



# **MARKSCHEME**

**May 2006**

**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 indicated.*

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

**(i) market economy (paragraph 1)** **[2 marks]**

level

0 *Wrong definition* **0**

1 *Vague definition* **1**

The idea that it is a free market economy.

2 *Precise definition* **2**

An explanation that it is an economy where resource allocation is determined mainly by market forces of demand and supply.

**(ii) supply-side policies (paragraph 1).** **[2 marks]**

level

0 *Wrong definition* **0**

1 *Vague definition* **1**

The idea that they are policies to increase supply.

2 *Precise definition* **2**

An explanation that they are policies designed to shift the AS curve to the right.

**OR**

A vague definition, with an accurate diagram or correct example.

**(b) Using an appropriate diagram, explain the impact on the coal industry of reductions in subsidies.** **[4 marks]**

level

0 *Inappropriate answer* **0**

1 *Identification of appropriate theory* **1-2**  
 For drawing a demand and supply diagram for the coal industry showing a shift to the left in the supply curve **or** an explanation that a reduction in the level of subsidies will result in a decrease in coal output and an increase in price.

2 *Correct application of appropriate theory* **3-4**  
 For drawing a demand and supply diagram for the coal industry showing a shift to the left in the supply curve **and** an explanation that a reduction in the level of subsidies will result in a decrease in coal output and an increase in price.

**(c) “Computer firms, IBM and Hewlett Packard have both recently indicated their intention to establish data processing plants in the cities of Warsaw and Krakow.”**

**Use an AD/AS diagram to explain the likely effect of the above on the Polish economy.** **[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 right in aggregate demand and/or aggregate supply **or** for an explanation of the possible effects on output and price level.

2 *Correct application of appropriate theory* **3-4**  
 For drawing an AD/AS diagram showing a shift to the right in aggregate demand and/or aggregate supply **and** for an explanation of the possible effects on output and price level.

If AD is shifted to the right, then output will increase and the price level will also rise.

If AS is shifted to the right, then output will increase but the price level will fall.

- (d) **Using the information in the text and table and your knowledge of economics, evaluate the performance of the Polish economy.**

**[8 marks]**

Answers **may** include:

- the rate of real GDP growth slowed in 2001 but increased to previous levels in 2003 and is expected to improve in 2004
- there has been a rise in the GDP per capita in each of the years shown
- the current account deficit has declined significantly in dollar terms, but a very small rise is expected in 2004
- CAD (% GDP) shows a significant improvement, particularly in 2001
- the level of inflation was high in 2000, but in the years following 2000 a much lower level of inflation has been achieved. Better candidates may comment on the importance of achieving this low level of inflation in order to also achieve other economic objectives
- a high rate of unemployment has been experienced throughout the years shown. Better candidates may explain this in terms of the problems facing an economy in transition. Candidates should refer to examples of the industries, which have suffered from the text
- some industries are already heavily foreign owned and fear a flood of imports
- some sectors of the economy have seen new investment, including computing and tourism. Prospects for the future in such industries are good

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

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

If there is no direct reference to the data, then candidates may not be rewarded beyond Level 2.

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.	<b>0</b>
1	Few relevant concepts recognized. Little discussion or only basic understanding.	<b>1-2</b>
2	Relevant concepts recognized and developed in reasonable depth. Some attempt at application and analysis.	<b>3-5</b>
3	Relevant concepts developed in reasonable depth, demonstrating effective evaluation, supported by appropriate evidence or theory.	<b>6-8</b>

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

**(i) opportunity costs (paragraph 1)** *[2 marks]*

level

0 *Wrong definition* **0**

1 *Vague definition*  
The idea that it is something given up or an alternative. **1**

2 *Precise definition*  
An explanation that it is the cost of an economic decision in terms of the next best alternative foregone. **2**

**or**

A weak definition, with a correct example.

**(ii) Gross Domestic Product (paragraph 1).** *[2 marks]*

level

0 *Wrong definition* **0**

1 *Vague definition*  
The idea that it is a measure of economic activity. **1**

2 *Precise definition*  
An explanation that it is the total value of all goods and services/ final/ produced within an economy over a period of time (usually one year). **2**

Two points from above for full marks.

**(b) Using a demand and supply diagram, explain how the dwindling reserves of oil in Norway will impact on its domestic market for oil. [4 marks]**

level

0 *Inappropriate answer* 0

1 *Identification of appropriate theory* 1-2

For drawing a demand/supply diagram for oil in Norway showing a leftward shift of the supply curve **or** providing an explanation that the dwindling reserves of oil will lead to a decrease in the supply of oil, an increase in price and a fall in quantity (demanded and supplied).

2 *Correct application of appropriate theory* 3-4

For drawing a demand/supply diagram for oil in Norway showing a leftward shift of the supply curve **and** providing an explanation that the dwindling reserves of oil will lead to a decrease in the supply of oil, an increase in price and a fall in quantity (demanded and supplied). **Note:** In reality, the supply curve will not shift to the left in the short run. A candidate may realise this and explain it and should be fully rewarded for doing so.

**(c) Using an appropriate diagram, explain the consequences of failing to consider the negative externalities associated with drilling for oil in the Arctic Sea. [4 marks]**

There are two possible approaches to this question part:

level

0 *Inappropriate answer* 0

1 *Identification of appropriate theory* 1-2

For drawing a diagram where MSC is greater than MPC **or** providing an explanation of how environmental damage may be caused by drilling for new oil reserves, but is not reflected in private costs, as a result making social costs greater than private costs, hence creating a negative externality.

For drawing a supply/demand diagram for fish, where supply shifts to the left **or** for explaining that drilling for oil may harm fishing, which will have consequences such as higher prices, less supply, or unemployment.

2 *Correct application of appropriate theory* 3-4

For drawing a diagram where MSC is greater than MPC **and** providing an explanation of how environmental damage may be caused by drilling for new oil reserves, but is not reflected in private costs, as a result making social costs greater than private costs, hence creating a negative externality.

For drawing a supply/demand diagram for fish, where supply shifts to the left **and** for explaining that drilling for oil may harm fishing, which will have consequences such as higher prices, less supply, or unemployment

**(d) Using information from the text and your knowledge of economics, evaluate the economic consequences of the Norwegian government providing incentives for producers of alternative energy.**

*[8 marks]*

Answers **may** include:

Positive consequences

- increased investment in new energy sources
- increased use of alternative energy sources
- sustainable development
- reduced environmental damage
- new employment opportunities
- correction of market failure in allocation of resources

Negative consequences

- cost to taxpayers of providing any incentives
- distortion to free market resource allocation
- negative externalities related to the production of new energy
- possible reduced investment and employment in the oil industry

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

**(i) negative externalities (Text 1) [2 marks]**

level

0 *Wrong definition* **0**

1 *Vague definition* **1**  
The idea that they are costs to society.

2 *Precise definition* **2**  
An explanation that they are costs to a third party caused by the production, or consumption of a good (or service).

**OR**

An explanation that MSC is greater than MSB in the market for a good (or service).

Vague definition with an accurate diagram, or example, would gain full marks.

**(ii) indirect taxation (Text 2). [2 marks]**

level

0 *Wrong definition* **0**

1 *Vague definition* **1**  
The idea that it is a tax on a product.

2 *Precise definition* **2**  
An explanation that it is a tax on a good or service/imposed by the government/expenditure tax.

Two points from above for full marks.

Vague definition with an example, would gain full marks.

**(b) Using an appropriate diagram, explain why the number of motor vehicles in London declined by 20 % in the first few months of congestion charging.** **[4 marks]**

level

0 *Inappropriate answer* **0**

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

For a diagram showing a shift of the supply curve upward (to the left) after tax **or** for explaining that the charge will increase the cost of travelling and so reduces quantity demanded.

**OR**

For a diagram showing a demand curve, with a movement along it and no supply curve **or** for explaining that the charge will lead to a higher price and thus a fall in quantity demanded.

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

For a diagram showing a shift of the supply curve upward (to the left) after tax **and** for explaining that the charge will increase the cost of travelling and so reduces quantity demanded.

**OR**

For a diagram showing a demand curve, with a movement along it and no supply curve **and** for explaining that the charge will lead to a higher price and thus a fall in quantity demanded.

**(c) Using an appropriate diagram, explain the conditions necessary for another rise in the congestion charge to create further revenue for government to spend on improving public transport services.** **[4 marks]**

level

0 *Inappropriate answer* **0**

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

For drawing a diagram showing relatively price inelastic demand **or** for explaining that, if demand is price inelastic, then revenue will increase when the price (charge) is increased.

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

For drawing a diagram showing relatively price inelastic demand **and** for explaining that, if demand is price inelastic, then revenue will increase when the price (charge) is increased.

**(d) Using the information provided and your knowledge of economics, evaluate the effectiveness of taxation as one of the government measures, to solve environmental problems.**

**[8 marks]**

Answers **may** include:

Reasons for the need for government intervention, such as:

- market failure
- externalities
- free riders
- imperfect markets/monopoly power
- public goods.

Comparisons of the effectiveness of taxation with

- regulation
- negative advertising
- property rights

Comparisons of those who gain and those who lose from the imposition of the taxes (congestion charging).

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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.	<b>0</b>
1	Few relevant concepts recognized. Little discussion or only basic understanding.	<b>1-2</b>
2	Relevant concepts recognized and developed in reasonable depth. Some attempt at application and analysis.	<b>3-5</b>
3	Relevant concepts developed in reasonable depth, demonstrating effective evaluation, supported by appropriate evidence or theory.	<b>6-8</b>

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

(i) **economic growth (Table 1)** [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1

The idea that it relates to increased economic activity in a country.

2 *Precise definition* 2

An explanation that it is an increase in real output for an economy over time. It is measured as an increase in real GDP (actual growth).

**OR**

An increase in the potential output of an economy through an increase in the quantity/quality of resources (potential growth).

Vague definition with a diagram would gain full marks.

(ii) **current account balance (Table 2).** [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1

The idea that it is the difference between exports and imports.

2 *Precise definition* 2

An explanation that it is the difference between the revenues earned from exports of goods and services and the expenditure on the imports of goods and services. The impact of investment, income, and net transfers may be included, but are not necessary for full marks.

(b) **Using an aggregate demand and aggregate supply diagram, explain the possible effects of higher than expected oil prices on the Algerian economy.** **[4 marks]**

level

0 *Inappropriate answer* **0**

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

For drawing a diagram showing either AD shifting to the right, or AS shifting to the left, or both **or** for explaining that higher oil prices may lead to an increase in export revenue (and possibly government expenditure) shifting AD to the right or that an increase in oil prices may increase costs of production shifting AS to the left or both.

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

For drawing a diagram showing either AD shifting to the right, or AS shifting to the left, or both **and** for explaining that higher oil prices may lead to an increase in export revenue (and possibly government expenditure) shifting AD to the right or that an increase in oil prices may increase costs of production shifting AS to the left or both.

(c) **Select two economic indicators from the information provided, other than GDP per capita, and explain why they are an indication that the Algerian economy has experienced economic development.** **[4 marks]**

level

0 *Inappropriate answer* **0**

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

Selecting two indicators of economic development without, or with vague, explanations.

**OR**

Clearly explaining one indicator of economic development.

No marks for referring to GDP per capita or economic growth.

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

For clearly explaining two indicators of economic development.

**(d) Using the information provided and your knowledge of economics, evaluate the problems the Algerian economy needs to overcome if it is to sustain economic development in the longer term.**

**[8 marks]**

Answers **may** include:

References to, and discussion of, the following ideas found in the material provided, including:

- high unemployment
- unequal distribution of the benefits of growth
- rural-urban migration
- dependence on oil income
  - by government
  - by exporters economy
- small manufacturing and service sector
- dual economy
- low levels of human capital.

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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**

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1	Few relevant concepts recognized. Little discussion or only basic understanding.	<b>1-2</b>
2	Relevant concepts recognized and developed in reasonable depth. Some attempt at application and analysis.	<b>3-5</b>
3	Relevant concepts developed in reasonable depth, demonstrating effective evaluation, supported by appropriate evidence or theory.	<b>6-8</b>

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

(i) **World Trade Organization (paragraph 1)** [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1  
The idea that it is an international body that tries to improve trade.

2 *Precise definition* 2  
An explanation that it is an international body that encourages the reduction of trade barriers between its member nations.

(ii) **dumping (paragraph 2).** [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1  
The idea that it involves selling exports at a price below the normal market price.

2 *Precise definition* 2  
An explanation that involves the sale of a commodity on a foreign market at a price below the price in the exporter's domestic market or below production costs.

**(b) Using a demand and supply diagram, explain how subsidies impact on the world market for agricultural products such as cotton. [4 marks]**

level

- 0 *Inappropriate answer* **0**
  
- 1 *Identification of appropriate theory* **1-2**  
For drawing a demand/supply diagram showing the imposition of a subsidy by shifting the supply curve downwards (to the right) **or** for an explanation that producers in the protected market will be able to produce and sell more cotton at a lower price.
  
- 2 *Correct application of appropriate theory* **3-4**  
For drawing a demand/supply diagram showing the imposition of a subsidy by shifting the supply curve downwards (to the right) **and** for an explanation that producers in the protected market will be able to produce and sell more cotton at a lower price.

**(c) Explain the difference between a multilateral trading system and a bilateral trading system. Use examples to support your answer. [4 marks]**

level

- 0 *Inappropriate answer* **0**
  
- 1 *Identification of appropriate theory* **1-2**  
For an explanation that multilateral trade takes place between a number of countries **or** for an explanation that bilateral trade takes place between two countries.
  
- 2 *Correct application of appropriate theory* **3-4**  
For an explanation that multilateral trade takes place between a number of countries **and** for an explanation that bilateral trade takes place between two countries.

For full marks, an example should be given. However, this may be a simple hypothetical example about countries A, B and C. Two explanations, without an example, would gain 3 marks.

**(d) Using information from the text and your knowledge of economics, evaluate the economic consequences for developing countries if agricultural subsidies were removed in developed countries.**

**[8 marks]**

Answers **may** include:

- producers in developing nations should be better able to compete in both domestic and international markets
- positive impact on the balance of payments
- positive impact on employment
- positive impact on incomes
- positive impact on business profitability
- positive impact on investment
- positive impact on possibly reducing poverty
- the supply of some agricultural products may decrease
- the price of some agricultural products may increase
- the movement of MNCs into the developing countries.

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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

Two or three points, well discussed with appropriate evaluation, would be sufficient for full marks.

**Level**

0	No valid discussion.	0
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3	Relevant concepts developed in reasonable depth, demonstrating effective evaluation, supported by appropriate evidence or theory.	6-8

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