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Economics
Higher level
Paper 1

Tuesday 3 November 2015 (afternoon)

1 hour 30 minutes

Instructions to candidates

- Do not open this examination paper until instructed to do so.
- You are not permitted access to any calculator for this paper.
- Section A: answer one question.
- Section B: answer one question.
- Use fully labelled diagrams and references to examples where appropriate.
- The maximum mark for this examination paper is **[50 marks]**.

Section A

Answer **one** question from this section.

Microeconomics

- (a) Explain why a government might decide to impose an indirect tax on the consumption of cigarettes. [10]
 - (b) Discuss the possible consequences of the imposition of an indirect tax on cigarettes for the different stakeholders in the market. [15]
- (a) Explain why a firm in monopolistic competition will make normal profit in the long run. [10]
 - (b) Evaluate the view that monopolistic competition is a more efficient market structure than monopoly. [15]





Section B

Answer **one** question from this section.

Macroeconomics

- 3. (a) Explain how fiscal policy can be used to achieve long-term economic growth (increases in potential output). [10]
- (b) Discuss the view that economic growth always leads to a more equal distribution of income and a reduction in unemployment. [15]

- 4. (a) Explain why, using the monetarist/new classical model, the economy will always return to the full employment level of output following a recession. [10]
- (b) Evaluate the view that an increase in aggregate demand will always be inflationary. [15]

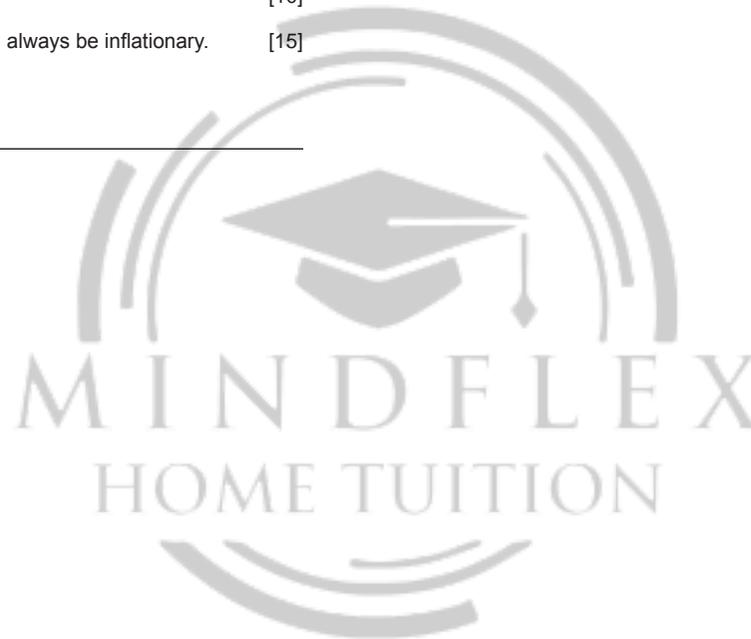
Markscheme

November 2015

Economics

Higher level

Paper 1



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

Section A

Microeconomics

1. (a) Explain why a government might decide to impose an indirect tax on the consumption of cigarettes. [10]

Answers *may* include:

- definition of indirect tax
- theory to explain how imposing an indirect tax on cigarettes will achieve government objectives of raising revenue and reducing consumption
- diagrams to illustrate the imposition of the tax on cigarettes
- examples of instances and/or reasons why governments impose indirect tax on cigarettes.

N.B. Candidates can be awarded full marks for coverage of one reason why a government might impose an indirect tax.

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Assessment Criteria

Part (a) 10 marks

Level	Marks
0	0
1	1-3
2	4-6
3	7-8
4	9-10

- (b) Discuss the possible consequences of the imposition of an indirect tax on cigarettes for the different stakeholders in the market.

[15]

Assessment Criteria

Part (b) 15 marks

Answers may include:

- definitions of indirect tax and market
- theory to explain the implications for consumers; for producers; for the government
- diagram to show the application of a tax to illustrate the impacts on different stakeholders
- examples of use of indirect taxes and the impact on stakeholders in practice
- synthesis or evaluation (discuss).

Discussion **may** include: the advantages and disadvantages as applied to the different stakeholders and more generally in terms of society, for example reduced passive smoking for all as well as reduced consumption for individual consumers.

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

Opinions or conclusions should be presented clearly and should be supported by appropriate examples.

Level

Marks

0	The work does not reach a standard described by the descriptors below.	0
1	There is little understanding of the specific demands of the question. Relevant economic terms are not defined. There is very little knowledge of relevant economic theory. There are significant errors.	1–5
2	There is some understanding of the specific demands of the question. Some relevant economic terms are defined. There is some knowledge of relevant economic theory. There are some errors.	6–9
3	There is understanding of the specific demands of the question. Relevant economic terms are defined. Relevant economic theory is explained and applied. Where appropriate, diagrams are included and applied. Where appropriate, examples are used. There is an attempt at synthesis or evaluation. There are few errors.	10–12
4	There is clear understanding of the specific demands of the question. Relevant economic terms are clearly defined. Relevant economic theory is clearly explained and applied. Where appropriate, diagrams are included and applied effectively. Where appropriate, examples are used effectively. There is evidence of appropriate synthesis or evaluation. There are no significant errors.	13–15

2. (a) Explain why a firm in monopolistic competition will make normal profit in the long run.

[10]

Assessment Criteria

Answers **may** include:

- definitions of monopolistic competition, normal profit and long run
- theory to explain how the lack of barriers leads to firms responding to short-run abnormal profits/losses to enter/leave the market to restore normal profits in the long run
- diagram to show monopolistic competition in the long/short run
- example of sectors that might reflect monopolistic market structures.

Part (a) 10 marks

Level

Marks

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

0

1 There is little understanding of the specific demands of the question. Relevant economic terms are not defined. There is very little knowledge of relevant economic theory. There are significant errors.

1-3

2 There is some understanding of the specific demands of the question. Some relevant economic terms are defined. There is some knowledge of relevant economic theory. There are some errors.

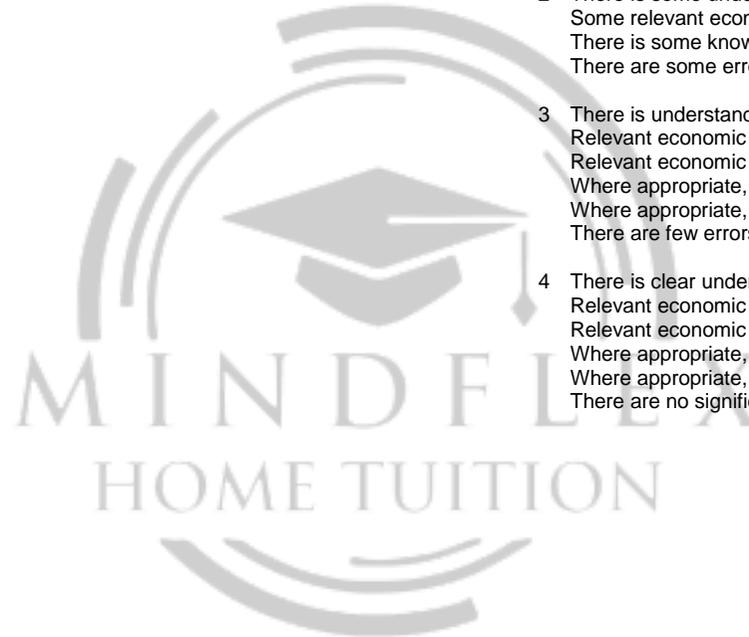
4-6

3 There is understanding of the specific demands of the question. Relevant economic terms are defined. Relevant economic theory is explained and applied. Where appropriate, diagrams are included and applied. Where appropriate, examples are used. There are few errors.

7-8

4 There is clear understanding of the specific demands of the question. Relevant economic terms are clearly defined. Relevant economic theory is clearly explained and applied. Where appropriate, diagrams are included and applied effectively. Where appropriate, examples are used effectively. There are no significant errors.

9-10



- (b) Evaluate the view that monopolistic competition is a more efficient market structure than monopoly.

[15]

Assessment Criteria

Part (b) 15 marks

Answers may include:

- definitions of monopoly, monopolistic competition and efficiency
- theory to explain how monopolistic competition may or may not be more efficient than monopoly
- diagram of a monopoly and monopolistic competition diagram to compare efficiency
- examples of industries that could represent these types of competition to highlight the points made
- synthesis or evaluation (evaluate).

Evaluation **may** include: the relative efficiencies of the two market structures, consideration of dynamic efficiency, economies of scale, responsiveness to consumer demand.

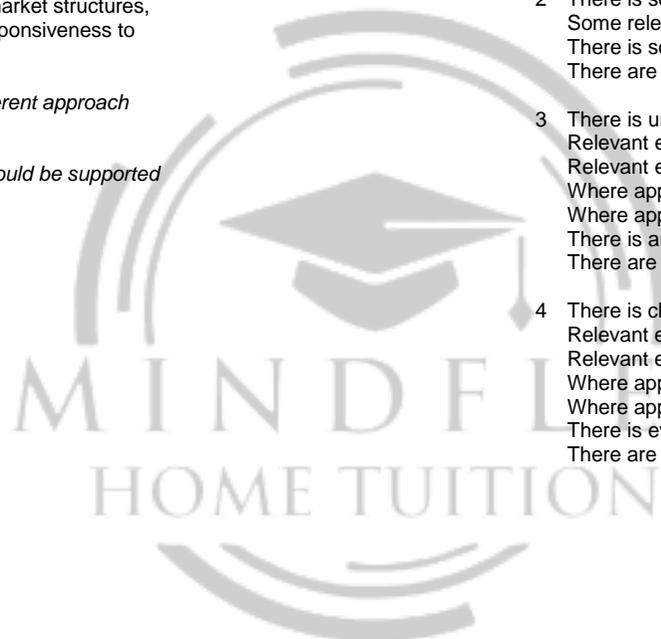
Examiners should be aware that candidates may take a different approach which, if appropriate, should be rewarded.

Opinions or conclusions should be presented clearly and should be supported by appropriate examples.

Level

Marks

0	The work does not reach a standard described by the descriptors below.	0
1	There is little understanding of the specific demands of the question. Relevant economic terms are not defined. There is very little knowledge of relevant economic theory. There are significant errors.	1–5
2	There is some understanding of the specific demands of the question. Some relevant economic terms are defined. There is some knowledge of relevant economic theory. There are some errors.	6–9
3	There is understanding of the specific demands of the question. Relevant economic terms are defined. Relevant economic theory is explained and applied. Where appropriate, diagrams are included and applied. Where appropriate, examples are used. There is an attempt at synthesis or evaluation. There are few errors.	10–12
4	There is clear understanding of the specific demands of the question. Relevant economic terms are clearly defined. Relevant economic theory is clearly explained and applied. Where appropriate, diagrams are included and applied effectively. Where appropriate, examples are used effectively. There is evidence of appropriate synthesis or evaluation. There are no significant errors.	13–15



Section B

Assessment Criteria

Macroeconomics

Part (a) 10 marks

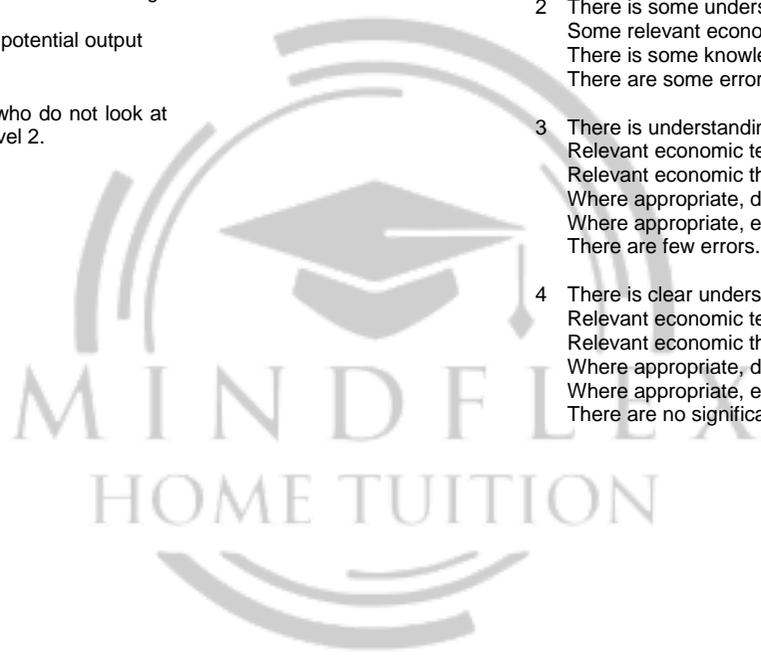
3. (a) Explain how fiscal policy can be used to achieve long-term economic growth (increases in potential output). [10]

Answers may include:

- definitions of fiscal policy, economic growth and potential output
- theory to show how government spending on investment in physical and human capital and infrastructure, and/or government provision of incentives to invest through reductions in taxes, result in an increase in LRAS and potential output. Reference may be made to the indirect effects of creating a favourable environment for investment
- diagram to show an increase in LRAS and an increase in potential output
- examples of where this may have been the case.

N.B. Candidates who consider only the impact on AD and who do not look at long-term economic growth should not be awarded above level 2.

Level	Marks
0	0
1	1-3
2	4-6
3	7-8
4	9-10



- (b) Discuss the view that economic growth always leads to a more equal distribution of income and a reduction in unemployment.

[15]

Assessment Criteria

Part (b) 15 marks

Level	Marks
0	0
1	1-5
2	6-9
3	10-12
4	13-15

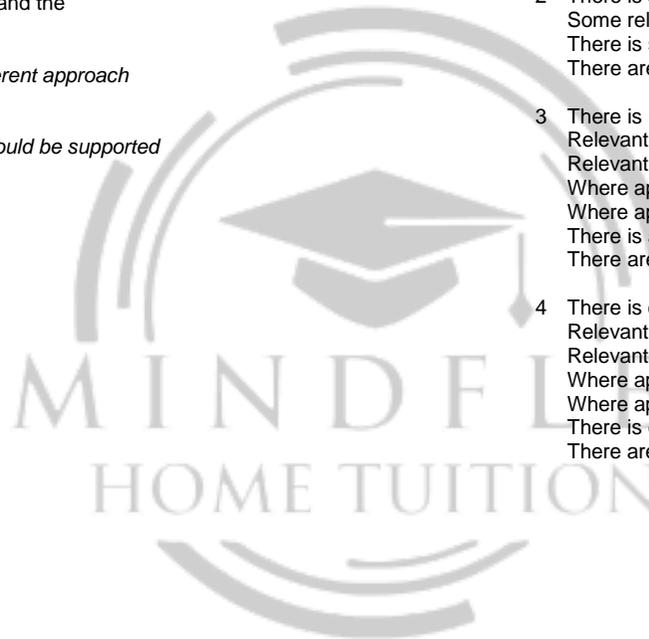
Answers **may** include:

- definitions of unemployment, distribution of income and economic growth
- theory to explain how economic growth may lower/raise unemployment and improve/worsen the distribution of income
- diagrams to indicate falling unemployment and a more equal distribution of income
- examples of where this may have happened
- synthesis or evaluation (discuss).

Discussion **may** include: the impact that economic growth can have, both positive and negative effects, on the level of unemployment and the distribution of income.

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

Opinions or conclusions should be presented clearly and should be supported by appropriate examples.



4. (a) Explain why, using the monetarist/new classical model, the economy will always return to the full employment level of output following a recession.

[10]

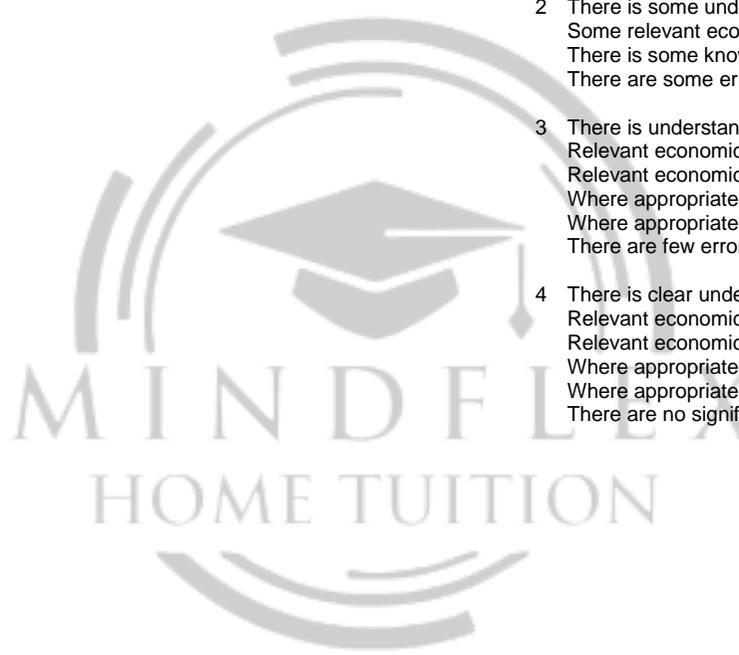
Assessment Criteria

Answers **may** include:

- definitions of full employment and recession
- theory to explain how wages and prices adjust to bring the economy back to full employment equilibrium in the long run
- diagram to show AD/AS with a vertical LRAS and deflationary gap
- examples of where this might have occurred or a suitable development of a theoretical example.

Part (a) 10 marks

Level	Marks
0 The work does not reach a standard described by the descriptors below.	0
1 There is little understanding of the specific demands of the question. Relevant economic terms are not defined. There is very little knowledge of relevant economic theory. There are significant errors.	1-3
2 There is some understanding of the specific demands of the question. Some relevant economic terms are defined. There is some knowledge of relevant economic theory. There are some errors.	4-6
3 There is understanding of the specific demands of the question. Relevant economic terms are defined. Relevant economic theory is explained and applied. Where appropriate, diagrams are included and applied. Where appropriate, examples are used. There are few errors.	7-8
4 There is clear understanding of the specific demands of the question. Relevant economic terms are clearly defined. Relevant economic theory is clearly explained and applied. Where appropriate, diagrams are included and applied effectively. Where appropriate, examples are used effectively. There are no significant errors.	9-10



- (b) Evaluate the view that an increase in aggregate demand will always be inflationary.

[15]

Assessment Criteria

Part (b) 15 marks

Answers **may** include:

- definitions of aggregate demand and inflation
- theory to explain the new classical view that LRAS is vertical and therefore increases in AD are purely inflationary. Consideration that the SRAS curve suggests that increases in AD are partly inflationary. A consideration of opposing Keynesian views regarding the shape of AS
- diagram to show an AD/AS illustrating the different views
- examples of situations regarding differing views of the shape of the new classical LRAS and the Keynesian AS curves
- synthesis or evaluation (evaluate).

Evaluation **may** include: whether and under what conditions an increase in AD is always inflationary.

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

Opinions or conclusions should be presented clearly and should be supported by appropriate examples.

Level

Marks

0	The work does not reach a standard described by the descriptors below.	0
1	There is little understanding of the specific demands of the question. Relevant economic terms are not defined. There is very little knowledge of relevant economic theory. There are significant errors.	1–5
2	There is some understanding of the specific demands of the question. Some relevant economic terms are defined. There is some knowledge of relevant economic theory. There are some errors.	6–9
3	There is understanding of the specific demands of the question. Relevant economic terms are defined. Relevant economic theory is explained and applied. Where appropriate, diagrams are included and applied. Where appropriate, examples are used. There is an attempt at synthesis or evaluation. There are few errors.	10–12
4	There is clear understanding of the specific demands of the question. Relevant economic terms are clearly defined. Relevant economic theory is clearly explained and applied. Where appropriate, diagrams are included and applied effectively. Where appropriate, examples are used effectively. There is evidence of appropriate synthesis or evaluation. There are no significant errors.	13–15



Economics
Higher level
Paper 2

Wednesday 4 November 2015 (morning)

1 hour 30 minutes

Instructions to candidates

- Do not open this examination paper until instructed to do so.
- You are not permitted access to any calculator for this paper.
- Section A: answer one question.
- Section B: answer one question.
- Use fully labelled diagrams and references to the text/data where appropriate.
- The maximum mark for this examination paper is **[40 marks]**.

Section A

Answer **one** question from this section.

1. Study the extract below and answer the questions that follow.

Swiss current account surplus grows

- 1 Switzerland recorded a current account surplus of 11 % of gross domestic product (GDP) in 2012. This was an increase from 9 % of GDP the year before.
- 2 According to Switzerland's central bank, the Swiss National Bank (SNB), which released its balance of payments figures recently, this increase in the current account surplus was caused mainly by an increase in investment income, which nearly doubled to CHF40 billion.
- 3 In terms of trade in goods and services, a surplus of CHF57 billion was recorded, compared with CHF59 billion in 2011. The decline was due to the fact that there was a 3 % increase in expenditure on imports of goods and services, but only a 2 % increase in the revenues from exports of goods and services.
- 4 The Swiss financial account saw a net capital outflow of CHF97 billion – nearly three times the 2011 figure. This occurred after the SNB purchased large amounts of foreign exchange in an attempt to keep the Swiss franc from appreciating to damaging levels. The high level of the Swiss franc was a result of financial investors seeking safety in the Swiss franc, when severe problems in the eurozone created fears about the value and safety of the euro.
- 5 The Swiss economy outperformed the eurozone in early 2013 as GDP in the eurozone shrank for a sixth straight quarter. This was largely caused by contracting economies in France, Italy, the Netherlands and Spain. The eurozone is now stuck in its longest recession on record.
- 6 The Swiss economy performed better than expected in the first quarter of 2013, with GDP growth rising to 0.6 % as a result of strong levels of **consumption**, particularly in health and housing.

[Source: adapted from <http://centralbanking.com>, 15 August 2013; <http://genevalunch.com>, 15 August 2013 and <http://futurecurrencyforecast.com>, 31 July 2013]

(This question continues on the following page)

(Question 1 continued)

- (a) (i) List **two** components of the financial account (paragraph ❶). [2]
- (ii) Define the term *consumption* indicated in bold in the text (paragraph ❸). [2]
- (b) Explain the difference between direct/portfolio investment and income from investment in the balance of payments. [4]
- (c) Using an exchange rate diagram, explain how the problems in the eurozone impacted the Swiss franc (paragraph ❷). [4]
- (d) Using information from the text/data and your knowledge of economics, discuss the consequences of a rising current account surplus. [8]

2. Study the extract below and answer the questions that follow.

Gulf banks debating currency peg to US dollars

- ❶ Qatar's central bank suggests some Gulf States* should consider moving from a **fixed exchange rate**, with their currencies pegged to the US dollar, to a floating exchange rate system. Bankers and economists throughout the region are debating this issue.
- ❷ Qatar's central bank governor said the country planned no change to its peg to the dollar, with the exchange rate now fixed at QAR3.64/US\$1. However, "with increasing integration in international trade, services, and asset markets, a higher degree of exchange rate flexibility may become more desirable" he said. Qatar is battling against higher rates of inflation in 2013. Inflation is at the highest level since 2009.
- ❸ Saudi Arabia and the United Arab Emirates (UAE) have pegged their currencies to the dollar for decades. They have been able to do this because their inflation rates have been low and stable, and they have had substantial oil export revenues giving them large reserves of foreign currency.
- ❹ As a result there has been no need to change official exchange rates, said the chief economist at National Bank of Abu Dhabi: "Fixing the currency gives stability and visibility for business contracts". There are good arguments for pegging the currency to the US dollar. However, it can result in imported inflation from other economies. In 2007, the US was cutting interest rates. This meant that, in order to maintain the fixed exchange rate, the UAE also had to cut its interest rates. This was at a time when the UAE was booming and experiencing high inflation.
- ❺ Currently there is no pressure on the pegged rate and if necessary a central bank can revalue or devalue its currency when required. It is commonly agreed that the best time to change a fixed currency regime is when there is no pressure.
- ❻ A senior economist at a commercial bank agrees that the UAE should consider dropping its currency peg to the US dollar and moving to a floating exchange rate for the dirham (the UAE currency). He says that the US dollar's weakness relative to other currencies was a positive stimulus for **economic growth**. However, growth in the UAE is already quite strong and so having its currency pegged to a weak currency could harm the economy by leading to higher inflation.

[Source: Albawaba extract: Republished with permission from Albawaba, <http://www.albawaba.com/business/qatars-currency-peg-here-stay-514355>, 'Qatar's currency peg here to stay', 18 August 2013, permission conveyed through Copyright Clearance Center, Inc.
Extracts from *The National*, Abu Dhabi: <http://www.thenational.ae/business/industry-insights/finance/uae-should-drop-dirhams-peg-to-us-dollar-says-economist#ixzz2cfjYpl71>, 22 November 2011
<http://www.thenational.ae/business/industry-insights/economics/gulf-banks-debating-currency-peg-to-us-dollar#ixzz2cfivZBbz>, 7 June 2013]

* Gulf States: include Bahrain, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates

(This question continues on the following page)

(Question 2 continued)

- (a) (i) Define the term *fixed exchange rate* indicated in bold in the text (paragraph 1). [2]
- (ii) Define the term *economic growth* indicated in bold in the text (paragraph 6). [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]
- (c) Distinguish between a devaluation and a depreciation of a currency. [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]

Section B

Answer **one** question from this section.

3. Study the extract and data below and answer the questions that follow.

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(This question continues on the following page)

(Question 3 continued)



- (a) (i) List **two** Millennium Development Goals **other than** universal primary education (paragraph ❶). [2]
- (ii) Define the term *sustainability* indicated in bold in the text (paragraph ❷). [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]
- (c) Using an AD/AS diagram, explain why inflation may fall as a result of “lower demand-side pressures” (paragraph ❸). [4]
- (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 ❹). [8]

4. Study the extract below and answer the questions that follow.

Brazil government gives coffee farmers a lifeline

- ❶ Coffee prices in 2011 encouraged **investment** by Brazilian coffee farmers who increased the land devoted to coffee and spent heavily on new farming techniques and fertilizer. High prices also convinced farmers in Columbia to replant many coffee plantations with more productive coffee bushes. In 2012, good weather resulted in an unexpectedly large crop. As a result of these combined factors, the price of coffee beans has dropped sharply from more than US\$1.50 per pound (lb) to less than US\$0.30 per lb.
- ❷ To make matters worse for Brazilian growers, falling prices have been accompanied by rising costs; coffee is still largely picked by hand, and wages are rising fast in Brazil. Farmers who grow coffee beans tend to specialize in the production of coffee, and do not plant other crops. Diversification is the usual way for farmers to protect themselves from volatile prices. Sugar cane, which could be a potential alternative crop, also has low prices.
- ❸ The International Coffee Organization (ICO) has called for governments in coffee producing countries to offer support to their farmers. The ICO observes that farmers in many countries are facing coffee bean prices that are below their total costs of production. “The socio-economic importance of coffee as a key source of income, particularly in rural areas, means that every effort should be made by governments to support their farmers”, the organization said.
- ❹ Comments from the ICO came just ahead of a Brazilian government announcement that it was going to provide support for Brazil’s coffee growers by offering to buy up to 3 million bags of coffee at a price of BRL343 per bag. This is equivalent to around US\$1.12 per lb. The offer, which sets a **price floor**, should provide temporary relief to farmers. The extra 3 million bags of coffee would bring government coffee stocks to their highest levels in more than a decade.
- ❺ The Brazilian president announced the support programme on a trip to Minas Gerais, Brazil’s top coffee-producing state, in the following terms, “I was here in the region when I was a candidate for president in 2010 and I know how important the coffee producers are for the economy”.

[Source: adapted from <http://reuters.com>, 7 August 2013; <http://economist.com>, 13 July 2013 and <http://agrimoney.com>, 7 August 2013]

(This question continues on the following page)



(Question 4 continued)

- (a) (i) Define the term *investment* indicated in bold in the text (paragraph 1). [2]
- (ii) Define the term *price floor* indicated in bold in the text (paragraph 1). [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]
- (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 1). [4]
- (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]

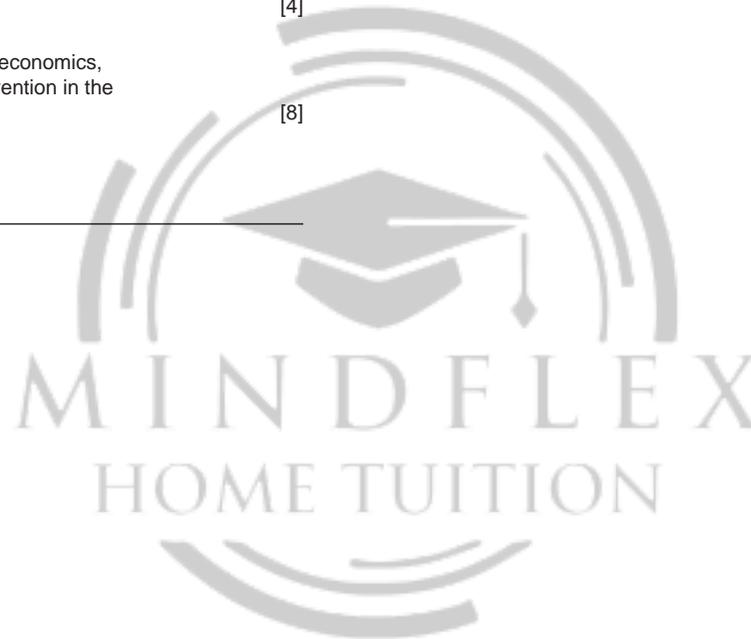
Markscheme

November 2015

Economics

Higher level

Paper 2



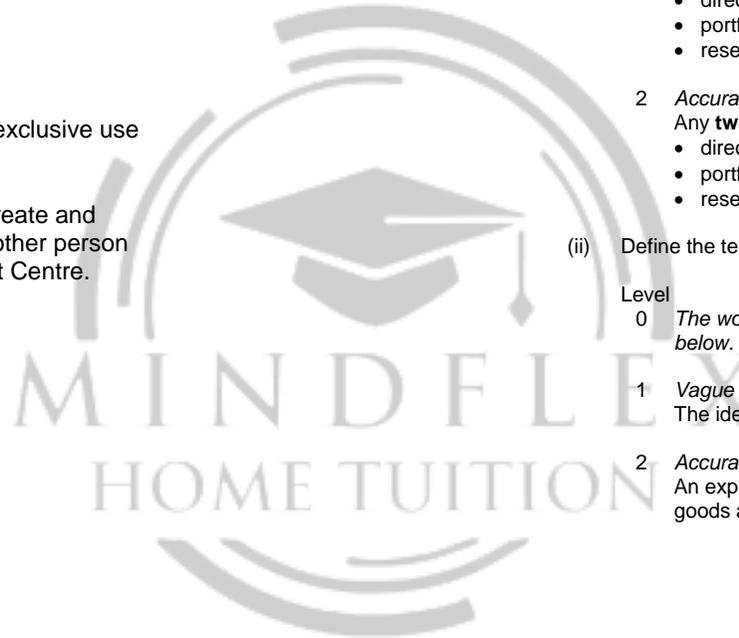
Use the paper-specific markscheme together with the markbands. Award up to the maximum marks as indicated.

Section A

1.	(a)	(i)	List two components of the financial account (paragraph ①).	[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 <i>consumption</i> indicated in bold in the text (paragraph ②).	[2]
			Level	Marks
			0 <i>The work does not reach a standard described by the descriptors below.</i>	0
			1 <i>Vague definition.</i> The idea that 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

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- (b) Explain the difference between direct/portfolio investment and income from investment in the balance of payments.

[4]

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.

Level

Marks

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

0

1 There is a partially correct explanation.

1-2

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.

2 There is a correct explanation.

3-4

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.

- (c) Using an exchange rate diagram, explain how the problems in the eurozone impacted the Swiss franc (paragraph 4).

[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.

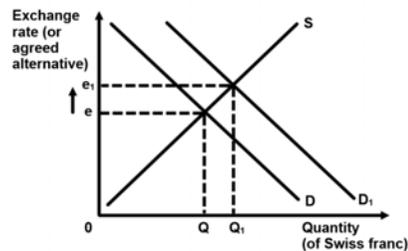
1-2

For drawing a correctly labelled 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.

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

3-4

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.



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

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<https://singaporetuitionteachers.com>

- (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 ❸). **[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

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

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

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.*

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.

Marks

0

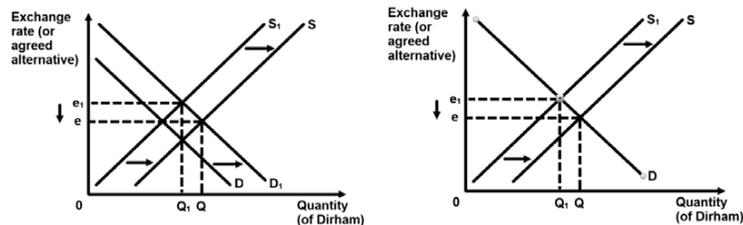
1-2

3-4

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

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

- 1 *There is limited understanding.*

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.

- 2 *There is clear understanding.*

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.

- (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).

Marks

0

1-2

3-4

[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

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

- 1 *Few relevant concepts are recognized.*

There is basic knowledge/understanding.

- 2 *Relevant concepts are recognized and developed in reasonable depth.*

There is clear knowledge/understanding.
There is some attempt at application/analysis.

- 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.

Marks

0

1-2

3-5

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.

Section B

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 ❶)
- 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 ❷)
- 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 ❶) 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 ❷)
- central bank needs large amounts of foreign reserves to maintain the fixed currency and discourage speculators (paragraph ❸) but this is not a problem (currently) for Saudi Arabia and UAE (paragraph ❹)
- 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 ❺).

Arguments against floating exchange rates:

- instability and lack of predictability for firms, consumers, importers and exporters – difficult to plan (paragraph ❶)
- 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.

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

Level		Marks
-------	--	-------

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

1	Vague response. Any one of the following reasons:	1
---	---	---

- 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	Accurate response. Any two of the following reasons:	2
---	--	---

- 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.

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

Level		Marks
-------	--	-------

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

1	Vague definition. The idea that it is deals with the long-term use of resources.	1
---	---	---

2	Accurate definition. 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 *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 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).

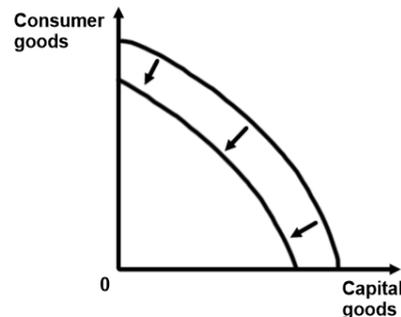
2 *There is a correct diagram and an accurate written response.*

3-4

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).

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 9).

[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 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.

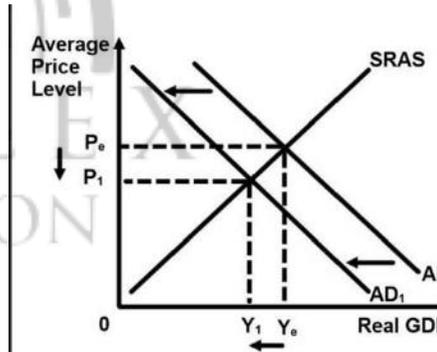
2 *There is a correct diagram and an accurate written response.*

3-4

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.

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 ④).

[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 *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

“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:

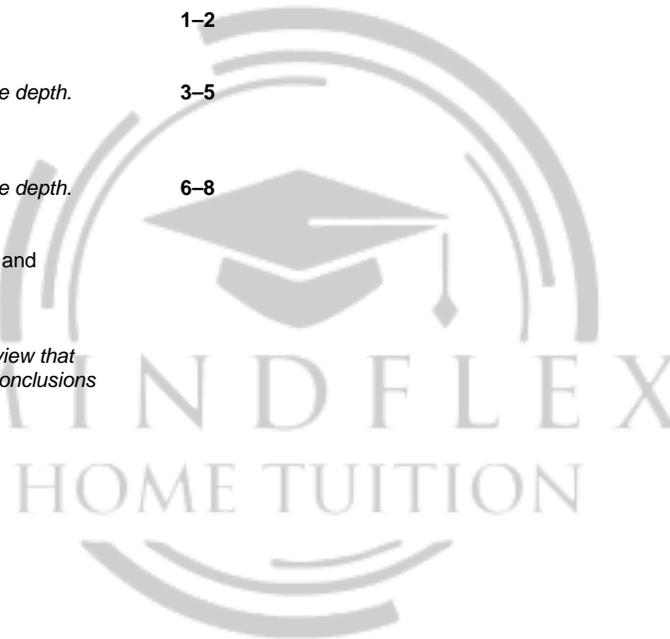
- may lead to higher levels of economic growth
- may lead to higher employment (paragraph ④)
- with higher growth, there may be higher tax revenues to meet development objectives
- trade liberalization could promote economic growth
- more efficient allocation of resources
- privatization results in government revenues
- smaller public sector (paragraph ④) 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 ④)
- 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 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 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 ❶). [2]

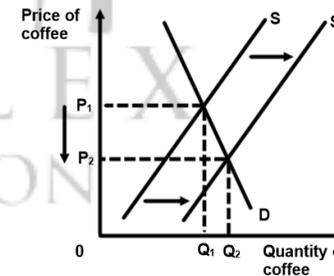
Level	Marks
0 <i>The work does not reach a standard described by the descriptors below.</i>	0
1 <i>Vague definition.</i> The idea that is a price set by the government or a type of intervention to help poor producers.	1
2 <i>Accurate definition.</i> An explanation that it is a price (set by the government) 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 ❶). [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 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.	1-2
2 <i>There is a correct diagram and an accurate written response.</i> 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.	3-4

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 ⑤).

[4]

Level

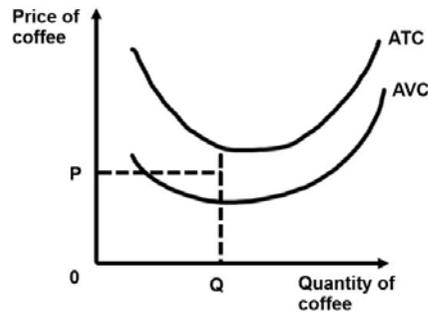
0 *The work does not reach a standard described by the descriptors below.*

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

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

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.



Marks

0

1-2

3-4

- (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

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

1 *Few relevant concepts are recognized.*
There is basic knowledge/understanding.

2 *Relevant concepts are recognized and developed in reasonable depth.*
There is clear knowledge/understanding.
There is some attempt at application/analysis.

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.

Marks

0

1-2

3-5

6-8

Command term

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

*Responses **may** include:*

- a 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 ⑥)
- it supports rural employment and may prevent rural urban migration (paragraph ⑥)

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 4)
- allocatively inefficient.

Any reasonable discussion.

Economics
Higher level
Paper 3

Wednesday 4 November 2015 (morning)

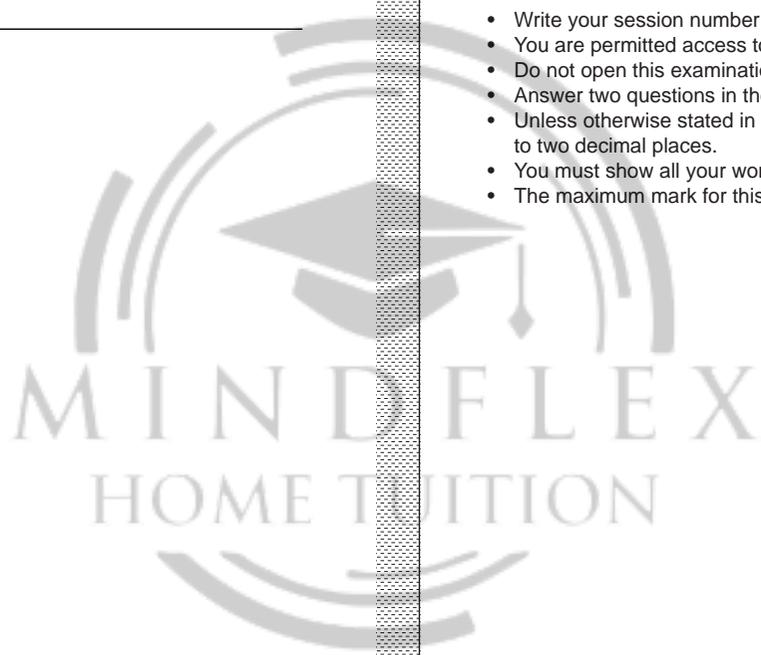
Candidate session number

1 hour

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Instructions to candidates

- Write your session number in the boxes above.
- You are permitted access to a calculator for this paper.
- Do not open this examination paper until instructed to do so.
- Answer two questions in the boxes provided.
- Unless otherwise stated in the question, all numerical answers must be given exactly or correct to two decimal places.
- You must show all your working.
- The maximum mark for this examination paper is **[50 marks]**.



14 pages

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