



MARKSCHEME

May 2012

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) Explain why, in markets dominated by a few firms, prices may remain relatively stable. **[10 marks]**

Answers **should** include:

- an explanation of “markets dominated by a few firms” as oligopoly
- an explanation of stable prices in terms of at least one theory of oligopoly, such as:
 - use of the kinked demand curve model and diagram
 - price leadership aspects of collusive oligopoly
 - the operation of cartels.

Answers **may** include:

- non-price competition
- a plausible general explanation of why prices are particularly likely to be rigid in a downwards direction.

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) **“An industry with a larger number of firms will experience lower prices and greater efficiency than an industry with a smaller number of firms.” Evaluate this view.**

[15 marks]

Answers **may** include:

- a definition of productive efficiency
- a definition of allocative efficiency
- an explanation of different market structures in terms of number of firms
- analysis of the linkages between a large number of firms in an industry, allocative and productive efficiency and prices
- analysis of the linkages between a large number of firms in an industry, and lower prices through price-taking
- the linkage between a large number of firms, and lower costs due to the avoidance of diseconomies of scale
- the linkages between a small number of firms, dynamic efficiency, economies of scale and lower prices
- specific references to, and illustrations from, the four main market structures of perfect competition, monopoly, oligopoly and monopolistic competition
- appropriate application of contestable market theory
- evaluation of above arguments.

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. (a) **Explain why governments may pursue the macroeconomic goals of low inflation and low unemployment.**

[10 marks]

Answers **should** include:

- a definition of inflation
- a definition of unemployment
- an explanation of why governments may pursue the goal of low unemployment in terms of the costs of high unemployment; *e.g.* the financial costs to the government (lower tax revenue/higher welfare spending), the economic costs in terms of lost output and the broader social and human costs
- an explanation of why governments may pursue the goal of low inflation in terms of the costs of inflation; *e.g.* lack of competitiveness in export markets, adverse effects on business confidence and the level of investment, the impact on creditors and debtors, the impact on fixed income groups, *i.e.* pensioners.

Answers **may** include:

- an explanation of the linkage between low inflation and low unemployment with the goal of economic growth
- use of relevant diagrams.

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- (b) **Evaluate the extent to which the use of expansionary demand-side policies may lead to conflicts between the various goals of macroeconomic policy.** [15 marks]

Answers **may** include:

- a definition of demand-side policies
- an explanation of expansionary demand-side policies in terms of fiscal and monetary policies
- expansionary fiscal policies involving a reduction in taxation and/or a rise in government spending and expansionary monetary policies most likely involving lower interest rates and possibly an expansion of the money supply
- an explanation of expansionary demand-side policies aiming to increase growth and to decrease unemployment/to avoid deflation/to get out of recession
- the possible conflict between expanding demand to reduce unemployment and the goal of lower inflation (the short run and long run Phillips curves and the natural rate of unemployment)
- the adverse consequences on long-run economic growth of higher rates of inflation
- the possible conflict between expanding demand and a deteriorating balance of payments on current account leading to exchange rate depreciation and imported inflation
- use of AD/AS diagram to illustrate expanding aggregate demand with AS curves of different shapes; *e.g.* the importance of spare capacity in the economy
- the extent to which conflicts may be avoided through the use of accompanying supply-side policies
- evaluation of the above arguments.

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.

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

Assessment Criteria

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3. (a) **Explain the possible consequences for a country of a persistent deficit on the current account of its balance of payments.**

[10 marks]

Answers **should** include:

- a definition of balance of payments on current account
- a definition of persistent deficit
- explanations of balance of payments on current account and deficit on current account
- an explanation of possible consequences.

Answers **may** include:

- an explanation of various consequences, such as:
 - possibility of financing the deficit in the short run through running down foreign exchange reserves
 - the need to borrow foreign exchange in the long-run, with conditions imposed by lenders such as the IMF
 - the need to reduce the deficit in the long-run, *e.g.* through deflationary demand-side policies
 - the deficit may engender a cycle of further deficits
 - the possibility of a current account deficit as a reflection of higher living standards
 - the need to counter the current account deficit with a capital account surplus, possibly through higher interest rates
 - the downward pressure on the exchange rate
 - the need to increase interest rates in order to attract foreign funds
 - the likely depreciation/devaluation resulting from the deficit
- a suitable diagram.

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- (b) **Evaluate the view that balance of payments deficits on current account are best resolved through the use of supply-side policies.**

[15 marks]

Answers **may** include:

- a definition of balance of payments
- a definition of supply-side policies
- an explanation of supply-side policies
- examples of supply-side policies
- an explanation of the link between successful supply side policies and an improvement in the current account deficit in terms of a shift of the LRAS to the right, lower inflation and more competitive export prices
- the disadvantages of particular supply-side policies
- supply-side policies as a long-run solution
- the advantages and disadvantages of using other policies such as exchange rate depreciation, expenditure reducing policies and expenditure switching policies
- use of appropriate diagrams, *e.g.* AD/AS
- evaluation of above arguments.

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) “The banking system, the education system, health care and a country’s infrastructure are four sources of economic development.” Explain how *three* of these factors might contribute to economic development. *[10 marks]*

Answers **should** include:

- a definition of economic development
- an explanation of how the three chosen factors might contribute to economic development:
 - possible links between the banking system and economic development
 - possible links between the education system and economic development
 - possible links between a country’s health care and economic development
 - possible links between a country’s infrastructure and economic development.

Answers **may** include:

- AD/AS and PPC diagrams.

Where candidates consider two factors a maximum of *[8 marks]* can be awarded and where only one factor is considered a maximum of *[6 marks]* can be awarded.

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- (b) **Evaluate the view that the impact of globalization on the economic growth and development of developing countries has, on balance, been beneficial.** *[15 marks]*

Answers **may** include:

- a definition of globalization
- a definition of economic growth
- a definition of economic development
- a definition of developing countries
- an explanation of the difference between growth and development
- analysis of the costs and benefits of:
 - free trade for developing countries
 - FDI for developing countries
 - unrestricted financial capital flows for developing countries
 - global economic crises for developing countries
 - technology transfers and improvements in technology for developing countries
 - free movement of labour for developing countries
 - lower transport costs for developing countries
 - better access to information
 - cultural transfers
- consideration of dependence and vulnerability of developing countries with regard to global economic crises
- reference to particular developing countries to illustrate the impact of globalization
- evaluation of above arguments.

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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