



MARKSCHEME

November 2012

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 a monopoly can earn supernormal (abnormal) profits in the long run.** *[10 marks]*

Answers **should** include:

- a definition of monopoly
- a definition of abnormal profit
- an explanation of the long run
- an explanation as to why abnormal profits are attainable in the long run
- an explanation of barriers to entry.

Answers **may** include:

- use of a diagram to illustrate monopoly market equilibrium
- an explanation of the short run
- an explanation of the sources of monopoly power
- examples of monopoly.

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 reasons why a government might allow a competitor into an industry that was previously a monopoly.

[15 marks]

Answers **may** include:

- reasons for allowing competition:
 - to improve allocative efficiency
 - to lower price
 - to encourage innovation
 - to improve quality of product/service
- reasons for not allowing competition:
 - loss of economies of scale (natural monopoly)
 - it may discourage innovation in some industries *e.g.* research and development (R&D)
 - if the competition is foreign based it may damage domestic trade and jobs
- use of diagram(s) to illustrate market structure
- use of examples.

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 how a government could bring about a more equal distribution of income.**

[10 marks]

Answers **should** include:

- a definition of a more equal distribution of income
- an explanation of viable methods which might be used such as progressive taxation.

Answers **may** include:

- explanation of methods of government intervention that give a more equal distribution of income:
 - progressive taxation
 - spending on merit goods and public goods
 - transfer payments
 - subsidies
 - price controls
 - minimum wages
- use of diagrams such as the Lorenz curve
- reference to the Gini coefficient.

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Assessment Criteria

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(b) Evaluate the effectiveness of government policies designed to reduce inequalities in income.

[15 marks]

Answers **may** include:

- when it may be effective:
 - progressive taxation – fairness, ability to pay, raises tax revenue
 - spending on merit goods and public goods – used by people on low incomes, positive externalities
 - transfer payments – direct benefit to the neediest, automatic stabilizer
 - the use of subsidies – reduces the cost and increases consumption
 - price ceilings – affordability to people on low incomes
 - price floors – income support for farmers
 - minimum wages – incentives, reasonable pay
- where it may not be effective:
 - progressive taxation – disincentives, avoidance, tax evasion, cost of administration, the Laffer curve
 - spending on merit goods and public goods – expensive to provide
 - transfer payments – cost of provision, can be paid to people who don't need it, reduces incentive to work
 - the use of subsidies – cost of provision, allocative inefficiency
 - price ceilings – distorts markets, shortages, allocative inefficiency, costs of administration
 - price floors – distorts markets, surpluses, allocative inefficiency, costs of administration
 - minimum wages – distorts the labour market, raises business costs.

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 why a country might experience a deficit in the current account of the balance of payments.**

[10 marks]

Answers **should** include:

- a definition of the current account of the balance of payments
- an explanation of a deficit in the current account of the balance of payments
- an explanation of possible cause(s) of a deficit in the current account of the balance of payments.

Answers **may** include:

Explanation of how any of the following might be a cause:

- an overvalued currency
 - excess aggregate demand
 - loss of competitiveness
 - government budget deficit
 - higher relative inflation
 - trade restrictions amongst trading partners
 - low economic growth of trading partners
 - increase in the price of an important import, *e.g.* oil for net importers of oil
 - factors that could cause negative net income flows, *e.g.* net investment incomes, net transfers of money
-
- use of a diagram(s), *e.g.* to show an overvalued exchange rate
 - candidates may consider the relevance of price elasticity of demand with regard to some of the points listed above.

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- (b) Evaluate the policies by which a deficit in the current account of the balance of payments might be corrected.

[15 marks]

Answers **may** include.

- explanation of policies used to correct a deficit
- where policies might help correct the current account:
 - the devaluation/depreciation of the domestic currency could boost exports and reduce imports (expenditure switching). This depends on the Marshall Lerner condition
 - trade barriers could be used to reduce imports (expenditure switching)
 - tight monetary and fiscal policy could be used to reduce imports (expenditure reducing)
 - tight monetary and fiscal policy could be used to reduce inflation and improve export competitiveness
 - supply side policies could be used to improve the competitiveness of domestic firms
- where policies might not help correct the current account:
 - devaluation/depreciation increases import prices and adds to inflation, reducing domestic competitiveness
 - trade barriers lead to retaliation which reduces exports and increases domestic costs and domestic and global resource misallocation
 - tight fiscal and monetary policies reduce domestic economic growth and employment
 - supply-side policies need time to work and reduce a deficit.

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

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4. (a) **Explain why multinational corporations enter new markets in less developed countries.** *[10 marks]*

Answers **should** include:

- a definition of a multinational corporation
- a definition of a less developed country
- an explanation of possible reason(s) why MNCs expand into less developed countries.

Answers **may** include:

- an explanation of possible reasons:
 - access to new markets
 - increased sales
 - profits
 - access to raw materials
 - lower labour costs
 - avoidance of legal and environmental controls
 - tax and other incentives.

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Assessment Criteria

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- (b) **“Multinational corporations do not help economic development.”**
Evaluate this statement.

[15 marks]

Answers **may** include:

- a definition of economic development
- unhelpful impacts of MNCs:
 - damage to domestic firms
 - repatriation of profits
 - generation of imports
 - negative externalities
 - limited range of employment
 - skill levels may not increase
 - income inequality
 - rural-urban migration problems
 - tax revenues may not increase
 - inappropriate technology
- helpful impacts of MNCs:
 - may provide investment to help fill savings gap
 - generation of tax revenue which may support public goods and merit goods
 - increased exports
 - positive externalities
 - improved standard of living through higher wages, tax revenues *etc.*
 - technology transfer
 - improvement of domestic skills.

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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