



MARKSCHEME

May 2007

ECONOMICS

Standard Level

Paper 2

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In addition to the assessment criteria use the paper-specific markscheme below. Award up to the maximum marks as indicated.

1. (a) Define the following terms indicated in bold in the text:

(i) real output (paragraph ③)	[2 marks]
level	
0 <i>Wrong definition</i>	0
1 <i>Vague definition</i> The idea that it is the production of goods and services of a country.	1
2 <i>Precise definition</i> An explanation that it is the value (accept output) of final goods and services produced in a country, adjusted for inflation. (“Final” is not essential for full marks)	2
(ii) trade cycle (paragraph ⑤).	[2 marks]
level	
0 <i>Wrong definition</i>	0
1 <i>Vague definition</i> The idea that it is changes in economic activity over a period of time.	1
2 <i>Precise definition</i> An explanation that it is a cycle/pattern in economic activity over a period of time. (A diagram showing slump, recovery, boom and recession would be sufficient for full marks.)	2

(b) Using an appropriate diagram, explain how the drought has impacted on the Australian beef market. **[4 marks]**

level

0 *Inappropriate answer* **0**

1 *Identification of theory* **1-2**

For drawing a demand and supply diagram for Australian beef showing a shift in the supply curve to the right **or** for providing an explanation of how farmers have been selling their beef, because it is too expensive to keep them, thus increasing the supply of beef and lowering the price.

Because of language problems, candidates may take the following approach, which should be rewarded:

For drawing a demand and supply diagram for Australian beef showing a shift in the supply curve to the left **or** for providing an explanation of

1. How a drought will cause a decrease in the supply of beef (an agricultural product) and so there will be a rise in price.
2. How increased cost of feeding cattle would shift the supply curve to the left.
3. How killing cattle now will lead to a fall in supply in the long run.

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

For drawing a demand and supply diagram for Australian beef showing a shift in the supply curve to the right **and** for providing an explanation of how farmers have been selling their beef, because it is too expensive to keep them, thus increasing the supply of beef and lowering the price.

Because of language problems, candidates may take the following approach, which should be rewarded:

For drawing a demand and supply diagram for Australian beef showing a shift in the supply curve to the left **and** for providing an explanation of

1. How a drought will cause a decrease in the supply of beef (an agricultural product) and so there will be a rise in price.
2. How increased cost of feeding cattle would shift the supply curve to the left.
3. How killing cattle now will lead to a fall in supply in the long run.

Candidates who incorrectly label diagrams cannot be rewarded with full marks.

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

(c) **Using an appropriate diagram, explain how the drought may impact on the exchange rate of the Australian dollar.** **[4 marks]**

level

- | | | |
|---|---|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
For drawing a demand and supply diagram for the Australian dollar showing a shift to the left in demand or a shift to the right in supply. Either will lead to a decline in the value of the Australian dollar or for providing an explanation that a drought will lower exports (reducing the demand for Australian dollars) and raise imports (increasing supply of Australian dollar). The currency will depreciate in a floating exchange rate. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing a demand and supply diagram for the Australian dollar showing a shift to the left in demand or a shift to the right in supply. Either will lead to a decline in the value of the Australian dollar and for providing an explanation that a drought will lower exports (reducing the demand for Australian dollars) and raise imports (increasing supply of Australian dollar). The currency will depreciate in a floating exchange rate. | 3-4 |

Both shifts are not necessary for a candidate to receive full marks. A single shift of demand or supply, properly explained, should be fully rewarded.

Candidates may say that the fall in the price of beef may lead to greater exports, an increase in demand for the \$A, and an appreciation of the exchange rate. If clearly explained, and illustrated, then this should be fully rewarded.

Candidates who incorrectly label diagrams cannot be rewarded with full marks.

“Price of A\$” or “Exchange rate” on the vertical axis is sufficient.

- (d) **Using information from the text and your knowledge of economics, evaluate the consequences of possible government intervention to reduce the economic impact of severe droughts in Australia.**

[8 marks]

Answers **may** include:

- a definition of government intervention
- forms of government intervention
- an explanation of how the market system may resolve drought issues

Positive consequences of intervention:

- provides income support for those most affected by drought
- finance can be borrowed by farmers at a lower cost
- products with price controls are available to consumers at cheaper prices
- price controls may allow farmers to receive better prices for their produce

Negative consequences of intervention:

- cost to tax payers of income support, interest rate subsidies and costs of infrastructure improvement
- the imposition of price controls distorts the operation of the price mechanism/distorts allocation of resources
- intervention delays the inevitable shift of farmers from rural to urban areas (although this may not apply to Australia at the moment)
- intervention delays the retraining of people currently unemployed
- intervention continues support for businesses that may be unprofitable in the long run
- possible inflationary consequences from increased government expenditure

Four forms of intervention are given in the text. However, we should not expect an evaluation of all of the forms. An appropriate evaluation of one of the forms of intervention may be fully rewarded.

Do not award more than *[5 marks]* if the answer does not contain references to the information provided in the text.

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

Effective evaluation may be to:

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

Level

0	No valid discussion.	0
1	Few relevant concepts recognized. Little discussion or only basic understanding.	1-2
2	Relevant concepts recognized and developed in reasonable depth. Some attempt at application and analysis.	3-5
3	Relevant concepts developed in reasonable depth, demonstrating effective evaluation, supported by appropriate evidence or theory.	6-8

2. (a) Define the following terms indicated in bold in the text:

(i) negative externalities (paragraph 3) [2 marks]

level

0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that they are additional costs not paid for by the producer. A diagram with no explanation would receive [1 mark].	1
2	<i>Precise definition</i> An explanation that they are the costs that are suffered by a third party when a good or service is produced or consumed.	2

(ii) resource allocation (paragraph 4). [2 marks]

level

0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that it is how resources are used in an economy.	1
2	<i>Precise definition</i> An explanation that the allocation of resources is concerned with how resources (land, labour, capital and management) are distributed in an economy.	2

(b) Using an appropriate diagram, explain how the fatalities from malaria are likely to affect future economic growth. **[4 marks]**

level

- | | | |
|---|---|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
For drawing a production possibility curve showing an inward shift of the PPC and so a reduction in potential economic growth or for providing an explanation that the deaths of children will, in the future, reduce the size of the workforce, and so potentially reduce the amount of goods and services that could be produced. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing a production possibility curve showing an inward shift of the PPC and so a reduction in potential economic growth and for providing an explanation that the deaths of children will, in the future, reduce the size of the workforce, and so potentially reduce the amount of goods and services that could be produced. | 3-4 |

Candidates may, alternatively, draw an AD/AS diagram and shift the LRAS to the left. This is acceptable.

Candidates who incorrectly label diagrams cannot be rewarded with full marks.

For a PPC, anything with two competing goods is acceptable on the axes, even Good X and Good Y (but not price and quantity).

For AD/AS, the vertical axis may be price level or average price level. The horizontal axis may be output, national output, real national output, national income or GDP.

(c) Using a diagram that illustrates externalities, explain why a new plant-based treatment would be regarded as a “merit good” (paragraph 4). [4 marks]

level

0 *Inappropriate answer* 0

1 *Identification of appropriate theory* 1-2

For drawing a MSC/MSB diagram showing the new plant-based treatment will have benefits to society which exceed the private benefits considered by the market **or** for providing an explanation of these social benefits (for example a healthier work force) with reference to merit goods.

2 *Correct application of appropriate theory* 3-4

For drawing a MSC/MSB diagram showing the new plant-based treatment will have benefits to society which exceed the private benefits considered by the market **and** for providing an explanation of these social benefits (for example a healthier work force) with reference to merit goods.

Candidates who incorrectly label diagrams cannot be rewarded with full marks.

The vertical axis may be price, but could be costs or benefits. The horizontal axis is quantity.

(d) Evaluate a decision by governments to place large orders for the new plant-based treatment as the only way to “guarantee supply of the treatment” (paragraph 4).

[8 marks]

Answers may include:

- explanation of why placing large orders will raise demand stimulating an increase in production
- explanation that if the demand rises, then it is possible that the price of the treatment may also rise
- while this may increase output, the resulting fall in prices may still not make the treatment more affordable to everyone
- as price rations consumption, some of the victims of malaria will be excluded from accessing the treatment
- other alternative government initiated options may be required, including subsidies, direct and free provision of the treatment and an extensive advertising campaign emphasizing the benefits of the treatment
- role of foreign organisations/charities as a way to supply the treatment
- discussion of other ways to guarantee the supply of the treatment

The question implies economies of scale, but this is a higher level topic and should not be expected in the answers.

Do not award more than [5 marks] if the answer does not contain references to the information provided in the text.

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

Effective evaluation may be to:

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

Level

0	No valid discussion.	0
1	Few relevant concepts recognized. Little discussion or only basic understanding.	1-2
2	Relevant concepts recognized and developed in reasonable depth. Some attempt at application and analysis.	3-5
3	Relevant concepts developed in reasonable depth, demonstrating effective evaluation, supported by appropriate evidence or theory.	6-8

3. (a) Define the following terms indicated in bold in the text:

(i)	real wages (paragraph 2)	[2 marks]
level		
0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that wages are the payment for labour/working.	1
2	<i>Precise definition</i> An explanation that wages are the payment for labour/working and that real wages are the value after they have been adjusted for inflation. An explanation that refers to the “purchasing power” of wages would be sufficient	2

(ii)	recession (paragraph 3).	[2 marks]
level		
0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that it involves a downturn in the level of economic activity. A business cycle diagram, with no explanation, would receive 1 mark.	1
2	<i>Precise definition</i> An explanation that it is two or more consecutive quarters of negative economic growth.	2

(b) With reference to Graph 2 – United States – Business Conditions, explain the possible relationship between business investment and corporate profits. **[4 marks]**

level

0 *Inappropriate answer* **0**

1 *Identification of theory* **1-2**
 For identifying an apparent positive relationship (this term does not have to be used) between corporate profits and business investment.

2 *Correct application of appropriate theory* **3-4**
 For identifying the relationship and for explaining a possible reason why investment and profits might move in the same direction; e.g. use of retained profits to finance investment, the link between rising profits, business confidence and investment.

Candidates may identify a time lag between changes in corporate profits and changes in business investment. This should be rewarded. They may also reverse the link and explain that there will be an impact on profits when investment is changed. If suitably explained, this should also be rewarded.

(c) Using an appropriate diagram, explain how the oil price rises (paragraph 4) might lead to an increase in inflation. **[4 marks]**

level

0 *Inappropriate answer* **0**

1 *Identification of appropriate theory* **1-2**
 For drawing an AD/AS diagram showing a shift to the left of SRAS **or** for providing an explanation that increased oil prices add to business costs and so cause a decrease in short-run aggregate supply leading to, other things being equal, an increase in the general level of prices.

2 *Correct application of appropriate theory* **3-4**
 For drawing an AD/AS diagram showing a shift to the left of SRAS **and** for providing an explanation that increased oil prices add to business costs and so cause a decrease in short-run aggregate supply leading to, other things being equal, an increase in the general level of prices.

Candidates who incorrectly label diagrams cannot be rewarded with full marks.

For AD/AS, the vertical axis may be price level or average price level. The horizontal axis may be output, national output, real national output, national income or GDP.

- (d) **Using information from the text and graphs and your knowledge of economics, evaluate the Federal Reserve’s decision to raise interest rates (*paragraph 4*).**

[8 marks]

Answers **may** include:

- the reason for raising interest rates is to reduce inflationary pressure
- inflation is mainly caused by rising oil prices
- better candidates will also note that strong growth in GDP in 2004 is a contributing factor (*Graph 1*)
- how it will help reduce inflationary pressures as inflation is currently above the 2-3 per cent target
- increased investment from 2001 onwards may have led to higher inflation
- alternative policies – supply-side
- reference to the data

However:

- not appropriate for cost-push inflation
- will contribute to business and consumer pessimism
- business investment and consumer spending will fall
- corporate profits will fall
- GDP may fall sharply as it is already falling in 2004
- cyclical unemployment may rise
- speculative investment becomes more attractive leading to an inefficient allocation of resources
- inequalities in income distribution are heightened
- upward pressure on the exchange rate making exports less internationally competitive
- consequences for the balance of payments
- an appraisal of the decision

Do not award more than **[5 marks]** if the answer does not contain references to the information provided in the text.

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

Effective evaluation may be to:

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

Level

0	No valid discussion.	0
1	Few relevant concepts recognized. Little discussion or only basic understanding.	1-2
2	Relevant concepts recognized and developed in reasonable depth. Some attempt at application and analysis.	3-5
3	Relevant concepts developed in reasonable depth, demonstrating effective evaluation, supported by appropriate evidence or theory.	6-8

4. (a) Define the following terms indicated in bold in the text: *[2 marks]*

(i) free trade (paragraph 2)

level

0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that there is no government intervention. A diagram illustrating a free trade area, with no explanation, would receive <i>[1 mark]</i> .	1
2	<i>Precise definition</i> An explanation that it exists where there is trade between different countries, or exporting and importing, without government intervention/regulation.	2

(ii) developing countries (paragraph 3). *[2 marks]*

level

0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that they are countries where people have low incomes.	1
2	<i>Precise definition</i> Any two of the following points would be sufficient: <ul style="list-style-type: none"> • low per capita income • high rates of poverty • low standard of living • low HDI ranking/value • any other relevant point 	2

(b) Using an appropriate diagram, explain how, according to the EU an increase in sugar production by Brazil could “harm poorer developing countries” (paragraph 9). **[4 marks]**

level

- | | | |
|---|--|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of theory</i>
For drawing a demand and supply diagram for sugar showing a shift in the supply curve to the right or for providing an explanation that an increase in sugar production by Brazil will increase the world supply of sugar, driving down the price, which may mean lower export revenue for developing countries that produce and export sugar. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing a demand and supply diagram for sugar showing a shift in the supply curve to the right and for providing an explanation that an increase in sugar production by Brazil will increase the world supply of sugar, driving down the price, which may mean lower export revenue for developing countries that produce and export sugar. | 3-4 |

Candidates who incorrectly label diagrams cannot be rewarded with full marks.

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

(c) **Using an appropriate diagram, explain the likely impact on EU consumers and producers of a reduction in the guaranteed minimum price for wheat.** *[4 marks]*

level

- | | | |
|---|--|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
For drawing a demand and supply diagram illustrating that a reduction in the guaranteed minimum price for wheat will lead to a contraction of supply/expansion of demand above the equilibrium market situation or for providing an explanation that a reduction in the guaranteed minimum price of wheat will cause a fall in production of wheat by European farmers but an increase in the quantity of wheat demanded by consumers. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing a demand and supply diagram illustrating that a reduction in the guaranteed minimum price for wheat will lead to a contraction of supply/expansion of demand above the equilibrium market situation and for providing an explanation that a reduction in the guaranteed minimum price of wheat will cause a fall in production of wheat by European farmers but an increase in the quantity of wheat demanded by consumers. | 3-4 |

Candidates who incorrectly label diagrams cannot be rewarded with full marks. However, since the diagram in (b) is also supply and demand, if a mark has been deducted in (b) for incorrect labelling, then another mark should **not** be deducted here.

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

(d) Using information from the text and your knowledge of economics, evaluate the WTO’s aim of “eventually eliminating all direct aid to exporters” (paragraph 3).

[8 marks]

Answers may include:

- a description of the aims of the WTO
- an evaluation of the positive/negative impacts of the removal of direct support to exporters

Positive impacts may include:

- improved resource allocation
- market distortions will be removed, allowing comparative advantage to operate
- benefits to consumers from lower prices (except where subsidies are removed)
- increased exports for the most price competitive/efficient nations
- government budgets no longer need to finance direct aid to exporters
- an end to the export dumping of products

Negative impacts may include:

- reduced production in countries where direct aid had been given
- increased unemployment/business failure in countries where direct aid is removed
- loss of export income from sales in countries where direct aid is removed and, hence, balance of payments problems.

Do not award more than [5 marks] if the answer does not contain references to the information provided in the text.

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

Effective evaluation may be to:

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

Level

0	No valid discussion.	0
1	Few relevant concepts recognized. Little discussion or only basic understanding.	1-2
2	Relevant concepts recognized and developed in reasonable depth. Some attempt at application and analysis.	3-5
3	Relevant concepts developed in reasonable depth, demonstrating effective evaluation, supported by appropriate evidence or theory.	6-8

5. (a) Define the following terms indicated in bold in the text: [2 marks]

(i) **indebtedness (Text 1)**

level

0 *Wrong definition* 0

1 *Vague definition* 1

The idea that it is the amount of money that a country has borrowed and still owes.

2 *Precise definition* 2

An explanation that it is the amount of money that a country owes to other countries and/or international institutions.

(ii) **current account (Text 2).** [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1

The idea that it is the measure of exports and imports.

2 *Precise definition* 2

An explanation that it is a measure of a country's trade in goods and services with the rest of the world. (Net investment income and net transfers may be included, but are not necessary for both marks.)

(b) Using your knowledge of the balance of payments, explain the relationship between high levels of international indebtedness and the size of a current account deficit. **[4 marks]**

level

- | | | |
|---|---|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of theory</i>
For realising that indebtedness requires repayments and that the repayments would be money leaving the country. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
An explanation linking interest payment to the size of the debt. A high level of international indebtedness determines a high level of debt interest servicing. Such interests are recorded as debits in the current account and will worsen an eventual deficit. | 3-4 |

Candidates may take an alternative approach and consider the relationship the other way around, i.e. between the size of a current account deficit and subsequent high levels of international indebtedness. If logically expressed, this approach should also be rewarded. However, it should only gain a maximum of **[2 marks]**.

(c) Using a production possibilities diagram, explain how Uganda's National Poverty Eradication Plan might lead to potential economic growth.

[4 marks]

level

0 *Inappropriate answer*

0

1 *Identification of appropriate theory*

1-2

For drawing a correctly labelled production possibilities diagram for Uganda, showing an expansion in the PPC **or** an explanation that as financial resources are diverted from debt servicing to infrastructure and human capital expenditure (as referred to in the text) the quantity and quality of productive resources increases leading to increased potential economic growth.

2 *Correct application of appropriate theory*

3-4

For drawing a correctly labelled production possibilities diagram for Uganda, showing an expansion in the PPC **and** an explanation that as financial resources are diverted from debt servicing to infrastructure and human capital expenditure (as referred to in the text) the quantity and quality of productive resources increases leading to increased potential economic growth.

Candidates who incorrectly label diagrams cannot be rewarded with full marks.

For a PPC, anything with two competing goods is acceptable on the axes, even Good X and Good Y (but not price and quantity).

- (d) **Using information from the text and your knowledge of economics, evaluate the role of multilateral organizations like the World Bank and the IMF in assisting the economic development of Heavily Indebted Poor Countries.**

[8 marks]

Answers **may** include:

- definition of economic development
- overview of the assistance provided by the IMF such as financial assistance to correct balance of payment deficits or structural adjustment programmes
- overview of the assistance provided by the World Bank such as offering developmental assistance to middle and poor-income countries
- reference to specific assistance provided by both the IMF and the World Bank mentioned in the text

Discussion **may** include:

- evaluation of assistance provided to HIPC in the context of the text
- evaluation of impact on economic growth
- evaluation of impact on development such as income distribution, reduction of absolute poverty, income distribution
- evaluation of impact on human development such as literacy, life expectancy, HDI progress
- evaluation of macro impact on unemployment, inflation, exchange rate, fiscal and monetary stability, saving, investment, role of government
- evaluation of impact on balance of payments performance such as current account and capital account
- critical approach towards the IMF and the World Bank
- any money received may often not get to the intended recipients because of corruption

Candidates cannot reach Level 3 unless they evaluate the role in terms of economic **development**.

Do not award more than *[5 marks]* if the answer does not contain references to the information provided in the text.

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

Effective evaluation may be to:

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

Level

0	No valid discussion.	0
1	Few relevant concepts recognized. Little discussion or only basic understanding.	1-2
2	Relevant concepts recognized and developed in reasonable depth. Some attempt at application and analysis.	3-5
3	Relevant concepts developed in reasonable depth, demonstrating effective evaluation, supported by appropriate evidence or theory.	6-8
