

MARKSCHEME

May 2003

ECONOMICS

Standard Level

Paper 2

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Section A — Data Response Questions — Paper Specific Markscheme

Question 1: Falling world coffee prices create winners and losers

		Partial Mark	Maximum Mark
(a)	(i) Explain the difference between a cash crop and a food crop.		
	<ul style="list-style-type: none"> • for explaining that a cash crop is one grown for export rather than domestic consumption, whereas a food crop is likely to be for domestic consumption or for personal consumption (<i>[1mark] for each point.</i>) 	2	2
	(ii) Define the term transnational company.		
	<ul style="list-style-type: none"> • for defining a TNC as an enterprise that operates across national borders • for some expansion in terms of production, administration or customer services being located in more than one country • weak definition and relevant example. 	1 2 2	2
(b)	Use a supply and demand diagram to explain the main reason behind the collapse in coffee prices on world markets.		
	<ul style="list-style-type: none"> • for stating that supply has grown faster than demand, leading to surplus stocks • for producing a correctly labelled diagram that shifts the supply curve to the right • for explaining that this would result in lower price and higher output • for a partially labelled diagram. 	1 2 2 1	4
	<i>N.B. Maximum of [2 marks] if no diagram is used/diagram is completely incorrect.</i>		
(c)	“The result: they collectively export more for less revenue.”		
	(i) State what this tells us about the elasticity of demand for coffee beans.		
	<ul style="list-style-type: none"> • for stating that PED is less than unity/inelastic. 	1	1
	(ii) Use a supply and demand diagram to explain how more is exported but less revenue is earned.		
	<ul style="list-style-type: none"> • for producing a correctly labelled diagram showing the fall in revenue as a result of the rightward shift in supply along an inelastic demand curve or for a correct demand and total revenue diagram • for a partially labelled diagram that shows that total revenue is less after the rightward shift in supply • for a correct explanation. 	2 1 2	3
	<i>N.B. Maximum of [2 marks] for a correct explanation without a diagram.</i>		

**Partial Maximum
Mark Mark**

**(d) (i) “Not everyone involved in the coffee trade is losing out”
(paragraph 5). Explain why this is the case.**

- for fully explaining that for MNCs, coffee is a raw material and the fall in coffee prices means a fall in their production costs and an increase in profit **3**
- for explaining that the fall in cost has not been matched by a proportional fall in price that the coffee companies charge **3** **3**
- cheaper coffee for consumers. **1**

(ii) Explain *one* possible way in which coffee producers could protect themselves against falling prices.

Allow full marks for any well-developed relevant explanation.

Different methods might include:

- formation of a cartel **3**
- fair trade price agreements **3**
- diversification to another economic activity **3**
- buffer stock scheme **3**
- production quotas **3**
- any other suitable agreement to restrict supply. **3** **3**

(e) Discuss the development problems associated with free trade and globalization which are raised in this text?

Areas for discussion might include:

- dangers of over-specialisation
- powerful MNCs
- lack of economies of scale for LDCs
- markets for commodities controlled by MDCs
- lower GDP/growth
- rural unemployment/poverty/rural-urban shift
- deteriorating terms of trade
- B/P problems
- debt repayment problems
- less investment (physical and human capital)
- social unrest
- diversification, *e.g.* into drug production
- *any reasonable answer.*

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

Question 2:

	Partial Mark	Maximum Mark
With reference to Item 1, explain the following terms which are in bold in the passage.		
(a) (i) bilateral free trade agreement		
<ul style="list-style-type: none"> • for explaining a free trade agreement in terms of a reduction of barriers to trade • for explaining that bilateral is between two countries. 	1 1	2
(ii) expansionary monetary policy		
<ul style="list-style-type: none"> • for identifying monetary policy as involving changes in interest rates (and/or the money supply). <p><i>N.B. Candidates only need to mention interest rates for [1 mark]</i></p> <ul style="list-style-type: none"> • for explaining “expansionary” in terms of lowering interest rates (and/or increasing the money supply). <p><i>N.B. A candidate who therefore says that expansionary monetary policy involves lowering interest rates would score [2 marks]</i></p>	1 1	2
(b) Explain how low interest rates may have “contributed towards the peso hitting a record low” (Item 1, Paragraph 1).		
<ul style="list-style-type: none"> • for stating that low interest rates would affect the demand for and/or supply of a currency (the peso) • for explaining how low interest rates may lead to greater selling of the currency, increased supply and a lowering of the exchange rate • for explaining how low interest rates may lead to less buying of the currency, reduce the demand for the currency and lower the exchange rate • for a correct diagram and explanation. 	1 4 4 4	4

		Partial	Maximum
		Mark	Mark
(c)	(i) With reference to Item 2, briefly describe what has happened to the current account balance since 2000.		
	• for noting the increased deficit as a % of GDP	1	
	• for accurately illustrating this using the data	1	
	• the absolute value of the balance cannot be determined.	2	2
	(ii) Using any of the data provided, give <i>one</i> possible reason for this change.		
	<i>Allow up to [2 marks] for any plausible reason cited from the data e.g.</i>		
	• “slow growth of international demand and a deceleration of the world economy” (<i>Item 1</i>) – fewer exports	2	
	• low value of peso raising import prices (<i>Item 1</i>) – effect on current account depends on elasticities	2	
	• decline in growth of GDP (<i>Item 2</i>) – possible decline in exports	2	
	• decline in industrial output (<i>Item 3</i>) – possible fall in exports of manufactured goods	2	
	• relatively high growth (by global standards) in 2000/1 fuelling import orders which impact on the current account in following years (<i>Item 2</i>).	2	2
(d)	Using Items 2 and 3,		
	(i) describe the possible relationship between GDP and industrial output		
	• for noting a direct relationship between GDP and industrial output (no need for use of items 2 and 3, but they may be used).	2	2
	(ii) explain this relationship.		
	For explaining the relationship in terms of:		
	• industrial output being one component of GDP, so it is likely that the two would move in the same direction	2	
	• the relationship between the level of GDP, income, expenditure and industrial sales and output	4	
	• aggregate demand/aggregate supply analysis	4	4
	<i>N.B. Allow credit for the candidate who throws doubt upon the precise nature of the relationship / emphasizes the importance of other variables.</i>		

The two parts of the question overlap and examiners may need to take a holistic view and award a whole answer mark out of [6].

- (e) Use the data and your knowledge of economics to assess the likely impact on the Chilean economy of the government’s plans to “eliminate its remaining controls on capital flows”.

In order to earn full marks, candidates are expected to show recognition of the fact that the complete removal of controls on capital flows could have both beneficial and harmful effects on the economy, depending to a large extent on the direction of the flows.

The removal of controls on capital flows may have a number of beneficial effects, including:

- increased inward investment, leading to an increase in employment, output, income, multiplier effects
- greater access to foreign exchange
- a favourable impact on the Balance of Payments
- *any reasonable answer.*

The removal of controls on capital flows may have a number of harmful effects, including:

- outflow of investment funds from the domestic economy (capital flight)
- destabilization of the exchange rate through “hot money” flows
- increased influence of MNCs
- repatriation of interest and profits
- *any reasonable answer.*

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

Section 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) Describe *three* strategies which governments may use to increase their economic growth rates.

[12 marks]

- use of expansionary fiscal/monetary policies
- use of supply side policies
- exchange rate policies
- R & D grants
- investment grants
- investment in human capital
- investment in infrastructure
- FDI
- trade agreements
- commodity agreements
- aid/loans
- export led growth
- import substitution policies
- *any reasonable answer.*

Any three methods which are appropriate should be accepted. Candidates who only offer two methods, well explained, may not be rewarded with more than **[9 marks]**. Candidates who only offer one method, well explained, may not be rewarded with more than **[4 marks]**.

- (b) Should increasing the rate of economic growth be the major policy objective of governments? [13 marks]**

A variety of approaches are possible in response to this question, and candidates who are able to provide an answer from different standpoints should be suitably rewarded. A sensible overall evaluation is also required.

Issues and areas for discussion might include:

- the difference between growth and development
- the importance of achieving growth with development as indicated, for example, by the HDI
- benefits of growth in terms of material living standards, government revenues, economic, political and military power, elimination of poverty, trickle down *etc.*
- costs of growth in terms of negative externalities, depletion of finite resources, opportunity costs, the possible conflicts with other goals of economic policy *etc.*
- the need for sustainable development
- the importance of other goals of economic policy
 - a more equal distribution of income and wealth
 - stable prices
 - full employment
 - a satisfactory balance of payments(with reasons why each of the goals above are important for governments)
- *any reasonable answer.*

Question 4

Evaluate the view that the market should have no role whatsoever in the provision of health care and education.

[25 marks]

This is a wide ranging, open-ended question in which a variety of perspectives are possible. Candidates should be rewarded for examining different standpoints, using economic analysis, and providing an overall evaluation.

Possible issues and areas for discussion include:

- health and education as merit goods
- under-provision of merit goods through the market
- merit goods and positive externalities
- merit goods and the distribution of income/problem of lack of effective demand
- difficulties for consumers of making rational decisions
- difficult to predict future health care needs
- the possibility of private monopolies in health and education emerging
- drawbacks of government provision and arguments for the free market in health and education in terms of
 - implications for the level of government spending, borrowing and taxation
 - opportunity cost of government provision
 - the free market and consumer choice
 - the free market, competition, costs and efficiency
- the possibility of government provision **and** free market provision
- government and private partnerships
- private insurance schemes
- internal markets
- subsidized private provision
- any reasonable answer.

Question 5

- (a) Explain why a country's balance of payments on current account may at times be in deficit and at other times be in surplus. [12 marks]**

Candidates should clearly define the term balance of payments on current account and explain the terms deficit and surplus on current account.

Explanations of deficits and surpluses might include the following:

- changes in exchange rates which alter the relative prices of imports and exports
- the impact of the level of economic activity in overseas markets on exports
- the impact of the level of domestic economic activity on imports
- relative domestic and foreign rates of inflation
- changes in the pattern of comparative advantage and overseas competition
- the impact of changes in barriers to trade
- changes in investment income and transfers
- changes in the terms of trade
- the impact of fiscal and monetary policies
- any reasonable answer.

- (b) To what extent does the existence of a current account deficit represent an economic problem? [13 marks]**

Reward candidates who are able to discuss circumstances in which a current account deficit may and may not represent a problem and who are able to provide an overall evaluation.

Issues and areas for discussion might include:

- not a problem if
 - deficit is small and/or temporary
 - it is counterbalanced by capital inflows
 - other countries are continuously willing to finance the deficit
 - it reflects a growing economy and higher living standards
 - automatic correction of a deficit under a floating exchange rate system
 - any reasonable answer.
- reasons why it may be a problem
 - need to finance deficit may lead to depletion of foreign exchange reserves/overseas borrowing/greater indebtedness
 - a reflection of trading uncompetitiveness/overvalued exchange rate
 - overseas creditors decide to “turn off the taps”
 - the impact on the exchange rate and inflation
 - the need for domestic deflation and the conflict with the goals of full employment and economic growth
 - any reasonable answer.

Question 6

(a) Outline the different types of foreign aid.

[10 marks]

- definition of aid

Types of aid might include:

- official/unofficial aid
- tied/untied aid
- bilateral aid
- multilateral aid
- food aid
- soft loans
- NGOs
- technical aid
- debt cancelling
- any reasonable answer.

(b) Discuss the view that foreign aid benefits the donor more than the recipient.

[15 marks]

A variety of approaches are possible in response to this question, and candidates who are able to provide an answer from different standpoints should be suitably rewarded. A sensible evaluation is also required.

Candidates may consider individual types of aid from (a) and assess/evaluate the relative benefits to the donor and to the recipient of each type of aid.

They may, instead, list possible benefits of aid in general to the donor and to the recipient and then evaluate the relative overall benefits.

Benefits to donors might include:

- aid given to finance imports from donor countries
- aid given to pay for debt/aid which increases indebtedness to the donor
- aid given to support political regimes sympathetic to donor countries
- aid given to provide employment in the industries of the donor country or to sell products from the donor country, *e.g.* construction contracts or military defence products
- *any reasonable answer.*

Benefits to recipients might include:

- aid given to bridge the savings gap
 - aid given to bridge the foreign exchange gap
 - aid given as FDI
 - aid given to finance provision of merit goods in recipient country
 - aid given to finance imports of “appropriate” technology
 - aid given to finance infrastructure projects in LDCs
 - *any reasonable answer.*
-