N11/3/ECONO/HP2/ENG/TZ0/XX/M

International Baccalaureate®
Baccalauréat International
Bachillerato Internacional

MARKSCHEME

November 2011

ECONOMICS

Higher Level

Paper 2

11 pages

*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. Explain the problems a transition economy could face as it moves towards a free market economy.

Candidates **may** include:

- a definition of a transition economy as an economy in the process of moving from a centrally planned economic system towards a more market-oriented economic system
- a definition of an economy based on the free market
- an explanation of the characteristics of free market economy
- an explanation of the characteristics of a centrally planned economy
- problems facing an economy in transition such as:
  - inflation
  - unemployment
  - lower and/or negative economic growth
  - establishing market institutions
  - establishing currency convertibility
  - greater income inequality – loss of social safety net; increased poverty
  - current account problems
  - capital flight
  - difficulties with privatization – methods, corruption
  - consequences of privatization – layoffs, higher prices
  - side effects of removing price controls
  - rise in crime rates
- examples of transition economies.

Candidates who explain two problems well could be awarded 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. Using an appropriate diagram, explain how the removal of a subsidy on fossil fuels such as oil, coal and natural gas could help reduce negative externalities.

Candidates **may** include:
- a definition of subsidy
- a definition of negative externality
- negative externalities associated with fossil fuels; pollution, health problems
- an explanation of how removing a subsidy on fossil fuels reduces the negative externalities associated with their production and/or consumption
- an explanation of how subsidies on fossil fuels increase negative externalities by increasing the market quantity
- demand and supply or a marginal social cost/marginal social benefit diagram to show the impact of removing the subsidy on a fossil fuel, *e.g.* oil, coal and natural gas
- an explanation of the diagram showing how the removal of the subsidy will help reduce the negative externality and move the market closer to the socially optimal output
- examples where subsidies are used or removed on fossil fuels.

A negative externality diagram is needed for full marks.

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

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3. Explain why firms in perfect competition can make supernormal (abnormal) profit in the short run but can only make normal (zero) profit in the long run.

Candidates **may** include:

- a definition of normal (zero) profit
- a definition of supernormal (abnormal) profit
- an explanation of the characteristics of perfect competition
- an explanation of the process allowing normal profit only to be achieved in the long run through freedom of entry and exit:
  - if incumbent firms make short-run supernormal (abnormal) profit, new firms will enter the market causing the market supply to increase, and market price and industry profit to fall
  - this process reaches a long run equilibrium, when P/MR = MC at ATC (normal profit) and new firms have no incentive to enter the market
- a diagrammatic analysis showing a firm in perfect competition making supernormal (abnormal) profit in the short run; S/D diagram illustrating the impact on supply and price when firms enter the market; perfect competition model illustrating the firm making normal (zero) profit in the long run.

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4. Explain how an understanding of the Laffer curve could be used by a government to increase tax revenue.

Candidates **may** include:
- a definition of tax revenue
- an explanation of the Laffer curve
- an explanation of the incentive effects of tax cuts – willingness to work harder; willingness to invest
- an explanation of how an increase or decrease in the tax rate can increase or decrease tax revenue depending on where the country is on the Laffer curve
- a diagram showing the Laffer curve with the tax rate corresponding to the maximum tax revenue indicated and an appropriate explanation
- difficulties involved in the use of the Laffer curve to increase tax revenue
- examples of countries where supply-side tax cuts based on the Laffer Curve were implemented.

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5. Explain the limitations of the theory of comparative advantage.

Candidates **may** include:

- a definition of comparative advantage
- an explanation of some of the various limitations due to simplifying assumptions:
  - perfect competition
  - perfect knowledge
  - full employment
  - fixed technology
  - perfect substitutability of resources
  - factor immobility
  - equal imports and exports
  - perfectly free trade
  - no transport costs
  - constant economies of scale
  - identical goods traded
- trade based on comparative advantage may lead to over specialization, preventing development
- theory might work well between countries at similar stages of development but not necessarily between LDCs and MDCs, where it could be used as a justification for exploitation.

Candidates who explain two limitations well can be awarded full marks.

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6. Using examples, explain how the poverty cycle can be a barrier to economic development.

Candidates **may** include:

- a definition of economic development
- measures of development, *i.e.* HDI
- an explanation of the poverty cycle, as low income leading to low savings leading to low investment, leading to low income:
  - low income levels result in low savings levels as saving is positively related to disposable income
  - low savings mean that less funds will be available for lending
  - low savings lead to low investment, which in turn leads to lower aggregate demand and lower real GDP
- a diagram illustrating the poverty cycle
- examples of the poverty cycle and its effects linked to development such as:
  - households and governments not being able to spend on health care and education, resulting in lower economic and human development
  - households and government not being able to spend on health care and education, resulting in a lower quality of the labour force and a decrease in LRAS
  - resulting lack of skilled labour and/or possible political instability that come with poverty may discourage FDI and limit the possibility of development through trade
  - an indication that the poverty cycle is transmitted from generation to generation due to the low income-low savings-low investment-low income relationship, thus affecting future generations.

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