

MARKSCHEME

May 2002

ECONOMICS

Standard Level

Paper 2

SECTION A

Question 1: Time to put the oil lobby in its place

Partial Mark	Maximum Mark
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(a) Define the following terms which are in bold in the text:

(i) **competitive demand (paragraph 2);**

For candidates who

- state that it refers to goods which are substitutes for each other.

1	2
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(ii) **a subsidy (paragraph 2).**

A subsidy is a government grant to suppliers of goods and services designed to keep prices below the factor cost of production.

- for a vague notion
- for an accurate definition with some elements of the above

1	
2	2

(b) Use separate demand and supply diagrams to explain the likely effect on the market for petrol of

(i) **panic buying of petrol (paragraph 1);**

For candidates who

- accurately draw a demand and supply diagram, which is correctly and fully labelled, showing a shift of the demand curve to the right;
- accurately explain the rightward shift of demand and the effect on price and quantity.

2	
2	3

(ii) **OPEC increasing production (paragraph 1).**

For candidates who

- accurately draw a demand and supply diagram which is correctly and fully labelled, showing a shift of the supply curve to the right;
- accurately explain the rightward shift of supply and the effect on price and quantity.

2	
2	3

	Partial Mark	Maximum Mark
(c) With reference to the passage, explain how rising petrol prices might affect		
(i) the distribution of income;		
<ul style="list-style-type: none"> • for stating, from the passage, that people living in the countryside, commuters and low income earners will be most affected; 	1	
<ul style="list-style-type: none"> • for linking this to a more unequal distribution of income; 	1	
<ul style="list-style-type: none"> • for any relevant elaboration in terms of price elasticity of demand, proportion of income spent in comparison to high income earners, captive markets, lack of alternatives, transfer of wealth from consumers to oil producers <i>etc.</i>, <i>allow up to [3 marks]</i>. 	3	4
(ii) the environment.		
<ul style="list-style-type: none"> • for stating that rising petrol prices are likely to reduce the demand for petrol and help the environment; 	1	
<ul style="list-style-type: none"> • for recognising that the extent of the reduction in demand following a price rise depends on PED, <i>up to [2 marks]</i>; 	2	
<ul style="list-style-type: none"> • for linking this to a reduction of negative externalities (higher prices, lower output), perhaps but not necessarily, using the standard MSC / MSB diagram, <i>allow up to [3 marks]</i>. 	3	4
(d) Evaluate the view that the government should take the measures outlined in paragraph 3, rather than lowering petrol prices.		

Issues and areas for discussion might include the impact of:

- lower public transport prices (*e.g.* on the environment and public finances)
- increased tax allowance for travel
- increased income support for the low paid (*e.g.* on the distribution of income)
- lower petrol prices

In order to score full marks, candidates are expected to make an evaluative argument about the relative merits of the above policies.

Level 0	No valid discussion.	0
Level 1	Very few relevant issues recognised with little discussion or basic understanding.	1-2
Level 2	A few issues recognised with some attempt at discussion or just one issue well-developed.	3-4
Level 3	Two or more issues well developed with some reference to the data and with sensible evaluation.	5-7

Question 2:

	Partial Mark	Maximum Mark
(a) With reference to Item 1, explain what is meant by		
(i) “current unemployment comprises both a cyclical and structural component”.		
• for explaining the cyclical component in terms of a deficiency of aggregate demand;	2	
• for explaining the structural component in terms of the equilibrium rate of unemployment, NAIRU or that part which is due to long term changes in the pattern of demand and / or supply.	2	3
(ii) labour market equilibrium.		
• for a partial explanation in terms of the demand for labour;	1	
• for a partial explanation in terms of the supply of labour;	1	
• for explaining that labour market equilibrium is where the demand for labour equates the supply of labour;	2	
• for an explanation in terms of the NRU.	2	3
(b) (i) With reference to Item 2, briefly describe the changes in unemployment in the United States and the Euro area from 1990 onwards.		
• for noting that USA unemployment was lower throughout the period (in percentage terms);	1	
• for stating that unemployment increased in both areas in the early part of the period;	1	
• but moved in opposite directions for most of the remainder of the decade (increased in Euro area and decreased in USA).	1	2
(ii) Using the data in each of Items 3, 4 and 5, explain the changes you identified in b(i) above.		
• for explaining the greater unemployment in the Euro area in terms of		
• Item 3 – the faster growth of business sector employment in the USA;	2	
• Item 4 – lower real interest rates in the USA, explaining the links between interest rates, the level of demand and the level of employment; and / or interest rates, business costs and employment;	4	
• Item 5 – greater productivity in the USA and the links between productivity and employment.	3	7

If an answer concentrates on two items but does it well, it can be awarded full marks.

If a candidate introduces external information that is relevant, reward up to a maximum of [3 marks].

Partial Mark Maximum Mark

(iii) What other data might be useful in explaining the changes in unemployment in the United States and the Euro Area from 1990 onwards.

Allow up to *[2 marks]* for each plausible type of data mentioned; *e.g.* growth of real wages, data on the components of aggregate demand (C+I+G+X–M), social security payments, indicators of labour market flexibility/inflexibility, *e.g.* job protection legislation, full-time versus part-time employment, relative methods of measuring unemployment, relative participation rates, government training schemes *etc.*

2 3

(c) Use the data and your knowledge of economics to evaluate the ways in which unemployment might be most effectively tackled.

[7 marks]

Candidates who produce an answer which makes no reference to the data should be restricted to a maximum of [4 marks].

Issues which could be raised include:

- need for supply side and demand side measures because of the cyclical and structural nature of unemployment
- use of demand management policies, including use of interest rates (Item 4)
- problems of demand management, *e.g.* inflation and fiscal deficits
- use of supply side policies
- problems of supply policies *etc.*

Level 0	No valid discussion.	0
Level 1	Very few relevant issues recognised with little discussion or basic understanding.	1-2
Level 2	A few issues recognised with some attempt at discussion or just one issue well-developed.	3-4
Level 3	Two or more issues well developed with some reference to the data and with sensible evaluation.	5-7

SECTION B

Question 3:

- (a) **Explain how the existence of “positive externalities” may cause free markets to misallocate resources.**

[10 marks]

Candidates would be expected to discuss the allocation of resources under a free market, including discussion of some of the following:

- free market “scissor” diagram
- assumptions that underpin the theory of competition, particularly profit maximisation and self-interest
- linking the concept of equilibrium quantity to the allocation of resources required to produce that quantity of a good
- consumer sovereignty

Discussion of the impact of externalities on the free market allocation of resources may include:

- definition of positive externalities
- examples of positive externalities
- social benefits
- the effect of including positive externalities on equilibrium quantity and the allocation of resources required to produce that quantity of the good
- meaning of socially optimum

Candidates might include some discussion of the following:

- diagrams referring to deadweight loss or welfare triangles
- merit goods
- the existence of negative externalities
- reference to real world examples of externalities
- positive externalities and income distribution

- (b) Evaluate the options available to governments to overcome the failure of markets to take account of positive externalities. Refer to real world examples in your answer.**

[15 marks]

*Candidates should be rewarded for the **evaluation** of options. An answer that evaluates well several options would be expected to outscore an answer that described a full range of options without evaluation. It is acceptable to use historical examples of countries which have experienced inflation but examples should not go back more than 25 years.*

As a general guide, candidates should be rewarded more for using specific rather than generalised examples to illustrate their answers.

Possible areas for evaluation are:

- use of maximum prices *e.g.* for rented accommodation
- legislation *e.g.* to wear seat belts
- provision of goods/services free at the point of contact *e.g.* education/health
- a mixture of “free” and market provision
- use of subsidies
- positive advertising campaigns
- tax subsidies

Candidates might also include discussion of some of the following:

- problems in identifying social optimality
- measurement problems such as valuing intangibles and the issue of time (current versus future generations)
- the influence of cultural perspective on valuing externalities

Question 4:

- (a) What problems can a prolonged period of high inflation bring to an economy? [10 marks]**

Candidates would be expected to define inflation and better candidates will examine the meaning of “prolonged period of high inflation”.

Problems examined may include

- shoe leather and menu costs
- distribution of income
 - fixed incomes
 - borrowers and lenders
- resource allocation
- investment - speculation versus real investment
- international competitiveness
 - exchange rates
 - balance of payments
- macro economic responses and conflicting goals of governments

Candidates should be rewarded for applying theory to their discussion of these points. Detailed discussion should score better than a listing of points without discussion.

- (b) Evaluate the strategies that can be used to reduce the level of inflation. Include some reference in your answer to countries with which you are familiar. [15 marks]**

In evaluating strategies candidates should be rewarded for:

- applying relevant theory
- referring to examples (but not every point needs to be illustrated with an example) rather than relying solely on vague generalisations

Discussions may include:

- demand management
 - fiscal policy
 - monetary policy
- supply-side policies such as:
 - microeconomic reforms
 - privatisation
 - deregulation of markets
 - improvements in health, education (human capital)
 - taxation reform

Candidates should be rewarded for drawing on theoretical analysis

- AS/AD diagrams
- Keynesian diagrams
- Phillips Curve

Note: *There may be a crossover between part (a) and part (b) in the candidate's response. Marks should be awarded to give a fair reward for any valid points and discussion a candidate makes.*

Question 5:

Discuss the possible causes and consequences of a persistent deficit balance in a country's current account.

[25 marks]

This is a broad question that will receive a variety of approaches from candidates.

Candidates should demonstrate an understanding of what a current account is and what a deficit balance means. Other points for explanation may include:

- links to the balance of payments accounts
- the meaning of "persistent deficit balance"

Causes

Discussion may include the following:

- reference to the imbalance of credit and debit items, such as imports are greater than exports or net invisibles may be negative. *(Candidates who limit their answer to this level would not be expected to gain high marks.)*
- the nature of exports and imports (both current and over time)
 - price elasticity and income elasticity
 - endowment of natural resources
- higher rate of domestic growth compared to trading partners
- deterioration in the terms of trade
 - volatility of export and import markets
 - effect of protection on world prices (such as the Common Agricultural Policy of the EU on agricultural prices)
- loss of international competitiveness
 - comparative rates of inflation
 - factor costs
 - overvalued currency
 - infrastructure
 - R&D
- level of foreign debt
 - inappropriate use of foreign capital
 - debt servicing directly linked to the CAD
 - valuation effect of currency depreciation on debt servicing
- currency fluctuations, such as the J-curve effect of a depreciation.

Consequences

Answers will be less predictable for this part of the question. Candidates should be rewarded for their depth of understanding rather than the quantity of points they make. Points discussed may include:

- recession due to demand management policies designed to reduce the level of imports, such as higher levels of taxation and lower levels of government expenditure, and higher interest rates
- social and economic change due to structural adjustment policies designed to promote exports and encourage import replacement
- capital inflows leading to increased foreign indebtedness
- reliance on MNCs as a source of capital
- depreciation of currency due to the imbalance between current and capital accounts
- intervention by foreign agencies, such as the IMF, that will require structural adjustment
- assistance by aid agencies

Question 6:

- (a) **What evidence would indicate to an economist that a country is experiencing economic development as well as economic growth?**

[10 marks]

Candidate responses should clearly distinguish between economic growth and economic development.

Economic growth

Candidates should define economic growth (*e.g.* in terms of an increase in the real level of output (or national income) of a country over time).

Discussion may include:

- measures used such as GDP and GNP
- distinctions between real and potential economic growth
- use of PPC's to illustrate
- measurement problems

Economic development

Candidates should define economic development (*e.g.* in terms of an increase in the material and non-material well-being of the people in an economy over time).

Discussion may include:

- relative nature of development indicators
- more equitable distribution of income (real GNP per capita, Lorenz curves)
- improved standard of living indicators, such as health, literacy, housing and energy consumption
- lower population growth rates (birth, death and fertility indicators)
- decline in the percentage of the population engaged in agriculture and more in manufacturing and service provision (and associated increased urbanisation)
- higher levels of labour productivity and use of capital
- use of composite indexes such as the Human Development Index

- (b) **Evaluate the strategies that may be used to achieve economic development. Refer to real world examples in your answer.**

[15 marks]

Candidates should be rewarded for evaluating (as distinct from describing) a range of strategies that would lead to economic development. Candidates should also be rewarded for referring to specific examples to illustrate their points as required by the question.

Discussion will be quite varied and candidates should be rewarded for depth of understanding rather than the length of their list of strategies (presented without discussion).

It is also valid for candidates to discuss the debates that exist on development strategies, such as trade versus aid, inward-oriented development versus outward-oriented development, free enterprise versus planning, etc.

Strategies may include but **are not limited** to the following:

- open to foreign assistance
 - aid (multilateral and bilateral)
 - direct assistance from agencies such as the IMF and World Bank
 - trade agreements
 - commodity agreements
- export oriented development
- reliance on foreign investment
- inward oriented strategies
 - import replacement
 - government targeted sector development
 - government manipulation of aggregate demand and aggregate supply
 - planning
- sustainable development
- redistribution policies

MARKING GRID: IB ECONOMICS, MARKBANDS AND RANGES; PAPERS SL2, HL3 SECTION B (ESSAYS) Read the band descriptors (detailed marking criteria) before using this grid								
BRIEF BAND DESCRIPTOR (Also refer to detailed criteria)	BAND	MAXIMUM MARK FOR QUESTION/SUB-QUESTION						
		25	15	13	12	10	9	8
Excellent	4a	24–25	14–15	12–13	12	10	9	8
Very Good	4b	20–23	12–13	10–11	10–11	8–9	7–8	7
Good	3	15–19	9–11	8–9	7–9	6–7	5–6	5–6
Satisfactory/adequate	2	10–14	6–8	5–7	5–6	4–5	4	3–4
Weak	1	5–9	4–5	3–4	3–4	2–3	2–3	2
Very Weak	0	0–4	0–3	0–2	0–2	0–1	0–1	0–1