



MARKSCHEME

May 2008

ECONOMICS

Higher 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 how a firm operating in an oligopolistic market might attempt to increase its market share.** **[10 marks]**

Answers **should** include:

- definition of oligopoly
- explanation of market share
- an explanation of some of the ways a firm in an oligopolistic market can increase its market share.

The ways **may** include:

- price wars
- the creation of entry barriers
- take-overs and mergers
- collusion
- the use of product differentiation to create brand loyalty
- the use of advertising and other forms of non-price competition
- the exploitation of large scale production and economies of scale.

Candidates who are able to fully explain at least two ways can access the top mark band.

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

- (b) **Evaluate the view that producers, and not consumers, are the main beneficiaries of oligopolistic market structures.** *[15 marks]*

Answers **may** include:

- the advantages and disadvantages to the producer of being in an oligopoly
- the advantages and disadvantages to consumers
- distinction between collusive and non-collusive oligopoly
- notion of joint profit maximization
- impact of collusion in reducing uncertainty for firms
- impact of cartels in restricting output and raising prices charged
- impact of oligopoly on different types of efficiency
- impacts on producer and consumer sovereignty
- advantages/disadvantages of non-price competition for consumers and producers
- implications of kinked demand curve model for producers and consumers
- possibility of market contestability and the implications thereof.

Answers not referring to benefits that consumers may receive from an oligopolistic market structure cannot reach the top mark band.

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

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.

2. (a) **“The effect of a decrease in aggregate demand on output and the price level depends on the shape of the aggregate supply curve.” Explain this statement.** *[10 marks]*

Answers **should** include:

- definitions of AD and AS
- at least one AD/AS diagram explaining how the shape of AS will determine the effect of a decrease in AD on the price level and/or output.

Answers **may** include:

- distinction between SRAS and LRAS
- distinction between SRAS at full employment and less than full employment
- distinction between Keynesian and neo-classical AS.

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

(b) Evaluate the likely effects of a falling rate of inflation on the performance of an economy.

[15 marks]

Answers **may** include:

- definition of inflation
- explanation of “falling rate of inflation”
- the significance of how the fall was produced, *e.g.* reduction of AD/increase in AS
- the possible relationship between low inflation and economic growth, *e.g.* increased business confidence leading to a higher level of investment
- significance of costs and demand factors
- explanation of economic performance in terms of employment (job losses/job creation)
- explanation of economic performance in terms of economic growth
- explanation of economic performance in terms of the balance of payments, exchange rates and international competitiveness
- explanation of economic performance in terms of income distribution
- the extent and sustainability of the fall.

An evaluation of the effects of a falling rate of inflation should consider the possibility that such a fall may not always be positive for an economy.

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

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.

3. (a) Explain the principle of comparative advantage and the benefits which might arise from free trade. *[10 marks]*

Answers **should** include:

- explanation of comparative advantage, verbally, numerically or diagrammatically with a clear reference to opportunity cost
- definition of free trade
- an explanation of benefits from free trade.

Answers **may** include:

- distinction between absolute and comparative advantage
- explanation of the possible benefits of free trade in terms of
 - greater levels of output and employment and government taxation revenue
 - higher living standards
 - more efficient resource allocation
 - greater choice for consumers
 - lower prices for consumers.

Candidates who are able to fully explain at least two benefits can access the top mark band.

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

- (b) **Evaluate the importance of membership of a trading bloc for the export performance of a country.**

[15 marks]

Answers **may** include:

- examples of trading blocs
- explanation of the term “export performance”
- implications for exporting of membership of different types of trading blocs, *e.g.* the implications of a single market and/or a single currency
- discussion in terms of trade creation and trade diversion
- importance of other factors such as the
 - extent of protectionism outside the bloc
 - relative rates of inflation
 - relative rate of growth of productivity
 - importance of non-price factors
 - significance of the exchange rate
 - degree of exploitation of comparative advantage.

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

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.

4. (a) Explain how development might be measured.

[10 marks]

Answers **should** include:

- definition of development
- measures of development.

The measures **may** include:

- use of GDP/GNP figures
- Lorenz curve and Gini coefficient as a measurement of potential access
- alternative methods of measurement, *e.g.* health, education/literacy, quality of life, environmental indicators, stock of asset indicators, political freedoms, composite indices, *e.g.* HDI.

Candidates who are able to fully explain at least two measures, can access the top mark band.

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

- (b) Evaluate the view that the most effective way that a government could improve the welfare of its citizens is through the pursuit of faster economic growth.

[15 marks]

Answers **may** include:

- definition of growth
- explanation of the concept of welfare
- links between faster growth and welfare
- policies necessary to achieve faster growth
- implications of implementation of specific policy measures
- growth and the ability of the government to increase its spending on welfare enhancing programmes
- links between growth and employment
- growth and externalities
- growth and income distribution
- growth and sustainability
- possible conflicts between growth and other goals such as price stability, a satisfactory balance of payments, low unemployment
- possible opportunity costs
- importance of development, as opposed to growth only, in improving living standards
- alternatives to economic growth *e.g.* policies to redistribute income and wealth.

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

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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