



# **MARKSCHEME**

**November 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 differences between price elasticity of demand (PED) and cross-elasticity of demand (XED). [10 marks]**

Answers **should** include:

- a definition of price elasticity of demand (PED)
- a definition of cross-elasticity of demand (XED)
- the equation for PED
- the equation for XED
- interpretation of PED figures in terms of: elastic, inelastic and unitary elasticity figures
- interpretation of XED figures in terms of: substitutes, complement and unrelated goods.

Answers **may** include:

- diagrams to illustrate different PEDs and XEDs
- examples of goods with different PEDs and XEDs.

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

**Assessment Criteria**

<b>Part (a) 10 marks</b>		
Level		Marks
0	Completely inappropriate answer.	<b>0</b>
1	Little understanding of the specific demands of the question. Very little recognition of relevant economic theory. Relevant terms not defined. Significant errors.	<b>1–3</b>
2	Some understanding of the specific demands of the question. Some recognition of relevant economic theory. Some relevant terms defined. Some errors.	<b>4–6</b>
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.	<b>7–8</b>
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.	<b>9–10</b>

- (b) **Discuss the usefulness of price elasticity of demand (PED) and cross-elasticity of demand (XED) to businesses trying to increase their sales revenue.**

[15 marks]

Answers **may** include:

- an explanation of the link between price changes and total revenue with different price elasticities of demand (PED)
- a diagram to show how revenue changes with different PED
- examples of how businesses can increase the revenues of certain products by increasing the price of products with price inelastic demand and reducing the price of goods with PED
- an explanation of how businesses can use the complementary relationship between products to increase sales by cutting the price of one product to sell more of a complement
- diagrams to show how a price reduction in one product increases the demand for a complementary product
- examples of businesses cutting the price of one product to sell more of its complements
- an explanation of how businesses can use the substitute relationships between products to predict sales of rival businesses, or to predict sales of substitutes owned by the same business
- diagrams to show how a price change in one product affects the demand for a substitute product
- examples of businesses responding to price changes in complements and substitute products
- evaluation of the usefulness of PED and cross-elasticity of demand (XED) by considering the problems of measuring PED/XED *e.g.* PED and XED are constantly changing
- evaluation of how the factors affecting the demand for a product are all changing at the same time
- evaluation of how PED/XED changes over time.

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.	<b>0</b>
1	Little understanding of the specific demands of the question. Very little recognition of relevant economic theory. Relevant terms not defined. Significant errors.	<b>1–5</b>
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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.	<b>10–12</b>
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.	<b>13–15</b>

2. (a) Explain *three* factors that could cause an economy to go into recession. [10 marks]

Answers **should** include:

- a definition of recession
- how a fall in any one of the components of AD could lead to a recession:
  - consumption
  - investment
  - government expenditure
  - net exports
- an AD/AS diagram to illustrate a recession.

Answers **may** include:

- how a rise in costs could cause a recession on the supply-side, *e.g.* a rise in the price of oil
- any factor explained on the demand-side or supply-side can be treated as a separate cause of a recession
- recessions are often global in nature; a recession in one country can lead to recessions in other countries.

Where a candidate considers one factor the maximum level awarded is level 2; for two factors, maximum level 3.

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- (b) Evaluate the effectiveness of governments using demand-side policies to take an economy out of a recession.**

*[15 marks]*

Answers **may** include:

- an explanation of how fiscal policy through reducing tax and raising government expenditure can be used to raise AD
- a discussion of the problems of using an expansionary fiscal policy:
  - leads to an increase in a country’s budget deficit
  - finance through government borrowing
  - time lags associated with fiscal policy
  - the effectiveness of government spending
  - cutting tax to raise AD
- an explanation of how monetary policy through reducing interest rates and encouraging bank lending can be used to raise AD
- an AD/AS diagram(s) to show the effects of demand-side policies and supply-side policies
- a discussion of the problems of using monetary policy to raise AD:
  - the unpredictable reaction of households to cuts in interest rates
  - time lags
  - reluctance of banks to lend and pass on interest rate cuts
- a discussion of the possible problem of inflation if AD is increased through demand-side policies
- the effect of the shape of the AS curve on the impact demand-side policies
- an explanation of alternative policies such as supply-side 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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### Assessment Criteria

#### Part (b) 15 marks

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3. (a) **Explain the benefits a country might experience from an increase in free trade.** *[10 marks]*

Answers **should** include:

- a definition of free trade
- the benefits of free trade:
  - the benefits of specialization through trade (explanation of comparative and absolute advantage not required)
  - lower prices to consumers and producers from increased competition
  - greater variety of goods and services available to consumers and producers.

Answers **may** include:

- other benefits:
  - opportunity for businesses to benefit from larger markets
  - domestic producers learn better production techniques from foreign competitors
  - increased competition and greater efficiency in production
  - increased political cooperation
- use of production possibility frontier diagrams to illustrate benefits
- use of demand and supply diagrams to illustrate benefits.

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**(b) Evaluate the reasons why countries try to restrict free trade through protectionism.**

*[15 marks]*

Answers **may** include:

- a definition of protectionism
- a definition of trade barriers
- methods of protectionism
- examples of protectionism
- reasons for protectionism:
  - infant industries
  - declining industries
  - domestic employment
  - assist domestic diversification
  - strategic factors
  - protect national culture
  - maintain product standards
  - raise revenue through tariffs
  - political pressure from interest and pressure groups
  - to prevent dumping
  - to correct balance of payments problems
- limitations of the reasons for protectionism:
  - infant industries may not become efficient
  - maintaining inefficient declining industries
  - retaliation from other countries causes unemployment in export industries
  - reasons for protectionism are often used as an excuse to protect the interests of domestic businesses
  - problems of protectionism for economic efficiency, higher prices and reduced consumer choice
- appropriate diagram(s) to illustrate trade barriers.

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 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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**Assessment Criteria**

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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

#### Part (b) 15 marks

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