International Baccalaureate®
Baccalauréat International
Bachillerato Internacional

MARKSCHEME

May 2010

ECONOMICS

Higher Level

Paper 2

*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 the aid of a diagram, explain why the price elasticity of supply is likely to change over time.

Candidates **may** include:

- a definition of price elasticity of supply
- the formula for calculating the PES
- an explanation of why the PES can change over time:
  - how quickly the costs of using resources rise as output increases; if the cost of resource use increases quickly as production increases, producers are less likely to increase supply, resulting in an inelastic supply
  - time period:
    - the longer the time period considered, the more elastic supply will be (for example, difficulty in expanding capital *e.g.* constructing another factory)
  - amount of excess capacity; the greater the excess capacity, the more elastic supply will be
  - availability of substitutes in production; the more the substitutes, the easier it is to switch production, and the more elastic supply will be
  - reference may be made to the market period, the short run and the long run
- a diagram showing supply curves with different values of PES
- examples, such as primary products (agriculture, minerals) which have a lower PES than manufactured products.

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.

Assessment Criteria

Level		Marks
0	Completely inappropriate answer.	0
1	Little understanding of the specific demands of the question Very little recognition of relevant economic theory Relevant terms not defined Significant errors	1–3
2	Some understanding of the specific demands of the question Some recognition of relevant economic theory Some relevant terms defined Some errors	4–6
3	Understanding of the specific demands of the question Relevant economic theory explained and developed Relevant economic terms defined Few errors Where appropriate, diagrams included	7–8
4	Clear understanding of the specific demands of the question Relevant economic theory clearly explained and developed Relevant economic terms clearly defined No major errors Where appropriate, diagrams included and explained Where appropriate, examples used	9–10

2. Explain why an airline would want to practice price discrimination. Under what conditions would the airline be able to do so?

Candidates **may** include:

- a definition of price discrimination
- an explanation of why an airline would want to practice price discrimination
  – it can earn higher revenues and earn greater economic (supernormal) profits through the capture of consumer surplus
  – it can drive higher cost competitors out of the market by lowering prices for some consumer groups, and therefore it can increase its monopoly power
- an explanation of how an airline can practice price discrimination:
  – an airline can split the market and discriminate between different buyers: they can charge the elderly lower prices on certain days, give discounts for students' weekend travel, offer lower fares to travellers who make advance bookings and charge higher fares to those making their travel plans closer to the day of travel
- conditions for price discrimination:
  – the producers have price setting ability because the market is imperfect, and can distinguish between separate groups of buyers on the basis of age, income *etc.*
  – consumers have different price elasticity of demand *i.e.* different demand curves for different consumers *e.g.* holidaymakers, business people and therefore some consumers are willing to pay higher prices than others
  – producers must be able to keep the markets separate.

Candidates may illustrate how a monopolist can charge different prices in different markets using marginal revenue and marginal cost curves.

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3. With the aid of a diagram, explain how the government could try to eliminate a deflationary (recessionary) gap.

Candidates **may** include:
- a definition of a deflationary (recessionary) gap
- graphical representation of a deflationary (recessionary) gap.

Government shifting the AD curve to the right:
- an explanation of government expenditure increases and how this will increase AD
- an explanation of tax decreases or transfer payment increases and how this will increase AD
- an explanation of interest rate decreases that could be expected to influence consumption/investment/exchange rate and how this will increase AD
- graphical illustration of the above
- influence of the multiplier effect.

Candidates may choose to draw a 45° diagram and this would be equally acceptable. Candidates who incorrectly label diagrams cannot be rewarded with full marks.

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4. With the aid of a diagram, explain how an increase in transfer payments to the poorest households in a nation is likely to affect the Lorenz curve and the Gini coefficient of that nation.

Candidates **may** include:

- a definition of transfer payments
- a definition of the Lorenz curve
- a definition of the Gini coefficient
- a diagram illustrating a Lorenz curve and the Gini coefficient
- an explanation that an increase in transfer payments to the poorest households can lead to an improvement in income distribution, by increasing the incomes of lower income groups
- an explanation that an improvement in income distribution will cause the Lorenz curve to move towards the line of absolute equality
- an explanation that the Gini coefficient (index) will become lower indicating a more equitable distribution of income.

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5. Explain the difference between a fixed exchange rate and a floating (flexible) exchange rate.

Candidates **may** include:

- a definition of an exchange rate
- a definition of a fixed exchange rate
- a definition of a floating (flexible) exchange rate.
- Explanation of the difference between a fixed exchange rate and a floating (flexible) exchange rate in terms of how they function:
  - explanation of how a fixed exchange rate is maintained at a fixed level: buying and selling by the government of a country of its domestic currency in the foreign exchange market
  - explanation of the factors causing variations of a floating (flexible) exchange rate: changes in the demand for and supply of a currency resulting from changes in trade flows, international interest rate differentials, international price level differentials and speculation.

Diagrams may be used in response to this question but are not essential for the achievement of full marks.

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6. Explain the difference between outward-oriented growth strategies and inward-oriented growth strategies.

Candidates **may** include:

- an explanation that an outward-oriented growth strategy relies on increasing exports as the basis of growth, while an inward-oriented growth strategy relies on protection and increased self-reliance
- an explanation that outward-oriented growth strategies are based on free trade whereas inward-oriented growth strategies are based on import substitution
- an explanation that outward-oriented growth strategies are based on market liberalization whereas inward-oriented growth strategies based on government intervention to regulate domestic industries and protect infant industries
- an explanation of the advantages and disadvantages of outward-oriented growth strategies and inward-oriented growth strategies.

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