



MARKSCHEME

November 2009

ECONOMICS

Higher Level

Paper 3

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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) **economies of scale** (*paragraph 2*) [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1

The idea that they are falling costs as a firm gets larger.

2 *Precise definition* 2

An explanation that they are a fall in long-run unit costs that come about as a result of a firm increasing its scale of output **or** a vague definition with a good example of an economy of scale.

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

level

0 *Wrong definition* 0

1 *Vague definition* 1

The idea that it is to do with the purchasing of machinery.

2 *Precise definition* 2

An explanation that it is the addition of capital stock to the economy or expenditure by firms on capital.

(b) Using an appropriate diagram, explain why BAA’s monopoly operation of London’s airports might result in allocative inefficiency (*paragraph ⑤*). [4 marks]

level

- | | | |
|---|--|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
For drawing a diagram showing the situation of supernormal/abnormal profits in monopoly, indicating the point of allocative efficiency ($MC = AR/P$) or for providing an explanation of how monopolists produce where $MC = MR$ and that this does not coincide with the point of allocative efficiency ($MC = AR/P$). | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing a diagram showing the situation of supernormal/abnormal profits in monopoly, indicating the point of allocative efficiency ($MC = AR/P$) and for providing an explanation of how monopolists produce where $MC = MR$ and that this does not coincide with the point of allocative efficiency ($MC = AR/P$). | 3-4 |

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. A title is not necessary.

(c) **Using an appropriate diagram, explain why air transport emissions are seen as an example of market failure (paragraph 9).** [4 marks]

level

- | | | |
|---|--|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
For drawing a MSC/MSB diagram showing that the private costs of air transport are lower than the social costs of air transport or for providing an explanation of how greater air transport will mean that there are more emissions that will negatively affect third parties. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing a MSC/MSB diagram showing that the private costs of air transport are lower than the social costs of air transport and for providing an explanation of how greater air transport will mean that there are more emissions that will negatively affect third parties. | 3-4 |

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

An alternative diagram might be a demand and supply diagram with, S_{private} and S_{social} .

An alternative approach would be to draw and explain the market failure in terms of a negative externality of consumption.

The vertical axis may be price, but could be costs or benefits. The horizontal axis is quantity.

(d) Using information from the text/data and your knowledge of economics, evaluate the argument that the BAA monopoly should be broken up by the Competition Commission.

[8 marks]

Responses may include:

- definitions of monopoly and other market forms
- diagrams showing supernormal/abnormal profits under monopoly.

Advantages of the monopoly:

- economies of scale – BAA claims regarding its ownership (paragraph 2)
- higher profits leading to higher investment – need to “improve the passenger experience and increase capacity” (paragraph 2).

Disadvantages of the monopoly:

- higher prices to consumers (paragraph 2)
- lack of competition – thus no incentives to improve services (paragraph 3)
- lack of incentives to improve (paragraph 3)
- not achieving allocative efficiency (paragraph 3)
- not achieving productive efficiency (paragraph 3)
- at the moment, the monopoly does not give the benefits of competition (paragraph 4)
- supernormal/abnormal profits.

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

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

Effective evaluation may be to:

- consider short-term versus long-term 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) **consumption (Table 1)** [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1

The idea that it is to do with spending by consumers.

2 *Precise definition* 2

An explanation that it is spending by households on consumer goods and services.

(ii) **unemployment rate (Figure 3).** [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1

The idea that it is to do with the number of unemployed in a country.

2 *Precise definition* 2

An explanation that it is the number of unemployed expressed as a percentage of the total workforce. (If this is expressed as an equation, then full marks should be awarded if the equation is correct.)

(b) **Using the data in Table 1, calculate the value of GDP. Explain your calculation.** [4 marks]

level

0 *Inappropriate answer* 0

1 *Identification of appropriate theory* 1-2

For correctly calculating the value of GDP as €478 billion **or** for explaining that GDP is calculated by adding consumption, investment, government expenditure and export revenue and then subtracting expenditure on imports. This may be expressed as a formula.

2 *Correct application of appropriate theory* 3-4

For correctly calculating the value of GDP as €478 billion **and** for explaining that GDP is calculated by adding consumption, investment, government expenditure and export revenue and then subtracting expenditure on imports. This may be expressed as a formula.

(c) **Identify *one* positive statement and *one* normative statement from Text A. Explain your reasoning.** **[4 marks]**

level

- | | | |
|---|--|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
For explaining that a positive statement is one that may be proven to be correct or false by looking at the facts and that a normative statement is a matter of opinion or for providing examples of positive and a normative statement from Text A. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For explaining that a positive statement is one that may be proven to be correct or false by looking at the facts and that a normative statement is a matter of opinion and for providing examples of positive and a normative statement from Text A. | 3-4 |

N.B. Examples of positive statements are “economic growth was almost 3 % and “exports benefited from faster demand in the Euro area”. Examples of normative statements are “the economy grew well”, “a tighter fiscal policy should be put in place to reduce demand pressures” and “the government needs to implement policies...”.

- (d) **Using information from the text/data and your knowledge of economics, evaluate the role of demand-side policies and supply-side policies in maintaining the growth of the Dutch economy.**

[8 marks]

Responses **may** include:

- an explanation of demand-side policies
- an explanation of supply-side policies
- if expansionary fiscal policy is used, then there is the danger of inflation (*Text A*)
- if contractionary fiscal policy is used (*Text A*), then growth may slow down
- the inflation rate is not really very worrying (*Figure 2*) and so perhaps there is no present need for deflationary policies
- unemployment is low (*Figure 3*), so is likely to be mostly structural and frictional unemployment, which cannot be helped by expansionary demand-side policies
- growth is reasonable at almost 3 % (*Figure 1*), so perhaps a laissez-faire approach should be taken in terms of demand-side policies
- lowering interest rates (by the European Central Bank) may lower the value of the Euro, which may help exports (*Text A*)
- lowering interest rates (by the European Central Bank) would increase consumption and investment, but may be inflationary (*Text A*)
- current account is in surplus (*Figure 4*) but may be damaged by the strength of the Euro (*Text A*), so supply-side policies could be used to maintain competitiveness of exports
- supply-side policies may be the answer, such as increasing labour market participation and the number of hours worked (*Text A*), thus avoiding the danger of excessive growth.

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

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

Effective evaluation may be to:

- consider short-term versus long-term 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
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3. (a) Define the following terms indicated in bold in the text:

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

level

0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that it is to do with using the amount of money to control the economy.	1
2	<i>Precise definition</i> An explanation that it is a demand-side policy using changes in the money supply or interest rates.	2

(ii) current account surplus (paragraph 5). **[2 marks]**

level

0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that it is to do with exporting more than is imported.	1
2	<i>Precise definition</i> An explanation that it is where the revenue from (or the value of) the export of goods and services is greater than the expenditure on (or value of) the import of goods and services in a given year. (Net income flows may also be mentioned, but this is not necessary for full marks.)	2

(b) Using an appropriate diagram, explain why rising labour costs could contribute to high inflation rates (*paragraph 2*). [4 marks]

level

0 *Inappropriate answer* 0

1 *Identification of appropriate theory* 1-2

For drawing an aggregate demand and aggregate supply diagram where AS shifts to the left **or** for providing an explanation of how rising labour costs is a supply-side factor that will contribute to higher costs of production and a decrease in aggregate supply.

2 *Correct application of appropriate theory* 3-4

For drawing an aggregate demand and aggregate supply diagram where AS shifts to the left **and** for providing an explanation of how rising labour costs is a supply-side factor that will contribute to higher costs of production and a decrease in aggregate supply.

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”, “real national income” or “GDP”.

(c) Using an appropriate diagram, explain why market forces are likely to lead to an appreciation of the yuan. [4 marks]

level

0 *Inappropriate answer* 0

1 *Identification of appropriate theory* 1-2

For drawing a demand and supply diagram for the yuan showing a shift to the right in demand and thus an increase in the value of the yuan **or** for providing an explanation of how an increase in the demand for Chinese exports will lead to greater demand for the yuan and thus an increase in its exchange rate value.

2 *Correct application of appropriate theory* 3-4

For drawing a demand and supply diagram for the yuan showing a shift to the right in demand and thus an increase in the value of the yuan **and** for providing an explanation of how an increase in the demand for Chinese exports will lead to greater demand for the yuan and thus an increase in its exchange rate value.

Candidates may suggest that the shift of the demand curve for the yuan is caused by increased interest rates and, if appropriately explained, this should be fully rewarded.

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

“Price of yuan” or “exchange rate” on the vertical axis is sufficient.

- (d) **Using information from the text/data and your knowledge of economics, evaluate the likely consequences for the Chinese economy if the government allows the yuan to appreciate.**

[8 marks]

Answers **may** include:

- an explanation of appreciation
- an explanation of how the government may or may not allow the exchange rate to appreciate
- an explanation of how appreciation of the yuan might lead to lower inflation
- downward pressure on inflation would help with the problems (*paragraphs ② and ③*)
- more imports can be bought with a more powerful yuan, thus reducing prices for consumers and also prices of imported raw materials
- this may help with the increased energy costs (*paragraph ②*) as an inflationary factor
- falling inflation may help reduce the expectations (*paragraph ②*)
- it may force domestic producers to improve their efficiency in order to compete with the cheaper imports
- there may be damage to export industries, depending upon elasticity, leading to unemployment
- there may be damage to domestic industries, depending upon elasticity, leading to unemployment
- deteriorating effects on current account
- distinction between short-term and long-term effects
- benefits to the global economy as Chinese imports begin to increase.

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

Effective evaluation may be to:

- consider short-term versus long-term 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) foreign direct investment (paragraph 4) *[2 marks]*

level

0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that it is to do with investment in countries from overseas.	1
2	<i>Precise definition</i> An explanation that it is investment by multinational corporations in another country.	2

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

level

0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that it is to do with freer international trade.	1

Do not reward candidates who simply define WTO as World Trade Organization.

2	<i>Precise definition</i> An explanation that it is an international body which hosts negotiations concerning the reduction of trade barriers between its member nations.	2
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(b) Explain two non-tariff barriers that might reduce EU-South Korean trade (paragraph 4). [4 marks]

level

- 0 *Inappropriate answer* 0
- 1 *Identification of appropriate theory* 1-2
For defining two suitable non-tariff barriers, such as quotas, subsidies, voluntary export restraints, administrative barriers, health and safety standards, environmental standards, embargoes, or nationalistic campaigns.
- 2 *Correct application of appropriate theory* 3-4
For providing an explanation of the way that the two barriers might reduce bilateral trade.

(c) Using a comparative advantage diagram, explain why free trade in machinery and ships between South Korea and the EU may be beneficial to both economies (paragraph 2). [4 marks]

level

- 0 *Inappropriate answer* 0
- 1 *Identification of appropriate theory* 1-2
For drawing a production possibility curve diagram for the two countries with the labels machinery and ships on the axes showing that South Korea has the absolute advantage in both ships and machinery, but a comparative advantage in ships **or** for providing an explanation of how both countries will benefit if the EU specializes in producing machinery and South Korea in producing ships because South Korea has a lower opportunity cost of producing ships.
- 2 *Correct application of appropriate theory* 3-4
For drawing a production possibility curve diagram for the two countries with the labels machinery and ships on the axes showing that South Korea has the absolute advantage in both ships and machinery, but a comparative advantage in ships **and** for providing an explanation of how both countries will benefit if the EU specializes in producing machinery and South Korea in producing ships because South Korea has a lower opportunity cost of producing ships.

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

- (d) **Using information from the text/data and your knowledge of economics, evaluate the possible outcomes of the proposed free trade agreement between South Korea and the EU.**

[8 marks]

Responses **may** include:

- an explanation of a bilateral free trade agreement as mentioned in paragraph ①
- the effect of the deal on “giving valuable momentum to the liberalization of global trade” (paragraph ①)
- the danger that bilateral agreements might compromise multilateral negotiations (paragraph ④)
- the opportunity for greater FDI by EU multinationals (paragraph ④).

Possible advantages for both countries:

- improvements in the balance of payments – increase in two-way trade of up to 40 %/€24 billion per year (paragraph ①)
- lower prices for consumers in both areas because of comparative advantage – machinery, chemicals, transport equipment and agricultural products for South Korea – automobiles, consumer electronics, semi-conductors and ships for the EU (paragraph ②)
- more choices for consumers in both countries – in the categories above
- an incentive for domestic firms to become more efficient
- more efficient use of resources in both countries.

Possible disadvantages for both countries:

- unemployment in the short run in the industries where the other country has the comparative advantage (the categories of products mentioned in paragraph ②)
- the short-term problems relating to the automobile industry (paragraph ③)
- loss of government revenues if tariffs have been in place
- danger of lower quality products entering the country.

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

Effective evaluation may be to:

- consider short-term versus long-term 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) infrastructure (paragraph 5) *[2 marks]*

level

0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that it is to do with building facilities to help the economy.	1
2	<i>Precise definition</i> An explanation that it is capital that is necessary for economic activity to take place and is usually provided by the government.	2

(ii) minimum price (paragraph 9). *[2 marks]*

level

0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that it is the lowest possible price.	1
2	<i>Precise definition</i> An explanation that a minimum price is imposed by an authority and is set above the market price. Prices cannot fall below this price.	2

(b) Using an appropriate diagram, explain the main reason for the change in the real price of tea since 1977 (paragraph 2). **[4 marks]**

level

- | | | |
|---|---|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
For drawing a demand and supply diagram for the tea market, where the supply curve for tea is shifted to the right, thus lowering the price of tea or for providing an explanation of how increases in the world supply of tea are pushing down the price of tea and the real price of tea when adjusted for inflation. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing a demand and supply diagram for the tea market, where the supply curve for tea is shifted to the right, thus lowering the price of tea and for providing an explanation of how increases in the world supply of tea are pushing down the price of tea and the real price of tea when adjusted for inflation. | 3-4 |

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) Explain why falling tea prices may result in deteriorating terms of trade for countries where income from tea is the primary source of income. **[4 marks]**

level

- | | | |
|---|---|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
For explaining that the terms of trade are calculated by an equation where the index of export prices is divided by the index of import prices and multiplied by 100 or for providing an explanation of how falling tea prices represent a fall in export prices for tea producing countries, which will reduce the terms of trade <i>ceteris paribus</i> . | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For explaining that the terms of trade are calculated by an equation where the index of export prices is divided by the index of import prices and multiplied by 100 and for providing an explanation of how falling tea prices represent a fall in export prices for tea producing countries, which will reduce the terms of trade <i>ceteris paribus</i> . | 3-4 |

(d) Using information from the text/data and your knowledge of economics, evaluate *two* possible measures which might be used to improve the standard of living of tea farmers.

[8 marks]

Answers **may** include:

- a definition of standard of living.

Possible measures **may** include:

- increased investment in infrastructure in the tea industry in order to grow and increase revenue for tea farmers, as implied in paragraph 5
- agreements to reduce global production, as suggested by paragraph 6 and 7, such as a commodity agreement
- the adoption of more fair trade involvement as mentioned in paragraph 9
- subsidies for tea farmers.

In order to gain the top level of response, candidates must display an evaluation of the two measures chosen in terms of their effects on tea farmers’ standards of living.

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

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Effective evaluation may be to:

- consider short-term versus long-term 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
