

MARKSCHEME

November 2007

ECONOMICS

Standard Level

Paper 2

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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) Define the following terms indicated in bold in the text:

(i) economic growth (paragraph 5)	[2 marks]
level	
0 <i>Wrong definition</i>	0
1 <i>Vague definition</i> The idea that it is a growth of economic activity in the economy.	1
2 <i>Precise definition</i> 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.	2
(ii) sustainable development (paragraph 6).	[2 marks]
level	
0 <i>Wrong definition</i>	0
1 <i>Vague definition</i> The idea that it is related to the use of the world's resources.	1
2 <i>Precise definition</i> An explanation that it is the development needed to meet the needs of the present generation without compromising the ability of future generations to meet their own needs.	2

(b) Using an appropriate diagram, explain how the company’s mining of gold near Buyat Bay is a source 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 mine’s marginal private cost curve is to the right of the marginal social cost curve, causing a negative externality **or** for providing an explanation of how the mining company is causing pollution, which it does not have to pay for, so its private costs are less than social costs.

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

For drawing a correctly labelled externalities diagram, where the mine’s marginal private cost curve is to the right of the marginal social cost curve, causing a negative externality **and** for providing an explanation of how the mining company is causing pollution, which it does not have to pay for, so its private costs are less than social costs.

For an external costs diagram, labels could simply be price and quantity. Alternatively, the y-axis could be costs or costs and benefits.

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

(c) Using an appropriate diagram, explain how “appropriate ways to dispose of their waste” (*paragrah* ☺) would affect the Indonesian gold market. [4 marks]

level

0 *Inappropriate answer* **0**

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

For drawing a correctly labelled diagram, where the supply curve for gold is shifted to the left, reducing output and raising the price **or** for providing an explanation of how costs would be higher because of implementing the waste disposal processes, which would reduce output in the market and also raise the price.

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

For drawing a correctly labelled diagram, where the supply curve for gold is shifted to the left, reducing output and raising the price **and** for providing an explanation of how costs would be higher because of implementing the waste disposal processes, which would reduce output in the market and also raise the price.

There are a number of diagrams that may be used to show the above and any appropriate diagram may be fully rewarded.

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

- (d) Using information from the text and your knowledge of economics, evaluate the arguments for and against the “foreign direct investment” (paragraph 5).

[8 marks]

Responses **may** include:

- a definition of FDI

Arguments **for** FDI:

- FDI brings investments into countries where savings are difficult to build (as in Indonesia)
- FDI transfers technology to the host country
- FDI provides employment (paragraph 5)
- taxation of FDI contributes badly needed government revenue (paragraph 5)
- output of enterprises resulting from FDI contributes to increased exports and improved balance of payment prospects
- FDI creates demand for locally produced inputs
- may provide national, regional or local multiplier effects
- to attract FDI governments often invest in infrastructure, which has positive spin-offs in the rest of the economy

Arguments **against** FDI:

- tax incentives offered by the host government may outweigh the expected tax revenue from FDI
- output from foreign enterprises may drive local enterprises out of business
- local labour is exploited and high technical or executive posts are filled by foreign personnel
- FDI may solve short-run balance of payment difficulties but may also introduce long-run outflows of income in the form of profit repatriation
- FDI may bring in inappropriate technology
- FDI makes the host country vulnerable to MNC influence. Government attempts to tighten control of foreign enterprises may result in FDI leaving the country
- transfer pricing reduces potential tax revenue
- MNCs may not follow local laws/regulations – “waste had exceeded government regulations on legal limits for heavy metals (paragraph 2)
- FDI may produce negative externalities – “polluting the environment”, president has been accused of “allowing toxic waste to be put into the sea” (paragraph 1) – “villagers at Buyat Bay complained last year of illnesses that they said were the result of the mine’s operations” (paragraph 3) – “tumors, skin rashes and dizziness suffered by local residents” (paragraph 4).

As the main agents of FDI, some candidates may approach this question by referring to standard advantages and disadvantages of investments from MNCs, which is a legitimate and acceptable alternative.

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) **demand** (*paragraph ①*) [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.

(ii) **opportunity cost** (*paragraph ②*). [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1

The idea that there is something given up.

2 *Precise definition* 2

An explanation that it is the next best alternative foregone when an economic decision is made.

(b) Using an appropriate diagram, explain how the “tourism deficit” (paragraph 4) might affect the value of the UK currency. [4 marks]

level

0 Inappropriate answer 0

1 Identification of appropriate theory 1-2

For drawing a correctly labelled diagram, where the supply of the pound shifts to the right, as more foreign currencies are demanded, reducing the value of the pound or for providing an explanation of how the increase in travelling abroad, increases the demand for foreign currencies, thus increasing the supply of the pound on the international currency markets.

2 Correct application of appropriate theory 3-4

For drawing a correctly labelled diagram, where the supply of the pound shifts to the right, as more foreign currencies are demanded, reducing the value of the pound and for providing an explanation of how the increase in travelling abroad, increases the demand for foreign currencies, thus increasing the supply of the pound on the international currency markets.

Candidates who incorrectly label diagrams cannot be rewarded with full marks. It is not sufficient to simply write “price” on the vertical axis. The following are acceptable: “price of £ in other currencies”, “price of £” or simply “exchange rate”. It is sufficient to write “quantity” on the horizontal axis.

(c) Using information from the text, calculate the value of income elasticity of demand for foreign holidays and explain what the value signifies. [4 marks]

level

0 Inappropriate answer 0

1 Identification of appropriate theory 1-2

For correctly calculating the YED as being 2 (50 % / 25 %) or for providing an explanation of how an increase in income is leading to a greater proportional increase in the amount spent on holidays abroad, so that the income elasticity of demand for holidays is income elastic.

2 Correct application of appropriate theory 3-4

For correctly calculating the YED as being 2 (50 % / 25 %) and for providing an explanation of how an increase in income is leading to a greater proportional increase in the amount spent on holidays abroad, so that the income elasticity of demand for holidays is income elastic.

- (d) Using information from the text and your knowledge of economics, evaluate the possible effects of the expansion of airports and runways on the UK economy.

[8 marks]

Responses **may** include:

- growth because AD will increase due to investment spending by firms and the government (possible multiplier effect), “air travel is essential to the UK’s economic growth and to our continued prosperity” (*paragraph 3*)
- growth because AD may increase due to increased tourism by foreigners
- increased prosperity from higher income levels
- job creation – “helping to keep 200 000 jobs in the industry” (*paragraph 3*)
- increased inflationary pressure
- AD may decrease if it leads to an increase in tourism expenditure abroad
- AD may decrease, increase in withdrawals/leakages – “withdraw funds from the economy” (*paragraph 4*)
- growth because AD will increase due to investment... “air travel is essential to the UK’s economic growth and to our continued prosperity” (*paragraph 3*)
- the current account may deteriorate
- external costs to residents will increase – “there is much opposition to the proposed expansions to the airports... who pay the external costs of the huge boom in the industry” (*paragraph 7*)
- government may have to increase spending to reduce external costs
- increased expenditure by British tourists abroad, *ceteris paribus*, may lead to a depreciation of the British pound
- any reasonable answer.

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) **monetary policy** (*paragraph 1*) [2 marks]

level

0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that it is a policy that uses interest rates.	1
2	<i>Precise definition</i> An explanation that it is a demand-side policy to control the money supply or alter interest rates.	2

(ii) **depreciation** (*paragraph 3*). [2 marks]

level

0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that it is a fall in the value of a currency.	1
2	<i>Precise definition</i> An explanation that it is a fall in the value of one currency against another currency in a floating exchange rate system.	2

(b) Using an appropriate diagram, explain how Indonesia’s monetary policy on interest rates will prevent “the continued fall in the value of the Indonesian currency” (*paragraph 2*).

[4 marks]

level

0 *Inappropriate answer*

0

1 *Identification of appropriate theory*

1-2

For drawing a correctly labelled diagram, where the demand for the rupiah shifts to the right, raising its value **or** for providing an explanation of how “hot money” (short-term speculative money) will enter the economy, attracted by the higher interest rates and increasing the demand for the Indonesian currency.

2 *Correct application of appropriate theory*

3-4

For drawing a correctly labelled diagram, where the demand for the rupiah shifts to the right, raising its value **and** for providing an explanation of how “hot money” (short-term speculative money) will enter the economy, attracted by the higher interest rates and increasing the demand for the Indonesian currency.

For full marks, the y-axis must be accurately labelled, *e.g.* price of Indonesian rupiah or price of Indonesian rupiah in US\$.

Any valid alternative diagram and/or explanation may be fully rewarded.

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

(c) Using an appropriate diagram, explain how “the depreciation of the rupiah against the US dollar has added to inflationary pressures” (paragraph ③).

[4 marks]

level

0 *Inappropriate answer*

0

1 *Identification of appropriate theory*

1-2

For drawing a correctly labelled diagram, where the AS curve shifts to the left causing cost-push inflation **or** for providing an explanation of how a fall in the value of the rupiah will increase the cost of imported raw materials and components, thus raising the costs of firms and reducing supply.

2 *Correct application of appropriate theory*

3-4

For drawing a correctly labelled diagram, where the AS curve shifts to the left causing cost-push inflation **and** for providing an explanation of how a fall in the value of the rupiah will increase the cost of imported raw materials and components, thus raising the costs of firms and reducing supply.

Candidates may opt for explaining that the fall in the rupiah leads to an increase in demand for exports and a shift of the AD curve to the right. If explained properly, this may also gain full credit.

Candidates who incorrectly label diagrams cannot be rewarded with full marks. The vertical axis may be “price level” or “average price level”. The horizontal axis may be “output”, “national output”, “real national output” or “GDP”.

(d) Using information from the text and your knowledge of economics, evaluate the likely effects of higher interest rates on the Indonesian economy.

[8 marks]

Responses **may** include:

- fall in consumption as people borrow less, shifting AD to the left, reducing growth and employment
- fall in investment as firms borrow less, shifting AD to the left, reducing growth and employment
- fall in inflationary pressures (*paragraph 1*)
- effects on the exchange rate and thus imports and exports (*paragraph 2*)
- implications of falling investment on future growth rates (*paragraph 6*)
- impact on income distribution
- any reasonable answer

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) **fiscal policy** [2 marks]

level

- | | | |
|---|---|---|
| 0 | <i>Wrong definition</i> | 0 |
| 1 | <i>Vague definition</i>
The idea that it is a policy to do with government spending or taxation. | 1 |
| 2 | <i>Precise definition</i>
An explanation that it is the use of government spending and taxation to achieve government economic objectives. | 2 |

(ii) **unemployment rate.** [2 marks]

level

- | | | |
|---|---|---|
| 0 | <i>Wrong definition</i> | 0 |
| 1 | <i>Vague definition</i>
The idea that it is the number of people who are willing and able to work but do not have a job. | 1 |
| 2 | <i>Precise definition</i>
An explanation that it is the number of workers without a job, who are willing and able to work, expressed as a percentage of the workforce. | 2 |

(b) **With reference to oil prices, explain the likely reason for the size of Norway's current account balance, compared with the OECD average.** [4 marks]

level

- | | | |
|---|--|-----|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
For providing an explanation of how the increase in the price of oil will increase export revenues, since demand is inelastic, and thus contribute to Norway's large current account surplus or for explaining that most OECD countries are oil importers and so the OECD average current account balance will be negatively affected. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For providing an explanation of how the increase in the price of oil will increase export revenues, since demand is inelastic, and thus contribute to Norway's large current account surplus and for explaining that most OECD countries are oil importers and so the OECD average current account balance will be negatively affected. | 3-4 |

- (c) Using an appropriate diagram, explain the possible relationship that may exist between the change in the current account balance and the change in GDP between 2003 and 2004 in Norway.

[4 marks]

level

0 *Inappropriate answer*

0

1 *Identification of appropriate theory*

1-2

For drawing a correctly labelled AD/AS diagram, where the AD curve shifts to the right, thus raising output (GDP) in the economy **or** for providing an explanation of how increased net exports, being a determinant of AD, will lead to increased output in the economy.

2 *Correct application of appropriate theory*

3-4

For drawing a correctly labelled AD/AS diagram, where the AD curve shifts to the right, thus raising output (GDP) in the economy **and** for providing an explanation of how increased net exports, being a determinant of AD, will lead to increased output in the economy.

Candidates who incorrectly label diagrams cannot be rewarded with full marks. The vertical axis may be “price level” or “average price level”. The horizontal axis may be “output”, “national output”, “real national output” or “GDP”.

- (d) **Using information from the text and your knowledge of economics, evaluate policies that might be undertaken by the Norwegian government to increase the incentives to work, thus helping to solve “Norway’s fiscal problems”.**

[8 marks]

Responses **may** include:

- reducing benefits for the unemployed
- raise the retirement age
- introduce incentives to work beyond the retirement age
- reduce direct taxation to encourage people to work
- government training programmes
- removing/lowering any minimum wage
- any reasonable answer

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) **wages** (*paragraph 2*) [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1
The idea that they are money earned.

2 *Precise definition* 2
An explanation that they are payments made to the factor of production labour.

(ii) **anti-dumping** (*paragraph 3*). [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1
The idea that it is preventing the cheap selling of goods in another country.

2 *Precise definition* 2
An explanation that it is government legislation to prevent the selling of an imported good at a price below its cost of production.

(b) With the help of an appropriate diagram, show how the proposed tariff would affect the price and level of bicycle imports. [4 marks]

level

- 0 *Inappropriate answer* **0**

- 1 *Identification of appropriate theory* **1-2**
For drawing a correctly labelled diagram, showing the effect of a tariff on imported bicycles, *i.e.* an upward shift in the world supply curve for bicycles **or** for providing an explanation of how a tariff will lead to an increase in the price and a fall in the level of imported bicycles.

- 2 *Correct application of appropriate theory* **3-4**
For drawing a correctly labelled diagram, showing the effect of a tariff on imported bicycles, *i.e.* an upward shift in the world supply curve for bicycles **and** for providing an explanation of how a tariff will lead to an increase in the price and a fall in the level of imported bicycles.

Candidates who incorrectly label diagrams cannot be rewarded with full marks. The use of P and Q on the axes is sufficient for a demand and supply diagram.

(c) Describe the nature of the cross elasticity of demand between cars and bicycles suggested in paragraph 4. [4 marks]

level

- 0 *Inappropriate answer* **0**

- 1 *Identification of appropriate theory* **1-2**
For explaining that cross elasticity of demand measures the responsiveness of the demand for one product to a change in the price of another **or** for providing an explanation that the cross elasticity of demand between cars and bicycles should be positive, because they are substitutes for each other.

- 2 *Correct application of appropriate theory* **3-4**
For explaining that cross elasticity of demand measures the responsiveness of the demand for one product to a change in the price of another **and** for providing an explanation that the cross elasticity of demand between cars and bicycles should be positive, because they are substitutes for each other.

- (d) **Using information from the text and your knowledge of economics, evaluate the use of protectionism in the Canadian bicycle industry.** [8 marks]

Responses **may** include:

- discussion of “dumping”
- discussion of “unfair foreign trade” (*paragraph 1*)
- effects on employment (*paragraph 1*)
- effects on the price level (*paragraph 4*)
- impact on the environment (*paragraph 4*)
- discussion of efficiency in the bicycle industry (*paragraph 5*)
- retaliation by foreign governments (*paragraph 6*)
- flow-on effects on other manufacturers (*paragraph 5*)
- political implications (*paragraph 2*)
- global misallocation of resources
- welfare analysis (*paragraph 4*)
- any reasonable answer

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
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