

MARKSCHEME

May 2006

ECONOMICS

Standard Level

Paper 1

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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) The basic economic problem is one of scarcity of productive resources.

Explain how resources are allocated between competing uses in a market economy.

[10 marks]

Answers may include:

- an explanation of the economic problem in terms of consumer wants being greater than scarce resources.
- an outline of the different productive resources/factors of production
- a description of the characteristics of a market economy, *e.g.* private capital, limited role of government, consumer sovereignty, *etc.*
- an explanation of the role of the price mechanism in the allocation of resources through:
 - the interaction of demand and supply
 - the signalling function of price
 - the incentive function of price
 - the rationing function of price
- an explanation of the role of profit in allocating resources
- use of correct diagrams, *e.g.* demand and supply, production possibility frontiers, *etc.*

(b) Discuss the view that there is strong justification for government intervention in the market for health care.

[15 marks]

It is important to mark this question with an understanding that candidates will live in countries, which have a variety of different types of healthcare system and their answers may reflect this.

For the view that there is strong justification for government intervention in the market for healthcare answers may include a discussion of:

- types of government intervention: state provision, subsidies, compulsory health insurance, maximum price of healthcare products, regulation of healthcare providers, *e.g.* licensing of drugs, care as a merit good
- underprovision of healthcare as a merit good market failure
- the positive externalities associated with health care, *e.g.* productive workforce
- under-provision of healthcare to the less well-off people in society
- the provision of healthcare education and information, *e.g.* HIV, diet, contraception, *etc.*
- the importance of government planning in healthcare, *e.g.* future provision of health resources
- the correct use of MSC/MSB diagrams to illustrate the need for government intervention in healthcare.

The arguments against government intervention in healthcare may include the discussion of:

- higher taxation to pay for state provision
- the opportunity cost of resources for other areas of government intervention *e.g.* education
- inefficiency of state provision, *e.g.* bureaucracy, political decision making, *etc.*
- the problem for government of judging and meeting the socially efficient level of output for healthcare
- how free markets may lead to a more efficient provision of healthcare through the interaction of demand and supply (signalling and incentive functions of price)

For an evaluative approach candidates should consider the advantages and disadvantages of Government intervention.

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2. (a) **Identify the components of aggregate demand and briefly explain two factors which might determine each of these components.** [10 marks]

Answers may include:

- a definition of aggregate demand(AD)
- a definition of the components of AD: Consumption, Investment, Government Expenditure, Exports – Imports(net Exports), (candidates may use C+I+G+X which is rewarded in the same way)
- an explanation of any two factors that determine:
 - consumption *e.g.* real income, consumer confidence, interest rates and availability of credit, attitudes to saving, wealth, *etc.*
 - investment factors *e.g.* business expectations, interest rates, level of profit, available finance(level of savings)
 - government spending *e.g.* political priorities (improve public services, defence *etc.*) rate of economic growth, unemployment/inflation, tax revenue
 - exports minus imports *e.g.* rate of economic growth, exchange rate changes, domestic producer efficiency, foreign producer efficiency, changes in the terms of trade, protectionism

It is important to award candidates for showing an understanding of the factors which affect AD rather than just listing factors. Where candidates just write list factors the maximum mark should be level 2.

- (b) **Evaluate the likely impact on an economy of a substantial rise in the level of interest rates.** [15 marks]

Answers may include a discussion of the impact of a rise in interest rates on:

- consumption spending
- saving rates
- investment spending
- government spending(government borrowing costs increase)
- rate of inflation

- level of unemployment
- rate of economic growth
- balance of payments
- current account (imports and exports)
- capital account (capital flows)
- exchange rates
- use of AD/AS analysis to illustrate impact of shifts of AD/AS:
reducing AD(reducing C, I, *etc.*)
reducing AS(increasing costs of production)
- for an evaluative approach candidates may discuss:
 - costs and benefits of higher interests rates
 - the short and long term consequences higher interest rates
 - the significance of the impact of higher interest rates on different factors

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3. (a) **Explain how changes in a country's exchange rate may occur under a floating exchange rate system.** [10 marks]

Answers may include:

- definition of exchange rate
- an explanation of floating exchange rate system
- an explanation of how changes in demand for the currency affect the exchange rate, *e.g.* exports, travel and tourism, capital inflows, speculation, inflation, *etc.*
- an explanation of how changes in the supply of the currency affect the exchange rate, *e.g.* imports, travel and tourism, capital outflows, speculation, inflation rate, *etc.*
- a description of how government may intervene to manage the exchange rate *e.g.* direct investment, interest rates
- use of correct diagrams to illustrate how changes in demand and supply affect the exchange rate.

- (b) **Discuss the view that exchange rate changes are the most important factor in determining a country's export sales.** [15 marks]

Answers may include a discussion of:

- the impact of exchange rate changes on the price of and demand for exports
- the influence of price elasticity of demand on export sales
- importance of other factors affecting exports sales such as:
 - non-price factors *e.g.* quality of products
 - efficiency of domestic producers
 - comparative advantage
 - degree of protectionism
 - world economic growth
 - membership of a trading bloc
 - rate of inflation

For an evaluative approach candidates may discuss

- the relative importance of the different factors affecting export sales
- the short run and long run determinants of export sales
- make a judgment on the importance of the exchange rate affecting export sales compared to other factors

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4. (a) **Explain how an increase in the quantity and quality of a nation's factors of production can promote economic development.** [10 marks]

Answers may include:

- definition of factors of production
- definition of economic development
- explanation of an increase in the quantity of resources *e.g.* discovery of oil, new labour supply through immigration
- the impact of an increase in the quantity of resources on productive capacity, economic growth, and economic development
- explanation of an increase in the quality of resources *e.g.* new technology, educated labour, *etc.*
- the impact of an increase in the quality of resources on development *e.g.* the use of improved health and education programmes, reduction in poverty *etc.*

- (b) **Evaluate the impact of globalization on the economic development of developing countries.** [15 marks]

Answers may include a discussion of:

- features of developing countries
- the nature of globalization
- evaluation of the impact of globalization on
 - free trade
 - FDI by MNCs
 - liberalisation of capital markets
 - greater labour mobility
 - the transfer of knowledge and technology
 - income and wealth inequality
 - increased industrialisation and urbanisation
 - greater tourism
 - protectionism in developed countries

For an evaluative approach candidates may discuss

- the advantages and disadvantages of globalization
- the relative importance of the different consequences of globalization
- the short and long run consequences of globalization

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