

MARKSCHEME

November 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 as indicated.

1. (a) **Explain why underprovision of merit goods in an economy is considered to be a market failure.** [10 marks]

Candidates **may** include any of the following:

- definition of market failure
- definition of merit good
- explanation of positive externalities
- how the underprovision of merit goods leads to market failure
- diagram of underprovision of merit goods
- example of merit goods
- social benefits and marginal social benefits

Examiners should be aware that candidates may take a different approach, which if appropriate should be rewarded.

- (b) **Evaluate the possible measures that a government might use to correct such a market failure.** [15 marks]

Candidates **may** include any of the following:

- government financing the production of the good
- direct provision of merit goods
- subsidies
- legislation to make consumption of the good or service mandatory
- advertising to encourage consumption

Candidates may illustrate government measures with examples.

Examiners should be aware that candidates may take a different approach, which if appropriate should be rewarded.

Effective evaluation may be to:

- consider short run versus long run consequences
- examine the impact on different stakeholders
- discuss advantages and disadvantages
- prioritize the arguments

2. (a) **Explain the following different types of unemployment:** *[10 marks]*

- **frictional unemployment:** search time workers experience between jobs
- **structural unemployment:** mismatch of skills between unemployed and available work
- **cyclical/demand-deficient unemployment:** in a recession or because of falling AD
- **real wage/classical unemployment:** when real wages are pushed above the market clearing level by minimum wages

(b) **Evaluate the effectiveness of the different measures available to governments to deal with the types of unemployment in (a).** *[15 marks]*

Candidates **may** include any of the following:

- explanation of how demand management can be used to reduce cyclical/demand-deficient unemployment
- discussion of the problems associated with expansionary fiscal and monetary policy: *e.g.* inflation, time lags, export competitiveness
- explanation of how supply-side policies can be used to reduce the other three types of unemployment
- discussion of the problems associated with supply-side policies: *e.g.* less protection for workers, time lags, cost and effectiveness of policies

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Effective evaluation may be to:

- consider short run versus long run consequences
- examine the impact on different stakeholders
- discuss advantages and disadvantages
- prioritize the arguments

3. (a) **Explain the reasons why countries trade with each other.** *[10 marks]*

Candidates **may** include any of the following:

- differences in factor endowments
- variety and quality of goods
- gains from specialization
- political considerations
- learning about new production techniques and technology

No need to mention “comparative advantage” for full marks.

Examiners should be aware that candidates may take a different approach, which if appropriate should be rewarded.

(b) **Given the benefits of trade, evaluate the economic arguments in favour of protectionism.** *[15 marks]*

Candidates **may** include any of the following:

- infant industry argument
- efforts of a developing country to diversify
- protection of employment
- source of government revenue
- strategic arguments
- means to overcome a balance of payments disequilibrium
- anti-dumping
- maintenance of health, safety and environmental standards

Examiners should be aware that candidates may take a different approach, which if appropriate should be rewarded.

Effective evaluation may be to:

- consider short run versus long run consequences
- examine the impact on different stakeholders
- discuss advantages and disadvantages
- prioritize the arguments

4. (a) **Explain why a firm may benefit from becoming a multinational corporation.** *[10 marks]*

Candidates **may** include any of the following:

- definition of multinational corporation
- examples of MNCs
- access to new markets
- access to cheap resources
- reduce transport costs
- take advantage of less regulations
- transfer pricing

Examiners should be aware that candidates may take a different approach, which if appropriate should be rewarded.

- (b) **Evaluate the effectiveness of Foreign Direct Investment (FDI) as a means of achieving economic growth and economic development in a less developed country.** *[15 marks]*

- definition of FDI
- understanding of difference between economic growth and economic development

Candidates **may** include any of the following possible advantages of FDI:

- fills saving gap
- fills foreign exchange gap resulting from deficit on current account of the balance of payments
- fills revenue gap by taxing MNC activities
- transfer of technology from MDC to LDC
- increased demand for local labour resources
- training opportunities for local workers
- reduced unemployment in LDC
- extra goods for consumption and for export will be produced
- local suppliers will be used by MDC to source supplies
- source of capital for LDC which stimulates growth

Candidates **may** include any of the following possible disadvantages of FDI:

- loss of sovereignty by host nation
- dependence of host nation on activities of MNC
- repatriation of profits by MNC
- exploitation of local labour force – low wages and poor working conditions
- may drive out local businesses
- dual economies result
- income inequalities due to widening wage differentials in urban and rural areas
- capital intensive technology rather than labour-intensive technology limits benefits to host country
- MNCs exert political control to influence government policy
- environmental degradation

Advantages and disadvantages of FDI should be related to growth **and** development.

Examiners should be aware that candidates may take a different approach, which if appropriate should be rewarded.

Effective evaluation may be to:

- consider short run versus long run consequences
 - examine the impact on different stakeholders
 - discuss advantages and disadvantages
 - prioritize the arguments
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