INTERNATIONAL BACCALAUREATE BACCALAURÉAT INTERNATIONAL BACHILLERATO INTERNACIONAL

IBO

M04/330/H(2)M

MARKSCHEME

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ECONOMICS

Higher Level

Paper 2

5 pages

*Each question is worth **[10 marks]**. Award up to the maximum marks indicated.*

1. "As price falls the quantity supplied falls. As supply increases price falls." Use supply and demand analysis to explain why these two statements do *not* contradict each other.

The first part of the statement refers to a movement along the supply curve resulting from a shift of the demand curve to the left and a fall in price. The second part of the statement refers to a shift of the supply curve to the right, a movement along the demand curve and fall in price. Good answers will clearly demonstrate the difference between a shift and a movement along a supply curve and will use suitable, well-labelled diagrams to illustrate this.

Allow a maximum of ***[6 marks]*** if no diagrams are used (as it is very difficult to answer adequately without diagrams).

Allow a maximum of ***[4 marks]*** if only one part of the statement is correctly explained; *i.e.* there is no attempt to explain the seeming contradiction.

For full marks, the contradiction should be expressed explicitly.

2. Why is the concept of income elasticity of demand likely to be important for a producer of an agricultural product? Use supply and demand analysis in your answer.

The concept of income elasticity of demand should be clearly defined. Answers not progressing beyond this point should be limited to a maximum of ***[3 marks]***. For most agricultural products, demand expands less than proportionately as real incomes grow, so demand tends to be income inelastic and the value of the YED tends to be low. Thus YED determines the extent to which the agricultural producers' demand curve will shift to the right in response to an increase in income.

Reward answers which show a clear understanding of the importance of the concept of income elasticity of demand for an agricultural producer, and which demonstrate this understanding using demand and supply analysis.

Students should be rewarded for recognising that income is a determinant of demand and therefore can shift the demand.

Appropriate diagrams should be properly labelled and could include (either/or)

- demand curves shifting to the right
- income elasticity diagram

Also reward answers which recognize LDCs dependence on agricultural exports although this is not necessary for full marks

A maximum of ***[6 marks]*** should be awarded if no diagrams are used.

3. A firm in perfect competition is producing at the profit maximizing output, but making a loss. Using diagrammatic analysis, explain how this is possible.

The profit maximizing output is where MC = MR. If, at this output, AC is greater than AR, the firm will make a loss in the short run. Answers should illustrate this point using the standard perfect competition diagram.

Providing the above is clearly and accurately explained and illustrated, nothing further would be required for full marks. It would be extremely difficult to fully answer this question without the use of a diagram, and a maximum of ***[6 marks]*** should be awarded if there is no appropriate diagrammatic illustration.

4. Use an aggregate demand/aggregate supply diagram to explain how cost push inflation may occur, and outline *two* ways in which it might be controlled.

Answers should identify how costs can rise and push up prices. This should be illustrated by a well-labelled diagram with a leftward shift of the aggregate supply curve.

If cost push inflation is defined without the diagram a maximum of ***[3 marks]*** should be awarded.

Various measures to combat cost push inflation should be outlined; *e.g.* fiscal measures to lower costs, *e.g.* subsidies or lowering corporation tax; monetary measures to lower costs, *e.g.* reduction in interest rates, exchange rate policy, incomes policy, prices policy; supply side policy to raise productivity and lower unit costs.

A maximum of ***[7 marks]*** should be awarded if only one measure is explained. If two measures are explained and no AD/AS diagram is used in explaining cost push inflation, a maximum of ***[6 marks]*** should be awarded.

5. Explain how, in theory, balance of payments deficits and surpluses on current account are automatically adjusted under a system of flexible exchange rates. Illustrate your answer using supply and demand analysis.

Answers might usefully start by defining key terms such as current account deficit and surplus, and flexible exchange rates. If no progress is made beyond this point, a maximum of ***[3 marks]*** should be awarded.

Good responses should explain that a current account deficit should cause the exchange rate to fall, export prices will fall and import prices will rise. The demand for exports will rise, while the demand for imports will fall. Balance of payments equilibrium will be restored; and *vice versa* for a surplus.

A maximum of ***[6 marks]*** should be awarded if no diagrams are used. To obtain full marks, at least some reference to the adjustment of a deficit and a surplus should be made, with one being explained in reasonable detail.

6. Use a production possibility curve to explain the distinction between economic growth and economic development.

Some answers might distinguish between economic growth and economic development without any use of a production possibility curve, and a maximum of ***[6 marks]*** should be awarded for such an approach.

Economic growth should be illustrated by an outward shift of the PPC.

Economic development may be illustrated in terms of the goods chosen for the two axes; *e.g.* with military goods on one axis and merit goods on the other, consumer and merit goods or others such as luxuries or necessities. A reallocation of resources into one, away from another, would constitute an example of economic development.

Students who do illustrate growth on a diagram but not development but recognise it is a multi-dimensional process and therefore difficult to illustrate on a PPC can achieve full marks.