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M03/330/H(2)M+

# **MARKSCHEME**

**May 2003**

**ECONOMICS**

**Higher Level**

**Paper 2**

1. **“Economics is primarily concerned with the allocation of scarce resources which have alternative uses.” Use a production possibility curve to help you explain this statement.**

Emphasis in this answer needs to be on an explanation of the economic problem of unlimited wants, limited resources, scarcity, choice and opportunity cost, and should relate to a two good model of the economy, using a PPC. Allow a maximum of **[5 marks]** if there is no use of a PPC.

To obtain full marks, the PPC must be used to explain the economic problem rather than existing as a “bolt-on”.

*N.B. Answers which emphasise efficiency and shifts in the PPF are not central to this answer.*

2. **Explain how the use of expenditure / indirect taxation might be an appropriate response to the problem of negative externalities.**

Candidates might usefully begin by explaining what is meant by negative externalities; and that indirect taxation might be an appropriate response to market failure caused by the generation of negative externalities, where the problem is one of overproduction/consumption at the free market price. Good candidates will use the standard MSC/MSB diagram, or equivalent, to show how taxation can shift the PMC curve to the left to raise price, reduce output and achieve optimum social benefits.

*N.B. Answers which emphasise notions like elasticity and incidence of tax without fully relating to externalities will not usually go beyond Band 2.*

3. **Explain why firms operating in a perfectly competitive market would be able to make normal profits only in the long run.**

Candidates might usefully start by defining normal profit and briefly explaining what perfect competition is. For this question the crucial condition is that of freedom of entry and exit. If short run losses are made, the industry supply curve shifts left, and the market price rises back to a level where normal profits are being made; and the opposite is the case for short run supernormal profits. Better candidates might use demand and supply diagrams, as well as the standard perfect competition normal profit, supernormal profit and loss diagrams.

To earn full marks some use of diagrams is needed, but not necessarily all of the above – for example, a full discussion of **either** profits **or** losses would be sufficient. Some of this could be explained descriptively.

A maximum of **[3 marks]** if candidates are unable to progress beyond the conditions for perfect competition, and/or an explanation of normal profit.

**4. Why might the goal of full employment conflict with the goal of economic growth?**

A wide range of answers is possible. Allow for any reasonable discussion.

Reasons might include: growth may imply changes in the pattern of demand and supply leading to structural and technological unemployment; full employment may lead to greater inflation (Phillips relationship) which may cause the government to deflate the economy; unemployment may facilitate efficient resource reallocation, allowing the price system to work more “efficiently”, thus aiding growth.

Full marks could be earned by any one reason being fully developed or by two or more reasons being developed in less detail.

If an answer goes no further than a definition of full employment and growth, then a maximum of *[3 marks]* should be awarded.

Candidates who take issue with the question and argue that there is *not* a conflict between growth and full employment should be suitably rewarded.

**5. What impact is a substantial rise in the level of interest rates in a country likely to have on its balance of payments?**

A rise in interest rates may impact on the balance of payments as follows:

- greater capital inflows (improves capital account)
- capital inflows may increase indebtedness and cause longer term outflows from the current account (worsens current account)
- the fall in domestic demand may decrease the demand for imports (improved current account)
- the exchange rate might appreciate and this could worsen competitiveness (worsens current account)
- stockpiling of imported goods because of anticipated inflation (particularly with respect to LDCs).

If only one point is explained full marks cannot be awarded. Reward candidates who argue that the conflicting influences may cancel each other out, thereby making the impact of interest rate policy on the balance of payments rather indeterminate.

*N.B. It should be noted that often more than one point will be woven into an holistic explanation.*

**6. Explain *two* reasons why international indebtedness is a problem for less developed countries.**

Candidates might usefully begin by explaining the nature of the debt problem of the LDCs and link this to the concept of development. Specific problems which might be addressed include: diversion of export earnings into debt repayment; opportunity costs of debt repayment; involvement of institutions such as the IMF and structural readjustment programmes; loss of freedom to determine national economic and social policies; effects on domestic resource allocation, *e.g.* cash cropping; links between indebtedness, cash cropping and the environment; the cumulative, non-reducing nature of international debt.

If only one point is explained full marks cannot be awarded.

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