



MARKSCHEME

May 2011

ECONOMICS

Higher 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) **Using an appropriate diagram, explain how a monopolist might be able to make supernormal (abnormal) profits in the short-run, and why these profits might continue to be earned in the long-run.** **[10 marks]**

Answers **should** include:

- a definition of a monopolist
- a definition of supernormal (abnormal) profits
- an explanation of supernormal (abnormal) profit in terms of average revenue (AR) being greater than average cost (AC) or total revenue (TR) being greater than total cost (TC)
- an explanation of long-run supernormal (abnormal) profit in terms of the existence of barriers to entry
- a standard monopoly diagram showing profit maximization.

Answers **may** include:

- a distinction between the short-run and long-run in microeconomics
- an explanation of the various barriers to entry
- an explanation that a monopolist might make use of price discrimination and the ability to do research and development to prevent the market becoming contestable in the long-run
- a comparison with perfect competition.

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) **Evaluate the view that monopolistic competition is a more economically desirable market form than monopoly.**

[15 marks]

Answers **may** include:

- an explanation of the difference between monopoly and monopolistic competition
- monopoly and monopolistic competition diagrams
- an explanation of the term “economically desirable” and consideration of desirable for whom?
- comparison in terms of:
 - productive efficiency
 - allocative efficiency
 - short-run and long-run efficiency
 - economies of scale
 - price, output and profits
 - consumer choice
 - impact of product differentiation/non-price competition
 - freedom of entry to the markets
- assessment of which market form is most desirable.

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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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
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. An attempt at evaluation.	10–12
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. Evidence of appropriate evaluation.	13–15

2. During the global financial crisis of 2008–2009, there was a fall in consumer spending in many countries.

(a) Explain the factors which might be responsible for causing consumer spending to fall.

[10 marks]

Answers **should** include:

- an explanation of “consumer spending” in the context of aggregate demand and some of the factors which may cause it to fall such as:
 - a fall in disposable incomes
 - a change in the distribution of income
 - the wealth effect *e.g.* of falling property and share values
 - an increase in unemployment or the threat of unemployment
 - less availability of credit
 - an increase in the cost of credit
 - a decrease in consumer confidence.

Two or three factors explained fully or more factors explained in less detail would be sufficient for full marks.

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- (b) Evaluate the possible consequences of falling consumer spending for a country's macroeconomic performance.

[15 marks]

Answers **may** include:

- an explanation/definition of macroeconomic performance
- the use of AD/AS diagrams
- the use of a PPC diagram
- linkages to the level of investment and possible accelerator/multiplier effects
- the impact on the level of employment
- the impact on economic growth (processing, depression, the business cycle)
- the impact on the rate of inflation
- the impact on the balance of payments and the exchange rate
- the impact on government revenues and expenditures.

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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3. (a) **Using the theory of comparative advantage, explain how specialization and free trade might lead to welfare gains for developed countries.** *[10 marks]*

Answers **should** include:

- a definition of developed countries
- a definition of comparative advantage
- an explanation of comparative advantage
- an explanation of specialization
- an explanation of free trade
- an explanation of welfare gains
- an explanation of the impact of comparative advantage on resource allocation
- an explanation of links between the concepts
- the effect on the level of output, employment and incomes
- the effect on variety and prices of consumer goods and services.

Answers **may** include:

- a distinction between absolute and comparative advantage
- numerical and/or diagrammatic representation of the principle of comparative advantage
- use of the tariff diagram to illustrate welfare gains
- limitations of the theory of comparative advantage
- an explanation that free trade for developed countries may improve efficiency and productivity and lead to trade creation.

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- (b) **Evaluate the possible impact of globalization on the economies of developed countries.** *[15 marks]*

Answers **may** include:

- a consideration of the meaning and nature of globalization
- factors which have contributed to the globalization of the world economy
- the impact on the macro economy in terms of employment, the price level, growth, balance of payments and income distribution
- the benefits/drawbacks of free trade and freely floating exchange rates
- the benefits/drawbacks of greater reliance on multinational corporations (MNCs)
- the impact of greater financial capital inflows and outflows
- the impact of greater mobility of labour
- globalization and the transfer of knowledge and technology
- the impact on allocative, productive and long-run efficiency.

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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Assessment Criteria

Part (b) 15 marks

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4. (a) **Explain the main features of market-led strategies used to achieve economic development in less-developed countries (LDCs).** *[10 marks]*

Answers **should** include:

- a definition of economic development
- a definition of less-developed countries (LDCs)
- an explanation of market-led strategies such as:
 - trade liberalization/low levels of protectionism
 - an emphasis on private enterprise rather than state intervention
 - a floating exchange rate
 - encouragement of FDI
 - privatization
 - use of supply-side policies
 - flexible labour markets.

Answers may include references to recent/current examples of market-led strategies.

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- (b) **Evaluate the view that economic development in less-developed countries (LDCs) can best be achieved through market-led strategies rather than interventionist strategies.**

[15 marks]

Answers **may** include:

- an explanation of interventionist strategies, *e.g.* in terms of the state playing an active role in the management of the economy, economic planning, protectionism exchange controls, nationalization
- use of PPC diagrams to illustrate development
- the advantages of market-led strategies, *e.g.* in terms of more efficient resource allocation along the lines of comparative advantage, benefits of MNCs, benefits of free trade, flexible labour and capital markets, greater consumer choice, a reduction in government budget deficits
- the disadvantages of market-led strategies, *e.g.* in terms of market failure, increased likelihood of structural unemployment, problems of MNCs, problems of structural adjustment programmes, greater wealth and income inequality, problems of capital outflows, the greater vulnerability of countries to international economic crises
- the advantages of interventionist strategies, *e.g.* in terms of greater diversity of economic activity, supply-side improvements as a result of investment in health care and education and training, protectionism allowing industry a breathing space to grow, a more equal distribution of income and wealth, less inequality between rural and urban sectors, higher levels of employment
- the disadvantages of interventionist strategies, *e.g.* in terms of possible growth of the public sector and government spending, inability to benefit from the gains from free trade, inefficient resource allocation, growth of inefficient monopolies, drawbacks of planning
- after consideration of market-led and interventionist strategies, factors favourable to development regardless of strategy may be suggested, *e.g.* absence of corruption.

N.B. This question, as the markscheme indicates, is particularly broad, so a very wide range of answers is possible. Only some of the above points can be expected within the time allowed.

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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Assessment Criteria

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