

MARKSCHEME

November 1999

ECONOMICS

Subsidiary/Standard Level

Paper 2

Section A – Data Response Questions – Paper Specific Markscheme

Question 1: Aid

		Partial Mark	Maximum Mark
(a)	(i) For a partial answer that only recognises that Japan and the USA have the largest GNPs of the countries listed. For developing a fuller answer that recognises that the ranking position of Japan and the USA is reversed between the tables in Item 1 and Item 2 due to the size of their economies.	1 2	 2
	(ii) Given the nature of the question the marking scheme cannot be too prescriptive but marks should be allocated along the lines indicated below: for stating that the level of aid provided by the DAC donors as % of GNP has fallen for developing a fuller answer that as well as arriving at the above conclusion also provides relevant numerical comparisons of aid as a % of GNP for stating that the level of aid in terms of volume has fallen for stating that the overall level of aid in terms of volume has fallen and providing some numerical comparisons of relevant data	1 2 1 2	 2
	(iii) The points that candidates might wish to address include the following: the continuing effects of the end of the Cold War the conclusion of the Uruguay Round of GATT has given further impetus to those economists and governments who believe that the solution to poverty in developing societies is greater integration in world markets, and that aid is a distortion of the market the establishment of trade blocs and the resultant severing of trade links and associated aid programmes from the poorest nations by colonial powers, <i>e.g.</i> Britain reorienting its trade from Commonwealth countries to Europe the attempts by many EU countries to reduce government expenditure in order to meet the Maastricht criteria	4 4 4 4	 5
(b)	Possible points might include: for stating that the two principal forms are bilateral and multilateral aid although credit should also be given to students who mention tied aid.	2	
	Full credit should be awarded to candidates who attempt to provide valid examples, even if they are unable to use the terms bilateral and multilateral aid, for example, candidates may identify these two main forms through examples such as the Pergau Dam, military purchases, structural adjustment loans <i>etc.</i>	2	2

(c) (i)	For stating that absolute poverty is commonly defined in terms of <ul style="list-style-type: none">• insufficient income to purchase the basic necessities of food, clothing and shelter• insufficient income to sustain human life	2	
	For stating that absolute poverty is not a relative concept and it is not defined in terms of other groups.	2	2
(ii)	This question permits a variety of answers. Students should receive full credit for showing the changes implied by the attainment of such an objective. Candidates who choose to discuss a chosen objective in the context of a specific country should again receive full credit for doing so.		5
(iii)	Possible points might include: a recognition of the small sum involved, relative to the scale of the world economy corruption within both MDCs and LDCs will siphon off any aid provided from the public purse aid payments return to the MDCs as capital flight aid has not flowed historically to the poorest nations but to political and economic allies, or at best to a handful of LDCs tied aid increases prices to the LDCs and narrows their choice aid is often in an inappropriate form, <i>e.g.</i> large infrastructural projects rather than directed to poverty relief or welfare requirements aid can sustain existing inequalities by <i>e.g.</i> allowing wealthy elites to subsidise cheap food prices at little or no cost to themselves conditions of multilateral aid provided by the World Bank and the IMF in the form of structural adjustment loans reduces the role of the state and therefore its ability to provide welfare channelling of aid through NGOs might overcome some of these difficulties. However, the scale of NGO involvement though growing is small. The central problem remains: <ul style="list-style-type: none">• is it realistic to expect wealthy MDCs to act other than from self interest?• can aid be transmitted by wealthy MDCs via wealthy elites of LDCs to the poor? Aid may create or reinforce unequal relations between nations, <i>e.g.</i> food aid may create new consumer tastes and / or destroy local production by undercutting local farmers. Once local production is destroyed, such foods, <i>e.g.</i> wheat-based, must be imported at commercial prices at much greater cost to the balance of payments. Aid will distort the more efficient mechanisms of the market by reinforcing the role of the state in LDCs. Trade better than aid.		
	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.		3–5
	Level 3: A range of issues discussed in reasonable depth.		6–7

Question 2: Winners and losers in Mexico

		Partial Mark	Maximum Mark	
(a)	(i)	The points that might be included by candidates:		
		the creation / extension of world markets	1	
		reductions in trade barriers	1	
		greater significance of global telecommunications	1	
		increased role of supranational institutions (<i>e.g.</i> WTO, IMF, WB, <i>etc.</i>)	1	
		increased role of MNCs	1	
		increased consumerism	1	
		reduced role of the state	1	
				2
		(ii)	For simply stating that it is a trade bloc.	1
		For explaining that it consists of Canada, Mexico and the USA.	1	
		For explaining that its central purpose is to establish one free trade area with no trade or investment restrictions amongst member countries.	1	
			2	
	(iii)	For linking the term to the theory of comparative advantage.	2	
		For mentioning that Mexico's natural advantages should include cheap labour and some raw materials.	2	
		For also mentioning that inward investment should increase in labour intensive areas (<i>i.e.</i> maquiladoras).	2	
		Candidates should also be given credit for stating that the USA is the dominant partner in the bloc with a technical, manufacturing and agricultural comparative advantage.	2	
			3	
(b)	(i)	When identifying those who win from Mexico's policies of deregulation and liberalisation, candidates might wish to mention the following groups:		
		shareholders	1	
		the wealthy	1	
		large scale farmers and landowners	1	
		waged factory workers	1	
		The following groups are amongst those who lose:		
		maize farmers	1	
		rural populations	1	
		specific regions	1	
		rural waged workers	1	
woman (households)	1			
			2	

		Partial Mark	Maximum Mark
(ii)	The points that candidates might wish to address include the following: redistribution of wealth towards the wealthy the greater efficiency of subsidised capital intensive North American agriculture declining real wages in rural areas public to private transfers reduces welfare to poor migration from rural to urban areas results in depopulation and overcrowding respectively uneven social development exacerbates social inequalities	2 2 2 2 2 2	5
(c)	(i) For restating the relevant section from the passage. For developing a fuller answer that includes some discussion of the following points: deregulation of financial markets reduction of trade barriers joining a free trade zone export orientated industrialisation privatisation of public assets land reform	3 2 2 2 2 2	5
(ii)	Given the nature of the question the marking scheme cannot be too prescriptive and the following are just some of the points that could be mentioned. It is important to give appropriate credit to any relevant point suitably developed even if it is not included in the list below: Mexico will gain increased inward investment from USA companies with subsequent increases in employment higher integration in world markets should increase exports and output consumers will benefit as, without protection, prices fall to world price levels higher growth and higher GDP per capita possibly increased independence for women due to increased female employment higher FDI could be of the 'screwdriver' type movement to agribusiness (the end of peasant producers) increased poverty in rural areas more unequal distribution of income greater environmental damage as less environmental regulation encourages the shift of toxic waste from the USA to Mexico exploitation of natural resources dependency on the policies of MNCs cheaper imports leading to increasing consumerism, resulting in environmental problems restrictions on trade unions limits to state policies to promote welfare, regional development or to protect 'infant industries'		
	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.	5–6	

Question 3:

- (a) **Explain the functions that prices perform in a market economy.** [10 marks]

The 'expected' answer is likely to develop the signalling, incentives and rationing / allocation functions of prices. Appropriate use of S & D diagrams should be rewarded.

- (b) **Discuss the view that education and health are best provided through the market rather than by the state.** [15 marks]

Possible areas for discussion include:

education and health care as merit goods
underprovision of merit goods through the market
merit goods and externalities
income distribution and effective demand
problems of private monopoly power
problem of consumer ignorance
the general case for markets in terms of competition, costs, efficiency, profits, consumer choice
the possibility of state provision and markets, e.g. through the use of internal markets and private insurance schemes

Question 4:

- (a) **Carefully distinguish between saving and investment.** [10 marks]

Candidates might develop their answers in terms of the following:

definitions of saving and investment
suitable examples of saving, e.g. putting money in a bank and of investment, e.g. spending by firms on new machinery
different types of saving and investment
saving as a leakage from and investment as an injection into the circular flow of income / circular flow of income diagram

- (b) **Assess the importance of saving and investment in the process of economic development. Refer in your answer to both Less Developed and More Developed Countries.** [15 marks]

Possible areas for discussion include:

links between saving, investment and economic development
problems arising from shortages of saving and investment
the vicious circle of poverty
different uses to which savings may be put
the importance of investment in the growth process: empirical evidence; type rather than quantity of investment; investment as a cause or consequence of economic growth
assessment of **other** factors in contributing to economic development

Question 5:

Why do some countries attempt to fix their exchange rates while others allow them to float?

[25 marks]

This is a fairly open-ended question which is likely to evoke a variety of responses. It is hoped, however, that candidates will consider the relative merits / demerits of each exchange rate system.

Candidates who are able to provide a balanced response and relate their points to examples, *e.g.* the ERM, should be well rewarded, as should candidates who display knowledge of relevant recent events.

Areas for discussion might include some of the following:

For fixed exchange rates:

Candidates could argue for fixed exchange rates either in terms of the potential problems of floating or in terms of the advantages of a fixed exchange rate system, *e.g.* the ERM.

Possible drawbacks of floating include the problems of:

- a too rapidly depreciating exchange rate, inflation, loss of confidence and capital outflows
- a too rapidly appreciating exchange rate and loss of competitiveness, demand for exports, the level of output and employment
- exchange rate volatility caused by speculative flows and the uncertainty for exporters, importers and the domestic economy

Possible advantages of fixed exchange rates include:

- reduction of uncertainty / better environment for investment
- the disciplining of inflationary pressures
- could represent a movement towards full monetary union and a single currency, *e.g.* in Europe

Against fixed exchange rates:

Candidates could argue against fixed exchange rates either in terms of the advantages of floating or in terms of the disadvantages of a fixed exchange rate system.

Possible advantages of floating include:

- automatic adjustment of balance of payments disequilibrium
- market forces better at determining prices than governments
- possibility of forward trading

Possible disadvantages of fixed exchange rates:

- deflation if currency overvalued
- export / import price effects of undervalued / overvalued currency;
- need to keep reserves
- loss of domestic economic policy freedom
- possible increases in uncertainty if realignment within the system occurs frequently

Question 6:

- (a) **Explain the difference between inward orientated and outward orientated strategies of development.** *[10 marks]*

Candidates could explain the difference between inward orientated and outward orientated strategies of development by reference to some of the points within the two contrasting lists below:

Features of inward orientated strategies

- an active autonomous state that plays a role in ensuring that industrialisation and development occurs
- development is viewed as a long term goal which is linked to industrialisation and manufacturing
- a belief that market forces left to themselves will lead to polarisation
- high levels of protectionism, particularly for infant or strategic industries
- nationalisation is seen as an appropriate way to obtain the full benefits of foreign exchange and government revenue
- a belief that foreign ownership and control of industry and land results at best in unbalanced development and at worst in underdevelopment
- a conviction that the so-called laws of comparative advantage reflect the needs of the powerful nations and MNCs
- tight controls over imports, foreign exchange and capital flight
- few incentives to export
- overvalued exchange rate

Features of outward orientated strategies

- a belief in the efficiency of the market and the centrality of the individual
- the view that economic development is best left to private economic agents
- the state is to be confined to a minimum role in economic affairs, with the role of government limited to the provision of services and infrastructure not provided by the market
- trade liberalisation is believed to result in a more efficient economy
- low levels of protection
- encouragement of foreign investment to obtain technology transfers
- privatisation and liberalisation policies in the domestic market
- export incentives
- realistic exchange rates
- a willing integration into world markets

(b) Which strategy do you consider to be most effective. Justify your answer. [15 marks]

This is an open-ended question which could evoke a variety of responses. Candidates who develop a suitably applied answer with reference to a particular country should be given full credit.

Candidates might refer to some of the following points in their assessment of the relative effectiveness of these strategies.

Possible advantages of the inward strategy

- manufacturing industry, especially heavy industry can be established with state support, overcoming any specialisation imposed by the world market
- wealth can be transferred from the rural sector to the urban / industrial sector permitting industrial growth
- investment in education and training for the population will improve
- inequalities of income will be lessened
- greater autonomy as a result of a more diverse economy which is less dependent on the whims of Northern consumers

Possible disadvantages of the inward strategy

- unable to gain the benefits of comparative advantage
- no gains from free trade
- state expenditures become excessive
- creation of monopolies
- planning is of limited benefit
- governments become 'rent seekers'
- bias against exports

Possible advantages of the outward strategy

- an emphasis on expanding markets can achieve rapid growth
- reduction in budget deficits accompanying a reduced role for the state
- free trade will reduce the costs of protectionism
- increased competitiveness internally and globally-lower prices
- greater technology transfers
- greater flexibility in markets, e.g. capital and labour
- financial liberalisation increases the efficiency of investment

Possible disadvantages of the outward strategy

- declining terms of trade undermine comparative advantage, e.g. primary commodities
 - outflow of capital to developed countries
 - increased power of MNCs
 - ignores the specific social structures of individual countries, e.g. who owns what affects the outcome of market forces
 - austerity imposed by structural adjustment falls upon the poor – growth without development
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