



MARKSCHEME

May 2011

ECONOMICS

Higher Level

Paper 2

8 pages

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In addition to the assessment criteria, use the paper-specific markscheme below. Award up to the maximum marks indicated. Each question is worth [10 marks].

1. Explain the concept of opportunity cost and how it may be used to show the difference between free goods and economic goods.

Candidates **may** include:

- a definition of opportunity cost
- a definition of free goods
- a definition of economic goods
- examples of free goods
- examples of economic goods
- an explanation of free goods having no opportunity cost and therefore no price
- an explanation of economic goods having an opportunity cost
- an explanation of opportunity cost using examples and PPC diagram
- use of supply and demand diagrams to distinguish between free goods and economic goods.

Candidates who incorrectly label diagrams cannot be rewarded with full marks.

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

Assessment Criteria

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

2. Explain *two* possible ways a government may respond to market failure resulting from a polluting power station.

Candidates **may** include:

- a definition of market failure
- an explanation of how a polluting power station would represent a negative externality
- use of a negative externality diagram
- ways a government may respond include:
 - regulation through legal controls
 - tradable permits
 - imposition of indirect taxation supported by a supply and demand diagram (or a MPC/MSD diagram)
 - international cooperation among governments
 - extension of property rights.

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3. Explain why structural unemployment might persist despite high economic growth.

Candidates **may** include:

- a definition of structural unemployment
- a definition of economic growth
- an explanation that economic growth is usually associated with the creation of employment opportunities
- use of an AD/AS diagram to illustrate economic growth
- an explanation of unemployment remaining because of geographical and occupational immobility
- an explanation of links with technological and regional unemployment and lack of retraining opportunities
- an explanation of how economic growth may also lead to structural unemployment due to structural change
- an explanation of how economic growth based on capital-intensive technologies can also lead to greater unemployment.

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4. A country suffers an inflation rate of 10 %. Explain the costs associated with this for the country’s economy?

Candidates **may** include:

- a definition of inflation
- a definition of rate of inflation
- an explanation of the effect of higher inflation on real income
- families suffer a loss of purchasing power if incomes do not keep up with the rate of inflation
- fixed income earners suffer lower real income
- savers and lenders suffer lower real returns unless interest rates keep up with the rate of inflation
- the demand for real assets (such as real estate) increases at the expense of productive investment
- business decision-making may be hampered by uncertainty
- menu costs
- the signalling power of relative price change is undermined
- increased unemployment if inflation is cost-push
- the country loses international competitiveness if trade partners experience a lower rate of inflation with negative consequences for the balance of payments
- inflation may lead to a depreciation/devaluation of the currency that would reduce the country’s purchasing power abroad and increase its external debt burden.

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5. Given that a country’s terms of trade are improving, explain the possible impact on its balance of payments on current account.

Candidates **may** include:

- a definition of terms of trade
- a definition of balance of payments on current account
- an explanation of improving terms of trade
- an explanation of possible fall in quantity demanded for exports and increase in quantity demanded for imports
- consideration of price elasticity of demand (PED)
- consideration of the importance of the causes of the changes of terms of trade
- if the improvement in the terms of trade occurs due to an increase in demand for exports and/or decrease in demand for imports then the current account balance would improve regardless of PED
- if the improvement in the terms of trade occurs due to a decrease in the supply of exports and/or increase in the supply of imports, then the effect on the current account balance depends on PED.

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6. Explain the importance of the concept of income elasticity of demand for the exports and imports of less-developed countries (LDCs).

Candidates **may** include:

- a definition of income elasticity of demand (YED)
- a definition of less-developed countries (LDCs)
- an explanation of type of exports from LDCs, assumed to be primary products
- an explanation of relatively low YED for exports of primary commodities
- an explanation of type of imports for LDCs, assumed to be mainly manufactured goods
- an explanation of relatively high YED for imports of manufactured goods
- an explanation that as trading partners (MDCs) experience economic growth, there will be a less than proportionate increase in the demand for LDCs exports
- an explanation that as LDCs experience economic growth, there will be a higher than proportionate increase in the demand for LDCs imports
- an explanation that the terms of trade may deteriorate over the long term
- the impact on the current account balance of payments of LDCs
- examples.

N.B. The question and markscheme assume the classical conditions prevailing in LDCs some years ago. Some candidates may comment on this. These candidates may refer to a distinction between “less” developed countries and “least” developed countries. Many LDCs now export manufactures and services more than primary products.

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