



MARKSCHEME

November 2010

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) Explain why negative externalities are an example of market failure. [10 marks]

Answers **should** include:

- a definition of market failure
- a definition of negative externalities
- examples of negative externalities
- an explanation of over-provision at the free market price in the case of negative externalities

Answers **may** include:

- use of diagram(s) to illustrate the above.

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) Evaluate *three* policies that governments might implement to reduce negative externalities associated with the environment.

[15 marks]

Answers **may** include:

- an explanation of negative externalities associated with the environment (e.g. pollution, climate change, deforestation, over-fishing)
- an explanation of three appropriate policies, such as legislation, taxation, tradable permits, extension of property rights, international cooperation
- an evaluation of each of the three policies chosen.

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
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2. (a) **Explain how supply-side improvements to an economy may be achieved through the use of taxes and government spending.** *[10 marks]*

Answers **should** include:

- an explanation of “supply-side improvements”
- use of AD/AS diagrams
- an explanation of how taxes and government spending may be used to affect AS, *e.g.* through:
 - greater government spending on healthcare, education and training
 - less government spending on benefits
 - a reduction in income tax to increase work incentives
 - lower corporation tax to encourage investment
 - lower indirect taxes to reduce business costs.

Answers **may** include:

- distinction between SRAS and LRAS.

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(b) Evaluate the use of supply-side policies to reduce unemployment.**[15 marks]**

Answers **may** include:

- a definition of unemployment
- a definition of supply-side policies
- examples of supply-side policies
- the concept of a natural rate of unemployment
- the importance of the different types of unemployment, *e.g.* demand deficient, frictional and structural
- an explanation of how supply-side policies may work to reduce unemployment in the longer term
- use of AD/AS analysis, showing LRAS shifting to the right
- an assessment of the effectiveness of such measures
- unemployment beyond the control of national governments, *e.g.* arising from demand-side shocks or international recession
- consideration of the use and effectiveness of alternative short-term demand-side measures to reduce unemployment, *i.e.* fiscal and monetary policies
- an evaluation of the effectiveness of particular supply-side policies, *e.g.*:
 - tax cuts
 - cuts in welfare benefits
 - education and training/retraining
 - privatization/deregulation
 - trade union policies.

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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3. (a) **Explain *two* factors which may cause a depreciation of a country's exchange rate.**

[10 marks]

Answers **should** include:

- a definition of exchange rate
- an explanation of depreciation
- relevant demand and supply analysis in the context of exchange rates
- an explanation of any **two** of the following:
 - the role of demand for imports and exports
 - the role of relative interest rates
 - the role of relative inflation rates
 - the role of FDI and portfolio investment
 - the role of speculation
 - the role of government management of foreign currency reserves.

Answers **may** include:

- use of diagram(s) to illustrate the above.

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- (b) **Evaluate the extent to which a depreciating exchange rate may benefit or harm an economy.**

[15 marks]

Answers **may** include:

- an explanation of how a depreciation affects relative export and import prices
- the likely impact on AD
- use of AD/AS diagrams, or other relevant diagrams, *e.g.* demand and supply
- the impact of a depreciation on the current account
- the importance of the Marshall-Lerner condition and the J-curve effect
- the impact of a depreciation on economic growth
- the impact of a depreciation on the level of employment/unemployment
- the impact of a depreciation on the rate of inflation
- consideration of the relative size of the depreciation
- consideration of the cause of the depreciation
- consideration of the automatic adjustment process.

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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4. (a) **Explain why economic growth rates may differ between developing countries.**

[10 marks]

Answers **should** include:

- a definition of economic growth
- an explanation of reasons for differences which **may** include:
 - natural factors
 - human factors
 - physical capital and technological factors
 - various institutional factors.

Answers **may** include:

- illustration of growth using a PPC diagram
- reference to the Harrod-Domar growth model
- effects on growth of different strategies, *e.g.* export-led versus import substitution
- reference to the compound nature of growth in the effects of varying growth rates over time
- examples of particular countries.

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- (b) **Evaluate the role of foreign direct investment in assisting a developing country to achieve greater growth and development.**

[15 marks]

Answers **may** include:

- a definition of development
- a definition of growth
- an explanation of FDI
- a distinction between growth and development
- MNCs as the main agents of FDI
- FDI and the impact on AD and AS
- FDI as part of a market-led/outward-orientated growth strategy
- FDI and the distribution of income and wealth
- FDI and the creation of “dual” economies
- FDI as part of IMF/World Bank structural adjustment programmes, including privatization of utilities
- the impact of FDI on employment
- FDI and multiplier/accelerator effects
- the impact of FDI on rural/urban migration
- FDI and the tax base
- FDI and the destination and use of profits
- FDI and the allocation of scarce resources (towards MNC production rather than the needs of the population)
- the impact of FDI on the environment
- FDI and the vulnerability of the host country to global cities
- examples from particular countries.

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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