

# **MARKSCHEME**

**May 2005**

**ECONOMICS**

**Higher 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 as indicated. Each question is worth [10 marks].*

**1. Use production possibility curve diagrams to explain the difference between actual output and potential output and between economic growth and economic development.**

- distinction between actual and potential output
- use of PPC to explain the difference
- distinction between economic growth and economic development
- use of PPC to explain the difference.

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

**2. Explain the relationship in the short-run between the marginal costs of a firm and its average total costs.**

Definition

- definition of short-run
- definition of marginal cost (MC)
- possible explanation of MC in terms of marginal product (MP) – diminishing returns
- definition of average total cost (ATC)
- diagram showing marginal cost (MC) and average total cost (ATC)
- possible explanation of ATC in term of average product (AP) – diminishing returns
- MC cuts ATC at lowest point
- Explanation in terms of impact of marginal cost (MC) changes on average total cost (ATC)
- derived from MP cuts AP at highest point.

A very good verbal discussion can score up to **[7 marks]** without diagrams.

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**3. What are the likely consequences of deflation for a country's economy?**

- definition of deflation

Consequences might include:

- deflation (like inflation) disrupts the price mechanism so that people are confused about the true value of things
- if consumers delay spending in anticipation of falling prices economic activity falls, unemployment increases
- businesses see profits fall; as they do so dividends and investment returns fall and so share prices fall
- business insolvencies increase, productive investment falls – also leading to falling output and increased unemployment
- the principle problem of deflation is that it leads to a rise in the real value of debt. In the early stages low interest rates and low prices encourage borrowing but as the real weight of the borrowing is recognised so borrowing is reduced
- monetary policy can prove ineffective when interest rates (nominal) are already low (e.g. of Japan and Europe).

The use of appropriate diagrams should be rewarded.

A good clear definition of deflation can earn up to **[4 marks]**. To achieve level 4 a candidate must include either an in-depth discussion of two consequences or a wider coverage of the impact.

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**4. Use the Phillips Curve to explain the concept of the natural rate of unemployment.**

- definition of Phillips Curve
- an acceptable definition of the natural rate of unemployment
- graphical treatment of short-term Phillips Curve
- graphical treatment of long-run Phillips Curve/natural rate of unemployment
- explanation of relationship: e.g. in terms of an expansionary fiscal policy to reduce unemployment below the prevailing level or a contractionary monetary policy to reduce a high level of inflation

Up to **[7 marks]** for an answer without diagrams.

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**5. Why might a government prefer to negotiate Voluntary Export Restraints (VERs) rather than impose tariffs as a means of restricting international trade?**

- definition of tariffs and VERs
- graphical treatment

Factors that might be considered include:

- a VER provides the foreign exporter with a profit
- government may want to avoid a tariff or quota war with retaliation
- a VER is a way to achieve trade restrictions to protect domestic industries but with some sort of compensation to encourage the foreign country to accept that situation and not retaliate
- VERs can be entered into legally
- most tariffs are now outlawed; VERs reduce transparency

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

**6. Explain how overdependence on primary products may act as a barrier to economic development.**

- definition of primary products
- income inelastic demand } graphical treatment
- inelastic supply }
- implications for earnings
- consequences for economic development.
- long-term decline in Terms of Trade
- short-term fluctuations in income

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