

MARKSCHEME

May 2005

ECONOMICS

Standard Level

Paper 1

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Paper Specific Markscheme

In addition to the assessment criteria, use the paper-specific markscheme below. Award up to the maximum marks indicated. Examiners should be aware that candidates may take a different approach, which if appropriate should be fully rewarded.

1. (a) **Explain how a buffer stock system might be used to stabilize agricultural prices.** **[10 marks]**

- definition of buffer stock system
- explanation of the reasons for the existence of buffer stock systems
- explanation of the instability of agricultural prices through inelastic demand and supply, along with the unpredictable nature of the supply side in agriculture
- explanation of how a buffer stock system works in terms of minimum and maximum prices and intervention buying and selling
- correct application of the buffer stock diagram

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- (b) **Discuss the view that intervention in agricultural markets causes more problems than it solves.** **[15 marks]**

Points for discussion might include:

- the different forms of intervention
 - commodity agreements
 - minimum/maximum price controls
 - buffer stock schemes
 - fair trade schemes
 - subsidies
 - protectionism *e.g.* tariffs
- the arguments for intervention
 - stabilize prices
 - provide a stable income for producers
 - combat falling agricultural commodity prices for producers
 - protect employment in agriculture
 - ensure adequate food supplies
 - provide affordable, stable prices for consumers
 - prevent rural depopulation
 - reduce balance of payments problems
- the arguments against intervention
 - interference in the price mechanism can cause a misallocation of resources, *e.g.* shortages and surpluses
 - costs of operating buffer stock schemes, *e.g.* storage costs, management costs, setting a target price, perishable goods
 - problems of enforcing commodity agreements
 - the financial cost of providing agricultural subsidies

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2. (a) Describe the main causes of inflation.

[10 marks]

- definition of inflation
- explanation of the cost push causes of inflation
 - rising unit labour costs
 - rising raw materials costs, *e.g.* rising oil price
 - rising capital costs
 - profiteering by businesses
- explanation of the demand pull causes of inflation
 - rising consumer demand
 - expansionary fiscal policy
 - expansionary monetary policy
- correct application of AD and AS diagram to illustrate the causes of inflation

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(b) **“If inflation is a major problem faced by governments it must follow that the opposite, deflation, is desirable.” To what extent do you agree with this statement?**

[15 marks]

Points for discussion might include:

- definition of deflation
- distinction between inflation and deflation
- the consequences of inflation on:
 - re-distribution of income *e.g.* fixed incomes, borrowers and lenders
 - business investment
 - economic growth and development
 - international competitiveness
 - menu costs
 - shoe leather costs
- beneficial effects of inflation *e.g.* business profitability
- the consequences of deflation on:
 - economic growth and development
 - unemployment
 - impact on borrowers and lenders
 - business profitability
 - international competitiveness
- beneficial effects of supply side deflation

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3. (a) Describe *three* possible economic consequences of a persistent current account deficit for a country. [10 marks]

- explanation of balance of payments current account deficit
- explanation of the possible consequences of a current account deficit:
 - cost of financing a deficit
 - depletion of foreign exchange reserves
 - cost of running a capital account surplus
 - interest payments on borrowing
 - reduced AD and economic growth
 - depreciation of the exchange rate
 - as an indicator of underlying lack of business competitiveness
 - on government policy *e.g.* increased protectionism
 - problems of import penetration *e.g.* unemployment
- for one consequence described: maximum level 1 awarded
- for two consequences described: maximum level 2 awarded

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(b) Evaluate different methods of correcting a current account deficit. [15 marks]

Points for discussion might include considering advantages and disadvantages of:

- expenditure reducing policies *e.g.* contractionary fiscal and monetary policy
- expenditure switching policies *e.g.* devaluation of the exchange rate, depreciation
- supply side policies to improve business efficiency *e.g.* deregulation of markets
- policies to promote exports *e.g.* subsidies
- policies to reduce imports *e.g.* protectionism

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4. (a) **Explain the main characteristics of a market economy.** [10 marks]

Points for explanation might include:

- consumer sovereignty
- private ownership of the means of production
- the profit motive
- self interest
- competition between firms
- allocation of resources through the interaction of supply and demand
- signalling, rationing through the price mechanism
- free international trade
- the difference between the pure market economy and the mixed market economy

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(b) **Evaluate the proposition that economic development is best achieved through the market system.** [15 marks]

Points for discussion might include:

- definition of economic development
- the advantages of the market system in terms of enhancing development
 - more efficient resource allocation
 - greater productivity
 - greater consumer choice
 - increased business competitiveness
 - export led economic growth
 - problems of state planning/interventionist policies
- the disadvantages of the market system in terms of enhancing development
 - under provision of merit goods
 - over provision of demerit goods
 - positive and negative externalities
 - under provision of public goods
 - income inequality
- benefits of alternative development strategies
 - inward-orientated strategies *e.g.* import substitution
 - state planning/interventionist policies.

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