



MARKSCHEME

November 2006

ECONOMICS

Higher 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 the necessary conditions for price discrimination to take place. [10 marks]

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

- definition of price discrimination
- the ability to set market price
- the ability to separate the market segments
- separation and splitting of markets based on time, place and income
- PED must differ in each market
- examples of price discrimination
- degrees of price discrimination

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

(b) Discuss the advantages *and* disadvantages of price discrimination for consumers and producers. [15 marks]

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

- effects on consumers
- effects on producers
- appropriation of consumer surplus (a diagram may be used)
- effect on competition
- effect on profits
- redistributive effects
- predatory pricing advantages
- diagram showing separation of markets
- advantages and disadvantages may be illustrated 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 how interest rates can be used to bring about an increase in economic activity.** [10 marks]

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

- explanation of interest rates as a tool of monetary policy
- explanation that a cut in interest rates reduces the cost of borrowing
- consumption will increase for a number of reasons
- investment will increase for a number of reasons
- possible effect on net exports
- diagram showing increased spending shifting out AD curve and leading to an increase in national income
- possibility of a supply-side effect

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

- (b) **Discuss the strengths *and* weaknesses of demand-side policies.** [15 marks]

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

- explanation of demand-side policies: fiscal policy and monetary policy
- explanation of how demand-side policies can be used to reduce inflation or unemployment
- discussion of a possible trade-off between inflation and unemployment
- discussion of the problems associated with deflationary fiscal policy *e.g.* unemployment, time lags
- discussion of the problems associated with contractionary monetary policy: an increase in interest rates slows economic growth and negatively affects exports due to increase in exchange rate.
- discussion of the problems associated with expansionary fiscal and monetary policy *e.g.* inflation, time lags, export competitiveness, crowding out
- use of an appropriate diagram

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

3. (a) **What are the causes of inflation?** *[10 marks]*

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

- define inflation
- explanation of demand pull inflation
- explanation of cost push inflation
- reference to monetary growth

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

(b) **Evaluate the possible effects of a persistently high inflation rate on a country's current account balance and its exchange rate.** *[15 marks]*

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

- define current account balance
- define exchange rate
- exports become less competitive while imports become more competitive
- impact on current account balance depends on relative elasticities of demand for exports and imports. Reference to the Marshall-Lerner condition to be rewarded
- the likely impact of the current account balance change on the exchange rate
- reference to the purchasing power parity theory should be rewarded

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
- seeking economies of scale
- 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 savings gaps
- 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