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ECONOMICS

Higher Level

Paper 2

4 pages

1.   **Briefly explain what is meant by 'consumer sovereignty'. For what reasons might it only partly exist in real world markets?**

Expect and accept a range of definitions of consumer sovereignty. One definition is a situation in which the allocation of society's resources is determined by the spending patterns of consumers, rather than by state direction or powerful producers. Reasons for its absence might include the lack of perfect competition/existence of imperfect markets, an unequal distribution of income/lack of effective demand, the role of advertising and other forms of non-price competition, imperfect market information, government interference, *e.g.* in the form of subsides, indirect taxes or price controls.

Allow up to *[4 marks]* for candidates who explain only consumer sovereignty and do not answer the second part of the question.

Many candidates are likely to frame their answer entirely around a description and critique of perfect competition compared to imperfect competition. Provided this is clearly related to the question of consumer sovereignty, it should be possible to earn full marks. Candidates are likely to observe that consumer sovereignty only exists in perfect competition.

Alternatively, students could obtain full marks by offering a description of consumer sovereignty and then discussing two reasons well.

2.   **Distinguish between the law of diminishing returns and decreasing returns to scale.**

There is considerable scope for confusion here, so candidates who are able to provide a clear and accurate distinction between the two should be highly rewarded. The law of diminishing returns relates to the short run, with at least one factor fixed in supply and considers the effect on marginal output of adding more variable factors to the fixed factor. This could be illustrated with a short-run average cost curve. Returns to scale is a long run concept with all factors variable and refers to the physical relationship between inputs and output. It could be illustrated with a long-run average cost curve/envelope curve showing diseconomies of scale.

A maximum of *[5 marks]* should be awarded if only one of the concepts is explained.

3.   **What is demand pull inflation and what can governments do about it?**

It is not essential to use a diagram to score full marks for this question, but it is likely that the better responses will make some use of the Keynesian cross diagram and/or aggregate demand and supply analysis, both to explain what demand pull inflation is and to suggest how it might be cured. Reward accurate use of economic language, *e.g.* in terms of excess demand, deflationary monetary and fiscal policies *etc*.

A maximum of *[5 marks]* should be awarded if only one aspect of the question is attempted.

4. **Use demand and supply analysis to explain the possible effects of currency speculation on a country's exchange rate.**

For full marks to be earned it is sufficient to discuss the two aspects of speculation (*i.e.* buying and selling of a currency) with appropriate diagrams. Selling shifts supply to the right and lowers the exchange rate, while buying shifts demand to the right and increases the exchange rate. Implicit in the answer should be an awareness of why speculation takes place. Candidates who consider only one aspect correctly should be limited to *[5 marks]*. In addition, candidates may also be rewarded for discussing other relevant points such as: the importance of the type of exchange rate regime; whether the exchange rate rises or falls depends on the magnitude of the speculation; possible central bank action; the impact of changes elsewhere in the balance of payments.

5. **As countries develop, the secondary and tertiary sectors tend to grow at the expense of the primary sector. Why is this the case?**

Candidates might offer descriptions of the sectors without clearly analysing <u>why</u> the transition takes place. In this case award a maximum of *[4 marks]*.

Any plausible argument for the transition using economic analysis should be rewarded. Possible areas for discussion could include the following: the importance of income elasticity of demand; changes in technology and productivity; changes in comparative advantage; de-industrialisation.

Any one point developed fully could earn full marks.

6. **Poor people in less developed countries often derive little benefit from economic growth. Why might this be so?**

Areas for discussion might include: the significance of the difference between economic growth and development; unequal distribution of income, wealth and power; exclusion of various poor groups from growth, *e.g.* the unemployed, rural peasants; economic growth and externalities. It should be possible to obtain full marks by explaining two relevant points well, although an answer framed entirely in terms of the existence and perpetuation of inequality could earn full marks if very well done.