

Markscheme

November 2020

Economics

Higher level

Paper 1

12 pages

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Section A

Microeconomics

1. (a) Explain how knowledge of price elasticity of demand could be used by a firm that is considering changing the price of its product. **[10]**

Answers may include:

- definition of price elasticity of demand
- diagram to show the revenue consequences of elasticity when the price is changed
- explanation of how total revenue changes following a change in price depending on whether the demand for the product is price elastic, price inelastic or unit elastic
- examples of “real-world” products with different elasticities to support the explanation (students do not need to provide actual total revenue figures, but should provide a consideration of why demand for the product might be more or less likely to be elastic or inelastic).

Assessment Criteria

Part (a) 10 marks

Level		Marks
0	<i>The work does not meet a standard described by the descriptors below.</i>	0
1	<i>There is little understanding of the specific demands of the question.</i>	1–3
	Relevant economic terms are not defined. There is very little knowledge of relevant economic theory. There are significant errors.	
2	<i>There is some understanding of the specific demands of the question.</i>	4–6
	Some relevant economic terms are defined. There is some knowledge of relevant economic theory. There are some errors.	
3	<i>There is understanding of the specific demands of the question.</i>	7–8
	Relevant economic terms are defined. Relevant economic theory is explained and applied. Where appropriate, diagrams are included and applied. Where appropriate, examples are used. There are few errors.	
4	<i>There is clear understanding of the specific demands of the question.</i>	9–10
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- (b) Discuss how the introduction of a subsidy in a market will affect consumers, producers and the government. [15]

Answers may include:

- definition of subsidy
- diagram to show the imposition of a subsidy and the consequences for the three stakeholders
- explanation of how a subsidy lowers the price of the product and may lead to increased consumption/consumer surplus by consumers, increased production/revenue/producer surplus for producers and increased government expenditure
- examples of markets where subsidies have been introduced in practice
- synthesis or evaluation (discuss).

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

Discussion may include: judgments about which stakeholders are better off and which stakeholders are worse off due to the imposition of a subsidy, which are well supported by the explanation of the theory, the diagram and the example(s).

Assessment Criteria

Part (b) 15 marks

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2. (a) Explain how a natural monopoly may arise.

[10]

Answers **may** include:

- definition of natural monopoly
- diagram to show falling long-run average costs at least up to the point where the LRAC curve intersects the market demand curve
- explanation that a natural monopoly is a firm that experiences such significant economies of scale (eg due to investment in fixed capital) that it is able to satisfy the demand for the entire market at a level of output where it still experiences falling average total cost and/or that natural monopoly arises due to a natural barrier to entry such as ownership of vital input for production
- examples of natural monopoly.

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(b) Discuss how governments restrict monopoly power.

[15]

Answers may include:

- definition of monopoly power
- a monopoly diagram to show a monopoly which is not producing at the profit-maximizing level of output because the price of its product is regulated by the government
- explanation of why governments might choose to restrict monopoly power and how it might be done through government regulation of prices, legislation to prevent cartels and mergers, nationalization or the break-up of firms with monopoly power
- examples of industries that were monopolized where a government has sought to exercise control
- synthesis or evaluation (discuss).

Discussion may include: consideration of the relative merits of alternative means by which monopolies might be restricted. “Real-life” examples would be very suitable as a means to support the discussion.

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

NB It should be noted that definitions, diagrams, theory and examples that have already been given in part (a), and then referred to in part (b), should be rewarded.

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Section B

Macroeconomics

3. (a) Explain why there is a possible trade-off between the unemployment rate and the inflation rate in the short run. **[10]**

Answers may include:

- definitions of unemployment (rate), inflation (rate)
- diagram of the short-run Phillips curve to illustrate the trade-off between inflation and unemployment and AD/AS diagram to support the explanation
- explanation that, in the short-run, if aggregate demand in the economy increases, this would lead to increase in national output, forcing firms to hire more workers and decreasing the unemployment rate, while simultaneously increasing the inflationary pressures in the economy, and/or vice versa
- examples of countries that have possibly experienced a trade-off between inflation and unemployment.

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- (b) Discuss the view that the redistribution of income is the most important impact that inflation has on an economy. [15]

Answers may include:

- definition of inflation
- AD/AS diagram to show the increase in the price level or a Lorenz curve to show changed distribution of income
- explanation that (unexpectedly) high inflation affects positively the real income/wealth of borrowers and the groups in society with variable income while affecting negatively the real income/wealth of lenders and the groups in society with fixed income
- examples of countries that have experienced inflation with attempt to identify consequences of inflation
- synthesis or evaluation (discuss).

Discussion may include: consideration of alternative impacts of inflation (such as a loss of export competitiveness, increases in short-run economic growth, decreases in savings and increases in uncertainty resulting in lower investment and hence lower long-run economic growth, “menu costs”) with the candidate making judgment with regard to what might be the most important impact and whether or not the candidate feels the potential redistributive effect is the most significant impact of inflation, the importance of how high the inflation rate is, the difference between expected and unexpected inflation.

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

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4. (a) Explain why measuring unemployment in a country is difficult.

[10]

Answers **may** include:

- definition of unemployment
- a diagram is not required for full marks, but candidates may use a labour market diagram, AD/AS diagram or Phillips curve diagram
- explanation of the challenges in measuring the exact number of people of working age who are without work, available for work and actively seeking work, resulting in inability to assess the underemployment/the hidden unemployment and the unreported employment in the informal (underground) economy
- examples of specific cases or countries where there is unemployment that may be difficult to measure.

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- (b) Discuss whether the most important consequence of unemployment is a loss of income for individuals. [15]

Answers may include:

- definition of unemployment
- appropriate diagram(s) to show the loss of income due to unemployment and/or other consequences of unemployment
- explanation of the different economic (loss of income), social and political consequences of unemployment
- examples of the consequences of unemployment for individuals, communities and/or countries
- synthesis or evaluation (discuss).

Discussion may include: whether or not a loss of income is the most important consequence of unemployment that may be set in the context of other impacts of unemployment, such as reduced economic growth, reduced government revenues, increased government expenditures on unemployment benefits, personal and social problems, political instability, with judgment being made with regard to whether a loss of income is the most important impact of unemployment.

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