

# **MARKSCHEME**

**May 2006**

**ECONOMICS**

**Higher Level**

**Paper 3**

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*In addition to the assessment criteria use the paper-specific markscheme below. Award up to the maximum marks as indicated.*

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

<b>(i) price discrimination (paragraph ③)</b>	<b>[2 marks]</b>
level	
0 <i>Wrong definition</i>	<b>0</b>
1 <i>Vague definition</i> Vague response about different prices.	<b>1</b>
2 <i>Precise definition</i> Precise definition such as charging a different price to customers for an identical good or service.	<b>2</b>
<b>(ii) multinational corporations (paragraph ④).</b>	<b>[2 marks]</b>
level	
0 <i>Wrong definition</i>	<b>0</b>
1 <i>Vague definition</i> Vague response about a large company.	<b>1</b>
2 <i>Precise definition</i> Precise definition such as a company that has productive units in more than one country.	<b>2</b>

**(b) Explain, using the text and your knowledge of economics, the conditions necessary for pharmaceutical companies to successfully employ “differential pricing schemes” (paragraph ⑤).** **[4 marks]**

level

- |   |   |            |
|---|---|------------|
| 0 | <i>Inappropriate answer</i>   | <b>0</b>   |
| 1 | <i>Identification of theory</i><br>Candidates who give a broad answer or who focus on the text only.  | <b>1-2</b> |
| 2 | <i>Correct application of appropriate theory</i><br>Precise description of at least two of the conditions necessary for successful price discrimination, such as <ul style="list-style-type: none"><li>• the company must have monopoly power (price maker)</li><li>• the company must keep buyers from different market groups separate (illustrated in the text)</li><li>• there must be different demand curves and therefore different PED for separate groups of buyers.</li></ul> | <b>3-4</b> |

To reach full marks, there must be some reference to the text.

**(c) Using a production possibility curve diagram, explain the impact on economic growth of any delay in dealing with the HIV/AIDS epidemic in countries such as South Africa.** **[4 marks]**

level

- |   |  |            |
|---|--|------------|
| 0 | <i>Inappropriate answer</i>  | <b>0</b>   |
| 1 | <i>Identification of appropriate theory</i><br>Vague description heavily based on the text.  | <b>1-2</b> |
| 2 | <i>Correct application of appropriate theory</i><br>A PPC diagram showing an inward shift in the PPC due to a decrease in the quantity or the quality of labour due to HIV/AIDS. The axes must be labelled with some type of competing uses, e.g. consumer goods and capital goods. A maximum of <b>[3 marks]</b> may be awarded if the axes are inappropriately labelled. | <b>3-4</b> |

- (d) **Using information from the text and your knowledge of economics, evaluate the role of a multinational corporation in assisting the economic development of a less developed economy.**

**[8 marks]**

Answers **must** include:

An examination of the role of MNCs in development. Answers should not focus on the negative alone but evaluate the benefits that MNCs can bring as well as the problems

Items covered may include:

MNCs provide a source of

- capital
- technology
- employment
- tax revenue
- export earnings
- demand for local marketed goods
- possible multiplier effects

Further emphasis: The points above must be related to development. For example, if tax revenue is earned, it can lead to development if the revenues are used for developmental prospects, *e.g.* improved education/literacy, redistribution of income, reduction of absolute poverty.

May retard development through

- transfer pricing
- inappropriate use and exploitation of resources
- negative externalities
- threat to sustainable development
- establishment of a dual economy/rural-urban migration/income inequality
- driving local enterprises out of business
- use of inappropriate technology
- excessive profit repatriation.

Evaluations should consider both the positive and the negative impact that MNC's can have in promoting development.

Possible reference to the material provided such as:

- the redistribution of resources from the developed to the less developed economies through price discrimination
- improvement in the level of human capital through the availability of pharmaceuticals.

Candidates who incorrectly label diagrams cannot be rewarded with full marks.

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If there is no direct reference to the data, then candidates may not be rewarded beyond Level 2.

Effective evaluation may be to:

- consider short run versus long run consequences
- examine the impact on different stakeholders
- discuss advantages and disadvantages
- prioritize the arguments

**Level**

0	No valid discussion.	<b>0</b>
1	Few relevant concepts recognized. Little discussion or only basic understanding.	<b>1-2</b>
2	Relevant concepts recognized and developed in reasonable depth. Some attempt at application and analysis.	<b>3-5</b>
3	Relevant concepts developed in reasonable depth, demonstrating effective evaluation, supported by appropriate evidence or theory.	<b>6-8</b>

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

**(i) unemployment rate (paragraph ②)** **[2 marks]**

level

0 *Wrong definition* **0**

1 *Vague definition* **1**

The idea that the unemployment rate is the percentage of people that are unemployed.

2 *Precise definition* **2**

An explanation that unemployment rate is the percentage of people that are unemployed, expressed as a percentage of the labour force or workforce.

**(ii) business/trade cycle (paragraph ③).** **[2 marks]**

level

0 *Wrong definition* **0**

1 *Vague definition* **1**

The idea that the business/trade cycle shows the increases and decreases in national income (or the level of economic activity or GDP)

2 *Precise definition* 2

**Different approaches are likely here.**

A definition should note two of the following:

- the periodic or regular fluctuations in national income or economic activity or GDP.
- around the productive potential (or long term trend of the economy)
- Economies tend to move through stages including “boom” and “bust”, or other terminology noting the same.

A properly labelled diagram showing a business cycle could earn the full two marks

**(b) Using an appropriate diagram, explain how a government may attempt to close a deflationary gap.** *[4 marks]*

level

0 *Inappropriate answer* 0

1 *Identification of theory* 1-2

To draw an appropriate diagram illustrating a deflationary gap **or** an explanation of how a government may close a deflationary gap.

2 *Correct application of appropriate theory* 3-4

There are several possible approaches here, all of which are equally valid.

- a diagram with a vertical LRAS showing a short run equilibrium output at a level that is less than full employment illustrating a deflationary gap. In this case, the government could fill the gap using supply side policies
- a diagram with a Keynesian LRAS showing a short run equilibrium output at a level that is less than full employment illustrating a deflationary gap. The government could fill this gap by using expansionary fiscal and/or monetary policy
- a Keynesian 45 degree diagram illustrating a deflationary gap. The government could fill this gap by using expansionary fiscal and/or monetary policy

- (c) Explain why deflation (a downward movement in the average level of prices) creates conditions that make it “unfavourable” for business to invest (*paragraph 4*). [4 marks]

level

- |   |  |            |
|---|--|------------|
| 0 | <i>Inappropriate answer</i>  | <b>0</b>   |
| 1 | <i>Identification of appropriate theory</i><br>A vague explanation linking deflation to investment   | <b>1-2</b> |
| 2 | <i>Correct application of appropriate theory</i><br>A correct explanation discussing any of the following points would be sufficient for full marks: <ul style="list-style-type: none"> <li>• falling consumer demand reduces the need for investment</li> <li>• investment decisions may be largely affected by expectations and confidence and deflation may reduce consumer and business confidence. There is no reason to increase capacity if expectations are poor</li> <li>• deflation creates uncertainty which deters investment</li> <li>• accelerator effect</li> </ul> | <b>3-4</b> |

- (d) Using information from the text and your knowledge of economics, evaluate the extent to which unemployment would still be a problem if inflation were allowed to increase. [8 marks]

Answers **may** include:

- An identification of the natural rate of unemployment
- distinction between SR and LR conditions
- use of AD/AS analysis (with diagram) showing that as an economy approaches LRAS inflation rises and unemployment may remain at the natural rate
- use of Phillips curve analysis (with diagram) distinguishing between SR and LR conditions
- use of the data in the article to support the existence of the SRPC relationship
- there may be an observation that supply side policies would be effective at solving both problems

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If there is no direct reference to the data, then candidates may not be rewarded beyond Level 2.



Effective evaluation may be to:

- consider short run versus long run consequences
- examine the impact on different stakeholders
- discuss advantages and disadvantages
- prioritize the arguments

**Level**

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1	Few relevant concepts recognized. Little discussion or only basic understanding.	<b>1-2</b>
2	Relevant concepts recognized and developed in reasonable depth. Some attempt at application and analysis.	<b>3-5</b>
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**3. (a) Define the following terms indicated in bold in the text:**

**(i) interest rates (*Text 1*)** **[2 marks]**

level

0 *Wrong definition* **0**

1 *Vague definition* **1**  
Vague description of interest rates.

2 *Precise definition* **2**  
Precise definition might include any of the following:

- the price of capital
- the price of borrowed (or loaned) money
- interest rates are determined by the demand and the supply for money
- interest rates are used as a tool of monetary policy

**(ii) exchange rate appreciation (*Text 3*).** **[2 marks]**

level

0 *Wrong definition* **0**

1 *Vague definition* **1**  
Vague response such as the value of the currency going up.

2 *Precise definition* **2**  
Precise definition such as an increase in the value of one currency expressed in terms of another currency in a floating exchange rate system

**(b) Using an appropriate diagram, explain how an increase in interest rates may have caused a decline in retail sales. [4 marks]**

level

- 0 *Inappropriate answer* **0**
- 1 *Identification of theory* **1-2**  
A link may be made between the interest rate and consumer spending.
- 2 *Correct application of appropriate theory* **3-4**  
An explanation that an increase in interest rates may result in an increase in savings and a decrease in consumption and thus a fall in retail sales. A diagram is likely to show a fall in AD, but other diagrams may also be used.

**(c) With reference to the diagrams, explain the relationship between the level of interest rates in Australia (Diagram 1) and the value of the Australian dollar (Diagram 2). [4 marks]**

level

- 0 *Inappropriate answer* **0**
- 1 *Identification of appropriate theory* **1-2**  
Vague description of the two diagrams should not score beyond this level.
- 2 *Correct application of appropriate theory* **3-4**  
Well-argued explanation of the relationship, noting the impact of changes in interest rates on the demand and/or supply for the Australian currency. Candidates could draw an exchange rate diagram showing the impact of the capital inflow to Australia but this is not necessary for full marks

**(d) Using information from the text and your knowledge of economics, evaluate the use of interest rates as a tool for controlling inflation. [8 marks]**

Answers **may** include:

An examination of the strengths and weaknesses of interest rates as a tool of economic management:

- quick to implement
- time lags between implementation and impact
- inadequate economic information on which decisions are made.

Reference to the material provided such as:

- the appreciation of the dollar due to domestic policy decisions
- the effect of the appreciation on exporters and related sectors, including employment.

Reference to the problem of conflicting policy goals, such as

- economic growth,
- unemployment,

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Effective evaluation may be to:

- consider short run versus long run consequences
- examine the impact on different stakeholders
- discuss advantages and disadvantages
- prioritize the arguments

**Level**

0	No valid discussion.	<b>0</b>
1	Few relevant concepts recognized. Little discussion or only basic understanding.	<b>1-2</b>
2	Relevant concepts recognized and developed in reasonable depth. Some attempt at application and analysis.	<b>3-5</b>
3	Relevant concepts developed in reasonable depth, demonstrating effective evaluation, supported by appropriate evidence or theory.	<b>6-8</b>

4. (a) Define the following terms indicated in bold in the text: [2 marks]

(i) **productively efficient (paragraph 4)**

level

0 *Wrong definition* 0

1 *Vague definition* 1

A vague explanation that productive efficiency exists when production is achieved at lowest cost.

2 *Precise definition* 2

An explanation that productive efficiency exists when production is achieved at lowest cost per unit of output. This is achieved at the point where average total cost is at its lowest value. (Some candidates may choose to illustrate this with a cost diagram showing, but a diagram is not required for full marks.)

(ii) **anti-dumping (paragraph 5).** [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1

The idea that anti-dumping is an action to stop foreign being sold cheaply in a domestic market.

2 *Precise definition* 2

An explanation that anti-dumping is an action against the export of goods at a price below their production costs

**(b) Using an appropriate diagram, explain why a knowledge of comparative advantage is important for a developing country.** **[4 marks]**

level

- |   |  |            |
|---|--|------------|
| 0 | <i>Inappropriate answer</i>  | <b>0</b>   |
| 1 | <p><i>Identification of theory</i></p> <p>To draw an appropriate diagram illustrating comparative advantage <b>or</b> an explanation that the country should specialise in the production of the product in which it has a lower opportunity cost and thus a comparative advantage</p>                   | <b>1-2</b> |
| 2 | <p><i>Correct application of appropriate theory</i></p> <p>To draw an appropriate diagram illustrating comparative advantage <b>and</b> an explanation that the country should specialise in the production of the product in which it has a lower opportunity cost and thus a comparative advantage</p> | <b>3-4</b> |

**(c) Using an appropriate diagram, explain how a knowledge of income elasticity of demand (YED) is useful for exporters in a less developed country such as Thailand.** **[4 marks]**

- |   |   |            |
|---|---|------------|
| 0 | <i>Inappropriate answer</i>   | <b>0</b>   |
| 1 | <p><i>Identification of appropriate theory</i></p> <p>A definition of income elasticity of demand</p>   | <b>1-2</b> |
| 2 | <p><i>Correct application of appropriate theory</i></p> <p>An explanation of any plausible application of YED to developing countries. (e.g. developing countries could produce goods that have low income elasticity or high income elasticity depending on the nature of the good.) A diagram showing low income elasticity (<i>i.e.</i> a fairly steep upward-sloping line on a diagram with income on the y-axis and demand on the x-axis) or high income elasticity (a flatter line) is required to get full marks. (Candidates may draw diagrams illustrating price elasticity of demand, but these are not correct.)</p> | <b>3-4</b> |

**(d) Using information from the text and your knowledge of economics, evaluate the costs and benefits of membership of a free trade area for a country.**

**[8 marks]**

Answers **may** include:

- an explanation that a free trade area is a group of countries with free trade between them but retaining independent tariffs on trade with non-members,
- trade creation
- economies of scale
- increased competition
- spread of technology
- reference to Thailand’s benefits from an eventual free trade agreement with the USA, *e.g.* market access for Thai producers such as shrimp exporters, benefits to Thailand due to its lower costs of labour
- reference to Thailand’s costs of an eventual free trade agreement with the USA.
- Costs to U.S. producers who would have to compete with low wages in Thailand
- An assessment of the likelihood of such a free trade area, given the protectionism discussed in the text

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5. (a) Define the following terms indicated in bold in the text: [2 marks]

(i) free good (paragraph 2)

- level 0 Wrong definition 0
- 1 Vague definition 1  
The idea that a good or service is available in a larger quantity than is needed.
- 2 Precise definition 2  
An explanation that goods or services which are unlimited in supply and have no opportunity cost are free goods. OR Goods that are not scarce. OR goods that are unlimited in supply at a price of zero

(ii) sustainable development (paragraph 4). [2 marks]

- level 0 Wrong definition 0
- 1 Vague definition 1  
The idea that development represents economic growth taking into consideration the environment.
- 2 Precise definition 2  
The development needed to meet the needs of the present generation without compromising the ability of future generations to meet their own needs.

(b) Using an appropriate diagram, explain why the demand for water would be price inelastic. [4 marks]

- level 0 Inappropriate answer 0
- 1 Identification of theory 1-2  
To draw an appropriate diagram illustrating how demand for water would be price inelastic **or** an explanation of how demand for water would be price inelastic due to the lack of substitutes and its necessity.
- 2 Correct application of appropriate theory 3-4  
To draw an appropriate diagram illustrating how demand for water would be price inelastic **and** an explanation of how demand for water is price inelastic due to the lack of substitutes and/or its necessity.

(c) Using an appropriate diagram, explain how the availability of a safe water supply may improve living standards in less developed countries.

[4 marks]

level

0 *Inappropriate answer*

1 *Identification of appropriate theory*

For drawing an appropriately labelled diagram **or** an explanation of how water as a resource can encourage economic development.

0

2 *Correct application of appropriate theory*

For drawing an appropriately labelled diagram **and** an explanation of how water as a resource can encourage economic development.

1-2

Diagrams that might be used could include:

3-4

- a PPC, with the observation that the provision of safe quantity may result in improved health and life expectancy, thus would result in an outwards shift in the PPC
- a positive externalities diagram, showing how the provision of safe water would result in an increase in the quantity of water
- a modified poverty cycle diagram showing how safe water may result in higher human capital and thus higher incomes.
- a demand and supply diagram showing that if there is increased availability of water (increase in supply), then there will be a fall in the price of water, allowing more people to buy it.



- (d) **Using information from the text and your knowledge of economics, evaluate the externalities to be considered in determining whether water should be supplied and sold by the private sector.**

*[8 marks]*

Answers **may** include:

- an explanation that externalities are benefits or costs of consumption/production, and clean water is under-provided

Although the questions refers to externalities, candidates are to be rewarded for analysing the consequences of the provision of water by the private sector. To reach top marks, this should include appropriate economic analysis, rather than just description.

Positive consequences of consuming clean water:

- healthy workforce that is more productive, with greater life expectancy
- higher production, more employment, income and higher standard of living in the long run
- saving in the costs of purifying and boiling water for human consumption in households
- fewer water-borne illnesses

Negative consequences:

- the social and economic upheaval/inequity as a cost of implementing the policy
- the costs of strikes and demonstrations
- regardless of the quality of the water, the price will increase, leading to inequity.
- Profit maximising companies may be able to exploit monopoly power and the inelasticity of demand of water to charge prices well above marginal costs
- profit repatriation resulting from privatisation of water supply and concessions to foreign firms.
- Larger gains for foreign firms (such as European banks, business service firms) than for the people in developing countries

Candidates might evaluate the possibility of continued provision of water by the public sector, which, due to insufficient financial resources would mean that there is unlikely to be an improvement in the quality of water, **but**, more people would have access to it.

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Effective evaluation may be to:

- consider short run versus long run consequences
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