

MARKSCHEME

May 2000

ECONOMICS

Higher Level

Paper 2

PAPER-SPECIFIC GUIDANCE – MAY 2000

The following comments are intended to provide extra guidance to Assistant Examiners, but they are not meant to be a ‘straitjacket’.

They are meant to indicate some of the main points which the question-setter hoped to elicit, and/or indicate sensible approaches; however, it is often possible for candidates to respond to a question in a way which is unanticipated and yet which contains valid economic arguments, so please keep an open mind.

THE GENERAL MARKING CRITERIA REMAIN THE MAIN BASIS FOR AWARDING MARKS.

PLEASE REMEMBER THAT CANDIDATES HAVE ONLY ONE HOUR IN WHICH TO ANSWER FOUR QUESTIONS ON THIS PAPER. PROVIDED THAT CANDIDATES GRASP THE IMPORT OF EACH QUESTION AND ANSWER RELEVANTLY, THEY SHOULD BE REWARDED.

Question 1 Pollution and market failure

Candidates should identify pollution as a negative externality and explain this term, along with the concept of market failure. Full marks can be earned for a descriptive approach so long as this is sufficiently technically based, *e.g.* in terms of $MSC > MPC$, allocative efficiency/inefficiency, overproduction at the free market price *etc.* However, better answers are likely to make use of the appropriate diagram(s) to illustrate the previous points.

[10 marks]

Question 2 PED and PES and primary commodities

Better answers are likely to define clearly PED, PES, inelasticity and short run, and then to explain separately the factors which may account for the low inelasticities; *e.g.* inelastic demand due to lack of availability of substitutes, degree of necessity of good *etc.*; and inelastic supply due to time taken to increase capacity to produce, length of growing seasons, availability of stocks *etc.* Less accomplished answers are likely to confuse the factors influencing elasticity of demand and elasticity of supply.

[10 marks]

Question 3 Oligopoly and market share

Ways of increasing market share might include the following: takeovers and mergers, creation of entry barriers, advertising, product differentiation and the use of other forms of non-price competition, and price wars. Candidates who use the kinked demand curve model to explain why price competition may not be appropriate should be rewarded.

[10 marks]

Question 4 The budget deficit and the external trade deficit

A useful start would be to distinguish between the budget and trade deficit. Different approaches to this question are possible. From a Keynesian viewpoint, an increase in the budget deficit may stimulate aggregate demand and create a multiplier effect, the impact on the trade balance being determined by the MPM. From a supply side perspective, an increase in the budget deficit may adversely affect the trade balance via its effect on inflation and private sector crowding out. Providing that the various linkages are well explained, either approach could obtain full marks.

[10 marks]

Question 5 Rise in the exchange rate

A basic answer is likely to explain that the exchange rate is determined by the demand for and the supply of the currency on the foreign exchange market, and that an appreciation would occur due to an increase in demand and/or a decrease in supply. High scoring answers are likely to progress beyond this to explain the influence of specific factors on demand and supply, and to relate these to appreciation; *e.g.* exports, imports, capital flows, official financing. The influence of such factors as the level of interest rates and inflation, comparative advantage/competitiveness, speculation and government policy could be examined. Students who distinguish between short run reasons (*e.g.* speculation) and long run reasons (*e.g.* underlying competitiveness) should be rewarded. A few issues examined in detail, or several in less depth, could gain full marks.

[10 marks]

Question 6 Reducing income and wealth inequality

Candidates may cite a range of methods; *e.g.*, wealth – nationalisation, land reform, wealth taxes; income – minimum wage policy, progressive income tax, cash benefits, government spending on merit goods, training *etc.* A high scoring answer could survey a range of points or examine a few in greater depth, but a distinction between wealth and income must be made for full marks to be awarded. Reward highly any relevant evaluation, but the question also allows a comprehensive list to be rewarded. Also give some credit if the Lorenz Curve is used (but this is not directly relevant to the question).

[10 marks]
