

MARKSCHEME

November 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. Using appropriate diagrams, explain the difference between the law of diminishing returns and economies of scale.

- short run versus long run
- definition of law of diminishing returns
- definition of economies of scale
- diagram illustrating law of diminishing returns, this may be product curves and/or short run cost curves
- diagram illustrating economies of scale using long run cost curves
- explanations of the above and of the linkage between the two concepts

Allow a maximum of **[6 marks]** if no diagrams are used.

Allow a maximum of **[5 marks]** if only one part of the question is correctly explained.

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

2. Explain the multiplier effect of an increase in government spending.

- definition of government spending as an injection to the circular flow
- definition of multiplier (including a multiplier equation for higher marks)
- distinction between the simple multiplier and the full multiplier
- a diagrammatic representation and/or use of a numerical example to help explain the effect
- good responses will fully explain the impact on output, employment and, possibly, prices

It is possible to achieve maximum marks without the use of a diagram.

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

3. Using an example, explain how the concept of opportunity cost is a key element in the theory of comparative advantage.

- definition of opportunity cost
- definition of comparative advantage (absolute advantage not necessary but may be given)
- diagrammatic representation of comparative advantage may be given as an example, using the relative slopes of two curves to illustrate the concept of opportunity cost
- a numerical example showing the comparative advantages between two countries in terms of opportunity cost
- opportunity cost enables countries to identify areas for specialization

Allow a maximum of *[5 marks]* if no example is offered.

It is possible to achieve maximum marks without the use of a diagram.

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4. With reference to the Marshall-Lerner condition, explain how the depreciation of a country's exchange rate might affect its current account balance.

- definition of depreciation (better candidates will know that this refers to a freely floating exchange rate)
- definition of the Marshall-Lerner condition
- explanation of how a depreciation will only be successful if the PED_{exports} plus the PED_{imports} is greater than one
- definition of current account balance
- explanation that exports will be cheaper, imports more expensive, and that elasticity will determine the ultimate impact on export revenue and import expenditure
- some candidates will extend the analysis with the J-curve effect, but this is not necessary for full marks

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

5. Explain why economic growth is likely to generate external costs, which are a threat to sustainable development.

- definition of economic growth
- definition of external costs
- examples of external costs of economic growth *e.g.* over-farming, pollution, deforestation to emphasise that there are external costs of production
- definition of sustainable development
- explanation that development cannot be sustained if resources are being used up faster than they can be replaced

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

6. Explain the difference between outward-oriented and inward-oriented growth strategies.

- definition of outward-oriented growth strategies, export-led growth
- identification of elements of the strategy *e.g.* low value-added/high volume production, high investment, opening up of the economy to international trade, any reasonable point
- examples of export led growth, *e.g.* Japan, Hong Kong, Taiwan, Singapore
- definition of inward-oriented growth strategies, import substitution
- identification of elements of the strategy, *e.g.* protectionism, limiting imports to essentials, achieving economies of scale through the creation of domestic monopolies, any reasonable point
- examples of import substitution, *e.g.* India
- brief explanation of the differences

Allow a maximum of **[5 marks]** if only one part of the question is correctly explained.

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