MERIDIAN EDUCATION

IB Economics Essay & IA Materials

Meridian Education professional presentation edition

COMPLETE ORGANIZED DECK

LaTeX-style presentation PDF | Meridian Education

Organized Materials

Rebuilt from the shared Drive folder into a unified Meridian presentation system.

MERIDIAN EDUCATION

IA STRATEGY | INTERNAL ASSESSMENT

Level-7 IB Economics IA Guide

2022 onwards commentary framework

Coverage

16

source pages

- Article selection and key concept linkage
- Rubric-driven paragraph structure
- Evaluation and conclusion framing

(2020 Version) How to write a Level-7 IB Economics IA in 2 hours

MERIDIAN FILE

Level-7 IB Economics IA Guide

- Article selection and key concept linkage
- Rubric-driven paragraph structure
- Evaluation and conclusion framing

01
of 16 pages

Econ IA requirements

- 3 IAs, each on a different key concept
- Interdependence, Scarcity, Choice, Efficiency, **Equity**, **Economic wellbeing**, sustainability, **Intervention**

MERIDIAN FILE

Level-7 IB Economics IA Guide

- Article selection and key concept linkage
- Rubric-driven paragraph structure
- Evaluation and conclusion framing

02
of 16 pages

Here is what to do

- IA #1: Follow the old Micro video (Government intervention)
- IA #2: Focus on Macroecon, Use this video (equity)
- IA #3: Follow the old development video (Economic well-being)

MERIDIAN FILE

Level-7 IB Economics IA Guide

- Article selection and key concept linkage
- Rubric-driven paragraph structure
- Evaluation and conclusion framing

Finding the ideal article

- Search “income inequality” news.google.com
- Make sure the article is not an opinion piece
- Ideally has useful data and focuses primarily on one country

MERIDIAN FILE

Level-7 IB Economics IA Guide

- Article selection and key concept linkage
- Rubric-driven paragraph structure
- Evaluation and conclusion framing

The rubric requirements

- Diagrams: 3 marks
- Terminology: 2 marks
- Application and analysis: 3 marks
- Key concept: 3 marks
- Evaluation: 3 marks

MERIDIAN FILE

Level-7 IB Economics IA Guide

- Article selection and key concept linkage
- Rubric-driven paragraph structure
- Evaluation and conclusion framing

Overall essay outline

- Paragraph 1: Briefly summarise the article, define terms, explain linkage to the key concept
- Paragraph 2,3: Draw a full-labelled diagram and explain it well
- Paragraph 4: Linkage between inequality and inequity
- Paragraph 5: Explanation of policy choices
- Paragraph 6 & 7: Evaluation of policy responses
- Paragraph 8: Conclusion

MERIDIAN FILE

Level-7 IB Economics IA Guide

- Article selection and key concept linkage
- Rubric-driven paragraph structure
- Evaluation and conclusion framing

Paragraph 1:

- The article discusses the issue of income inequaltiy in India in comparison to other countries and the issue of growing poverty in India
- Define income inequality: Refers to how income is unevenly distributed amongst a population
- The key concept of equity will be discussed in this essay
- Define equity: Equity refers to fairness, the notion that everyone should be given equal opportunity to succeed

MERIDIAN FILE

Level-7 IB Economics IA Guide

- Article selection and key concept linkage
- Rubric-driven paragraph structure
- Evaluation and conclusion framing

Paragraph 2:

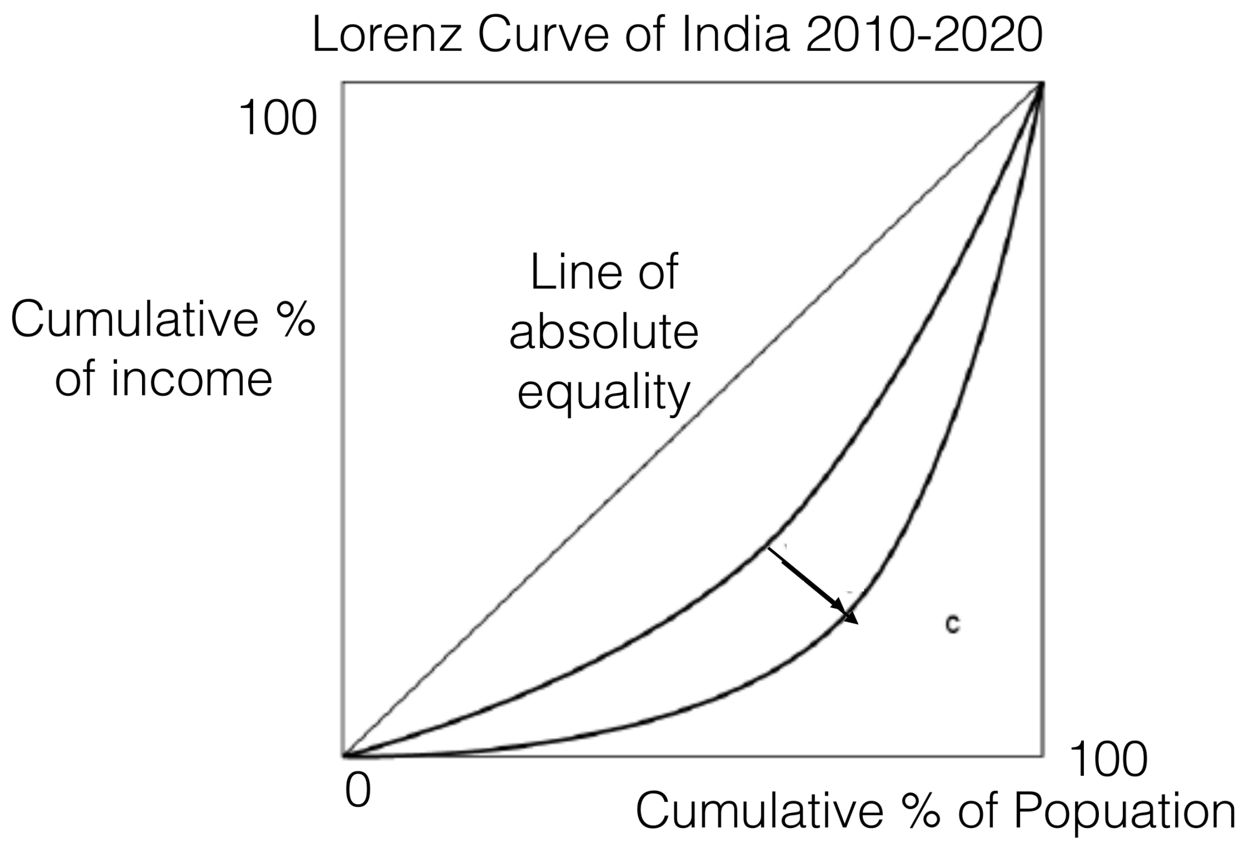
- As mentioned in the article, while China's income inequality stabilised, India's income inequality continued to rise
- Increasing income inequality can be illustrated by a Lorenz Curve

MERIDIAN FILE

Level-7 IB Economics IA Guide

- Article selection and key concept linkage
- Rubric-driven paragraph structure
- Evaluation and conclusion framing

Diagram



MERIDIAN FILE

Level-7 IB Economics IA Guide

- Article selection and key concept linkage
- Rubric-driven paragraph structure
- Evaluation and conclusion framing

Paragraph 3

- As shown in the diagram, the Lorentz curve of India have shifted further away from the link of absolute equality
- This means that the lower income quintiles of the population earns a smaller percentage of national income

MERIDIAN FILE

Level-7 IB Economics IA Guide

- Article selection and key concept linkage
- Rubric-driven paragraph structure
- Evaluation and conclusion framing

Paragraph 4

- While there is a difference between income inequality and inequity, there is often a connection
- Like discussed in the article, poverty eradication has also been slower in India compared to China
- Households in poverty have access to fewer opportunities which leads to inequity (give examples)

MERIDIAN FILE

Level-7 IB Economics IA Guide

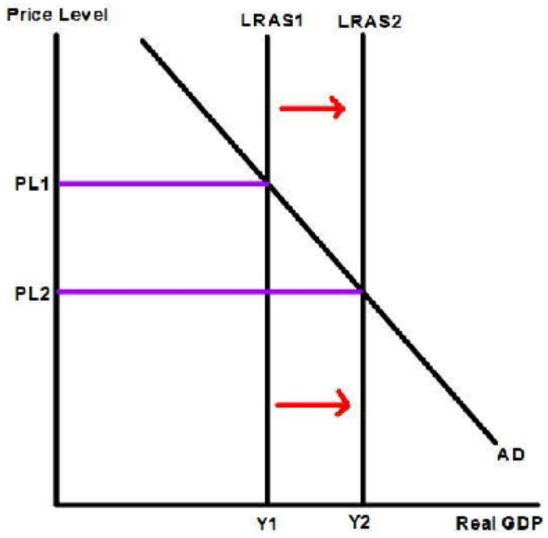
- Article selection and key concept linkage
- Rubric-driven paragraph structure
- Evaluation and conclusion framing

Paragraph 5

- As mentioned in the article, “economic policies do matter and lower inequality levels can accelerate both poverty reduction and overall economic growth rates” and “countries with strong investments in public services and welfare policies have the lowest inequality levels”
- Progressive tax
- Transfer payments
- Investment in public services, including healthcare and education

Paragraph 6

- Improving public services like education and healthcare can increase long term economic growth, while improving equity.
- It can help improve human capital and therefore labor producitivty in the country, leading the LRAS to shift right and a higher real GDP



MERIDIAN FILE

Level-7 IB Economics IA Guide

- Article selection and key concept linkage
- Rubric-driven paragraph structure
- Evaluation and conclusion framing

Paragraph 6

- Progressive tax can help to raise neccesary tax revenues for such investemnts
- Transfer payment can have an immediate impact on alleviating poverty and suffering

MERIDIAN FILE

Level-7 IB Economics IA Guide

- Article selection and key concept linkage
- Rubric-driven paragraph structure
- Evaluation and conclusion framing

Paragraph 7

- A more progressive tax system will can have a negative impact on economic growth.
- Incentive for investment will be reduced
- Incentive for work and entrepreneurship can be reduced, leading to LRAS shifting left
- Excessive and inefficient investments in healthcare and education can lead to a budget deficit, threating the long term financial future of the country

Paragraph 8

- Policies to promote equity will benefit lower income segments of the population while having a negative impact for the higher income households
- In the short run, transfer payments can help alleviate poverty. But it will be important for India to strike a careful balance promoting equity and maintaining incentives neccesary for economic growth
- Investment in human capital is vital. In the short run, it can lead to a budget deficit, but in he long run, it will promote growth and equity

MERIDIAN EDUCATION

TOPIC 1.1 | SAMPLE ESSAYS

Foundations of Economics

PPC, price mechanism and efficient allocation

Coverage

5

source pages

- Definitions and diagram explanation
- Scarcity, choice and opportunity cost
- Price signaling and incentive functions

Key things to remember for 10 mark questions:
- Include definitions of key terms mentioned in the question
- Draw diagram
- Explain diagram and what it is showing
- Real world example
- Answer the question

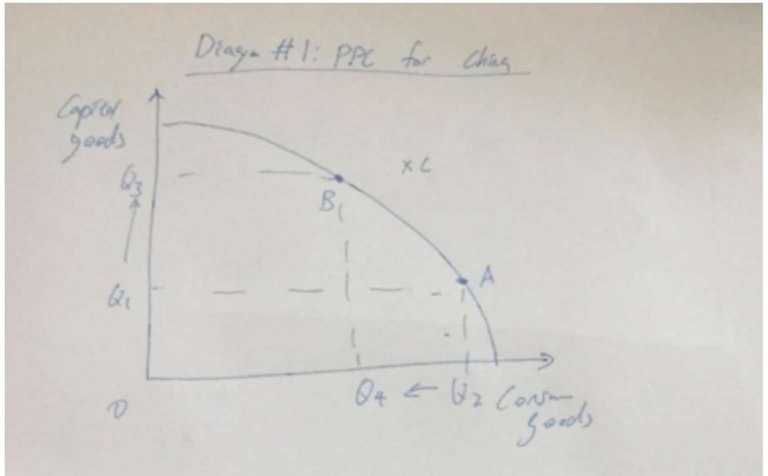
MERIDIAN FILE

Foundations of Economics

- Definitions and diagram explanation
- Scarcity, choice and opportunity cost
- Price signaling and incentive functions

Sample essay:
With reference to the PPC, explain the concepts of scarcity, resource allocation, choice, opportunity cost

The hypothetical production possibility curve for China shows the maximum possible combinations of output that can be produced with the factors of production in an economy.



Scarcity refers to how factors of production are limited while consumers' wants are unlimited. Hence, goods and services are scarce relative to people's unlimited wants. The PPC shows the maximum possible combinations of goods that can be produced. Any point outside of the PPC, such as point C shown in the diagram above, is unattainable for China. This shows how scarcity exists in an economy, as limited factors of production cannot produce sufficient goods and services to meet people's unlimited wants.

Since resources are scarce, an economy must make a choice about how to allocate its resources. Each point on the PPC or inside is a specific resource allocation that the economy can choose from. For example, referring to the diagram 1, if the Chinese economy produces on point A, resources are allocated in a way to produce Q1 units of capital goods and Q2 units of consumer goods. If the Chinese Economy decides to produce on another point on the PPC or inside the PPC, this would be a reallocation of resources

MERIDIAN FILE

Foundations of Economics

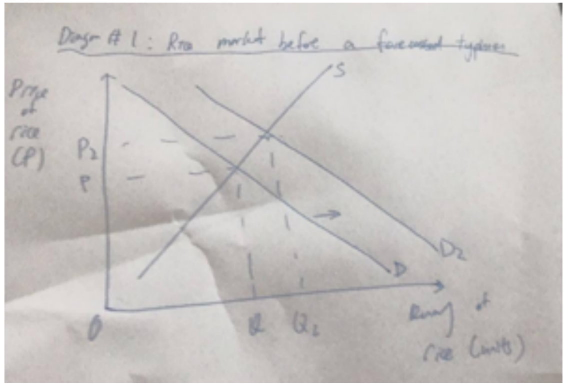
- Definitions and diagram explanation
- Scarcity, choice and opportunity cost
- Price signaling and incentive functions

Opportunity cost is defined as the next best alternative foregone. Since resources are scarce, reallocating resources can often bring about an opportunity cost. For example, if the Chinese Economy changes production from point A to point B, there will be an increase in production of capital goods from Q1 to Q3, but a reduction in the production of consumer goods from Q2 to Q4. It can be said that the opportunity cost of production Q1-Q3 units of capital goods is Q2-Q4 units of consumer goods. The reason for this opportunity cost is because resources are limited. Hence, when more resources are allocated in China to produce capital goods, there will be fewer resources available to produce consumer goods.

Sample essay: Explain the incentive and signaling function of price (10 marks)

The signaling function of price refers to how price changes can send out signals to consumers and producers. The incentive function of price refers to how changes in price can incentivize consumers or producers to change their behavior.

Consider the following example for the price of rice in the wet market before a forecasted typhoon.



During a typhoon, the demand for rice increases as households expect a sharp increase in price during a typhoon, due to limited supply. This exception will cause an increase in demand for rice as shown in the diagram above. initially, the equilibrium price is at P,Q. When the demand of rice increase, there will be excess demand at the original price. The bidding process causes price to start to rise. As the price rise, it sends out a signal to all consumers and producers that there is a shortage in the rice market. For producers, the increase in price incentives them to increase quantity supplied by increasing the profitability of providing the good. For consumers, the increase in price incentives them to reduce quality supplied due to the income effect and the substitution effect. The income effect refers to how a rise in price will reduce the purchasing power of a certain amount of income. The substitution effect refers to how when the price of rice rise, consumers will switch to substitutes. Ultimately, as the price rises, quantity supplied rises while quantity demanded falls, until quantity demand equal quantity supplied and equilibrium is established again.

MERIDIAN FILE

Foundations of Economics

- Definitions and diagram explanation
- Scarcity, choice and opportunity cost
- Price signaling and incentive functions

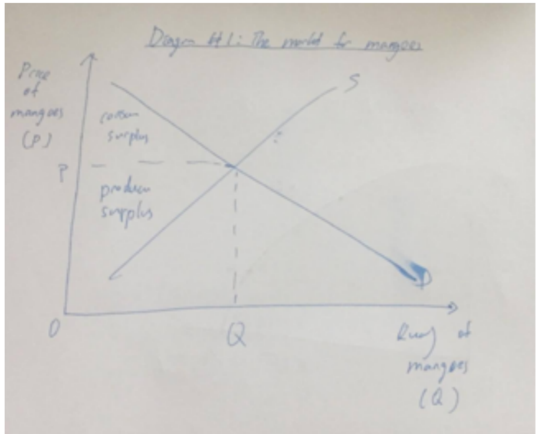
04

of 05 pages

Sample essay: Explain why the price mechanism leads to an efficient allocation of resource

The price mechanism refers to how demand and supply interacts in a free market to set an equilibrium price in a market. Equilibrium price is the price in which quantity demand equals quantity supplied.

Consider the diagram below



The diagram above shows the market for mangoes in Hong Kong in equilibrium. There are two reasons why the price mechanism leads to an efficient allocation of resource. Firstly, the price mechanism always work to eliminate excess demand or excess supply. If there is excess supply, producers will start to cut price in free market, leading to a fall in quantity supplied and a rise in quantity demanded until excess supply is eliminated. If there is excess demand, price will start to rise due to the bidding process, leading to a rise in quantity supplied and a fall in quantity demanded until equilibrium is established again. The elimination of excess demand or excess supply means that consumers and producers wants can be met efficiently.

Secondly, when the market is in equilibrium, consumer surplus and producer surplus are maximized. Consumer surplus, equal to the area labelled in the diagram, refers to the difference between the price that consumers are willing to pay and the equilibrium price. Producer surplus, equals to the area labelled in the diagram, refers to the difference between the equilibrium price and the price that producers are willing to accept. When the market price is at equilibrium, both consumer and producer surplus are maximized.

MERIDIAN FILE

Foundations of Economics

- Definitions and diagram explanation
- Scarcity, choice and opportunity cost
- Price signaling and incentive functions

05

of 05 pages

MERIDIAN EDUCATION

TOPIC 1.2 | SAMPLE ESSAYS

Elasticity Sample Essays

PED, XED and YED applications

Coverage

8

source pages

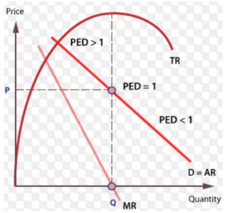
- Revenue strategy using PED and XED
- YED across primary, secondary and tertiary sectors
- Evaluation for luxury and low-price car producers

Elasticity:

1. Explain how PED and XED can help businesses to increase revenue (10 marks)

Price elasticity of demand (PED) measures the responsiveness of quantity demanded to a change in price and it is computed as the percentage change in quantity demanded divided by percentage change in price. Cross price elasticity of demand (XED) measures the responsiveness of quantity demanded of a good to change in price of another good. It is computed as the percentage change in quantity demanded for a particular good divided by the percentage change in price of the other good. Knowledge of PED allows firm to set a price to maximize revenue while knowledge of XED allows firms to understand relationship between two goods which can be useful in many occasions.

PED is useful for businesses as it can be used to maximize total revenue of the producers. The relationship between total revenue (TR) and PED can be illustrated by the diagram below:



When PED >1, firms would like to lower price and raise quantity so as to boost revenue, reaching the maximum point of the TR curve.
This is because % increase in Qd > % decrease in P with a price elastic demand. So it is of firm's best interest to lower price.
When PED<1, firms should increase price despite the fall in quantity demanded. Since raising price would allow firms to reach the maximum point of total revenue. Given that % increase in price > % decrease in Qd, it is revenue maximizing for firms to raise price.

Thus, PED allows firms to make proper decisions and is useful for businesses to maximize total revenue. For example, since the demand for housing in price inelastic as housing in a necessity, housing producers can raise price to increase total revenue.

MERIDIAN FILE

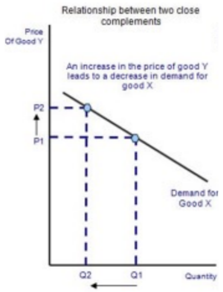
Elasticity Sample Essays

- Revenue strategy using PED and XED
- YED across primary, secondary and tertiary sectors
- Evaluation for luxury and low-price car

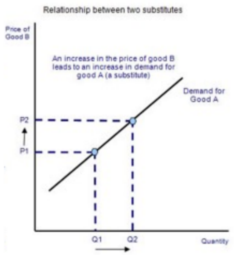
01

of 08 pages

XED can help producers in making business decisions as it shows relationship between 2 goods.



When XED <0, it would mean that the two goods are complements. When price of good Y increases, the quantity demanded for good X falls. An example would be an increase in price of DVD, causing the fall in quantity demanded for DVD. Thus, with DVD players used with DVD, even when price of DVD players does not change, there is a fall in demand for DVD players, causing a fall in quantity demanded for DVD players.



When XED>0, two goods are substitutes of one another. When price of good B increases, quantity demanded of good A increases. An example would be Pepsi and Coke, when price of Pepsi increases, more people will switch to its substitute, which is Coke. As demand for Coke increases, quantity demanded of coke increases.

This is particularly useful for businesses to understand how price change in one good affect the sales of another. For example, in supermarket which sells beer and wine, substitute of each other. Increase in price of beer would lead to an increase in wine as well. Considering both PED and XED, raising the price of beer would be beneficial for businesses for both beer and wine. Since beer is relatively less price elastic and the XED of beer and wine is greater than zero. Hence, increase in price of beer would lead to increase in sales revenue for both beer and wine. This is also true for complements with XED>0, fall in price of airlines will lead to a higher quantity demanded for hotel rooms which allow travel agencies to increase revenue for hotel rooms.

Moreover, firms that sell complements can cooperate to increase each other's revenues. For example, airline companies can cooperate with hotels to offer discounts, which can increase each others's demand and revenue.

MERIDIAN FILE

Elasticity Sample Essays

- Revenue strategy using PED and XED
- YED across primary, secondary and tertiary sectors
- Evaluation for luxury and low-price car

02

of 08 pages

Furthermore, knowledge of XED can allow a firm to identify its closest competitors, because its closest competitors will produce close substitutes, which will have a high XED with the firm's goods. Firms can then acquire or merge its closest competitors to increase revenue and market share. For example, Apple, which produces headphones, acquired headphone producer Beats. This allows Apple to increase market share in the headphone industry.

MERIDIAN FILE

Elasticity Sample Essays

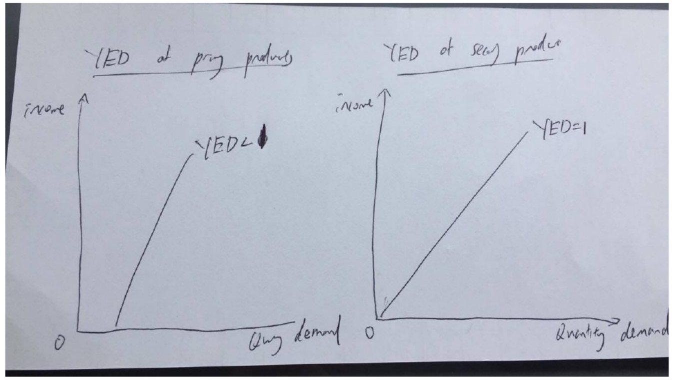
- Revenue strategy using PED and XED
- YED across primary, secondary and tertiary sectors
- Evaluation for luxury and low-price car

2. Discuss the significance of YED to primary, secondary and tertiary producers (15 marks)

Income elasticity of demand (YED) measures the responsiveness of demand when consumer's income changes. It is the % change in Qd over the % change in income. Primary producers are producers of raw materials like agricultural goods. Secondary producers are those who produce physical or tangible goods using raw materials from primary producers. Tertiary producers are mainly service providers, like hairdressers.

Producers of different types of production has different YED and this will be explained in the following paragraph. For primary goods like agricultural goods, in general, has a low YED. Since most of them are necessities and their YED is often between 0 and 1. Among manufacturers, some has higher YED some has lower YED within the manufacturing sector but usually for secondary producers, they have a relatively higher YED than that of primary producers but lower than that of service providers. Tertiary producers tend to have the highest YED among all the three types since most of them are not producing necessities.

This can be shown in the diagrams below.



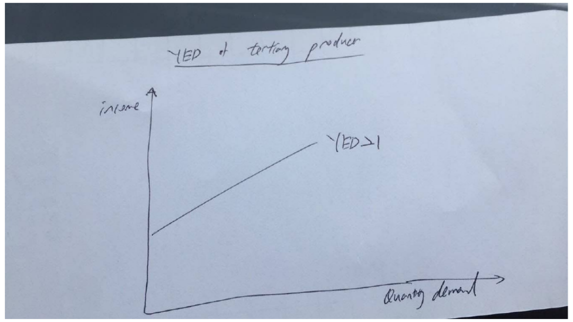
MERIDIAN FILE

Elasticity Sample Essays

- Revenue strategy using PED and XED
- YED across primary, secondary and tertiary sectors
- Evaluation for luxury and low-price car

04

of 08 pages



Tertiary producers are likely to have a YED larger than one. This means that the percentage change in demand will be greater than the percentage change in income. Primary producers, on the other hand, are likely to have a YED lower than one, meaning the percentage change in demand will be less than the percentage change in income. Secondary producer will likely have a YED that is in the middle. In the diagram above, it is assumed that they have YED=1. In this case, the percentage change in demand will be equal to the percentage change in income

YED affects revenue of producers in different economic conditions. When the economy is growing, income of consumers increases. With an increase in income, demand and hence revenue will rise, if YED>0. Producers of primary goods would enjoy a smaller increase in demand and revenue due to a lower YED. For manufacturers, they will face a greater increase in demand and revenue. Service providers would yield the greatest rise in demand and revenue. In a recession, income falls and demand and revenue for producers fall. Primary producers will experience just a small fall in demand and revenue. However, tertiary producers would experience a great fall in demand and revenue. This shows a more stable demand for primary goods and less fluctuation in revenue of primary producers. For tertiary producers, they face a highly volatile demand and uncertainty in revenue during different economic phases.

YED also affect the relative importance of sectors. Over the long run, income increases and the economy grows. Tertiary producers who have a higher YED will gain relative importance in the economy. This is because the % increase in spending will exceed % increase in income, meaning that higher proportion will be spent in the tertiary sector. For primary producers with low YED, % increase in income will be greater than that of spending.

MERIDIAN FILE

Elasticity Sample Essays

- Revenue strategy using PED and XED
- YED across primary, secondary and tertiary sectors
- Evaluation for luxury and low-price car

05

of 08 pages

Hence, people spend relatively less in the primary sector. This can be seen in the economic growth of Hong Kong from 1960s to 1990s. Hong Kong's economy is transforming from focusing on primary and secondary sector to tertiary sector. With economic growth, the economy has placed increasing attention and focus on the tertiary sector.

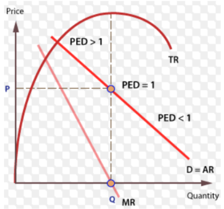
In conclusion, YED is important to producers as it allows them to understand and predict how their demand will change when the economy's income changes. In the long run, it will also allow producers to predict their relative importance in the entire economy.

3. Discuss the importance of PED for luxury car producers and lower price car producers (15 marks)

Price elasticity of demand (PED) measures the responsiveness of quantity demanded to a change in price and it is computed as the percentage change in quantity demanded divided by percentage change in price.

Luxury car producers and lower price car producers face different PED as the proportion of income spent of the cars are very different. In general, we can say that the PED faced by luxury car producers are higher due to a higher proportion of income spent on the car. This is due to the income effect, when price rises people have less purchasing power and affordability would fall, resulting in a high PED. Therefore, the higher the proportion, the more consumers are forced to lower quantity demand by a greater extent as price rises. The reverse is true for lower price cars, with less portion of income spent on the car, the income effect will be little compared to that of the luxurious car. Consumers are facing less constraints and would not lower consumption a lot like luxurious car.

Knowledge of PED can allow car producers to increase revenue. The relationship between total revenue (TR) and PED can be illustrated by the diagram below:



When PED >1, firms would like to lower price and raise quantity so as to boost revenue, reaching the maximum point of the TR curve.
This is because % increase in Qd > % decrease in P with a price elastic demand. So it is of firm's best interest to lower price.
When PED<1, firms should increase price despite the fall in quantity demanded. Since raising price would allow firms to reach the maximum point of total revenue. Given that % increase in price > % decrease in Qd, it is revenue maximizing for firms to raise price.

Since luxury cars tend to have a higher PED as explained above, they can likely lower price to increase total revenue. For lower priced car producers, they can likely increase price to increase total revenue due to a lower PED.

PED of luxury cars is likely to be higher than lower priced cars if other

MERIDIAN FILE

Elasticity Sample Essays

- Revenue strategy using PED and XED
- YED across primary, secondary and tertiary sectors
- Evaluation for luxury and low-price car

07
of 08 pages

factors are held constant. However, it wont be necessarily true when we try to consider other factors affecting PED. There are also other determinants of PED like availability of substitutes. For example, electric cars are likely to have lower PED since there are not many substitutes available. Therefore, regardless of whether it is luxury or cheap car, it has low PED. Hence, car producers cannot predict the PED of their cars purely on the basis of the car's price. They need to also consider other factors, such as the number of substitutes.

Moreover, there are many other factors affecting a car producer's revenue and profits. For instance, XED could possibly affect the sales revenue of car producers. An increase in gasoline prices will lead to a fall in quantity demanded and revenue for all car producers. Since cars and gasoline are complements, and the XED<0, a rise in price of gasoline can lead to a fall in demand for cars. Revenue could possibly be lowered with the change in price of its complements or substitutes. Besides, firms tend to maximize profits rather than maximize revenue. They also consider costs or production, even if revenue is high, it can be that the cost is high too, lowering firms' profits. Therefore, most firms do not solely look at the revenue but also the cost. They would maximize profits by producing at where MC = MR.

To conclude, PED is useful for both luxury and lower-priced car producers for price setting so as to achieve revenue maximization. It serves as an indicator for firms to decide when to raise or cut prices. However, PED cannot be only dependent on whether the car is a luxurious or a cheap one. Producers must consider other factors which would affect PED, like availability of substitutes and necessity of products. Even after considering all determinants of PED, a firm may not be aiming at revenue maximization. Instead, most firms look at both costs and revenues and focus on profits maximization. In short, there are many factors that will affect revenue and profit of firms. Hence, PED is only significant to car producers to a certain extent.

MERIDIAN FILE

Elasticity Sample Essays

- Revenue strategy using PED and XED
- YED across primary, secondary and tertiary sectors
- Evaluation for luxury and low-price car

MERIDIAN EDUCATION

TOPIC 1.3 | SAMPLE ESSAYS

Government Intervention

Taxes, subsidies and price controls

Coverage

6

source pages

- Indirect tax incidence and PED
- Agricultural subsidies and stakeholder effects
- Price ceiling and price floor evaluation

MERIDIAN EDUCATION

Level-7 Econ Sample essays written by Ryan Reagan
Written by Ryan Reagan- the most popular IB Econ strategist in the world
** Ryan's videos on Youtube have been watched by over 100,000 IB students world-wide*

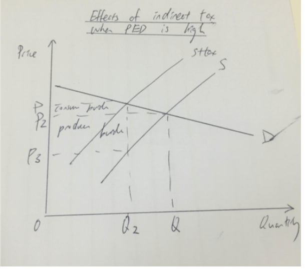
Topic 1.3: Government intervention

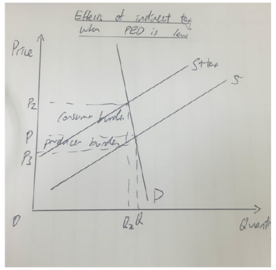
Question: Explain how PED influence the effects of an indirect tax
(10 mark)

Sample Level-7 Answer:

PED is a measure of the responsiveness of quantity demanded to change in price. Indirect tax, on the other hand, is a tax on expenditure. An example is a 2 dollar tax on each package of cigarettes.

The effects of an indirect tax on a good with high PED and on a good with low PED can be shown in the two diagrams below.





After a tax is imposed, there is a higher cost of production for producers, leading to a leftward shift of the supply curve. As supply curve shifts left, equilibrium price increases to P2 while equilibrium quantity decreases to Q2.

PED influences the effects of an indirect tax in 3 ways. Firstly, if PED is high, the indirect tax will be more effective in reducing the quantity demanded of a good. This is because consumers are more responsive to price change. Hence, as the price increases, there will be a greater fall in quantity demanded. If PED is low, the fall in quantity demanded will be less. For example, an indirect tax tend to only have a small effect on reducing quantity demanded for cigarettes due to low PED. Secondly, PED influences the consumer and producer burden of the indirect tax. When PED is low, consumer burden tend to be higher. This is because consumers are less responsive to changes in price and producers can increase price more to pass on a greater tax burden to consumers. In the case of cigarettes, consumers tend to have most of tax burden as there is a low PED. Thirdly, PED influences the amount of tax revenue that the government can collect from the indirect tax. If PED is low, tax revenue will be greater. This is because there is only a small decrease in quantity demanded. Consequently, the government can collect tax revenue on a large quantity of goods. In the case of cigarettes, tax revenue tend to be high because many smokers will continue smoking even after the imposition of the indirect tax.

MERIDIAN FILE

Government Intervention

- Indirect tax incidence and PED
- Agricultural subsidies and stakeholder effects
- Price ceiling and price floor evaluation

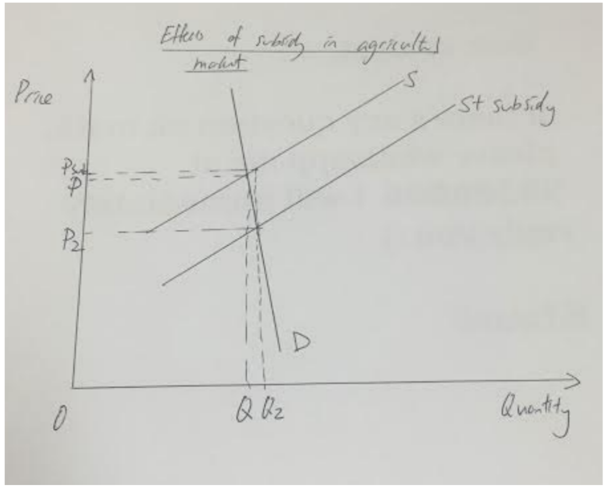
01
of 06 pages

Level-7 Econ Sample essays written by Ryan Reagan
Written by Ryan Reagan- the most popular IB Econ strategist in the world
** Ryan's videos on Youtube have been watched by over 100,000 IB students world-wide*

Question: Evaluate the view that agricultural producers should be subsidized. (15 marks)

Sample Level-7 Answer:

A subsidy is a grant from the government to producers in order to lower cost of production and to lower price for a certain good or service. The effects of a subsidy on an agricultural good can be shown in the diagram below.



After a subsidy is imposed, cost of production for producers fall, which lead to a rightward shift of the supply curve. This then leads to an increase in equilibrium quantity and a fall in equilibrium price. It is important to note that since agricultural goods are necessities, they tend to have a low PED. Since PED is low, after the subsidy is imposed, there will be a significant drop in price for consumers, but only a small rise in quantity demanded.

There are a number of advantages of subsidizing agricultural producers. Firstly, it lowers equilibrium price, which will lead to lower cost of production for food. Since food is a necessity, a subsidy will increase the disposable income of consumers and contribute to higher living standards. Secondly, as shown in the diagram above, the supply and quantity demanded of food will rise after the subsidy. Hence, it can be argued that a

MERIDIAN FILE

Government Intervention

- Indirect tax incidence and PED
- Agricultural subsidies and stakeholder effects
- Price ceiling and price floor evaluation

02

of 06 pages

subsidy can help to ensure a stable a sufficient food supply and thereby help to reduce poverty. Thirdly, revenue for producers will also rise. Before the subsidy, producers revenue is PxQ. After the subsidy, they receive the price of Psub and sell a quantity of Q2, which leads to a revenue of Psub x Q2. It is important to note that farmers often suffer from low living standards, because the supply of agricultural goods tend to be unstable and prices tend to fluctuate significantly. This makes it difficult for farmers to plan investment in health and education to improve living standards. Hence, one may argue that governments should subsidize farmers in order to improve their standards of living.

The main disadvantage of a subsidy is that it incurs a high cost on the government. This will lead to an opportunity cost because the government must cut back on spending on other areas. For example, government may need to reduce spending on healthcare. Ultimately, whether to impose a subsidy on an agricultural good depends on a number of factors. Firstly, it may depend on the type of agricultural good. Some agricultural goods, such as wheat, are used to produce neccesities such as rice. For such agricultural goods, a subsidy will be more justifiable because a reduction in price for a necessity can bring a significant improvement to standards of living. Agricultural goods that have positive externalities, such as organic healthy crops, should also be subsidized. This is because increase consumption of goods with positive externalities can lead to a welfare gain. Another factor that the government should consider is the current affordability of agricultural goods. In some countries where income is low, such as Philipines, governments often subsidize important agricultural goods to reduce poverty. However, in more developed countries, there may be less of a reason to subsidize agricultural goods. Moreover, some countries such as Japan also impose subsidies to protect their farmers who will suffer without a subsidy due to fierce international competition. In cases where farmers suffer low living standards without government protection, the benefits of a subsidy may also be more significant.

In conclusion, a subsidy for agricultural goods will benefit both consumers and producers in the market. However, there is an opportunity cost for the government. A subsidy on agricultural products means that there must be less spending on another area. The government should carefully consider the type of agricultural good and the current living standards of consumers and producers to decide whether a subsidy is worthwhile.

MERIDIAN FILE

Government Intervention

- Indirect tax incidence and PED
- Agricultural subsidies and stakeholder effects
- Price ceiling and price floor evaluation

03
of 06 pages

MERIDIAN EDUCATION

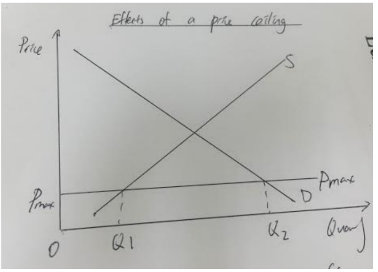
Level-7 Econ Sample essays written by Ryan Reagan
Written by Ryan Reagan- the most popular IB Econ strategist in the world
** Ryan's videos on Youtube have been watched by over 100,000 IB students world-wide*

Question: Evaluate the view that price ceilings and price floor often lead to undesirable side effects. (15 marks)

Sample Level-7 Answer:

Price ceiling is a maximum price control where the government sets a legislation in which prices can only be lower than a specific level but not higher than a specific level. Price ceilings are generally used to lower the price of certain necessities to help consumers. For examples, some countries may impose a price ceiling for food. A price floor, on the other hand, is when a government sets a legislation in which price can be higher than a specific level but not lower than a specific level. Price floors are generally used to protect producers by increasing their profit margins. For example, some countries may impose a price floor for agricultural goods to protect farmers. Another example is minimum wage to protect low skilled workers.

It is true that a price ceiling can often lead to undesirable consequences. The market effects of a price ceiling can be shown in the diagram below.



After a price ceiling is imposed, the market price drops to a level below equilibrium. There will be an increase in quantity demanded and a fall in quantity supplied. This leads to a shortage in the market by Q2-Q1. In this situation, producers will suffer a loss in revenue in profits as the quantity supplied and price both falls. Lower revenue by producers may lead to unemployment. The government may also suffer, because in order to monitor and enforce compliance to the policy, a cost will be incurred. There will be an opportunity cost to implementing such a policy, because the government will need to cut back on spending on other areas such as healthcare and education. For consumers, although they can purchase the good at a lower price, they will likely have less access to the good. This is because the quantity demand is now higher than the quantity supplied. In other words, some consumers who are willing and able to buy the good at the market price will not be able to buy the good because of a shortage in quantity supplied. For example, a price ceiling for rice can actually increase poverty in a country, because it discourages

MERIDIAN FILE

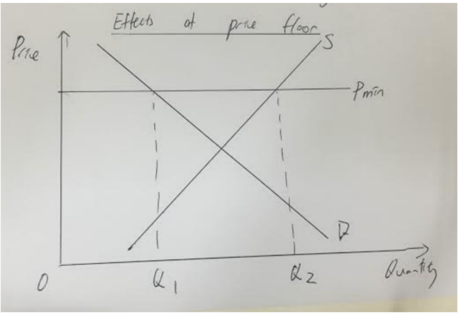
Government Intervention

- Indirect tax incidence and PED
- Agricultural subsidies and stakeholder effects
- Price ceiling and price floor evaluation

04
of 06 pages

producers from producing rice. The shortage also represents a source of inefficiency in the market, because the price ceiling prevents the shortage from clearing and the market from reaching equilibrium. Moreover, the price ceiling will lead to a fall in consumer surplus to only triangle A and the producer surplus will fall to triangle B. This represents a loss in social surplus by triangle C.

A price floor on the other hand, can also lead to many undesirable consequences. The effects of a price floor can be shown in the diagram below.



After a price floor is imposed, the market price will rise to Pmin, which is above equilibrium. The higher price increases quantity supplied in the market and reduces quantity demanded. There will be excess supply by Q2-Q1. For consumers, there is a negative impact as prices rise. In the case of minimum wage, firms will suffer higher costs of production and lower profitability as a result of minimum wage. For producers, although price is higher, the quantity demanded is also less. Hence, whether total revenue rise would depend on the price elasticity of demand (PED). If PED is lower than 1, the percentage increase in price will exceed percentage fall in quantity demand, leading to a rise in revenue for producers. If PED is higher than 1, the revenue will fall as the percentage fall in quantity demanded will exceeded the percentage rise in price. Another potential negative consequence on producers is that the increase in price will cushion inefficiency as producers are guaranteed a higher price. The excess supply also represents an inefficiency caused by the price floor because the price floor prevents market price to fall in order to clear the surplus. Moreover, there is a fall in consumer surplus to triangle A and a fall in producer surplus to triangle b, resulting in a loss in social surplus by triangle C. In the case of a minimum wage, unemployment also tends to rise because the increase in market wage will lead to excess supply of labour.

In conclusion, the costs of price controls tend to outweigh its benefits. In both a price ceiling or price floor, there is a loss in social welfare. Hence, in the real world, government will only consider using price controls in extreme conditions to protect certain stakeholders. For example, in Hong Kong, low skilled workers cannot afford basic

MERIDIAN FILE

Government Intervention

- Indirect tax incidence and PED
- Agricultural subsidies and stakeholder effects
- Price ceiling and price floor evaluation

MERIDIAN FILE

Government Intervention

- Indirect tax incidence and PED
- Agricultural subsidies and stakeholder effects
- Price ceiling and price floor evaluation

06

of 06 pages

MERIDIAN
EDUCATION

Level-7 Econ Sample essays written by Ryan Reagan
Written by Ryan Reagan- the most popular IB Econ strategist in the world
** Ryan's videos on Youtube have been watched by over 100,000 IB students world-wide*

necessities. Hence, despite of the potential negative consequences, minimum wage policy was implemented in 2011.

MERIDIAN EDUCATION

TOPIC 3.1 | SAMPLE ESSAYS

Protectionism

Trade barriers, tariffs and comparative advantage

Coverage

4

source pages

- Reduction in protectionism
- Short-run job protection versus long-run efficiency
- Tariff and subsidy evaluation

MERIDIAN
EDUCATION

Level-7 Econ Sample essays written by Ryan Reagan
Written by Ryan Reagan- the most popular IB Econ strategist in the world
** Ryan's videos on Youtube have been watched by over 100,000 IB students world-wide*

Topic 3.1: Protectionism

Question:

USA and Australia enter trade agreement

Text 1
With the Australia-United States Free Trade Agreement coming into force on 1 January 2005, the Australian Government has officially joined much of the rest of the world in promoting the opportunities and benefits of bilateral and regional free trade agreements.

Text 2
Until recently, Australia had focused its attention on multilateral trade negotiations. In fact, prior to 2003, Australia had signed only one free trade agreement with New Zealand. Since then, Australia has signed agreements with Singapore, the US and Thailand.

As a result of this relative inactivity on the bilateral front, Australia is now facing discrimination in many key markets. For this reason, the Government is looking to Asia and investigating the possibility of forming a **free trade area** with ASEAN, China, South Korea and Japan.

Text 3
The Australian Government has signalled its on-going commitment to multilateral trade agreements. It recently played an important role in negotiating the World Trade Organization (WTO) "Doha" agreement of July 2004 that provides for a reduction in protectionism, like tariffs and **subsidies**, in controversial areas such as agriculture. The removal of barriers will, hopefully, improve the access of developing nations into the markets of developed nations.

Text 4
Australia has greatly benefited from the freer market access resulting from WTO membership, with Australian exports rising from $93 billion to more than $154 billion since 1995 and a strengthening of the Australian dollar. The sharp increase in trade has also significantly contributed to more than 250 000 jobs created in Australia during that time. It would be unwise for Australia to turn its back on the multilateral trading regime despite nationalistic fears of job losses, dumping and the need to raise taxes.

[Source: adapted from *The Australian*, 6 January 2005]

Evaluate the effects of WTO trade negotiations aimed at reducing protectionism
(8 marks)

MERIDIAN FILE

Protectionism

- Reduction in protectionism
- Short-run job protection versus long-run efficiency
- Tariff and subsidy evaluation

01
of 04 pages

MERIDIAN EDUCATION

Level-7 Econ Sample essays written by Ryan Reagan
Written by Ryan Reagan- the most popular IB Econ strategist in the world
** Ryan's videos on Youtube have been watched by over 100,000 IB students world-wide*

Suggested answer:

This article discusses the trade negotiations and agreements between Australia and the rest of the world.

There are a number of advantages of a reduction in protectionism mentioned in the article. As mentioned in the article, the removal of barriers will hopefully improve the access of developing nations to developed nations. This suggests that exports from developing nations into developed nations will rise. The increase in exports will lead to an increase in aggregate demand, which increases economic growth for developing countries. Since developed countries have higher income than developing countries, this can help generate significant increase in aggregate demand and economic growth for developing countries, leading to significant improvements in living standards. Like mentioned in paragraph 4, freer market access also helps to increase Australian exports, which will also help to increase economic growth of Australia. This increase in economic growth has also created 250, 000 jobs in Australia like mentioned in the article. Another advantage of freer is that there will be greater specialization of different countries according to comparative advantage, which will increase efficiency and also increase the total output of all countries combined.

Despite all the advantages mentioned above, reduction in protectionism also has a number of unintended consequences. Firstly, there is a greater fear of job losses like mentioned in the article. This is because more efficient importers will replace less efficient domestic producers when free trade increases. This will lead to a fall in output by less efficient domestic producers and lead to a reduction of job opportunities. Secondly, there is also greater fear of dumping. Dumping refers to the situation when a country exports goods to another country at a price below average cost. Dumping ultimately hurts domestic producers because it reduces the market price and hence, the profitability of domestic producers. More domestic firms may shut down if there are less protectionism measures to protect domestic producers from dumping. Lastly, the article also mentions a fear of the need to raise taxes. A reduction in protectionism generally means a reduction in tariffs, which reduces tax revenue for the government. To make up for this loss in tax revenue from tariffs, the government may need to increase tax on domestic firms or consumers. This will reduce the disposable income for domestic consumers and the profitability of domestic firms.

Overall, there are both winners and losers to reduction in protectionism. The winners are exporters, while the losers are inefficient domestic producers. However, over the long term, the benefits of reducing protectionism tend to outweigh the costs, because freer trade will ultimately increase economic efficiency and increase living standards of all countries.

MERIDIAN FILE

Protectionism

- Reduction in protectionism
- Short-run job protection versus long-run efficiency
- Tariff and subsidy evaluation

02
of 04 pages

MERIDIAN EDUCATION

Level-7 Econ Sample essays written by Ryan Reagan
Written by Ryan Reagan- the most popular IB Econ strategist in the world
** Ryan's videos on Youtube have been watched by over 100,000 IB students world-wide*

Question:

Car subsidies blow good money out of the exhaust

1. The Australian government intends to reduce tariffs on foreign car imports from 10% to 5% in 2010. They say the future of the industry lies in "innovation and global integration, not industry protection with old-fashioned **quotas** and tariffs". However, its plan keeps protection for the Australian car industry through increased subsidies, doubling industry assistance to 6.2 billion Australian dollars.

2. The 1.3 billion Australian dollars Green Car Innovation Fund provides some environmental respectability to an outdated industry policy. However, Australia can import as many fuel efficient cars as it wants without having to make them itself.

3. Car makers are already responding to the **demand** for more fuel-efficient cars and the car industry does not need further incentives. If the government's intention is to lower carbon emissions from car use in Australia, then it should aim to provide consumers with access to low-emission cars at the cheapest possible price. Lowering tariffs on imported cars achieves this objective at a much lower cost than building cars locally.

4. The government argues "only 15 countries, including Australia, can design, engineer and build a car from scratch" and says its car plan "demonstrates the government's commitment to modern manufacturing and to providing high-skill, high-wage jobs for Australians". The notion that only the car industry can provide high-skill, high-wage jobs is mistaken.

5. What cost will taxpayers pay for the government's determination to maintain the capacity to build cars locally? The billions of dollars in help provided by successive Australian governments to the local car industry has come at the expense of consumers and taxpayers, destroying jobs and income in other industries. This is the real, but largely unseen, cost of industry assistance.

6. The new car plan is the latest of many support packages for this industry, yet the government argues things will be different this time, with "a high level of support at the beginning, eventually falling towards zero".

7. The car industry has failed to benefit from the efforts of previous Australian governments to support it, because such support limits the competitive pressures that are the best guarantee of a competitive car industry.

Evaluate whether increased protectionism in the car industry can benefit the economy

MERIDIAN FILE

Protectionism

- Reduction in protectionism
- Short-run job protection versus long-run efficiency
- Tariff and subsidy evaluation

03
of 04 pages

MERIDIAN EDUCATION

Level-7 Econ Sample essays written by Ryan Reagan
Written by Ryan Reagan- the most popular IB Econ strategist in the world
** Ryan's videos on Youtube have been watched by over 100,000 IB students world-wide*

Suggested answer:

This article discusses how Australian government is intending to reduce tariff on cars and a subsidy that is in place to support domestic Australian car producers.

There are a number of disadvantages to protectionism that may be suggested in the article. Firstly, it is mentioned in paragraph 3 that lowering tariffs on imported car achieves the objective of increasing access to low-emission cars at a much lower cost than building cars locally. This suggests that reducing tariff is a very efficient method to increase access to fuel-efficient cars by lowering price of imports and increasing imports. In fact, this will also improve economic efficiency as more efficient foreign producers replace less efficient domestic car producers. Another disadvantage of protectionism mentioned in the article is that the subsidy, which is a form of protectionism, comes at the expense of many domestic tax payers, which "destroys jobs and income in other industries". This is because the government must increase taxes for other industries in order to raise money for subsidizing car producers. The increase in tax reduces profitability for firms in other industries and can lead to unemployment. Moreover, it is also mentioned in the article that protectionism to support domestic car producers tend to reduce competitive pressure, which is "the best guarantee of a competitive car industry." The reduction in competitive pressure will reduce incentive for domestic producers to innovate and improve efficiency. From consumers point of view, protectionism also has a negative impact. This is because protectionism measures such as tariff and quotas tend to increase market price for cars. Furthermore, protectionism reduce the quantity of imports, which lead to a fall in consumer choice.

The main reason why Australia aims to support its car industry seem to be the fact that the car industry can help to provide high skill, high wage jobs. Hence, if the industry is not protected, it can suffer from foreign competition, leading to unemployment. However, it is also stated in the article that "the notion that only car industry can provide high skill, high wage jobs is mistaken." This suggests that it is unnecessary to protect domestic car producers because other industries can also provide job opportunities

Protectionism can have a positive effect for workers in the short run. However, in the long run, protectionism will lead to an inefficient allocation of resources. Moreover, protecting workers in the car industry will lead to unemployment in other industries due to the need for higher taxes. Hence, in conclusion, the cost of protecting car industry outweights the benefit and protectionism should not be adopted.

MERIDIAN FILE

Protectionism

- Reduction in protectionism
- Short-run job protection versus long-run efficiency
- Tariff and subsidy evaluation

04
of 04 pages

MERIDIAN EDUCATION

TOPIC 3.2 | SAMPLE ESSAYS

Exchange Rates

Appreciation, devaluation and fixed exchange rates

Coverage

4

source pages

- Stakeholder effects of appreciation
- Exchange-rate policy during recession
- Inflation, debt and export competitiveness

MERIDIAN EDUCATION

Level-7 Econ Sample essays written by Ryan Reagan
Written by Ryan Reagan- the most popular IB Econ strategist in the world
** Ryan's videos on Youtube have been watched by over 100,000 IB students world-wide*

Topic 3.2: Exchange rate

Question:

Boom or bust

1. The freely floating Australian dollar has been appreciating, creating winners and losers. Australian tourists overseas are getting bargain hotel rooms while some local exporters are suffering huge falls in demand. The **appreciation** of the Australian dollar gives a good reason to foreign students not to study in Australia. But as the Australian dollar continues to gain strength it seems that the economy is coping with the appreciating currency better than many economists expected.

2. Australia's exports are dominated by minerals, energy and agricultural products, and all are enjoying record prices. Continued strong demand means that the exporters of these products have not needed to look for other markets. For example, coal and iron ore prices have more than doubled in the last two years, these commodity prices rising even more quickly than the appreciating currency.

3. The Australian dollar is only one factor affecting exporters, and at the moment the strong economic growth of the Asian economies is adding to the increasing demand for Australian commodities.

4. However, not everyone in Australia is happy. Service industries have not enjoyed an increase in the price of their output, nor have they enjoyed booming foreign demand. The problems with the appreciating Australian dollar are most evident in the fact that fewer students and tourists are coming to Australia. Manufacturers have a similar problem and are suffering from the results of the rising Australian dollar and increased domestic interest rates.

5. The higher Australian dollar has provided many indirect benefits. By making imported resources cheaper, it has reduced the inflationary pressures which were caused by the economic boom that gave consumers greater spending power. As a result, it allowed the Australian government to slow down the **interest rate** increases which it was imposing in order to tackle inflation.

Evaluate the possible effects of appreciation on the Australian economy (8 marks)

MERIDIAN FILE

Exchange Rates

- Stakeholder effects of appreciation
- Exchange-rate policy during recession
- Inflation, debt and export competitiveness

01
of 04 pages

MERIDIAN EDUCATION

Level-7 Econ Sample essays written by Ryan Reagan
Written by Ryan Reagan- the most popular IB Econ strategist in the world
** Ryan's videos on Youtube have been watched by over 100,000 IB students world-wide*

Suggested Answer:

This article discusses the effects of appreciation on various stakeholders in Australia.

There are a number of winners due to the appreciation in Australia. Firstly, like mentioned in the article, "Australian tourists overseas are getting bargain hotel rooms." This suggests that Australian tourists will have a higher purchasing power due to higher value of Australian dollar. Another benefit is that it lowers inflation. As mentioned in paragraph 5, the appreciation "by making imported resources cheaper, it has reduced inflationary pressures." When appreciation occurs, imports are cheaper in terms of the Australian dollars, which lowers cost of production and causes inflation to fall. This will benefit local producers as well, because they can enjoy lower cost of production and higher levels of profitability. Moreover, the appreciation also "allowed the Australian government to slow down the interest rate increases, which it was imposing in order to tackle inflation." Since appreciation already works to lower inflation, the Central bank would no longer need to increase interest rates to tackle inflation. This will benefit borrowers because it will slow down the increase in cost of borrowing.

There are also losers from the appreciation in Australian. As mentioned in paragraph 1, "some local exporters are suffering huge falls in demand." As the Australian dollar appreciates, exports will become more expensive in terms of foreign currencies. This will lead to a fall in demand for exports and a fall in export revenues. However, it is important to note that not all exportors suffer to the same extend. Like mentioned in the article, the demand for primary commodities from Asian is increasing because of higher levels of income in Asian countries. Thus, the appreciation will not have a noticeable effect on Australian exports of primary commodity. However, other producers such as service providers who are not enjoying an increase in demand from Asian are suffering more as a result of the appreciation of Australian dollar. For example, fewer foreign students are studying in Australia as it will cost more in terms of foreign currencies to study in Australia. Hence, schools in Australia will suffer from lower revenues.

In conclusion, appreciation benefits domestic consumers and domestic producers price of imports. On the other hand, exporters are worse off as they will suffer a fall in demand. There are winners and losers in this situation.

MERIDIAN FILE

Exchange Rates

- Stakeholder effects of appreciation
- Exchange-rate policy during recession
- Inflation, debt and export competitiveness

02
of 04 pages

MERIDIAN
EDUCATION

Level-7 Econ Sample essays written by Ryan Reagan
Written by Ryan Reagan- the most popular IB Econ strategist in the world
** Ryan's videos on Youtube have been watched by over 100,000 IB students world-wide*

Question:

Should Latvia's currency be devalued?

❶ Badly hit by the financial crisis, Latvia is going through severe recession, losing 25 %–30 % of its Gross Domestic Product (GDP) in two years. It has very large budget and trade deficits, a large and growing public debt, and the deep recession has resulted in **deflation**.

❷ In view of these developments, the lat (Latvia's currency) would face **depreciation** in a freely floating exchange rate system. However, the lat has been pegged (fixed) to the euro since 2005 (0.7 lat : 1 euro). The Latvian government has shown its determination not to allow the lat to devalue. A stable currency relative to the euro is a condition for future adoption of the euro.

❸ Yet with very large trade and budget deficits, it has had to turn to the International Monetary Fund (IMF) and the European Union (EU) for loans. To qualify for the loans it has been forced to implement a highly restrictive fiscal policy, involving deep cuts in government spending on education and health care. Another government policy involves cutting wages in an effort to increase firms' export competitiveness.

❹ To maintain the pegged value of the lat, the Latvian central bank must keep interest rates at a relatively high level, in order to attract financial capital and prevent currency outflows. If the government devalued the lat, this could work to solve some of the problems. It would help correct the trade deficit and could also encourage economic growth. Economic growth might help reduce the public debt. A devaluation of the lat would also allow the government to pursue expansionary fiscal and monetary policies to deal with its deep recession.

❺ However, devaluation comes with risks. The government argues that it may create inflationary pressures due to higher import prices and a loss of export competitiveness. Widespread bankruptcies could arise because 85 % of consumer borrowing is in euros, meaning that the real value of consumer debt would increase.

❻ Estonia, Lithuania and Bulgaria (also with currencies pegged to the euro) may also devalue their currencies, reducing Latvia's competitive advantage from a devaluation of the lat.

Evaluate Latvia's decision to fix its exchange rate (8 marks)

MERIDIAN FILE

Exchange Rates

- Stakeholder effects of appreciation
- Exchange-rate policy during recession
- Inflation, debt and export competitiveness

03
of 04 pages

MERIDIAN EDUCATION

Level-7 Econ Sample essays written by Ryan Reagan
Written by Ryan Reagan- the most popular IB Econ strategist in the world
** Ryan's videos on Youtube have been watched by over 100,000 IB students world-wide*

The article discusses how Latvia is going through a severe recession while it is aiming to fix its exchange rate. The fixed exchange rate prevents depreciation of the Lat.

Since Latvia is facing deflation and recession, fixing the exchange rate and preventing depreciation will have a negative effect on the economy. This is because depreciation will reduce export price and help to increase export demand while increases aggregate demand. The increase in aggregate demand will help to increase GDP and average price level, helping to end deflation and recession. In order "to maintain the pegged value of the lat, the Latvian central bank must keep interest rates at a relatively high level." The high interest rates help to increase the demand of the lat and maintain a high level of exchange rate. However, the high interest rate will actually work to worsen to recession because it will increase cost of borrowing, which reduces consumption, investment and aggregate demand. Moreover, devaluation of lat will also help to reduce public debt of the government, which allows the government to pursue expansionary fiscal policy. The use of expansionary fiscal policy will also help the economy to increase its GDP and help to end the recession. Overall, devaluation will help to Latvian economy to deal with the recession.

However, fixing the exchange rates also has several benefits. As mentioned in paragraph 2, "a stable currency relative to Euro is a condition for the future adoption of Euro." Fixing the exchange rate will allow Latvia to adopt the Euro. In paragraph 5, it also mentions that devaluation will lead to higher inflation. This is because when there is devaluation, the price of imports will be higher in terms of the Lat, which increases cost of production and leads to inflation. The higher import price can also lead to a loss of export competitiveness, because exporters that use imports as factors of production will suffer higher cost of production. Moreover, widespread bankruptcies could arise because 85% of borrowing is in Euro. If the Latvian currency devalues, the value of debt will increase in terms of Lat, which will lead to bankkrupcies. Furthermore, if the Latvian currency is devalued, other countries such as Estonia and Bulgaria will retaliate by also devaluing their currency, which reduces Latvia's competitive advantage from devaluation. This means that even if Lat is devalued, it may not have a significant impact on increasing export demand since other countries will retaliate. Overall, the fixed exchange rate will help Latvia to adopt the Euro, lower inflation and reduce value of debt.

In conclusion, the main concern for Latvia's economy at the moment is the severe recession, losing 25-30% of GDP in just 2 years. If this recession continues, Latvian citiznes will suffer a severe drop in standards of living. Hence, the cost of fixing the exchange rate outweighs the benefits in the current situation, because fixing the exchange rate prevents the government from using expansionary fiscal or expansionary monetary policy which are needed to end the recession.

MERIDIAN FILE

Exchange Rates

- Stakeholder effects of appreciation
- Exchange-rate policy during recession
- Inflation, debt and export competitiveness

04
of 04 pages

MERIDIAN EDUCATION

IA GUIDELINE | INTERNAL ASSESSMENT

Economics IA Commentary Playbook

Rubric, article strategy and sample commentary

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.

MERIDIAN FILE

Economics IA Commentary Playbook

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

01

of 13 pages

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

MERIDIAN FILE

Economics IA Commentary Playbook

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

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

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

MERIDIAN FILE

Economics IA Commentary Playbook

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

04
of 13 pages

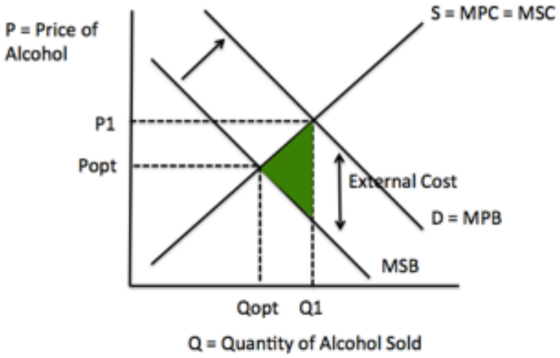


Diagram 1 shows the alcohol market in the United States. The current market equilibrium is where MPC = MPB. However, the social optimum level is MSC = MSB. Thus, MPB > MSB, proving a negative consumption externality because private firms benefit more than society and there is overconsumption. Often times, 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

MERIDIAN FILE

Economics IA Commentary Playbook

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

05

of 13 pages

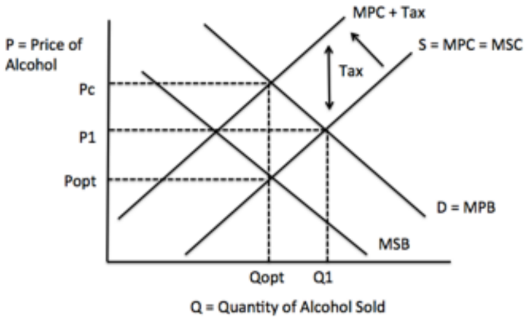


Diagram 2 shows the effects of the increased excise tax. Imposing an indirect tax raises MPC upwards because costs of production for firms increase. The tax also decreases equilibrium quantity (from Q1 to Qopt) and increases the price (from P1 to Pc) of alcohol. This is done in hopes of leading the market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

MERIDIAN FILE

Economics IA Commentary Playbook

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

06
of 13 pages

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.

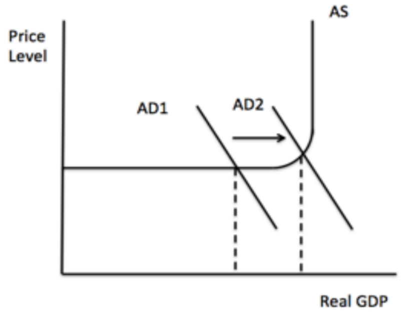
Suggested approach for macroeconomics
- Find articles related to monetary policy or fiscal policy on news.google.com

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.

MERIDIAN FILE

Economics IA Commentary Playbook

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

Diagram 2 – India decreasing Interest Rate

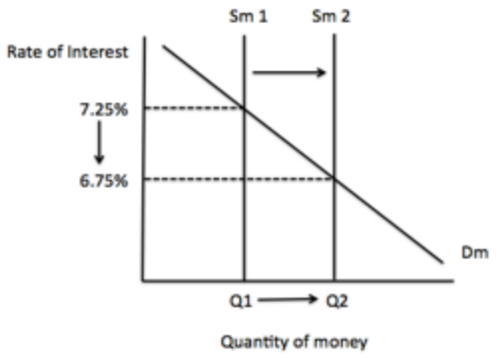


Diagram 2 shows the effect of The Reserve Bank of India (RBI) implementing expansionary monetary policy by "reducing its repo rate to 6.75% from 7.25%". The repo rate is defined as "the level at which the central bank lends to commercial banks". A rightward shift in the money supply curve from Sm1 to 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

MERIDIAN FILE

Economics IA Commentary Playbook

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

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.

MERIDIAN FILE

Economics IA Commentary Playbook

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

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

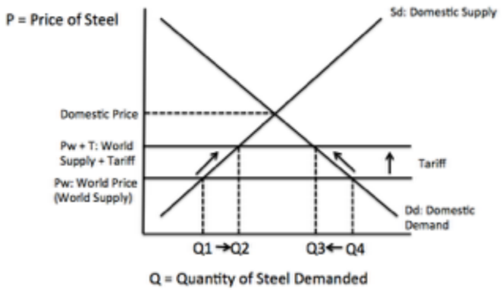


Diagram 1 shows the effects of the tariff. Originally under free trade, the United States would accept the price at Pw and imports from between Q1 to Q4. However, the tariff would cause a decrease in Chinese imports to between Q2 to Q3, an increase in domestic quantity supplied from Q1 to Q2, and a decrease 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

MERIDIAN FILE

Economics IA Commentary Playbook

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

11
of 13 pages

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

MERIDIAN FILE

Economics IA Commentary Playbook

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

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

MERIDIAN FILE

Economics IA Commentary Playbook

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

13

of 13 pages