



# OXFORD IB DP ECONOMICS

**Concept-based  
support for the  
2020 syllabus**

- Explore changes to the course structure
- Take a look inside new resources
- Get help with evaluation and ordering



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# Exploring the changes to the DP Economics syllabus

**By Jocelyn Blink and Ian Dorton, experienced IB teachers, workshop leaders and Principal Examiners**

The Economics course will be changing for first assessment in 2022. This guide will help you to understand the changes and introduce you to the latest Oxford resource that has been developed in cooperation with the IB to fully support you in delivering the new Economics syllabus.

## Why is the course structure changing?

The new Economics course is similar to past programmes with its inclusion of a wide range of core economic theories. However, in line with movements across the world to make the discipline of Economics more relevant to the 'real world', the new course helps students make more meaningful connections between economic theories and what is happening in the world around them.

Through the inclusion of an introductory unit which provides the origin of economic ideas in a historical context, the new course encourages students to appreciate that economic theories are based on the development of models which may differ, depending on the assumptions upon which they are based. This will support the development of critical thinking.

The new course is more firmly grounded in the pedagogical principles of the IB and reflects the value of using a concept-based and inquiry approach to teaching and learning.

## What are the changes?

### A conceptual approach

A fundamental change to the course is that it is founded on nine broad concepts that are seen as fundamental for a deeper understanding of the complex global economic environment. Each unit begins with statements of conceptual understanding that allow students to make meaningful connections between topics and helps them to apply the content to the real world. This conceptual focus will encourage students to approach the content in different ways, through multiple perspectives.



## The role of inquiry

Students of Economics have always been expected to find their own real-world examples to support their analysis. In the new course, this expectation has been enhanced by the emphasis on inquiry as a teaching and learning strategy. Students will develop their international-mindedness and higher order critical thinking skills by investigating their own real-world examples. The focus on student inquiry will ensure that students are more actively engaged in their own learning. The integration of examples into the analysis will be more formally assessed in the new course.

### Conceptual understanding

Key concept

SCARCITY



Key concept

INTERVENTION



Key concept

CHOICE



Key concept

INTERDEPENDENCE



Key concept

EFFICIENCY



Key concept

CHANGE



Key concept

EQUITY



Key concept

SUSTAINABILITY



Key concept

ECONOMIC WELLBEING



## Content and structure

The Standard Level material is a subset of the Higher Level. HL content is an extension of SL content throughout the course, with some topics explored in greater depth, and some content treated exclusively at HL.

Given its relevance in contemporary economics, some elements of behavioural economics are now included in the course. There is a greater focus on key global issues related to the environment, inequality and poverty. These areas are explored in depth in the new resource.

Following an introductory unit, the course is divided into three main areas, each of which has two overarching real-world issues.

### 1. Microeconomics

- How do consumers and producers make choices in trying to meet their economic objectives?
- When are markets unable to satisfy important objectives and how can government intervention help?

### 2. Macroeconomics

- Why does economic activity vary over time and why does this matter?
- How do governments manage the economy and how effective are their policies?

### 3. The Global Economy

- Who are the winners and losers of the integration of the world's economies?
- Why is economic development uneven?

## What will students gain from the new courses?

Both SL and HL will help students to:

- ✓ Develop curiosity and self-determination through inquiry
- ✓ Develop an understanding of the concepts, theories, and nature of Economics
- ✓ Appreciate the exciting and dynamic nature of Economics
- ✓ Appreciate the role of Economics in the real-world
- ✓ Develop an understanding of the evolution of Economic thinking in an historical context
- ✓ Develop an understanding of the assumptions inherent in Economic models
- ✓ Become global citizens who understand global issues, such as those related to the environment, inequality, and poverty

## Assessment

The assessments at SL have not been greatly altered, although there has been some change of emphasis. In the SL Paper 1, (the essay paper), the questions may be taken from all areas of the SL syllabus, and not just from microeconomics and macroeconomics. In addition, there is a stated emphasis upon the effective use of real-world examples in part (b) of the essay.

In the SL Paper 2, (the data response paper), the questions may be taken from all areas of the SL syllabus and not just international and development economics. Only one question, out of two, has to be answered, but the data is more detailed and there are more question parts than previously. There will be quantitative questions in part (b) and calculators may be used.

In HL Papers 1 and 2, the changes are the same as for SL above, although the questions may be taken from all areas of the syllabus, **including the HL extension topics**.

HL Paper 3 is now a policy paper. There will be two questions and candidates are required to answer them both. As in the past, there will be quantitative questions, as well as a need for definitions and explanations. The final part of each question will ask candidates to recommend a policy to address the issue raised in the question.

In the Internal Assessment, for both SL and HL, the word limit for each of the three commentaries is now 800 words. In each of the three commentaries, students are to use one of the nine key concepts as a lens through which to analyse their extract. Each commentary must use a different key concept.

## Economics SL assessment summary

Assessment	Time/weighting	Additional information
Paper 1	1 hour 15 minutes / <b>30%</b>	An essay paper, with a choice of one question from three. Each question is subdivided into two parts, (a) and (b). The questions are taken from the four units of the syllabus, excluding HL only topics. Relevant real-world examples need to be identified and developed to support the argument in part (b).
Paper 2	1 hour 45 minutes / <b>40%</b>	An essay paper, with a choice of one question from three. Each question is subdivided into two parts, (a) and (b). The questions are taken from the four units of the syllabus, excluding HL only topics. Relevant real-world examples need to be identified and developed to support the argument in part (b).
Internal Assessment	Throughout the course / <b>30%</b>	The IA is internally assessed and externally moderated by the IB. Students produce a portfolio of three commentaries, based on different units of the syllabus (excluding the introductory unit) using published extracts from the news media as the stimulus material. Each of the three commentaries should use a different key economic concept to support the analysis of the published extracts. There is a maximum 800 words for each commentary.

## Economics HL assessment summary

Assessment	Time/weighting	Additional information
Paper 1	1 hour 15 minutes / <b>20%</b>	This is the same as for SL. The questions may be taken from the four units of the syllabus, including HL extension material.
Paper 2	1 hour 45 minutes / <b>30%</b>	This is the same as for SL. The questions may be taken from the four units of the syllabus, including HL extension material.
Paper 3	1 hour 45 minutes / <b>30%</b>	A policy paper where students answer two compulsory questions. Each question is subdivided into a number of parts. The questions are taken from the four units of the syllabus, including HL extension material. Many of the question parts will require the use of a calculator. The final part of each question requires the proposal of a policy appropriate to the question.
Internal Assessment	Throughout the course / <b>20%</b>	This is the same as for SL



**Ian Dorton** has 41 years experience teaching Social Sciences, Economics, Business & Management, and Theory of Knowledge. Ian has led IB Economics workshops worldwide, as well as being an examiner for the IB since 1988. He has been a Deputy Chief Examiner, Principal Examiner, and Team Leader for IB Economics. In addition, Ian has been involved in the last four syllabus reviews. Ian is co-author of Oxford's new Course Companion for Economics along with his wife, Jocelyn Blink.



**Jocelyn Blink** taught at the Vienna International School for 26 years. She began working with the IB as an examiner in 1993. Since that time, she has been a workshop leader, Team Leader, Deputy Chief Examiner and Principal Examiner. She has also been actively involved in curriculum development. Jocelyn is co-author of Oxford's new Course Companion for Economics along with her husband, Ian Dorton.





# Deliver clear support for the new syllabus

Address all aspects of the new guide, with resources developed in cooperation with the IB, providing the most accurate match to the new syllabus.

Links to the IB syllabus

Links to contemporary economic thinkers

1 Introduction

## 2 THE EVOLUTION OF ECONOMIC THINKING

By the end of this chapter, you should be able to:

- Describe the basic ideas of Adam Smith
- Explain the meaning of *laissez-faire* economics
- Describe the evolution of microeconomic and macroeconomic thinking through the nineteenth century
- Describe the thinking behind Keynesian economics
- Describe the thinking behind monetarist/new classical economics
- Describe the growing role of behavioural economics
- Understand the concept of a circular economy.

There are full-length university courses on different aspects of the history of economic thought, and it is impossible to give the topic full justice within just a few pages. In this chapter, we introduce you to several names and theories associated with the evolution of modern economic thought. Some are treated in slightly more depth than others, and most are returned to later in the book. What is important at this stage is that you have some understanding of the evolution of the economic theory that we study today.

At the end of the chapter, you will see that the rapid changes in the world, and the tremendous threats that we are facing in terms of socioeconomic inequalities and threats to sustainability, may not be able to be explained through traditional, "orthodox" economic theories. This

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2 The evolution of economic thinking

has raised demands for a more "heterodox" approach to economics: one which incorporates a range of economic theories and questions the assumptions of many of the earlier models that have driven much of the decision-making of businesses and policy makers.

As Ha-Joon Chang shows in his excellent book, *Economics: The User's Guide* (highly recommended!), there many different ways of "conceptualising and explaining the economy". This gives rise to very different economic theories and models, none of which is "right". As he notes, "all theories, including natural sciences like physics, necessarily involve abstraction and this cannot capture every aspect of the real world". But what is most important is his comment that "this means that no theory is good at explaining everything. Each theory possesses particular strengths and weaknesses, depending on what it highlights and ignores, how it conceptualises things, and how it analyses relationships between them."<sup>1</sup> The fact that no one theory is "right" is what should encourage students of economics to adopt a heterodox approach where they consider issues from a variety of perspectives, using a range of theories.

Let's look at some of these different theories and their origins.

### Where did "modern" economics begin?

#### Classical economics – the eighteenth century

Until the beginning of the industrial revolution and the birth of capitalism, the prevailing view of economics was that there was a certain amount of gold and silver in the world, and that the amount of gold and silver a nation state had was the only measure of its worth. Under this theory of what is now known as *mercantilism*, rulers aimed to accumulate wealth by obtaining more gold and silver through trade. The goal was to maximize exports to earn more gold and silver, and use barriers to imports such as customs and tariffs to prevent gold and silver from leaving the economy. The government was heavily involved in controlling aspects of the economy. Having colonies abroad was one important way in which countries were able to produce and export goods to accumulate more gold and silver.

In 1776, the first "revolution" occurred in economic thought and the *classical school* of economics was born. The "father" of classical economics is Adam Smith, a moral philosopher from Scotland, who published what is often referred to as the first book on modern economics, *An Inquiry Into the Nature and Causes of the Wealth of Nations*, in 1776. Smith's book, more commonly known as *The Wealth of Nations*, completely changed the way that economic activity was understood and became the backbone of economic theory for the classical school until later in the nineteenth century. Although there have been changes in economic thought since then, his observations form the basis of many of the theories that we still study today and his book is still considered to be extremely influential in terms of its contributions to economic thought.

<sup>1</sup> *Economics: The User's Guide* by Ha-Joon Chang, Pelican Books, 2014

The cover of *Economics: The User's Guide*, by Ha-Joon Chang

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Recognising the importance of different approaches to economics

3 Demand

### Higher Level

#### What is choice architecture?

Choice architecture is the theory that the decisions that we make are heavily influenced by the ways in which the choices are presented to us. We make many decisions every day but we might not realize the extent to which those choices are influenced by the way that someone, referred to as a "choice architect", presents the choices to us.

A very simple example from supermarkets can be used to explain the term. When you shop in a supermarket, you will find all kinds of products right at the cash desk that encourage you to "impulse buy". They are not there by accident; the "choice architect" has placed them there because it is assumed that while you are waiting there, you will be tempted to buy those products. This is especially the case if they are chocolate bars or candies and you are waiting with a small child who will have a temper tantrum if you don't buy them!

An example of an area where choice architecture can be observed is when a *default choice* is changed. There are two ways of explaining the default choice. One is that it is the pre-set option that is effectively selected if the decision-maker does nothing. In other words, it is what you get if you do nothing. For example, Google is the default search engine on many browsers – it does not have to be selected, it opens automatically. The second is that it is the choice that is always followed unless a deliberate decision is made to change it. In other words, you carry on making the same choice because it is a habit. For example, if you always get a caffè latte when you go to the coffee shop, then it becomes your default option.

Although the default options do not always result in a good outcome, they are very popular for many reasons. The status quo bias described earlier can be very powerful. Consumers may not have the time or the resources to research alternatives, they may lack the cognitive skills to understand the alternatives, they may lack the courage to make changes, they are comfortable with what they normally choose and they generally like the easier options!

Consider the case of organ donation. There is always a shortage of organs for organ transplants. One way to increase the supply of organs available for transplants is to increase the number of people that consent to donate their organs in the event of their death. There are different systems for doing this. One system is the opt-in/opt-out approach. If a country operates an opt-in system, it is the responsibility of people to actively sign up to the organ donation register. This allows hospitals to use their organs for transplants after death. In an opt-out system, organs will automatically be donated unless people make a specific request before death that their organs should not be taken. If a country operates an opt-in system, then opting-in is the default option. If people do nothing, then their organs cannot be used, as they will not have given their consent. Changing the default option from opt-in to opt-out is seen as one way of using choice architecture to increase the number of people who consent to having their organs donated.

Another way in which choice architects can influence consumers is through *mandated choice*. These are situations where people are required by law to make a choice in advance. In the example of an organ donation, people are required by law to indicate if they are willing to become an organ donor in the event of their death. The way that the government can do this is by requiring people to tick a box to say whether or not they are willing to be donors when they renew their driver's licences. Although many people would like to be organ donors, when left to themselves to register as donors, many do not make the effort to indicate this choice. When the choice architects force people to make the choice, the number of organ donations increases substantially.

#### How can people be encouraged to make better choices?

Nudge theory was developed by behavioural economist Richard Thaler. The theory suggests that the choice architecture offered to people can be carefully designed to gently encourage (nudge) the people to voluntarily choose the option which is better for them. Behavioural economics in general, and nudge theory in particular, became much more well-known and accessible to the general population following the publication of Richard Thaler and Cass Sunstein's book *Nudge: Improving decisions about health, wealth and happiness*.

The key to nudge theory is that consumers maintain their *consumer sovereignty* (their right to choose) but are encouraged to make better decisions. A commonly cited example of this relates to the positioning of food in a school cafeteria. If healthy foods are placed in a very convenient, easy-to-reach, easy-to-see place, evidence shows that students will consume more of them. They are not forced by anyone to choose the healthy foods, but the placement "nudges" the students subconsciously to choose them. The key thing is that the students are not forced to choose the healthy option, but they do it themselves. The argument is that students are more likely to pick up healthy habits if they are making the choices themselves.

When designing positive choice architecture, the "architects" must essentially override certain cognitive biases. If consumers use their *System 1* thinking system and subconsciously fall back on rules-of-thumb which cause them to make poor decisions, then they may need to be nudged towards better decisions.

A good example where nudges have been used to help people make better decisions is in the area of pension savings. In many more economically developed countries, governments provide pension schemes that are designed to allow people to have a decent standard of living when they retire. However, these pensions schemes are under considerable threat due to the fact that people are living longer, and governments are unable to finance the pensions. Therefore, there is a need for people to set up private savings schemes to ensure that they

### Economics in action

Thinking, Communication and Research

A global problem is a lack of organs for organ transplants. Using the theory of choice architecture, explain the ways that different governments approach this problem and identify which method you think is the best. Justify your choice.

The cover of *Nudge*, by Richard Thaler

More Evidence That Menu Design Can Nudge Us Toward Better Choices

<https://www.forbes.com/sites/maissigauker/2019/07/25/more-evidence-that-a-menu-design-can-nudge-us-toward-better-choices/#2d7a916b52a1>

### Higher Level

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Coverage of behavioural economics theories

Practical and relevant examples to make the theory more meaningful for students



In-depth coverage of all new areas of the syllabus, including the origins of economic thought, behavioural economics, the Sustainable Development goals, and a deeper look at the economics of the environment, inequality and poverty.

Opportunities to build vital ATL skills throughout each unit

22 Economics of inequality and poverty

22 Economics of inequality and poverty

and companies. When they are elected, those politicians are then more likely to develop policies that are in the interest of the wealthy people and businesses supporting them, such as reduced minimum wages, reduced business regulations and tax cuts for the wealthy, thus worsening the economic well-being of lower income people.

Low-income people are also less likely to become involved in the political process. They may lack the background, the education, the social networks or they may simply lack the time to engage in political activities. As a result, the “voice” of low-income people may not be adequately represented in government policy.

**What are the consequences of inequality and poverty?**

- For economic growth**

The debate about the link between inequality and economic growth has fueled much theoretical and empirical research. On the one hand, large gaps between high- and low-income groups provide the incentives for entrepreneurship and innovation. The attractiveness of high incomes gives lower paid workers the motivation to work harder and improve their education and skills so that they may move into the higher paid jobs. When there is more equality and the gap is smaller, there are fewer incentives. Furthermore, it is argued that high levels of investment are needed for an economy to grow, and that the pools of savings needed for investment will not be as available in a more equal society.

On the other hand, it is also argued that inequality harms economic growth. Where there is high inequality and high levels of poverty, there are increasingly fewer opportunities for lower income members of society, and as we have already seen, this can become a vicious cycle. Children from poorer backgrounds are likely to leave school without appropriate skills and training. This may result in lower productivity levels, which damages economic growth. As noted by the OECD, “If a large swathe of the population is unable to invest in its skills, that’s bad news for the economy.” Furthermore, the social and political instability that is often associated with high levels of poverty can be a deterrent to growth. This underlines a very important point written about by a wide range of economists – that inequality is damaging for everyone, not just the poor.
- For living standards and social stability**

Logically, wide gaps in income mean that those living below the average level of income are living in some degree of poverty. Poverty may take all kinds of shapes, but the clear result is unacceptably low living standards and economic vulnerability.

People in poverty have to make difficult choices about how to use their very limited incomes – food, fuel, school supplies and

transportation. The Joseph Rowntree Foundation identifies what it means to be poor in the UK: “Poverty means not being able to heat your home, pay your rent or buy the essentials for your children. It means waking up every day facing insecurity, uncertainty and impossible decisions about money. It means facing marginalization – and even discrimination – because of your financial circumstances. The constant stress it causes can lead to problems that deprive people of the chance to play a full part in society.”

In unequal societies, neighbourhoods and areas of cities may become identified by their income groups, with “rich” areas and “poor” areas, and this may be self-perpetuating. If government-subsidized housing is concentrated in particular areas, this will result in even greater concentration of people living with low incomes. Low-income areas are less likely to have good schools and attract good teachers, so education prospects suffer. Low-income areas may suffer from poor infrastructure and facilities, so this limits opportunities for its residents.

Social stability is precarious in situations of high inequalities. Where people are living in extremely disadvantaged circumstances, with low living standards, resentment and hostility may be high. Studies have shown that this leads to social tension and increased criminal behaviour. This is particularly the case where young people feel that they have no job prospects and legitimate ways of earning a living. There may be increased gang-related activity. People living in impoverished areas may feel unsafe, and law enforcement may not be able to deal with the dangers. Social instability may result in threats to private property.

When a significant proportion of a population lives in relative poverty and people see a system that they perceive is unfair and not working for them, they are unlikely to support the political system and democratic process. This can give rise to an unstable social and political climate and tension between low-income people and those that govern. This further emphasizes the conclusion that high levels of inequality are harmful for everyone.

**Exercise 22.2**  
Thinking and Communication

Even back in 1776, Adam Smith, who became known for his support of laissez faire economic policies (see Chapter 2), recognized the lack of equity in a society with a large share of people in poverty. Try to translate the following into modern language!

“No society can surely be flourishing and happy, of which the far greater part of the members are poor and miserable. It is but equity that they who feed, clothe and lodge the whole body of people should have such a share of the produce of their own labour as to be themselves tolerably well-fed, clothed and lodged”.

Adam Smith, *The Wealth of Nations*

**Economics in action**  
Thinking, Communication and Research

Work in pairs and choose a city in a developed country of your choice. Make a presentation to demonstrate any consequences of inequality and/or poverty that are evident in the city. Support your presentation with specific data and pictures.

**Key concept**  
EFFICIENCY

**Economics in action**  
Thinking, Communication and Research

As we have already stated, inequality is not a function of national income. It is the result of national policies and institutions that shape the way in which a nation’s advantages and benefits are shared. Therefore, governments have it within their power to shape institutions and develop policies that reduce inequalities in opportunities, income and wealth. The policies identified in the rest of this chapter are by no means exhaustive, and include just a few country-specific examples. It is expected that you will find your own examples of government action in different countries, so that

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Students are presented with different viewpoints and encouraged to use their knowledge of economics to reflect and debate real-world issues

Throughout the book, key terms from the syllabus are italicised when introduced

Economics in action boxes are designed to provide a gateway to student inquiry

Modern and relevant real-world examples to show how the economic theory may be applied

Clearly signposted concepts promote reflection and discussion

Fresh and topical TOK features encourage critical reflection and drive independent thought

## 9 Market Failure

The Kyoto Protocol was the first main agreement made under the UNFCCC. Its objective was to cut global emissions of greenhouse gases (GHGs). The treaty was negotiated in Kyoto, Japan in 1997, and came into force in February 2005. The goal was to cut GHG emissions by 5% between 2008 and 2012, relative to 1990 levels. The agreement mainly targeted the advanced industrialized nations, with developing countries being asked to comply voluntarily. Whilst the Kyoto Protocol had some success in reducing emissions from signatory countries, it was not successful for reducing global emissions. Nonetheless, the process created a foundation for the next international agreement, known as the Paris Agreement.

In December 2015, all countries of the United Nations Framework Convention on Climate Change met in Paris, and agreed to an historic commitment to "combat climate change and to accelerate and intensify the actions and investments needed for a sustainable low-carbon future. The Paris Agreement's central aim is to strengthen the global response to the threat of climate change by keeping a global temperature rise this century well below 2 degrees Celsius above pre-industrial levels and to pursue efforts to limit the temperature increase even further to 1.5 degrees Celsius" (<https://unfccc.int/resource/bigpicture/index.html#content-the-paris-agreement>).

Along with the targets to reduce emissions, the Paris Agreement also aims to "increase the ability of countries to deal with the impacts of climate change". Within the Paris agreement is the recognition of the interrelationship between human rights and climate change. Human rights include the rights to shelter, access to clean water and nutritious food. Global warming is threatening these human rights for millions of people around the world, particularly in developing countries. Included in the agreement are means to financially support developing countries and the most vulnerable countries.

### Key concept

SUSTAINABILITY

### Theory of knowledge

#### Language as a way of knowing

The Guardian newspaper in the UK has instructed its journalists to change the language they are using when referring to the environment, so that the language more accurately reflects the environmental crises facing the world.

The Editor-in-Chief of the newspaper commented, "We want to ensure that we are being scientifically precise, while also communicating clearly with readers on this very important issue. The phrase 'climate change', for example, sounds rather passive and gentle when what scientists are talking about is a catastrophe for humanity. Increasingly, climate scientists and organisations from the UN to the Met Office are changing their terminology and using stronger language to describe the situation we're in."

<https://www.theguardian.com/environment/2019/may/17/why-the-guardian-is-changing-the-language-it-uses-about-the-environment>

The following replacements are to be made in the newspaper's articles:

Use:	Instead of:
Climate crisis, climate emergency or climate breakdown	Climate change
Global heating	Global warming
Wildlife	Biodiversity
Fish populations	Fish stocks
Climate science denial	Climate sceptic

1. Explain whether or not you think that the language used by newspapers makes a difference to the way readers understand the issues.
2. Why might the "new" terminology be more effective than the former terminology used by the Guardian in terms of conveying the problems?

To meet the goal of limiting the increase in the global temperature, countries have to reduce the amount of emissions being released into the atmosphere, and reduce the current concentration of carbon dioxide by increasing "carbon sinks", such as forested areas. Reducing emissions and increasing sinks is known as "mitigation".

Each country sets its own Nationally Determined Contributions (NDCs) which establish its mitigation goals and plans. Unlike the Kyoto Protocol, which set binding targets, the Paris agreement gives each country the freedom to set its NDCs. Under the agreement, each country is to update its NDCs every five years, and each new target is supposed to show a higher level of commitment to mitigation, ie a lower level of emissions.

We will now look at some of the specific mitigation strategies that can be used to meet the Paris Agreement targets and reduce negative externalities of production.

"Climate change is a result of the greatest market failure the world has seen. The problem of climate change involves a fundamental failure of markets: those who damage others by emitting greenhouse gases generally do not pay."

— Nicholas Stern, Stern Review Report on the Economics of Climate Change, 2006

"Climate change is now affecting every country on every continent. It is disrupting national economies and affecting lives, costing people, communities and countries dearly today and even more tomorrow. Weather patterns are changing, sea levels are rising, weather events are becoming more extreme and greenhouse gas emissions are now at their highest levels in history. Without action, the world's average surface temperature is likely to surpass 3 degrees centigrade this century. The poorest and most vulnerable people are being affected the most."

— <https://www.un.org/sustainabledevelopment/climate-change/>

How might tradable permits reduce or eliminate negative externalities of production and reduce the threats to common pool resources?

Tradable permits are a market-based approach to reducing negative externalities of production and reducing the ability of people to degrade a common pool resource. In a tradable permit scheme, a governing body sets a limit on the ability of users to access a resource. For example, if the common pool resource is a fishery, the governing body would set a maximum amount of fish that could be caught (allowable catch) that would allow the fish stock to be sustainable. If the common resource is a water supply, then there would be a maximum amount of water that

## 9 Market Failure

Regular links to the Sustainable Development Goals



### Key concept

INTERVENTION

Economics in action boxes indicating inquiry activities that invite students to extend the syllabus topics in the context of their own real-world examples

## 12 Market power: Monopoly and oligopoly

### Did you know?

#### Avoiding anti-competitive behaviour in New Zealand

Anyone who runs a business in New Zealand must comply with the Commerce Act, which aims to promote competition in markets for the long-term benefit of consumers.

Competitive markets help to keep prices down and ensure that the quality of goods and services remains high. Competition also ensures consumers have a range of choices, and firms have incentives to innovate, invest and operate efficiently. Anti-competitive behaviour can jeopardise all of this, as well as a company's ability to win new customers.

It is important that businesses are aware of what they can and cannot do when talking to their competitors. The Commerce Act prohibits anti-competitive agreements between firms such as agreements to fix prices, allocate markets or restrict output.

The Commission can take enforcement action against businesses and individuals who breach the Commerce Act and the court can impose significant penalties for breaches against both businesses and individuals. Businesses should seek independent legal advice to ensure they are not at risk of breaching the Commerce Act.

**Source:** Commerce Commission, New Zealand, <https://comcom.govt.nz/business/avoiding-anti-competitive-behaviour>

Given the enormous benefits of effective competition for consumers and the allocation of resources, and the dangers associated with the abuse of monopoly power, governments usually have agencies to promote competition and prevent the abuse of monopoly power. There could be lots of different names for such an agency, including "Competition Commission" or "Commerce Department". It might be referred to as a "Monopoly watchdog". The actions of a competition authority could include the following:

- Governments usually pass laws that restrict the ability of firms to grow through mergers or takeovers. A merger is where two companies, often of similar size, agree to combine and become one larger firm. A takeover is usually the acquisition of a company by another company (normally a larger one). Takeovers are mostly "hostile", ie without the consent of the company being taken over. The laws may not permit mergers or takeovers that would give an individual firm more than a certain percentage of the market – for example, 25%. In addition, they may pass laws that do not permit mergers or takeovers that enable a specified number of the largest firms in an oligopoly to control more than a certain percentage of the market – for example, the four largest firms may be restricted to 60%.
- Governments pass laws against price fixing, making it illegal for firms to collude over prices, thus making collusive oligopolies illegal. This is the case in the majority of the countries in the world.
- If firms are insisting that retailers charge a certain price for their product, or if firms are refusing to supply their products to certain retailers, then governments may also legislate to stop the practice.

Such bodies are then empowered to take action, or to recommend that the government should take some action, if it can be shown that the public interest is being harmed. When anti-competitive behaviour is suspected, the competition authority will undertake intense investigations. If investigations reveal that anti-competitive behaviour has been used, governments may fine those involved, or even jail the executives responsible for the abuse of market power.

"Dominant companies have a special responsibility not to abuse their powerful market position by restricting competition."  
— European Commission

Governments may also set up regulatory bodies for certain industries that have a duty to represent the interests of consumers, where possible by promoting competition. An example of this might be the Office of Gas and Electricity Markets (Ofgem) in the UK.

Regulatory bodies may have a number of different powers, such as:

- The ability to set price controls (price capping).
- The ability to impose fines for anti-competitive behaviour.

- The ability to insist on average price levels that set a "fair rate of return", based upon profit levels which might be expected in a competitive market.
  - The ability to make firms "unbundle" their products, thus making it easier for other firms to enter the market and compete. Bundling is where firms sell a number of their products together in a "bundle". An example of this would be Microsoft, which sells Word, Excel, PowerPoint and Access as a single product.
  - The ability to break up a monopoly into separate businesses, thus promoting competition. However, this rarely happens and is considered to be an extreme action.
  - The ability to set standards for the quality of service in an industry.
- In an extreme situation, the government may take the industry into public (government) ownership. In this case, the goods and services sold in the market would be produced in a nationalized industry, owned by the state. This is likely to be a highly-publicized issue.

### EXAMINATION QUESTIONS

#### Paper 1, part (a) questions

1. Explain the level of output at which a monopoly firm will produce. [10 marks]
2. Explain the concept of a natural monopoly. [10 marks]
3. Explain whether a monopoly is likely to be more efficient or less efficient than a firm in perfect competition. [10 marks]
4. Explain three barriers to entry that might allow a firm to be a monopoly. [10 marks]
5. Explain why firms in oligopolies engage in non-price competition. [10 marks]
6. Explain the difference between a collusive and a non-collusive oligopoly. [10 marks]

#### Paper 1, part (b) questions

1. Using real-world examples, evaluate the view that governments should always prevent firms from being monopolies. [15 marks]
2. Using real-world examples, evaluate the view that governments should maintain strong policies to control collusive behaviour by oligopolies. [15 marks]
3. Using real-world examples, discuss the possible risks involved when a market is dominated by one or a few very large firms. [15 marks]
4. Using real-world examples, evaluate possible government responses to the abuse of significant market power. [15 marks]

Big Four accounting firms accused of 'anti-competitive' behaviour

EU fines Google \$2.4b for anti-competitive behaviour

Economics in action  
Thinking, Communication and Research

Using your country, or another country of your choice, produce a brief report including the following, where appropriate:

1. The name of the competition commission/anti-trust authority, and one case that it has investigated in the last year (include a summary of who was involved, how the anti-competitive behaviour was discovered, what the charges were, and what, if any, were the outcomes).
2. The name of an industry regulatory body and a list of its powers.
3. The name of a nationalized industry and some explanation of the reason for its existence.

Did you know? boxes presenting real-world case studies to highlight the application of theory

# Effectively prepare for IB assessment

Support assessment preparation with exam-style practice questions, worked examples for quantitative topics, and a chapter devoted to written examinations, IA, and the EE in Economics.

Examination-style practice questions at the end of each chapter

Clear guidelines on the best practice in writing effective economic analysis

**3 Demand**

**Assessment advice: Paper 1 – Essay questions**

You have already been introduced to Paper 1, which is divided into two parts. In Chapter 3, there were examples of part (a) questions. In part (b) you are expected to go a little further.

Part (b) invites the use of the skills of evaluation and synthesis. These are higher order skills that you should practice a great deal. Evaluation is a process that involves careful consideration of a topic or issue with a view to forming a balanced conclusion. Questions that begin with "evaluate", "discuss", "to what extent", "compare", "contrast", "compare and contrast", "examine" and "justify" are all questions requiring this higher order skill.

In part (b), you will also be expected to identify and develop relevant real world examples (e) to support your argument or conclusion. These should be the examples that you have come across through the inquiries that you have carried out throughout your economics course.

Remember that in part (a) and part (b) answers, it is necessary that you use diagrams to support your explanations. There will be very few questions where a diagram is not appropriate and needed.

**EXAMINATION QUESTIONS**

**Paper 1, part (a) questions**

1. Distinguish between a shift of the demand curve for a product and a movement along the product's demand curve. [10 marks]
2. With reference to two different determinants of demand, explain why the demand for environmentally friendly products might increase. [10 marks]

**Paper 1, full question – HL Only**

- a) Describe two cognitive biases that influence consumers when making consumption choices. [10 marks]
- b) Using real-world examples, evaluate the effectiveness of nudge theory in helping consumers to make better choices. [15 marks]

**Assessment advice: Paper 2 – Data response**

This is the first of many data response part questions that you will be doing in this course. In your second examination paper (Paper 2), you will be asked to choose one or two, multi-part, data response questions. The data response questions will all follow exactly the same pattern, which you will come to recognize. Each question will have seven part questions, labelled (a) to (g). The first part, (a), requires simple knowledge and understanding, usually asking for definitions from the text.

**7 Market Equilibrium, the Price Mechanism and Market Efficiency**

**Assessment advice: What is good about this answer?**

- Good to include specific economic terminology, "tastes and preferences" as a "determinant of demand"
- Necessary to say exactly what is happening in the diagram
- Valuable to include the references to the diagram
- Pleading to see the references to excess profit, as it shows you are aware that you are isolating the effect of one change in the determinants of demand
- Necessary to have accurate labels on the axes, and valuable if you show that you know it is the price per unit, and indicating the actual market (price of microwave popcorn, \$10 per package)
- Necessary to have accurate labels on the curves, with an indication that there has been a change (D<sub>1</sub> to D<sub>2</sub>)
- An arrow to show the change that is occurring in the market.

**Exercise 7.1**

Using fully labelled diagrams, illustrate what will happen to the equilibrium price and quantity in each of the markets below, and then explain what has happened. A worked example for the first question is given below. You should try to use this as a template to do the remaining two questions.

1. The media has published an article saying that eating microwave popcorn results in a higher risk of dementia (popcorn market).
2. a) An early drought has severely harmed the olive harvests in Italy (olive market).  
b) Without drawing a diagram, how would this then affect the olive oil market? Why?
3. There has been an improvement in production technology in the textile industry (textile market).

**Model answer:**

*If there is a media report pointing out that microwave popcorn might contribute to dementia, it means that there is likely to be a change in tastes and preferences which is a determinant of demand. Demand is likely to fall from D<sub>1</sub> to D<sub>2</sub>, as shown in the diagram.*

*Even though the demand curve has shifted, supply remains the same. Therefore, at the original equilibrium price (P<sub>1</sub>), Q<sub>1</sub> is still supplied, but the quantity demanded has decreased to Q<sub>2</sub> and so there will now be excess supply. In order to eliminate the excess supply, the price will fall until the quantity demanded once more equals the quantity supplied at a new price of P<sub>2</sub> and a new quantity of Q<sub>2</sub>.*

**Thinking outside the box**

As we have seen, economic models are based on a set of assumptions. In the case of this equilibrium analysis, there are key assumptions used to develop the theory of demand and the theory of supply. If these assumptions may be challenged, then the conclusions of the analysis may also be questioned. For example, behind the theory of demand are the assumptions that consumers act rationally, seeking to maximize their own utility, making all decisions with perfect information. (Remember that in Chapter 3, we looked at the limitations of these assumptions.) Behind the theory of supply is the assumption that producers act rationally, seeking to maximize their profits. If these assumptions are not valid, then conclusions based on the theory may have limited validity. This is something we will come back to later.

**22 Economics of inequality and poverty**

**Assessment advice**

In HL, P3, you may be asked to calculate total tax, average tax and the amount of indirect tax from a set of data. Here is one example of the type of questions you might be asked. You are given half of the answers as a model.

The following table shows the tax rates for income tax in the country of Opportunity for 2018.

Income bracket	Disposable income	Tax rate
1	Up to \$11,000	0%
2	Over \$11,000 and up to \$18,000	25%
3	Over \$18,000 and up to \$31,000	35%
4	Over \$31,000 and up to \$60,000	42%
5	Over \$60,000 and up to \$90,000	48%
6	Over \$90,000 and up to \$1,000,000	55%
7	Over \$1,000,000	55%

In Opportunity, there is also an indirect VAT (Value added tax) on all goods and services purchased of 5%.

Samaga and Westley both work in Opportunity. Their incomes are given in the table below. Read the information in the table and use it to answer the questions that follow. The calculations for the questions concerning Samaga are given for you in blue, so you should complete the questions for Westley.

	Annual income (EUR)	Income tax paid (EUR)	Disposable income (Y <sub>d</sub> )	5% of Y <sub>d</sub> (VAT)	VAT paid (Gross)	Total tax paid	Average tax rate
Samaga	45,000	\$12,180	\$32,820	80	\$3,952.50	\$16,132.50	35.8%
Westley	90,000						

a) Calculate the annual income tax to be paid by Samaga and Westley.

For Samaga: (Bracket 1)  $11,000 \times 0\% = 0$   
(Bracket 2)  $7,000 \times 25\% = 1,750$   
(Bracket 3)  $13,000 \times 35\% = 4,550$   
(Bracket 4)  $14,000 \times 42\% = 5,880$   
 $= \$12,180$

b) Calculate the disposable income earned by Samaga and Westley.

Samaga's disposable income (total income minus income tax) is:  $45,000 - \$12,180 = \$32,820$

c) Calculate the GST paid by Samaga and Westley.

Samaga spends 90% of her disposable income (gross).

Therefore, Samaga spends:  $32,820 \times 90 = \$29,538$

This amount that Samaga spends includes the VAT on the goods and services that she bought. Therefore, we have to work out how much of her spending was the indirect tax.

There are two different methods that you might use to work this out.

Assessment advice on each of the assessment components throughout the book

Model answers to illustrate good practice

Worked examples to show the steps involved in answering quantitative questions

## Comprehensive advice for tackling the Internal Assessment

### 32 Assessment advice

- Key concept**  
INTERDEPENDENCE
- Key concept**  
SCARCITY
- Key concept**  
CHOICE
- Key concept**  
EFFICIENCY
- Key concept**  
EQUITY
- Key concept**  
ECONOMIC WELLBEING
- Key concept**  
SUSTAINABILITY
- Key concept**  
INTERVENTION
- Key concept**  
CHANGE

#### Internal Assessment

Every IB Economics student completes a portfolio containing three "commentaries", each a maximum of 800 words. You select your own articles from published news media and write a commentary in which you apply economic theory to the real-world example discussed in the article. Ideally, the three commentaries are written as the course progresses, as you learn more and more economic theory.

Each commentary must be based upon a different unit of the syllabus, but not the Introduction unit, so the three commentaries must cover Microeconomics, Macroeconomics and the Global Economy. In addition, each commentary must refer to a different key concept from the syllabus. Remember that the key concepts are: scarcity; choice; efficiency; equity; economic well-being; sustainability; change; interdependence; and intervention.

The portfolio as a whole is worth 20% of the final grade for HL students and 30% of the final grade for SL students. Assessment of the portfolio is identical for both groups and is based on five criteria. These mirror the skills that are emphasized in the examinations, but without the time pressure of an exam! The criteria are listed and briefly explained in Table 32.1.

Criterion	Title	What is expected	Marks available
A	Diagrams	An ability to construct and explain relevant diagrams.	3
B	Terminology	An ability to use appropriate economic terminology accurately.	2
C	Application and analysis	An ability to apply economic theory with effective economic analysis.	3
D	Key concept	An ability to identify and link a key concept to a real-world situation.	3
E	Evaluation	An ability to make judgements supported by effective and balanced reasoning.	3
Total			14 marks

▲ Table 32.1 Internal Assessment Criteria

In addition to the 14 marks that are awarded for each commentary, there are an additional three marks to be awarded based on the way that you manage to meet the rubric requirements (each article is based on a different unit of the syllabus, each article is taken from a different and appropriate source, each commentary includes reference to a different key concept).

Therefore, the total marks available for the portfolio is 45 marks (14 × 3 commentaries + 3 for rubric requirements). It is not possible to provide the full assessment details in this companion so it is absolutely vital that you are given access to the full IB document about internal assessment. This includes sample commentaries that will help you have an understanding of the end result.

The first step in approaching the task of writing a commentary is to find a suitable current article. Nowadays, the bulk of articles come from internet sources and there are a number of search engines that are useful in finding appropriate articles. Ideally, you will find articles that highlight the theory that you have just finished studying. This way, the material will be fresh, and hopefully you will have been discussing relevant examples in class. Table 32.2 provides some examples of words that can be used on search engines to generate articles on topics once they have been studied.

You should not take the first article that you find. You should read through several and take your time to select the one that allows you to write down relevant definitions, apply the theory through the use of graphs and written explanation, and illustrate evaluative skills. Short articles, concerned with real economic matters, are recommended. The article that you choose may be written in any language, but you are required to provide a translation of the article if it is not in the working language of your school. This allows you to choose one in your own language, but will give you some extra work. Please note that as part of the requirements, you must choose the three articles from three different sources.

One danger in the writing of commentaries is that students often simply summarize or paraphrase their article. This is not the correct approach. You might provide a brief introduction in which you summarize what the issue is about, but the bulk of the commentary must include definitions, diagrams, analysis and evaluation.

As with any of the assessments carried out in economics, it is very important to include diagrams. Just as in any data response exercises that you do, make sure that you label the axes accurately and use the relevant data from the text. For example, if the article is about sugar subsidies to European farmers, don't just write price on the y-axis, write price of sugar in euros. If there are any figures in the text, then try to use them on the diagrams.

The presentation of your portfolio will be enhanced if you adopt a common format throughout the portfolio. That is, use a common font, size and style for each of the commentaries. According to the IB guidelines, a standardized cover sheet that includes the following information must accompany each commentary:

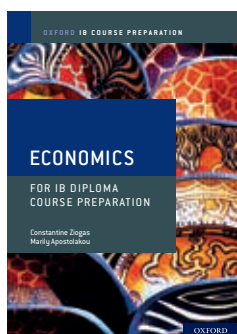
- the title of the article
- the source of the article (including the date of access to the site if taken from the internet)

Topic covered	Possible search words or phrases
Market failure [Unit 2]	External costs, air pollution, water pollution, road-pricing, cigarette taxes, alcohol taxes, sustainable development
Market power [Unit 2]	Monopoly power, price-fixing, collusion, competition commission, competition watchdog
Macroeconomics [Unit 3]	Consumer confidence, interest rate changes, aggregate demand, unemployment, inflation
International trade [Unit 4]	Trade disputes, tariffs, subsidies, quotas
Exchange rates and balance of payments [Unit 4]	Value of the euro [or any other currency], current account deficit, trade deficit
Economic development [Unit 4]	Aid, MNCs, micro credit, agricultural subsidies, debt, foreign direct investment

▲ Table 32.2 Suggestions for finding articles

This allows you to choose one in your own language, but will give you some extra work. Please note that as part of the requirements, you must choose the three articles from three different sources.

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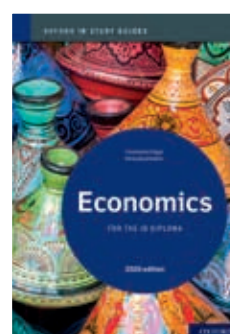
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