



MARKSCHEME

May 2011

ECONOMICS

Standard 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 distinction between public goods and merit goods and why these goods are examples of market failure. [10 marks]

Answers **should** include:

- definitions of public goods, merit goods, market failure
- public goods are under-provided/not provided in a free market economy because of their characteristics of non-excludability and non-rivalry
- reference to the free rider problem with public goods
- merit goods are provided in a free market economy but would be under-consumed at market price
- examples of public goods and merit goods
- merit and public goods have strong positive externalities so governments often provide public goods themselves, while merit goods may be provided by the government or subsidized.

Answers **may** include:

- public goods can also be merit goods, but not all merit goods are public goods as the latter do not necessarily have the characteristics of non-excludability and non-rivalry.
- governments may find it difficult to estimate the extent of positive externalities
- diagrams to show the market failure associated with public goods and merit goods.

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

Assessment Criteria

Part (a) 10 marks

Level	Description	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) **“The operation of the free market is always the best way to allocate scarce resources.” Evaluate this statement.**

[15 marks]

Answers **may** include:

- a definition of a free market economy
- a definition of scarce resources
- a definition of the centrally planned economy
- a definition of mixed economy
- explanation of the characteristics of a free market economy
- the advantages of the free market economy: relative efficiency with few surpluses or shortages thanks to the signalling and incentive functions of price to consumers and producers
- the disadvantages of the free market economy: market failures such as overprovision of merit and demerit goods and positive and negative externalities, public goods monopolies; economic instability and inequality
- the advantages of the centrally planned economy: central planning can potentially lead to full employment, stable prices and more equal distribution of income
- the disadvantages of the centrally planned economy: planning errors lead to resource misallocation, inefficiency, shortages and surpluses; lack of incentives, choice and motivation
- the reality that all economies are mixed with the private sector and public sector providing certain goods and services.

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) **Using appropriate diagrams, explain how an increase in government spending could affect both aggregate demand and aggregate supply in an economy.**

[10 marks]

Answers **should** include:

- a definition of government spending
- a definition of aggregate demand
- a definition of aggregate supply
- an explanation of an increase in government spending influencing AD
- use of an AD/AS diagram showing shift of AD to the right
- an explanation of the possible linkage between an increase in government spending affecting the supply-side of the economy, *e.g.* education and training, government spending on infrastructure
- use of an AD/AS diagram showing shift of LRAS to the right.

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- (b) “The lower the level of government spending, the better.” Evaluate this view.

[15 marks]

Answers **may** include:

Arguments in favour of lower government spending:

- lower government spending and greater use of market forces to allocate resources leading to greater economic efficiency
- lower government spending leading to lower taxation
- lower government spending reduces government borrowing
- the importance of reduced government spending as a means of reducing AD, to reduce inflation and a current account deficit.

Arguments against lower government spending:

- the importance of government spending for the supply-side of the economy
- the importance of government spending on merit goods, public goods and infrastructure
- the importance of government spending as a means of influencing the distribution of income through public services and state benefits
- the importance of government spending as a means of regulating AD, *e.g.* use of higher government spending to increase AD to encourage growth and to reduce unemployment.

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 the main reasons why international trade takes place.** *[10 marks]*

Answers **should** include:

- a definition of international trade
- the differences in factor endowments
- the variety and quality of goods available to consumers increases with trade
- gains from specialization, *e.g.* countries can consume goods from outside their PPC, greater output, economies of scale, technology transfer, higher incomes, better resource allocation
- political benefits of trade.

Answers **may** include:

- use of a PPC diagram
- examples from particular countries
- law of comparative advantage and differences in opportunity cost.

N.B. Examiners should be aware that consideration of absolute and comparative advantage is not required as they are higher level extension topics.

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Assessment Criteria

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- (b) **Evaluate the consequences of a deterioration of the terms of trade for a country's balance of payments on current account and for its domestic economy.**

[15 marks]

Answers **should** include:

- a definition of terms of trade
- a definition of deterioration of the terms of trade
- a definition of balance of payments on current account.

Answers **may** include:

- an explanation of consequences of deterioration of the terms of trade in terms of export prices falling and import prices rising
- an explanation of consequences of deterioration of the terms of trade in terms of **possible** fall in the quantity demanded of imports as import prices rise and increase in quantity demanded of exports as export prices fall thus improving the balance of payments
- the importance of the price elasticity of demand (PED) of exports and imports in determining whether a deterioration in the terms of trade increases export revenue and reduces import expenditure
- deteriorating terms of trade as an international trade barrier to development for less-developed countries (LDCs)
- an explanation that deterioration of the terms of trade could occur because of a fall in demand for exports and/or rise in demand for imports which could increase a balance of payments current account deficit.
- the impact on employment, living standards, incomes, aggregate demand.

N.B. Examiners should be aware that consideration of the Marshall-Lerner condition and J-curve is not required as they are higher level extension topics.

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 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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