



MARKSCHEME

November 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:

(i) negative externalities (paragraph ①) [2 marks]

level

0 *Wrong definition* **0**

1 *Vague definition* **1**

The idea that they are bad consequences

2 *Precise definition* **2**

An explanation that they are the “bad” effects that are suffered by a third party when a good or service is produced or consumed.

(ii) tradeable permits (paragraph ②). [2 marks]

level

0 *Wrong definition* **0**

1 *Vague definition* **1**

The idea that they are a means of reducing negative externalities.

2 *Precise definition* **2**

An explanation that they are permits to pollute, issued by a governing body, which sets a maximum amount of pollution allowable. Firms may trade these permits for money.

(b) Using an appropriate diagram, explain how travelling by commercial airlines may be a source of market failure. [4 marks]

level

0 *Inappropriate answer* 0

1 *Identification of appropriate theory* 1-2

For drawing a correctly labelled externalities diagram, where the consumers' marginal private benefit curve of flights is to the right of the marginal social benefit curve, causing a negative externality **or** for providing an explanation of how the consumption of flights produces pollution, which they do not have to pay for, so their private benefits are greater than social benefits.

2 *Correct application of appropriate theory* 3-4

For drawing a correctly labelled externalities diagram, where the consumers' marginal private benefit curve of flights is to the right of the marginal social benefit curve, causing a negative externality **and** for providing an explanation of how the consumption of flights produces pollution, which they do not have to pay for, so their private benefits are greater than social benefits.

An acceptable alternative approach, for candidates who may be unaware of the difference between externalities of production and consumption, is to explain the market failure in terms of the negative externality of production.

There may be different diagrams and/or labelling used to show the above, and any appropriate diagram and/or labelling may be fully rewarded.

(c) **Using an appropriate diagram, explain how the tax-free fuel allows commercial airlines to earn more profits.** **[4 marks]**

level

- | | | |
|---|---|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i> For drawing a correctly labelled diagram, where the marginal and average costs are lower, because of the lack of tax, and thus greater profits are being made or for providing an explanation of how lower costs, because of the lack of fuel taxes, means that revenue minus costs, <i>i.e.</i> profit, will be greater. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i> For drawing a correctly labelled diagram, where the marginal and average costs are lower, because of the lack of tax, and thus greater profits are being made and for providing an explanation of how lower costs, because of the lack of fuel taxes, means that revenue minus costs, <i>i.e.</i> profit, will be greater. | 3-4 |

Candidates who use a demand and supply diagram to answer this question cannot achieve beyond Level 1, because they would not be able to show profit.

There may be different diagrams and/or labelling used to show the above, and any appropriate diagram and/or labelling may be fully rewarded.

(d) Using information from the text and your knowledge of economics, evaluate *two* possible solutions to the environment problems caused by commercial airline travel in the article.

[8 marks]

Responses **may** include:

- removing the tax-free status of aviation fuel
- introduce aviation emissions into the Kyoto Protocol
- provide funding for research and development into more environmentally friendly aviation fuel
- advertising to make people aware of the damage caused by airline travel
- taxation to internalise the externality
- regulation
- tradeable permits
- any reasonable answer.

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

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

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. | 0 |
| 1 | Few relevant concepts recognized. Little discussion or only basic understanding. | 1-2 |
| 2 | Relevant concepts recognized and developed in reasonable depth. Some attempt at application and analysis. | 3-5 |
| 3 | Relevant concepts developed in reasonable depth, demonstrating effective evaluation, supported by appropriate evidence or theory. | 6-8 |

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

(i) **GDP** [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1

The idea that it is a measure of economic activity in a country.

2 *Precise definition* 2

An explanation that it is the value of all final goods and services produced in an economy in a given time limit.

(ii) **current account deficit.** [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1

The idea that it is where imports are greater than exports.

2 *Precise definition* 2

An explanation that it is where revenues from the exports of goods and services are less than the spending on the imports of goods and services. The impact of investment, income and net transfers may be included, but are not necessary for both marks.

- (b) **Using an appropriate diagram, explain how making the labour market more flexible may “ease some of the problems relating to rising unemployment”.** **[4 marks]**

level

- | | | |
|---|---|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <p><i>Identification of appropriate theory</i></p> <p>For drawing a correctly labelled demand and supply of labour diagram, where the supply curve shifts to the right because of the greater flexibility or for providing an explanation of how things such as lower unemployment benefits, retraining, and reduced legislation may make workers more prepared to accept lower paid jobs.</p> | 1-2 |
| 2 | <p><i>Correct application of appropriate theory</i></p> <p>For drawing a correctly labelled demand and supply of labour diagram, where the supply curve shifts to the right because of the greater flexibility and for providing an explanation of how things such as lower unemployment benefits, retraining, and reduced legislation may make workers more prepared to accept lower paid jobs.</p> | 3-4 |

There may be different diagrams and/or labelling used to show the above, and any appropriate diagram and/or labelling may be fully rewarded.

- (c) **Using an AD/AS diagram, explain *one* possible reason why Czech consumer prices might have risen since 2003.** **[4 marks]**

level

- | | | |
|---|---|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <p><i>Identification of appropriate theory</i></p> <p>For drawing a correctly labelled aggregate demand and supply diagram, where either the AD curve is shifting to the right, or the AS curve is shifting to the left or for providing an explanation of how inflation may have been caused by appropriate demand-pull or cost-push factors.</p> | 1-2 |
| 2 | <p><i>Correct application of appropriate theory</i></p> <p>For drawing a correctly labelled aggregate demand and supply diagram, where either the AD curve is shifting to the right, or the AS curve is shifting to the left and for providing an explanation of how inflation may have been caused by appropriate demand-pull or cost-push factors.</p> | 3-4 |

There may be different diagrams and/or labelling used to show the above, and any appropriate diagram and/or labelling may be fully rewarded.

(d) Using information from the text and your knowledge of economics, evaluate *two* possible measures that could be adopted by the Czech government to reduce the current account deficit.

[8 marks]

Responses **may** include:

- central bank intervention to reduce the value of the exchange rate (expenditure switching)
- protectionism (expenditure switching)
- contractionary fiscal policy (expenditure reducing)
- contractionary monetary policy (expenditure reducing)
- supply side policies to increase competitiveness
- any reasonable answer

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

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

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. | 0 |
| 1 | Few relevant concepts recognized. Little discussion or only basic understanding. | 1-2 |
| 2 | Relevant concepts recognized and developed in reasonable depth. Some attempt at application and analysis. | 3-5 |
| 3 | Relevant concepts developed in reasonable depth, demonstrating effective evaluation, supported by appropriate evidence or theory. | 6-8 |

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

(i) **managed exchange rates** (*paragraph 4*) [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1
The idea that it is a means of altering the exchange rate.

2 *Precise definition* 2
An explanation that it is a system where the exchange rate is determined by market forces, but the government intervenes from time to time in order to pursue macro-economic objectives. Another point which might be made is that the government/central bank lets the currency float, but keeps it within a certain “band”.

(ii) **appreciation** (*paragraph 7*). [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1
The idea that it is an increase in the value of a currency.

2 *Precise definition* 2
An explanation that it is an increase in the value of one currency against another currency either in a floating exchange rate system, or due to an increase in demand/decrease in the supply of the currency.

(b) Using an appropriate diagram, explain how the American economy could be affected by economic expansion in Europe. [4 marks]

level

0 *Inappropriate answer* 0

1 *Identification of appropriate theory* 1-2

For drawing a correctly labelled aggregate demand and supply diagram, where the US AD curve shifts to the right as exports rise **or** for providing an explanation of how an economic expansion in Europe would lead to greater demand for US goods and services.

2 *Correct application of appropriate theory* 3-4

For drawing a correctly labelled aggregate demand and supply diagram, where the US AD curve shifts to the right as exports rise **and** for providing an explanation of how an economic expansion in Europe would lead to greater demand for US goods and services.

There may be different diagrams and/or labelling used to show the above, and any appropriate diagram and/or labelling may be fully rewarded.

(c) **Using an appropriate diagram, explain how the actions of central banks have led to downward pressure on the US dollar.** [4 marks]

level

0 *Inappropriate answer* 0

1 *Identification of appropriate theory* 1-2

For drawing a correctly labelled demand and supply diagram for the US dollar, where the demand for the dollar has shifted to the left, thus causing a fall in its exchange rate value **or** for providing an explanation of how the Central Banks have reduced their holdings of the dollar, *i.e.* they have reduced their demand for dollars and lowered its value.

2 *Correct application of appropriate theory* 3-4

For drawing a correctly labelled demand and supply diagram for the US dollar, where the demand for the dollar has shifted to the left, thus causing a fall in its exchange rate value **and** for providing an explanation of how the Central Banks have reduced their holdings of the dollar, *i.e.* they have reduced their demand for dollars and lowered its value.

There are a number of diagrams that may be used to show the above and any appropriate diagram may be fully rewarded. For example, some candidates may say that the central banks have been selling dollars and so it is the supply curve that has shifted to the right.

For full marks the y-axis must be accurately labelled – *e.g.* price of US dollar, or price of US dollar measured in other currencies.

(d) Using information from the text and your knowledge of economics, evaluate the possible consequences of the strengthening euro on the countries which use the euro.

[8 marks]

Responses **may** include:

Advantages:

- imports will become cheaper
- lower inflationary pressure
- no need for high interest rates to support the currency
- any reasonable answer

Disadvantages:

- EU firms become less competitive abroad
- deterioration in the current balance
- increased unemployment
- discourages tourism
- any reasonable answer

Candidates using an appropriate diagram should be rewarded. However, candidates who incorrectly label diagrams cannot be rewarded with full marks.

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

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. | 0 |
| 1 | Few relevant concepts recognized. Little discussion or only basic understanding. | 1-2 |
| 2 | Relevant concepts recognized and developed in reasonable depth. Some attempt at application and analysis. | 3-5 |
| 3 | Relevant concepts developed in reasonable depth, demonstrating effective evaluation, supported by appropriate evidence or theory. | 6-8 |

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

(i) **dumping (paragraph 2)** [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1

The idea that it is selling of cheap goods abroad.

2 *Precise definition* 2

An explanation that it is the selling of a good in another country at a price below its cost of production. Given that the WTO defines dumping as the situation that occurs when “a company exports a product at a price lower than the price it normally charges on its home market”, it is acceptable for [2 marks].

(ii) **deteriorating terms of trade (paragraph 4).** [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1

The idea that it is to do with the prices of exports and imports.

2 *Precise definition* 2

An explanation that it is where the average price of exports falls relative to the average price of imports, or making it more expensive to buy imports, in terms of exports that need to be sold. The equation would also be acceptable, with an example.

- (b) **Using an appropriate diagram, explain how the granting of subsidies to EU sugar producers will give them an advantage over other producers.** [4 marks]

level

- | | | |
|---|--|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <p><i>Identification of appropriate theory</i> For drawing a correctly labelled demand and supply diagram, where the domestic supply curve for sugar shifts to the right because of the subsidy, leading to greater domestic output or for providing an explanation of how the subsidy on sugar will lead to domestic producers being able to sell at a lower price than other producers, thus giving a trade advantage.</p> | 1-2 |
| 2 | <p><i>Correct application of appropriate theory</i> For drawing a correctly labelled demand and supply diagram, where the domestic supply curve for sugar shifts to the right because of the subsidy, leading to greater domestic output and for providing an explanation of how the subsidy on sugar will lead to domestic producers being able to sell at a lower price than other producers, thus giving a trade advantage.</p> | 3-4 |

There are a number of diagrams that may be used to show the above and any appropriate diagram may be fully rewarded. For example, candidates may show the situation on a diagram comparing EU costs with other producers.

- (c) **Using a comparative advantage diagram, explain why, “Europe should be importing sugar” (paragraph ③).** [4 marks]

level

- | | | |
|---|--|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <p><i>Identification of appropriate theory</i> For drawing a correctly labelled diagram, showing two PPFs, where the EU PPF displays a lack of comparative advantage for sugar by comparison with the other countries or for providing an explanation of how the EU has a comparative advantage in sugar production, because its opportunity cost of producing sugar is higher than the opportunity cost faced by other sugar producers.</p> | 1-2 |
| 2 | <p><i>Correct application of appropriate theory</i> For drawing a correctly labelled diagram, showing two PPFs, where the EU PPF displays a lack of comparative advantage for sugar by comparison with the other countries and for providing an explanation of how the EU has a comparative advantage in sugar production, because its opportunity cost of producing sugar is higher than the opportunity cost faced by other sugar producers.</p> | 3-4 |

- (d) **Using information from the text and your knowledge of economics, evaluate the statement that, “maintaining the current sugar regime is a situation that, in the long run, is bad for both Europe and the developing world” (paragraph 9).**

[8 marks]

Responses **may** include:

Advantages for Europe:

- provides jobs for European workers
- costs of production are lower for producers
- increases national incomes
- reduces competition

Long run problems for Europe:

- the cost of the scheme – tax payers’ burden
- consumers paying higher than necessary prices
- the encouragement of inefficiency
- eventual retaliation
- any reasonable answer.

Long run problems for the developing world:

- loss of export revenues and thus foreign currencies
- the collapse of local production
- unemployment
- lack of economic growth
- LDCs can only export raw sugar thus inhibiting the development of their own refining industries
- any reasonable answer.

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Effective evaluation may be to:

- consider short run versus long run consequences
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Level

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| 3 | Relevant concepts developed in reasonable depth, demonstrating effective evaluation, supported by appropriate evidence or theory. | 6-8 |

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

(i) foreign direct investment (paragraph ③) **[2 marks]**

level

0 *Wrong definition* **0**

1 *Vague definition* **1**

The ideas that it is investment coming from overseas.

2 *Precise definition* **2**

An explanation that it is investment by multinational corporations in another country.

(ii) investment (paragraph ④). **[2 marks]**

level

0 *Wrong definition* **0**

1 *Vague definition* **1**

The idea that it is spending on machines by firms.

2 *Precise definition* **2**

An explanation that it is expenditure by firms on capital equipment and is an injection into the economy (or any other reasonable second point).

- (b) Explain how allowing for differences in purchasing power may give a more realistic value of the average GDP per head in India. [4 marks]**

level

- | | | |
|---|--|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i> For explaining that allowances for differences in purchasing power, shows the GDP per head of the population taking into account the local prices in the country. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i> For explaining that allowances for differences in purchasing power, shows the GDP per head of the population taking into account the local prices in the country and for going on to explain that prices in India are very low and so average GDP figures, which are usually expressed in US dollars will, in fact, buy a lot more than in many other countries. | 3-4 |

- (c) Using an appropriate diagram, explain how the government could help to protect farmers against fluctuating prices. [4 marks]**

level

- | | | |
|---|---|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i> For drawing a correctly labelled demand and supply diagram, where a buffer stock scheme has been implemented or for providing an explanation of how a buffer stock scheme could be put into place, where the government buys up surpluses in good years and sells from stocks in bad years, in order to stabilise prices. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i> For drawing a correctly labelled demand and supply diagram, where a buffer stock scheme has been implemented and for providing an explanation of how a buffer stock scheme could be put into place, where the government buys up surpluses in good years and sells from stocks in bad years, in order to stabilise prices. | 3-4 |

There may be different diagrams and/or labelling used to show the above, and any appropriate diagram and/or labelling may be fully rewarded.

- (d) **Using information from the text and your knowledge of economics, evaluate the effectiveness of adopting an outward oriented strategy to achieve economic development.**

[8 marks]

Candidates should explain outward oriented strategy and economic development.

Responses **may** include:

- a fall in the proportion of people living below the poverty line in India
- the increase in GDP per head in India
- the increase in growth rates in India
- the 36 per cent increase in HDI in India
- greater consumer choice
- higher growth rates do not necessarily lead to an increase in economic development
- issues relating to FDI and MNCs
- the failure of import substitution policies
- access to foreign markets
- vulnerability resulting from dependence on foreign markets
- any reasonable response.

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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. | 0 |
| 1 | Few relevant concepts recognized. Little discussion or only basic understanding. | 1-2 |
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| 3 | Relevant concepts developed in reasonable depth, demonstrating effective evaluation, supported by appropriate evidence or theory. | 6-8 |