



MARKSCHEME

May 2005

ECONOMICS

Higher Level

Paper 1

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Paper Specific Markscheme

In addition to the assessment criteria, use the paper-specific markscheme below. Award up to the maximum marks indicated. Examiners should be aware that candidates may take a different approach, which if appropriate should be fully rewarded.

1. (a) Explain how profit is determined in perfect competition. [10 marks]

- definition of profit/normal profit/abnormal profit/loss
- definition of perfect competition
- abnormal profit in the short run only
- losses in the short run only
- normal profit in the short and long run
- diagrams to illustrate the above

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(b) “Whatever the type of market structure, profit maximization will always be the only goal of firms.” Discuss. [15 marks]

Points for discussion might include:

- different market structures
- explanation of profit maximization in terms of MC/MR, TC/TR
- profit maximization in perfect competition and imperfect competition
- profit maximization diagrams
- importance of profit maximization in reality
- other goals of firms, *e.g.* sales, volume or output maximization, revenue maximization, environmental concerns
- managerial goals
- preservation of dominant market position
- collusion, creation of barriers to entry
- contestable markets where firms may not profit maximize due to the threat of competition

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2. (a) **Using suitable examples, explain the difference between the multiplier and the accelerator.**

[10 marks]

- explanation of multiplier
- use of numerical examples
- explanation of accelerator
- use of examples
- key differences. *E.g.* multiplier is autonomous, accelerator is induced

Emphasis will normally be placed on the multiplier. This is acceptable as long as the candidate displays a basic understanding of the accelerator. Reward candidates who appreciate the interaction between them, that the multiplier is investment led and the accelerator is income led.

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- (b) **Evaluate the proposition that the most effective way to reduce unemployment is through the use of demand-side policies.**

[15 marks]

Points for discussion might include:

- explanation of demand-side policies
- explanation of monetary and fiscal policies
- different types of unemployment: equilibrium/disequilibrium and “traditional” types
- evaluation of the appropriateness of demand-side policies to combat types of unemployment, *e.g.* appropriate to cyclical and demand deficient, but not to seasonal and structural.
- AD/AS analysis
- problems of demand side policies
- benefits of supply-side policies
- drawbacks of supply-side policies
- overall evaluation

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3. (a) Describe the factors which might cause a change in a country's terms of trade.

[10 marks]

- definition of terms of trade
- meaning of change in the terms of trade.

Factors that may be considered include:

- changes in international competitiveness
- changes in global economic growth
- changes in access to markets
- inflation
- changes in AD/AS which affect terms of trade
- exchange rate changes
- changes in demand and supply
- protection/subsidies
- wage movements
- technology
- productivity
- costs of raw materials
- supply shocks in commodity markets

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(b) Evaluate the significance for less developed countries of a deterioration in the terms of trade.

[15 marks]

Points for discussion might include:

- definition of LDC
- explanation of deterioration in terms of trade
- distinction between short and long run
- “getting nowhere fast” – exporting more to buy same quantity of imports
- significance of elasticity of demand for imports and exports
- balance of payments effects
- implications for debt and debt servicing
- impact on exchange rate
- impact on living standards
- the need for long term structural change
- overall evaluation
- degree of dependence on overseas trade

4. (a) **Explain the main characteristics of a market economy.**

[10 marks]

Characteristics might include:

- private ownership of the means of production
- the profit motive
- self interest
- competition between firms
- allocation of resources via interaction of supply and demand
- Signalling and rationing function of prices
- the pure market economy and the mixed market economy
- private and public sectors
- free trade

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

(b) **Evaluate the proposition that economic development is best achieved through the market system.**

[15 marks]

Points for discussion might include:

- definition of economic development
- explanation of market system

benefits of market system, *e.g.* in terms of

- resource allocation
- efficiency
- choice
- competitiveness
- export led/outward orientated strategies
- problems of state intervention

problems of market system, *e.g.* in terms of

- merit goods
- demerit goods
- externalities
- public goods and income inequality

benefits of alternative development strategies

- inward orientated strategies
- benefits of state intervention

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