



MARKSCHEME

May 2008

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) equilibrium price (paragraph 2) [2 marks]

level

0 *Wrong definition* **0**

1 *Vague definition* **1**

The idea that equilibrium is a point (as opposed to price) where demand equals supply.

2 *Precise definition* **2**

Any one of the following:

- the price at which quantity demanded is equal to quantity supplied
- the market-clearing price, set where $D = S$
- the price at which there is no excess demand or supply
- a vague definition accompanied by a diagram.

(ii) allocative efficiency (paragraph 3). [2 marks]

level

0 *Wrong definition* **0**

1 *Vague definition* **1**

The idea that resources are allocated efficiently.

2 *Precise definition* **2**

Any one of the following:

- where price is equal to marginal cost (or marginal social cost) or $MC = AR$
- where no one can be made better-off by transferring resources from one industry to another without making someone else worse off
- where resources are allocated in such a way that neither too much nor too little is produced from society's point of view.

- (b) Using an appropriate diagram, explain the likely impact of removing the 10% indirect tax on wine (an ad valorem tax) on the supply of, and demand for, wine. *[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 showing a shift in the supply curve and an increase in quantity or for providing an explanation that the removal of the 10 % indirect tax would lead to an increase in supply and, ceteris paribus, an increase in quantity demanded. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing a correctly labelled demand and supply diagram showing shift in the supply curve and an increase in quantity and for providing an explanation that the removal of the 10 % indirect tax would lead to an increase in supply and, ceteris paribus, an increase in quantity demanded. | 3-4 |

Candidates whose diagram does not show a divergent shift of supply (corresponding to an ad valorem tax), cannot be rewarded with more than *[3 marks]*.

Candidates who incorrectly label diagrams cannot be rewarded with full marks. “Price” and “quantity” are sufficient for full marks.

- (c) Using a production possibility curve (PPC) diagram, explain how grape growers having to pull out some of their vines, could reduce the potential economic output of the Australian economy. [4 marks]

level

- | | | |
|---|---|-----|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
A correctly labelled PPC diagram showing a shift inwards of the production possibility curve or for providing an explanation that removing grape vines (a factor of production), will reduce the productive capacity of the Australian economy and reduce the potential economic output of Australia. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
A correctly labelled PPC diagram showing a shift inwards of the production possibility curve and for providing an explanation that removing grape vines (a factor of production), will reduce the productive capacity of the Australian economy and reduce the potential economic output of Australia. | 3-4 |

Candidates who incorrectly label diagrams cannot be rewarded with full marks. The axes should reflect two competing categories of output, such as “wine” and “other goods” or “manufactured goods” and “primary goods”, “consumer goods” and “capital goods”.

- (d) Using information from the text and your knowledge of economics, evaluate the role of falling prices in reallocating resources in Australia’s wine market.

[8 marks]

Discussions that **may** be covered include:

- role of price in resource allocation
- causes of falling price
 - “large crops” (*paragraph 1*)
 - “slower than expected export market” (*paragraph 1*)
- falling prices reduce profits (*paragraph 4*)
- falling prices are a signal to producers to reduce allocation of their resources to wine production, *i.e.* ”pull up some of their vines” (*paragraph 1*)
- need to improve efficiency (adjust output according to demand requirements: pull out unwanted varieties, plant wanted varieties (*paragraph 3*))
- need for some producers to find “substitute products to grow” (*paragraph 3*)
- falling prices may encourage export growth, but this may be limited by appreciating Australian dollar (*paragraph 5*)
- the exchange rate affects the price of wine in foreign markets in ways that do not reflect the demand and supply of wine
- resources may not be (geographically or occupationally) mobile enough to be reallocated, at least in the short run
- information about other market opportunities might not be available to producers of wine.

Candidates can evaluate in a variety of ways including the impact on various stakeholders, the distinction between the short-term and the long-term effects on the market and the importance of market imperfections such as factor immobility.

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

Do not award more than [5 marks] if the answer does not contain reference to the information provided.

Effective evaluation may be to:

- consider short-term versus long-term 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) structural unemployment (paragraph ⑤) **[2 marks]**

level

0 *Wrong definition* **0**

1 *Vague definition* **1**
The idea that unemployment is due to a change in the structure of the economy.

2 *Precise definition* **2**
Any one of the following would be appropriate:

- long term unemployment that is caused as a result of a fall in the demand for a particular type of labour
- unemployment that occurs as a result of the changing structure of an economy resulting from changes in demand/supply and/or technology
- unemployment that occurs when there is a mismatch between the skills of unemployed workers and the jobs available
- unemployment that exists as a result of rigidities in the labour market.

(ii) average costs (paragraph ⑤). **[2 marks]**

level

0 *Wrong definition* **0**

1 *Vague definition* **1**
The idea that it is what it costs, on average, to produce.

2 *Precise definition* **2**
An explanation that it is the cost of production per unit **or** the total cost divided by the quantity produced.

- (b) **Using a production possibility curve (PPC) diagram, explain how increased unemployment could lead to a fall in the output of a nation.** **[4 marks]**

level

- | | | |
|---|--|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
An appropriate PPC diagram showing a movement from a point on or inside the curve to a point closer to the origin or for providing an explanation that increased unemployment means that all resources in the economy are not being fully employed (or are being used inefficiently) and could result in a movement to a point closer to the origin which represents a fall in output. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
An appropriate PPC diagram showing a movement from a point on or inside the curve to a point closer to the origin and for providing an explanation that increased unemployment means that all resources in the economy are not being fully employed (or are being used inefficiently) and could result in a movement to a point closer to the origin which represents a fall in output. | 3-4 |

Candidates who incorrectly label diagrams cannot be rewarded with full marks. The axes should reflect two competing categories of output, such as “manufactured goods” and “primary goods”, “consumer goods” and “capital goods”.

- (c) **Using an appropriate diagram, explain why average costs in Canadian timber firms might fall in the long-run.** **[4 marks]**

level

- | | | |
|---|---|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
For drawing a LRAC curve showing a movement down the existing curve or for providing an explanation that firms can benefit from economies of scale (or increasing returns to scale) if they increase the level of output, and that this means a fall in long run average costs. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing a LRAC curve showing a movement down the existing curve and for providing an explanation that firms can benefit from economies of scale (or increasing returns to scale) if they increase the level of output, and that this means a fall in long run average costs. To receive full marks, the actual term “economies of scale” must be mentioned. | 3-4 |

Candidates who incorrectly label diagrams cannot be rewarded with full marks. The y-axis should be “costs”, and the x-axis could be “quantity” or “output” or “scale”.

- (d) **Using information from the text and your knowledge of economics, evaluate the effects of the removal of US timber tariffs on US consumers, US producers and the US government.**

[8 marks]

Responses **may** include:

- definition of a tariff
- diagram to illustrate a removal of a timber tariff.

Effects on US consumers:

- observation that the consumers of timber are likely to be producers of wood products and the removal of tariffs will lead to lower costs of production for such producers. This may lead to lower prices for wood products
- lower prices increase consumer surplus (*paragraph 5*)
- changes in welfare
- the obligation of the US government to pay back the Canadian producers may affect consumers through higher taxes or reduced government spending in other areas.

Effects on US producers:

- lower output
- collapse of inefficient firms (*paragraph 5*)
- unemployment in US timber industry
- producers who use timber in production will have lower costs of production if the tariff on imported timber is removed. This may increase profits in such industries
- possible increase in employment in wood products industries.

Effects on the US government/economy:

- impact on government revenue (forgone tariff revenue and hand back of C\$4 billion to Canadian exporters) (*paragraph 4*)
- possible impact on macroeconomic policy objectives (inflation, unemployment) (*paragraph 5*)
- effects of increased imports on the balance of payments.

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

Do not award more than **[5 marks]** if the answer does not contain reference to the information provided.

Effective evaluation may be to:

- consider short-term versus long-term 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) nominal (paragraph ❶) **[2 marks]**

level

0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that nominal has something to do with inflation	1
2	<i>Precise definition</i> The idea that nominal is either the money value or the current value or the market value or an explanation that it is the value of an economic variable that has not been adjusted for the effects of inflation.	2

(ii) inflationary gap (paragraph ❷). **[2 marks]**

level

0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that inflationary pressure is created because of too much demand.	1
2	<i>Precise definition</i> An explanation that an inflationary gap arises when aggregate demand exceeds an economy's potential output, or inflationary pressure created by the SR equilibrium being above the LR equilibrium or a vague definition accompanied by a diagram.	2

- (b) Using an appropriate diagram, explain how the change in New Zealand's current account in 2005 could have contributed to the depreciation of New Zealand's exchange rate during 2005. [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 of the New Zealand currency illustrating a depreciation of the New Zealand dollar (though either an increase in supply or a decrease in demand) or for providing an explanation of how an increase in the current account deficit could lead to a depreciation of the New Zealand exchange rate as a result of either an increase in supply of the currency due to increased imports or decreased demand for the currency due to decreased exports. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing a correctly labelled demand and supply diagram of the New Zealand currency illustrating a depreciation of the New Zealand dollar (though either an increase in supply or a decrease in demand and for providing an explanation of how an increase in the current account deficit could lead to a depreciation of the New Zealand exchange rate as a result of either an increase in supply of the currency due to increased imports or decreased demand for the currency due to decreased exports. | 3-4 |

Candidates who incorrectly label diagrams cannot be rewarded with full marks. The y-axis must reflect the fact that this is an exchange rate diagram. For example, "price of NZ\$ in other currencies" or "price of NZ\$ in US\$" or "exchange rate".

(c) Explain the likely impact of “a fall in forecast economic growth (actual growth) from 4.4% to 2.8%” (*paragraph 4*), on the amount of goods and services produced. *[4 marks]*

level

- | | | |
|---|---|-----|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
An explanation that a fall in the rate of economic growth means that there will be economic growth, but at a slower rate or an explanation that the amount of goods and services being produced will increase by (only) 2.8%. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
An explanation that a fall in the rate of economic growth means that there will be economic growth, but at a slower rate and an explanation that the amount of goods and services being produced will increase by (only) 2.8%. | 3-4 |

Although a diagram is not specifically requested, candidates who correctly use an AD/AS diagram showing an increase in AD should be rewarded.

- (d) Using information from the text/data and your knowledge of economics, evaluate the consequences for New Zealand of raising domestic interest rates.

[8 marks]

Responses **may** include:

- an AD/AS diagram showing a decrease in AD
- a possible fall in investment with possible implications for economic growth
- a slowing down of economic activity in the domestic economy *i.e.* “moderate demand-side pressures”
- a reduction in inflation below the target of 3% (*paragraph 5*)
- a fall in “very strong consumer spending” (*paragraph 1*) due to higher costs of borrowing and increased debt servicing costs
- an increase in capital inflow from overseas and an appreciation in the exchange rate (*paragraph 5*)
- consequences of appreciation include a fall in export competitiveness (*paragraph 5*) and an increase in the competitiveness of imports leading to higher levels of unemployment in export industries and import competing industries
- imported raw materials may be cheaper worsening the current account (*data*)
- cheaper imported raw materials can reduce cost-push pressure
- in the long run, a lower inflation rate could improve export competitiveness
- lower inflation rate and lower prices for foreign inputs may increase New Zealand’s efficiency and competitiveness
- impact on income and wealth distribution
- consumption and/or investment may not be responsive to interest rate changes
- observation that increasing interest rates may reduce inflationary pressure but may contribute to slower growth and/or higher unemployment, illustrating the conflict between policy objectives and/or the Phillips Curve
- evaluation that fighting inflation may be the most important policy objective for the long run health of the economy and therefore and worth the disadvantages.

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

Do not award more than [5 marks] if the answer does not contain reference to the information provided.

Effective evaluation may be to:

- consider short-term versus long-term 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) **indirect taxation (paragraph 2)** [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1

The idea that indirect taxation is a tax paid by consumers.

2 *Precise definition* 2

An explanation that indirect taxation is an expenditure tax **or** a tax levied on goods and services.

(ii) **crowding out (paragraph 2).** [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1

The idea that there is an increase in government spending causing a fall in investment.

2 *Precise definition* 2

An explanation that crowding out is a situation where the government spends more (government expenditure) than it receives in revenue (mainly taxation), and needs to borrow money, forcing up interest rates thereby reducing investment and consumption **or** an explanation that the government (public sector) uses the economy's factors of production, thereby reducing the ability of the private sector to use those resources.

- (b) Using an appropriate diagram, explain how “the sudden downturn in world trade in 2001-2002” (*paragraph ①*) could have contributed to the fall in the rate of growth of real GDP in Singapore in 2002-2003. [4 marks]

level

- | | | |
|---|--|-----|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
For an AD/AS diagram showing a small shift in the AD curve to the right or for providing an explanation that a downturn in world trade will mean that fewer exports from Singapore will be purchased and so less export revenue will be earned. The (X-M) component of aggregate demand is likely to have fallen causing Singapore’s AD and real GDP to increase by less than the previous year. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For an AD/AS diagram showing a small shift in the AD curve to the right and for providing an explanation that a downturn in world trade will mean that fewer exports from Singapore will be purchased and so less export revenue will be earned. The (X-M) component of aggregate demand is likely to have fallen causing Singapore’s AD and real GDP to increase by less than the previous year. | 3-4 |

Candidates who incorrectly label diagrams cannot be rewarded with full marks. Correct labels for the vertical axis would include “average price level”, “price level”. Correct labels for the horizontal axis would include “real output”, “real GDP”, “output”, “GDP”, “real income”, “national income. Any abbreviations of the above are also correct.

- (c) Using an appropriate diagram, explain how a government budget deficit could stimulate the economy. *[4 marks]*

level

- | | | |
|---|--|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <p><i>Identification of appropriate theory</i></p> <p>Using an AD/AS diagram to illustrate how a budget deficit could shift the AD curve to the right and increase real output/GDP or for providing an explanation that a budget deficit would result in an increase government spending (G) or a reduction taxation and lead to an increase in AD.</p> | 1-2 |
| 2 | <p><i>Correct application of appropriate theory</i></p> <p>Using an AD/AS diagram to illustrate how a budget deficit would shift the AD curve to the right and increase real output/GDP and for providing an explanation that a budget deficit would result in an increase government spending (G) or a reduction taxation and lead to an increase in AD.</p> | 3-4 |

Candidates who incorrectly label diagrams cannot be rewarded with full marks. Correct labels for the vertical axis would include “average price level”, “price level”. Correct labels for the horizontal axis would include “real output”, “real GDP”, “output”, “GDP”, “real income”, “national income”. Any abbreviations of the above are also correct.

- (d) **Using information from the text/data and your knowledge of economics, evaluate the relative performance of Sri Lanka’s economy compared with Singapore’s economy since 2002.**

[8 marks]

Responses **may** include:

- Sri Lanka’s economy is growing faster than Singapore’s economy (real GDP growth)
- negative externalities and income inequalities might increase
- Sri Lanka has a significantly higher level of inflation
- this means Sri Lanka’s goods and services are less competitive and resource allocation is likely to be less efficient
- Singapore’s low rate of inflation should boost business and consumer confidence and contribute to strong growth in the future
- Singapore has moved from a budget deficit into a budget surplus, while Sri Lanka has a very high budget deficit as a percentage of GDP
- this means Singapore has the ability to re-pay debt, while Sri Lanka is adding to public debt
- Singapore has a large current account surplus while Sri Lanka has a current account deficit
- there is, therefore, downward pressure on Sri Lanka’s exchange rate but upward pressure on Singapore’s exchange rate
- on balance the economy of Singapore is in a stronger position than that of Sri Lanka.

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

Do not award more than **[5 marks]** if the students do not move beyond a basic description of the data.

Effective evaluation may be to:

- consider short-term versus long-term 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) tied aid (Text box 2) **[2 marks]**

level

0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that it is aid tied to a donor.	1
2	<i>Precise definition</i> An explanation that it is aid granted on the condition that it is used to buy goods or services from the donor country.	2

(ii) infrastructure (Text box 4). **[2 marks]**

level

0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that the government provides things like roads.	1
2	<i>Precise definition</i> Any one of the following: <ul style="list-style-type: none"> • physical capital typically provided by the government to make economic activity possible • physical capital that provides positive externalities • essential facilities and services that add to the capital stock of a nation. 	2

- (b) **Using an appropriate diagram, explain how the removal of agricultural subsidies in developed countries (Text box 2) would affect the farmers in those countries.** **[4 marks]**

level

- | | | |
|---|---|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <p><i>Identification of appropriate theory</i></p> <p>For a demand and supply diagram showing a shift in the supply curve to the left with an increase in price and a decrease in quantity or for providing an explanation that a removal of a subsidy can lead to an increase in production costs and a consequent decrease in supply, rise in price, reduction in quantity demanded and a fall in income for the producers in developed countries.</p> | 1-2 |
| 2 | <p><i>Correct application of appropriate theory</i></p> <p>For a demand and supply diagram showing a shift in the supply curve to the left with an increase in price and a decrease in quantity and for providing an explanation that a removal of a subsidy can lead to an increase in production costs and a consequent decrease in supply, rise in price, reduction in quantity demanded and a fall in income for the producers in developed countries.</p> | 3-4 |

Candidates who incorrectly label diagrams cannot be rewarded with full marks. “Price” and “quantity” are sufficient for full marks.

- (c) **Using an AD/AS diagram, explain the likely supply-side impact of increased investment in Less Developed Countries (LDC).** **[4 marks]**

level

- | | | |
|---|--|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <p><i>Identification of appropriate theory</i></p> <p>For drawing an AD/AS diagram showing a shift in the LRAS curve to the right and an increase in real output or for providing an explanation of how increased investment can expand the productive capacity of the LDC.</p> | 1-2 |
| 2 | <p><i>Correct application of appropriate theory</i></p> <p>For drawing an AD/AS diagram showing a shift in the LRAS curve to the right and an increase in real output and for providing an explanation of how increased investment can expand the productive capacity of the LDC.</p> | 3-4 |

Candidates who use a SRAS curve should receive a maximum of **[3 marks]**.

Candidates who incorrectly label diagrams cannot be rewarded with full marks. Correct labels for the vertical axis would include “average price level”, “price level”. Correct labels for the horizontal axis would include “real output”, “real GDP”, “output”, “GDP”, “real income”, “national income”. Any abbreviations of the above are also correct.

- (d) **Using information from the text and your knowledge of economics, evaluate the significance of debt relief to fight poverty in Less Developed Countries (LDCs) in Africa.**

[8 marks]

To move beyond level 2 **[5 marks]** students **must** make a link between debt relief and poverty reduction.

- explanation of the term debt relief
- explanation of poverty.

Positive impacts **may** include:

- a reduction in the opportunity cost of debt servicing in terms of expenditure on health, education and infrastructure, all of which could promote economic development and growth and therefore alleviate poverty
- balance of payments effects (less debt servicing)
- bridges the savings gap and the foreign exchange gap, making investment in human and physical capital more likely and thereby contributing to a reduction in poverty
- reduction in the transfer of human capital (brain drain), and the transfer of domestic savings (capital flight), both of which can contribute to economic development and the reduction of poverty.

Negative impacts **may** include:

- incompetent governments can run up more debt (*Text box 1*)
- corruption not likely to be eliminated
- misuse of the extra funds available (*Text box 1*)
- disadvantages associated with the conditions attached to debt relief and/or tied aid.

As part of an evaluation, candidates may look at alternative means of fighting poverty such as export-led growth (*Text box 3*), the removal of protectionist policies, and “improved investment relationships” (*Text box 2*).

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

Do not award more than **[5 marks]** if the answer does not contain reference to the information provided.

Effective evaluation may be to:

- consider short-term versus long-term 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
