

# **MARKSCHEME**

**May 2003**

**ECONOMICS**

**Higher Level**

**Paper 3**

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Section A — Data Response Questions — Paper Specific Markscheme

Question 1: IMF’s four steps to damnation

Partial Maximum  
Mark Mark

(a) With reference to the article, define the following terms highlighted in bold.

(i) privatization (*paragraph 2*)

- for a statement along the lines that privatization means the sell off of nationalized industries”.

2 2

(ii) market-based pricing (*paragraph 7*).

- for a simple definition along the lines of prices being determined by the market
- for a fuller definition that prices are determined by the forces of demand and supply.

1  
1 2

(b) Use a supply and demand diagram to explain why market-based pricing (*paragraphs 7 and 8*) may result in higher prices.

Allow [*2 marks*] for a properly-labelled diagram and [*2 marks*] for an explanation.

- Diagram should show the removal of subsidies as a leftward shift of the supply curve showing a lower output and a higher price.
- An alternative explanation and diagram might show a removal of price controls causing a higher price.

4

**Partial Maximum  
Mark Mark**

- (c) **Explain why the IMF and the World Bank demand that nations in need of capital funds raise their interest rates (*paragraphs 4 and 5*).**

*Allow up to [3 marks] for one well developed relevant explanation.*

An increase in interest rates might:

- attract capital flows
- increase domestic savings
- reduce the outflow of capital
- be used to stabilize the currency
- reduce inflationary pressure.

**4**

- (d) **Discuss *one* consequence of the IMF and the World Bank policies regarding free trade for each of the following:**

*Allow [1 mark] for mention of a consequence and up to [2 marks] in addition for a well-developed explanation.*

- (i) **advanced industrialized countries**

- benefits of pursuing comparative advantage
- greater choice
- economies of scale
- lower prices
- increased exports
- increase in structural unemployment.

**3**

- (ii) **less developed agricultural countries.**

*Allow [1 mark] for mention of a consequence and up to [2 marks] in addition for a well-developed explanation.*

- benefits of pursuing comparative advantage
- greater choice
- lower prices
- economies of scale
- increased exports
- increased opportunity to diversify
- benefits of export led growth
- changing terms of trade
- increased vulnerability to changing commodity prices
- protectionism in MDCs
- expansion of cash crops.

**3**

- (e) Use the text and your knowledge of economics to evaluate the view that the IMF and the World Bank policies are designed to further the interests of more developed countries at the expense of less developed countries.

The question is phrased in such a way that candidates should consider the possibility that the policies recommended by the IMF and the World Bank further the interests of MDCs at the expense of LDCs but **also** that this is not necessarily the case. Candidates might observe that the policies were not **designed** to be at the expense of LDCs, but that in some ways they have indeed been harmful.

Areas for discussion might include:

- privatization may lead to increased ownership by MNCs in which case there may be an outflow of profits. On the other hand, privatization might increase efficiency leading to lower prices and higher output
- capital market liberalization may lead to capital flight from LDCs. However, there may also be inflows of capital which could benefit LDCs.
- capital market liberalization might lead to increased vulnerability to speculative flows
- privatization and capital markets have both given people in MDCs the opportunity to “pick off assets at rock bottom prices”. This is at the expense of LDCs
- if market-based pricing leads to higher prices, the benefits might accrue to foreign-owned firms.

There may be some overlap with question (d)(ii) above, but the answer should not be a simple repetition. Allow appropriate credit for candidates who illustrate their arguments with the help of real world examples.

<b>Level 0:</b>	No valid discussion.	<b>0</b>
<b>Level 1:</b>	Very few relevant issues recognized with little discussion or basic understanding.	<b>1-2</b>
<b>Level 2:</b>	A few issues recognized with some attempt at discussion or just one issue well-developed.	<b>3-4</b>
<b>Level 3:</b>	A range of issues developed in reasonable depth. Must also show an awareness of alternative viewpoints and engage in some sensible evaluation.	<b>5-7</b>

**Question 2**

	<b>Partial Mark</b>	<b>Maximum Mark</b>
<b>(a) With reference to <i>Item 1</i>, describe</b>		
<b>(i) the projected changes in Mexico’s population structure between 1999 and 2025.</b>		
For describing the		
• increase in the over 65s	<b>1</b>	
• decrease in the 0 to 9s and 10 to 24s	<b>1</b>	
• increase in the 25 to 49s and 50 to 64s.	<b>1</b>	<b>2</b>
<b>(ii) the likely impact of these changes on government spending and taxation in Mexico.</b>		
• possible increase in spending on health care and pensions due to an ageing population	<b>2</b>	
• possible decrease in spending on education due to the fall in the proportion of the population aged between 0 to 24	<b>2</b>	
• possible increase in tax revenues due to the increase in the proportion of people of working age.	<b>2</b>	<b>3</b>

**Partial Maximum  
Mark Mark**

**(b) Using the data provided**

**(i) explain the term current account balance, percentage of GDP  
(Item 3)**

- for a simple statement that it is exports minus imports expressed as a percentage of GNP 1
- for noting that it is exports and imports of goods **and** services 1
- for using the text to explain that a negative number means a deficit and a positive number means a surplus. 1      2

**(ii) describe the changes shown in the GDP of the USA over the period shown (Item 2).**

- for stating that there has been an overall decline in the rate of increase 1
- for briefly using the data to illustrate this decline. 1      2

*N.B. No marks for saying that GDP had fallen.*

**(iii) explain how the changes identified in (b)(ii) above are likely to affect Mexico’s exports to the USA.**

- For noting that spending on imports is dependent on income 1
- For observing that the slowdown in the US economy may cause a decrease in demand for Mexican exports 2
- For correctly noting that the slowdown in the US economy may cause a slowdown in the growth of Mexican exports. 3      4

**(c) Explain two other ways in which the macroeconomy of Mexico may be affected by changes in GDP of the USA.**

*Allow up to [3 marks] for any one plausible factor stated and explained.*

- Factors which might be explained 3
- a fall in US investment in Mexico 3
  - possible depreciation of the Mexican currency 3
  - the possibility of falling commodity prices 3
  - the possibility of an increase in US protectionism 3
  - increased unemployment 3
  - slower growth 3
  - reduction in inflationary pressure. 3      5

**(d) Using the data and your knowledge of economics, assess the performance of the Mexican economy during the 1990s.**

This question is fairly open-ended. It is therefore difficult to make the marking scheme too prescriptive. However, in order to reach Level 3, answers are expected to make some reference to all three indicators provided and to make some evaluative judgments about the Mexican economy. Answers need to describe the changes which have occurred over the period, but if this is all that is done, a maximum of **[2 marks]** should be awarded. To progress beyond **[2 marks]**, judgements about the performance of the economy need to be made; *e.g.* the rate of inflation fell from the mid 1990s, but was still at a very high level in 1999 (nearly 20 %); the economy suffered from a significant recession in 1995, and did well to achieve significant growth rates in the following years, although the rate of growth declined from 1996; the current balance remained in deficit over the whole decade suggesting an underlying weakness in Mexico's international trading position, but this might have been offset by net capital inflows.

Better answers should discuss the relationships between the indicators, *e.g.* GDP and the current balance, or discuss the need for more information, *e.g.* on unemployment or the distribution of income *etc.*

Reward answers that make a genuine effort to critically assess and which make good use of relevant economic analysis.

<b>Level 0:</b>	No valid discussion.	<b>0</b>
<b>Level 1:</b>	Very few relevant issues recognized with little discussion or basic understanding.	<b>1-2</b>
<b>Level 2:</b>	A few issues recognized with some attempt at discussion or just one issue well-developed.	<b>3-4</b>
<b>Level 3:</b>	A range of issues developed in reasonable depth. Must also show an awareness of alternative viewpoints and engage in some sensible evaluation.	<b>5-7</b>



## B Essays: Paper-Specific Guidance

The following comments are intended to provide extra guidance to Assistant Examiners, but they are not meant to be a “straitjacket”.

They are meant to indicate some of the main points which the question-setter hoped to elicit, and/or indicate sensible approaches; however, it is often possible for candidates to respond to a question in a way which is unanticipated and yet which contains valid economic arguments, so please keep an open mind.

**THE GENERAL MARKING CRITERIA REMAIN THE MAIN BASIS FOR AWARDING MARKS.**

### Question 3

- (a) **What role do prices play in the allocation of resources in free market economies?**

*[12 marks]*

Candidates might include the following:

- explanation of resource allocation
- definition of a market economy
- definition of a market
- characteristics of a market economy
- price determination
- role of prices in resource allocation (signalling, rationing and incentive functions)
- demand and supply diagrams to illustrate resource allocation
- consumer sovereignty/producer sovereignty.

- (b) **Evaluate the options available to governments to overcome the failure of markets arising from the production and consumption of demerit goods. Illustrate your answer with examples where possible.**

*[13 marks]*

*High scoring answers should not only explain the options available, but should also evaluate them in terms of potential strengths and weaknesses.*

Issues and areas for discussion might include:

- definition of demerit good
- explanation of how the market fails in the case of demerit goods
- suitable diagram to show overproduction of demerit goods
- use of persuasion/negative advertising to shift the demand curve to the left
- explanation of taxation on demerit goods – shifts supply to the left
- evaluation of taxation policy in terms of
  - a market-based solution
  - difficulty of assessing the value of negative externalities
  - inelastic demand for demerit goods
- explanation of different forms of regulation *e.g.* complete ban, spatial and age restrictions
- evaluation of regulation in terms of
  - a direct means of tackling the problem
  - interference with market forces
  - problem of unofficial markets arising in the case of a complete ban
  - the problems of enforcement.

**Question 4**

**(a) Outline the ways in which monopoly power might arise.**

**[10 marks]**

Candidates might include the following barriers to entry:

- natural monopolies
- ownership and control of raw materials
- economies of scale
- start-up costs
- technical knowledge
- legal barriers
- agreements between producers
- protectionism
- state monopolies.

**(b) Should governments seek to control the growth of monopoly power?**

**[15 marks]**

*High scoring answers should consider both sides of the coin, i.e. reasons why governments should and should not control the growth of monopoly power, and arrive at an overall assessment.*

Points for discussion might include:

- natural monopolies
- monopoly profits as a reward for innovation
- monopoly profits as a source of funds for research and development
- monopoly profits as a source of funds for investment
- economies of scale
- provision of otherwise unprofitable goods through price discrimination
- allocative inefficiency
- productive inefficiency
- drawbacks of lack of competition
- lack of choice
- abuse of monopoly power in terms of higher price/lower output/abnormal profits
- misallocation of resources.

### Question 5

**Discuss the view that the achievement of price stability should be the major objective of government economic policy.**

**[25 marks]**

*There are several ways in which this question could be answered. Candidates are not expected to make all the points below but in order to reach the upper mark bands some “discussion” is required, involving different perspectives.*

Points and areas for discussion might include the following:

- price stability should be a major objective because of the various drawbacks of inflation, *e.g.*
  - shoe-leather costs
  - menu costs
  - redistributive effects
  - impact on international competitiveness
  - creation of uncertainty / impact on business confidence
- bringing about price stability may involve sacrificing other objectives of economic policy; there are potential conflicts between the achievement of price stability and the achievement of
  - full employment
  - economic growth

A diagram to illustrate these conflicts should be rewarded

- a certain level of inflation (demand pull) may be preferable to deflation in terms of
  - profits
  - investment
  - wages
  - resource allocation
  - economic growth
- other goals of economic policy are also important
  - economic growth (*e.g.* affects living standards and government’s ability to finance education, health *etc.*)
  - full employment (unemployment involves a range of financial, economic and social costs)
  - satisfactory balance of payments (*e.g.* unsustainability of long term deficits)
  - a more equal / unequal distribution of income and wealth (*e.g.* implications for levels of poverty, incentives and efficiency)
  - sustainable development.

Alternatively, candidates might legitimately argue that the achievement of price stability will actually assist the achievement of growth, full employment and external balance. References may be made to theoretical debates such as the Keynesian-monetarist debate.

**Question 6**

- (a) Describe the main barriers to economic development that countries may experience. [12 marks]**

Candidates should define economic development and may describe the following barriers:

- institutional/political
- international trade
- financial
- distribution of income
- infrastructure
- population
- geographical.

- (b) Evaluate the view that countries with a more equal distribution of income and wealth are more likely to experience higher levels of development. [13 marks]**

*To reach the upper mark bands candidates need to demonstrate skills of critical evaluation.*

Possible points and areas for discussion:

- saving and investment
- the level and pattern of consumption
- human capital
- “trickle down”
- incentives to work
- efficiency
- government revenues
- capital flows/flight
- level of poverty
- rural/urban migration
- taxation
- land reform
- other routes to development.

It is quite possible that a candidate could effectively argue the point that a less equal distribution of income and wealth might contribute to increased growth which might then contribute to higher levels of development.

Candidates might answer this question by using a particular country as a reference point, and should be given suitable credit. However, top marks should only be awarded if candidates introduce some underlying economic theory into their response.

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