International Baccalaureate®
Baccalauréat International
Bachillerato Internacional

MARKSCHEME

November 2012

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. Using a production possibility curve, explain the problem of scarcity faced by all societies.

Candidates **may** include:

- a definition of a production possibility curve
- a definition of opportunity cost
- an explanation of the problem of scarcity (unlimited wants, limited resources, choice and opportunity costs)
- examples of limited resources: land, labor, capital and entrepreneurship
- use of a PPC diagram with an appropriate choice of goods (any two competing goods would be acceptable)
- use of the PPC to illustrate how, when the economy lies on the curve, increasing the production of one good would necessarily entail a decrease in the production of the other, as resources are limited
- examples of trade-offs faced by societies.

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 *at least one* diagram, explain how a buffer stock scheme might function.

Candidates **may** include:

- a definition of a buffer stock scheme
- an explanation of a buffer stock scheme as a means of stabilizing the price of a commodity
- use of a diagram showing a range of minimum and maximum prices allowed by the scheme
- an explanation of how the buffer stock would function. It would be enough to outline any two of the following points:
  - if the equilibrium price changes within the predetermined range, the administrative body would take no action
  - if the equilibrium price falls short of the minimum price, the government would increase the demand by buying
  - if the price exceeds the maximum, the administrative body would release stocks to increase supply
- difficulties associated with buffer stock management, *e.g.* a build up of surpluses
- examples of buffer stock schemes.

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3. Using *at least one* diagram, explain how firms operating in monopolistic competition will make normal profit (zero economic profit) in the long run.

Candidates **may** include:

- a definition of long run
- a definition of normal profit (zero economic profit)
- an explanation of the characteristics of firms in monopolistic competition
- an explanation of the short run profit maximizing output of a firm operating in monopolistic competition, with the firm making either abnormal profit or loss
- an explanation of how free entry in the long run, will result in a leftward shift in the demand curve facing the monopolistically competitive firm when existing firms are making abnormal profit in the short run
- an explanation of how free exit in the long run, will result in a rightward shift in the demand curve facing the monopolistically competitive firm when existing firms are making losses in the short run
- an explanation of how free entry/exit would lead firms in monopolistic competition to make normal profit in the long run
- use of a diagram showing the abnormal profit/loss of monopolistically competitive firms in the short run
- use of a diagram showing the long run equilibrium where the firm earns normal profit
- examples of monopolistically competitive firms.

Candidates need not examine both abnormal profit and loss scenarios; an explanation of one or the other is enough for full marks.

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4. Using *at least one* diagram, explain the difference between demand-pull and cost-push inflation.

Candidates **may** include:

- a definition of inflation
- an explanation of demand-pull inflation as inflation occurring due to an increase in AD
- an outline of AD components and various reasons/policies that might result in demand-pull inflation
- use of an AD/AS diagram showing a rightward shift in the AD curve and the resulting demand-pull inflation indicated
- an explanation of cost-push inflation as inflation caused by a decrease in the short run AS
- an explanation of possible reasons that would shift the SRAS curve to the left
- an explanation of the effect on real output associated with demand-pull, and cost-push inflation
- use of an AD/AS diagram showing the SRAS curve shifting to the left and the resulting cost-push inflation indicated
- examples of either demand-pull or cost-push inflation.

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5. Explain possible disadvantages that may be associated with the adoption of a single currency.

Candidates **may** include:

- a definition of a single currency
- an explanation of the various disadvantages associated with the adoption of a single currency:
  - the loss of independent monetary policy as an economic tool
  - the loss of the self-correcting mechanism, associated with a free-floating exchange rate, in the BOP
  - the pressures and difficulties associated with monetary integration, *e.g.* the interest rate adopted by the common central bank may not suit the needs of every single country within the union
  - the ability to use fiscal policy could be bound by common policy agreements (*e.g.* EU stability and growth pact)
  - countries with high inflation could export it to the rest of the currency area
  - one-off transition costs
- an example of a single currency, *e.g.* the euro, and any disadvantage associated with its adoption.

Candidates who fully develop two disadvantages may be awarded full marks.

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6. Explain how a significant fall in the price of commodities (raw materials) would affect the economy of a less developed country.

Candidates **may** include:

- a definition of a less developed country
- an explanation of how a fall in the price of export commodities may result in a fall in revenues from exports due to the price inelasticity of demand of primary products
- the impact on the economy depends on the proportion of exports that are primary
- less developed countries export largely unprocessed primary products and are therefore more sensitive to price movements than if exports were processed
- impact on less developed countries' levels of employment, growth and government revenue
- the effect of lower commodity prices on the terms of trade and the consequences of an adverse shift in the terms of trade
- an explanation of how a fall in the price of imported commodities would result in lower import payments, and hence have positive effects on cost-push inflation and the current account
- examples of countries that were affected by a fall in the price of commodities.

Candidates who fully develop two effects of falling commodity prices on the economy, or who fully develop one effect but show how two aspects of the economy are affected as a result, may be awarded full marks.

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