

Markscheme

November 2015

Economics

Higher level

Paper 2

20 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) List **two** components of the financial account (paragraph ④). [2]

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>Vague response.</i> Any one of the following components: <ul style="list-style-type: none"> • direct investment (net) • portfolio investment (net) • reserve assets (funding). 	1
2 <i>Accurate response.</i> Any two of the following components: <ul style="list-style-type: none"> • direct investment (net) • portfolio investment (net) • reserve assets (funding). 	2

(ii) Define the term *consumption* indicated in bold in the text (paragraph ⑥). [2]

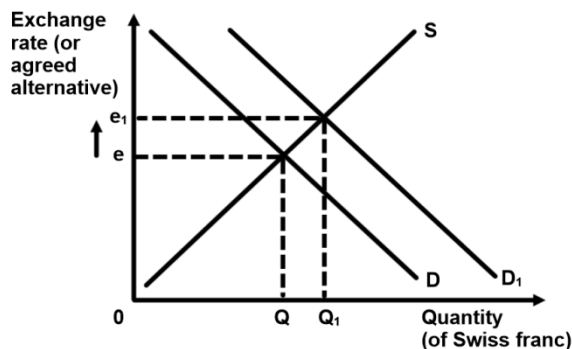
Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>Vague definition.</i> The idea that it is a component of AD, or that it is consumer spending.	1
2 <i>Accurate definition.</i> An explanation that it is spending by households (consumers) on goods and services.	2

- (b) Explain the difference between direct/portfolio investment and income from investment in the balance of payments. [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 an explanation that direct/portfolio investment is a component of the financial account involving the purchase of assets in another country or for an explanation that income from investment is a component of the current account involving the return gained from investments such as profit (or dividends or interest) in another country.	1–2
2 <i>There is a correct explanation.</i> For an explanation that direct/portfolio investment is a component of the financial account involving the purchase of assets in another country and for an explanation that income from investment is a component of the current account involving the return gained from investments such as profit (or dividends or interest) in another country.	3–4

- (c) Using an exchange rate diagram, explain how the problems in the eurozone impacted the Swiss franc (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 correct diagram or an accurate written response.</i> For drawing a correctly labelled exchange rate diagram showing a shift of the demand curve of the Swiss franc to the right and an increase in the exchange rate or for an explanation that people wanted a safe haven, so demanded more Swiss francs, increasing the price (exchange rate) of the Swiss franc.	1–2
2 <i>There is a correct diagram and an accurate written response.</i> For drawing a correctly labelled exchange rate diagram showing a shift of the demand curve of the Swiss franc to the right and an increase in the exchange rate and for an explanation that people wanted a safe haven, so demanded more Swiss francs, increasing the price (exchange rate) of the Swiss franc.	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 Swiss francs in euro, euro/Swiss franc, Swiss franc/euro or euros per Swiss franc. The horizontal axis should be quantity, or quantity of Swiss francs. A title is not necessary.

- (d) Using information from the text/data and your knowledge of economics, discuss the consequences of a rising current account surplus. [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 a current account surplus
- reference to current account surplus of 11 % (paragraph ❶)
- implications of the increase from 9 % (paragraph ❶)
- record current account surplus linked to strong investment income (paragraph ❷)
- investment income may be valuable to economy, increasing AD
- an appreciation of the Swiss franc (paragraph ❸)
- strong Swiss franc may lead to reduced export competitiveness
- surplus on balance of trade in goods and services is falling (paragraph ❹) may be due to strong Swiss franc
- increased attraction of imports due to strong currency (3% increase in expenditure on imports (paragraph ❺))
- large purchases of foreign exchange/selling of Swiss francs needed (paragraph ❻) to reduce pressure on Swiss franc
- implications for employment
- current account surplus in Switzerland means trading partners have current account deficits. This may damage trade relations/employment in other countries.

Any reasonable discussion.

2. (a) (i) Define the term **fixed exchange rate** 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 a country's currency is fixed by the government (central bank).	1
2 <i>Accurate definition.</i> An explanation that a currency's value is fixed against any one of the following: <ul style="list-style-type: none"> • the value of another currency • a basket of other currencies • gold. 	2

(ii) Define the term **economic growth** 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 is an increase in GDP (output).	1
2 <i>Accurate definition.</i> An explanation that it is the growth in the value of real output (over time) or an explanation that it is growth in real GDP (real output).	2

- (b) Using an exchange rate diagram, explain how the United Arab Emirates (UAE) could maintain a fixed value of its dirham to the US dollar if there were upward pressure on the dirham.

[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 currency diagram showing a fixed exchange rate value, an equilibrium above the fixed value and an increase in the supply curve to return the currency to the fixed value **or** for explaining that if the currency goes above its fixed value, the central bank (government/UAE) will have to intervene and sell its currency (buy foreign currency) to restore the fixed value of the currency.

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

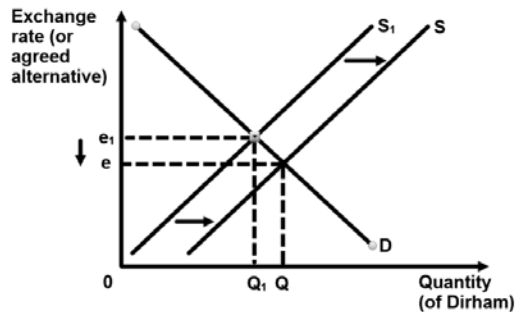
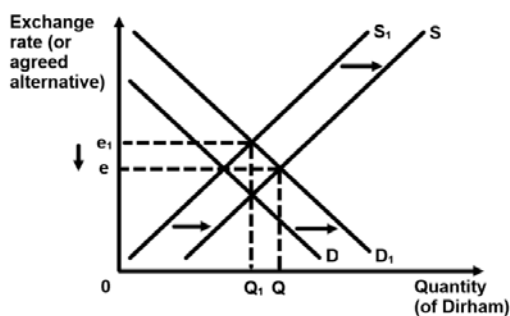
3-4

For drawing a correctly labelled currency diagram showing a fixed exchange rate value, an equilibrium above the fixed value and an increase in the supply curve to return the currency to the fixed value **and** for explaining that if the currency goes above its fixed value, the central bank (government/UAE) will have to intervene and sell its currency (buy foreign currency) to restore the fixed value of the currency.

An alternative correct answer is for the diagram to show a decrease in demand for the dirham to return the currency to its fixed value, with an explanation that the central bank can lower interest rates, making financial investments in the UAE less attractive, thus causing a fall in the demand for the dirham. If correctly explained a diagram showing a decrease in demand should be fully rewarded with a maximum of [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 dirham in US\$, US\$/dirham, dirham/US\$, or US dollars per dirham. The horizontal axis should be quantity, or quantity of dirham. A title is not necessary.



N.B. The cause of the increase in the dirham's value may or may not be shown.

(c) Distinguish between a devaluation and a depreciation of a currency. **[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> A devaluation is the deliberate downward adjustment of the official exchange rate by the central bank (government) to reduce the currency's value in a fixed exchange rate system or in contrast, a depreciation is a fall in the value of a currency due to market forces in a floating exchange rate system.	1–2
2 <i>There is clear understanding.</i> A devaluation is the deliberate downward adjustment of the official exchange rate by the central bank (government) to reduce the currency's value in a fixed exchange rate system and in contrast, a depreciation is a fall in the value of a currency due to market forces in a floating exchange rate system.	3–4

(d) Using information from the text/data and your knowledge of economics, discuss the view that some Gulf States “should consider moving from a fixed exchange rate” to “a floating exchange rate system” (paragraph 1). **[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 floating exchange rate.

Arguments for fixed exchange rate:

- provide greater predictability and certainty for exporters and importers to calculate earnings (paragraph ④)
- creates a stable environment for firms to invest and households to consume due to greater exchange rate certainty
- encourages government policies to maintain low inflation which can be caused by fixing the currency – “inflation rates have been low and stable” (paragraph ⑤)
- can discourage speculation – assuming sufficient foreign currency reserves to protect the currency.

Arguments against fixed exchange rates:

- loss of domestic monetary policy freedom – if priority is to keep exchange rate fixed then little room to set interest rates to manage AD; was a problem for UAE in 2007 (paragraph ④) when it had to lower interest rates to maintain peg to US dollar
- when the exchange rate is fixed to a currency that is weak, it can lead to imported inflation when the costs of imported resources rise
- low value of US dollar causes relatively cheaper exports and expensive imports hence potential inflationary gap for UAE (paragraph ⑥)
- central bank needs large amounts of foreign reserves to maintain the fixed currency and discourage speculators (paragraph ⑤) but this is not a problem (currently) for Saudi Arabia and UAE (paragraph ⑤)
- fixing the currency at the most appropriate level is difficult
- can create conflict with trading partners if fixed too low.

Arguments for floating exchange rates:

- allows current account to be self-correcting
- more freedom to set interest rates and domestic monetary policy
- large amounts of foreign reserves are not required (paragraph ⑤).

Arguments against floating exchange rates:

- instability and lack of predictability for firms, consumers, importers and exporters – difficult to plan (paragraph ④)
- governments not required to keep exchange rate fixed, hence there is less incentive for governments to keep inflation in check
- speculative activity can greatly influence the exchange rate.

Any reasonable discussion.

Section B

3. (a) (i) List **two** Millennium Development Goals **other than** universal primary education (paragraph 4). [2]

Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>Vague response.</i> Any one of the following reasons: <ul style="list-style-type: none"> • eradicate extreme poverty and hunger • promote gender equality and empower women • reduce child mortality • improve maternal health • combat HIV/AIDS, malaria, and other diseases • ensure environmental sustainability • develop a Global Partnership for Development. 	1
2 <i>Accurate response.</i> Any two of the following reasons: <ul style="list-style-type: none"> • eradicate extreme poverty and hunger • promote gender equality and empower women • reduce child mortality • improve maternal health • combat HIV/AIDS, malaria, and other diseases • ensure environmental sustainability • develop a Global Partnership for Development. 	2

- (ii) Define the term *sustainability* indicated in bold in the text (paragraph 7). [2]

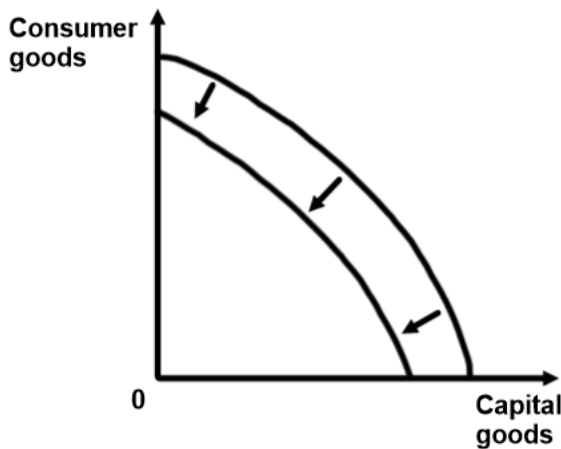
Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>Vague definition.</i> The idea that it is deals with the long-term use of resources.	1
2 <i>Accurate definition.</i> An explanation that it is development that meets the needs of the present generation without compromising the ability of future generations to meet their needs.	2

(b) Using a production possibilities curve (PPC) diagram, explain the likely effect of the high HIV/AIDS rate on production possibilities in Botswana. [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 clearly labelled PPC diagram showing an inward shift of the PPC or an explanation that a high rate of HIV/AIDS affects the quality and/or quantity of the workforce, reducing production possibilities (potential output) in the economy (and leading to negative potential growth).	1-2
2 <i>There is a correct diagram and an accurate written response.</i> For drawing a clearly labelled PPC diagram showing an inward shift of the PPC and an explanation that a high rate of HIV/AIDS affects the quality and/or quantity of the workforce, reducing production possibilities (potential output) in the economy (and leading to negative potential growth).	3-4

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

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

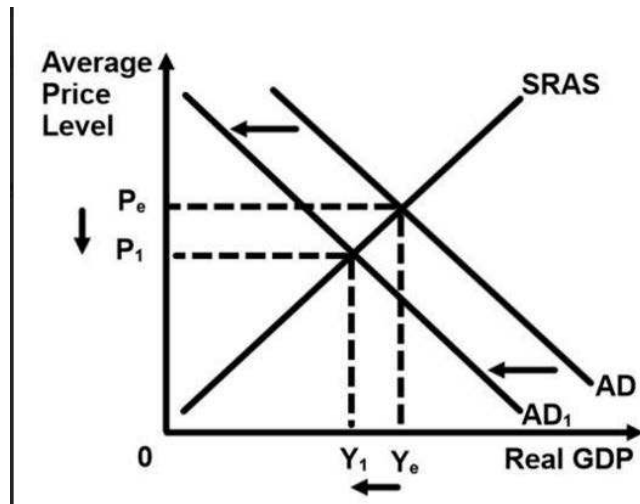


(c) Using an AD/AS diagram, explain why inflation may fall as a result of “lower demand-side pressures” (paragraph 6). [4]

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 clearly labelled AD/AS diagram with a shift of the AD curve to the left and a lower price level or for explaining that lower demand-side pressures will reduce aggregate demand in the economy, thus reducing inflationary pressures in the economy.	1–2
2 <i>There is a correct diagram and an accurate written response.</i> For drawing a clearly labelled AD/AS diagram with a shift of the AD curve to the left and a lower price level and for explaining that lower demand-side pressures will reduce aggregate demand in the economy, thus reducing inflationary pressures in the economy.	3–4

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

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 possible outcomes of a move away from government intervention and towards more market-oriented strategies in Botswana (paragraph ③). [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 market-oriented strategies
- examples of market-oriented strategies
- explanation and examples of government intervention.

Benefits of moving towards market-oriented strategies:

- may lead to higher levels of economic growth
- may lead to higher employment (paragraph ⑤)
- with higher growth, there may be higher tax revenues to meet development objectives
- trade liberalization could promote economic growth
- more efficient allocation of resources
- privatization results in government revenues
- smaller public sector (paragraph ⑥) frees up resources
- Botswana’s good governance might allow for effective implementation of economic policy (paragraph ②).

Possible negative outcomes of moving towards market-oriented strategies:

- market-oriented strategies may lead to worsened income inequality, Gini coefficient already high (paragraph ② and Figure 1)
- may concentrate attention on the urban sectors, increasing relative poverty in rural areas (paragraph ⑤)
- infrastructure is unlikely to be created through a market-based approach

- there may be short-run costs to the poorest people if unemployment rises (paragraph ⑤)
- there may be market failure and the exhaustion of natural resources (paragraph ⑦)
- prices of essential products may increase
- the provision of public services may fall
- protectionism in developed countries may make it difficult to achieve growth through trade
- may result in lower expenditure on education (paragraph ④ and ⑤)
- diversification may require government intervention (paragraph ⑦).

Any reasonable discussion.

4. (a) (i) Define the term *investment* 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 it is buying machinery.	1
2 <i>Accurate definition.</i> An explanation that it is any addition to the capital stock of the economy or expenditure by firms on capital.	2

(ii) Define the term *price floor* indicated in bold in the text (paragraph 4). [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 is a price set by the government or a type of intervention to help poor producers.	1
2 <i>Accurate definition.</i> An explanation that it is a price (set by the government) above the equilibrium price or a price (set by the government) below which the price may not fall.	2

- (b) Using a demand and supply diagram explain, referring to the concept of price elasticity of demand, why there has been such a sharp drop in the price of coffee beans (paragraph 1).

[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 clearly labelled demand and supply diagram showing a shift of the supply curve to the right and a significant fall in price **or** for an explanation that the increase in supply, accompanied by relatively inelastic demand, will lead to a sharp fall in the coffee prices.

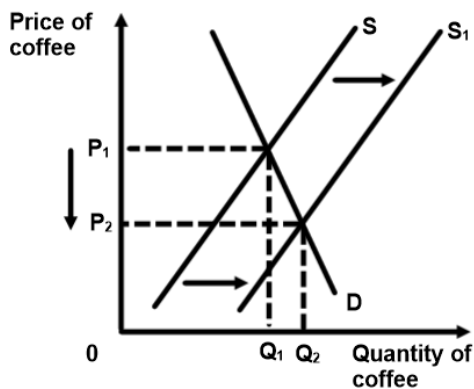
2 *There is a correct diagram **and** an accurate written response.*

3-4

For drawing a clearly labelled demand and supply diagram showing a shift of the supply curve to the right and a significant fall in price **and** for an explanation that the increase in supply, accompanied by relatively inelastic demand, will lead to a sharp fall in the coffee prices.

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

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

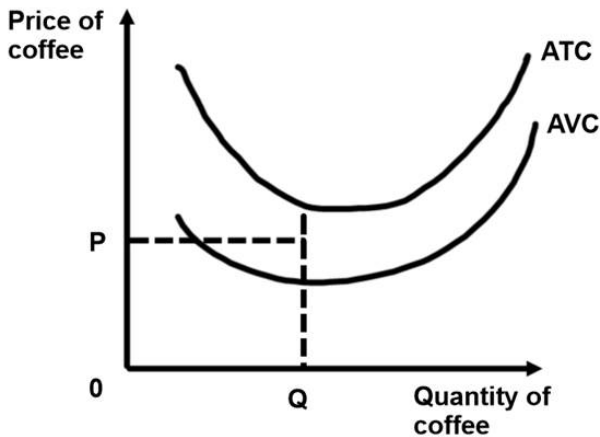


- (c) Using a diagram that shows a firm's short-run costs of production, explain why some farmers may still be able to produce even though they are in a situation where coffee bean prices are below their total costs of production (paragraph ③). [4]

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 clearly labelled SR costs diagram, where price is below ATC, but above AVC or for explaining that the farmers will continue to produce in the short run as long as they are covering their variable costs.	1-2
2 <i>There is a correct diagram and an accurate written response.</i> For drawing a clearly labelled SR costs diagram, where price is below ATC, but above AVC and for explaining that the farmers will continue to produce in the short run as long as they are covering their variable costs.	3-4

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

The use of P and C on the vertical axis and Q on the horizontal axis is sufficient. A title is not necessary.



- (d) Using information from the text/data and your knowledge of economics, discuss the likely impact of the Brazilian government’s intervention in the coffee market on economic development in Brazil. **[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
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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:

- a definition of economic development
- a diagram showing a price floor (paragraph ④)

Benefits of government intervention

- supports an important sector of the economy (paragraph ⑤)
- may guarantee a minimum income for farmers with resulting benefits for health care, education, poverty cycle
- offers protection against volatile prices, which harm producers’ incomes
- may prevent coffee producers who would not be covering costs from going out of business (paragraph ③)
- it supports rural employment and may prevent rural urban migration (paragraph ③)

Concerns

- only “temporary relief to farmers” (paragraph ④)
- large government stocks (paragraph ④) will eventually have to be sold
- may discourage coffee farmers from diversifying
- may encourage over-supply, which will further lower the price
- opportunity cost of government spending eg on merit goods (paragraph ④)
- price floor may simply be a short-term political strategy (paragraph ⑤)
- allocatively inefficient.

Any reasonable discussion.
