

MARKSCHEME

May 2005

ECONOMICS

Standard Level

Paper 2

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Paper Specific Markscheme

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) demand (paragraph ①)	[2 marks]
level	
0 <i>Wrong definition</i>	0
1 <i>Vague definition</i> The idea that it means consumers' want, need or desire for a product with the ability to pay for it.	1
2 <i>Precise definition</i> An explanation that demand is the quantity of goods and services that consumers are willing, and able to buy at each possible price (over a given period of time).	2
(ii) oligopoly (paragraph ②).	[2 marks]
level	
0 <i>Wrong definition</i>	0
1 <i>Vague definition</i> The idea that it is an industry in which there are a few large firms.	1
2 <i>Precise definition</i> An explanation that it is an industry where there are a few large firms, with at least one other characteristic of the market form.	2

(b) Using an appropriate demand and supply diagram, explain the impact of the SARS virus on the airline industry in the Asia-Pacific region. **[4 marks]**

level

- 0 *Inappropriate answer* **0**

- 1 *Identification of appropriate theory* **1-2**
For drawing a demand/supply diagram indicating a decrease in demand/shift to the left for airline tickets **or** providing an explanation of how the SARS virus impacted on the airline industry.

- 2 *Correct application of appropriate theory* **3-4**
For drawing a demand/supply diagram indicating a decrease in demand/shift to the left for airline tickets **and** providing an accurate explanation of how the SARS virus impacted on the airline industry.

(c) Using appropriate diagram(s), explain why the price elasticity of demand for travel by business travellers is likely to differ from that of tourists. **[4 marks]**

level

- 0 *Inappropriate answer* **0**

- 1 *Identification of appropriate theory* **1-2**
For drawing appropriate demand diagrams illustrating the relative PED for air travel by business travellers and tourists **or** for demonstrating an understanding of the factors which may influence the relative PED for air travel by business travellers and tourists.

- 2 *Correct application of appropriate theory* **3-4**
For drawing appropriate demand diagrams illustrating the relative PED for air travel by business travellers and tourists **and** for demonstrating an understanding of the factors which may influence the relative PED for air travel by business travellers and tourists.

Candidates are likely to argue that business travel will have more inelastic demand for air travel than tourists. A range of answers are possible and should be rewarded.

- (d) Using information from the text and supply and demand analysis, evaluate the likely future movements in ticket prices.**

[8 marks]

Responses may include:

- increase in demand as the fear of SARS diminishes leading to higher prices and more air travel
- possible increase in supply as regional carriers pick up businesses and, eventually, as foreign carriers re-enter the market. This would reduce prices and increase air travel
- possible switch to substitute methods of communication for business meetings, shifting demand to the left and lowering prices
- cut price tickets may lead to a price war.

Evaluation may be based on short run/long run price effects.

Examiners should be aware that candidates may take a different approach which if appropriate should be fully rewarded. If there is no direct reference to the data, then candidates may not be rewarded beyond Level 2.

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) **real GDP (Diagram 1)** [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1
For the idea that it is the value of production in an economy.

2 *Precise definition* 2
For an explanation, such as the measurement of a nation's income, output or expenditure generated from resources within its boundaries over a given time period adjusted for inflation.

(ii) **unemployment rate (Diagram 2).** [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1
Vague reference to the number of people unemployed.

2 *Precise definition* 2
Precise definition that it is the number of workers without a job, who are willing and able to work, expressed as a percentage of the workforce.

(b) **Explain using appropriate economic terms, what occurred to the level of prices in the two time periods, 1991 to 1994 and 1999 to 2002.** [4 marks]

level

0 *Inappropriate answer* 0

1 *Identification of appropriate theory* 1-2
Vague description of the movement of prices noting a period of rising prices and a period of falling prices.

2 *Correct application of appropriate theory* 3-4
Precise description of falling levels of inflation and then a period of deflation.

A maximum of [2 marks] should be awarded if the candidate writes that prices fell throughout both periods.

(c) **Using an appropriate diagram, explain how monetary policy may be used to reduce unemployment.** **[4 marks]**

level

0 *Inappropriate answer* **0**

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

For drawing an appropriate diagram showing how lower interest rates will shift AD to the right, lowering unemployment **or** for explaining the link between lower interest rates and higher output/lower unemployment.

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

For drawing an appropriate diagram showing how lower interest rates will shift AD to the right, lowering unemployment **and** for explaining the link between lower interest rates and higher output/lower unemployment.

Candidates who recognise that monetary policy has an impact on AS as well as AD should be rewarded.

(d) Using information from the text and your knowledge of economics, evaluate the effectiveness of the policy tools available to the Japanese government in managing the economy.

[8 marks]

Responses may include:

- recognition of tight monetary policy in the early 1990s with interest rates effectively falling to zero as monetary policy was eased
- recognition of tight fiscal policy in the early 1990s with a movement from government sector surpluses to deficits as fiscal policy was eased
- recognition that the easing of policy coincided with increased economic growth in the mid 90s followed by stagnant growth
- explanation of how monetary policy or fiscal policy are implemented
- recognition that the easing of policy has been ineffective in improving unemployment
- appropriate diagrams such as AS/AD diagrams, to illustrate the above are expected
- the use of the supply-side policies

Reward responses that evaluate the effectiveness of the policy tools as opposed to those which merely report changes. Better responses will recognise that the data indicates some periods where the economy responds as expected and some periods where it does not.

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1	Few relevant concepts recognized. Little discussion or only basic understanding.	1-2
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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) **economic growth** (*Extract 1*) [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1
Vague description of an increase in production in an economy.

2 *Precise definition* 2
Precise definition mentioning increased real output for an economy over time.

(ii) **currency appreciation** (*Extract 3*). [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1
The idea that the value of the currency goes up.

2 *Precise definition* 2
Precise definition referring to the value of the currency increasing, expressed in terms of another currency (in a floating exchange rate system).

(b) **Explain, using an appropriate diagram, why “the revival of the tourism sector, export expansion, and growth in private sector investment” is expected to push up economic growth** (*Extract 1*). [4 marks]

level

0 *Inappropriate answer* 0

1 *Identification of appropriate theory* 1-2
For drawing an appropriate diagram showing how increases in AD will increase output **or** for explaining that increases in tourism, exports and investment are components of AD.

2 *Correct application of appropriate theory* 3-4
For drawing an appropriate diagram showing how increases in AD will increase output **and** for explaining that increases in tourism, exports and investment are components of AD.

(c) Using an appropriate diagram, explain how the current account surplus may be creating upward pressure on the baht (*Extract 2*). **[4 marks]**

level

0 *Inappropriate answer*

0

1 *Identification of appropriate theory*

1-2

For drawing an appropriate diagram, showing how the demand curve for the baht will be shifted to the right **or** for explaining that a current account surplus implies increased demand for the currency as a result of increased demand for Thai exports.

2 *Correct application of appropriate theory*

3-4

For drawing an appropriate diagram, showing how the demand curve for the baht will be shifted to the right **and** for explaining that a current account surplus implies increased demand for the currency as a result of increased demand for Thai exports.

(d) Using information from the text and your knowledge of economics, evaluate the concern of Thai exporters that “the strength of the baht would deal a heavy blow to exporters in all sectors and to the whole Thai economy” (Extract 3).

[8 marks]

Responses may include:

- showing that an appreciation will lead to an increase in export prices
- the impact on the terms of trade
- export income may increase if the price elasticity of demand is inelastic
- loss of international competitiveness
- link to the current account balance
- the impact of lower export income on the broader economy such as GDP, unemployment, inflation, taxation income, provision of government services, distribution of income and wealth
- Exporters who import raw materials would be less adversely affected

Responses are **not** expected to refer to the Marshall-Lerner condition where an appreciation will lead to an improvement in the current account balance if the combined elasticities of exports and imports are less than one.

Examiners should be aware that candidates may take a different approach which if appropriate should be fully rewarded. If there is no direct reference to the data, then candidates may not be rewarded beyond Level 2.

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

(i) floating the exchange rate (*paragraph 1*)

[2 marks]

Candidates will almost certainly answer this question by defining **floating exchange rates** but the phrase taken from the text is floating **the** exchange rate; this phrase has a slightly different emphasis and could elicit slightly different answers. Both responses should be rewarded.

level

0 *Wrong definition*

0

1 *Vague definition*

The idea of adapting a floating rate instead of a fixed rate of exchange **or** the idea that it is an exchange rate which changes due to the market forces of demand and supply.

1

2 *Precise definition*

An explanation of adopting a rate of exchange that is determined by the market forces of demand and supply in place of a rate of exchange fixed and managed by the government **or** an explanation that the exchange rate (*i.e.* price of one currency in terms of another) appreciates/ increases or depreciates/ decreases according to the market forces of demand and supply.

2

(ii) official aid (*paragraph 2*).

[2 marks]

level

0 *Wrong definition*

0

1 *Vague definition*

The idea that it is any assistance given to a country from outside.

1

2 *Precise definition*

An explanation that official aid is provided to a country by another government. It may be multilateral or bilateral in nature.

2

(b) Using an appropriate diagram, explain how a subsidy will impact on the price of EU dairy products. **[4 marks]**

level

- 0 *Inappropriate answer* **0**

- 1 *Identification of appropriate theory* **1-2**
For drawing an appropriate diagram indicating that a subsidy to EU producers will shift the supply curve to the right **or** an explanation of how a subsidy will impact on the price of EU dairy products by reducing it.

- 2 *Correct application of appropriate theory* **3-4**
For drawing an appropriate diagram indicating that a subsidy to EU producers will shift the supply curve to the right **and** an explanation of how a subsidy will impact on the price of EU dairy products by reducing it.

(c) Using a demand and supply diagram, explain the effects of Australia imposing lower tariffs on imported cars. **[4 marks]**

level

- 0 *Inappropriate answer* **0**

- 1 *Identification of appropriate theory* **1-2**
For drawing an appropriate demand and supply diagram showing the price with the existing tariff and a new lower price with a reduced tariff level **or** for explaining that a reduced tariff will lower price and increase imports.

- 2 *Correct application of appropriate theory* **3-4**
For drawing an appropriate demand and supply diagram showing the price with the existing tariff and a new lower price with a reduced tariff level **and** for explaining that a reduced tariff will lower price and increase imports.

Alternatively responses may explain possible effects of the lower tariff such as lower prices on imported cars, increased demand for imported cars, lower demand for domestically produced cars and increased pressure on Australian producers to become more efficient/improve productivity.

(d) Using information from the text and your knowledge of economics, evaluate the arguments for increased globalization.

[8 marks]

Responses may include:

- a definition of globalization.

Candidates may also wish to consider arguments **against** increased globalization in their evaluation of the arguments **for** increased globalization.

Responses for globalization may include:

- markets more open/increased international trade
- faster economic growth
- real average national income up more than 50 % in 20 years
- key products have become cheaper because of free trade
- increased consumer choice
- foreign manufacturers pay more than domestic companies
- absolute poverty in developing economies is declining
- multinational transfer technology.

Responses may include some of these points against increased globalization:

- gains from globalization are divided unevenly amongst countries
- trade liberalization has been unfair to developing countries
- globalization creates “winners” and “losers” within each country
- globalization is widening the gap between rich and poor countries
- volatile capital flows have destabilized developing economies
- globalization boosts the power of multinationals at the expense of sovereign governments
- multinationals pay their workers in poor countries less.

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

(i) **infrastructure (paragraph 2)** [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1
The idea that it relates to essential facilities and services.

2 *Precise definition* 2
For an explanation that it involves essential facilities and services such as roads, airports, sewage treatment, water systems, railways, telephone and other utilities.

(ii) **poverty cycle (paragraph 4).** [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1
The idea that it concerns having insufficient income to obtain a basic standard of living.

2 *Precise definition* 2
For the explanation that such a cycle involves low incomes which lead to low savings and low investment which ensure low incomes in the future.

(b) **Using an appropriate diagram(s), explain the difference between economic growth and development.** [4 marks]

level

0 *Inappropriate answer* 0

1 *Identification of appropriate theory* 1-2
For drawing a production possibility frontier which distinguishes between economic growth and development **or** an explanation of the difference between economic growth (an increase in national income) and development (a much broader concept involving non-economic improvements to the standard of living).

2 *Correct application of appropriate theory* 3-4
For drawing a production possibility frontier which distinguishes between economic growth and development **and** an explanation of the difference between economic growth (an increase in national income) and development (a much broader concept involving non-economic improvements to the standard of living).

(c) Explain *two* reasons why increased investment in education is essential for development in developing economies.

[4 marks]

Responses may include that an increased investment in education:

- is an investment in human capital and is designed to improve the quality of labour resources available in the economy
- may lead to increased labour productivity
- may increase the efficiency of development programmes regarding health and population growth
- may increase the level of entrepreneurship in the economy.

There are many possible responses. Any reasonable suggestion should be rewarded.

level

0 *Inappropriate answer*

0

1 *Identification of appropriate theory*

For one reason, well explained **or** for two reasons briefly noted.

1-2

2 *Correct application of appropriate theory*

For two reasons well explained.

3-4

- (d) Using information from the text and your knowledge of economics, evaluate the view that increased trade is more important than increased aid for less developed economics.**

[8 marks]

Responses for this view may include:

- aid can only help to a small extent
- trade brings greater benefits than aid does
- these benefits include increased employment, increased incomes, increased foreign income and increased economic growth
- aid by itself is not a solution to the economic problems of the developing world
- freer trade is critical if developing economies are to escape the cycle of aid dependency.

Responses against this view may include:

- many developing countries do not have enough resources in order to focus on trade rather than aid
- many developing economies do not have well functioning markets for goods, services, insurance, credit, a sound banking system, well defined property rights, a skilled and healthy workforce, a well functioning legal and tax system and good infrastructure
- aid is vital in strengthening the aspects listed above
- aid can accelerate the process of infrastructure improvement that may otherwise take decades longer
- aid to improve education and skill levels, sanitation and health is essential for helping the poorest countries to reduce poverty
- participating in the WTO system is very costly and may soak up the development budget of the least developed countries
- aid has an important disaster prevention role and acts as an insurance policy against future conflicts
- aid works and it makes a huge difference to the lives of poor people
- there are strong humanitarian reasons for providing aid and aid should be considered an investment in the future, rather than as a cost.

Examiners should be aware that candidates may take a different approach, which if appropriate should be fully rewarded. If there is no direct reference to the data, then candidates may not be rewarded beyond Level 2.

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