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Economics IA Commentary Playbook

Rubric, article strategy and sample commentary

IA GUIDELINE | INTERNAL ASSESSMENT

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Coverage

13

source pages

- Diagram, terminology and application rubric
- Micro, macro and international article approaches
- Evaluation methods for Level-7 writing

Meridian Economics IA Outline Created by Ryan

Rubric:

Criterion A (Diagrams) ______ marks (3)	Relevant, accurate and correctly labelled diagrams are included, with a full explanation.
Criterion B (Terminology) ______ marks (2)	Terminology relevant to the article is used appropriately throughout the commentary.
Criterion B (Application) ______ marks (2)	Relevant economic concepts and/or theories are applied to the article appropriately throughout the commentary.
Criterion D (Analysis) ______ marks (3)	There is effective economic analysis relating to the article.

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Criterion E (Evaluation) ______ marks (4)	Judgments are made that are supported by effective and balanced reasoning. <u>Evaluation may include any of the following</u>: • Policy analysis • Advantages and Disadvantages • Stakeholder effects • Short-run vs. Long-run Analysis • Prioritizing arguments • Questioning the validity of a theory

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General outline suggested by Ryan:

P1:
- Summarise article in 1-2 sentences
- Define key terms

P2&3:
Pick two diagrams that can be used to explain key econ concepts mentioned in the article

P3&P4:
State advantages and disadvantages of the policy using quotations from the article

P5:
Conclusion & Overall evaluation

Methods to conclude/evaluate:
- Evaluate the SR and LR consequences
- Evaluate effects to various stakeholders
- Weigh the benefits versus cost of the policy
- Make an “it depends..” statement. For example, it depends on the government’s budget whether tax should be interested.

General way to tackle an IA article suggested by Ryan:

1. Go on news.google.com and search relevant key terms to find a suitable article (there are diff key terms suitable for each part of the syllabus, read below to find out)
2. Read the article to understand what is going on. Think of 1-2 diagrams that can be drawn to illustrate economic concepts in the article
3. Read the article again and underline relevant adv and disadv
4. Write the article

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Suggested approach for microeconomics
- Find articles related to cigarette indirect tax on news.google.com
- Its best to find articles that suggest some adv and disadv related to the indirect tax policy

Suggested diagrams to draw:
- negative consumption extanalities diagram
- Negative consumption externalities diagram with tax

Suggested evaluation points (should quote from article to support arguments stated below):
- Tax increases price for consumers and reduces disposable income
- Indirect tax can help to reduce the quantity demanded of cigarettes and thereby welfare loss in cigarette market.
- Tax reduce revenue for producers and can lead to unemployment
- Tax generates tax revenue, which can be used for other useful purposes, such as subsidizing healthcare or financing the production public goods
- PED of cigarettes is usually low in the SR, which makes consumers unresponsive to the tax. This means that there will only be a small reduction quantity demanded in the short run. However, PED tends to rise in the long run as consumers have more time to find substitutes. Hence, indirect tax tend to be more effective in the long run
- Consumers that are younger and currently are non-smokers will be less addicted to cigarettes. Hence, PED for these consumers tend to be higher. Thus, the indirect tax is likely to be more effective towards younger consumers
- In order for the indirect tax to eliminate the welfare loss completely, the indirect tax must have the same value as the negative externalities. However, its very difficult for the government to accurately measure the value of the negative externalities. Thus, it is very difficult for the government to impose the right amount of indirect tax to bring the market back to the socially optimal quantity.
- Whether to government should impose the indirect tax depends on the government budget and whether it is in need of tax revenues

Sample IA (do not let students copy this):
This article argues that higher alcohol taxes lead to less binge drinking. Alcohol is a demerit good, a good considered to be undesirable for consumers, but is overprovided by the market. Alcohol is a demerit good because it has a negative consumption externality, which occurs when an act has negative consequences on third parties. Thus, the alcohol market is an example of market failure because it allocates resources inefficiently.

Diagram 1 - Negative Consumption Externality in the United States Alcohol Market

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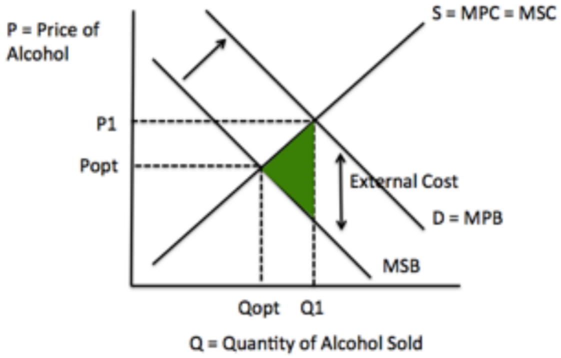

Diagram 1 shows the alcohol market in the United States. The current market equilibrium is where MPC = MPB. However, the social optimum level is MSC = MSB. Thus, MPB > MSB, proving a negative consumption externality because private firms benefit more than society and there is overconsumption. Often times, the external costs for alcohol are due to binge drinking, as it "causes more than half of nearly 90,000 alcohol-attributable deaths in the United States each year and accounts for three-quarters of the $224 billion in annual economic costs of those deaths".

In diagram 1, the green area represents welfare loss, the reduction in benefits for society. Many states have attempted to correct welfare loss by increasing excise tax on beer. So far, increasing tax has been effective, as a study conducted by Boston University proved that as taxes rise, binge drinking rates fall and taxes "[account] for approximately 20% of the difference in the prevalence rates of binge drinking".

Diagram 2 – Effect of Indirect Tax on Negative Consumption Externality

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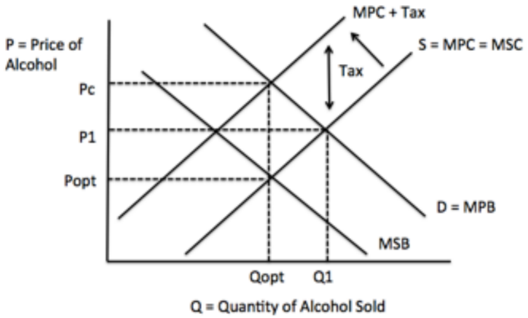

Diagram 2 shows the effects of the increased excise tax. Imposing an indirect tax raises MPC upwards because costs of production for firms increase. The tax also decreases equilibrium quantity (from Q1 to Qopt) and increases the price (from P1 to Pc) of alcohol. This is done in hopes of leading the market to allocative efficiency. The amount of tax is meant to equal the external cost.

One advantage of having indirect tax is that it can generate a lot of government revenue, particularly since "price is strongly associated with alcohol consumption". The money the government collects could then be used to subsidize merit goods, goods that are held to be desirable for consumers but which are underprovided for the market, instead.

Another advantage is that higher taxes create incentives to reduce consumption since alcohol would become more expensive. Specifically, a "1% increase in alcohol [leads] to a 1.4 percent decrease in the proportion of adults who binge drink". The PED value, therefore, is 1.4, which is high, meaning there is a high responsiveness of quantity demanded to price. Thus, governments can expect a large decrease in quantity demanded.

However, there are disadvantages to increasing tax. Since tax increases the price of alcohol for consumers, it could lead to a reduction in the disposable income of consumers who are unwilling to stop drinking. Another possibility is that if the tax is too high, consumers might search for cheaper sources. This invites the creation of a black market.

Furthermore, the taxes would be subject to inflation. The article says that "a key vulnerability of volume based taxes is their erosion over time due to inflation" and that this problem is currently being faced by "most US states". Because of this, the government should revise the amount of indirect tax every few years to make sure its

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significance is maintained. Also, since the tax is regressive, it would harm poor people who are addicted to alcohol and would further increase income inequality.
In addition, increases in tax lead to decreases in producer revenue. As shown in diagram 2, before tax is implemented producer revenue is at P1, Q1. However, after the tax, their revenue decreases to Pc, Qopt. Particularly since the article states that high taxes have “strong preventative effects on binge drinking”, in the long run, producers would definitely decrease their output. In turn, fewer workers would be needed, thus leading to unemployment.

Despite the negative consequences that arise from tax, tax has still proven to be effective in discouraging consumption because the PED value is high (1.4). In the long run, the tax would lead to less welfare loss because social costs (such as higher death rates and an unhealthy labor force) would be reduced. However, since the tax would lead to unemployment, perhaps the government should strike a balance between reducing unemployment and reducing social costs from drinking. It is important for the government to look at the bigger picture and accurately access the value of alcohol’s negative externality and impose a tax to the same value that can bring the free market to the socially optimal quantity.

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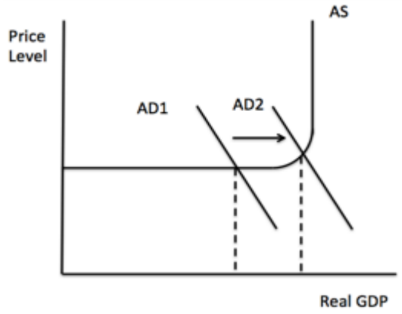
Suggested approach for macroeconomics
- Find articles related to monetary policy or fiscal policy on news.google.com

Suggested diagrams to draw:
- AD/AS diagram to show AD shifting
- Money supply to show how interest rates change

Suggested evaluation points:
- Consider how the policy impacts GDP, inflation rate and unemployment rate
- Talk about the general adv and disadv of the policy (refer to notes economics 2.4)

Sample IA:
This article is about India using expansionary monetary policy by decreasing interest rate to encourage economic growth. Expansionary monetary policy refers to the central bank increasing money supply to expand aggregate demand (AD). Interest rate refers to the amount charged for a loan. Economic growth refers to an increase in the amount of goods and services produced over a period of time (measured by GDP).

Diagram 1 – Increase in Aggregate Demand



Economic growth in India "slowed to an annual rate of 7% between April and June". In addition, inflation rates were "well below the central bank's target of 6% for January". Overall, this led to a recessionary gap developing in India and prevented the economy from reaching its full potential level of output. Since the Indian central bank "thought underlying growth was still subdued", it chose to close the recessionary gap by implementing expansionary monetary policy. As shown in diagram 1, expansionary monetary policy increases AD and shifts it to the right. A rightward shift in AD occurs because the policy causes the total quantity of aggregate output to increase (from AD1 to AD2). The equation for AD is C + I + G + (X-M), where C represents consumption, I represents investment, G represents government spending, and X-M represents net exports.

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Diagram 2 – India decreasing Interest Rate

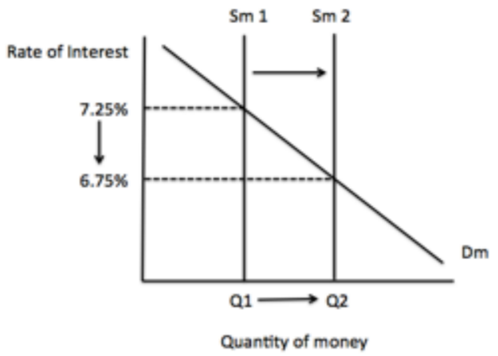

Diagram 2 shows the effect of The Reserve Bank of India (RBI) implementing expansionary monetary policy by “reducing its repo rate to 6.75% from 7.25%”. The repo rate is defined as “the level at which the central bank lends to commercial banks”. A rightward shift in the money supply curve from Sm1 to Sm2 causes the interest rates to drop. In turn, this leads to a lower cost of borrowing, which then increases the C and I components of AD.

One advantage of expansionary monetary policy is that it can be implemented relatively quickly. This is because the policy is decided by the central bank and therefore does not have to go through the political process.

Another advantage is that expansionary monetary policy allows the Indian central bank to decrease interest rates incrementally, which it has been doing recently since it “had already [made] reductions in January, February and June”. This is important because the central bank is able to adjust interest rates to reflect changes in the economy, which allows the bank to ‘fine tune’ the economy better in comparison with fiscal policy.

A third advantage is that expansionary monetary policy will reduce cyclical unemployment in India by closing the deflationary gap as recently “economic growth

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had slowed". Cyclical unemployment is caused by downturns in the business cycle; therefore, an increase in aggregate demand will decrease the demand-deficient unemployment.

However, there are disadvantages to expansionary monetary policy as well. First, the policy is heavily reliant on consumer confidence. The article suggests that the policy "[may not lead to] increased domestic demand" because there is not enough "certainty". Since Indian consumers think there may there be a recession, they may not increase consumption because they would want to save their money and therefore also borrow less. Low confidence levels will also affect banks, as they may be unwilling to lend money.

Another disadvantage is that there will still be time lags. The decrease in India's interest rates will take several months to have an impact on aggregate demand, real output, and price level. Therefore, India's economic conditions may change before the estimates about effectiveness can be taken. While there have been increases in India's shares in the short run, this increase may not be immediately reflected by India's economy as a whole because the market and the stock market are not closely linked.

Despite the negative consequences that may arise from expansionary monetary policy, it has proven to be an effective policy given India's current situation, as "Indian shares have reversed losses". This suggests that there is a positive response to the interest rate cut. This rise in value in Indian stocks due to the fall in interest rates will also stimulate economic growth as it increases consumption by increasing wealth. In addition, India does not need to worry about expansionary monetary policy leading to inflation since inflation is currently at "a record low at 3.6%". The article suggests that inflation is well below target of 6%, so "inflation is not a key risk at the moment." Hence, it is correct for Central bank to lower interest rate to increase economic growth at the expense of higher inflation.

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Suggested approach for macroeconomics
- Find articles related to tariffs on news.google.com

Suggested diagrams to draw:
- Tariff diagram

Suggested evaluation points:
- Refer to economics 3.1 notes

Sample IA:
This article is about the U.S. imposing a 256% tariff on Chinese steel imports following claims that China has been dumping steel. A tariff is a form of trade restriction that places a tax on imports to either protect a domestic industry or raise revenue for the government. Tariffs are a form of trade protection, which is government intervention in international trade through the imposition of trade restrictions. Dumping is the illegal practice of selling a good in international markets at a price below the cost of producing it.

Diagram 1 – United States Tariff on Chinese Steel

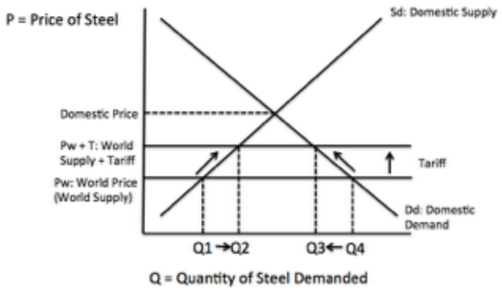

Diagram 1 shows the effects of the tariff. Originally under free trade, the United States would accept the price at Pw and imports from between Q1 to Q4. However, the tariff would cause a decrease in Chinese imports to between Q2 to Q3, an increase in domestic quantity supplied from Q1 to Q2, and a decrease in domestic quantity demanded from Q4 to Q3. This will cause U.S. producers to be better off because they receiver a higher price (at Pw + T) and sell a larger quantity (Q2 instead of Q1). Conversely, Chinese producers will be worse off because they now export a smaller quantity and will therefore lose export revenue.

One advantage of tariffs is that it will protect U.S. producers from dumping. The article suggests that protection is needed because the prices of steel “plunged about

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40% this year and U.S. mills have idled as much as 38% of their capacity due to rising imports". This shows that the U.S. industry will grow more as a result of the tariff.

Another advantage is that the tariff will reduce the supply of imported steel. The article states that the "global steel industry is currently suffering from a crisis of overcapacity and the Chinese steel industry is the predominant global contributor to this problem [as it produces 49% of the world's crude steel]". Nine U.S., South American, and European steel manufacturing industry bodies have alleged that China's oversupply of steel has proven to severely harm the profitability of steel producers worldwide. Thus, limiting China's steel production by implementing tariffs could be beneficial to steel producers elsewhere.
A third advantage is that the tariff allows the U.S. government to protect domestic jobs. Since the oversupply of Chinese steel has caused "U.S. mills to idle", reducing the amount of Chinese steel on the market would allow U.S. producers to increase production. This not only will protect the people currently working in the steel industry, but can also increase U.S. employment.

However, there are disadvantages to the tariff as well. First, the tariff will worsen U.S. income distribution. Since the imposed tariff is a form of regressive tax, it burdens people with lower incomes proportionately more than people with higher incomes. Since lower income individuals will be adversely affected more by the tariff, this will worsen income distribution.

Another disadvantage is that this may lead to a 'trade war', a situation in which countries try to damage each other's trade. The article states that the U.S. also called for taxes for steel imports from India, South Korea, and Italy "at markedly lower rates" even though these countries were found to be dumping as well. Although South Korea and India had lower dumping margins (the amount by which the normal value exceeds the export price), China may still view the tariff imposed on it's steel as unfairly high and may retaliate by imposing trade restrictions on U.S. products. It can be argued that this has a reasonably high chance of occurring since the 256% tax is very high.

A final disadvantage of the tariff is that it will inevitably lead to increased inefficiency in production if Chinese steel is not being subsidized heavily by the government. Domestic price for steel before the tariff was higher than the price for steel produced by China because China has a comparative advantage in steel production. Therefore, since U.S. producers are relatively inefficient compared to Chinese producers, this results in an increase in production by inefficient producers. In turn, this causes a global misallocation of resources.

In conclusion, since China was found to be dumping, the U.S. government does have reason to impose tariffs to protect domestic jobs and producers. However, the government should also consider whether or not the 256% tariffs imposed are too high, since they may give China reason to retaliate and will lead to a high degree of

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resource misallocation. Therefore, perhaps implementing such high tariffs is not justified in the long run.

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