

# **MARKSCHEME**

**November 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: National Income Statistics**

	<b>Partial Mark</b>	<b>Maximum Mark</b>
<b>(a) Define the following terms, indicated in bold in the tables:</b>		
<b>(i) consumer price inflation (Table 2)</b>		
• for the idea that there is an increase in prices over time	<b>1</b>	
• a sustained rise in the general level of the prices of consumer goods	<b>2</b>	<b>2</b>
<b>(ii) current account balance (Table 3).</b>		
• for the idea that there is a balance between export revenue and import expenditure	<b>1</b>	
• the value, positive or negative, of a country's trade in goods and services with the rest of the world, over a given time period	<b>2</b>	<b>2</b>
<b>(b) (i) Identify the countries which had economic growth in 2001.</b>		
• South Korea	<b>1</b>	
• Hong Kong	<b>1</b>	<b>2</b>
<b>(ii) What further information might you need in order to assess the levels of economic development of the countries shown in the table?</b>		
• distribution of income		
• non-marketed items		
• externalities		
• types of goods and services being produced		
• non-monetary factors		
• HDI	<b>1 each</b>	<b>4</b>

*Reward any other reasonable answer.*

	<b>Partial Mark</b>	<b>Maximum Mark</b>
<b>(c) Using the information in <i>Table 1</i>, explain why there are differences between the figures for GDP per head (\$) and GDP per head (\$ at PPP).</b>		
• for an accurate definition of PPP	2	
• for an explanation that there are differences between prices in countries	2	
• for an explanation using the figures in <b>Table 1</b> , e.g. that in Japan, prices must be relatively high, because the PPP value of GDP is lower than the \$ value and in the other countries, prices are relatively low	3	
• for an explanation that prices are relatively the lowest in Taiwan and South Korea	3	5
<b>(d) Using information in the tables, identify the country that you feel is the most dependant upon international trade. Explain your answer.</b>		
• Singapore	1	
• for an explanation that Singapore's current account balance is 27.2 % of GDP	2	3

**Partial Maximum  
Mark Mark**

**(e) Using the evidence from the tables and your knowledge of economics, identify the country that you feel to be in the strongest economic position. Justify your answer.**

Responses should use as much of the information given as possible.

From **Table 1**, South Korea and Hong Kong are the only countries with positive economic growth. When PPP is taken into account, Hong Kong and Singapore take the lead, with relatively high GDP per head (\$) and relatively lower prices than Japan.

From **Table 2**, only South Korea has a relatively high inflation level and unemployment appears to be significantly higher in Hong Kong and Japan than in the other countries.

From **Table 3**, Singapore has a good current account balance, but Japan's is very high (although it is a very small percentage of GDP). Little can be known from the foreign exchange reserves, unless one knows the relative sizes of the countries. South Korea looks as if it may have debt problems, with external debt greater than foreign exchange reserves and a 12.9 % debt-service ratio.

Better responses might say that we only have one set of figures and so there is no idea of movement over time.

*There is no right answer to the country chosen. What matters is the economic argument behind the choice. Reward any plausible argument.*

*A candidate failing to choose a country cannot reach Level 3.*

<b>Level 0:</b>	No valid discussion.	<b>0</b>
<b>Level 1:</b>	Very few points recognized with little or no valid discussion.	<b>1-2</b>
<b>Level 2:</b>	A few points recognized with some attempt at discussion or just one issue developed fully.	<b>3-4</b>
<b>Level 3:</b>	A range of issues discussed in reasonable depth. The candidate must also show an awareness of alternative viewpoints and engage in some sensible evaluation.	<b>5-7</b>

**Question 2: Rise in price of oil adds to world's problems**

	<b>Partial Mark</b>	<b>Maximum Mark</b>
<b>(a) Define the following terms, indicated in bold in the text:</b>		
<b>(i) economic growth</b>		
• for the idea that growth is an increase in output of the economy	1	
• a percentage increase in GDP (or GNP or GDP per capita) in a one year period	2	2
<b>(ii) appreciation.</b>		
• for the idea that it is an increase in the value of one currency with respect to another currency	1	
• brought about by an increase in the demand for the currency <b>or</b> a decrease in supply of the currency in the foreign exchange market	1	
• in a floating exchange rate system	1	
• an example from the text	1	2
<b>(b) Using supply and demand analysis explain <i>two</i> possible reasons for the increase in the price of oil, identified in the text.</b>		
• for a correct, accurately labelled diagram	2	
• for a correct explanation of a leftward shift of the supply curve as a result of falling supply of oil from Venezuela	2	
• for a correct explanation of a rightward shift of the demand curve as a result of expectations of military conflict in Iraq	2	
• reward specific labelling of real values on y-axis ( <i>e.g.</i> +40 % in price, or new equilibrium price of \$31.87)	1	6

**Partial Maximum  
Mark Mark**

**(c) (i) Using an aggregate demand/aggregate supply diagram and evidence from the text, explain why the euro-zone economy is at risk of inflation.**

- for a correct accurately labelled AD/AS diagram – maximum *[1 mark]* here if axes are labelled simply “P” and “Q” **2**
- for an explanation that higher oil prices will cause a leftward shift of AS curve **2**
- for correct drawing of this shift in AS **1**
- for statement that this is cost-push inflation **1** **4**

**(ii) Using an aggregate demand/aggregate supply diagram and evidence from the text, explain why the euro-zone economy is at risk of unemployment.**

- for a correct accurately labelled AD/AS diagram – maximum *[1 mark]* here if axes are labelled simply “P” and “Q” **2**
- for an explanation that the high value of the euro damages export industries leading to a fall in AD and an increase in unemployment **2**
- for correct drawing of this shift in AD **1**
- for statement that this is demand-deficient unemployment **1** **4**

**Partial Maximum  
Mark Mark**

- (d) **Using the evidence from the text and your knowledge of economics, evaluate possible reasons which explain why economic growth in the euro-zone “will be, on average, only half as strong as growth in the United States”.**

Responses should use as much information from the text as possible.

*Paragraph 4*

- Europe is heavily dependent on imported oil
- European economies already fragile, being dragged down by near-recessionary growth in Germany.

*Paragraph 5*

- the appreciation of the euro against the dollar is damaging European exports
- upward spiral in oil prices is inflationary.

*Paragraph 6*

- US economy has more flexible labour market, reducing upward pressure on labour costs
- low cost of imports into USA as a result of globalization.

<b>Level 0:</b>	No valid discussion.	<b>0</b>
<b>Level 1:</b>	Very few points recognized with little or no valid discussion.	<b>1-2</b>
<b>Level 2:</b>	A few points recognized with some attempt at discussion or just one issue developed fully.	<b>3-4</b>
<b>Level 3:</b>	A range of issues discussed in reasonable depth. The candidate must also show an awareness of alternative viewpoints and engage in some sensible evaluation.	<b>5-7</b>



## 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) **What are the main characteristics of a free market economy and a centrally planned economy?** *[10 marks]*

#### **Centrally-planned economy**

- all decisions about what to produce, how to produce and for whom to produce are made by central planners
- state ownership of factors of production
- responses may note what is **absent** in a CPE such as profits, incentives, competition, role of prices in allocating resources
- motive for production is social welfare, rather than profit

#### **Free-market economy**

- all decisions about what to produce, how to produce and for whom to produce are made according to the price mechanism
- no government intervention
- profit motive provides incentives
- private ownership of factors of production
- responses may note the existence of market failure

Responses may certainly be awarded full marks even if not all points are covered. There is no obligation to discuss disadvantages of each system.

- (b) **Evaluate the possible consequences that may be encountered when an economy makes a transition from central planning towards a free market.** *[15 marks]*

Responses are likely to discuss the following:

On the negative side

- **inflation**, as a result of shortages which occur because choices are being made by consumers, rather than the government.
- **unemployment**, as a result of privatization and increased competition. Increased competition arises as a markets open up to trade and FDI.
- **income inequality**, through the introduction of market forces.
- growth of **parallel markets**, resulting from shortages.
- possibility of budget deficit and trade deficit.

On the positive side

- greater efficiency
- wider competition
- increased trade and FDI.

Responses should make use of examples, possibly noting differences between Asian transition economies, Eastern European transition economies and developing country transition economies.

#### Question 4

**Discuss the possible consequences that might occur when a government attempts to reduce inflation.**

*[25 marks]*

- Responses should include a definition of inflation and note that there are several causes.
- Better responses will note that the policies used to reduce inflation will depend on the cause of inflation.
- Government attempts to reduce inflation will include deflationary monetary and fiscal policies as well as supply side policies.

If solution is deflationary monetary policy (higher interest rates), consequences include

- higher loan repayments
- lower purchasing power of income
- appreciation of currency reducing competitiveness of exports, leading to trade balance problems
- decreased investment, with negative implications for economic growth.

If solution is deflationary fiscal policy (higher taxes and decreased government spending), consequences include

- lower disposable income
- less consumption
- disincentive effect
- fall in spending on health and education and other public/merit goods.

If solution is supply-side policies, consequences include

- increased efficiency
- reduced trade union power
- reduced social security benefits
- greater privatization
- more competition
- increased flexibility in labour markets.

Responses should note that the deflationary policies are likely to lead to increased unemployment. There might be some reference to the trade-off between inflation and unemployment and the Phillips curve.

**Question 5**

**(a) What might cause a depreciation of a country's currency?**

**[10 marks]**

Responses should begin with a definition of depreciation as a fall in the value of one currency with respect to another in a floating exchange rate system.

Depreciation can come about as a result of an increase in the supply of a currency. This may be caused by

- increased spending on imports (visible and/or invisible)
- capital outflows in response to higher interest rates abroad
- capital outflows caused by speculation
- capital flights in LDCs.

Depreciation can come about as a result of a fall in the demand for a currency. This may be caused by

- decrease in demand for exports (visible and/or invisible) because of relatively higher inflation rates.
- decrease in demand for exports (visible and/or invisible) because of changes in tastes abroad.

Responses should be expected to produce a supply and demand diagram to show depreciation.

**(b) Discuss whether a country benefits more from a low value of its currency or a high value of its currency.**

**[15 marks]**

Responses should include a discussion of the change in the value of a currency on exporters, importers, consumers, government.

Better responses will carry the argument through to an awareness of the broader macroeconomic issues of inflation (if exchange rate is low) and unemployment (if exchange rate is high) and discuss the implications of these/or government policies.

**Question 6**

- (a) What are the main types of aid available to less developed countries (LDCs)?** **[10 marks]**

Responses should introduce and explain at least three of the following in order to move above Level 2 *i.e.* be awarded more than **[5 marks]**. Three well-developed examples can obtain full marks.

- Bilateral aid – aid from one country to another.
- Multilateral aid – aid is given to international aid agencies, who then decide where the need is greatest.
- Grant aid – where money, food aid, or emergency relief is provided as a gift, with no repayment expected.
- Soft loans – loans that are given to LDCs at below-market rates of interest.
- Official aid – aid administered by governments or government agencies.
- Unofficial aid – administered by a non-governmental body, such as a charity.
- Tied aid – the recipient country has to agree to buy goods or services from the donor country.
- Mixed credits – MDCs lend LDCs money for the purchase of MDC exports at below-market prices. In effect, this is a mixture of a loan and an export subsidy.

- (b) To what extent is aid effective in terms of addressing the problems faced by LDCs?** **[15 marks]**

Responses must show awareness of both the positive and negative effects of aid. Good responses will distinguish between the effect of aid on growth and the effect of aid on development. Better responses will discriminate between the effects of **different** types of aid.

Positive effects might include:

- fill the “savings gap”, “investment gap” “technology gap”, “foreign exchange gap”
- NGO aid is more successful in contributing towards development.

Negative effects might include:

- displaces local producers
  - debt service problems
  - dependency culture
  - corruption – misuse of aid
  - contributes to military struggle
  - tends to focus on urban areas reinforcing income inequalities and worsening rural-urban migration
  - food aid damaging to domestic agriculture.
-