



MARKSCHEME

May 2010

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) **With the aid of at least one diagram, explain the difference between a movement along an existing demand curve for a good and a shift of the demand curve for a good.**

[10 marks]

Answers **should** include:

- a definition of demand
- an explanation that a change in the price of the good itself leads to a movement along the existing demand curve as the price of the good is one of the axes
- a reference to the *ceteris paribus* assumption
- a correctly labelled diagram showing movement along the demand curve and the resultant change in price and quantity demanded
- an explanation that a change in any of the non-price determinants of demand will lead to a shift of the demand curve to either the left or right *e.g.* income, tastes, price of other goods
- a correctly labelled diagram showing a shift of the demand curve for a good.

Answers **may** include:

- examples of goods to illustrate such movements and shifts, particularly complements and substitutes
- diagrams may or may not include a supply curve to illustrate the change in price and quantity.

Both a movement and a shift in demand needed for full marks (one or two diagrams may be used).

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 view that the market forces of demand and supply will always lead to the best allocation of resources.**

[15 marks]

Answers **may** include:

- a definition of resource allocation, best allocation of resources
- an explanation that “market forces of demand and supply” refers to a free market system in which demand and supply are left alone to set prices in the economy
- an explanation of “invisible hand”
- an explanation of how the price mechanism is signalled by changes in consumer demand and producer supply
- an explanation of how price acts as an incentive to consumers to make decisions about how to get the best value for their money
- an explanation of how price acts as an incentive to producers who decide how to best allocate their productive resources in order to make the most profit
- an explanation that prices will rise or fall until a shortage or surplus is eliminated and there is an equilibrium price and quantity arrived at in the market
- an explanation of how consumers acting in their own best interest and producers acting in their own best interest produce a situation in which there is no pressure in the market and resources are optimally allocated
- an explanation that the free market rarely leads to the best allocation of resources because of market failures
- reference to some market failures (lack of provision of public goods, overprovision of demerit goods, externalities)
- an explanation that government intervention is often necessary to assist in resource allocation and correct market failures.

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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.

Assessment Criteria

Part (b) 15 marks

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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
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2. (a) **Aggregate demand consists of consumption, investment, government spending and net exports (exports minus imports). Explain *two* factors that may influence consumption and *two* factors that may influence government spending.** *[10 marks]*

Answers **should** include:

- a definition of consumption
- a definition of government spending
- an explanation of **any two** factors which may influence consumption such as the distribution of income, changes in wealth, the availability of credit, social attitudes, interest rates, changes in personal taxes, confidence in economy, expectations of future income. Reference to disposable better than just income
- an explanation of **any two** factors which may influence government spending such as the population structure (*e.g.* an aging population), the rate of interest/cost of government borrowing, unexpected events, *e.g.* a credit crunch, war, the economic cycle (government spending usually rises in the downturn), political decisions, unemployment.

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- (b) **Evaluate the possible impact of an increase in consumption expenditure on the performance of an economy.** [15 marks]

Answers **may** include:

- an explanation of “performance of an economy” in terms of growth, employment, price stability and the balance of payments
- possible linkages between consumption and investment
- consideration of an increase in consumption leading to an increase in real GDP (economic growth)
- a diagram showing a shift of AD to the right
- comparison with potential growth
- the likely impact on employment, *e.g.* distinction between demand deficient and structural unemployment
- the possibility of demand pull inflation, depending on where the economy is operating
- the adverse impact on balance of payments if there is a large increase in demand for imports
- consumption financed by credit, payments default and the credit crunch, may have a negative effect on the economy in the longer-term
- an overall assessment of the impact.

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3. (a) **Explain the possible consequences of an improvement in a country's terms of trade for a country with a current account deficit.** *[10 marks]*

Answers **should** include:

- a definition of current account
- a definition of terms of trade: ratio of average price exports/average price imports
- an explanation of improvement in terms of trade
- an explanation of current account deficit
- an explanation of possible adverse effect on the current account in terms of higher export prices/lower import prices
- an explanation that a rise in export prices could improve the current account when export prices increase because of an increase in demand for a country's exports
- an explanation that a rise in export prices could worsen the current account when export prices rise as a result of domestic inflation, rising costs or greater inefficiency, or appreciation of the currency.

Answers **may** include:

- the importance of PED for exports and imports.

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- (b) **Evaluate the view that, in the long term, expenditure-switching policies (protectionism) are the most effective way to reduce a current account deficit.**

[15 marks]

Answers **may** include:

- an explanation of expenditure-switching and different types of protectionism, *e.g.* tariffs and quotas
- an explanation of how protectionism may be used to reduce a current account deficit
- arguments against protectionism to reduce a current account deficit, *e.g.* retaliation, contravention of WTO rules, impact on resource allocation and efficiency, impact on consumer prices
- consideration of expenditure reducing policies
- consideration of exchange rate policies
- consideration of supply-side policies to shift LRAS right and make exports more competitive in the long run
- consideration of the effect on other government objectives
- overall assessment.

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4. (a) **Explain the difference between economic growth and economic development, and how each of these may be measured.** [10 marks]

Answers **should** include:

- a definition of economic growth
- a definition of economic development
- an explanation that economic growth is a quantitative concept whereas economic development is more qualitative
- an explanation that economic growth is measured by the increase in real national income over a period of time, whereas economic development, in addition to the latter, could also include a whole variety of other measures such as schooling, life expectancy, provision of healthcare, income distribution, political freedoms *etc.* (just a few examples would suffice).

Answers **may** include:

- a production possibility diagram to illustrate the difference between economic growth and economic development
- a mention of specific indices such as the HDI or HPI.

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- (b) **Evaluate the view that the best way that developed countries can help the growth and development process of very poor, highly indebted countries is through a general cancellation of debts.**

[15 marks]

Answers **may** include:

- a definition of developing, highly indebted countries
- examples of such countries
- arguments for debt cancellation in terms of the problems of debt, *e.g.* the opportunity cost of debt repayments, the impact on development, the gearing of the economy towards exports, the potentially serious implications of the problem on absolute poverty
- arguments against debt cancellation, *e.g.* the danger of moral hazard, debt forgiveness and the creation of a dependency culture, the rewarding of irresponsible governments and penalizing of committed ones, debt as one of just many causes of poverty in developing countries
- alternatives to debt cancellation such as aid or trade agreements
- the role of the IMF and World Bank, *e.g.* through structural adjustment programmes
- an overall assessment as to how the highly indebted countries can best be helped: debt write-offs *versus* effective aid and by industrialized countries lifting trade barriers.

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