



MARKSCHEME

May 2007

ECONOMICS

Higher 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 indicated.

1. Examine the possible consequences of a high real rate of economic growth for sustainable development.

Answers **may** include:

- explain the meaning of a high real rate of economic growth (including the meaning of “real”)
- definition of sustainable development
- growth and development issue
- a simple diagram showing a shift of LRAS or PPF
- quantitative and qualitative aspects of growth and development
- the sustainability issue
- environmental degradation
- resource depletion
- externalities

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

2. “Normally, it would be expected that more would be demanded at lower prices as opposed to higher prices, all other things being equal, but this may not always be the case.” Explain this statement.

Answers **may** include:

(i)

- all other things being equal a rise in price causes a fall in the quantity demanded
- similarly a fall in price causes a rise in the quantity demanded
- the notion of the downward sloping demand curve
- properly labelled diagram

(ii)

- demand curves can sometimes slope upwards
- Giffen goods or
- Veblen goods or
- speculative goods (exception of higher prices in the future)
- appropriate diagrams

It is possible that candidates may use perfectly inelastic demand as an exception. This is acceptable and should be fully rewarded.

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3. Explain the law of diminishing returns using average and marginal product curves.

Answers **may** include:

- definition of the short-run
- definition of law of diminishing returns
- increasing output initially increases MP which pulls up AP
- as fixed factors are increasingly employed, so changes in MP and AP slow down and reverse
- MP cuts AP from above
- carefully labelled diagrammatic representation

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4. “Macroeconomic equilibrium does not necessarily occur at full employment.” Explain this statement using the concepts of inflationary *and* deflationary gaps.

Answers **may** include:

- definition of macro-equilibrium: when quantity of real GDP demanded equals the quantity of real GDP supplied
- full employment macro-equilibrium: where SRAS intersects AD on the LRAS curve. Diagrammatic representation
- deflationary or recessionary or under full employment gap, where planned expenditure is less than the full employment level of income. Occurs where AD intersects the SRAS curve at a level of real GDP that is below LRAS
- inflationary or over full employment gap, where planned expenditure is greater than the full employment level of income. Occurs where AD intersects the SRAS at a level of real GDP that is above LRAS
- some students may use the Keynesian Cross 45 degree model in place of the AD/AS model. Where this is appropriately done it should be fully rewarded.

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5. Distinguish between an outward-orientated growth strategy *and* an inward-orientated growth strategy.

Answers **may** include:

Characteristics of outward-oriented strategies:

- emphasis on comparative advantage
- specialization
- encouragement of free trade
- emphasis on supply-side policies to improve the flexibility of markets *e.g.* reduction of regulations on labour and business
- development/encouragement of markets such as capital markets
- exchange rate policies: use of floating rates
- encourages Foreign Direct Investment

Characteristics of inward-oriented strategies:

- emphasis on government intervention to regulate markets
- import substitution
- the infant industry argument
- encouragement of domestic industries through constraints on imports:
 - subsidies
 - tariffs
 - quotas
 - other regulations
- exchange rate policies: use of fixed/managed rates

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6. Using the principle of comparative advantage, explain why economic theory suggests that countries should specialize and trade with each other.

Answers **may** include:

- countries have different endowments of resources
- notions of absolute and comparative advantage, with examples
- comparative advantage and opportunity cost
- diagrammatic representation and/or numerical example
- specialization, trade and economic growth
- constraints on trade distort optimal outputs and limit growth and development

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