



MARKSCHEME

May 2010

ECONOMICS

Higher Level

Paper 3

22 pages

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

1. (a) Define the following terms indicated in bold in the text:

(i) **collusive oligopoly (paragraph 2)** [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1

The idea that it is where firms join together to act like a monopoly.

2 *Precise definition* 2

An explanation that it is a situation where a small number of firms act together to avoid competition by resorting to agreements to fix prices (or output).

(ii) **abnormal profits (paragraph 2).** [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1

The idea that revenues are greater than costs.

2 *Precise definition* 2

An explanation that they are where a firm earns a level of revenue that is greater than the total costs of production, including opportunity costs (or where a firm earns a level of revenue that is greater than that required to ensure that a firm will continue to supply its existing good or service).

(b) Using an appropriate diagram, explain how collusive oligopolies can earn abnormal profits. **[4 marks]**

level

- | | | |
|---|--|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
For drawing a correctly labelled diagram illustrating how a collusive oligopoly can earn abnormal profits (a monopoly diagram) or an explanation of how oligopolies can act together as a monopoly, charging a profit-maximising price that is higher than the costs of production and therefore earn abnormal profits. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing a correctly labelled diagram illustrating how a collusive oligopoly can earn abnormal profits (a monopoly diagram) and an explanation of how oligopolies can act together as a monopoly, charging a profit-maximising price that is higher than the costs of production and therefore earn abnormal profits.. | 3-4 |

Candidates who incorrectly label diagrams can receive a maximum of **[3 marks]**.

For the vertical axis, the label may be price, costs, a currency or any abbreviations of these. For the vertical axis, quantity (or Q) is sufficient.

(c) Using an appropriate diagram, explain how the increased size of the supermarkets has led to economies of scale (*paragraph 4*). [4 marks]

level

- | | | |
|---|---|-----|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
For drawing a correctly labelled diagram showing a fall in the LRAC or an explanation that economies of scale are achieved when the supermarkets' costs per unit of output (or average costs) decrease as the level of output increases (a percentage increase in inputs results in a larger percentage increase in output) as a result of <i>e.g.</i> bulk buying (or any other economy of scale). | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing a correctly labelled diagram showing a fall in the LRAC and an explanation that economies of scale are achieved when the supermarkets' costs per unit of output (or average costs) decrease as the level of output increases (a percentage increase in inputs results in a larger percentage increase in output) as a result of <i>e.g.</i> bulk buying (or any other economy of scale). | 3-4 |

Candidates who incorrectly label diagrams can receive a maximum of [3 marks].

For the vertical axis, the label may be costs, a currency or any abbreviations of these. For the vertical axis, quantity (or Q) is sufficient. The curve must be labelled LRAC or LAC.

- (d) Using information from the text/data and your knowledge of economics, evaluate a decision by the Australian government to reduce the total market share of the three largest supermarket chains to 75 %.

[8 marks]

Responses **may** include:

Reasons in favour of such a decision:

- reduce market share for the three largest supermarket chains allowing for greater competition (*paragraph 4*) with the benefits of competition such as lower prices, higher output and more choice
- less (productive and allocative) inefficiency in the allocation of resources
- less risk that the dominant firms will achieve dominance in other areas *e.g.* banking (*paragraph 3*)
- greater opportunity for small independent food stores
- greater employment opportunities if overall output increases
- a possible slowdown in food price inflation.

Reasons against such a decision:

- extended hours of service to the consumer may be reduced (*paragraph 4*)
- rental agreements may not be favourable for the large chains (*paragraph 4*)
- less employment and career opportunities in the large chains (*paragraph 5*)
- a reduction in the potential for economies of scale for the large chains (*paragraph 4*) with higher prices as a result.

Additional points:

- reducing the market share from 80 % to 75 % might make little difference to the market
- a better policy might be for the government to ensure that collusion does not take place.

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

If there is no direct reference to the text/data, then candidates may not be rewarded beyond level 2.

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.

Level

0	No valid discussion.	0
1	Few relevant concepts recognized. Little discussion or only basic understanding.	1-2
2	Relevant concepts recognized and developed in reasonable depth. Some attempt at application and analysis.	3-5
3	Relevant concepts developed in reasonable depth, demonstrating effective evaluation, supported by appropriate evidence or theory.	6-8

2. (a) Define the following terms indicated in bold in the text:

(i) indirect taxes (paragraph 4) *[2 marks]*

level

0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that they are a payment by households/firms to government.	1
2	<i>Precise definition</i> An explanation that an indirect tax is a tax on expenditure (or a tax levied on goods and services).	2

(ii) resources (factors of production) (paragraph 4). *[2 marks]*

level

0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that resources (factors of production), are land, labour, capital (and enterprise).	1
2	<i>Precise definition</i> An explanation that resources (factors of production), land, labour, capital (and enterprise), are those needed for the production of goods and services.	2

(b) Using an appropriate diagram, explain how a fall in consumer spending could lead to a recession. [4 marks]

level

- | | | |
|---|--|-----|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
For drawing a correctly labelled AD/AS diagram showing how a fall in consumption (a component of AD) could lead to a fall in real output through a shift of the AD curve to the left, or an explanation showing how a fall in consumption (a component of AD) could lead to a fall in real output causing negative growth. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing a correctly labelled AD/AS diagram showing how a fall in consumption (a component of AD) could lead to a fall in real output through a shift of the AD curve to the left, and an explanation showing how a fall in consumption (a component of AD) could lead to a fall in real output causing negative growth. | 3-4 |

Candidates who incorrectly label diagrams can receive a maximum of **[3 marks]**.

For AD/AS, the vertical axis may be price level, average price level or inflation. The horizontal axis may be output, real output, national output, real national output, national income, GDP. Any appropriate abbreviations, such as APL, CPI, RNO or RNY are allowable. A title is not necessary.

(c) **Using a demand and supply diagram, explain why the price of labour (wages) will fall if businesses hire less labour.** **[4 marks]**

level

- | | | |
|---|--|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
For drawing a correctly labelled demand and supply diagram for the labour market showing a decrease in demand by businesses for labour will result in a lower price of labour (wages) or an explanation of how a decrease in demand for labour will result in a lower price of labour (wages). | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing a correctly labelled demand and supply diagram for the labour market showing a decrease in demand by businesses for labour will result in a lower price of labour (wages) and an explanation of how a decrease in demand for labour will result in a lower price of labour (wages). | 3-4 |

Candidates who incorrectly label diagrams can receive a maximum of **[3 marks]**.

The vertical axis may be price, price of labour, wage, average wage or P. The horizontal axis may be quantity of labour, quantity or Q. A title is not necessary.

A similar and equally correct approach may be to draw a labour market diagram with aggregate supply of labour and aggregate demand for labour.

- (d) **Using information from the text/data and your knowledge of economics, evaluate the role of fiscal policy in stimulating the USA economy.**

[8 marks]

Responses **may** include:

- an explanation/definition of fiscal policy
- an AD/AS diagram showing a rightward shift of AD
- a reference to Keynesian policies.

Positive role that fiscal policy may have:

- the effect direct investment may have on business investment (*paragraph 3*)
- the possible effect on consumer spending (*paragraph 3*)
- lower production costs as a result of tax cuts in indirect taxes (*paragraph 4*)
- direct tax cuts increase disposable income (*paragraph 4*)
- supply side benefits of increased government spending on infrastructure
- possible increase in business confidence (*paragraph 4*)
- multiplier and accelerator effects
- impact on employment.

Negative role fiscal policy may have:

- inflationary pressures conflicting with growth and the desire to stimulate the economy (*paragraph 3*)
- is the package powerful enough to convince investors?
- inflexibility in that it cannot be changed easily and quickly
- time lags for policy measures to have an effect
- financing a budget deficit
- “crowding out” effect of increased borrowing
- could add to the trade deficit.

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

If there is no direct reference to the text/data, then candidates may not be rewarded beyond level 2.

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.

Level

0	No valid discussion.	0
1	Few relevant concepts recognized. Little discussion or only basic understanding.	1-2
2	Relevant concepts recognized and developed in reasonable depth. Some attempt at application and analysis.	3-5
3	Relevant concepts developed in reasonable depth, demonstrating effective evaluation, supported by appropriate evidence or theory.	6-8

3. (a) Define the following terms indicated in bold in the text:

(i) exchange rate (paragraph 1) [2 marks]

level

0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that it is how much a currency is worth.	1
2	<i>Precise definition</i> An explanation that it is the price (or value) of one currency expressed or converted in terms of another, e.g. €1 = US\$1.5 (example not required).	2

(ii) foreign direct investment (paragraph 1) [2 marks]

level

0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that it is a company investing in another country.	1
2	<i>Precise definition</i> An explanation that it is a long-term investment by multinational corporations in another country.	2

(b) Using an appropriate diagram, explain how increased spending on food imports (paragraph 2) could affect Pakistan’s exchange rate. [4 marks]

level

- 0 *Inappropriate answer* 0
- 1 *Identification of appropriate theory* 1-2
For drawing a correctly labelled exchange rate diagram showing how an increase in spending on food imports results in an increase in the supply of the currency on the foreign exchange market and a fall in the value of the Pakistani rupee, *ceteris paribus* **or** an explanation that the increased purchase of food imports would lead to an increase in the supply of the currency on the foreign exchange market and a fall in the value of the Pakistani rupee, *ceteris paribus*.
- 2 *Correct application of appropriate theory* 3-4
For drawing a correctly labelled exchange rate diagram showing how an increase in spending on food imports results in an increase in the supply of the currency on the foreign exchange market and a fall in the value of the Pakistani rupee, *ceteris paribus* **and** an explanation that the increased purchase of food imports would lead to an increase in the supply of the currency on the foreign exchange market and a fall in the value of the Pakistani rupee, *ceteris paribus*.

A diagram showing and explaining a fall in demand for the rupee and so a depreciation may receive a maximum of [1 mark] for the diagram, and [0 marks] for the explanation.

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

The vertical axis may be price (or value) of the rupee in US\$ (or in other currencies), US\$/rupee or exchange rate. The horizontal axis should be quantity of rupees or just quantity (or Q). A title is not necessary.

- (c) Using an appropriate diagram, explain how the continuing increase in prices for imported raw materials (*paragraph 2*) could have contributed to the impact on the general price level and output in 2008 (*Table 1*). *[4 marks]*

level

- | | | |
|---|---|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
For drawing a correctly labelled AD/AS diagram (upward sloping AS) showing a decrease in AS or an explanation of how increased prices for raw materials will increase the costs of production, shifting AS and contributing to a higher price level and lower output. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing a correctly labelled AD/AS diagram (upward sloping AS) showing a decrease in AS and an explanation of how increased prices for raw materials will increase the costs of production, shifting AS and contributing to a higher price level and lower output. | 3-4 |

Candidates who incorrectly label diagrams can receive a maximum of *[3 marks]*.

For AD/AS, the vertical axis may be price level, average price level, or inflation. The horizontal axis may be output, real output, national output, real national output, national income (Y), or GDP. Any appropriate abbreviations, such as APL, CPI, RNO or RNY are allowable. A title is not necessary.

- (d) Using information from the text/data and your knowledge of economics, evaluate the impact on the Pakistani economy of the decision to introduce tariffs (*paragraph 4*).

[8 marks]

Responses **may** include:

- a definition of tariffs
- a tariff diagram
- revenue from tariffs could help reduce the budget deficit (*paragraph 4*)
- tariffs on imported goods will discourage their purchase and so less imports will reduce the current account deficit (*paragraph 4*)
- tariffs will encourage production in domestic import-competing industries
- tariffs can protect and encourage employment in domestic industries
- tariffs contribute to a dead-weight loss of welfare (*paragraph 4*), because of the loss of consumer surplus
- tariffs lead to an inefficient allocation of resources (*paragraph 4*), because goods are produced by relatively inefficient domestic farmers as opposed to more efficient foreign farmers
- tariffs can have an inflationary impact in a country with an existing problem of high inflation (*Table 1*)
- tariffs could encourage producers to diversify (*paragraph 5*) and avoid the risk of over-specialization
- the introduction of tariffs may result in retaliation which may affect export industries making it difficult to achieve export-led growth
- the tariffs may go against WTO rules (Pakistan is a member)
- a worsening of international political relations.

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

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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.

Level

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1	Few relevant concepts recognized. Little discussion or only basic understanding.	1-2
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3	Relevant concepts developed in reasonable depth, demonstrating effective evaluation, supported by appropriate evidence or theory.	6-8

4. (a) Define the following terms indicated in bold in the text:

(i) **sustainable development** (*paragraph ①*) [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1

The idea that it is related to the use of the world's resources.

2 *Precise definition* 2

An explanation that it is development that meets the needs of the present without compromising the ability of future generations to meet their own needs.

(ii) **free trade** (*paragraph ②*). [2 marks]

level

0 *Wrong definition* 0

1 *Vague definition* 1

The idea that it is to do with international trade.

2 *Precise definition* 2

An explanation that it is international trade that takes place without any protectionism (trade barriers).

(b) Using the concept of income elasticity of demand, explain the change in relative importance of the agricultural sector in comparison to the industrial and the service sectors in Vietnam (paragraph ③). **[4 marks]**

level

- | | | |
|---|--|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
An explanation that YED for manufactured goods and services is higher than for agricultural products or for explaining that as income increases, there will be a relatively greater increase in demand for manufactures and services, as they become relatively more important to consumers, than agricultural products. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
An explanation that YED for manufactured goods and services is higher than for agricultural products and for explaining that as income increases, there will be a relatively greater increase in demand for manufactures and services, as they become relatively more important to consumers, than agricultural products. | 3-4 |

(c) Using an appropriate diagram, explain the likely long-term impact of a rise in sea levels on the productive capacity of the Vietnamese economy (paragraph ⑤). **[4 marks]**

level

- | | | |
|---|---|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
For drawing a correctly labelled PPC diagram showing an inward shift in the PPC or an explanation that rising sea levels will reduce the amount of productive land and thus reduce the productive capacity of the Vietnamese economy. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing a correctly labelled PPC diagram showing an inward shift in the PPC and an explanation that rising sea levels will reduce the amount of productive land and thus reduce the productive capacity of the Vietnamese economy. | 3-4 |

Candidates may draw a diagram showing a shift of the LRAS curve to the left. If correctly labelled and explained this can be fully rewarded. If the Keynesian model is used, the productive capacity must be indicated on the horizontal axis. If not indicated, only one mark may be awarded for the diagram.

Candidates who incorrectly label diagrams can receive a maximum of **[3 marks]**.

For a PPC, the axes could be two alternative products, one on each axis, e.g. Good A and Good B: or two groups of products, e.g. consumer goods and capital goods. A title is not necessary.

- (d) **Using information from the text/data and your knowledge of economics, evaluate diversification as a policy option for improving export performance in Vietnam.**

[8 marks]

Responses **may** include:

- explanations of diversification and specialization.

Arguments in favour of diversification (and against specialization):

- avoids long-term declines in commodity terms of trade
- avoids extreme agricultural price fluctuations (*paragraph 4*)
- avoids developed country barriers to trade (agricultural subsidies)
- reduces vulnerability to “shocks” such as extreme weather conditions (*paragraph 5*)
- takes advantage of possibilities offered by “craft industries” and tourism (*paragraph 4*)
- diversification into manufacturing provides opportunities for increased employment, use of new technologies and development of skills
- diversification allows countries to achieve economic transformation (*paragraph 3*)
- over very long term must diversify into production that will not be affected by rising sea levels (*paragraph 5*)
- by diversifying, countries may produce a good or service in which they might have a comparative advantage.

Arguments against diversification (and in favour of specialization):

- specialization according to comparative advantage increases productive efficiency and the quantity of output produced
- specialization and trade according to comparative advantage allow countries to consume at a point outside their PPC
- specialization according to comparative advantage improves the global allocation of resources
- specialization allows countries to take advantage of economies of scale
- specialization allows farmers to take advantage of increases in food prices (*paragraph 4*)
- diversification implies structural change and so may lead to structural unemployment.

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

If there is no direct reference to the text/data, then candidates may not be rewarded beyond level 2.

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.

Level

0	No valid discussion.	0
1	Few relevant concepts recognized. Little discussion or only basic understanding.	1-2
2	Relevant concepts recognized and developed in reasonable depth. Some attempt at application and analysis.	3-5
3	Relevant concepts developed in reasonable depth, demonstrating effective evaluation, supported by appropriate evidence or theory.	6-8

5. (a) Define the following terms indicated in bold in the text:

(i) World Bank (paragraph 1) [2 marks]

level

0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that it is an international.	1
2	<i>Precise definition</i> An explanation that it is an: <ul style="list-style-type: none">• international organization whose aims include:<ul style="list-style-type: none">- providing aid and advice to developing countries- reducing poverty levels- encouraging and safeguarding international investment.	2

Any two points are sufficient for [2 marks].

(ii) free market (paragraph 4). [2 marks]

level

0	<i>Wrong definition</i>	0
1	<i>Vague definition</i> The idea that it is a market without any constraints.	1
2	<i>Precise definition</i> An explanation that a free market exists where prices and output are determined by demand and supply.	2

(b) Using an appropriate diagram, explain how a guaranteed price above the equilibrium price will benefit groundnut farmers (*paragraph 4*). [4 marks]

level

- | | | |
|---|---|-----|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
For drawing a correctly labelled demand and supply diagram with a guaranteed price above equilibrium or an explanation that a guaranteed price above equilibrium may mean that farmers can earn higher income/revenues. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing a correctly labelled demand and supply diagram with a guaranteed price above equilibrium and an explanation that a guaranteed price above equilibrium may mean that farmers can earn higher income/revenues. | 3-4 |

Candidates who incorrectly label diagrams can receive a maximum of [3 marks].

For the vertical axis, the label could be price of groundnuts, price or P. For the horizontal axis, quantity of groundnuts, quantity or Q are acceptable. A title is not necessary.

(c) **Using an appropriate diagram, explain how the provision of hospital services has positive externalities** (*paragraph 2*). **[4 marks]**

level

- | | | |
|---|--|------------|
| 0 | <i>Inappropriate answer</i> | 0 |
| 1 | <i>Identification of appropriate theory</i>
For drawing a marginal social cost/marginal social benefit diagram where there is a positive externality (either $MSB > MPB$ or $MSC < MPC$) or for an explanation that health care provides external benefits since third parties (or the economy) benefit when people are in better health. | 1-2 |
| 2 | <i>Correct application of appropriate theory</i>
For drawing a marginal social cost/marginal social benefit diagram where there is a positive externality (either $MSB > MPB$ or $MSC < MPC$) and for an explanation that health care provides external benefits since third parties (or the economy) benefit when people are in better health. | 3-4 |

Candidates who incorrectly label diagrams can earn a maximum of **[3 marks]**.

For the vertical axis, the label could be price, price of health care, price and costs, price and costs of health care, MSB, MSC or P. For the horizontal axis, quantity of health care, quantity or Q are acceptable. A title is not necessary.

An alternative positive externalities diagram would be a demand and supply diagram with a demand_{private} curve and a demand_{private + external benefit} curve (or a private_{private} curve and a supply_{private + external} curve).

- (d) **Using information from the text/data and your knowledge of economics, evaluate fair trade as a means of improving the welfare of people in Malawi.**

[8 marks]

Note: To be eligible for Level 3. Candidates must relate the points in the answer to the concept of improved economic welfare (or development) as stated in the question.

Responses **may** include:

- an evaluation that fair trade is an alternative to the world trading system as producers are seen to be poor and not receiving a fair price for their product
- an evaluation that fair trade enables the producer (farmer) to obtain a larger share of the final consumer price, and emphasizes environmental sustainability and labour rights.

Reasons why fair trade may result in improved welfare:

- fair trade provides improved infrastructure and better educational opportunities (*paragraph 3*)
- allows farmers to achieve a greater degree of economic security and self-sufficiency (*paragraph 4*)
- provides higher prices for products and so a higher income for farmers
- farmers can benefit from training and quality management
- fair trade is one of the fastest growing retail sectors in Great Britain and so farmers in Malawi that produce fair-trade certified products may enjoy greater demand
- the emphasis on sustainability may result in increased living standards for future generations of Malawians.

Reasons why fair trade may not result in improved welfare/arguments against fair trade:

- Malawi is one of the world's least developed countries (*paragraph 1*) and will require more than fair trade to improve this situation
- Malawi will still be dependent on economic assistance from the IMF, World Bank and donor nations
- fair trade that includes a guaranteed price above equilibrium may result in surpluses and represent a misallocation of resources (*paragraph 5*)
- if demand for groundnuts is inelastic, then the increase in price may result in lower incomes if there is not sufficient demand for fair trade groundnuts
- fair trade may cause Malawi to be dependent on agriculture, rather than diversifying
- most of the benefits could go to large supermarkets rather than diversifying (*paragraph 6*)
- fairtrade products may be among the first to experience a decrease in demand in economic downturns in more developed countries, thus continuing to make the fair-trade farmers vulnerable to forces outside their control.

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

If there is no direct reference to the text/data, then candidates may not be rewarded beyond level 2.

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.

Level

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