

MARKSCHEME

November 2007

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) economic growth (paragraph 5)	[2 marks]
level	
0 <i>Wrong definition</i>	0
1 <i>Vague definition</i> The idea that it is a growth of economic activity in the economy.	1
2 <i>Precise definition</i> An explanation mentioning increased real output for an economy over time and measured as an increase in real GDP. Alternatively, it may be explained as an increase in the potential output of the economy through an increase in the quantity/quality of resources.	2
(ii) sustainable development (paragraph 6).	[2 marks]
level	
0 <i>Wrong definition</i>	0
1 <i>Vague definition</i> The idea that it is related to the use of the world's resources.	1
2 <i>Precise definition</i> An explanation that it is the development needed to meet the needs of the present generation without compromising the ability of future generations to meet their own needs.	2

(b) Using an appropriate diagram, explain how the company’s mining of gold near Buyat Bay is 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 mine’s marginal private cost curve is to the right of the marginal social cost curve, causing a negative externality **or** for providing an explanation of how the mining company is causing pollution, which it does not have to pay for, so its private costs are less than social costs.

2 *Correct application of appropriate theory* **3-4**

For drawing a correctly labelled externalities diagram, where the mine’s marginal private cost curve is to the right of the marginal social cost curve, causing a negative externality **and** for providing an explanation of how the mining company is causing pollution, which it does not have to pay for, so its private costs are less than social costs.

For an external costs diagram, labels could simply be price and quantity. The y-axis could be costs or costs and benefits.

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

(c) Using an appropriate diagram, explain how “appropriate ways to dispose of their waste” (paragraph 6) would affect the Indonesian gold market. [4 marks]

level

0 *Inappropriate answer* **0**

1 *Identification of appropriate theory* **1-2**

For drawing a correctly labelled diagram, where the supply curve for gold is shifted to the left, reducing output and raising the price **or** for providing an explanation of how costs would be higher because of implementing the waste disposal processes, which would reduce output in the market and also raise the price.

2 *Correct application of appropriate theory* **3-4**

For drawing a correctly labelled diagram, where the supply curve for gold is shifted to the left, reducing output and raising the price **and** for providing an explanation of how costs would be higher because of implementing the waste disposal processes, which would reduce output in the market and also raise the price.

There are a number of diagrams that may be used to show the above and any appropriate diagram may be fully rewarded.

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

- (d) Using information from the text and your knowledge of economics, evaluate the arguments for and against the “foreign direct investment” (paragraph 5).

[8 marks]

Responses **may** include:

- a definition of FDI

Arguments **for** FDI:

- FDI brings investments into countries where savings are difficult to build (as in Indonesia)
- FDI transfers technology to the host country
- FDI provides employment (paragraph 5)
- taxation of FDI contributes badly needed government revenue (paragraph 5)
- output of enterprises resulting from FDI contributes to increased exports and improved balance of payment prospects
- FDI creates demand for locally produced inputs
- may provide national, regional or local multiplier effects
- to attract FDI governments often invest in infrastructure, which has positive spin-offs in the rest of the economy

Arguments **against** FDI:

- tax incentives offered by the host government may outweigh the expected tax revenue from FDI
- output from foreign enterprises may drive local enterprises out of business
- local labour is exploited and high technical or executive posts are filled by foreign personnel
- FDI may produce negative externalities and risks for the local population
- FDI may solve short-run balance of payment difficulties but may also introduce long-run outflows of income in the form of profit repatriation
- FDI may bring in inappropriate technology
- FDI makes the host country vulnerable to MNC influence. Government attempts to tighten control of foreign enterprises may result in FDI leaving the country
- transfer pricing reduces potential tax revenue
- MNCs may not follow local laws/regulations – “waste had exceeded government regulations on legal limits for heavy metals (paragraph 2)
- FDI may produce negative externalities – “polluting the environment”, president has been accused of “allowing toxic waste to be put into the sea” (paragraph 1) – “villagers at Buyat Bay complained last year of illnesses that they said were the result of the mine’s operations” (paragraph 3) – “tumors, skin rashes and dizziness suffered by local residents” (paragraph 4).

As the main agents of FDI, some candidates may approach this question by referring to standard advantages and disadvantages of investments from MNCs, which is a legitimate and acceptable alternative.

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) **demand** (*paragraph 1*) *[2 marks]*

level

0 *Wrong definition* **0**

1 *Vague definition* **1**
The idea that it is how much is bought of a good or service at a certain price.

2 *Precise definition* **2**
An explanation that it is the willingness and ability to purchase a quantity of a good or service.

(ii) **opportunity cost** (*paragraph 6*). *[2 marks]*

level

0 *Wrong definition* **0**

1 *Vague definition* **1**
The idea that there is something given up.

2 *Precise definition* **2**
An explanation that it is the next best alternative foregone when an economic decision is made.

(b) Using an appropriate diagram, explain how the “tourism deficit” (paragraph 4) might affect the value of the UK currency. [4 marks]

level

- 0 *Inappropriate answer* **0**
- 1 *Identification of appropriate theory* **1-2**
 For drawing a correctly labelled diagram, where the supply of the pound shifts to the right, as more foreign currencies are demanded, reducing the value of the pound **or** for providing an explanation of how the increase in travelling abroad, increases the demand for foreign currencies, thus increasing the supply of the pound on the international currency markets.
- 2 *Correct application of appropriate theory* **3-4**
 For drawing a correctly labelled diagram, where the supply of the pound shifts to the right, as more foreign currencies are demanded, reducing the value of the pound **and** for providing an explanation of how the increase in travelling abroad, increases the demand for foreign currencies, thus increasing the supply of the pound on the international currency markets.

Candidates who incorrectly label diagrams cannot be rewarded with full marks. It is not sufficient to simply write “price” on the vertical axis. The following are acceptable: “price of £ in other currencies”, “price of £”, or simply “exchange rate”. It is sufficient to write “quantity” on the horizontal axis.

(c) Using information from the text, calculate the value of income elasticity of demand for foreign holidays and explain what the value signifies. [4 marks]

level

- 0 *Inappropriate answer* **0**
- 1 *Identification of appropriate theory* **1-2**
 For correctly calculating the YED as being 2 (50 % / 25 %) **or** for providing an explanation of how an increase in income is leading to a greater proportional increase in the amount spent on holidays abroad, so that the income elasticity of demand for holidays is income elastic.
- 2 *Correct application of appropriate theory* **3-4**
 For correctly calculating the YED as being 2 (50 % / 25 %) **and** for providing an explanation of how an increase in income is leading to a greater proportional increase in the amount spent on holidays abroad, so that the income elasticity of demand for holidays is income elastic.

- (d) Using information from the text and your knowledge of economics, evaluate the possible effects of the expansion of airports and runways on the UK economy.

[8 marks]

Responses **may** include:

- growth because AD will increase due to investment spending by firms and the government (possible multiplier effect), “air travel is essential to the UK’s economic growth and to our continued prosperity” (*paragraph 3*)
- growth because AD may increase due to increased tourism by foreigners
- increased prosperity from higher income levels
- job creation – “helping to keep 200 000 jobs in the industry” (*paragraph 3*)
- increased inflationary pressure
- AD may decrease if it leads to an increase in tourism expenditure abroad
- AD may decrease, increase in withdrawals/leakages – “withdraw funds from the economy” (*paragraph 4*)
- growth because AD will increase due to investment... “air travel is essential to the UK’s economic growth and to our continued prosperity” (*paragraph 3*)
- the current account may deteriorate
- external costs to residents will increase – “there is much opposition to the proposed expansions to the airports... who pay the external costs of the huge boom in the industry” (*paragraph 7*)
- government may have to increase spending to reduce external costs
- increased expenditure by British tourists abroad, *ceteris paribus*, may lead to a depreciation of the British pound
- any reasonable answer.

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) quotas (paragraph 1) *[2 marks]*

level

0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that they are a restriction on imports.	1
2	<i>Precise definition</i> An explanation that they are import barriers that set limits on the quantity or value of imports into a country.	2

(ii) normal profit (paragraph 2). *[2 marks]*

level

0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that it is the profit needed to keep a firm operating.	1
2	<i>Precise definition</i> An explanation that it is the amount of revenue needed to cover the total costs of production, including the opportunity costs.	2

(b) Using an appropriate diagram, explain how the potential increase in the number of bicycle taxi operators in Kenya will create “too much competition to maintain normal profit (zero economic profit)” (paragraph 2).

[4 marks]

level

0 *Inappropriate answer*

0

1 *Identification of appropriate theory*

1-2

For drawing a correctly labelled diagram, where the supply of bicycle taxis increases, thus reducing profits for existing operators **or** for providing an explanation of how the lower price of bicycles will lead to more operators, increased competition, and thus lower profits.

2 *Correct application of appropriate theory*

3-4

For drawing a correctly labelled diagram, where the supply of bicycle taxis increases, thus reducing profits for existing operators **and** for providing an explanation of how the lower price of bicycles will lead to more operators, increased competition, and thus lower profits.

Candidates may assume perfect competition or monopolistic competition as their market form and should be fully rewarded for either. Diagram(s) used should show reduced profit levels. Use of AC and MC lines is expected.

Either a perfect competition diagram or monopolistic competition situation may be explained:

- If the PC diagram is drawn, then the candidates would be likely (but not necessary) to draw two diagrams side by side showing the industry and the individual bicycle taxi operator. The key point is that the increase in supply in the number of operators in the industry (increase in supply) would push down the price and with it, the perfectly elastic demand/MR revenue curve facing the firm, thus resulting in fewer profits.
- If a monopolistic competition model is assumed (perhaps more difficult), then the cost/revenue diagram would show a fall in demand and MR for the individual taxi operator and so fewer profits.

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

(c) **Using an appropriate diagram, explain how the elimination of the tariff will affect the level of bicycle imports into Kenya.** **[4 marks]**

level

- | | | |
|---|--|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
For drawing a correctly labelled diagram, where the price of bicycles falls to the world price as the tariff is eliminated, increasing quantity demanded and the number of imported bicycles or for providing an explanation of how the elimination of tariffs will lower the price of bicycles and so increase the volume of imports. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing a correctly labelled diagram, where the price of bicycles falls to the world price as the tariff is eliminated, increasing quantity demanded and the number of imported bicycles and for providing an explanation of how the elimination of tariffs will lower the price of bicycles and so increase the volume of imports. | 3-4 |

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

(d) **Using information from the text and your knowledge of economics, evaluate the implications for economic development in Tanzania of a reduced tariff on bicycles.** **[8 marks]**

Responses **may** include:

- a definition of economic development
- reduced transport costs for small producers
- increased schooling and the implications (*paragraph 5*)
- increased employment opportunities, especially for women (*paragraph 5*)
- improved access to markets (*paragraph 5*)
- increased ease of access to social capital, such as hospitals
- increased spending on imports
- a more efficient allocation of resources (elimination of deadweight losses)
- the significance for economic development of the above implications
- some domestic bicycle producers may be forced to leave the industry
- industry profits may fall (*paragraph 2*) leading to cheaper labour and lower levels of income
- reduction in the tariff of tyres “is an important first step but does not go far enough” (*paragraph 3*)
- the reduction in the tariff of tyres will make it “more affordable for people to keep bicycles in working order” (*paragraph 3*)
- any reasonable answer.

To enter the top mark level, candidates cannot simply discuss the effects of the reduced tariff; a clear link to the concept of economic development must be made.

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) inflation		<i>[2 marks]</i>
level		
0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that it is rising prices.	1
2	<i>Precise definition</i> An explanation that it is a sustained increase in the general or average level of prices.	2
(ii) supply-side policies.		<i>[2 marks]</i>
level		
0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that they are policies that change aggregate supply.	1
2	<i>Precise definition</i> An explanation that they are policies designed to shift the AS curve rightwards so as to improve the efficiency of the economy.	2

(b) Using an appropriate diagram, explain to what extent the data for Greece, from the beginning of 2003 to the beginning of 2004, supports the theory suggested by the short-run Phillips curve.

[4 marks]

level

0 *Inappropriate answer*

0

1 *Identification of appropriate theory*

1-2

For drawing a correctly labelled short-run Phillips curve diagram, where there is an inverse relationship between inflation and unemployment **or** for explaining that the unemployment rate increased and the inflation rate decreased in Greece during 2003, supporting the Phillips curve theory.

2 *Correct application of appropriate theory*

3-4

For drawing a correctly labelled short-run Phillips curve diagram, where there is an inverse relationship between inflation and unemployment **and** for explaining that the unemployment rate increased and the inflation rate decreased in Greece during 2003, supporting the Phillips curve theory.

Candidates who incorrectly label diagrams cannot be rewarded with full marks. Correct labels would be “inflation” or “inflation rate” on vertical axis and “unemployment rate” on horizontal axis.

(c) Using an appropriate diagram, explain why the Greek budget deficit may be causing crowding out as suggested in the last line of the text.

[4 marks]

level

0 *Inappropriate answer*

0

1 *Identification of appropriate theory*

1-2

For drawing a correctly labelled diagram, which could be a shift of AD, or a decrease in investment, or an increase in the demand for money **or** for providing an explanation of how increased borrowing by the government to fund the deficit means that interest rates are forced up and private investment is crowded out.

2 *Correct application of appropriate theory*

3-4

For drawing a correctly labelled diagram, which could be a shift of AD, or a decrease in investment, or an increase in the demand for money **and** for providing an explanation of how increased borrowing by the government to fund the deficit means that interest rates are forced up and private investment is crowded out.

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

- (d) **Using information from the text and data, and your knowledge of economics, evaluate the policies that might be used by the Greek government to improve the performance of its economy.**

[8 marks]

This is an open question and examiners are requested to use their discretion in assessing the depth of analysis and the quality of the application of economic theory. The best answers will address the policies to the specific conditions presented in the data.

Responses **may** include:

- fiscal policies including cuts in government spending (*text*)
- changes in interest rates as a tool of monetary policy
- market oriented supply-side policies (*text*)
- policies to reduce the “persistent current account deficit” (*text*)
- any reasonable answer.

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

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

(i) **recession** (*paragraph ㉓*) [2 marks]

level

- | | | |
|---|---|---|
| 0 | <i>Wrong definition</i> | 0 |
| 1 | <i>Vague definition</i>
The idea that it is a fall in economic activity. | 1 |
| 2 | <i>Precise definition</i>
An explanation that it is at least two consecutive quarters of negative economic growth. | 2 |

(ii) **consumption** (*paragraph ㉔*). [2 marks]

level

- | | | |
|---|--|---|
| 0 | <i>Wrong definition</i> | 0 |
| 1 | <i>Vague definition</i>
The idea that it is to do with spending by consumers. | 1 |
| 2 | <i>Precise definition</i>
An explanation that it is spending by individuals or households on consumer goods and services. | 2 |

(b) With the help of an appropriate diagram, explain how the fall in lending after 1998 (paragraph ②) contributed to the “decade long period of slowdown and recession” (paragraph ⑤). **[4 marks]**

level

- 0 *Inappropriate answer* **0**

- 1 *Identification of appropriate theory* **1-2**
 For drawing a correctly labelled AD/AS diagram, where the AD curve shifts to the left, causing a decrease in output (national income) **or** for providing an explanation of how there should be a decrease in investment (and possibly consumption), which will decrease the AD in the economy, possibly leading to recession.

- 2 *Correct application of appropriate theory* **3-4**
 For drawing a correctly labelled AD/AS diagram, where the AD curve shifts to the left, causing a decrease in output (national income) **and** for providing an explanation of how there should be a decrease in investment (and possibly consumption), which will decrease the AD in the economy, possibly leading to recession.

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

(c) Using the circular flow of income diagram, explain the link between saving and investment implied in the text (paragraph ⑥). **[4 marks]**

level

- 0 *Inappropriate answer* **0**

- 1 *Identification of appropriate theory* **1-2**
 For drawing an appropriately labelled circular flow diagram, showing savings as a withdrawal and investment as an injection **or** for providing an explanation of how the injection of investment is made possible by the withdrawal of savings.

- 2 *Correct application of appropriate theory* **3-4**
 For drawing an appropriately labelled circular flow diagram, showing savings as a withdrawal and investment as an injection **and** for providing an explanation of how the injection of investment is made possible by the withdrawal of savings.

There are a number of versions of the circular flow diagram that may be used to show the above and any appropriate diagram should be fully rewarded.

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

- (d) **Using information from the text and your knowledge of economics, evaluate the consequences of increased lending on the Japanese economy.** [8 marks]

Responses **may** include:

- increased consumption (*paragraph 6*)
- move funds for business investment (*paragraph 4*)
- the possible multiplier effect (*paragraph 6*)
- the multiplier/accelerator relationship
- the effect on employment and economic growth
- to help Japan escape deflation (*paragraph 6*)
- possible inflationary pressure
- possible consequences for international trade, such as an increased demand for imports or cheaper exports following greater investment
- a rise in credit-based spending in the economy
- any reasonable answer.

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
