



MARKSCHEME

May 2012

ECONOMICS

Higher Level

Paper 2

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In addition to the assessment criteria, use the paper-specific markscheme below. Award up to the maximum marks indicated. Each question is worth [10 marks].

1. Using the concept of market failure, explain why a government may try to decrease the use of motor vehicles in city centres.

Candidates may include:

- a definition of market failure
- a definition of negative externalities, consumption or production
- an explanation that this is a case of a negative consumption externality (private use of vehicles) or production externality (commercial use of vehicles) leading to over-use of motor-vehicles
- MSB less than MPB for consumption externality or MSC greater than MPC for production externality
- an explanation of the external costs, *e.g.* effects on third parties due to congestion or pollution, increase in business costs
- use of a diagram to illustrate the MSB curve lying below the MPB curve or the MPC curve lying below the MSC curve
- an explanation of the impact of negative externalities in terms of inefficient use of scarce resources/over-allocation of resources.

References to methods of reducing use of motor vehicles may be rewarded.

Candidates may be awarded full marks through either the MSB/MPB approach or the MSC/MPC approach.

Candidates who incorrectly label diagrams cannot be rewarded with full marks.

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

		Assessment Criteria	
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

2. Using a diagram, explain how a firm in perfect competition can be making losses whilst still producing at the level of output where marginal costs equal marginal revenue.

Candidates **may** include:

- a definition of perfect competition
- a definition of losses
- a definition of marginal cost, marginal revenue
- an explanation that profit maximization/loss minimization occurs at the level of output where MC equals MR
- an explanation that the firm makes a loss where ATC exceeds AR (P) at the profit maximizing/loss minimizing level of output
- use of a diagram of perfect competition to illustrate short-run losses at the level of output where MC equals MR
- reference to the condition that AR must be greater than or equal to AVC at the profit maximizing/loss minimizing level of output if the firm is to produce in the short run.

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3. With the aid of *at least one* diagram, explain how cost push and demand pull inflation may occur in an economy.

Candidates **may** include:

- a definition of inflation
- a definition of cost push inflation
- a definition of demand pull inflation
- an explanation of cost push inflation
- an explanation of demand pull inflation
- use of a diagram to illustrate cost push inflation showing SRAS curve shifting to the left
- the possible causes of cost push inflation, *e.g.* increase in wages, imported inflation, profit push inflation
- use of a diagram to illustrate demand pull inflation showing AD curve shifting to the right
- the possible causes of demand pull inflation, *e.g.* increase in consumption, government spending, investment or net exports.

Candidates who only address cost push or demand pull inflation cannot earn marks beyond level 2.

Candidates who incorrectly label diagrams cannot be rewarded with full marks.

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4. With the aid of a diagram, explain the potential trade gains and trade losses arising from the formation of a customs union.

Candidates **may** include:

- a definition of a customs union
- explanation of potential gains:
 - benefits of specialization according to comparative advantage
 - more competition
 - economies of scale
 - lower prices
 - improved product quality
 - increased efficiency
 - trade creation
 - increased output and economic growth
 - impact on resource allocation
- explanation of potential losses
 - unequal distribution of gains
 - inferior to global free trade
 - lower output and increases in unemployment due to closure of inefficient producers
 - trade diversion
- diagram showing elimination of protectionist measures (tariff, quota or subsidy) leading to increased imports
- diagram showing increased protectionist measures (tariff, quota or subsidy) toward non-member countries, leading to a fall in imports
- AD/AS diagram illustrating economic growth arising from trade gains and reflected in an increase in AD
- diagram showing comparative advantage.

Examiners should be aware of the limited time available to candidates when marking responses to this question.

Candidates who incorrectly label diagrams cannot be rewarded with full marks.

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5. Explain how fiscal policy can be used to reduce the level of unemployment.

Candidates **may** include:

- a definition of fiscal policy
- a definition of unemployment
- fiscal policy is mainly used to tackle cyclical/demand-deficient unemployment
- an explanation of expansionary/reflationary fiscal policy
- an explanation that lower direct and indirect taxes will increase aggregate demand
- an explanation of the impact of higher government spending
- possible multiplier effects
- use of an AD/AS diagram to illustrate the effect of increased aggregate demand on the level of output and employment.

Candidates who refer to the supply-side effects of fiscal policy should be rewarded.

It is possible for full marks to be earned if a diagram is not used, provided the explanation is sufficiently detailed along the lines shown in the markscheme.

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6. Explain *three* factors which may limit the effectiveness of aid as a means of promoting economic development.

Candidates **may** include:

- a definition of aid
- a definition of economic development
- examples of types of aid
- an explanation of factors:
 - problems associated with tied aid
 - misuse of aid revenues
 - much aid is in the form of soft loans which have to be repaid giving rise to indebtedness
 - conditionality and influence on the policies of the recipient government
 - aid which discourages self-reliance
 - food aid which discourages domestic production
 - aid motivated by political interests of donors.

If only one factor is explained candidates cannot be awarded more than **[4 marks]**. If only two factors are explained candidates cannot be awarded more than **[7 marks]**.

Candidates who argue that the effectiveness of aid will be limited by those factors which limit development in general, *e.g.* poor infrastructure, unequal distribution of income should be rewarded.

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

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