



MARKSCHEME

May 2010

ECONOMICS

Standard Level

Paper 1

17 pages

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

1. (a) **“World food prices have increased sharply over the past five years.”**
With the aid of *at least one* diagram, explain how *one* possible demand factor and *one* possible supply factor may have caused this increase. [10 marks]

Answers **should** include:

- a definition of demand; definition of supply
- a demand and supply diagram, or diagrams, showing demand shifting to the right and supply shifting to the left
- an explanation of the adjustment process to a new, higher equilibrium price
- an explanation of one possible demand factor, *e.g.* rising real disposable incomes in countries such as China and India, changing tastes
- an explanation of one possible supply-side factor, *e.g.* rising input costs, the impact of competitive supply, *e.g.* more output devoted to bio-fuels and less to food.

Answers **may** include:

- an explanation of any **possible** demand or supply factors that may also contribute to an explanation of the rise in food prices.

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

Assessment Criteria

Part (a) 10 marks		
Level		Marks
0	Completely inappropriate answer.	0
1	Little understanding of the specific demands of the question Very little recognition of relevant economic theory Relevant terms not defined Significant errors	1–3
2	Some understanding of the specific demands of the question Some recognition of relevant economic theory Some relevant terms defined Some errors	4–6
3	Understanding of the specific demands of the question Relevant economic theory explained and developed Relevant economic terms defined Few errors Where appropriate, diagrams included	7–8
4	Clear understanding of the specific demands of the question Relevant economic theory clearly explained and developed Relevant economic terms clearly defined No major errors Where appropriate, diagrams included and explained Where appropriate, examples used	9–10

(b) Consider the following *two* conflicting views:

“Food prices are best left to market forces.”

“Government should intervene to control rising food prices.”

Evaluate whether rising food prices should be left to market forces or controlled by government.

[15 marks]

Answers **may** include:

- an explanation of being “left to market forces”
- types of government intervention, *e.g.* buffer stocks, price controls and subsidies
- arguments for market forces in terms of:
 - the signalling, incentive and rationing functions of price
 - problems of buffer stocks, price controls and subsidies
 - general objections to government intervention such as market distortions, implications for the level of taxation and opportunity costs
- arguments for government intervention in terms of:
 - advantages of the various types of government intervention, *e.g.* stable prices for consumers and producers
 - market failure arguments, *e.g.* adequate food supply needs to be available to the whole population
 - impact of adequate food supply on labour productivity and health
 - equity and equality arguments.

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Effective evaluation may be to:

- consider short-term versus long-term consequences
- examine the impact on different stakeholders
- discuss advantages and disadvantages
- prioritize the arguments.

Assessment Criteria

Part (b) 15 marks

Level		Marks
0	Completely inappropriate answer.	0
1	Little understanding of the specific demands of the question Very little recognition of relevant economic theory Relevant terms not defined Significant errors	1–5
2	Some understanding of the specific demands of the question Some recognition of relevant economic theory Some relevant terms defined Some errors	6–9
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2. (a) **Aggregate demand consists of consumption, investment, government spending and net exports (exports minus imports). Explain *two* factors that may influence investment and *two* factors that may influence net exports.**

[10 marks]

Answers **should** include:

- a definition of investment
- a definition of net exports
- an explanation of **any two** factors which may influence investment such as the interest rate, business expectations, increased consumer demand, cost, economic stability and efficiency of capital equipment
- an explanation of **any two** factors which may influence net exports such as increases in foreign incomes increases a country's exports, increases in a country's national income leads to an increase in imports, decreases in a country's national income results in less exports from a country, decreases in a country's national income results in a decrease in imports, a fall in relative prices (if a country's goods and services fall in price relative to those of other countries) will result in a country selling more exports and buying less imports and improvements in the relative quality of a country's goods in comparison to other countries will result in it selling more exports and buying less imports.

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- (b) **Evaluate the effectiveness of an increase in investment expenditure on the performance of an economy.**

[15 marks]

Answers **may** include:

- a definition of investment
- an explanation of the “performance of an economy” in terms of growth, employment, price stability and the balance of payments
- consideration of an increase in investment leading to an increase in real GDP (economic growth)
- diagrams showing a movement from a point within to a point on the PPF or a shift of the AD to the right
- the supply-side effects of increasing investment on price and real output levels
- diagram to show shift in LRAS
- the possibility of demand-pull inflation, depending on where the economy is operating
- an explanation that it could adversely affect the current account of the balance of payments if investment expenditure is on imports
- impact of different types of investment in terms of sustainable development
- a comparison with potential growth
- the supply-side effects of increasing investment on price and real output levels
- short-run versus long-run effects
- an overall assessment of the impact.

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Effective evaluation may be to:

- consider short-term versus long-term consequences
- examine the impact on different stakeholders
- discuss advantages and disadvantages
- prioritize the arguments.

Assessment Criteria**Part (b) 15 marks**

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3. (a) **Explain the possible consequences of an improvement in a country's terms of trade for a country with a current account deficit.** *[10 marks]*

Answers **should** include:

- a definition of current account
- a definition of terms of trade: ratio of average price exports/average price imports
- an explanation of improvement in terms of trade
- an explanation of current account deficit
- an explanation of possible adverse effect on the current account in terms of higher export prices/lower import prices
- an explanation that a rise in export prices could improve the current account when export prices increase because of an increase in demand for a country's exports
- an explanation that a rise in export prices could worsen the current account when export prices rise as a result of domestic inflation, rising costs or greater inefficiency, or appreciation of the currency.

Answers **may** include:

- the importance of PED for exports and imports.

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- (b) **Evaluate the view that, in the long term, expenditure-switching policies (protectionism) are the most effective way to reduce a current account deficit.**

[15 marks]

Answers **may** include:

- an explanation of expenditure-switching and different types of protectionism, *e.g.* tariffs and quotas
- an explanation of how protectionism may be used to reduce a current account deficit
- arguments against protectionism to reduce a current account deficit, *e.g.* retaliation, contravention of WTO rules, impact on resource allocation and efficiency, impact on consumer prices
- consideration of expenditure reducing policies
- consideration of exchange rate policies
- consideration of supply-side policies to shift LRAS right and make exports more competitive in the long run
- consideration of the effect on other government objectives
- overall assessment.

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Effective evaluation may be to:

- consider short-term versus long-term consequences
- examine the impact on different stakeholders
- discuss advantages and disadvantages
- prioritize the arguments.

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4. (a) **Explain the difference between economic growth and economic development, and how each of these may be measured.** [10 marks]

Answers **should** include:

- a definition of economic growth
- a definition of economic development
- an explanation that economic growth is a quantitative concept whereas economic development is more qualitative
- an explanation that economic growth is measured by the increase in real national income over a period of time, whereas economic development, in addition to the latter, could also include a whole variety of other measures such as schooling, life expectancy, provision of healthcare, income distribution, political freedoms *etc.* (just a few examples would suffice).

Answers **may** include:

- a production possibility diagram to illustrate the difference between economic growth and economic development
- a mention of specific indices such as the HDI or HPI.

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- (b) **Evaluate the view that the best way that developed countries can help the growth and development process of very poor, highly indebted countries is through a general cancellation of debts.**

[15 marks]

Answers **may** include:

- a definition of developing, highly indebted countries
- examples of such countries
- arguments for debt cancellation in terms of the problems of debt, *e.g.* the opportunity cost of debt repayments, the impact on development, the gearing of the economy towards exports, the potentially serious implications of the problem on absolute poverty
- arguments against debt cancellation, *e.g.* the danger of moral hazard, debt forgiveness and the creation of a dependency culture, the rewarding of irresponsible governments and penalizing of committed ones, debt as one of just many causes of poverty in developing countries
- alternatives to debt cancellation such as aid or trade agreements
- the role of the IMF and World Bank, *e.g.* through structural adjustment programmes
- an overall assessment as to how the highly indebted countries can best be helped: debt write-offs *versus* effective aid and by industrialized countries lifting trade barriers.

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Effective evaluation may be to:

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