



MARKSCHEME

May 2014

ECONOMICS

Higher Level

Paper 2

19 pages

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In addition to the assessment criteria use the paper-specific markscheme below. Award up to the maximum marks as indicated.

SECTION A

1. (a) (i) Define the term *inflationary gap* indicated in bold in the text (paragraph ①). **[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 is to do with too much demand or rising prices in an economy.	1
2 <i>Accurate definition.</i> An explanation that it refers to the situation where: <ul style="list-style-type: none"> • the economy is (in equilibrium) at a level of output that is greater than the full employment level of output or above potential output OR <ul style="list-style-type: none"> • an increase in aggregate demand (when the economy is at full employment) results in an increase in the average price level with no increase in real GDP. 	2

(ii) Define the term *financial account* indicated in bold in the text (paragraph ⑦). **[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 is part of the balance of payments accounts.	1
2 <i>Accurate definition.</i> An explanation that it is the (net) balance arising from (two of the following): <ul style="list-style-type: none"> • flows of foreign direct investment • flows of portfolio investment • changes in reserve assets. OR An explanation that it is the net change in foreign ownership of domestic financial assets.	2

- (b) **With reference to the concept of price elasticity of demand, explain why rising oil prices have contributed to Turkey’s growing current account deficit (paragraph 5).** [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 explaining that oil is an import and that demand for oil is inelastic or for explaining that increases in price will lead to relatively smaller decreases in quantity demanded, increasing total expenditure on oil (and/or total import expenditure) thus contributing to the growing current account deficit.	1–2
2 <i>The written response is accurate.</i> For explaining that oil is an import and that demand for oil is inelastic and for explaining that increases in price will lead to relatively smaller decreases in quantity demanded, increasing total expenditure on oil (and/or total import expenditure) thus contributing to the growing current account deficit.	3–4

- (c) **Explain two reasons why “rapidly rising domestic demand” may have contributed to Turkey’s current account deficit (paragraph 6).** [4 marks]

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>An explanation of any one of the following:</i> <ul style="list-style-type: none"> • the increase in domestic demand would include an increase in the demand for imports thus increasing import expenditure • an increase in domestic demand would lead to inflation, increasing the price of exports and so (possibly) reducing export revenue • rapidly rising demand means that producers increase their sales to domestic consumers, cutting exports and export revenues • rising demand in the economy may mean that producers need to import more raw materials and capital to meet the demand, thus increasing spending in imports. 	1–2
2 <i>An explanation of any two of the following:</i> <ul style="list-style-type: none"> • the increase in domestic demand would include an increase in the demand for imports thus increasing import expenditure • an increase in domestic demand would lead to inflation, increasing the price of exports and so (possibly) reducing export revenue • rapidly rising demand means that producers increase their sales to domestic consumers, cutting exports and export revenues • rising demand in the economy may mean that producers need to import more raw materials and capital to meet the demand, thus increasing spending in imports. 	3–4

- (d) **Using information from the text/data and your knowledge of economics, evaluate the possible policies that the Turkish authorities might use to reduce the current account deficit.** *[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 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.

Responses **may** include:

- an explanation of a current account deficit
- expenditure-switching policies:
 - depreciating the currency to make exports more competitive and imports more expensive – might worsen the deficit if PED for oil is inelastic and Turkey is a “large net oil importer” (*paragraph 5*); will only be successful if the combined price elasticity of demand for exports and imports is greater than 1 (Marshall-Lerner condition)
 - protectionist measures such as tariffs, quotas or subsidies to reduce spending on imports – might lead to retaliation harming the “boom in foreign investment and trade” (*paragraph 2*)
- expenditure-reducing policies:
 - use contractionary monetary and/or fiscal policies to reduce overall AD in order to reduce spending on imports
 - would also serve to reduce the “inflationary gap” (*paragraph 1*)
 - contractionary monetary policy could lead to appreciation of the lira, which may help to reduce inflationary pressure; this could also reduce cost of imported capital which would increase LRAS
 - would reduce “rapidly rising domestic demand” (*paragraph 6*), however, it would be difficult to assess the correct amount of deflation needed. May overshoot and cause recession

- contractionary monetary policies, increasing interest rates, should reduce the fear of financial account outflows (*paragraph 7*)
- time lag involved
- supply-side policies
 - supply side policies may be used to improve the competitiveness of exports and increase the competitiveness of goods that compete with imports, but this is a long term solution.

Any reasonable discussion.

2. (a) (i) Define the term **investment** indicated in bold in the text (*Text A*). [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 is buying machinery.	1
2 <i>Accurate definition.</i> An explanation that it is: <ul style="list-style-type: none">• any addition to the capital stock of the economy OR <ul style="list-style-type: none">• expenditure/spending by firms on capital.	2

No credit for defining “financial investment”.

(ii) Define the term **comparative advantage** indicated in bold in the text (*Text C, paragraph 1*). [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 one country can produce more efficiently than another country.	1
2 <i>Accurate definition.</i> An explanation that it is when a country can produce a product at a lower opportunity cost than another country.	2

- (b) Using a cost diagram, explain how access to foreign markets may allow Australian farmers to “gain from the potential economies of scale” (Text C, paragraph ⑤). [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 diagram showing an LRAC curve indicating falling average cost as output increases or for an explanation that, as output increases due to the ability to sell to a larger market, Australian farmers may benefit from economies of scale and so benefit from reduced costs per unit of output.	1–2
2 <i>There is a correct diagram and an accurate written response.</i> For drawing a correctly labelled diagram showing an LRAC curve indicating falling average cost as output increases and for an explanation that, as output increases due to the ability to sell to a larger market, Australian farmers may benefit from economies of scale and so benefit from reduced costs per unit of output.	3–4

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

For full marks, it is essential to make some use of the diagram, either by referring to two points noted on the diagram, or referring to the section of the diagram where average costs are falling.

Some students may show two or more short run costs curves, with the “envelope” LRAC curve. This is certainly acceptable, but not necessary.

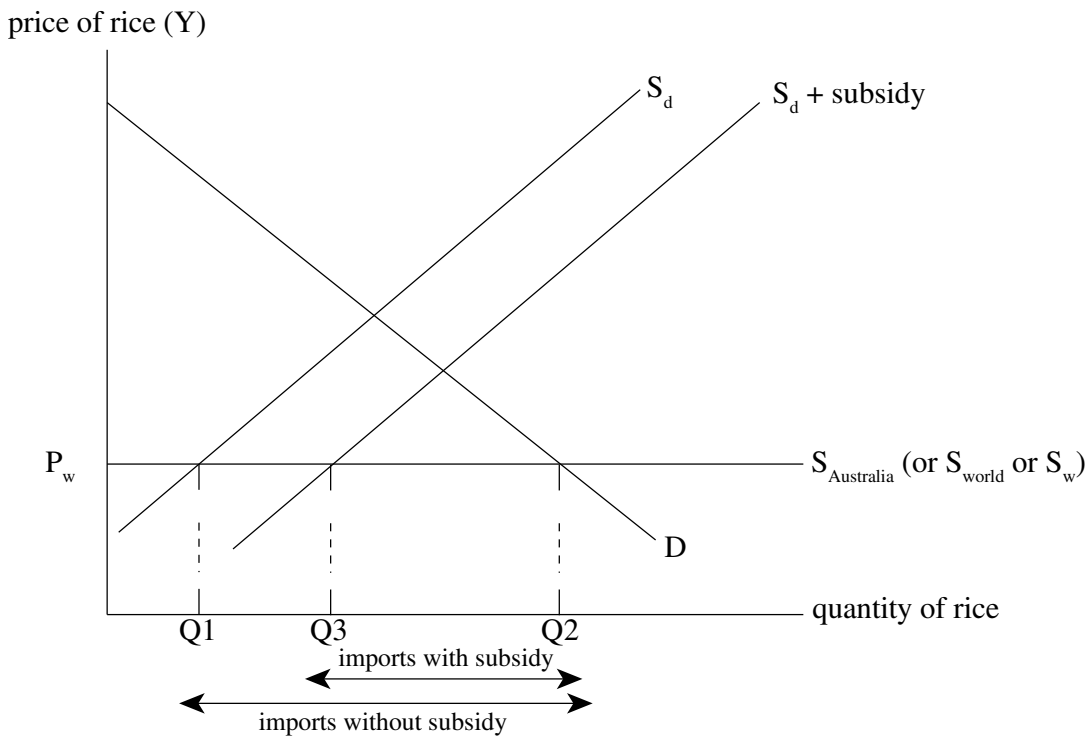
For costs diagrams, the use of Cost or Price and Output or Quantity on the axes is sufficient. A title is not necessary.

(c) Using an international trade diagram, explain how Japanese subsidies have been “limiting Australia’s access to the Japanese rice market” (*Text C, 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 international trade diagram showing the granting of a subsidy to Japanese rice farmers, an increase in quantity supplied by Japanese producers and a fall in the quantity of imports or for an explanation that a subsidy for Japanese farmers, reduces their costs, thus increasing their supply and reducing imports of Australian rice.	1–2
2 <i>There is a correct diagram and an accurate written response.</i> For drawing a correctly labelled international trade diagram showing the granting of a subsidy to Japanese rice farmers, an increase in quantity supplied by Japanese producers and a fall in the quantity of imports and for an explanation that a subsidy for Japanese farmers, reduces their costs, thus increasing their supply and reducing imports of Australian rice.	3–4

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. The world supply curve must be labelled S_w or S_{world} or $S_{Australia}$. A title is not necessary.



- (d) **Using information from the text/data and your knowledge of economics, discuss the possible consequences for Australian and Japanese producers of moving towards freer trade.** *[8 marks]*

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:

- definitions of free trade
- explanation of the gains from trade
- explanation of the benefits and drawbacks of comparative advantage (*Text C, paragraph ①*) (may include diagram)
- the gains from economies of scale (may refer back to part (b))
- varying effects on different producers
- favourable for Australian agricultural producers (*Text C, paragraph ①*) currently facing high levels of protection in Japanese markets (*Text C, paragraph ②*)
- favourable for Japanese producers of industrial products (*Text B, paragraph ②*) who are struggling due to strong yen
- unfavourable for Japanese farmers (*Text B, paragraph ③*) who may lose government subsidies and benefits of high tariffs
- possibility that Australian manufacturing industries may suffer (not mentioned in text)
- greater efficiency as producers in both countries face more competition
- loss of jobs when protection is removed
- diagram showing removal of tariff (in any of the markets) to show effects on domestic producers and foreign producers
- diagram showing removal of subsidy to show effects on domestic producers and foreign producers

- enhancement of trade and investment among the countries (*Text A*) may support producers in both countries
- promotion of innovation (*Text A*).

Any reasonable discussion.

SECTION B

3. (a) (i) **Define the term *gross domestic product (GDP)* indicated in bold in the text (Text A, paragraph 2).** [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 is the output produced in an economy.	1
2 <i>Accurate definition.</i> An explanation that it is the total value of all goods and services produced in an economy (in a given time period). OR An explanation that it is the sum of consumption, investment, government spending and net exports.	2

(ii) **Outline the main function of the International Monetary Fund (IMF) (Text B, paragraph 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> A list of unspecific functions is given.	1
2 <i>There is clear understanding.</i> A clear outline of one of the following: <ul style="list-style-type: none">• ensure the stability of the international monetary system• promote international monetary cooperation• lend money to help members in balance of payments difficulties.	2

(b) With reference to Text A and Figure 1, explain what is likely to have happened to Ivory Coast's terms of trade in 2011. [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 explaining that the terms of trade is an index that shows the value of a country's average export prices relative to the import prices (the formula would be acceptable, <i>ie</i> the index of export prices divided by the index of import prices times one hundred) or for explaining that coffee and cocoa prices went down, while petroleum oil prices went up, and if coffee and cocoa make up a larger percentage of its exports, then the terms of trade likely will have fallen.	1-2
2 <i>The written response is accurate.</i> For explaining that the terms of trade is an index that shows the value of a country's average export prices relative to the import prices (the formula would be acceptable, <i>ie</i> the index of export prices divided by the index of import prices times one hundred) and for explaining that coffee and cocoa prices went down, while petroleum oil prices went up, and if coffee and cocoa make up a larger percentage of its exports, then the terms of trade likely will have fallen.	3-4

As long as students show understanding of the concept through a definition/explanation, and make a logical link to the data, then they may receive full credit. For example, some of the main export prices went down (coffee and cocoa), while oil prices went up, so it is uncertain what would have happened to the terms of trade. For full credit, it is necessary to be aware that some prices have gone down while the price of oil has risen.

- (c) **Using an AD/AS diagram, explain how a loss of foreign direct investment (FDI) might have harmed economic growth in Ivory Coast (Text A).** [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 shift of the AD curve to the left and a fall in output or for an explanation that foreign investment is part of investment and so is a component of AD and, if it falls, then AD will also fall, resulting in a fall in total output.	1–2
2 <i>There is a correct diagram and an accurate written response.</i> For drawing a correctly labelled AD/AS diagram showing a shift of the AD curve to the left and a fall in output and for an explanation that foreign investment is part of investment and so is a component of AD and, if it falls, then AD will also fall, resulting in a fall in total output.	3–4

Alternative response:

For drawing a correctly labelled AD/AS diagram showing a shift of the LRAS curve to the left and a fall in output with an explanation that a fall in FDI would result in a reduction/deterioration in the level of capital, a factor of production, in the economy.

No credit may be given for an answer that focuses on a shift in short run aggregate supply.

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

For AD/AS, the vertical axis may be price level or average price level. The horizontal axis may be output, real output, national output, real national output, national income, or GDP. A title is not necessary.

- (d) **Using information from the text/data and your knowledge of economics, discuss the main challenges facing Ivory Coast as it seeks to achieve economic growth and economic development.** *[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.

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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
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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:

- definitions of economic growth and economic development
- distinction between economic growth and economic development
- discussion of challenges to achieve economic growth and economic development might include:
 - overspecialization on a narrow range of exports: dependence upon agricultural production (*Text A, paragraph 1*)
 - price volatility/fluctuations in world resource prices (*Text A, paragraph 1*) and changes in the terms of trade (*Figure 1*) creates uncertainty and reduces the ability of producers to invest and the ability of government to spend on development objectives
 - political unrest (*Text A, paragraph 2*) and post-election violence (*Text B, paragraph 1*) creates a poor investment climate and may make it difficult to complete the conditions necessary for debt relief (*Text B, paragraph 2*)
 - loss of FDI (*Text A, paragraph 2*)
 - deteriorating infrastructure (*Text A, paragraph 2*) makes it difficult to attract FDI
 - high levels of debt (*Text B, paragraph 1*) make it difficult for government to finance spending on development objectives.

Any reasonable discussion.

4. (a) (i) Define the term ***inflation*** 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>Vague definition.</i> The idea that it is an increase in prices.	1
2 <i>Accurate definition.</i> An explanation that it a sustained increase in the average (general) price level.	2

(ii) Define the term ***privatization*** 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 it is when government no longer owns a company.	1
2 <i>Accurate definition.</i> An explanation that the government sells state-owned enterprises (assets) to the private sector.	2

(b) Using a production possibilities curve (PPC) diagram, explain how “better bed nets” (paragraph ①) may contribute to economic growth. [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 PPC diagram to show an outward shift of the PPC curve or for an explanation that the nets improve the quality (health) and/or quantity of labour, a factor of production, thus increasing production possibilities and contributing to economic growth.	1–2
2 <i>There is a correct diagram and an accurate written response.</i> For drawing a correctly labelled PPC diagram to show an outward shift of the PPC curve and for an explanation that the nets improve the quality (health) and/or quantity of labour, a factor of production, thus increasing production possibilities and contributing to economic growth.	3–4

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

For a PPC, the axes could be two alternative products, one on each axis, eg Good A and Good B or Schools and Motor Cars; or two groups of products, eg Consumer Goods and Producer Goods. A title is not necessary.

(c) With reference to a poverty trap (poverty cycle), explain why “major poverty reduction will require higher economic growth” (paragraph ②). [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 explanation that a poverty trap is an inability to invest in (physical, human or natural) capital due to low savings, forming a self-perpetuating cycle (which may be illustrated by the use of a poverty cycle diagram) or an explanation that current rates of economic growth are not sufficient to break out of this trap so that higher rates of economic growth are necessary.	1–2
2 <i>The written response is accurate.</i> An explanation that a poverty trap is an inability to invest in (physical, human or natural) capital due to low savings, forming a self-perpetuating cycle (which may be illustrated by the use of a poverty cycle diagram) and an explanation that current rates of economic growth are not sufficient to break out of this trap so that higher rates of economic growth are necessary.	3–4

- (d) **Using information from the text/data and your knowledge of economics, evaluate the strengths and weaknesses of market-oriented policies used by African governments to encourage economic growth.** *[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
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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

“Evaluate” requires candidates to make an appraisal by weighing up the strengths and limitations.

Responses **may** include:

- Explanation of market-oriented policies:
 - reforms in regulations (*paragraph 3*)
 - trade liberalization (*paragraph 5*)
 - privatization (*paragraph 3*)
 - reduction in government expenditure – not in text, but might be mentioned
 - reference to the Washington Consensus – not in text, but could be mentioned
- Possible strengths:
 - faster economic growth **may** be attributable to such market-oriented policies
 - increased incomes
 - privatization may result in greater efficiencies
 - privatisation generates revenue for governments
 - greater role for entrepreneurship (*paragraph 5*)
 - increased role of incentives
 - increased competition with the growth of new firms (*paragraph 5*) leading to increased efficiency, lower prices, more choice
 - may attract more FDI, leading to more employment (*paragraph 4*)
 - more MNCs investing in consumer goods businesses, giving consumers increased access to goods and services (link to development)
 - benefits of trade liberalisation = greater choice, lower prices (*paragraph 3*)
 - regional trade is picking up)

- trade liberalisation may lead to increased efficiencies – possible reference to comparative advantage
- Possible weaknesses
 - under-provision of infrastructure, which is necessary for growth (*paragraph ③* – shortage of good roads) (*paragraph ⑥* – more roads and storage facilities needed for agriculture)
 - under-provision of merit goods and public goods: although advances in technology are contributing to health care (*paragraph ①*), market forces alone will not provide enough health care. Disease and hunger are still major problems that market-oriented policies are unlikely to solve
 - privatisation may mean that some essential goods (*eg* water) may not be affordable to all
 - possible vulnerability to external forces (*eg* FDI dropped significantly in 2008, *Figure 1*)
 - trade liberalisation may leave some African producers unable to compete
 - growth is not enough to reduce poverty (*paragraph ②*)
 - the agricultural sector needs support/government intervention (*paragraph ⑤*)
 - market-oriented policies may lead to increased inequality, with increased social tensions. This may threaten growth in the long term
 - profit motive may lead to negative externalities of production = threats to sustainability
 - unclear property rights (*paragraph ⑥*) may make it difficult for market-oriented policies to be successful.

Any reasonable discussion.
