

# **MARKSCHEME**

**May 2006**

**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 demand and supply analysis, explain how resources are allocated through changes in price in a market economy.**

Answers may include:

- the notion of scarcity
- allocation of resources via interaction of demand and supply
- no government intervention
- supply and demand diagram to illustrate the signalling effect of a change in demand
- the dynamic process
- supply and demand diagram to illustrate the rationing effect of a change in supply via a change in price
- the dynamic process explained.

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

**2. Define cross elasticity of demand and using diagrams, explain what determines whether cross elasticity of demand is positive or negative.**

Definition of cross elasticity of demand: the % change in quantity demanded of good X in response to a % change in the price of good Y.

Answers may include:

- quantity demanded of any product depends on the price of its substitutes and complements
- assertion that cross elasticity of demand with respect to the price of a complement is negative
- assertion that cross elasticity of demand with respect to the price of a substitute is positive
- explanation of why response of demand is negative or positive
- examples of negative and positive cross elasticity
- the degree to which the quantity of a product demanded changes when the price of substitutes or complements change depends on how close the substitute or complement is
- diagrammatic treatment:
  - a shift in the demand curve right or left
  - positive sloping positive cross elasticity of demand (substitutes)
  - negative sloping negative cross elasticity of demand (complements)

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

**3. Using appropriate diagrams, discuss whether monopoly is more efficient or less efficient than perfect competition.**

Answers may include:

- definitions of efficiency: allocative and productive efficiency
- the firm in perfect competition: in long-run equilibrium the firm is allocatively and productively efficient
- correctly drawn and labelled diagram
- explanation of perfect competition
- the firm in monopoly in long-run equilibrium the firm is neither allocatively nor productively efficient
- correctly drawn and labelled diagram
- explanation of monopoly
- dynamic efficiency: increased profits of monopoly used for investment leading to greater output and lower prices than in perfect competition (economies of scale)
- correctly drawn and labelled diagram

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

**4. Using AD/AS diagrams, analyse the likely impact on an economy of the following:**

- (a) a general rise in wage costs**
- (b) the discovery of new raw material sources**
- (c) capital stock increases.**

- a general rise in wage costs will shift the SRAS to the left; illustration of the effect and analysis (some answers may point out that an increase in wages could also result in an upward shift of the AD curve)
- the discovery of new raw material sources will shift the LRAS to the right; illustration of the effect and analysis
- capital stock increases will shift the LRAS curve to the right; illustration of the effect and analysis (some answers may point out that an increase in capital stock could also result in shift in the AD curve to the right)

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

**5. Using an appropriate diagram, explain who gains and who loses from the introduction of a tariff.**

- definition of a tariff
- diagrammatic representation of a tariff
- illustration of impact of tariff on the government and analysis
- illustration of impact of tariff on the consumer and analysis
- illustration of impact of tariff on the producer and analysis

Some responses may also refer to losses of foreign producers and to deadweight losses.

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

**6. Explain *two* ways in which the international indebtedness of developing countries might hinder their growth and development.**

Reasons why international trade is restricted answers may include:

- definitions of and distinction between growth and development
- brief discussion of causes of international indebtedness
- ways in which indebtedness can affect growth and development
  - any cuts in demand for exports from OECD countries
  - a fall in the price of primary products as debtor countries try to increase the volume of their exports in order to raise hard currency
  - a rise in real interest rates as capital flows out of the debtor countries to service the debts
  - opportunity costs of debt servicing (such as expenditure on education, public health, infrastructure)
  - balance of payments deficits and the effects of IMF policies on the poor.

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