p>For drawing a MSB/MSC diagram with MSC above MPC and a market equilibrium above a socially efficient level of output or for providing an explanation that carbon emissions produced by firms create external costs to third parties and are therefore a market failure where the market fails to produce at the socially efficient level of output.</p> | 1–2 |
| 2 | <p><i>Correct application of appropriate theory</i></p> <p>For drawing a MSB/MSC diagram with MSC above MPC and a market equilibrium above a socially efficient level of output and for providing an explanation that carbon emissions produced by firms create external costs to third parties and are therefore a market failure where the market fails to produce at the socially efficient level of output.</p> | 3–4 |

Candidates may approach this question by using a negative externality of consumption model. If the explanation matches the diagram, and is correctly explained, this may be rewarded full marks.

Candidates may use a supply and demand model to illustrate the market failure. The labels on the curves should be S_{private} , $S_{\text{private} + \text{external}}$ and D (or D_{private} , $D_{\text{private} + \text{external}}$ and S. If correctly explained, this may be rewarded full marks.

Candidates who incorrectly label diagrams can be rewarded with a maximum of **[3 marks]**.

For a market failure diagram, the vertical axis may be price, but could be costs or benefits. The horizontal axis is quantity. A title is not necessary.

- (d) Using information from the text/data and your knowledge of economics, evaluate the possible economic effects on the Australian economy of the Emissions Trading Scheme (ETS).

[8 marks]

Responses **may** include:

- since there is a significant market failure with implications for sustainable development, some solution to “the great moral and economic challenge” is needed (paragraph ①)
- Australia is the third largest per capita polluter, necessitating a solution/approach (paragraph ①)
- the ETS will increase costs for heavy polluters and decrease costs for low polluters. This should incentivise firms to reduce emissions and internalise the externality (paragraph ②)
- carbon permits will increase the marginal private costs to firms moving the market closer to the socially efficient level of output
- additional costs to heavy polluters are likely to be passed on to consumers (paragraph ③), resulting in higher energy prices and inflation in the economy
- as a result of higher costs faced by firms, supply will fall with the possible result that jobs are lost in the heavy polluting industries (paragraph ③). (Diagram from (b) could be referred to showing that the increased costs could cause inflation and unemployment.)
- loss in profits may reduce investment, and therefore productivity (paragraph ⑤), having long term implications for economic growth
- Australian firms will be at a disadvantage to international competitions, if foreign firms do not face the same requirements (paragraph ④), resulting in higher unemployment and possible worsening of the current account
- it is difficult for the government to correctly identify the level of pollution that would make an emission trading scheme successful
- if there is no appropriate technology available to firms to reduce their emissions, then the incentive function of the permits will not work (paragraph ⑤)
- if the government issues too many permits, emissions will not be reduced or the price of emissions would be too low to make a difference
- if it issues too few permits, the price will be too high, damaging the economy with higher inflation, higher unemployment, lower economic growth and a worsening in the current account balance.

Effective evaluation may be to:

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

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

If there is no direct reference to the text/data, then candidates may not be rewarded beyond level 2.

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:

(i) **indirect tax** (*paragraph 2*) [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1
The idea that it is when the government increases the price.

2 *Precise definition* 2
An explanation that it is tax on a good or service **or** an expenditure tax.

(ii) **inflation** (*table*). [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1
The idea that it is rising prices.

2 *Precise definition* 2
An explanation that it is a sustained increase in the average (or general) level of prices **or** an increase in the average price level over time **or** a fall in the purchasing power of money.

(b) Using an appropriate diagram, explain how an increase in VAT is likely to affect the market for consumer goods. **[4 marks]**

level

- | | | |
|---|---|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
For drawing a demand/supply diagram for the market for a consumer good showing a decrease in supply (with divergent supply curves) and a resulting increase in price and decrease in quantity or for providing an explanation that an increase in indirect taxes means an increase in costs of production for producers causing a decrease in supply, leading to an increase in the price and a fall in the quantity. | 1–2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing a demand/supply diagram for the market for a consumer good showing a decrease in supply (with divergent supply curves) and a resulting increase in price and decrease in quantity and for providing an explanation that an increase in indirect taxes means an increase in costs of production for producers causing a decrease in supply, leading to an increase in the price and a fall in the quantity. | 3–4 |

Candidates who illustrate a parallel shift of the supply curve may be rewarded with a maximum of **[3 marks]**.

Candidates who incorrectly label diagrams can be rewarded with a maximum of **[3 marks]**.

The use of P and Q on the axes is sufficient for a demand and supply diagram. A title is not necessary.

Candidates may approach this question using a macroeconomic model. An increase in indirect taxes will lead to an increase in the costs of production for firms, and therefore a decrease in short run aggregate supply, an increase in the price level and a decrease in real GDP.

For AD/AS, the vertical axis may be price level or average price level. The horizontal axis may be output, real output, national output, real national output, national income or real GDP. Any appropriate abbreviations of the labels are acceptable.

(c) **With the aid of an AD/AS diagram, explain the possible effect on the economic growth of Greece of the decision to reduce its budget deficit.** [4 marks]

level

- | | | |
|---|---|-----|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
For drawing an AD/AS diagram which shows a shift of the AD curve to the left, resulting in a fall in real GDP or an explanation that reducing the budget deficit means that government spending will be cut (or higher direct taxes will result in less consumption and/or investment) so that AD will decrease, leading to a fall in real GDP. | 1–2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing an AD/AS diagram which shows a shift of the AD curve to the left, resulting in a fall in real GDP and an explanation that reducing the budget deficit means that government spending will be cut (or higher direct taxes will result in less consumption and/or investment) so that AD will decrease, leading to a fall in real GDP. | 3–4 |

Candidates may use either a Keynesian AS curve or an upward-sloping short run aggregate supply.

An alternate approach would be to shift SRAS to the left as a result of increased taxes, and therefore increased costs of production, on firms. If this is correctly explained, it may be fully rewarded.

Candidates who incorrectly label diagrams can be rewarded with a maximum of [3 marks].

For AD/AS, the vertical axis may be price level or average price level. The horizontal axis may be output, real output, national output, real national output, national income or real GDP. Any appropriate abbreviations of the labels are acceptable.

- (d) **Using information from the text/data and your knowledge of economics, evaluate the effects of the measures taken by the Greek government to address its debt problem.**

[8 marks]

Responses **may** include:

- a definition of debt
- the proposed cut in the budget is an extremely large one
- steep cuts in public sector wages may result in less consumption by public sector workers, further affecting AD
- lower pensions may reduce living standards for retired people (and may lower consumption, further affecting AD (paragraph ②))
- raising the retirement age may increase the size of the working population and might actually increase unemployment in the short run
- reductions in public sector wages may affect the quality of services such as health care and education (paragraph ②); this may reduce the productivity of labour, further worsening economic growth in the future
- a reduction in the budget deficit (paragraph ②) may restrict growth and lead the country further into recession (may refer to diagram and analysis in part (c))
- an increase in indirect taxation will increase prices (paragraph ②) (may refer to diagram in part (b))
- an increase in indirect taxes will be regressive, therefore resulting in greater income inequality
- with a low level of inflation, the measures may push Greece into deflation (table)
- a reduction in the budget deficit acts as an expenditure-reducing policy which may lead to lower imports and an improvement in the current account balance (table)
- lower wage rates and falling inflation could reduce production costs and contribute towards an improvement in the current account balance (table) and (paragraph ②)
- reducing the deficit will reduce the need for government borrowing, which is very high (table)
- the measures may allow the government to borrow at lower rates (paragraph ①)
- Greece's GDP growth indicator was not as bad as the average in the eurozone (table)
- the deficit reducing measures may worsen growth to the extent that the deficit will actually grow (higher unemployment will reduce government's tax revenues)
- Greece has to prove that it can repay its debts, but the measures adopted may make the debt worse
- a Keynesian approach would be opposite to the approach taken – government should actively adopt measures to increase AD to promote growth in order to be able to reduce the deficit over the longer term.

Effective evaluation may be to:

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

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

If there is no direct reference to the text/data, then candidates may not be rewarded beyond level 2.

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:

(i) **informal market** (*paragraph 1*) *[2 marks]*

level

0 *Wrong definition* **0**

1 *Vague definition* **1**
The idea that informal markets are black markets.

2 *Precise definition* **2**
An explanation that informal markets refer to markets in which economic activity is not officially measured/recorded. Candidates may explain an informal currency market which, if accurate may be fully rewarded.

(ii) **exchange rate** (*paragraph 2*). *[2 marks]*

level

0 *Wrong definition* **0**

1 *Vague definition* **1**
The idea that it is the value (or price) of a currency.

2 *Precise definition* **2**
An explanation that it is the value (or price) of one currency expressed in terms of another currency.

(b) Explain why Venezuela operates a “two-tiered official exchange rate” (paragraph 2). [4 marks]

level

- | | | |
|---|---|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
For explaining that two different official exchange rates allow Venezuelans to pay less for imported food and medicine or for explaining that food and medicine are necessary imports and so a more favourable exchange rate will ensure the affordability of these products to low income Venezuelans. | 1–2 |
| 2 | <i>Correct application of appropriate theory</i>
For explaining that two different official exchange rates allow Venezuelans to pay less for imported food and medicine and for explaining that food and medicine are necessary imports and so a more favourable exchange rate will ensure the affordability of these products to low income Venezuelans. | 3–4 |

Candidates may also explain that the weaker exchange rate that is used for purchasing foreign exchange to buy “most” imports discourages imports and encourages the consumption of domestic products. This is a valid interpretation and, if correctly explained, may be fully rewarded.

- (c) **With the aid of an appropriate diagram, explain how the “rapidly falling value of the bolivar fuerte” (paragraph 4) is likely to influence inflation.** [4 marks]

level

- | | | |
|---|--|-----|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
For drawing an AD/AS diagram showing a shift of AS to the left, resulting in a higher price level and therefore an increase in the price level or an explanation that a weaker currency will increase the price of imported raw materials and finished goods, placing upward pressure on prices. | 1–2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing an AD/AS diagram showing a shift of AS to the left, resulting in a higher price level and therefore an increase in the price level and an explanation that a weaker currency will increase the price of imported raw materials and finished goods, placing upward pressure on prices. | 3–4 |

N.B. It is also acceptable for candidates to answer the question by showing a shift of AD to the right and an explanation that a weaker currency will make exports more competitive, causing an increase in exports and an increase in AD which will lead to a higher price level and therefore upward pressure on inflation.

Since the question does not specify a diagram, candidates may also choose to draw a diagram to illustrate the fall in the value of the VEF, and then explain how this will lead to increased costs of production and therefore result in inflation. If the exchange rate diagram is correctly explained and labelled (vertical axis – price of VEF in USD or USD/VEF), and then appropriately linked to inflation, then this may be fully rewarded.

Candidates who incorrectly label diagrams can be rewarded with a maximum of [3 marks].

For AD/AS, the vertical axis may be price level or average price level. The horizontal axis may be output, real output, national output, real national output, national income or real GDP. Any appropriate abbreviations of the labels are acceptable.

- (d) **Using information from the text/data and your knowledge of economics, evaluate the policy of the Venezuelan government of maintaining a fixed exchange rate.**

[8 marks]

Responses **may** include:

- an explanation of what fixed exchange rates are and a diagram to show an exchange rate is fixed.

Advantages of a fixed exchange rate:

- a fixed exchange rate may discourage currency speculation (paragraph ①)
- a fixed exchange rate may reduce business uncertainty, improving the attractiveness of domestic and foreign direct investment
- currency depreciation, causing inflation, may be prevented (paragraph ④)
- capital flight may be discouraged as fears of devaluation are lowered
- economic problems such as recession and inflation have to be tackled without allowing the exchange rate to solve the problems the economy
- the double-tiered fixed-exchange rate system is designed to produce a more equal distribution of income as food and medicine are imported at lower prices compared to other imports.

Disadvantages of a fixed exchange rate:

- the official rate does not correspond to the “real” value of the currency as proven by the low value on the informal market
- the formal banking system is unlikely to attract savings when there is such a divergence between the official rate and the informal rate. Thus there may be less money available for investment
- the VEF seems to be fixed at too strong a value, which damages exporters and adversely affects the current account balance
- a fixed VEF may actually encourage currency speculation (paragraph ①) if people believe that the central bank will not be able to support the value
- a fixed exchange rate may mean that the central bank will have to buy its own currency in the foreign exchange market. This means that it will have to maintain large reserves of foreign currencies – this may be unsustainable
- inflation may be imported via a fixed exchange rate system
- it encourages a destabilising informal market – managing the informal market may make the situation worse (paragraph ⑤)
- it introduces a distortion to the market where prices do not reflect their costs.

Answers that discuss the standard advantages and disadvantages of fixed exchange rates, without showing awareness of the Venezuelan context may not be rewarded beyond Level 2.

Effective evaluation may be to:

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

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

If there is no direct reference to the text/data, then candidates may not be rewarded beyond level 2.

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:

(i) **quotas** (*paragraph 3*) [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1
The idea that they are a limit on trade.

2 *Precise definition* 2
An explanation that they are import barriers that set limits on the quantity (or value) of imports that may be imported into a country.

(ii) **economic development** (*paragraph 4*). [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1
The idea that living standards improve.

2 *Precise definition* 2
An explanation that it is a broad concept involving any two of the following:
• improvement in standards of living
• reduction in poverty
• improved health and education
• reduction in unemployment
• greater equality in income distribution
• environmental protection
• increased freedom and economic choice.

(b) Explain *one* reason why a dependence on exports of primary products may be considered a barrier to economic development. **[4 marks]**

level

0 *Inappropriate answer* **0**

1 *Identification of appropriate theory* **1–2**

For explaining an appropriate reason why exports of primary product may result in low and fluctuating incomes for producers and/or revenues for governments.

The explanations might refer to:

- low PED, PES or YED
- primary products are of low value on the production chain (in comparison with processed products) and so the producers earn low incomes even in good economic times
- increased supply of primary products due to technological improvements
- vulnerability to forces outside producer control (e.g. weather, international shocks).

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

For explaining how low incomes/revenues may act as a barrier to economic development. The explanations might refer to:

- unstable revenues for governments make it difficult to allocate funds to development objectives
- low incomes for producers mean that producers may be stuck in a poverty cycle.

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

(c) **With the aid of a diagram, explain how the reduction of tariffs is likely to affect the level of trade between African nations.** **[4 marks]**

level

- | | | |
|---|--|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
For drawing a tariff diagram (trade creation diagram) showing how fall in a tariff causes a fall in the price and an increase in imports or for explaining how a reduction in the tariff results will reduce the price leading to increased imports and therefore increased trade. | 1–2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing a tariff diagram (trade creation diagram) showing how fall in a tariff causes a fall in the price and an increase in imports and for explaining how a reduction in the tariff results will reduce the price leading to increased imports and therefore increased trade. | 3–4 |

Candidates who incorrectly label diagrams can be rewarded with a maximum of **[3 marks]**.

For a demand and supply diagram, P and Q are sufficient. The perfectly elastic supply curve must be labelled as S_{world} or S_{Africa} .

- (d) **Using information from the text/data and your knowledge of economics, discuss the view that African countries should increase their focus on trade within Africa in order to increase economic development.**

[8 marks]

Responses **may** include:

Opportunities associated with increased trade:

- reliance on exports of raw cotton makes African nations vulnerable to market fluctuations (paragraph ❶) resulting in wide fluctuations in export revenues and preventing governments from achieving development objectives
- greater intra-Africa trade allows African countries to enjoy the advantages of trade creation
- greater processing of raw materials in African countries would allow other African countries to buy the processed goods at lower prices. (Instead of having the raw materials exported to processors in more developed countries, with the gains going to producers in the non-African countries) (paragraph ❷)
- poverty in Africa has increased due to the world economic crisis. If African countries traded more with each other, they would be less exposed to shocks from any one particular region (paragraph ❸)
- freer trade with other African countries will increase the potential market size (paragraph ❹)
- reduced transportation costs of shipping to neighbours
- increased export revenues may allow governments to pursue development objectives
- higher producer revenues may allow producers to escape the poverty cycle.

Challenges

- it will be difficult to increase intra-Africa trade because of poor infrastructure and transportation links, along with weak institutions
- political differences and historic protectionism may make increased intra-African trade difficult (paragraph ❺)
- USA and Europe provide stable, affluent markets which are growing following the recession (paragraph ❻)
- the African economy is still relatively weak and so may not provide growth and therefore development (paragraph ❼).

Effective evaluation may be to:

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

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

If there is no direct reference to the text/data, then candidates may not be rewarded beyond level 2.

Candidates who do not make explicit references to the way in which increased trade may contribute to economic development may not be rewarded beyond Level 2.

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
