



MARKSCHEME

May 2011

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) **Using at least one diagram, explain why a firm in perfect competition might only be able to make supernormal (abnormal) profits in the short-run and not in the long-run.** *[10 marks]*

Answers **should** include:

- a definition of supernormal (abnormal) profits
- an explanation of supernormal (abnormal) profits
- an explanation of perfect competition
- a standard short-run perfect competition diagram showing supernormal (abnormal) profit at profit maximizing output
- an explanation of short-run supernormal (abnormal) profit leading to entry of new firms into the industry, the market supply curve shifting right, price falling and the supernormal (abnormal) profits being eliminated (until only normal profits are made).

Answers **may** include:

- a distinction between the short-run and long-run in microeconomics
- diagrams to illustrate the last bullet point above
- an explanation of why short-run abnormal profit is made.

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 the view that perfect competition is a more desirable market form than oligopoly.**

[15 marks]

Answers **may** include:

- an explanation of the difference between perfect competition and oligopoly
- perfect competition and oligopoly diagrams
- an explanation of the term “desirable” (stakeholder approach)
- comparison in terms of:
 - productive efficiency
 - allocative efficiency
 - short-run and long-run efficiency
 - economies of scale
 - price, output and profits
 - consumer choice
 - impact of product differentiation/non-price competition
 - freedom of entry to the markets
 - the ability/lack of ability to price discriminate
- assessment of which market form is most desirable.

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.

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

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
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. An attempt at evaluation.	10–12
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. Evidence of appropriate evaluation.	13–15

2. (a) **Explain *two* policies a government might use to redistribute income.** [10 marks]

Answers **should** include:

- a definition of income distribution, as one of the goals of macroeconomic policy.

Plus any **two** of the following:

- progressive, regressive and proportional taxation (a diagram may be used)
- switching the burden of taxation between direct and indirect (more regressive) taxes
- transfer payments, minimum wage
- use of property or wealth taxes for redistributive purposes.

Answers **may** include:

- a method of describing or measuring income equality or inequality such as the Lorenz curve and/or Gini coefficient
- the redistributive effects of merit goods in an economy which provides them extensively
- reference to the redistributive effects of government subsidies.

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- (b) **“Measures to promote greater income equality should be a key feature of government economic policy.” Evaluate this proposition.**

[15 marks]

Answers **may** include:

- a definition of income equality
- reference to the difficulty and disagreement over “fair” distribution
- consideration of benefits of greater income equality such as reduction of poverty, increase in consumption of the poor, greater incentives for low income groups, attainment of economic development
- definitions of the four objectives of government economic policy, with an explanation that income equality is a fifth and not always considered as important
- consideration of the Laffer curve
- consideration of the presumed disincentive effects of taxation
- reference to the positive externalities of merit goods such as education and health care for lower income groups
- consideration of the normative nature of the statement in the question
- the positive multiplier effects resulting from transferring income from sectors with high MPS to sectors with high MPC
- a reference to where the economy is in the business cycle, as an influence on whether greater income equality would be a key feature of government economic policy.

N.B. Some candidates may mention the balanced-budget multiplier in connection with the last bullet point.

In attempting evaluation candidates might point to the fact that arguments for greater or less equality coexist within economics and that notions of income equality and fairness are not the same.

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.

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

Assessment Criteria

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3. (a) **Using the theory of comparative advantage, explain how countries might benefit from free trade and specialization.** *[10 marks]*

Answers **should** include:

- a definition of comparative advantage
- a definition of specialization, free trade
- an explanation of comparative advantage
- an explanation of specialization, free trade
- an explanation of the impact of comparative advantage on resource allocation
- an explanation of links between the concepts
- the effect on the level of output, employment and incomes
- the effect on variety and prices of goods and services.

Answers **may** include:

- a distinction between absolute and comparative advantage
- numerical and/or diagrammatic representation of the principle of comparative advantage
- use of the tariff diagram to illustrate welfare gains
- limitations of the theory of comparative advantage.

Candidates may still access high marks if they have not used a production possibility frontier diagram provided they use appropriate numerical examples.

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(b) Evaluate the arguments in favour of barriers to international trade.

[15 marks]

Answers **may** include:

- a definition of free trade
- a definition of protectionism
- the protection of declining industries to prevent structural unemployment
- the protection of infant industries until they are able to enjoy economies of scale and compete internationally
- the protection of the economy from low-cost labour imports from less-developed countries (LDCs)
- protection against dumping
- non-economic arguments such as artificial administrative regulations
- strategic considerations and self-sufficiency
- the exercise of political influence.

In attempting evaluation candidates might assess each argument against the general benefits of free trade which are assumed to offer gains to all, and are supported by institutions such as the WTO and the EU while protectionism is often to prevent the decline of a particular industry or economic group.

Candidates might consider the implications of barriers in more and less-developed countries and this may be fully rewarded.

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 the main features of export-led growth strategies used to achieve economic development.**

[10 marks]

Answers **should** include:

- a definition of economic development
- a definition of export-led growth strategies
- an explanation of any export-led growth strategies such as:
 - trade liberalization/low levels of protectionism
 - a belief in free enterprise rather than state intervention
 - a floating exchange rate
 - encouragement of FDI
 - privatization
 - use of supply-side policies
 - flexible labour markets
 - enterprise zones
 - free trade agreements
 - free movement of capital and labour
- an explanation of how export-led growth strategies might lead to economic development.

N.B. Candidates may utilise examples where actual policy has differed from theoretical analysis stated above.

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- (b) **Evaluate the view that economic development in less-developed countries (LDCs) can best be achieved through export-led growth strategies rather than import substitution.**

[15 marks]

Answers **may** include:

- a definition of less-developed countries (LDCs)
- a definition of import substitution
- use of PPC diagrams to illustrate development
- an explanation of import substitution strategies, *e.g.* in terms of protectionism, exchange controls, subsidies to domestic firms, the state playing an active role in the management of the economy, nationalization
- the advantages of export-led growth strategies, *e.g.* in terms of more efficient resource allocation from specialization, benefits of MNCs, benefits of free trade, flexible labour and capital markets, greater consumer choice, a reduction in government budget deficits
- the disadvantages of export-led growth strategies, *e.g.* in terms of exposure to the instability of world markets, vulnerability to foreign competition, over-dependence on a narrow range of exports, over-dependence on primary production, market failure such as the problem of environmental pollution, increased likelihood of structural unemployment, problems of MNCs, problems of structural adjustment programmes, greater wealth and income inequality, problems of capital outflows, vulnerability to international economic crises
- the advantages of import substitution, *e.g.* in terms of the infant industry argument, greater diversity of economic activity, supply-side improvements as a result of investment in health care and education and training, a more equal distribution of income and wealth, less inequality between rural and urban sectors, higher levels of employment, protection of local cultural heritage, protection from MNC dominance
- the disadvantages of import substitution, *e.g.* in terms of possible slower growth of the economy, inability to benefit from the gains from free trade such as greater choice and lower prices, inefficient resource allocation, preservation of inefficiency, drawbacks of government planning
- examples of countries that have used export-led growth
- examples of countries that have used import substitution.

N.B. This question, as the markscheme indicates, is particularly broad, so a very wide range of answers is possible. Only some of the above points can be expected within the time allowed.

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

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