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MARKSCHEME

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ECONOMICS

Higher Level

Paper 2

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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 what is meant by a production possibility curve and use a production possibility curve diagram to explain the concepts of scarcity, choice and opportunity cost.

Answers may include:

- explanation of a production possibility curve: the boundary between attainable and unattainable levels of production given current resources and technology
- correctly drawn and accurately labelled production possibility curve diagram
- scarcity and the production possibility curve: scarcity of resources determines the position of the production possibility curve and identifies the maximum that can be produced with available resources of land, labour and capital (quantity and quality)
- choice and the production possibility curve: better to choose a point on the production possibility curve than a point inside the curve, but points outside the curve cannot be chosen
- opportunity cost and the production possibility curve: making a choice of where to produce on the production possibility curve involves an opportunity cost; definition of opportunity cost and explanation. Making a choice to move from a point inside the production possibility curve to the production possibility curve involves no opportunity cost.

A maximum of ***[3 marks]*** for a candidate who only draws and explains the production possibility curve and who does not attempt to explain the notions of scarcity, choice and opportunity cost.

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

2. A concert is to be held in a stadium with limited seating capacity. The organizers set the ticket prices at a level below the equilibrium price. Using a diagram, explain the possible consequences of their decision.

Answers may include:

- explanation of equilibrium price
- explanation of ceiling price (fixed price below the equilibrium price)
- carefully drawn and accurately labelled diagram illustrating equilibrium price and ceiling price
- explanation of the diagram: excess demand exists (shortage)
- consequences of setting a ceiling price:
  - first-come first-served
  - ballot
  - queuing or waiting lines
  - parallel/black markets
  - rationing
  - favoured customers
  - impact on related markets.

A maximum of ***[3 marks]*** for an accurately drawn diagram showing equilibrium price and ceiling price and no discussion of consequences.

Explanation of one consequence can achieve up to ***[6 marks]***.

A discussion of two consequences in detail or a discussion of more than two consequences in less detail can be rewarded with full marks.

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

3. Using at least one diagram, explain the difference between profit maximization and sales revenue maximization as goals of the firm.

Answers may include:

- a carefully drawn and accurately labelled diagram illustrating profit maximization
- explanation of the diagram
- profit only maximized where MC = MR
- profit maximization as a goal of the firm
- a carefully drawn and accurately labelled diagram illustrating sales revenue maximization
- explanation of the diagram
- revenue only maximized where MR = 0, or where TR is at its maximum
- sales revenue maximization as a goal of the firm.

A maximum of ***[6marks]*** for a candidate who explains only one of the goals of the firm.

Some candidates will interpret sales revenue maximization as just sales maximization and consider the break-even point where P = AC. This is acceptable and should be rewarded.

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

4. A government decides to raise personal income tax rates. Using diagrams, explain *one* possible demand-side consequence and *one* possible supply-side consequence of this decision.

Answers may include:
- definitions of aggregate demand and aggregate supply
- explanation of income tax rates: direct taxes (usually progressive) on incomes
- taxes are a withdrawal from the circular flow of income: they reduce personal disposable income
- one possible demand-side consequence of a rise in personal income tax rates is that it can be expected to shift the AD curve to the left, ceteris paribus, as household disposable income falls
- the fall in AD may not be as great as it could be if some of the tax revenue is used to finance government expenditure
- AD may in fact increase if all of the tax revenue is used to finance government expenditure (due to the multiplier effect on government spending)
- a possible supply-side consequence is that the high tax rates may discourage people from saving, with a consequential fall in the accumulation of capital. Graphically the SR and LRAS curves may move to the left
- another possible supply-side consequence is that the labour force may be discouraged from working. Graphically the SR and LRAS curves may move to the left
- another supply-side consequence could be that with less disposable income workers may be compelled to work longer and harder
- the Laffer curve with a diagrammatic explanation.

Definitions of aggregate demand, aggregate supply and income tax alone up to ***[3 marks]***.

Explanation and illustration of one consequence up to ***[6 marks]***.

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

5. Explain why a depreciation of a country's exchange rate may not always lead to an improvement in its current account of the balance of payments.

Answers may include:

- definitions of depreciation, exchange rate and current account of balance-of-payments
- depreciation means exports become cheaper and imports more expensive
- if exports cheaper and imports more expensive then the current account can be expected to improve
- J-curve effect: the demand for exports and imports will be inelastic in the short-term as it takes time for demand to adjust to new relative prices *i.e.* current account may worsen before it begins to improve
- Marshall-Lerner condition: impact on current account depends on the sum of the elasticities of export and import demand
- if the sum of the elasticities is greater than 1 then current account will improve
- if the sum of the elasticities is less than 1 then current account will worsen
- the importance of non-price factors such as product quality
- possibility of other currencies depreciating at the same time
- an awareness of the fact that any improvement in the current account cannot be sustained over the long-run because the eventual rise in exports and fall in imports may lead to an appreciation of the currency.

Definitions alone (depreciation, exchange rate and current account of balance-of-payments) can earn up to ***[3 marks]***.

Definitions plus discussion other than discussion of J-curve or Marshall-Lerner condition (*e.g.* bullet points two and three) can earn up to ***[6 marks]***.

A thorough explanation of the Marshall-Lerner condition alone or a good explanation of both the Marshall-Lerner condition and the J-curve effect can be rewarded with full marks.

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

6. “Indebtedness, non-convertible currencies and capital flight are all significant barriers to economic development.” Explain *two* of these three factors.

Answers may include:

- explanation of indebtedness, non-convertible currencies, capital flight (two of them)
- explanation of economic development
- indebtedness means income may be diverted to interest and capital repayments and may not, therefore, be available for economic development expenditures (*i.e.* development is an opportunity cost of indebtedness)
- indebtedness may inhibit access to further loans, which could be used to facilitate economic development
- indebtedness could lead to a loss of economic freedom *e.g.* through the imposition of structural reforms by the IMF
- a non-convertible currency reduces the ability of a nation to earn net foreign currency through trade because the eventual gains from exports will be used to pay for its imports
- non-convertible currencies are a deterrent for inward capital investment
- non-convertible currencies make it difficult to import capital goods necessary for development
- non-convertible currencies produce incentives for capital flight
- capital flight may occur due to an unstable financial system, corruption or MNCs repatriating profits
- capital flight reduces the tax base that could have been used for development projects
- capital flight creates uncertainty and lack of confidence in the economy
- capital flight puts downward pressure on the exchange rate
- capital flight can be contagious and affect other countries.

Definitions of key economic terms alone up to ***[3 marks]***.

A maximum of ***[6 marks]*** can be awarded for an explanation of one factor and its effect on development.

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