



MARKSCHEME

November 2009

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.

1. (a) **Using at least one production possibility curve diagram, explain the concepts of scarcity, choice, opportunity cost and resource allocation.** [10 marks]

Answers **should** include:

- explanations of scarcity, choice, opportunity cost and resource allocation
- at least one production possibility curve diagram
- explanation of the way the production possibility curve diagram illustrates the concepts of scarcity, choice, opportunity cost and resource allocation.

Answers **may** include:

- explanation of the importance of the shape of the production possibility curve
- explanation of the significance of shifts of the production possibility curve.

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

- (b) **“The process of resource allocation is most efficiently carried out through the free interaction of demand and supply. This means the provision of merit goods, such as health care and education, should always be left to market forces.” Evaluate this statement.**

[15 marks]

Answers **may** include:

- definition of merit goods
- explanation of health care and education as merit goods
- use of other examples of merit goods
- explanation of how the market forces of demand and supply interact to allocate scarce resources
- the signalling function of price in resource allocation
- the incentive function of price in resource allocation
- the benefits of provision of merit goods through the market, *e.g.* in terms of competition, greater efficiency, lower costs, and greater consumer choice
- the possible drawbacks of state provision, *e.g.* formation of a large monopoly organization, unresponsive to consumer wants
- health care and education as basic human rights, unrelated to prices, costs and profits
- market failure due to under-provision
- positive externalities of merit goods
- lack of effective demand due to unequal distribution of income
- informational problems associated with health care and education.

Effective evaluation may be to:

- consider short-term versus long-term consequences
- examine the impact on different stakeholders
- discuss advantages and disadvantages
- prioritise the arguments.

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2. (a) Explain *two* possible demand-side factors that may cause an increase in the level of unemployment.

[10 marks]

Answers **should** include:

- definition of the level of unemployment
- an explanation that demand-side factors affect cyclical/demand deficient unemployment
- explanation of two demand-side factors, for example:
 - deflationary fiscal policy
 - deflationary monetary policy
 - factors leading to a fall in consumption, *e.g.* trends in earnings
 - trends in the housing market
 - a fall in foreign demand for exports
 - factors leading to a fall in investment, *e.g.* worsening business expectations.

Answers **may** include:

- explanation of labour market equilibrium/disequilibrium
- definition of full employment
- the concept of a natural rate of unemployment (HL extension, so not necessary)
- additional demand-side factors
- additional supply-side factors
- use of AD/AS diagrams.

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- (b) Evaluate the view that demand-side policies are more effective than supply-side policies in reducing the level of unemployment.

[15 marks]

Answers **may** include:

- explanation of demand-side policies in terms of fiscal and monetary policies
- explanation of supply-side policies
- definition of level of unemployment
- different types of unemployment
- effectiveness of demand-side policies under conditions of cyclical/demand deficient unemployment
- ineffectiveness of demand-side policies against other types of unemployment
- general problems of demand-side policies
- appropriate and inappropriate use of supply-side policies
- general problems in relation to specific supply-side policies
- use of policies which have a demand-side and supply-side effect, *e.g.* government spending on health and education/training
- use of AD/AS diagrams.

Effective evaluation may be to:

- consider short-term versus long-term consequences
- examine the impact on different stakeholders
- discuss advantages and disadvantages
- prioritise the arguments.

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3. (a) Explain *two* factors that might negatively affect a country's current account in its balance of payments. [10 marks]

Answers **should** include:

- definition of current account
- explanation of two factors such as:
 - appreciation of the exchange rate
 - falling foreign demand for exports
 - increasing domestic demand for imports
 - changes in comparative advantage
 - changes in relative interest rates
 - relatively lower productivity than foreign competitors
 - relatively higher inflation than competitor countries
 - expansionary government demand-side policies
 - a decrease in the levels of protection *e.g.* reduced tariffs.

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- (b) Evaluate the view that current account deficits are best corrected through the use of policies designed to reduce aggregate demand.

[15 marks]

Answers **may** include:

- explanation of demand-side policies in terms of fiscal and monetary policies
- explanation of linkages between higher interest rates/less supply of money/lower government spending/higher taxes and the level of AD
- explanation of how demand-side policies reduce AD in the short term and hence demand for imports
- drawbacks of reducing AD, *e.g.* higher interest rates may adversely affect growth and employment, disincentive effects of higher taxation, difficulties of reducing the level of government spending
- possibility of using other policies
- definition of supply-side policy
- examples of supply-side policies
- explanation of how supply-side policies may help the current account (long-term impact on productive potential and export competitiveness)
- illustration of above in terms of shift of LRAS to right
- drawbacks of particular supply-side policies
- distinction between supply-side policies as long-term and demand-side policies as short-term
- advantages and disadvantages of protectionism
- advantages and disadvantages of exchange rate adjustments
- use of AD/AS diagrams.

Effective evaluation may be to:

- consider short-term versus long-term consequences
- examine the impact on different stakeholders
- discuss advantages and disadvantages
- prioritise the arguments.

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4. (a) **Explain how buffer stock schemes/commodity price agreements may be used to reduce wide fluctuations in primary commodity prices.** *[10 marks]*

Answers **should** include:

- an explanation of primary commodities
- explanation of the meaning of buffer stock schemes/commodity price agreements
- an explanation of how such schemes operate to reduce price fluctuations
- a diagram to illustrate attempts to reduce price fluctuations through buffer stocks/commodity price agreements.

Answers **may** include:

- examples of such schemes in practice
- demand and supply diagrams to show why prices of primary products tend to fluctuate
- a range of diagrams showing relevant intervention (there are a number of possibilities)
- reference to primary commodity cartel agreements, such as OPEC.

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- (b) **Evaluate the view that, to achieve greater growth and development, developing countries must lessen their dependence on the production of primary commodities.**

[15 marks]

Answers **may** include:

- definitions of growth and development
- relationship between growth and development
- the nature of primary product dependence
- examples of primary product dependence
- primary product dependency as an international barrier to economic development
- an explanation that not all developing countries are dependent upon the production of primary products
- greater price stability of manufactured goods
- difficulties involved in trying to administer prices in commodity agreements, *e.g.* in terms of ease of entry, the scattered nature of the producers, the breakdown of attempts to stabilize prices, general problems of buffer stock schemes
- control of the market and dominance of the MNCs
- low income elasticity of demand for primary products
- impact on the ability of developing countries to import essential goods
- higher productivity in manufacturing
- development of synthetic substitutes for agricultural products
- greater multiplier effects from investment in manufacturing
- implications for debt servicing
- the importance of the terms of trade
- dependence on the business cycles of the developed economies to which they export
- the need to provide food stability and food security.

N.B. Reward candidates who demonstrate awareness of the recent (*i.e.* as at July 2008) food/energy crisis, *e.g.* in terms of the switch from traditional agriculture to bio-fuel, and ever rising demand from countries such as China and India.

Effective evaluation may be to:

- consider short-term versus long-term consequences
- examine the impact on different stakeholders
- discuss advantages and disadvantages
- prioritise the arguments.

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