



MARKSCHEME

May 2009

ECONOMICS

Higher Level

Paper 1

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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) **In the theory of the firm, a distinction is made between short-run cost curves and long-run cost curves. Using appropriate cost curve diagrams, explain this distinction.** [10 marks]

Answers **should** include:

- definitions of short-run and long-run
- U shaped SRAC diagram
- diagram showing LRAC as L-shaped and/or U-shaped.

***N.B.** Candidates may also include the SRMC diagram. This should be rewarded but is not necessary to achieve full marks.*

Answers **may** include:

- explanation of SRAC in terms of the law of diminishing returns
- explanation of the LRAC in terms of economies/diseconomies of scale.

A clear distinction between SRAC and LRAC must appear in the answer, for example, in terms of diminishing returns and diseconomies/economies of scale to achieve level 4.

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

- (b) **Evaluate the view that greater economic efficiency will always be achieved in perfect competition as compared to monopoly.**

[15 marks]

Answers **may** include:

- definitions of perfect competition and monopoly
- explanation of economic efficiency in terms of allocative and productive efficiency (and possibly dynamic efficiency)
- explanation of achievement of allocative efficiency ($P = MC$) in perfect competition
- diagram illustrating the above
- explanation of achievement of productive efficiency ($AC = MC$), operating at the minimum AC
- diagram illustrating the above
- explanation of allocative inefficiency (P greater than MC) in monopoly
- diagram illustrating the above
- explanation of productive inefficiency in monopoly (not operating with minimum AC)
- diagram illustrating the above
- possibility of economies of scale in monopoly and therefore lower costs and prices
- possibility of long-run dynamic efficiency in monopoly
- abnormal profits in monopoly provide funds for research and development
- importance of externalities for efficiency
- reference to the case of natural monopoly.

Effective evaluation may be to:

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

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2. (a) **Explain the possible causes of a rise in the rate of inflation in an economy.** [10 marks]

Answers **should** include:

- definition of inflation
- explanation of a rise in the rate of inflation
- explanation of the rise in terms of an increase in aggregate demand (AD)
- explanation of the rise in terms of an increase in costs (AS).

Answers **may** include:

- explanation of the rise in terms of an increase in the money supply (accept reference to $MV = PT$)
- use of an AD/AS diagram to illustrate the rise in AD
- use of an AD/AS diagram to illustrate the rise in costs
- factors which may cause AD to rise, *e.g.* lower taxation, higher government spending
- factors which may cause AS to rise, *e.g.* lower productivity, wage increases the impact of external shocks such as a rise in oil prices
- reference to other relevant factors such as expectations and a depreciating exchange rate.

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

(b) **Evaluate the possible impact on economic performance that may result from a government decision to bring inflation under control.** [15 marks]

Answers **may** include:

- explanation of “economic performance”
- different types of inflation according to the rate, *e.g.* hyperinflation
- importance of the distinction between demand-pull and cost-push inflation
- implications of the use of demand-side policies
- implications of the use of supply-side policies
- impact on employment
- use of Phillips curve
- impact on balance of payments
- impact on growth
- use of AD/AS diagrams.

Effective evaluation may be to:

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

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

3. (a) **Explain the importance of price elasticity of demand in relation to a country's balance of payments on current account.** *[10 marks]*

Answers **should** include:

- definition of price elasticity of demand (PED)
- definition of balance of payments on current account
- explanation of the importance of PED for exports and imports.

Answers **may** include:

- explanation of Marshall-Lerner condition
- explanation of the J-curve effect
- explanation of the importance of PED when a tariff is levied on imports.

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

- (b) **Evaluate the view that supply-side policies are more successful in correcting a country's current account deficit than demand-side policies.** *[15 marks]*

Answers **may** include:

- explanation of supply-side policies
- examples of supply-side policies
- explanation of demand-side policies in terms of fiscal and monetary policies
- explanation of how supply-side policies may help the current account (long-term impact on productive potential and export competitiveness)
- illustration of above in terms of shift of LRAS to the right
- limitations of particular supply-side policies
- explanation of how demand-side policies reduce AD in the short-term and hence demand for imports
- limitations of reducing AD, *e.g.* through higher interest rates
- use of AD/AS diagrams
- use of the trade cycle in relation to the two approaches and their relative appropriateness.

This question is relatively difficult so examiners should be aware that a narrow and well argued approach can be well rewarded.

Effective evaluation may be to:

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

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

4. (a) **Institutional and political factors such as an ineffective taxation structure, political instability and an unequal distribution of income, as well as social and cultural factors such as gender issues and tradition, may all act as barriers to economic development.**

Explain how any *three* of these factors may act as barriers to economic development.

[10 marks]

Answers **should** include:

- a definition of economic development
- a basic explanation of the significance of three of the above as barriers to economic development *e.g.*:
 - ineffective tax systems make it difficult to raise money for public services
 - political instability leads to civil unrest which deters FDI
 - unequal distribution of income leads to poverty
 - gender issues such as discrimination against women.

If a candidate uses a barrier that is not on the list above, give credit based on the validity of the response.

Answers **may** include:

- a more detailed explanation of the significance of three of the above for economic development.

Where candidates discuss one factor correctly they should achieve maximum level 2; for two correct factors maximum level 3.

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

- (b) **Evaluate the view that, in terms of achieving economic development in less developed countries, interventionist strategies, with a role for the government, are preferable to market-led strategies.**

[15 marks]

Answers **may** include:

- definitions of economic development and LDCs
- an explanation of interventionist strategies, *e.g.* in terms of the state playing an active role in the management of the economy, economic planning, import and exchange controls, nationalization of industries
- an explanation of market-led strategies, *e.g.* in terms of a belief in the free operation of markets, a minimum role for the state in economic affairs, trade liberalization, privatization, foreign direct investment (FDI)
- use of PPC diagrams to illustrate development
- 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 existing industries breathing space to grow and infant industries to achieve economies of scale, a more equal distribution of income and wealth, less inequality between rural and urban sectors, higher levels of employment
- disadvantages of interventionist strategies 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, possible bias against exports
- 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
- disadvantages of market-led strategies, *e.g.* in terms of market failure, increased likelihood of structural unemployment, problems associated with MNCs, greater wealth and income inequality, problems of capital outflows (*e.g.* profit repatriation) and a general vulnerability with regard to external fluctuations and shocks.

As this question refers to “economic development”, answers cannot obtain full marks if there is no reference to development factors beyond pure economic growth.

Effective evaluation may be to:

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

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