

Markscheme

November 2016

Economics

Higher level

Paper 2

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Use the paper-specific markscheme together with the markbands. Award up to the maximum marks as indicated.

Section A

1.	(a)	(i)	Define the term <i>subsidies</i> indicated in bold in the text (paragraph ②).	[2]
			Level	Marks
			0 <i>The work does not reach a standard described by the descriptors below.</i>	0
			1 <i>Vague definition.</i> The idea that the government gives money to an industry.	1
			2 <i>Accurate definition.</i> An explanation that the government gives money to an industry in order to, any one of the following: <ul style="list-style-type: none">• reduce cost of production• increase output/supply of a good• protect producers from foreign imports• reduce the price of a product.	2
		(ii)	Define the term <i>variable costs</i> indicated in bold in the text (paragraph ⑦).	[2]
			Level	Marks
			0 <i>The work does not reach a standard described by the descriptors below.</i>	0
			1 <i>Vague definition.</i> The idea that they are costs of production that change.	1
			2 <i>Accurate definition.</i> An explanation that they are the costs of production that change as output changes (or increase as output increases).	2

- (b) Using a supply and demand diagram with international trade values from the text, explain the statement that “The US imported 1200 million pounds (lb) of shrimp last year and produced 100 million pounds (lb) of shrimp domestically” (paragraph 2) (Does not need to be to scale). [4]

Level

Marks

0 *The work does not reach a standard described by the descriptors below.*

0

1 *There is a correct diagram **or** an accurate written response.*

1-2

For drawing a correctly labelled international trade diagram, showing a domestic supply of 100 million lb and an imported supply of 1200 million lb **or** explaining that at the world price, US shrimp farmers are only willing to supply 100 million lb and that the rest of the domestic demand is met by imports of 1200 million lb.

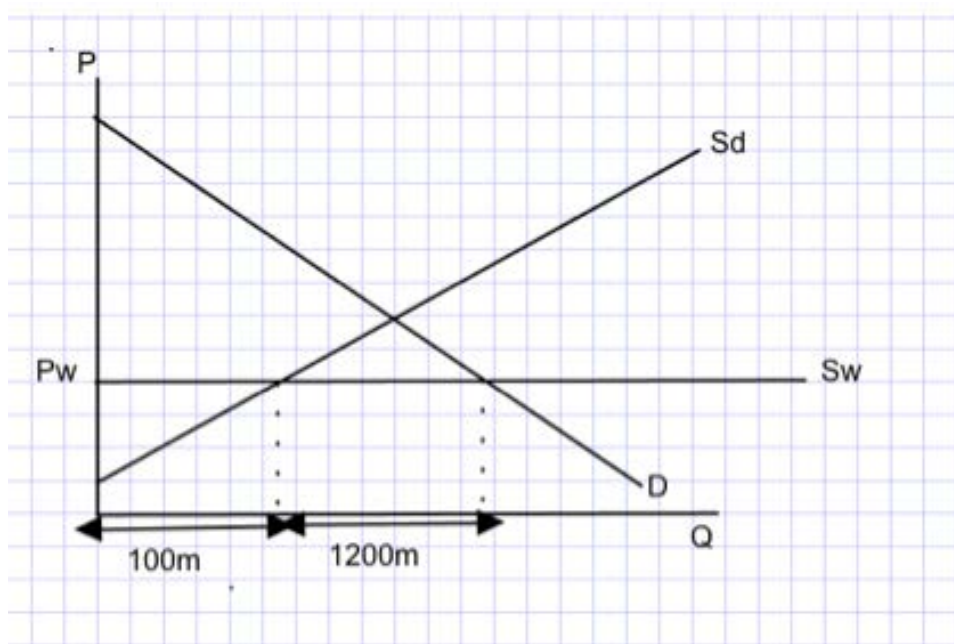
2 *There is a correct diagram **and** an accurate written response.*

3-4

For drawing a correctly labelled international trade diagram, showing a domestic supply of 100 million lb and an imported supply of 1200 million lb **and** explaining that at the world price, US shrimp farmers are only willing to supply 100 million lb and that the rest of the domestic demand is met by imports of 1200 million lb.

The numbers do not have to be on the diagram. Full marks may be awarded if the numbers from the text are used in the explanation with correct references to the quantities indicated on the diagram (eg 0Q1 is domestic supply of 100 million lb and Q1-Q2 is the imported amount of 1200 million lb).

The use of P and Q on the axes is sufficient for a demand and supply diagram. The world supply curve must be labelled S_W or S_{world} (to distinguish it from the domestic supply curve). S or S_D are both fine for the domestic supply curve.



(c) Using an average costs diagram, explain the short-run consequence for shrimp farmers if the price received “is not enough to cover their variable costs” (paragraph 7). [4]

Level Marks

0 *The work does not reach a standard described by the descriptors below.* 0

1 *There is a correct diagram **or** an accurate written response.* 1–2

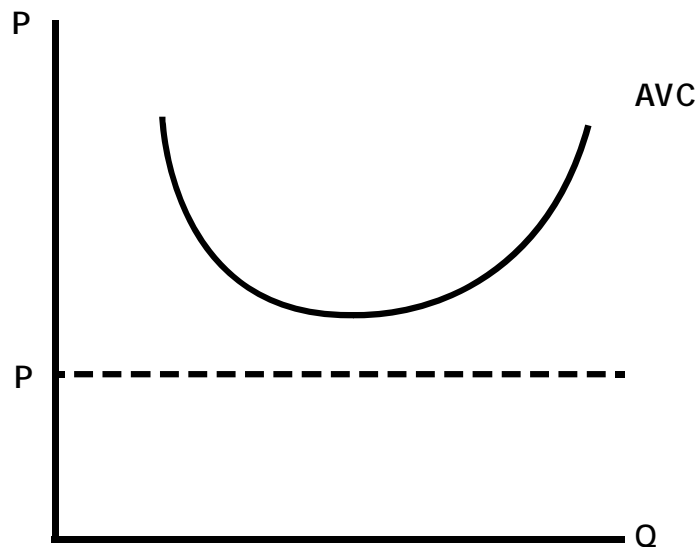
For drawing a correctly labelled costs diagram, showing AVC (MC not required for full marks) with a price below AVC **or** for explaining that since the shrimp farmers are not able to cover their average variable costs, some may have to shut down in the short run.

2 *There is a correct diagram **and** an accurate written response.* 3–4

For drawing a correctly labelled costs diagram, showing AVC (MC not required for full marks) with a price below AVC **and** for explaining that since the shrimp farmers are not able to cover their average variable costs, some may have to shut down in the short run.

An alternate approach would be to show the price at the minimum of AVC and explain that if the price were to go below this level, the firms would have to shut down as they would no longer be able to cover their variable costs.

For a costs diagram, the use of Price or Cost (P or C) on the vertical axis and Output or Quantity on the horizontal axis is sufficient.



- (d) Using information from the text/data and your knowledge of economics, discuss the view that the US should impose tariffs on the imported shrimp. **[8]**

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

Do not award beyond Level 2 if the answer does not contain reference to the information provided.

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>Few relevant concepts are recognized.</i> There is basic knowledge/understanding.	1–2
2 <i>Relevant concepts are recognized and developed in reasonable depth.</i> There is clear knowledge/understanding. There is some attempt at application/analysis.	3–5
3 <i>Relevant concepts are recognized and developed in reasonable depth.</i> There is clear knowledge/understanding. There is effective application/analysis. There is synthesis/evaluation, supported by appropriate theory and evidence.	6–8

Command term

Discuss requires candidates to offer a considered and balanced review that includes a range of arguments, factors, or hypotheses. Opinions or conclusions should be presented clearly and supported by appropriate evidence.

Responses **may** include:

- definition and diagram illustrating the effect of a tariff
- reasons to support the view that tariffs should be imposed:
 - higher costs of oil as a result of the oil spill have led to higher costs of production for US shrimp farmers and so higher prices for US shrimp (diagram possible) (paragraph ②)
 - if they are unable to cover their variable costs, many may go out of business leading to structural unemployment (may refer to part (c)) (paragraph ⑦)
 - there may be significant damage to the standard of living of shrimp farmers and their communities (paragraph ⑨)
 - foreign shrimp producers may have been given subsidies that are illegal under WTO rules, enabling them to lower prices to the point where US producers cannot cover their costs (paragraph ⑥)
- reasons against the view that tariffs should be imposed:
 - there will not be tariffs on shrimp from Thailand and Indonesia which are the largest producers of imported shrimp, and so the tariffs on the producers in the other five countries may not have that much of an effect on the level of imports (paragraph ⑤)
 - the tariff will be damaging to the shrimp producers in the five countries that are affected, all of which are developing countries; the tariff could hinder their development (paragraph ⑤)
 - the ruling was made by the US Commerce Department (not the WTO) and so the conclusion are likely to be in favour of the US producers
 - there may be insufficient evidence to support the claims (paragraph ⑥) and so tariffs will violate WTO rules
 - there may be retaliation from the countries affected, which could damage other US producers
 - the US producers are already getting financial support from BP (paragraph ③)
 - higher costs for food retailers and distributors
 - distortion of comparative advantage
 - misallocation of scarce resources
 - reduced consumer surplus.

Any reasonable discussion.

2. (a) (i) Define the term *interest rates* indicated in bold in the text (paragraph ❶). [2]

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>Vague definition.</i> The idea that it is a payment for a loan.	1
2 <i>Accurate definition.</i> An explanation that it is one of the following: <ul style="list-style-type: none"> • the price or cost of borrowed money • the price of credit (or the percentage paid on borrowed money) • the reward for saving. 	2

(ii) Define the term *normal profit* indicated in bold in the text (paragraph ❷). [2]

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>Vague definition.</i> The idea that costs are equal to revenue.	1
2 <i>Accurate definition.</i> Any one of the following explanations: <ul style="list-style-type: none"> • revenue covers all costs, including opportunity costs • total revenue is equal to implicit and explicit costs • the amount of profit needed to keep a firm in business (in the long run) • economic profit is equal to zero. 	2

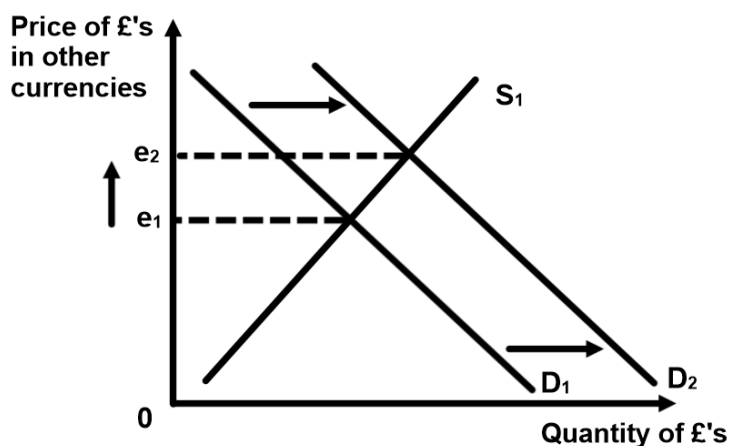
(b) Using an exchange rate diagram, explain how speculation is contributing to the rising value of the British pound (paragraph 1). [4]

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>There is a correct diagram or an accurate written response.</i> For drawing a correctly labelled exchange rate diagram showing an increase in demand and the appreciation of the British pound or for an explanation that speculators are anticipating that the pound will rise in value in the future and thus have been buying more British pounds, leading to appreciation.	1-2
2 <i>There is a correct diagram and an accurate written response.</i> For drawing a correctly labelled exchange rate diagram showing an increase in demand and the appreciation of the British pound and for an explanation that speculators are anticipating that the pound will rise in value in the future and thus have been buying more British pounds, leading to appreciation.	3-4

Candidates might explain that speculators are anticipating an increase in interest rates in the future, which would give a higher return on future savings, so are demanding British pounds now. This alternative approach should be fully rewarded.

Candidates who incorrectly label diagrams can be awarded a maximum of [3].

For an exchange rate diagram, the vertical axis may be exchange rate, price of British pound in other currencies, GBP/USD, USD/GBP or other currency per British pound. The horizontal axis should be quantity or quantity of British pounds. A title is not necessary.



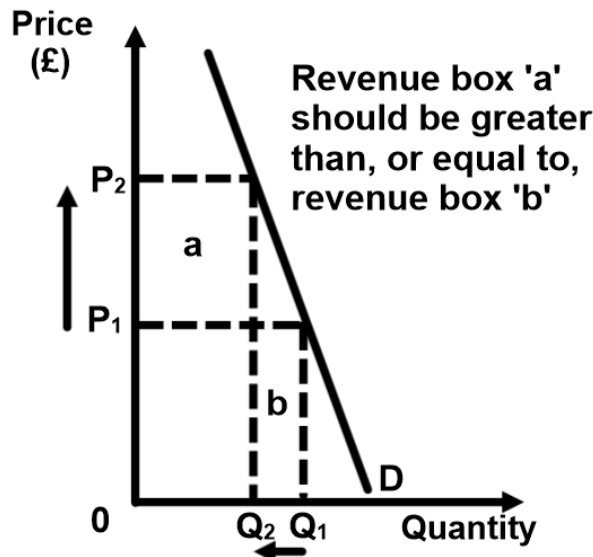
- (c) Using an appropriate diagram, explain why it is possible that “British firms producing exported goods that have few substitutes have reported no reduction in export revenue despite the appreciation” (paragraph ③). [4]

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>There is a correct diagram or an accurate written response.</i> For drawing a correctly labelled diagram showing a demand curve, with a price increase, a decrease in quantity (and revenue boxes) showing an increase in export revenue or for an explanation that since these firms produce goods with few substitutes, the demand is inelastic, and so when price increases due to appreciation, the total revenue increases.	1–2
2 <i>There is a correct diagram and an accurate written response.</i> For drawing a correctly labelled diagram showing a demand curve, with a price increase, a decrease in quantity (and revenue boxes) showing an increase in export revenue and for an explanation that since these firms produce goods with few substitutes, the demand is inelastic, and so when price increases due to appreciation, the total revenue increases.	3–4

Candidates may explain that the demand is unit elastic and so when the price increases due to appreciation, the total revenue will remain the same (“no reduction in export revenue”).

Candidates who incorrectly label diagrams can be awarded a maximum of [3].

The use of P and Q is sufficient for a demand and supply diagram. A title is not necessary.



- (d) Using information from the text/data and your knowledge of economics, discuss possible consequences of the appreciation of the British pound. [8]

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

Do not award beyond Level 2 if the answer does not contain reference to the information provided.

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>Few relevant concepts are recognized.</i> There is basic knowledge/understanding.	1–2
2 <i>Relevant concepts are recognized and developed in reasonable depth.</i> There is clear knowledge/understanding. There is some attempt at application/analysis.	3–5
3 <i>Relevant concepts are recognized and developed in reasonable depth.</i> There is clear knowledge/understanding. There is effective application/analysis. There is synthesis/evaluation, supported by appropriate theory and evidence.	6–8

Command term

Discuss requires candidates to offer a considered and balanced review that includes a range of arguments, factors, or hypotheses. Opinions or conclusions should be presented clearly and supported by appropriate evidence.

Responses may include:

- a strong British pound will lower the cost of imported raw materials, semi-finished goods, and finished goods, reducing inflationary pressure; whether or not this is beneficial depends on the level of inflation
- in the short run, export prices will rise and import prices will fall, possibly leading to reduced employment in both export industries, as demand for exports falls, and domestic industries, as people buy more imports
- the extent of the impact, and the effect on net exports and the current account depends on the elasticities of demand for exports and imports.
- reference to the (reverse) Marshall-Lerner condition
- negative impact on tourist sector in the UK (paragraph ②)
- positive impact on British tourists going overseas (paragraph ②)
- in markets where demand is inelastic, export revenue may not fall (part (c)) (paragraph ③)
- British firms are losing out to foreign competitors (paragraph ③) as goods and services are relatively more expensive
- a fall in net exports would lead to lower AD and so a fall in growth rates
- impact on British firms' profits
- the impact of cheaper fuel on household budgets (paragraph ④)
- prices of imports may not change immediately, as there are contracts that prevent price movements (paragraph ⑤).

Any reasonable discussion.

Section B

3. (a) (i) Define the term *market-oriented policies* indicated in bold in the text (paragraph 1). **[2]**
- | Level | | Marks |
|-------|---|----------|
| 0 | <i>The work does not reach a standard described by the descriptors below.</i> | 0 |
| 1 | <i>Vague definition.</i>
The idea that they are policies without government intervention. | 1 |
| 2 | <i>Accurate definition.</i>
An explanation that they are policies that support the allocation of resources by supply and demand (or the price mechanism) rather than through government intervention in markets. | 2 |
- (ii) Define the term *GDP per capita* indicated in bold in the text (Figure 1). **[2]**
- | Level | | Marks |
|-------|--|----------|
| 0 | <i>The work does not reach a standard described by the descriptors below.</i> | 0 |
| 1 | <i>Vague definition.</i>
The idea that it is a measure of output per person or the formula expressed as GDP/population. | 1 |
| 2 | <i>Accurate definition.</i>
An explanation that it is the total value of all final goods and services produced in an economy in one year per head of (divided by) the population. | 2 |

- (b) Explain why the Human Development Index (HDI) is considered to be a better indicator of economic development than GDP per capita. [4]

Level		Marks
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0	The work does not reach a standard described by the descriptors below.	0
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1	There is limited understanding.	1–2
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Shows an understanding of the multi-dimensional nature of the HDI by referring to **at least two** specific components of the HDI:

- life expectancy at birth
- mean years of schooling or expected years of schooling
- GNI (GDP) per capita (PPP US\$)

Or for an explanation that GDP per capita is a single indicator measuring only income, whereas the HDI is considered to be a better indicator, because it considers more indicators and/or the qualitative nature of economic development.

2	There is clear understanding.	3–4
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Shows an understanding of the multi-dimensional nature of the HDI by referring to **at least two** specific components of the HDI:

- life expectancy at birth
- mean years of schooling or expected years of schooling
- GNI (GDP) per capita (PPP US\$)

And for an explanation that GDP per capita is a single indicator measuring only income, whereas the HDI is considered to be a better indicator, because it considers more indicators and/or the qualitative nature of economic development.

Candidates who correctly describe **one** element of the HDI should be awarded [1].

- (c) With reference to the figures on the marginal propensity to consume (paragraph 9), explain how the value of the multiplier in China would compare with the value of the multiplier in a more developed-market economy (no calculation required). **[4]**

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>There is limited understanding.</i> For showing an understanding of the multiplier formula/equation/effect or for an explanation that the value of the multiplier in China would be lower than that in a more developed-market economy because the marginal propensity to consume (0.37) is lower than the average of more developed market economies (0.5).	1–2
2 <i>There is clear understanding.</i> For showing an understanding of the multiplier formula/equation/effect and for an explanation that the value of the multiplier in China would be lower than that in a more developed-market economy because the marginal propensity to consume (0.37) is lower than the average of more developed market economies (0.5).	3–4

*An answer that contains **only** a correct formula for the multiplier should receive **[1]** only.*

*For **[4]**, some reference to the data must be included.*

- (d) Using information from the text/data and your knowledge of economics, to what extent does unequal income distribution impact economic development in China? [8]

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

Do not award beyond Level 2 if the answer does not contain reference to the information provided.

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>Few relevant concepts are recognized.</i> There is basic knowledge/understanding.	1–2
2 <i>Relevant concepts are recognized and developed in reasonable depth.</i> There is clear knowledge/understanding. There is some attempt at application/analysis.	3–5
3 <i>Relevant concepts are recognized and developed in reasonable depth.</i> There is clear knowledge/understanding. There is effective application/analysis. There is synthesis/evaluation, supported by appropriate theory and evidence.	6–8

Command term

To what extent requires students to consider the merits or otherwise of an argument or concept. Opinions and conclusions should be presented clearly and supported with appropriate evidence and sound argument.

Responses may include:

- definitions of economic development
- use of a Lorenz curve diagram, showing a rise in inequality.

Impact of unequal income distribution:

- unequal allocation of society’s resources can lead to social unrest
- high income inequality results in small groups of powerful elites not interested in fairness or taxation as a redistributive mechanism (paragraph 3 and 4)
- low incomes reduce capacity for low-income households to borrow money (paragraph 4 difficulty accessing credit) reducing the capacity for low-income households to invest in technology or education to improve incomes in the long run
- low-income households carry the burden of tax payments further entrenching inequality (paragraph 4)
- poverty cycle
- “rich and powerful operate largely outside the tax system” contributing to low tax revenue as % of GDP (paragraph 4 and Figure 1)
- low tax revenue as % of GDP reduces government’s capacity to provide development projects in health and education (Figure 1)
- income inequality causes low marginal propensity to consume and high marginal propensity to save for private health and education expenditure thus reducing consumption and hence AD, causing lower economic growth, low tax receipts and poor expenditure on development (paragraph 5).

Any reasonable discussion.

4. (a) (i) Define the term ***budget deficit*** indicated in bold in the text (paragraph ❶). [2]

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>Vague definition.</i> The idea that it is to do with government revenue or spending.	1
2 <i>Accurate definition.</i> An explanation that it is when (planned) government spending is greater than government revenues.	2

(ii) Define the term ***economic development*** indicated in bold in the text (paragraph ❷). [2]

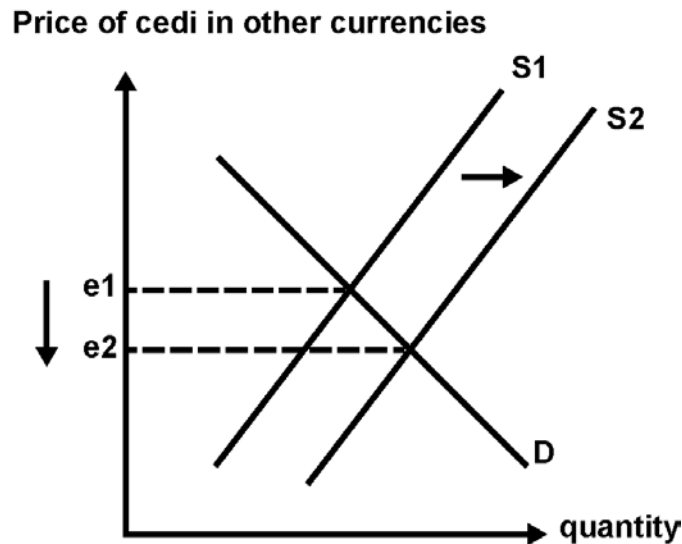
Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>Vague definition.</i> The idea that living standards improve.	1
2 <i>Accurate definition.</i> An explanation that it is a broad concept involving any two of the following: <ul style="list-style-type: none"> • improvement in standards of living • reduction in poverty • improved health • improved education • reduction in unemployment • greater equality in income distribution • environmental protection • increased freedom and economic choice • any other plausible aspect of development. 	2

(b) Using an exchange rate diagram, explain how the large current account deficit may have affected the value of the Ghanaian cedi. [4]

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>There is a correct diagram or an accurate written response.</i> For drawing a correctly labelled exchange rate diagram for the Ghanaian cedi with the supply curve shifting to the right and a fall in the exchange rate or for providing an explanation that outflows of money on the current account exceed inflows and hence there is increased selling of the Ghanaian cedi that will result in downward pressure on the currency (depreciation of the currency).	1–2
2 <i>There is a correct diagram and an accurate written response.</i> For drawing a correctly labelled exchange rate diagram for the Ghanaian cedi with the supply curve shifting to the right and a fall in the exchange rate and for providing an explanation that outflows of money on the current account exceed inflows and hence there is increased selling of the Ghanaian cedi that will result in downward pressure on the currency (depreciation of the currency).	3–4

Candidates who incorrectly label diagrams can be awarded a maximum of [3].

For an exchange rate diagram, the vertical axis may be exchange rate, cedi/USD, USD/cedi (or other currency), price of cedi in other currencies, or other currency per cedi. The horizontal axis should be quantity or quantity of cedi. A title is not necessary.



(c) Using an AD/AS diagram, explain how the falling value of the Ghanaian cedi may have contributed to inflation. [4]

Level Marks

0 *The work does not reach a standard described by the descriptors below.* 0

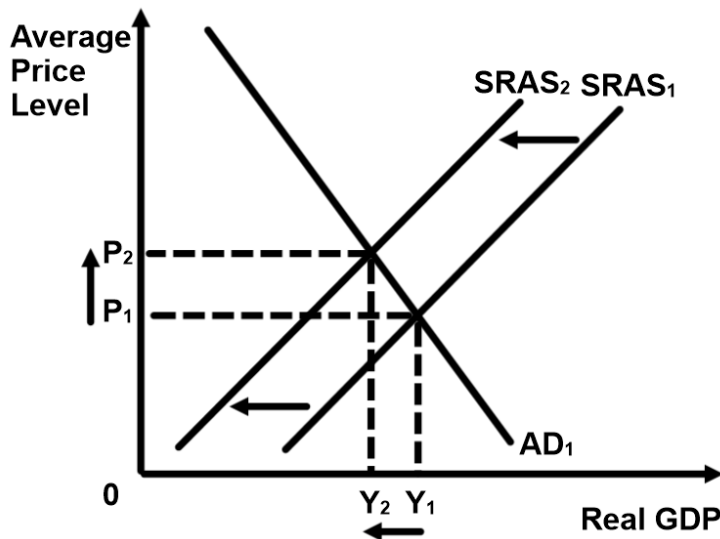
1 *There is a correct diagram **or** an accurate written response.* 1-2
For drawing a correctly labelled AD/AS diagram showing a fall in short-run aggregate supply and an increase in the average price level **or** for explaining that a fall in the value of the cedi will result in an increase in the cost of imported factors of production and therefore a fall in short-run aggregate supply, resulting in (cost-push) inflation.

2 *There is a correct diagram **and** an accurate written response.* 3-4
For drawing a correctly labelled AD/AS diagram showing a fall in short-run aggregate supply and an increase in the average price level **and** for explaining that a fall in the value of the cedi will result in an increase in the cost of imported factors of production and therefore a fall in short-run aggregate supply, resulting in (cost-push) inflation.

Candidates might explain that the falling cedi results in increasing net exports (X-M) due to cheaper exports and more expensive imports, which increases AD causing demand-pull inflation. This alternative approach should be fully rewarded.

Candidates who incorrectly label diagrams can be awarded with a maximum of [3].

For AD/AS, the vertical axis may be Average (General) Price Level, APL or Price level. The horizontal axis may be real output, real national output, real income, real national income, real GDP or real Y. A title is not necessary.



- (d) Using information from the text/data and your knowledge of economics, discuss possible consequences of International Monetary Fund (IMF) financial aid on Ghana's economic growth and development. **[8]**

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

Do not award beyond Level 2 if the answer does not contain reference to the information provided.

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>Few relevant concepts are recognized.</i> There is basic knowledge/understanding.	1–2
2 <i>Relevant concepts are recognized and developed in reasonable depth.</i> There is clear knowledge/understanding. There is some attempt at application/analysis.	3–5
3 <i>Relevant concepts are recognized and developed in reasonable depth.</i> There is clear knowledge/understanding. There is effective application/analysis. There is synthesis/evaluation, supported by appropriate theory and evidence.	6–8

Command term

Discuss requires candidates to offer a considered and balanced review that includes a range of arguments, factors, or hypotheses. Opinions or conclusions should be presented clearly and supported by appropriate evidence.

Responses may include:

- an explanation of the differences between economic growth and economic development
- an explanation of the links between growth and development
- an explanation of the sources of economic growth (eg improvements in the quality and quantity of physical and human capital, institutional reform).

Possible positive consequences:

- falling cedi may be limiting economic growth; financial aid from the IMF may be necessary to stop the cedi from falling further (paragraph ❶)
- if the cedi appreciates, it may reduce inflation
- any improvements in the economy may improve investor confidence, which will lead to more investment (FDI and portfolio investment) which will contribute to economic growth (paragraph ❷)
- the financial aid will force the government to reduce the budget deficit which is acting as a deterrent to investment (paragraph ❸)
- the financial aid will force the government to fight inflation which will help economic growth (paragraph ❹)
- if investment and growth pick up, there will be more leeway for the government to be able to afford to finance spending on development objectives, although this may only be possible over the longer term.

Possible negative consequences:

- the impact of IMF conditions of reduced government spending, a reduction in subsidies, privatisation and a wage freeze on development (paragraph 5)
- opportunity costs of servicing the debt
- IMF aid may be mismanaged (paragraph 6) which will have no impact on development
- the “sacrifices” (paragraph 6) Ghananians have to make will be anti-developmental.

Any reasonable discussion.

Discussion **may** include more general consideration of the nature of aid, growth and development and relationships between them.
