

Markscheme

May 2015

Economics

Higher level

Paper 2

21 pages

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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 *customs union* 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 it is where countries agree to trade freely.	1
2 <i>Accurate definition.</i> An explanation that it is a form of economic integration where member countries agree to liberalize trade (trade freely amongst themselves) and adopt a common external tariff (or common trade policies towards non members).	2

(ii) Define the term *direct taxes* indicated in bold in the text (paragraph 3). [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 taxes are paid to the government or tax paid by an individual (household).	1
2 <i>Accurate definition.</i> An explanation that they are taxes (paid to the government) on income (households and firms).	2

- (b) Using an AD/AS diagram, explain how devaluation of the lat (the Latvian currency) might have been used to improve the Latvian economy during the financial crisis (paragraph 3). [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

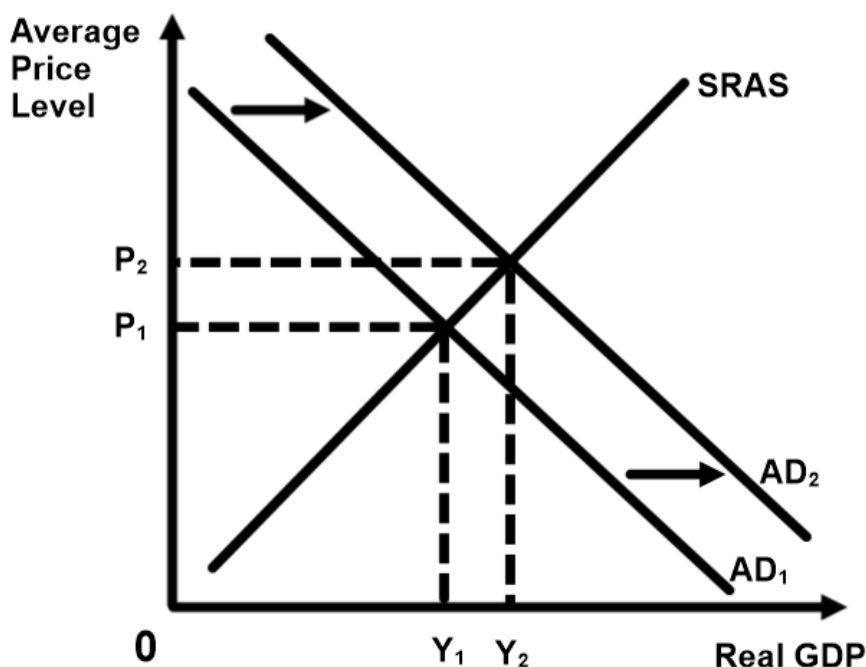
For drawing a correctly labelled AD/AS diagram showing a shift of AD to the right and an increase in real GDP **or** for an explanation that devaluation of the lat may have caused an increase in aggregate demand through an increase in exports and/or a decrease in imports, thus bringing about an increase in real GDP.

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

For drawing a correctly labelled AD/AS diagram showing a shift of AD to the right and an increase in real GDP **and** for an explanation that devaluation of the lat may have caused an increase in aggregate demand through an increase in exports and/or a decrease in imports, thus bringing about an increase in real GDP.

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

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



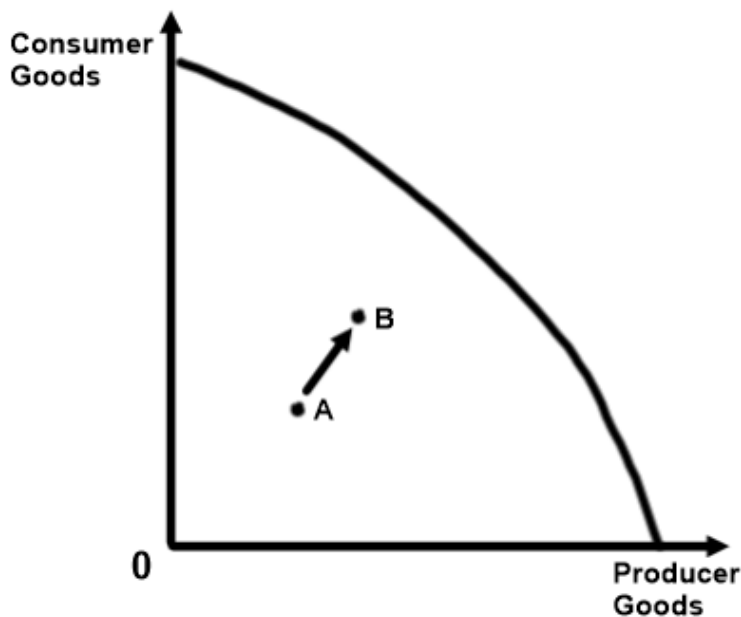
- (c) Using a production possibilities curve (PPC) diagram, explain the change in Latvia’s economy from 2008 to 2012 (paragraphs 2 and 4). [4]

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 PPC diagram showing a movement from one point within the curve to a new point closer to the curve or for an explanation that Latvia experienced economic growth from 2008 to 2012, which means that there was an increase in output shown as a movement to a new point, closer to the PPC.	1–2
2 <i>There is a correct diagram and an accurate written response.</i> For drawing a correctly labelled PPC diagram showing a movement from one point within the curve to a new point closer to the curve and for an explanation that Latvia experienced economic growth from 2008 to 2012, which means that there was an increase in output shown as a movement to a new point, closer to the PPC.	3–4

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

Candidates might show a different combination of points within the PPC on the diagram. There might be an initial movement from one point inside the curve to a further point inside the curve to reflect the 20% drop in output in 2008. To show the change from 2008 to 2012, there must be a new point closer to the PPC.

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



- (d) Using information from the text/data and your knowledge of economics, evaluate the possible impact of Latvia joining the eurozone. [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

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

*Responses **may** include:*

- definition of monetary union.

Arguments for:

- elimination of exchange rate uncertainty
- easier for future planning by firms
- increased investment and trade
- increased investor confidence
- reduction in transaction costs in trade with the eurozone
- increased foreign investment (paragraph 7)
- increased economic growth (paragraph 7)
- greater integration with the eurozone helps reduce dependence on Russia (paragraph 5)
- renewed confidence in the eurozone will bring benefits to all members (paragraph 7)
- may help to bring down unemployment, which is high (paragraph 4)
- Latvia had to exercise discipline to meet the criteria to join the eurozone which built a good economic foundation for moving forward (paragraph 1).

Arguments against:

- loss of sovereignty over monetary policy
- possible high changeover costs
- problems of supporting other eurozone members (paragraph ⑥)
- Latvia loses the power to control its own currency to improve competitiveness
- threat of inflation as well as deflation (paragraph ⑥)
- short term – lower consumer confidence (paragraph ⑥).

Any reasonable evaluation that offers a considered and balanced review of the strengths and limitations of Latvia joining the eurozone.

2. (a) (i) Define the term *interest rate* indicated in bold in the text (paragraph 9). [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 to the bank.	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 (credit) • the reward for saving • the percentage paid on borrowed money. 	2

(ii) Define the term *tariffs* indicated in bold in the text (paragraph 9). [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 form of tax.	1
2 <i>Accurate definition.</i> An explanation that it is a tax on imports.	2

(b) Distinguish between a current account deficit and a budget deficit (paragraph 4). [4]

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>There is a partially correct explanation.</i> For explaining that a current account deficit occurs when the outflow of money for imports of goods and services plus investment income and/or transfers is greater than the revenue gained from exports of goods and services plus investment income and/or transfers or for explaining that a budget deficit exists where government domestic revenue is less than government expenditure.	1–2
2 <i>There is a correct explanation.</i> For explaining that a current account deficit occurs when the outflow of money for imports of goods and services plus investment income and/or transfers is greater than the revenue gained from exports of goods and services plus investment income and/or transfer and for explaining that a budget deficit exists where government domestic revenue is less than government expenditure.	3–4

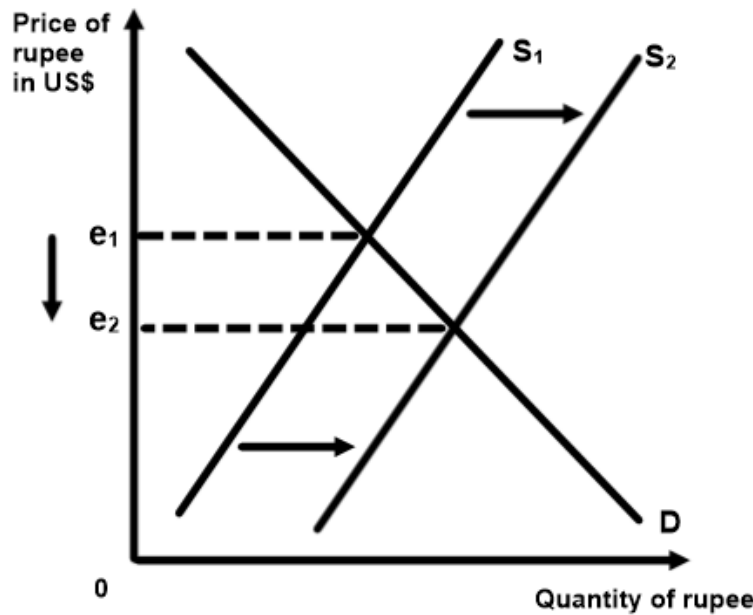
*To achieve full marks for the definition of current account deficit, students must refer to more than simply “trade in goods and service”. That is, there must be reference to at least **one** of “investment income” **or** “transfers”.*

- (c) Using an exchange rate diagram for the rupee (India's currency), explain how the value of the rupee has been affected by the expectation that the US central bank may change its monetary policy (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 exchange rate diagram with a shift of the supply curve of the rupee to the right and a fall in the exchange rate or for explaining that higher interest rates in the US will make it more attractive for people to save in the US rather than in India, and to do so they will have to exchange (sell) their rupees for dollars thus increasing the supply of rupees, and lowering the value of the rupee.	1-2
2 <i>There is a correct diagram and an accurate written response.</i> For drawing a correctly labelled exchange rate diagram with a shift of the supply curve of the rupee to the right and a fall in the exchange rate and for explaining that higher interest rates in the US will make it more attractive for people to save in the US rather than in India, and to do so they will have to exchange (sell) their rupees for dollars thus increasing the supply of rupees, and lowering the value of the rupee.	3-4

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

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



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

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

Responses **may** include:

Expenditure switching policies:

- an explanation of expenditure switching policies (trade protection and devaluation/depreciation) as a means of reducing spending on imports
- government has shown a willingness to use trade protection – gold tariffs (paragraph 5) (but trade protection may go against international trade agreements)
- falling rupee may help with expenditure switching (paragraph 5), depending on the PED for exports and imports (Marshall-Lerner condition)
- to encourage the “switch” from imports to domestic goods government should let the rupee continue to fall, not support it (paragraph 5), (but the falling rupee causes other problems).

Expenditure reducing policies:

- an explanation of expenditure reducing policies as a means of reducing spending on imports
- economic growth has dropped to 5 % so little room for expenditure reducing (paragraph 4)
- however, India has high inflation and large budget deficit and so expenditure reducing could help solve those problems (paragraph 4).

Supply-side policies:

- an explanation of supply side policies as a means of increasing the competitiveness of exports
- need to speed up reforms to help India reach its potential (paragraph 6)
- market-oriented policies, *eg* reducing the regulatory burden may encourage investment and increase productivity (paragraph 6)
- interventionist policies, *eg* increase investment in education and policies to support industry may help increase growth (paragraph 6).

To reach Level 3, students must be aware of the particular situation in the Indian economy, not just present an evaluation of policies to reduce a current account deficit in general.

Any reasonable evaluation.

Section B

3. (a) (i) Define the term ***bilateral trade agreements*** 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 trade agreement between two countries. | 1 |
| 2 <i>Accurate definition.</i>
An explanation that it is a trade agreement between two countries which aims to lower trade barriers, or to increase trade. | 2 |
- (ii) Define the term ***infrastructure*** 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 it (any one of the following is sufficient): <ul style="list-style-type: none"> • is essential facilities (capital) and services such as roads, airports, sewage treatment, water systems, railways, telephone and utilities • reduces the cost / increases efficiency of economic activity • is usually supplied by the government • is necessary for economic activity. | 1 |
| 2 <i>Accurate definition.</i>
An explanation that it (any two of the following is sufficient): <ul style="list-style-type: none"> • is essential facilities (capital) and services such as roads, airports, sewage treatment, water systems, railways, telephone and utilities • reduces the cost / increases efficiency of economic activity • is usually supplied by the government • is necessary for economic activity. | 2 |

- (b) Using a comparative advantage diagram, explain why “China’s exports tend to be concentrated in manufactured goods and the African countries mostly export primary goods” (paragraph 2). [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 comparative advantage diagram showing that China has a comparative advantage in manufactured goods and African countries have a comparative advantage in primary goods or an explanation that China has a lower opportunity cost in producing manufactured goods while African countries have a lower opportunity cost in producing primary goods.	1–2
2 <i>There is a correct diagram and an accurate written response.</i> For drawing a correctly labelled comparative advantage diagram showing that China has a comparative advantage in manufactured goods and African countries have a comparative advantage in primary goods and an explanation that China has a lower opportunity cost in producing manufactured goods while African countries have a lower opportunity cost in producing primary goods.	3–4

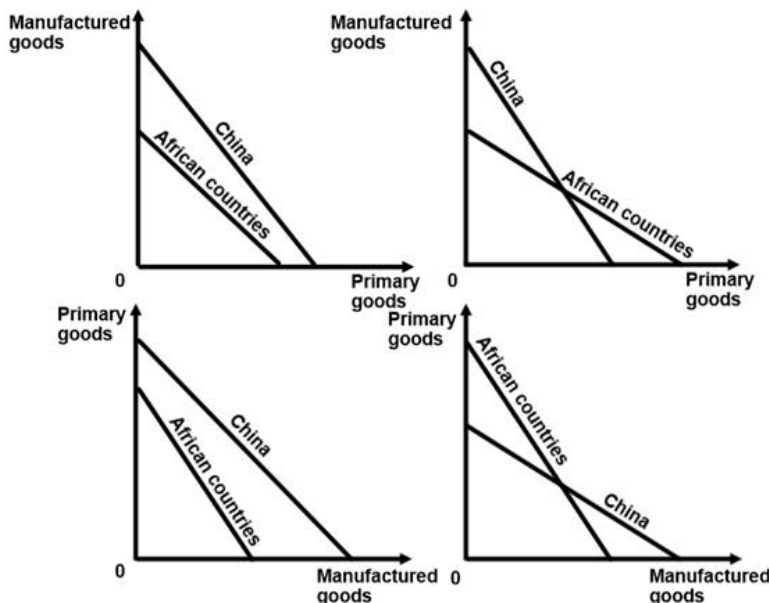
It is possible that students might show Africa with the absolute advantage. If accurately explained, this may be fully awarded.

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

The axes should indicate manufactured goods (or an example of a manufactured good listed in the text) and primary goods (or an example listed in the text).

The straight PPCs must indicate the correct country.

An alternative diagram would be to show reciprocal absolute advantage, with crossing PPCs (see below).

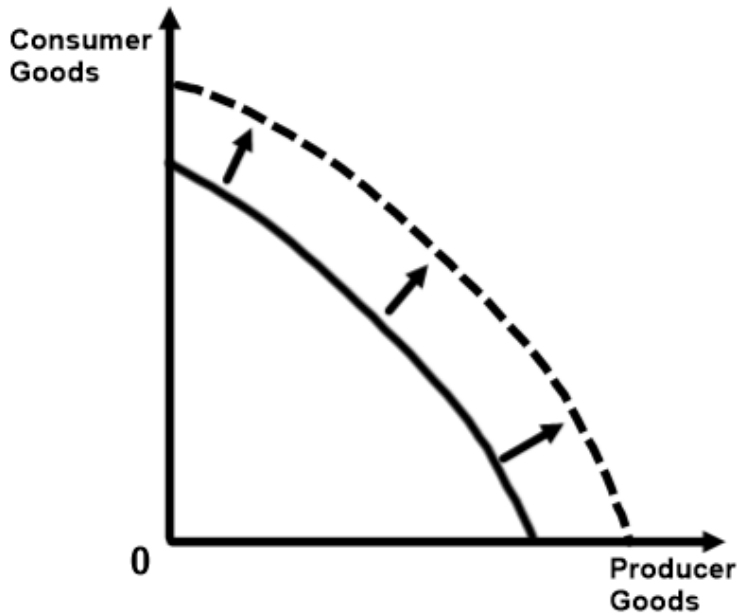


(c) Using a production possibilities curve (PPC) diagram, explain how the provision of “free training to 53700 people from Africa” will increase potential economic output (paragraph ⑥). [4]

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 PPC (outward shift) showing an increase in the potential output in African countries, or for explaining that “free training” would likely improve the quality of the factor of production labour and therefore may increase potential economic output.	1–2
2 <i>There is a correct diagram and an accurate written response.</i> For drawing a PPC (outward shift) showing an increase in the potential output in African countries, and for explaining that “free training” would likely improve the quality of the factor of production labour and therefore may increase potential economic output.	3–4

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

PPC: there must be two contrasting goods on the axes.



- (d) Using information from the text/data and your knowledge of economics, discuss the extent to which trade between China and African countries is a more effective way of achieving economic development than Chinese aid to African countries. **[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 of trade, aid, economic development.

Benefits of trade for economic development:

- access to export markets (paragraph ❶) and revenue (paragraph ❶)
- increased employment
- access to imports from China (paragraph ❶)
- import new technologies (paragraph ❷)
- exploit comparative advantage
- economies of scale
- improvements in efficiencies
- greater choice
- all of the above could result in higher economic growth, which **might** lead to economic development through higher incomes.

Limitations of trade for economic development:

- overdependence on a narrow range of commodity exports (Figure 1) leads to the inability to expand in value-added sectors
- vulnerability to price fluctuations and economic conditions in China results in fluctuations in government and business revenues
- overexploitation of resources in African countries may be a threat to sustainable development
- diagram to show negative externalities.

Benefits of aid for economic development:

- target specific sectors, *eg* agriculture, housing, education, healthcare (paragraph 6)
- targets development of human capital through education and training (paragraphs 4 and 5)
- break the poverty cycle, filling gaps
- building key infrastructure (paragraphs 5, 7 and Figure 2).

Limitations of aid:

- overdependence
- potential for abuse through corruption
- poorly targeted aid
- politically motivated aid targeted at inappropriate sectors
- tied aid.

*To reach level 3, students must show awareness of the ways in which aid and trade **impact upon economic development** (not simply discuss the advantages and disadvantages of aid and trade in general).*

Any reasonable discussion.

4.	(a)	(i)	Define the term <i>inflation</i> indicated in bold in the text (paragraph ❶).	[2]
			Level	Marks
			0	0
			<i>The work does not reach a standard described by the descriptors below.</i>	
			1	1
			<i>Vague definition.</i> The idea that prices increase.	
			2	2
			<i>Accurate definition.</i> An explanation that it is a sustained increase in the average (general) price level.	
		(ii)	Define the term <i>appreciation</i> indicated in bold in the text (paragraph ❷).	[2]
			Level	Marks
			0	0
			<i>The work does not reach a standard described by the descriptors below.</i>	
			1	1
			<i>Vague definition.</i> The idea that the exchange rate rises.	
			2	2
			<i>Accurate definition.</i> An explanation that it is an increase in the value (price) of a currency plus one of the following:	
			<ul style="list-style-type: none"> • in terms of a another currency • in a floating exchange rate system. 	

- (b) Using an accurate definition of the terms of trade, explain **one** reason for the change in Peru’s terms of trade index from January 2008 to January 2009 (Figure 1). **[4]**

Level Marks

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

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

For defining the terms of trade as the ratio of a country’s average export prices to their import prices (or for giving the equation

$$\text{Terms of trade} = \frac{\text{Average export prices}}{\text{Average import prices}} \times 100) \text{ **or** for explaining that there$$

was a fall in the terms of trade index that could have been caused by either a fall in the average prices of Peru’s exports, or an increase in the average prices of Peru’s imports.

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

For defining the terms of trade as the ratio of a country’s average export prices to their import prices (or for giving the equation

$$\text{Terms of trade} = \frac{\text{Average export prices}}{\text{Average import prices}} \times 100) \text{ **and** for explaining that there$$

was a fall in the terms of trade index that could have been caused by either a fall in the average prices of Peru’s exports, or an increase in the average prices of Peru’s imports.

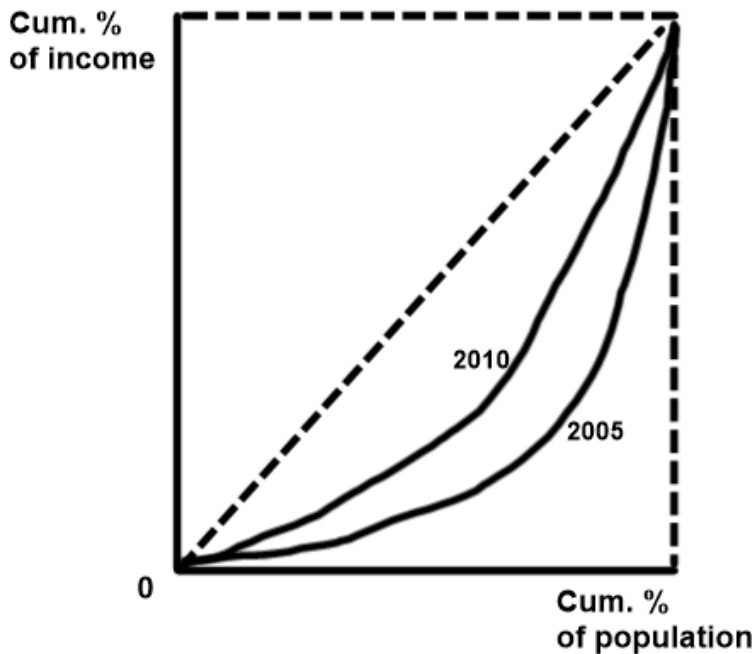
It is not necessary for students to explain a reason for the change in export (or import) prices.

(c) Using a Lorenz curve diagram, explain the change in Peru’s income distribution from 2005 to 2010 (Figure 2). [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 Lorenz curve diagram with a shift of the curve inwards towards the line of equality or for an explanation that the smaller figure for the Gini coefficient means that the income distribution has become more equal as shown by the inward movement of the curve (or a reduction in the area below the line of equality).	1–2
2 <i>There is a correct diagram and an accurate written response.</i> For drawing a correctly labelled Lorenz curve diagram with a shift of the curve inwards towards the line of equality and for an explanation that the smaller figure for the Gini coefficient means that the income distribution has become more equal as shown by the inward movement of the curve (or a reduction in the area below the line of equality).	3–4

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

The vertical axis should be labelled cumulative % of income or % of income and the horizontal axis should be cumulative % of population or % of population. There should be some indication on the diagram that the curve is moving inwards (either with an arrow, or with two dates on the curves. It is not necessary to provide a label on the “line of absolute equality”. A title is not necessary.



- (d) Using information from the text/data and your knowledge of economics, discuss the view that economic development may best be achieved through a balance of market-oriented policies and government intervention. [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 of economic development
- identification and explanation of market-oriented policies:
 - deregulation (paragraph ④)
 - increased flexibility in the labour market (paragraph ④)
 - free trade policy (paragraph ⑤)
- identification and explanation of interventionist policies:
 - new social programmes for the poor (paragraph ③)
 - transfer payments (cash transfers, pensions) (paragraph ③)
 - increased minimum wage (paragraph ③)
- market-oriented policies may lead to:
 - higher private investment (paragraphs ① and ⑥) will lead to economic growth, which may or may not translate into economic development
 - lower or higher unemployment, depending on the type of policy
 - benefits of free trade (greater choice, lower prices, higher consumer surplus) that may enhance peoples’ standards of living
 - efficient allocation of resources
 - higher economic growth, which may or may not translate into economic development
 - more inequality which hinders economic development
 - externalities associated with mining which worsen the standards of living of workers and third parties
 - insufficient provision of infrastructure and other merit goods

- Interventionist policies may lead to:
 - increased equality (lower Gini coefficient)
 - reduction in the poverty rate (paragraph 3)
 - opportunity cost issues
 - provision of infrastructure
 - reduction in the informal and untaxed sectors.

*To reach Level 3, students must show awareness of the ways in which market-oriented policies and government intervention **impact upon economic development** (not simply discuss the advantages and disadvantages of the two strategies).*

Any reasonable discussion.
