



MARKSCHEME

November 2013

ECONOMICS

Higher Level

Paper 2

18 pages

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

SECTION A

1. (a) (i) **Define the term *recession* indicated in bold in the text (paragraph 2).** [2 marks]

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> The idea that there is a fall in output or a deep slowdown.	1
2 <i>There is clear understanding.</i> An explanation that it occurs when an economy experiences two consecutive quarters of falling output (negative growth).	2

(ii) **Define the term *current account* indicated in bold in the text (paragraph 4).** [2 marks]

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 involves measuring exports and imports.	1
2 <i>Accurate definition.</i> An explanation that it is a measure of the flow of funds from trade in goods and services (value of exports minus imports), plus net income flows (profits, interest, wages, rents) and net transfers of money (foreign aid, grants, pensions, etc).	2

- (b) **Using an appropriate diagram, explain the reason for the improvement in Bolivia’s terms of trade (paragraph 4).** [4 marks]

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 demand and supply diagram showing an increase in demand for commodities and an increase in the price of commodities or an explanation that increasing demand for exported commodities leads to a rise in export prices (relative to import prices) and therefore an improvement in the terms of trade.	1–2
2 <i>There is a correct diagram and an accurate written response.</i> For drawing a correctly labelled demand and supply diagram showing an increase in demand for commodities and an increase in the price of commodities and an explanation that increasing demand for exported commodities leads to a rise in export prices (relative to import prices) and therefore an improvement in the terms of trade.	3–4

Students may take another approach to explain an increase in the price of exports. If correctly labelled and explained, this may be rewarded fully.

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

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

- (c) **Explain what is likely to have happened to any of the components of Bolivia’s financial account as a result of its current account surplus from 2004-2010 (assuming no change in the capital account).** [4 marks]

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>The written response is limited.</i> An awareness that the surplus on the current account between 2004 and 2010 means that there is a deficit on the financial (plus capital) account.	1–2
2 <i>The written response is accurate.</i> An explanation that the deficit on the financial account may have come about as a result of any one of the following: <ul style="list-style-type: none"> • an increase in foreign reserves (paragraph 4) • lending abroad • purchasing foreign assets. 	3–4

Alternatively, candidates may argue that excess funds generated by the current account are used to purchase overseas financial assets that appear on the financial account.

- (d) **Using information from the text/data and your knowledge of economics, evaluate the change in Bolivia’s exchange rate policy in moving from a fixed exchange rate to a managed float in late 2010 (paragraph ⑤).** **[8 marks]**

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

Command term

“Evaluate” requires candidates to make an appraisal by weighing up the strengths and limitations. Opinions and conclusions should be presented clearly and supported with appropriate evidence and sound argument.

Responses **may** include:

Arguments in favour of a fixed Boliviano: (the opposite of these arguments could also be used to explain the disadvantages of a managed float)

- high degree of certainty for stakeholders, allowing planning of investment and consumption spending; since 80% of imports are used by the manufacturing sector, a fixed exchange rate gives more certainty to manufacturers – (paragraph ⑤)
- reduced uncertainty associated with currency fluctuations encourages trade
- avoidance of exchange rate fluctuations with trading partners that are also fixed to the dollar
- the Bolivian central bank has large amounts of international reserves with which to support the Boliviano (paragraph ④)
- as long as there are current account surpluses, there is no fear of running out of international reserves
- reduced risk of inflation from a depreciation of the Boliviano.

Arguments in favour of a managed float: (the opposite of these arguments could also be used to explain the disadvantages of a fixed exchange rate)

- easier to adjust to external shocks
- ease of adjustment may be especially important to a country like Bolivia, which is highly dependent on a few commodity exports subject to high price volatility
- greater flexibility offered to policy makers to carry out independent monetary and fiscal policy, as interest rates and government spending do not have to respond to the needs of maintaining the fixed exchange rate
- an appreciation of the Boliviano is needed to reverse inflation, which was over 10% in mid-2011
- reduced inflationary pressures will reduce costs of imported inputs for manufacturers (*paragraph 3*)
- as the Boliviano appreciates, the current account surplus is likely to be reduced, due to lower imports and greater exports, helping to achieve a reasonable balance in the current account
- reference to the M-L condition (or inverse M-L condition)
- the achievement of a reasonable balance in the current account over the longer term will help avoid problems resulting from persistent current account surpluses (lower consumption and investment spending, reduced export competitiveness).

Any reasonable evaluation.

To reach Level 3, students must do more than deliver a standard discussion of the advantages and disadvantages of a fixed exchange rate versus a managed float exchange system. There must be an awareness of the Bolivian context. This might be related to the persistent current account surpluses, or the inflationary pressure that might have been the result of an undervalued boliviano.

2. (a) (i) Describe the term **business confidence** indicated in bold in the text (paragraph ②). [2 marks]

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> The idea that it is related to the expectations/sentiments of businesses about the economy.	1
2 <i>There is clear understanding.</i> An explanation that it is related to the expectations of businesses about the future of economic conditions, (which may be optimistic or pessimistic) and affects the level of investment.	2

- (ii) Define the term **deflation** indicated in bold in the text (paragraph ③). [2 marks]

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 prices are falling.	1
2 <i>Accurate definition.</i> An explanation that it is a sustained decrease in the average level of prices in an economy.	2

(b) Using an appropriate diagram, explain a possible effect of the overvalued yen on the Japanese economy. **[4 marks]**

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 AD/AS diagram showing a fall in aggregate demand or for explaining that the overvalued yen results in a fall in the demand for exports (or an increase in the demand for imports) therefore a fall in AD, and a fall in real GDP and/or a fall in the average price level and/or an increase in unemployment.	1–2
2 <i>There is a correct diagram or an accurate written response.</i> An explanation that an overvalued yen may lead to: For drawing a correctly labelled AD/AS diagram showing a fall in aggregate demand and for explaining that the overvalued yen results in a fall in the demand for exports (or an increase in the demand for imports) therefore a fall in AD, and a fall in real GDP and/or a fall in the average price level and/or an increase in unemployment.	3–4

N.B. Another approach would be to explain that the overvalued yen makes imported factors of production less expensive, leading to an increase in aggregate supply and a fall in the price level and/or an increase in real GDP. If correctly explained, this may be fully rewarded.

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

(c) Using an appropriate diagram, explain the impact of the Japanese current account surplus on the value of the yen (*paragraph 4*). [4 marks]

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 for the yen due to an increase in the demand for Japanese exports or for explaining that an increase in demand for the yen due to an increase in the demand for Japanese exports would cause its price to increase.	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 for the yen due to an increase in the demand for Japanese exports and for explaining that an increase in demand for the yen due to an increase in the demand for Japanese exports would cause its price to increase.	3-4

Candidates who incorrectly label diagrams can receive a maximum of [3 marks].

For an exchange rate diagram, the vertical axis may be exchange rate, price of yen in \$US, \$/yen or \$US. The horizontal axis may be quantity, or quantity of yen. A title is not necessary.

- (d) **Using information from the text/data and your knowledge of economics, discuss the likely consequences of intervention in the yen market.** [8 marks]

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 some 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 and conclusions should be presented clearly and supported by appropriate evidence.

Responses **may** include:

- an explanation of how Japan might intervene in the yen market to bring about a depreciation. (*paragraph 1*)

Arguments in favour of intervention:

- Net exports may rise as exports become more competitive and imports become more expensive
- Reference to the ML condition; the effect on net exports depends on the price elasticity of demand for exports and imports;
- an increase in net exports results in an increase in AD, which may help to bring Japan out of recession (*paragraph 3*), raise business confidence (*paragraph 2*) and help to bring about some inflation, which would be positive in Japan’s deflationary environment (*paragraph 5*)
- increased revenue for exporters (*paragraph 4*)
- may offset the effect of the trade protection in export markets (*paragraph 4*)
- may be seen as a better option than trade protection.
- Japan has little alternative, at least in the short run, to stimulate economic growth considering its economic situation
- If intervention successfully brings about depreciation, it may create some desirable inflation

Arguments against intervention

- possibility of a currency war (*paragraph 1*)
- prevents the economy from re-structuring away from a dependence on exports (*paragraph 5*)
- Japan may be accused of currency manipulation
- may spark increased protection in export markets
- can only do this by accumulating reserves, since interest rates have fallen to zero (*paragraph 5*).

Any reasonable discussion.

SECTION B

3. (a) (i) **Define the term *diversification* identified in bold in the text (paragraph ③).** [2 marks]

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 involves an increase in the variety of goods and services	1
2 <i>Accurate definition.</i> An explanation that it is a strategy to increase the variety of goods and services produced in order to avoid (the risks associated with) over-specialisation.	2

(ii) **Define the term *economic growth* identified in bold in the text (paragraph ④).** [2 marks]

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 of a growing economy.	1
2 <i>Accurate definition.</i> An explanation that it is an increase in output (real GDP) over time.	2

(b) Explain *two* reasons why multinational corporations (MNCs) expand into economically less developed countries. [4 marks]

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>The written response is limited.</i> A list of any two factors, such as: <ul style="list-style-type: none">• to access natural resources• to increase sales and revenues• to gain access to new markets• to lower costs of production• to bypass trade barriers• weaker regulations• to avoid transport costs• attracted by tax incentives offered by ELDC governments	1–2
2 <i>The written response is clear.</i> For explaining any two of the factors listed above	3–4

(c) Explain *one* reason why over-specialization on a narrow range of products may be a barrier to development for economically less developed countries. [4 marks]

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>The written response is limited.</i> For identifying any problem associated with over-specialization, such as: <ul style="list-style-type: none">• more vulnerable to commodity price volatility• more vulnerable to changes in external demand and supply factors• more vulnerable to long term deteriorating terms of trade• may face trade barriers on agricultural products imposed by developed countries• lose benefits from diversification into higher value added production, usually involving manufacturing.• Comparative advantage may change in the long run	1–2
2 <i>The written response is accurate.</i> For explaining that the reason identified acts as a barrier to development due to any reason, including any of the following: <ul style="list-style-type: none">• uncertainty about export revenues makes it difficult for an ELDC government to plan its spending on development objectives• falling prices mean that governments have less revenues to finance investment in development objectives• trade barriers in EMDCs prevent producers from accessing markets and raising incomes.• If comparative advantage is lost, this might result in structural unemployment and a fall in living standards.	3–4

- (d) **Using information from the text/data and your knowledge of economics, discuss the likely effects of Chinese and Indian foreign direct investment (FDI) in Africa on the development of countries in Africa.** *[8 marks]*

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 some 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 and conclusions should be presented clearly and supported by appropriate evidence.

Responses **may** include:

Defintions of FDI, MNCs, economic development

Consideration of potential benefits of FDI for development:

- supplement local savings/fill savings gap
- bring in more foreign exchange
- improve on technical skills and technology
- hiring and training of local workers by Indian MNCs (*paragraph 3*)
- improve on management skills /positive externalities of production with supporting diagram
- increased support of diversification by India may prevent problems associated with over-specialisation (*paragraph 3*)

- greater tax revenues may be used to finance development objectives
- promotion of local industry through increased links (*paragraph 3*)
- increase exports
- increase in AD with supporting diagram
- a comparison of the different approaches taken by China and India.

Consideration of potential costs of FDI for development:

- depending on the conditions, each of the potential benefits may not materialize
- negative externalities of production with supporting diagram (*paragraph 5*)
- inappropriate infrastructure geared toward MNC needs
- bypassing of labour protection laws
- the “race to the bottom” as countries compete to host MNCs
- a comparison of the different approaches taken by China and India.

Any reasonable discussion.

4. (a) (i) **Define the term *economic growth* indicated in bold in the text (*paragraph 4*).** [2 marks]

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 of a growing economy.	1
2 <i>Accurate definition.</i> An explanation that it is an increase in real output (real GDP) over time.	2

(ii) **State why the GNI (GNP) per capita for Moldova and India is higher than their GDP per capita (*Table 1*).** [2 marks]

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> The idea that there is more income from overseas.	1
2 <i>There is clear understanding.</i> An explanation that there must be a positive figure (balance) for net property income (current transfers).	2

- (b) Referring to Table 1, explain *two* possible reasons why India and Moldova have different Human Development Index (HDI) values from each other. [4 marks]

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>The written response is limited.</i> For recognising that the HDI is a composite index (or that the HDI measures several areas of development) and referring to at least two components.	1–2
2 <i>The written response is clear.</i> For explaining that since GNI per capita is similar in Moldova and India, this means that Moldova must have a higher value for life expectancy and/or mean years of schooling (or school enrolment/literacy – previous measure) since its HDI value is higher.	3–4

To gain full marks, as well as observing that the GNI per capita is similar, candidates must make reference to the specific indicators of health (life expectancy) and education (mean years of schooling or school enrolment/literacy).

- (c) Using a Lorenz curve diagram showing India’s changing income distribution, explain how India’s Gini coefficient will have changed (paragraph 1). [4 marks]

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 Lorenz curve diagram showing the Lorenz curve to be shifting away from the diagonal or for explaining that India’s inequality has increased shown by the outward shift in the Lorenz curve. This means that the Gini coefficient will have increased.	1–2
2 <i>There is a correct diagram and an accurate written response.</i> For drawing a correctly labelled Lorenz curve diagram showing the Lorenz curve to be shifting away from the diagonal and for explaining that India’s inequality has increased shown by the outward shift in the Lorenz curve. This means that the Gini coefficient will have increased.	3–4

Candidates who incorrectly label diagrams can receive a maximum of [3 marks].

For the vertical axis, the label may be cumulative percentage of income or percentage of income. For the horizontal axis, the label may be cumulative percentage of population or percentage of population. A title is not necessary.

- (d) Using information from the text/data in Table 2 and your knowledge of economics, examine Amartya Sen’s argument that economic growth should not be “our ultimate objective, but a very useful means to achieve ... a better quality of life” (paragraph 4). [8 marks]

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 some effective application/analysis. There is synthesis/evaluation, supported by appropriate theory and evidence.	6–8

Command term

“Examine” requires candidates to consider an argument or concept in a way that uncovers the assumptions and interrelationships of the issue. Opinions and conclusions should be presented clearly and supported by appropriate evidence.

Responses **may** include:

- definition of economic growth
- diagram illustrating growth in potential output (PPC or LRAS shifts)
- diagram illustrating growth in actual output (AD/AS shifts)
- relationship between quality of life and economic development
- relationship between economic growth and quality of life (economic development):
 - growth over long periods essential for development, but possible to have some development with less growth
 - reference to Bangladesh’s superior performance in spite of lower growth rates and lower GNI per capita (Table 2) and Moldova’s higher HDI despite lower GDP per capita (Table 1)
 - reference to indicators of quality of life/development (Table 2)
 - possible to have growth with little or no development. India not achieving MDGs (paragraph 1) despite average growth of 8.6% in the years 2005-2011 (paragraph 3)
 - outcomes depend on particular growth policies
- potential benefits of growth: more resources to pursue development objectives and improve quality of life

- interventionist supply-side policies (investment in health and education, industrial policies) can result in growth with development, improvements in quality of life, improved income distribution (*paragraph 3*)
- market-oriented supply-side policies may result in growth with increasing poverty and worsening income distribution - inequality increase by 14% (*paragraph 1*)
- importance of improved income distribution for growth with development (*paragraph 1*)
- for growth with development need growth policies that address the causes of poverty (increased employment opportunities, investments in human capital, *etc*)
- even growth of 10 % per year (*paragraph 3*) is unlikely to reduce poverty and improve standards of living if growth policies are not inclusive/aimed at poverty alleviation (investments in human capital, micro-credit for the poor, income redistribution policies, increased property rights, increased wages/improved labour conditions, improved human rights)
- growth may result in negative externalities which may lead to a lower quality of life.

Any reasonable examination.
