



MARKSCHEME

November 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) **Explain the different objectives that a firm in an oligopolistic market structure might try to achieve.** [10 marks]

Answers **should** include:

- a definition of an oligopolistic market structure
- an explanation of the characteristics of an oligopolistic market structure
- an explanation of profit maximization
- additional objectives other than profit maximization.

Answers **may** include:

- an explanation of alternative objectives such as:
 - sales revenue maximization
 - sales volume maximization
 - the goals of other stakeholders in the organization such as managers, workers and trade unions
 - to respond to pressure groups, *e.g.* environmental concerns
 - to comply with legal directives and policies of government
 - to collude
 - to maintain price stability
- an explanation of collusion: formal (*e.g.* cartel formation) and/or informal (*e.g.* price leadership)
- illustrating objectives through examples of imperfect competition
- a diagram to illustrate profit or sales revenue maximization.

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 an oligopolistic market is an inefficient market structure.**

[15 marks]

Answers **may** include:

- a definition of oligopolistic market structure
- a definition of allocative efficiency
- a definition of productive efficiency
- an explanation of oligopolistic market structure
- an explanation of collusive and non-collusive oligopoly
- examples of oligopolistic markets
- advantages of oligopoly:
 - economies of scale
 - supernormal (abnormal) profits allow research and development to be carried out
 - price stability
 - benefits of non-price competition, *e.g.* quality of product, wide distribution
 - competition in oligopoly gives it an efficiency advantage over monopoly
- disadvantages of oligopoly:
 - fails to achieve productive efficiency
 - fails to achieve allocative efficiency
 - higher prices and lower output to consumers
 - barriers to entry reduce competition
 - collusive behaviour
 - price rigidity reduces the effectiveness of the price mechanism
- a diagram to show that efficiency is not achieved.

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
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 what the multiplier is and, using a numerical example, demonstrate how it can be calculated.** *[10 marks]*

Answers **should** include:

- a definition of the multiplier
- multiplier formula. A variety of formulae are acceptable, *e.g.*

In general: $\frac{\Delta Y}{\Delta e}$

In a two-sector closed economy: $K = \frac{1}{1 - MPC}$ **or** $K = \frac{1}{MPS}$

In a four-sector open economy: $K = \frac{1}{MPW}$ **or** $K = \frac{1}{1 - MPC}$

- a numerical example demonstrating how the multiplier works
- an explanation that the multiplier expands, increases or decreases in spending by a multiplied amount.

Answers **may** include:

- an explanation of factors that determine the value of the multiplier, *e.g.* MPS, MPT, MPM, MPC
- acknowledgement of there being both positive and negative multipliers
- a diagram to illustrate the multiplier's effect.

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- (b) **Evaluate whether real Gross Domestic Product (GDP) can be increased by the use of demand-side policies.**

[15 marks]

Answers **may** include:

- a definition of real GDP
- a definition of demand-side policies
- an explanation of how fiscal policy can increase real GDP
- an explanation of how monetary policy can increase real GDP
- examples of demand-side policies being applied
- diagrams to illustrate an increase in real GDP
- problems of applying demand-side policies to increase real GDP:
 - where the economy is at full employment or close to full employment
 - “crowding out”
 - inflation
 - time lags
 - financing fiscal policy
 - business and consumer confidence
- a discussion about the shape of LRAS curves: Keynesian versus neo-classical approach.

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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3. (a) **Explain, using a diagram, how government intervention can change the exchange rate of a currency.** *[10 marks]*

Answers **should** include:

- a definition of the exchange rate
- an explanation of what government intervention might be
- an exchange rate diagram.

Answers **may** include:

- definitions of alternate exchange rate regimes, *e.g.* fixed, managed, floating
- an explanation of how the buying and selling of currency by government authorities can alter the exchange rate
- an explanation of how changes in interest rates can alter demand and supply for the currency.

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- (b) **Reducing the value of a country's currency is an effective solution for a balance of payments deficit on the current account. Evaluate this view.** [15 marks]

Answers **may** include:

- a definition of current account
- a definition of current account deficit
- an explanation that this is a type of expenditure switching policy
- an exchange rate diagram to show the depreciation or devaluation of a currency
- Marshall-Lerner condition to show the effects of PED for imports and exports
- J-curve
- a consideration of the costs, *e.g.* imported inflation
- a consideration of alternative policy measures such as protectionism and demand-side policies and the advantages and disadvantages of using them.

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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Part (b) 15 marks

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4. (a) **Explain the differences between foreign direct investment (FDI) and aid.** [10 marks]

Answers **should** include:

- a definition of aid
- a definition of FDI
- an explanation of aid
- an explanation of FDI in terms of multinationals setting up production in other countries
- types of aid:
 - bilateral
 - grant aid
 - multilateral
 - official aid
 - tied aid
 - soft loans, *etc.*

Answers **may** include:

- aggregate demand and supply analysis to illustrate the impact of aid and/or FDI
- examples of FDI.

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- (b) **Evaluate the view that aid is an effective means to achieve economic growth and development in less-developed countries (LDCs).** *[15 marks]*

Answers **may** include:

- a definition of LDCs
- a definition of economic growth
- a definition of economic development
- examples of aid
- diagram(s) to illustrate the impact of aid at a micro or macro level.

The advantages of aid in terms of:

- bridging the savings gap
- breaking the poverty cycle
- providing funds for:
 - investment
 - health care
 - education
 - infrastructure
 - debt repayment.

The disadvantages of aid in terms of:

- dependency
- misuse of funds
- corruption
- inappropriately targeted aid
- conditions of tied aid
- alternatives to reliance on aid:
 - import substitution
 - export-led growth
- reference to the trade versus aid debate.

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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