



# **MARKSCHEME**

**May 2009**

**ECONOMICS**

**Higher Level**

**Paper 2**

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*In addition to the assessment criteria, use the paper-specific markscheme below. Award up to the maximum marks indicated. Each question is worth [10 marks].*

1. **With reference to the concept of economic growth, explain the difference between a movement along an existing production possibility curve (PPC) and an outward shift in a production possibility curve (PPC).**

Candidates **may** include any of the following:

- diagram of a production possibility curve (PPC) indicating two alternative types of output (most likely “capital goods/consumer goods”)
- definition of PPC – distinction between potential and actual output
- explanation of economic growth in terms of a shift outwards in the PPC
- a movement along the PPC – the notions of reallocation of resources and opportunity cost
- substitution of capital goods for consumption goods (opportunity cost) along the PPC in the short-term leads to a shift outwards in the PPC (economic growth).

Candidates cannot access level 4 unless they clearly explain the **difference** *e.g.* economic growth is shown by the outward shift of the PPC, whereas a movement along the PPC does not show economic growth – just a reallocation of resources.

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

2. **Explain why prices tend to be relatively stable in a non-collusive oligopoly.**

Candidates **may** include any of the following:

- definition and explanation of an oligopoly market structure
- distinction between a collusive and non-collusive oligopoly
- explanation of why prices may not change – the notion of interdependence
- the kinked demand curve – diagrammatic representation
- explanation of the kinked demand curve – elastic and inelastic segments of the curve
- the discontinuous marginal revenue curve
- non-price competition such as advertising
- explanation of why, despite their relative stability, prices may change in a non-collusive oligopoly:
  - price change operated by market leaders
  - long-run changes leading to economies of scale and lower LRACs.

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

**3. With the aid of a diagram, explain how the application of a flat rate tax (a specific/fixed amount) could reduce the amount of pollution produced by a chemical factory.**

Candidates **may** include any of the following:

- explanation of a flat rate (specific/fixed) tax
- explanation of pollution as an example of market failure – the inability of an unregulated market to achieve allocative efficiency in all circumstances
- definition of pollution as an external cost of production: outputs of the chemical factory that affect the utility or costs of other consumers or producers *i.e.* third parties
- diagrammatic representation of an external cost of production
- discussion of the diagram
- illustration and discussion of how a flat rate tax could reduce pollution.

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

**4. Explain the possible impact on the distribution of income of a government shifting its main source of tax revenue from progressive direct taxes to regressive indirect taxes.**

Candidates **may** include any of the following:

- explanation of progressive direct taxes
- explanation of regressive indirect taxes
- examples of direct and indirect taxes
- impact of a reduction in direct taxes on the distribution of income
- impact of a rise in indirect taxes on the distribution of income in terms of equality and equity
- use of the Lorenz curve.

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

**5. Oil prices have risen in recent years. Explain the likely impact on the terms of trade and the current account balance of a country that depends on oil exports for most of its revenue.**

Candidates **may** include any of the following:

- definition of the Terms of Trade (T of T):
- a rise in oil prices will lead to an improvement in the T of T
- explanation of an improvement in the T of T:
  - the index of X prices rises relative to the index of M prices
  - more imports can be bought with the same amount of Xs
- the current account balance can be expected to improve in the short-term – reducing a deficit or increasing a surplus
- given that the demand for oil is price inelastic and constitutes most of the country's revenue the improvement in the current account may persist
- explanation that the improvement in the current account will lead to an increased demand for the currency that will make Xs more expensive and Ms relatively cheaper possibly reducing any surplus on the current account.

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

**6. Explain *three* possible limitations of using GDP as a measure to compare welfare between countries.**

Candidates **may** include any of the following:

- definition of GDP
- definition of welfare
- total GDP is an absolute value; comparison makes more sense using a relative value (GDP per capita)
- comparison should consider the purchasing power across countries (PPP-based comparison)
- GDP is a quantity measurement. Welfare should be compared considering quality measurements (economic development and human development in which real GDP per capita is only one of several components)
- size of GDP does not consider the negative externalities resulting from its production (pollution, depletion of natural resources). Comparison should consider sustainability
- comparison should measure the forgone leisure sacrificed to achieve a high value of GDP
- measurements of national accounts are not accurate. A comparison should consider the size of the informal sector, value of non-market output (like DIY, housewife/househusband services, voluntary work, output of the subsistence sector, output resulting from illegal activities).

Examiners should be aware that candidates may take a different approach, including discussion of alternative measures, which if appropriate, should be rewarded.

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