



MARKSCHEME

November 2006

ECONOMICS

Standard Level

Paper 2

*This markscheme is **confidential** and for the exclusive use of examiners in this examination session.*

*It is the property of the International Baccalaureate and must **not** be reproduced or distributed to any other person without the authorization of IBCA.*

In addition to the assessment criteria use the paper-specific markscheme below. Award up to the maximum marks as indicated.

1. (a) Define the following terms indicated in bold in the text:

(i) negative externalities (paragraph ①) [2 marks]

level

0 *Wrong definition* **0**

1 *Vague definition* **1**

The idea that they are bad consequences.

2 *Precise definition* **2**

An explanation that they are the “bad” effects that are suffered by a third party when a good or service is produced or consumed.

(ii) demand (paragraph ⑦). [2 marks]

level

0 *Wrong definition* **0**

1 *Vague definition* **1**

The idea that it is how much is bought of a good or service at a certain price.

2 *Precise definition* **2**

An explanation that it is the willingness and ability to purchase a quantity of a good or service at a certain price over a given time period.

(b) Using an appropriate diagram, explain how cigarette smoking is an example of market failure. **[4 marks]**

level

0 *Inappropriate answer* **0**

1 *Identification of appropriate theory* **1-2**

For drawing a correctly labelled externalities diagram, where the consumer’s marginal private benefit curve for cigarettes is to the right of the marginal social benefit curve, causing a negative externality **or** for providing an explanation of how the consumption of cigarettes has negative benefits for others, which the smoker does not have to pay for.

2 *Correct application of appropriate theory* **3-4**

For drawing a correctly labelled externalities diagram, where the consumer’s marginal private benefit curve for cigarettes is to the right of the marginal social benefit curve, causing a negative externality **and** for providing an explanation of how the consumption of cigarettes has negative benefits for others, which the smoker does not have to pay for.

If candidates are unaware of the difference between externalities of production and consumption, they may draw a negative externality of production but, if the explanation is correct, then they should be fully rewarded.

(c) Using evidence from the text, explain which group of consumers has the lower price elasticity of demand for cigarettes – adults or young people. **[4 marks]**

level

0 *Inappropriate answer* **0**

1 *Identification of appropriate theory* **1-2**

For explaining that adults have lower price elasticity of demand for cigarettes than young people.

2 *Correct application of appropriate theory* **3-4**

For explaining that adults have lower price elasticity of demand for cigarettes than young people and for supporting this statement with evidence from the text, where the PED for cigarettes is 0.7 for young people and 0.4 for adults.

(d) Using information from the text and your knowledge of economics, evaluate *two* possible methods of reducing the external costs of smoking.

[8 marks]

Responses **may** include:

- higher taxes
- banning smoking
- anti-smoking advertising campaigns
- Government sponsored help campaigns
- health education
- legislation (*e.g.* health warnings on cigarette packets, age restrictions and place restrictions)
- any reasonable answer.

Candidates who incorrectly label diagrams cannot be rewarded with full marks.

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

If there is no direct reference to the data, then candidates may not be rewarded beyond Level 2.

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

Level

0	No valid discussion.	0
1	Few relevant concepts recognized. Little discussion or only basic understanding.	1-2
2	Relevant concepts recognized and developed in reasonable depth. Some attempt at application and analysis.	3-5
3	Relevant concepts developed in reasonable depth, demonstrating effective evaluation, supported by appropriate evidence or theory.	6-8

2. (a) Define the following terms indicated in bold in the text:

(i) **monetary policy** (*paragraph ③*) [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1

The idea that it is controlling the money supply in some way.

2 *Precise definition* 2

An explanation that it is a demand-side policy to control the money supply or alter interest rates.

(ii) **consumption** (*paragraph ⑦*). [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1

The idea that it is to do with spending by individuals and households.

2 *Precise definition* 2

An explanation that it is spending by individuals and households on consumer goods and services over a period of time.

(b) Using an AD/AS diagram, explain the type of inflation that the New Zealand economy is facing. [4 marks]

level

0 *Inappropriate answer* 0

1 *Identification of appropriate theory* 1-2

For drawing a correctly labelled aggregate demand and supply diagram, where the aggregate demand curve shifts to the right **or** for providing an explanation of how the inflation is demand-pull inflation, stemming from increased demand in the economy because spending power has risen with greater employment.

2 *Correct application of appropriate theory* 3-4

For drawing a correctly labelled aggregate demand and supply diagram, where the aggregate demand curve shifts to the right **and** for providing an explanation of how the inflation is demand-pull inflation, stemming from increased demand in the economy because spending power has risen with greater employment.

It is possible that candidates could go for a cost-push explanation, because of the higher wage rates. If an appropriate diagram is provided and it is explained properly, then this should be fully rewarded.

There may be different labelling used to show the above, and any appropriate labelling may be fully rewarded.

(c) Using an appropriate diagram, explain how the New Zealand dollar has been affected by the increased interest rate. [4 marks]

level

0 *Inappropriate answer* 0

1 *Identification of appropriate theory* 1-2

For drawing a correctly labelled demand and supply diagram for the New Zealand dollar, where the demand curve shifts to the right **or** for providing an explanation of how the higher interest rate will lead to an inflow of speculative funds, increasing the demand for the New Zealand dollar and raising the exchange rate.

2 *Correct application of appropriate theory* 3-4

For drawing a correctly labelled demand and supply diagram for the New Zealand dollar, where the demand curve shifts to the right **and** for providing an explanation of how the higher interest rate will lead to an inflow of speculative funds, increasing the demand for the New Zealand dollar and raising the exchange rate.

For full marks the y-axis must be accurately labelled – e.g. price of New Zealand dollar, or price of New Zealand dollar measured in other currencies.

- (d) **Using information from the text and your knowledge of economics, evaluate the likely effects of the further tightening of monetary policy on the New Zealand economy.**

[8 marks]

Responses **may** include:

- reduced consumer demand
- increased unemployment
- higher costs for firms
- reduced investment
- an appreciation of the exchange rate, with all that entails
- reduction in inflationary pressure
- any reasonable answer

Candidates who incorrectly label diagrams cannot be rewarded with full marks.

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

If there is no direct reference to the data, then candidates may not be rewarded beyond Level 2.

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

Level

0	No valid discussion.	0
1	Few relevant concepts recognized. Little discussion or only basic understanding.	1-2
2	Relevant concepts recognized and developed in reasonable depth. Some attempt at application and analysis.	3-5
3	Relevant concepts developed in reasonable depth, demonstrating effective evaluation, supported by appropriate evidence or theory.	6-8

3. (a) Define the following terms indicated in bold in the text:

(i) **economic growth** [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1

The idea that it is a growth of economic activity in the economy.

2 *Precise definition* 2

An explanation mentioning increased real output for an economy over time and measured as an increase in real GDP. Alternatively, it may be explained as an increase in the potential output of the economy through an increase in the quantity/quality of resources.

(ii) **current account surplus.** [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1

The idea that it is where imports are less than exports.

2 *Precise definition* 2

An explanation that it is where revenues from the exports of goods and services are greater than the spending on the imports of goods and services. The impact of investment, income and net transfers may be included, but are not necessary for both marks.

(b) **Using an appropriate diagram, explain how Canada's current account balance is likely to have affected the Canadian dollar.** [4 marks]

level		0
0	<i>Inappropriate answer</i>	1-2
1	<i>Identification of appropriate theory</i> For drawing a correctly labelled demand and supply diagram for the Canadian dollar, where the demand curve shifts to the right causing an increase in the exchange rate or for providing an explanation of how a positive current account balance implies a higher value of exports compared to imports and so an increase in the demand for the Canadian dollar, raising its exchange rate.	3-4
2	<i>Correct application of appropriate theory</i> For drawing a correctly labelled demand and supply diagram for the Canadian dollar, where the demand curve shifts to the right causing an increase in the exchange rate and for providing an explanation of how a positive current account balance implies a higher value of exports compared to imports and so an increase in demand for the Canadian dollar, raising its exchange rate.	

There may be different diagrams and/or labelling used to show the above, and any appropriate diagram and/or labelling may be fully rewarded.

For full marks the y-axis must be accurately labelled – e.g. price of Canadian dollar, or price of Canadian dollar measured in other currencies.

(c) Using an AD/AS diagram, explain *one* possible reason for the increase in GDP suggested by the data. [4 marks]

level

- | | | |
|---|---|-----|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
For drawing a correctly labelled aggregate demand and supply diagram, where the aggregate demand curve shifts to the right, leading to greater domestic output or for providing an explanation of any factor that would cause this increase in AD, such as the falling unemployment or the current account surplus. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing a correctly labelled aggregate demand and supply diagram, where the aggregate demand curve shifts to the right, leading to greater domestic output and for providing an explanation of any factor that would cause this increase in AD, such as the falling unemployment or the current account surplus. | 3-4 |

Candidates may shift SRAS to the right as a consequence of lower import prices for raw materials due to the strong dollar and this may be fully rewarded.

There may be different diagrams and/or labelling used to show the above, and any appropriate diagram and/or labelling may be fully rewarded.

(d) Using information from the text and your knowledge of economics, evaluate *two* supply-side policies that the Canadian government could use to reduce the unemployment rate.

[8 marks]

Responses **may** include any of the following measures which would increase labour force participation.

Interventionist:

- provision of education/retraining
- improving the flow of information
- any reasonable answer.

Non-interventionist:

- reducing unemployment benefits
- reducing trade union power
- reducing high marginal income tax rates
- any reasonable answer.

Candidates who incorrectly label diagrams cannot be rewarded with full marks.

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

If there is no direct reference to the data, then candidates may not be rewarded beyond Level 2.

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

Level

0	No valid discussion.	0
1	Few relevant concepts recognized. Little discussion or only basic understanding.	1-2
2	Relevant concepts recognized and developed in reasonable depth. Some attempt at application and analysis.	3-5
3	Relevant concepts developed in reasonable depth, demonstrating effective evaluation, supported by appropriate evidence or theory.	6-8

4. (a) Define the following terms indicated in bold in the text:

(i) dumping (paragraph 2) **[2 marks]**

level

0 *Wrong definition* **0**

1 *Vague definition* **1**
The idea that it is selling of cheap goods abroad.

2 *Precise definition* **2**
An explanation that it is the selling of a good in another country at a price below its cost of production.

(ii) deteriorating terms of trade (paragraph 4). **[2 marks]**

level

0 *Wrong definition* **0**

1 *Vague definition* **1**
The idea that it is to do with the prices of exports and imports.

2 *Precise definition* **2**
An explanation that it is where the average price of exports falls relative to the average price of imports, or making it more expensive to buy imports, in terms of exports that need to be sold. The equation would also be acceptable, with an example.

- (b) **Using an appropriate diagram, explain how the granting of subsidies to EU sugar producers will give them an advantage over other producers.** [4 marks]

level

- | | | |
|---|---|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
For drawing a correctly labelled demand and supply diagram, where the domestic supply curve for sugar shifts to the right because of the subsidy, leading to greater domestic output or for providing an explanation of how the subsidy on sugar will lead to domestic producers being able to sell at a lower price than other producers, thus giving a trade advantage. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing a correctly labelled demand and supply diagram, where the domestic supply curve for sugar shifts to the right because of the subsidy, leading to greater domestic output and for providing an explanation of how the subsidy on sugar will lead to domestic producers being able to sell at a lower price than other producers, thus giving a trade advantage. | 3-4 |

There are a number of diagrams that may be used to show the above and any appropriate diagram may be fully rewarded. For example, candidates may show the situation on a diagram comparing EU costs with other producers.

(c) **Using an appropriate diagram, explain how the high tariffs on refined sugar harm developing countries.** [4 marks]

level

- | | | |
|---|---|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
For drawing a correctly labelled demand and supply diagram, including domestic (EU) demand and supply curves for refined sugar and the world supply curve for sugar, which is being raised by tariffs, reducing developing country exports or for providing an explanation of how a tariff on developing country exports of refined sugar to the EU raises their price and therefore causes a fall in their exports and their export revenue. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing a correctly labelled demand and supply diagram, including domestic (EU) demand and supply curves for refined sugar and the world supply curve for sugar, which is being raised by tariffs, reducing developing country exports and for providing an explanation of how a tariff on developing country exports of refined sugar to the EU raises their price and therefore causes a fall in their exports and their export revenue. | 3-4 |

There may be different diagrams and/or labelling used to show the above, and any appropriate diagram and/or labelling may be fully rewarded.

- (d) **Using information from the text and your knowledge of economics, evaluate the statement that, “maintaining the current sugar regime is a situation that, in the long run, is bad for both Europe and the developing world” (paragraph 5).**

[8 marks]

Responses **may** include:

Advantages for Europe:

- provides jobs for European workers
- costs of production are lower for producers
- increases national incomes
- reduces competitions

Long run problems for Europe:

- the cost of the scheme – tax payers’ burden
- consumers paying higher than necessary prices
- the encouragement of inefficiency
- eventual retaliation
- any reasonable answer

Long run problems for the developing world:

- loss of export revenues and thus foreign currencies
- the collapse of local production
- unemployment
- lack of economic growth
- any reasonable answer

Candidates who incorrectly label diagrams cannot be rewarded with full marks.

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

If there is no direct reference to the data, then candidates may not be rewarded beyond Level 2.

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

Level

0	No valid discussion.	0
1	Few relevant concepts recognized. Little discussion or only basic understanding.	1-2
2	Relevant concepts recognized and developed in reasonable depth. Some attempt at application and analysis.	3-5
3	Relevant concepts developed in reasonable depth, demonstrating effective evaluation, supported by appropriate evidence or theory.	6-8

5. (a) Define the following terms indicated in bold in the text:

(i) foreign direct investment (paragraph ③) *[2 marks]*

level

0 *Wrong definition* **0**

1 *Vague definition*
The ideas that it is investment coming from overseas. **1**

2 *Precise definition*
An explanation that it is investment by multinational corporations in another country. **2**

(ii) investment (paragraph ④). *[2 marks]*

level

0 *Wrong definition* **0**

1 *Vague definition*
The idea that it is spending on machines by firms. **1**

2 *Precise definition*
An explanation that it is expenditure by firms on capital equipment. It is an injection into the economy. **2**

(b) Explain how allowing differences in purchasing power may give a more realistic value of the average GDP per head in India. [4 marks]

level

0 *Inappropriate answer* **0**

1 *Identification of appropriate theory* **1-2**

For explaining that allowances for differences in purchasing power, shows the GDP per head of the population taking into account the local prices in the country.

2 *Correct application of appropriate theory* **3-4**

For explaining that allowances for differences in purchasing power, shows the GDP per head of the population taking into account the local prices in the country and for going on to explain that prices in India are very low and so average GDP figures, which are usually expressed in US dollars will, in fact, buy a lot more than in many other countries.

(c) Using an appropriate diagram, explain how the government could help to protect farmers against fluctuating prices. [4 marks]

level

0 *Inappropriate answer* **0**

1 *Identification of appropriate theory* **1-2**

For drawing a correctly labelled demand and supply diagram, where a buffer stock scheme has been implemented **or** for providing an explanation of how a buffer stock scheme could be put into place, where the government buys up surpluses in good years and sells from stocks in bad years, in order to stabilise prices.

2 *Correct application of appropriate theory* **3-4**

For drawing a correctly labelled demand and supply diagram, where a buffer stock scheme has been implemented **and** for providing an explanation of how a buffer stock scheme could be put into place, where the government buys up surpluses in good years and sells from stocks in bad years, in order to stabilise prices.

There may be different diagrams and/or labelling used to show the above, and any appropriate diagram and/or labelling may be fully rewarded.

- (d) **Using information from the text and your knowledge of economics, evaluate the effectiveness of adopting an outward oriented strategy to achieve economic development.**

[8 marks]

Candidates should explain outward oriented strategy and economic development.

Responses **may** include:

- a fall in the proportion of people living below the poverty line in India
- the increase in GDP per head in India
- the increase in growth rates in India
- the 36 per cent increase in HDI in India
- greater consumer choice
- higher growth rates do not necessarily lead to an increase in economic development
- issues relating to FDI and MNCs
- the failure of import substitution policies
- access to foreign markets
- vulnerability resulting from dependence on foreign markets
- any reasonable response

Candidates who incorrectly label diagrams cannot be rewarded with full marks.

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

If there is no direct reference to the data, then candidates may not be rewarded beyond Level 2.

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

Level

0	No valid discussion.	0
1	Few relevant concepts recognized. Little discussion or only basic understanding.	1-2
2	Relevant concepts recognized and developed in reasonable depth. Some attempt at application and analysis.	3-5
3	Relevant concepts developed in reasonable depth, demonstrating effective evaluation, supported by appropriate evidence or theory.	6-8