

MARKSCHEME

May 2004

ECONOMICS

Standard Level

Paper 2

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SECTION A

Data Response: Paper-Specific Markscheme

Award up to the maximum marks available.

Question 1 The Health Care Debate

	Partial Mark	Maximum Mark
(a) Define the following terms which are in bold in the text:		
(i) social benefits (<i>Item 1</i>)		2
• for an imprecise definition which equates social benefits with impacts on third parties	1	
• for a precise definition in terms of private benefits plus positive and/or negative externalities	2	2
(ii) consumer sovereignty (<i>Item 2</i>).		2
• for a vague statement about consumer power	1	
• for a more precise definition along the lines of consumer demand determining the allocation of resources	2	2
(b) With reference to <i>Item 1</i>, explain why a situation in which “human need rather than effective demand determines who gets what”, may be fairer than market provision.		3
• for explaining that effective demand depends upon the ability and willingness to pay the market price	2	
• for explaining how this will be unfair where certain needy consumers lack the ability to pay	2	3

	Partial Mark	Maximum Mark
(c) With reference to <i>Item 2</i>, explain <i>two</i> reasons why the demand for health care constantly rises.		5
For just stating the two points mentioned in the passage without any further relevant discussion.	2	
Demographic changes in the population		
• for an explanation in terms of an aging population/increases in population and the associated increase in the demand for health care	3	
Rising living standards		
• for an explanation in terms of the significance of increasing levels of real disposable income leading to increased demand for health care	3	
For an explanation of any other relevant point not mentioned in the passage, <i>e.g.</i> increased awareness/greater expectations of health care, medical advances driving demand, increased availability of private insurance schemes.	3	5
(d) In <i>Item 1</i>, it is claimed that market provision leads to a misallocation of resources, while in <i>Item 2</i>, it is claimed that government provision of health care leads to a misallocation of resources.		
Use the text and your knowledge of economics to explain how a misallocation of resources might arise in each case.		6
Item 1		
• for stating that market provision may lead to market failure	1	
• for a fuller explanation of this point in terms of health care as a merit good and under-provision	3	
Item 2		
• for stating that price is not allowed to perform its rationing function	1	
• for an explanation of the rationing function of price and how a misallocation of resources may occur if it is abandoned	3	
• for reasons why a government may be inefficient in terms of health care, <i>e.g.</i> lack of competition, profit motive, innovation, invention, ARA	3	6
<i>Therefore, a maximum of [4 marks] if misallocation is only explained using one of the two items given.</i>		

(e) **With reference to a country that you have studied, discuss the possible constraints on the ability of a government to meet the increasing demands for health care.**

[7 marks]

Possible constraints include:

- the high cost of health care and a lack of funds
- need for higher taxation to finance spending
- need for greater borrowing
- opportunity cost – alternative government spending foregone and political choices
- macroeconomic consequences of health spending
- rapidly rising costs in the health care sector, along with rapidly rising demand
- high population growth
- the impact of AIDS
- improvements in medicine leading to more treatment being possible
- any reasonable answer

Level 0	No valid discussion.	0
Level 1	Few relevant issues recognized with little discussion or basic understanding.	1-2
Level 2	A few issues recognized with some attempt at discussion or just one issue well-developed.	3-4
Level 3	Two or more issues well developed with some reference to a country, or LDCs and MDCs, and with sensible evaluation.	5-7

Question 2

	Partial Mark	Maximum Mark
(a) Define the following terms which are in bold in the text:		
(i) budget deficit (<i>Item 3</i>)		2
• for a vague definition	1	
• for a precise definition in terms of government expenditure exceeding government revenue	2	2
(ii) floating exchange rate (<i>Item 3</i>).		2
• for a vague definition	1	
• for a precise definition in terms of a currency being determined by the market forces of demand and supply	2	2
(b) Describe the relationship between GDP and industrial production as shown in <i>Item 4</i>.		2
• for stating that GDP and industrial production move in the same direction	1	
• for an explanation of how industrial production contributes to GDP	2	
• for making use of the data to illustrate this	1	2
(c) (i) With reference to <i>Item 4</i>, describe the change in the peso.		2
• for a general statement that the value of the peso has declined in terms of US\$	2	
• for relevant illustration of the depreciation, such as the magnitude of the change	1	2
(ii) What are the implications of this change in the peso for the economy of Argentina?		4
For explaining the impact on		
• the price of imported goods and services	2	
• the rate of inflation	2	
• Argentina's exports	2	
• the current account	2	
• foreign debt and foreign reserves	2	
• employment and income levels in Argentina	2	
• any other relevant economic variable	2	4

For a simple statement, allocate [1] and for further development of the idea allocate another [1].

	Partial Mark	Maximum Mark
(d) Examine the impact of interest rates at the level shown in Item 4 on the economy of Argentina.		6
For explaining the impact of the high interest rates on:		
• consumer spending	3	
• consumer and/or business confidence	3	
• the incentive to save	3	
• investment	3	
• the exchange rate	3	
• any other relevant economic variable	3	6
 (e) Evaluate the IMF view that reducing the budget deficit will assist an economic recovery in Argentina.		 [7 marks]

‘Positive’ points could include reference to:

- lower government expenditure and so lower inflation
- lower debt-servicing costs for the government
- macro-economic stability
- positive impact of IMF structural adjustment policies
- potentially lower taxation
- any reasonable answer

‘Negative’ points could include reference to:

- Unemployment
- growth and development
- negative impact on some sections of the community, depending on how the budget is reduced
- negative impact of IMF structural adjustment policies
- short term costs for long term gain
- any reasonable answer

Answers will need to attempt to evaluate, to some extent, the two views in order to be rewarded with a mark in Level 3.

Level 0	No valid discussion.	0
Level 1	Few relevant issues recognized with little discussion or basic understanding.	1-2
Level 2	A few issues recognized with some attempt at discussion or just one issue well-developed.	3-4
Level 3	Two or more issues well developed with some reference to the data and with sensible evaluation.	5-7

SECTION B

Essays: Paper-Specific Guidance

The following comments are intended to provide extra guidance to Assistant Examiners, but they are not meant to be a “straitjacket”.

They are meant to indicate some of the main points which the question-setter hoped to elicit, and/or indicate sensible approaches; however, it is often possible for candidates to respond to a question in a way which is unanticipated and yet which contains valid economic arguments, so please keep an open mind.

THE GENERAL MARKING CRITERIA REMAIN THE MAIN BASIS FOR AWARDING MARKS.

Question 3

- (a) **Briefly outline the various methods of price control open to governments.**

[10 marks]

Possible points for discussion:

- maximum (ceiling prices)
- minimum (floor prices)
- subsidies/indirect taxes
- price support schemes
- buffer stocks
- minimum wages.

Two methods, well covered, with relevant examples, would be sufficient to reach the highest mark band.

Candidates who confuse methods of price control with methods for controlling inflation should be limited to Band 2 and below.

- (b) **Evaluate the effectiveness of using price controls to reduce poverty.**

[15 marks]

Possible points for discussion:

- definition of poverty, perhaps involving absolute and relative poverty
- the ability to provide relatively cheap necessity goods
- the ability to provide merit goods
- the ability to provide cheaper accommodation
- the ability to ensure reasonable wage levels
- the cost to the government of implementing price controls
- parallel and black markets
- any reasonable answer

The best candidates will relate their discussion to the reduction of poverty.

Candidates who evaluate controlling inflation and the reduction of poverty should be limited to Band 2 and below.

Question 4

- (a) **The world economy may be subjected to economic shocks, such as a sudden increase in oil prices and terrorist attacks. With the help of an aggregate demand/aggregate supply diagram, explain the possible economic effects of such shocks.**

[12 marks]

Possible effects:

- shift of the AD curve, and/or the AS Curve, to the left
- reduction in output
- reduction in employment
- lower growth
- lower standard of living
- on the price level
- on the balance of payments
- on exchange rates
- any reasonable answer

Please note that this section carries 12 marks.

- (b) **Evaluate the main economic policies that governments might use to minimize these effects.**

[13 marks]

Discussions may include the following:

- fiscal policies
- monetary policies
- trade policies
- supply side policies.

Please note that this section carries 13 marks.

Question 5

- (a) Identify the main types of trading blocs and their characteristics. [10 marks]**

Possible points for discussion:

Free trade areas

- remove tariffs and quotas between themselves
- retain whatever restrictions they wish with non-member countries
- provisions may be implemented to stop imports entering the bloc via the country with the lowest tariff

Customs Unions

- free trade areas that also adopt common external tariffs and quotas with non members

Common Markets

Customs unions that may operate with the following additional elements

- free movement of labour and capital
- common system of taxation
- common employment legislation and workers rights
- common agricultural policy
- common competition policy
- the absence of special treatment by member governments of their own domestic industries
- supra national institutions.

Common Markets are sometimes extended to economic and monetary union with fixed exchange rates or single currencies, plus common macroeconomic policies.

Two types, well covered, with relevant examples, would be sufficient to reach the highest mark band.

- (b) **With reference to real-world examples, evaluate the advantages and disadvantages of membership of a trading bloc.**

[15 marks]

Possible points in favour of trading blocs:

- increased market size
- increased competition
- increased efficiency
- lower prices
- greater choice
- improvements in quality
- more rapid spread of technology
- trade blocs provide some of the benefits of free trade while awarding countries some protection
- trade blocs may attract FDI
- increased growth
- improvements in wages and working conditions
- members of trading blocs may gain greater bargaining power with the rest of the world.

Possible arguments against trading blocs:

- resources may flow to the more efficient larger countries to the detriment of the smaller members
- failure to recognize the specific requirements of smaller nations
- the economic costs of greater competition may be too great for certain nations
- high administrative costs
- trading blocs may represent barriers to world trade, especially for LDCs
- trading blocs may restrict certain forms of FDI
- trading blocs may produce trade wars
- any reasonable answer.

Question 6

Critically evaluate the significance of foreign direct investment (FDI) in the process of economic development for less developed countries (LDCs).

[25 marks]

Definitions of FDI and economic development.

Advantages:

- FDI as an injection into the circular flow
- skills transfers
- technology transfers
- exports and exports earnings
- Employment
- output growth
- productivity growth
- infrastructure
- association of FDI with
 - liberalization of trade and markets
 - increased wages
 - increased choice of products/quality
 - links with growth and development

Disadvantages:

- unemployment
- competition for domestic producers
- imports/balance of payments problems
- transfer pricing
- repatriation of profits
- dual economies
- inappropriate technologies/products
- environmental degradation
- partial and limited technology transfers
- some FDI dependent on cheap labour/raw materials and is volatile and transient
- dual currencies
- corruption
- health and safety risks
- exploitation of labour
- dependency.

Points made should be related to economic development. If candidates simply relate their discussion to economic growth, their responses should be limited to Band 2 and below.
