UNIVERSITY of CAMBRIDGE
International Examinations

Cambridge
International
AS & A Level

Example Candidate Responses (Standards Booklet)

Cambridge International AS and A Level Economics

9708

Cambridge Advanced

Contents

Introduction

The main aim of this booklet is to exemplify standards for those teaching Cambridge International AS and A Level Economics (9708), and to show how different levels of candidates' performance relate to the subject's curriculum and assessment objectives.

In this booklet a range of candidate responses has been chosen as far as possible to exemplify good, average and weak answers. Each response is accompanied by a brief commentary explaining the strengths and weaknesses of the answers.

For ease of reference the following format for each paper has been adopted:

Question

↓

Mark scheme

↓

Example candidate response

↓

Examiner comment

For Papers 2 and 4 each question is followed by an extract of the mark scheme used by examiners. This, in turn, is followed by examples of marked candidate responses, each with an examiner comment on performance. Comments are given to indicate where and why marks were awarded, and how additional marks could have been obtained. In this way, it is possible to understand what candiates have done to gain their marks and what they still have to do to improve their grades.

Past papers and Principal Examiner Reports for Teachers and other teacher support materials are available on http://teachers.cie.org.uk

Assessment at a glance

Paper		Weighting	
		AS Level	A Level
Paper 1 30 multiple choice questions (Core)	**1 hour**	40%	20%
Paper 2	**1 hour 30 mins**		
(a) Data response (Core) 1 question		30%	15%
(b) Structured essay (Core) 1 from a choice of 3		30%	15%
Paper 3 30 multiple choice questions (Supplement)	**1 hour**		15%
Paper 4	**2 hours 15 mins**		
(a) Data response (Supplement) 1 question			10%
(b) Essays (Supplement) 2 from a choice of 6			25%

Teachers are reminded that a full syllabus is available on www.cie.org.uk

Paper 2

Australia and its Northern Territory

The Northern Territory of Australia is a large, sparsely populated area. It relies heavily on tourism, mining, agriculture and fishing. The extraction of oil and gas and the mining of iron ore and bauxite have grown significantly in recent years. Its manufacturing is principally based on the processing of its natural resources.

The Northern Territory government publishes forecasts, which compare the economic prospects of the Northern Territory with those of Australia as a whole. The table below gives extracts from the forecasts in January 2009.

Table 1: Selected economic forecasts for Northern Territory and Australia

	Northern Territory		Australia	
	2008–9	2012–13	2008–9	2012–13
International exports, constant price (A$*m)	4172	6004	176 010	236 824
International imports, constant price (A$m)	2718	2811	217 675	224 521
Consumer price index, 1989–90 = 100	164.6	180.0	167.7	186.4
Average weekly nominal earnings, A$	954	1078	916	1050
Unemployment rate (%)	3.7	5.7	4.2	6.5
Population aged 15–64 (thousands)	170	186	17 456	18 627

* A$ = Australian dollars

Question 1(a)(i)

Calculate and compare the change in the trade balance between 2008–9 and 2012–13 of the Northern Territory with that of Australia. [4]

Mark scheme

Calculate and compare the change in the trade balance between 2008–9 and 2012–13 of the Northern Territory with that of Australia. [4]

Both improved (1), Northern Territory (NT) has an increased surplus (1), Australia goes from deficit to surplus (1), supporting calculation NT A$1454 to A$3193, Aus A$-41 665 to A$12 303 (2)
Comparative points without accurate calculation can be rewarded, but the points must relate to the 'balance', not the change in imports or exports alone.

Example candidate response

Trade balance of Northern Territory (2008)
= 4172 − 2718 = 1454 (surplus)

Trade balance of Northern Territory (2013)
= 6004 − 2811 = 3193 (surplus)

Trade balance of Australia (2008) =
= 176010 − 217675 = (41665) (Deficit)

Trade balance of Australia (2013)
= 236824 − 224521 = 12303 (surplus)

In Northern Territory there is an increase in trade surplus which shows that there is their Balance of Payment ~~are~~ and terms of trade are improved. Australia also improved at a greater rate comparitive to Northern Territory as proved by the figures calculated above. This shows that Australian government had made a significant improvement although Northern Territory also improved but Australia at a greater rate which is due to population.

4

Examiner comment

This answer gains full marks. The candidate provides an accurate calculation, although it would have been better if the balances had been shown in Australian dollars. It then goes on to make the comparative points that the balances of both areas had improved and that the balance in Australia had improved at a greater rate.

Mark awarded = 4 out of 4

Example candidate response

Trade balance for Northern Territory
2008-9 Exports - imports
4172 - 2718 = 1454
2012-13
6004 - 2811 = 3193
Exports increase in 2012-13 as compared to 2008-9. Trade Surplus.

Australia Trade Balance Exports - imports
~~176010+~~
2008-9
176010 - 217675 = (41665)
2012-13
236824 - 224521 = 12303
~~224524~~
In 2008-9 Australia has trade deficit but increase in exports over imports make trade surplus

2

Examiner comment

This answer contains the necessary calculation, but fails to provide any comparative comment. As a result the maximum mark available is two. The question clearly asks the candidate to 'calculate and compare'. Careful reading of question requirements is essential for maximum marks.

Mark awarded = 2 out of 4

Example candidate response

2i-) change in trade balance of the Northern territory =
$(X_2 - M_2) - (X_1 - M_1)$
$= (6004 - 2811) - (4172 - 2718)$
$= 1739\text{m A\$}$

~~percentage change =~~

change in trade balance for Australia =
$(X_2 - M_2) - (X_1 - M_1)$
$= (236824 - 224521) - (176010 - 217675)$
$= +53{,}968\text{m A\$}$

~~Both trade balances bettered from 2008-9 to 2012-13.~~

percentage increase for Northern Territory
$= \dfrac{6004 - 2811}{4172 - 2718} \times 100$
$= 219.6\%$

?

percentage increase for Australia
$= -29.5\%$

The trade balance for the Northern Territory will increase by 219.6% from 2008-9 to 2012-2013. The trade balance for the Northern Territory will keep increasing whereas a negative trade balance for Australia will change into a positive one. The percentage increase for australia will be -29.5% in 2012-13 as compared to the negative trade balance in 2008-09.

1

Ø

Examiner comment

This candidate provides a very confused calculation. In addition there is no real direct, comparative comment. There is some understanding of the meaning of 'trade balance' however and the recognition that in Australia the balance changes from a deficit to a surplus. It was considered to have sufficient understanding for one mark.

Mark awarded = 1 out of 4

Question 1(a)(ii)

Explain why exports and imports are often measured at constant prices. [2]

Mark scheme

Explain why exports and imports are often measured at constant prices. [2]

Constant prices exclude the effect of inflation (1), more accurate in real terms or shows the volume of trade.

Example candidate response

exports and imports are measured at constant prices in order ~~to~~ to ascertain the real growth in the trade balance without ~~the~~ inflation distorting the real balance. It helps the governments ~~undst~~ ~~seeb~~ see understand the increase or decrease which would help implement disequilibria policies. 1

Examiner comment

This answer gains both marks available. The idea of the 'real growth in the trade balance' and the fact that inflation distorts the real balance shows that there is clear understanding here.

Mark awarded = 2 out of 2

Example candidate response

Exports are the goods sold ~~in~~ abroad and imports are the goods bought from other countries. Using constant prices is better because there're always some changes that influence exports and imports. 1

Such as Inflation, change of exchange rate. 1

Examiner comment

This candidate gains a mark for the recognition that using constant prices is better because of the distorting effects of inflation and a change in the exchange rate. For a further mark the candidate needed to say a little more on why it was 'better'. This could have been for example a statement that the measurement was more accurate in real terms or that it would show the changes in the actual volume of trade.

Mark awarded = 1 out of 2

Example candidate response

Exports and imports are measured at constant prices because they donot relate to any of the other components of the economy. Exports and Imports when exchanged are according to the values and price of their own. They are not related to anything else.

0

Examiner comment

This candidate clearly does not understand the idea of 'constant prices'. An attempt is made to suggest a possible meaning, but with little success.

Mark awarded = 0 out of 2

Question 1(b)

Explain **two** additional pieces of information that would be useful in judging Australia's international financial position. [4]

Mark scheme

Explain <u>two</u> additional pieces of information that would be useful in judging Australia's international financial position. [4]

From net income, net transfers, capital account, financial account, foreign reserves, exchange rate, *terms of trade* or alternatives, identification (1), *plus 1 mark for explanation of identified point (1)*

Example candidate response

Australia's international financial position can be judged by the ~~balance of payment account~~ capital and financial section of the balance of payment account, which shows the capital inflows and outflows of the country. How much investment is done by the foreigners and how much investment is done abroad. For example: a Japanese motor car company setting up a factory in Australia. Or Australian government building a hospital overseas. The Capital and financial account consist of direct investment, portfolio investment flows, other reserves, acquisition/disposal of nonfinancial and nonproduced assets and capital transfer

Australia's financial position can even be ~~jule~~ judged by the terms of trade, that is, the rate at which a country exchanges its exports for imports. ~~How~~ The quantity of imports that a country can get by a unit of exports. The formula ~~is~~ of terms of trade is =

$$\frac{\text{Index of export prices}}{\text{Index of import prices}} \times 100$$

✓ ✓ ✓ ✓ ✓ 4

Examiner comment

This candidate provides two relevant and additional pieces of information that would be useful in judging Australia's international position. Both are explained with sufficient clarity and detail to ensure full marks.

Mark awarded = 4 out of 4

Example candidate response

The terms of trade can be used in ~~the~~ judging the Australia's financial position. Term of trade is the opportunity cost of the goods import~~ed~~ in terms of export ~~or it is the value~~

Terms of trade = $\frac{\text{Price of Exports}}{\text{Price of Imports}} \times 100$.

If Terms of trade is greater than 100, it is said to be favourable. If terms of trade is less than 100, it is said to be unfavourable.

2

The current specify Account can also be used to measure the international financial position

2

Examiner comment

This candidate identifies the terms of trade as an additional piece of information that would be useful in judging Australia's international financial position. The answer then goes on to explain how the terms of trade are calculated. This is worth two marks. The second piece of information identified by the candidate is the ' Current Account'. This fails to score because without elaboration, this is too vague. If the candidate had gone on to identify and explain some items within the Current Account, this would have been acceptable and would have gained further credit.

Mark awarded = 2 out of 2

Example candidate response

The consumer price index shows the rate of inflation in Australia. Inflation have a very important role in the financial position of a country. The consumer price index of Australia in 2008-9 was 167.7 and in 2012-13 was 186.4. The balance of trade given can ~~be~~ also be used to determine the financial international position of Australia as calculated above in the part (a).

0

Examiner comment

This candidate identifies the Consumer Price Index and the Balance of Trade as two additional pieces of information. These were not acceptable because both of these were provided in Table 1 and could not therefore be considered as 'additional'. This was a very common error amongst candidates. The most likely cause of this error was a failure to read the question requirements carefully and many candidates gained no marks here as a result.

Mark awarded = 0 out of 4

Question 1(c)

Analyse the change in average weekly earnings in Australia in real terms between 2008–9 and 2012–13. [4]

Mark scheme

Analyse the change in average weekly earnings in Australia in real terms between 2008–9 and 2012–13. [4]

For an understanding of meaning of 'real terms' (1 mark)

Real earnings will rise (1), earnings rise more rapidly than inflation (1), supporting calculation 14.6% v. 11.2% (2)

Example candidate response

The average weekly earnings in real terms would take into account inflation ~~because~~ into consideration. The consumer price index (inflation) rose by 11.2% (186.4 - 167.7 ÷ 167.7 x100) whereas the Average weekly nominal earnings (A$) rose by 14.6% between 2008-09 and 2012-13, according to the forecast. So, in real terms, the average weekly earnig (A$) rose by about 3.4%. 4

Examiner comment

This concise answer was awarded full marks. The candidate starts by showing a clear understanding of the meaning of 'real terms'. An accurate calculation is then provided showing that inflation rose by 11.2% whilst nominal earnings rose by 14.6%. This was then followed by the correct conclusion that in real terms the average weekly earnings rose.

Mark awarded = 4 out 4

Example candidate response

In the years between 2008-2009, the average weekly earning in Australia was 916 A$ which in 2012-2013 increased to 1050 A$. This change shows that as the years progressed, the ~~wage rate which can also~~ ~~per week~~ average weekly nominal earnings increased by 15%.

On the other hand, the ~~average~~ consumer price index shows that during the years 2008-2009, the inflation rate was 67.7% and in 2012-2013, it increased to 86.4%. Therefore there was a 28% increase in 2008-2013. This shows that prices rose at a higher rate in Australia.

Analyzing the situation of Australia, it can be said that the average weekly earnings in Australia in real terms decreased. ~~This is because as the nominal~~ Average weekly earning in Australia in real-terms refers to the wage rate related to the average price level in the country. As it is shown in the table, the average price level also showed a rise in the years 2008-2013, therefore the ~~disposable~~ income in real terms decreases over the years. In simple words, it can be said that the amount that people earned was equal or lesser than the ~~to the~~ amount they had to spend ~~or might be less~~.

2

Examiner comment

This answer showed understanding of the meaning of 'real terms', but unfortunately the candidate was unable to use the data to perform all parts of the calculation. A mark was awarded for the correct calculation of the percentage change in nominal earnings, but there is no figure provided for the percentage increase in prices. This meant that no conclusion regarding the change in real terms could be reached.

Mark awarded = 2 out of 4

Example candidate response

Ans:- Real change = Average weekly earnings – CPI.

Change Earnings :- 1050 – 916 = 134.

Change CPI :- 86.4 – 67.7 = 18.7.

=> 134 – 18.7 = A$115.3.

The real change is dependant on the average weekly earnings, i.e., the inflation rate. In nominal terms the earnings have increased by AS $ 134 but at a closer look the earnings have actually increased by AS $ 115.3 meaning that the rate of inflation has increased and the value or purchasing power of money has decreased.

Examiner comment

This candidate understands the meaning of 'real terms' and gains a mark for this, however the candidate's application and data handling skills are weak. The candidate does not grasp the distinction between absolute figures, percentages and index numbers and fails to gain any marks for the calculation.

Mark awarded = 1 out of 4

Question 1(d)

With the help of the text and the table, discuss the economic outlook for the Northern Territory.

[6]

Mark scheme

With the help of the text and the table, discuss the economic prospects of the Northern Territory. [6]

Good prospects: trade in tourism (income elastic), minerals and oil, rising surplus, relatively low inflation rate, higher real wages, growth of working population.
Poor prospects: rise in unemployment, dependence on narrow range of production, variable demand, externalities of tourism and mining, lack of sustainability of natural resources.

For the identification of points that could affect the economic prospects of the Northern Territories (2 max.)

For explanation of why the identified points are relevant to the economic prospects. (2 max.)

For comment on the economic prospects of the Northern Territories, for example a reasoned summary or conclusion. (up to 2 marks)

Example candidate response

The text given prove that Northern Territory of Australia is a developing country and is specialised in manufacturing sector and primary ~~sector~~ ~~manufacturing~~ such as extraction of oil and gas, mining ores etc. And Northern Territory also tourism one of the main business (service sector). The table shows growth in trade balance of Northern territory between 2008-9 and 2012-13. The consumer price index too showed as upward ship from 164.6 to 180.0 (rise of 9.36%). The actual inflation was forcasted to be 80% in 2012-13 compared to 1989-90 (base year) which might decrease country's ~~economic~~ internation competitiveness and attract less capital inflows ~~of~~ from abroad. Inflation rate is considered to be high and people may lose confidence in money. So, govt. should take the figure seriously to increase country's competitiveness. The Northern Territory's earning in real terms ~~would~~ has been forecasted to increase, which could increase marginal propensity to ~~consume~~ import due to high price of domestic goods. The unemployment rose to 5.7% (54% rise from 2008-9), which could pressurise govt. to provide more unemployment benefits. But labour force showed ~~a~~ rise ~~of~~ 9.4% from 2008-9 to 2012-13 which could ~~make~~ increase ~~GDP~~ Gross Domestic Product and output of country. Although, high dependence on natural resources will affect Northern territory in long term as the natural resources are scarce ~~and~~ high depency on them will lead to depletion of resources.

2
2
2

6
Jwr
(5)

19

Examiner comment

This answer starts by describing some features of the Northern Territory economy before identifying information provided in the data that would allow a judgement to be made concerning the economic prospects of this area. The surplus on the trade balance, which is expected to grow, is identified. The candidate then provides some inaccurate estimates of the rate of inflation but goes on to explain the dangers of a high rate of inflation. Some good analysis is then provided using relevant economic concepts. The final paragraph provides a valid comment on the danger of the Northern Territories relying upon natural resources which might run out. A rather fuller comment on the future economic prospects of the region would have resulted in full marks for this answer.

Mark awarded = 5 out of 6

Example candidate response

The Northern Territory constitutes a small economy (than Austrailia). Its main industries lie in the primary sector. The economy relies heavily on agriculture and mining. In other definitions, it could be labelled as a developing economy. According to forecasts ~~and~~ suggested by the text, the mining and extraction industries are growing significantly. In the future, this development could give way to factories and structural changes in the economy; likely to shift towards the secondary sector.

Balance of Payments are satisfactory under the circumstances, with exports significantly higher than its imports. Inflation is also considerably low and stable. This means risk-taking is encouraged and business owners have confidence in the economy.

Employment is low as well, however the situation might slightly worsen according to forecasts. This may as well be structural unemployment due to businesses moving towards secondary sector industries.

2+2+0

4

4

12

12

Examiner comment

This candidate identifies and then explains two items of data that could be used to assess the economic prospects of Northern Territory. Good explanations of the inflation rate and the unemployment rate and the significance of each are provided. Marks are lost here however, because there is insufficient attention paid to an assessment of the overall prospects for the region. No comment is provided for example on whether the negative indicators might be more powerful than the positive indicators. This comment might have been supplied in a concluding paragraph in which some evaluative judgement might have been provided.

Mark awarded = 4 out of 6

Example candidate response

Northern Territory as mentioned in the passage is a populated area, which relieves heavily on tourism, mining, agriculture and fishing which indicates that It has alot of industries to earn from as well as from the extraction of oil and gas and the mining of iron-ore and bauxite. It shows a very well developed infrastructure of the Northern territory of Australia.

According to the table 1. In 2008-9, It has a an excess of exports over imports showing a positive balance of payments. Further ahead in 2012-13 Its exports increased well enough, and again having a positive Balance of payments showing an increase of 1739. Consumer price Index in a

way of measuring inflation that in 2008-9 It has a
CPI of 164.6 and going off a little worse in
2012-13 ~~too~~ ~~by~~ to an increase rate. In 2012-13 It was
180.0, indicating that inflation rate increased.
Average weekly earning in 2008-9 was 954 which
increased in 2012-17 to 1072. showing a good
~~ide~~ sign. Next is the unemployment rate, that
in 2008-9 was 3.7 that rose to 5.7 in 2012-13
which is worse for Norther territory
Population aged about 15-64 in 2008-9 was
170 which rose to 186 in 2012-13. This factor 2
is considered with the infrastructure of the country.
Hence the Northern territory has well economic 2
outlook as per the table given Not expl 6
6

Section B.

Examiner comment

This candidate refers to a very wide range of economic indicators shown in the data. The answer starts with a description of the Northern Territory and then goes on to list the contents of Table 1. The weakness is that none of the indicators are used to answer the question. For example, it is stated that the unemployment rate is expected to rise from 3.7% to 5.7% and that this is 'worse' for the Northern Territory. This is clearly the case, but there is no explanation of why this is so. A simple statement that, for example, a rise in unemployment represents a waste of potential output or that the increase in unemployment benefits represents a drain on government finances would have been sufficient for a further mark here. Explanation of the points identified would have allowed an evaluative conclusion to be reached on the economic outlook of the region.

Mark awarded = 2 out of 6

Question 2(a)

Explain the role that a government should fulfil in a mixed economy. [8]

Mark scheme

Explain the role that a government must fulfil in a mixed economy. [8]

A mixed economy is based on private ownership, the profit motive, demand and supply etc. with a role for the government. The role is to provide the environment in which the market can operate successfully. This includes ensuring law and order, national defence, property rights and the provision of public goods and desirable merit goods. It intervenes with taxes, subsidies etc. to influence the behaviour of the private sector and markets and achieve a better allocation of resources.

For a definition of the mixed economy (2 marks)
For an explanation of the role of government in a mixed economy (6 marks)

Example candidate response

A mixed economy is a mixture of planned economy and free market economy. A planned economy is run by the government as it solely makes all the decisions. However, in a free market economy the decisions are taken by the private sector and the market forces, such as demand and supply. There is very little government intervention, such as to maintain law and order. 2

A mixed economy, being a mixture of both the extreme economies, involve two sectors only, private sector and the government. Private sector is free to make decisions but government when want or feel the requirement can intervene and alter the actions of the private sector to an extent only. (2)

In a mixed economy, private sectors make private goods only. They employ the factors of production according to their wants and decide what to make and for whom to make, themselves. However their decision is influenced by market structural forces, also known as the invisible hand, demand and supply. Their aim is to maximise prof

If the private sector is exploiting the consumers and charging a high price, government can intervene and apply price ceiling or if the producers are ~~being~~ exploited then price flooring can be adopted by the government.

Government collects taxes from the private sector and use them to make public goods for the people. The aim of the government is to maximise welfare so it could create job opportunities for the unemployed without putting any pressure on the private sector to employ more workers.

Government can increase awareness of merit goods and demerit goods and offer subsidies to the producers of merit goods to increase their allocation and impose taxes on the demerit goods to decrease their allocation.

The [redacted] government can decide to fix the balance of payments. It has the ability to impose tariffs, place quotas on the imports to improve the balance of payment. The government can also fix the exchange rate for a limited time as it also effects your balance of payments. If there are high imports the government can revalue the currency, making it difficult to import and instead rely on domestic products. On the other hand if the exports are falling then the government can devalue the currency, making your exports cheap and demanded more.

It's the government's job to provide the country with law and order & defence. This will make the private secter secure and will concentrate on their production and will feel free to expand.

Most of times, the actions of private secter are not disturbed by the government and Private sector [redacted] feels free to [redacted] produce what they

want to and how. It's the private |
sector's choice to decide for whom | 8
to produce too. They can give subsidies to |
to help producers & infant industries. | 8
246

Examiner comment

This is a very full answer. The candidate starts by providing a sound explanation of the mixed economy. The answer then goes on to consider a wide range of roles that the government undertakes in a mixed economy. The comment is made that the role of the government is to maximise welfare and various types of government intervention to achieve this are explained. These include price controls, policy concerning demerit and merit goods, the provision of public goods and the need to ensure law and order so that the private sector can operate.

Mark awarded = 8 out of 8

Example candidate response

Section B.

2 a) The mixed economy consists of ~~be~~ the market economy and the Public sector. The government operates in the public sector, the role of the government is to provide taxes and subsidies, nationalise industries when required, operate through a centralised economy?, Provide public goods and prevent market failure through the prevention of ~~≠~~ externalities by using methods such as regulation and taxes. Command Economy

The mixed economy ~~at~~ also consists of the market economy. The price system ~~would~~ determines this economy as it helps to interpret demand and supply and ~~help~~ also act as a rationing method. The Market economy will usually produce Private goods and consists of thousands of firms and millions of households.

So the government has a huge role to play in the command economy of the mixed economy. However the ~~market~~ mixed economy also consists of the market economy which will usually undermine any government policies.

Not fully clear on 'mixed'. 1+4

5
5

Examiner comment

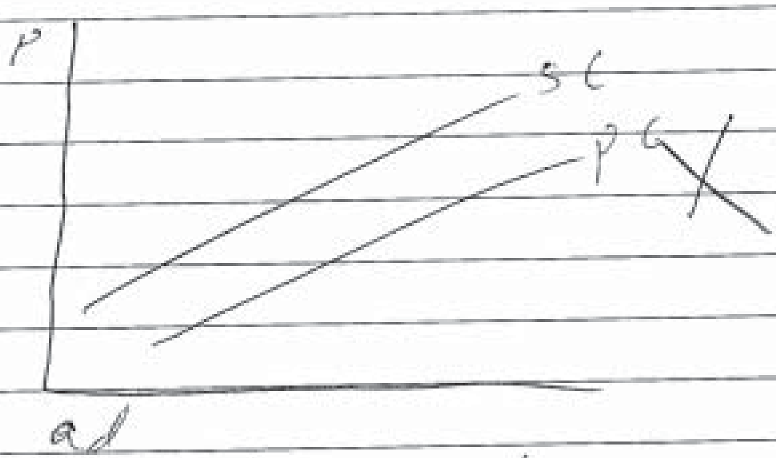
This answer starts with a rather uncertain explanation of the 'mixed economy'. It then continues with a number of reasons for government intervention, which are valid, but left insufficiently explained. The answer ends with a very confused concluding paragraph.

Mark awarded = 5 out of 8

Example candidate response

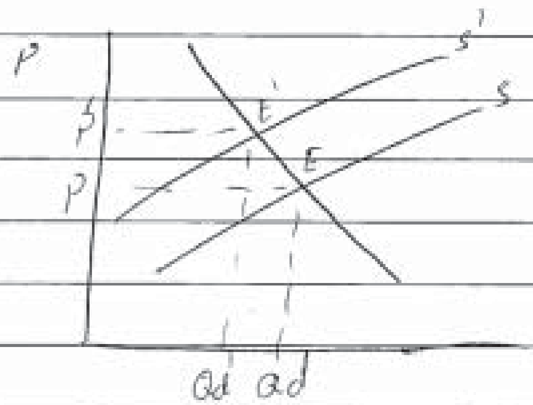
Mixed economy is defined as an economy which is controlled both by private Individuals and by goverment. It is the most realistic type of economy in todays world as relying solely of goverment might make the economy inefficient and private individuals would ignore social cost.

The government should play a vital role in a mixed economy as private individuals just aim at maximizing profits which might mean that they might even provide harmful goods and ignore negative externalities



The above daigram shows negative externalities ~~as socio~~. Negative externalities are the harmful third party effect which might arise from buseiness activity

Government role should be to control the negative externalities and to provide public goods and merit goods which private individuals do not provide as it is not profitable to do so. Government can impose taxes on the goods which create negative externalities



Imposing a tax will make the supply curve shift from ss to ss' and this will raise its price which will discourage people from buying it unless it has inelastic demand

Government can also keep control on Multinationals which might be running a monopoly and exploiting the consumers. The Government can do this by maintaing strict law and order so in my view goverment should keep a check and balance in the economy through taxes and subsidies rather than trying to provide all the goods itself. 4

1+3 4

Examiner comment

This candidate produces quite a weak answer. There is no clear explanation of the meaning of the term 'mixed economy' provided at the start of the essay. The role of the government is considered very briefly and there is a limited range in the reasons for intervention considered. The structure and content of the answer are both limited and a middling mark is the result.

Mark awarded = 4 out of 8

Question 2(b)

Discuss the accuracy of the definition of public and merit goods as 'goods that must be provided by the government'. [12]

Mark scheme

Discuss the accuracy of the definition of public and merit goods as 'goods that must be provided by the government'. [12]

Public goods are non-rival and non-excludable such as street lighting. Merit goods are goods underprovided by the market system. The consumers lack full information of the consequences of non-consumption. This might include healthcare and pension provision. Although the government provides public goods because it is not possible for the market due to free riders, merit goods are supplied to a greater or lesser extent by private providers. The government also provides other goods and services which are neither public nor merit goods. The definition fits public better than merit goods but is inadequate in itself.

For an understanding of public goods and why they are provided by the government (up to 6 marks)
For an understanding of merit goods and why they are provided by the government (up to 6 marks)
(10 marks max.)

Discussion of the accuracy of the definition. (4 marks)

Example candidate response

Public goods are only provided by the government, example being light house, defence, traffic signals and roads. They have the characteristics of non-rivalry and non-excludability. Non-rivalry means that consumption by one individual doesnot reduce the amount available to others. Non-excludability means that no one is excluded from the consumption, not even those who have not paid for it.

Public goods are provided by the government as private sector is not willing to produce it.

As no one is willing to pay for it due to the non-excludability, there is no proper demand registered thus private sector is not interested in making them. Non-excludability and non-rivalry gives birth to the problem of 'free-rider'. Thus the government takes the responsibility of

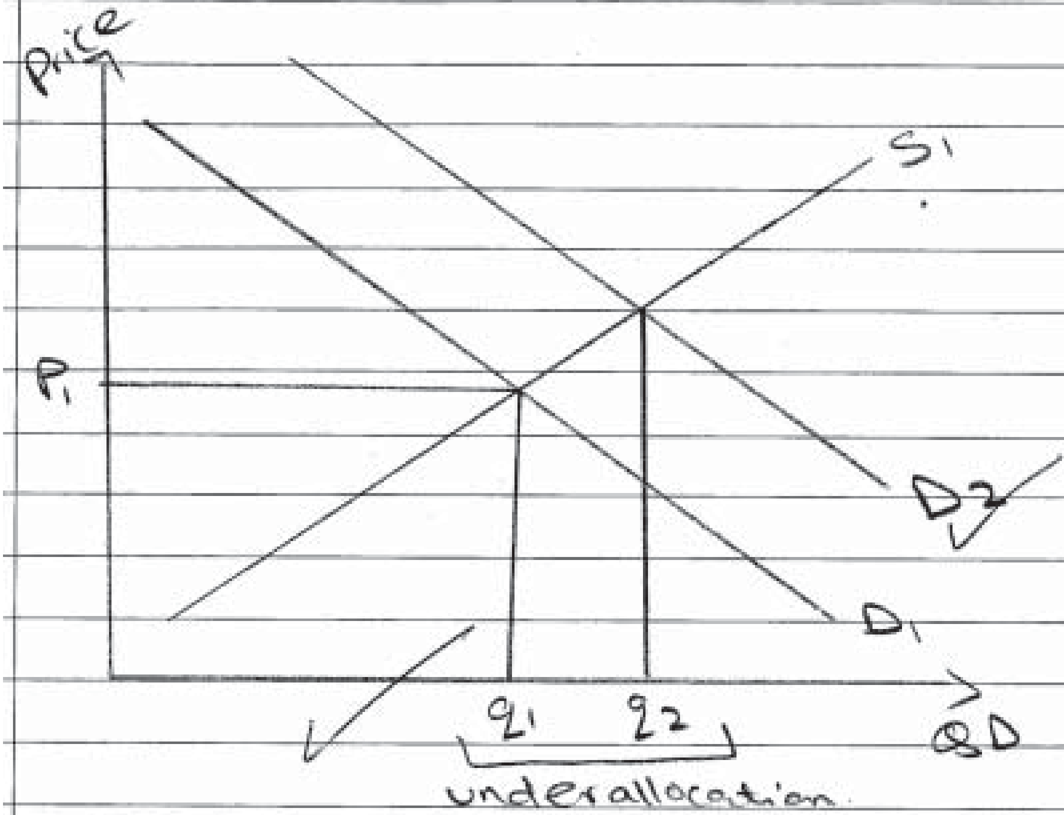
5 0

providing it to the ~~cos~~ people.

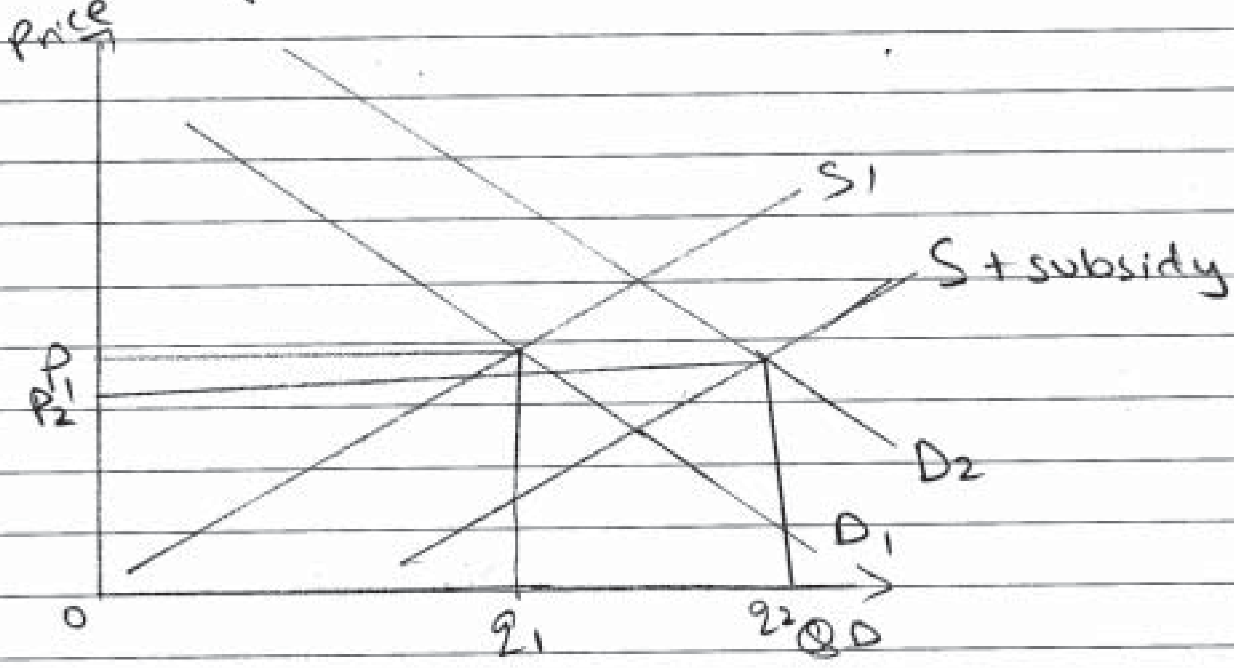
Merit goods are goods which ~~are good for the~~ have more benefits than the consumer realises, thus are demanded less. There are positive externalities associated to them. Examples being, ~~clas~~ education and healthcare.

Merit goods can be provided by the government but even the private sector wills to provide it. This is because there is a proper demand registered to it, people pay for these services and thus profits can be earned. Unlike public goods merit goods do not have non-excludability and non-rivalry associated to them. If a surgeon is operating a person, the same surgeon cannot operate another person at the same time so non-excludability is not associated to them. If medicines are bought by an individual then the quantity ~~..~~ ~~.......~~ available for others is reduced.

What government does is that it increases the awareness and allocation of resources needed to provide merit goods.



Initially the demand of merit goods is represented by 'D' and the supply by 'S'. Now the government thinks that they should be consumed by the individuals more as they are good for them. So the government increases awareness by advertising and the demand curve shifts from D_1 to D_2. This increases the quantity demanded from q_1 to q_2. This tells that before it was underallocation of resources needed to produce this. Another method used to increase the ~~vedo~~ allocation of resources and the product is to provide subsidies to the producer.



Before the demand had risen to D_2 and now after the subsidy the supply curve shifted ~~[illegible]~~ to rightwards. This increased the quantity consumed further and the price also came down. ~~Now~~ of merit goods will be consumed. 12

12

5+6+4 capped max

The government provides the public goods solely and only helps in ~~a~~ increasing the allocation of merit goods. It doesnt produce them solely. 20

Good answer 20

Examiner comment

This is an excellent answer. The features of public and merit goods are each explained in sufficient depth. It is clear that the candidate has a firm grasp of each type of good and can distinguish between them. This allows the candidate to consider whether each 'must' be provided by the government. The view reached on each type of good is clear and this is confirmed in a brief conclusion.

Mark awarded = 12 out of 12

Example candidate response

~~A Pup~~ A Public good has the features of bieng non-excludable, which means once a person has purchased a good other people will also benefit from it and of bieng non rival which means as more people consume the product the benefit provide to those people who consumed purchased the product will not be diminished. A Merit good is defined as something which provides benefit to people e.g education but they do people do not possess the right amount of information of these goods.

The government usually provides public goods such as defence as there are not suffecient resources to produce these goods in a market economy, the features of non-excludability and non rivalry result in the free rider problem which means consumers benefit from those goods that belong to others rather than purchase thier own good. This results in insuffecient scarce resources bieng devoted to a product and results in market failure. The government will establish regulation to help

4 2

prevent Market failure.
Mereit goods such as education usually result from the failure of information. As people are not provided enough ~~in~~ information for the good, this usually results in underproduction of a product which means there will be a decrease ~~and~~ in demand and reduction in supply. ~~The~~ This will cause a build up of stock and eventually cause the Market to fail. The government will usually provide subsidies to increase production and prevent Market Failure.
So Government intervention in Public and merit goods ~~in~~ is necessary as it helps prevents Market failure and improves the economy.

4+4+1

Reasonable und with a ref to Q in last para albeit 'hedging bets'.

9

9

14

Examiner comment

This answer contains evidence of an understanding of the main features of public and merit goods and gains marks for this. It would have been awarded further marks if the question had been answered more convincingly. A crucial point has been missed. This is that the government 'must' provide public goods because the free rider problem, which is mentioned by the candidate, means that private firms cannot charge a price and as a result cannot make profits from their provision. A more assured explanation of this point would have meant that the candidate would have provided a much more convincing answer to the question set.

Mark awarded = 9 out of 12

Example candidate response

Merit Public
~~Public~~ goods are basically those goods which have main two qualities in it. It should be non-excludable which means ~~it~~, the person benefiting from it does not have the full awareness of the benefits ~~go~~ provided to them, secondly the good should be non-rivalry - means that the type of good which is being provided could not be provided by any other organisation. e.g. street lights or infrastructure.
On the other hand merit goods are those goods which are

Write only the number of the question in this margin

Leave this margin blank

4

20

* These types of goods have positive externalities.

excludable - means the person paying for the good can exclude others and get benefit alone and there are competition in the market. For example education as the person paying for the good is only benefiting from it.*

But there is another part which are de-merit goods. These goods are also ~~excludable~~ and there is competition available. For example smoking ~~of~~ ciggerettes. As the person paying for the pack is able to benefit but in this type of goods there are negative externalities means which have bad effects on the society or the person in long-term.

NAQ

Above diagram (a) represents the supply ~~availibility~~ of merit goods but because of the lack of awareness population is not attracted towards it and government resources are getting wasted because they are not utilised fully. ~~Diagra~~

Diagram (b) represents de-merit goods of which supply is constant but demand is getting higher day by day.

Next comes the "goods that must be provided by the government" the authority of providing certain types of goods like "defense", "infrastructure" and "education" must be provided by government. As the decisions made ~~in~~ for the defense should not get into private hands because of national security. On the other hand infrastructure should be provided by government because the public as a whole is benefiting from it as the standard of living is improved which automatically increase the Gross Domestic Product (GDP) of the country. Than there is the education which must be provided by government because this which benefit the economy as there will be more awared and educated people. therefore the literacy rate of the country will rise. there will be more opportunities for jobs and less crimes and people would have the standard livings. this will also raise the reputation of the country as there would be litered population which could represent the country in abroad.

not relat to public goods.

2+0+0

Little of relevance to the Qu.

2

2

4

9

Examiner comment

This is a very poor answer that displays a complete lack of understanding, together with very poor exam technique. The candidate starts by stating that public goods are non-excludable and non-rival. This is correct, but it is clear from the explanation provided of each feature that the candidate has tried to learn these terms rather than understand them. This lack of understanding continues in the candidate's explanation of merit goods. It is correctly stated that these goods are excludable and that they have positive externalities, but these features are not explained sufficiently, nor are they used to answer the question about government provision. The answer then drifts into irrelevance with an explanation of demerit goods and some quite general comments on the benefits of for example education.

Mark awarded = 2 out of 12

Question 3(a)

Using economic analysis, explain the possible causes of the increase in the sales of electronic goods, such as mp3 players, in recent years. [8]

Mark scheme

Using economic analysis, explain the possible causes of the increase in the sales of electronic goods such as mp3 players in recent years. [8]

Influences have come from both the demand and supply side. Rising incomes, advertising, changing fashion and tastes have increased demand. Innovation, the introduction of new and improved products and the lowering of costs have increased supply. The fall in the price of the goods has resulted in an extension of demand. More are being sold at lower prices.

Understanding the significance of demand and supply	2 marks
Explanation of demand and/or supply changes (up to 3 marks for each factor explained)	6 marks

Example candidate response

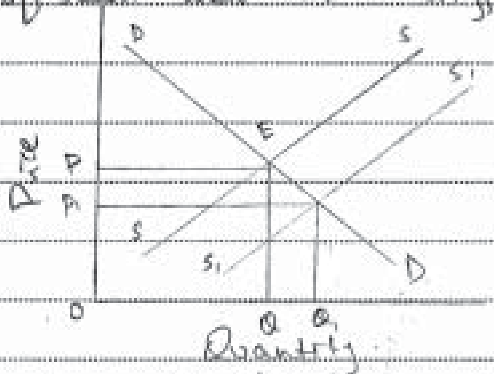
= 13

Q3) a)

Ans- There has been a massive hype in the production and sales of electronic devices such as phones, mp3 players, IPods etc. There are innumerable reasons for this boom in the electronics industry.

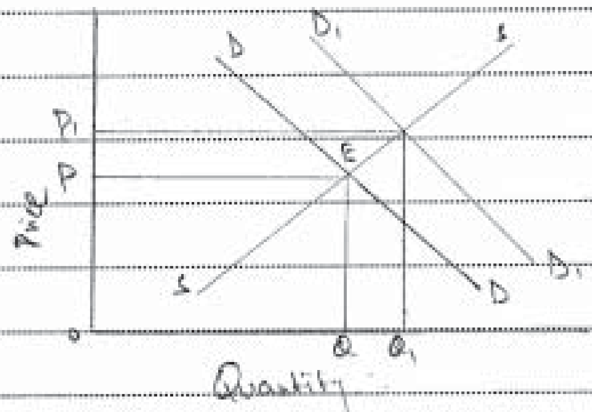
Firstly, it is the taste and trends of consumers that have changed. Earlier tape recorders and CD players used to serve the purpose of mp3 players but as these are more durable, of better quality, portable and have a much larger storage capacity these have risen in production to meet the demand of the consumers. In this modern era people prefer quality and capacity the most which the mp3 players provide.

The increase in the amount of capital intensive production methods is the reason for the possibility of the production and another reason for this increase in the sales of such devices. With growing technology goods can be produced which are much more cheaper, portable and of a very high quality. Firms take advantage of economies of scale such as marketing, financial etc which enables them to produce goods at low prices.



The graph shows that the equilibrium is at E with price 'P' and quantity Q. With the introduction of technology ... duction decreases shifting the supply curve from SS to S_1S_1 lowering the price and causing the consumer to Demand more at Price P_1 with quantity Q_1.

~~Mp3 players~~ Their substitutes play an important role in this type. The substitutes for Mp3 players are devices such as IPods, IPhones, mp4 players etc which are significantly cheaper. Everyone listens to music. With the tape recorder outdated, people tend to use these digital devices which are cheaper than their substitutes. An mp3 player costs around Rs. 1,500 – 2,000 while an expensive IPod costs around Rs. 8,000 – 10,000, over 5 times the price!



The graph shows that the rising prices of ~~3~~ substitutes cause a rise in demand for mp3 players with original Price at P and Quantity at Q the quantity rose to Q_1 causing the price to move to P_1.

Another reason for this could be the increased spending by the people and the increase in aggregate demand. As people have more money their demands for luxuries ~~have~~ rises by a margin thus causing situations that this.

These are the major reasons for rise in sales of mp3 players. As people demand more to satisfy their wants the suppliers supply more to make large amount of profits.

8/

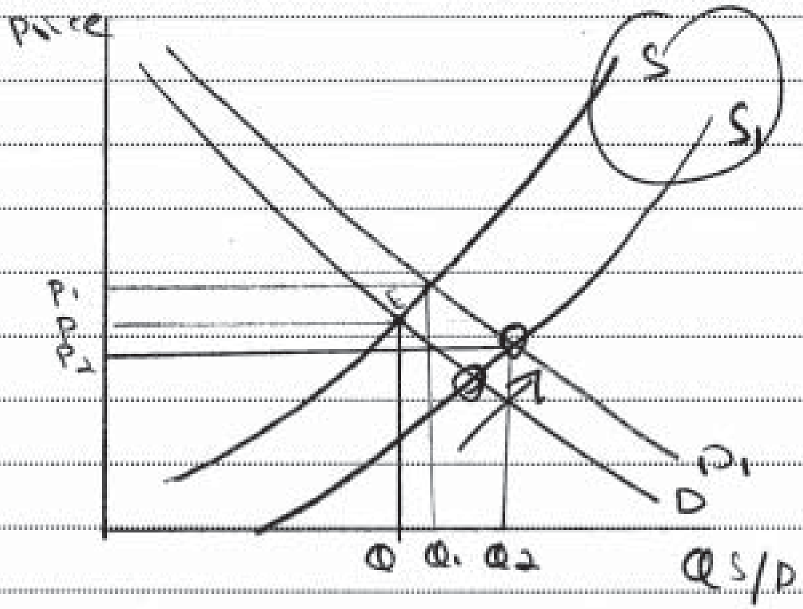
Examiner comment

This is a very good answer that displays a good grasp of the required supply and demand concepts allowing a very successful analysis of the possible causes of the increase in sales of electronic goods. Diagrams are accurate and the examples provided of a possible increase in demand and increase in supply of these products are valid and appropriate.

Mark awarded = 8 out of 8

Example candidate response

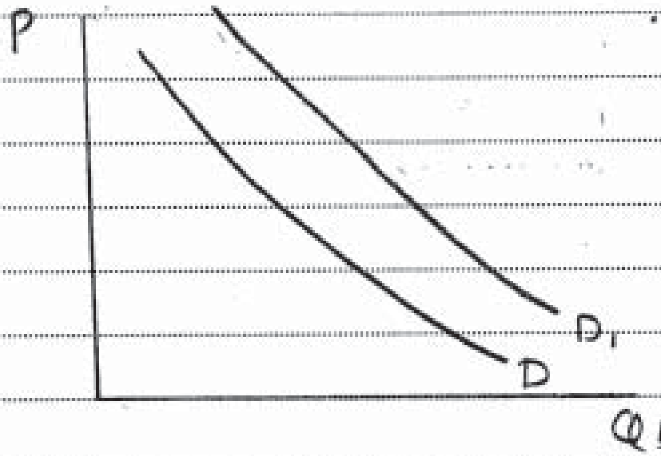
The ~~demand~~ Demand for the electronic goods have caused its sales to rise. The demand of such goods might have ~~been~~ increased because of competition, the competition between the firm led to an decrease ↑S ~~in~~ prices of such goods. The increase in competition might have caused because of increase in demand, as Demand curve shift, the prices of the electronic goods rise, which invited new firms to enter in the market ~~and~~ which eventually increased the Supply of such goods.



Initially, the eqb was at point E, then an increase in demand caused demand curve to shift, which increase the price to P1 and increased Q to Q1. Because of higher prices, new firm entered into the market and caused supply to shift to S1 and eqb qty to Q2 and price to P2.

The increase in ~~demand~~ Supply might have caused because of decrease in cost of production. The electronics goods are designed in countries like UK ~~and other~~ ~~developed countries~~ ... for Assembling

in China because of cheap labour. The decrease in cost of production might ~~have~~ have caused prices to fall which led to an increase in demand.
The increase in the sales might also have caused because of increase in ~~Marketing~~ Advertising. The persuasive advertising shift the demand curve rightwards.



In recent years, the consumers preferences and tastes have changed. They are diverted more towards luxuries. So ~~an~~ a change in preference might also have caused demand to shift.
The increase in sales ~~was to be~~ might also have led because of an increase in the ~~co~~ incomes of consumers.
The scale of preference of consumers might have changed, which means that the things which were ~~kno~~ called luxuries before ~~migh~~ might now be necessities for consumers now. 6

6

needs application to be clearer
2+2+2

Examiner comment

This answer contains some quite valid comment on the possible reasons for the increase in sales of electronic goods. Supply and demand curves are outlined and there are suggested reasons offered for shifts in both the demand curve and the supply curves. Some of the explanation provided is incorrect however and fails to score as highly as it could.

Mark awarded = 6 out of 8

Example candidate response

). Products are divided into two groups inelastic and Elastic products. Products like Electronic such as MP3 Player are Elastic Products.

Increase in the ~~elasticity~~ Sales of Electronic goods can be due to change in Price and Income in Price.

Price Elasticity of Demand measures the degree of responsiveness of quantity demanded towards a change in Price - Percentage change in quantity demanded / Percentage change in Price

NAQ

~~Price~~

Price	Electronic goods demanded
10	100
8	150

A change in Price of electronic good will increase its sales revenue because ~~will dem~~ demand increases if prices are reduce. In Elastic products such situation will occur.

AS

Other factor for increase in sales revenue will be high incomes because consumer spending Power will increase and they will demand for luxury.

Income Elasticity of demand measures the degree of responsiveness towards of quantity demanded towards a change in income of consumers.

Percentage change in Quantity demanded / " " " Price

When income increases consumer will move towards
luxury products. Income of consumer had been increase
so they want to enjoy the luxury of electronic goods
this increases the sales revenue for such products.
Advertising can be another factor ~~which~~ which
made desire in consumer to buy the product.
Sales revenue will increase in the situation 2
when demand increases and ability to buy
in high than revenue of such products will 2
increase.
0+2

Examiner comment

This is a weak answer. It is poorly focused and contains irrelevant material. The candidate seems aware of factors that affect sales, such as advertising and the price of the product, but there is no development of a supply and demand framework within which the answer can be delivered. As a result the candidate scores for one or two points made in a disorganised framework.

Mark awarded = 2 out of 8

Question 3(b)

Suggest **two** possible reasons why a government might increase the indirect tax on such goods and discuss, in light of these reasons, the likely effectiveness of such a policy. [12]

Mark scheme

Suggest two possible reasons why a government might increase the indirect tax on such goods and discuss, in the light of these reasons, the likely effectiveness of such a policy. [12]

Possible reasons include raising revenue to finance government expenditure, cutting the purchase of imports to help the balance of trade. It might be argued that the products are demerit goods because of the harm to hearing and disturbance to others. An indirect tax is imposed on spending and raises the price of the good. PED measures the responsiveness of demand to a change in price and affects the impact of an increase in an indirect tax. A tax will best reduce the quantity imported when demand for imports is elastic as there will be a more than proportionate fall in demand. To raise revenue it is better for demand to be inelastic so that the fall in demand is less than proportionate to the price rise. The effectiveness of internalising the negative externality will depend upon setting the tax at the appropriate rate.

For a definition of indirect tax (1 mark)

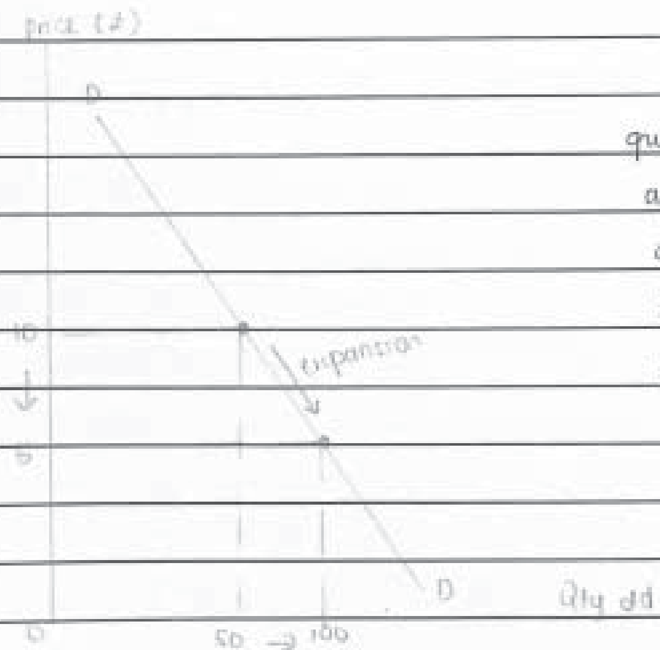
For an explanation of one reason for an indirect tax and a discussion of 'effectiveness' (up to 6 marks with 4 max. if only one element is considered)

For an explanation of a second reason for an indirect tax and a discussion of 'effectiveness' (up to 6 marks with 4 max. if onl

Example candidate response

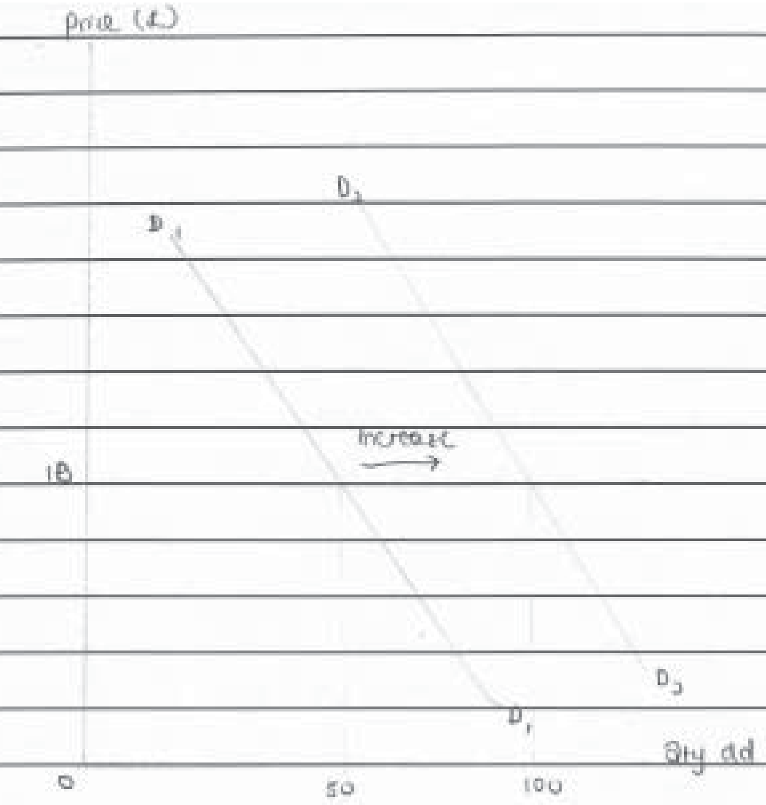
3. The ~~causes~~ market trend of goods and services may ~~show~~ have shown rapid changes ~~depending~~ influenced by several factors. The market interact by the forces of the demand and supply ✓ in the market. Demand is defined as the quantity demanded of a product that consumers are willing and able to buy at various prices per period of time, ceteris paribus. Electronic goods have seen a change in trend of demand where 50 years back, electronic devices are seen as luxury goods and recently, electronic devices are considered as one of the preference normal necessity goods especially among the young generations. ✓ ✓ I

There are several factors that causes ~~affect~~ the increase ~~change~~ in ~~demand~~ sales of electronic goods. According to ~~th~~ normal law of demand, the quantity demanded will rise as price fall. ~~Demo~~ This is shown by an expansion along the same demand curve and it is solely affected by the fall in price ✓ However, there are other factors that may affect demand. When electronic device are concerned, the major factors that causes this increase may be the ~~technology~~ ~~and~~ change in consumer's taste ~~tas~~ in favour of electronic devices. The other reason that contributes may also be ~~a~~ influence from the advertisement ✓ by the media. This factors causes a ~~sh~~ parallel rightward shift in demand curve. I I



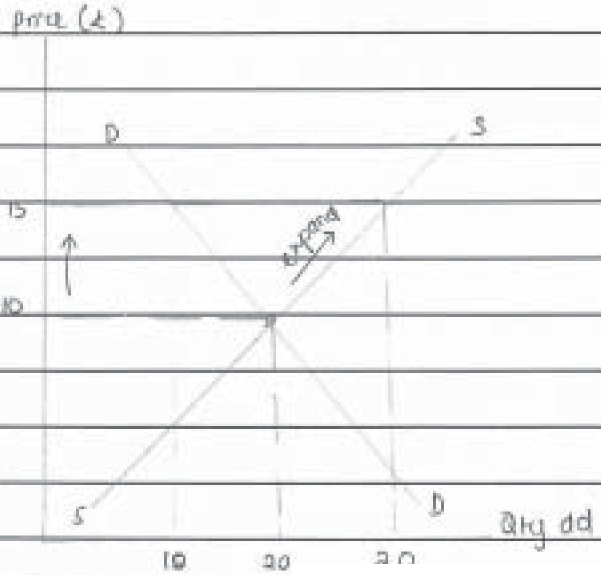
The ~~ex~~ expansion of ~~demand~~ quantity demanded ~~may~~ also affected by the price elasticity of demand. The more elastic it is the, more significant change may be observed as price fall. ✓ I

[Turn Over



The shift in demand curve as shown by the graph is not effected by the price. But other factors such as ~~trend~~, ~~consumer~~ price of other goods (substitute and complement), festivals and others.

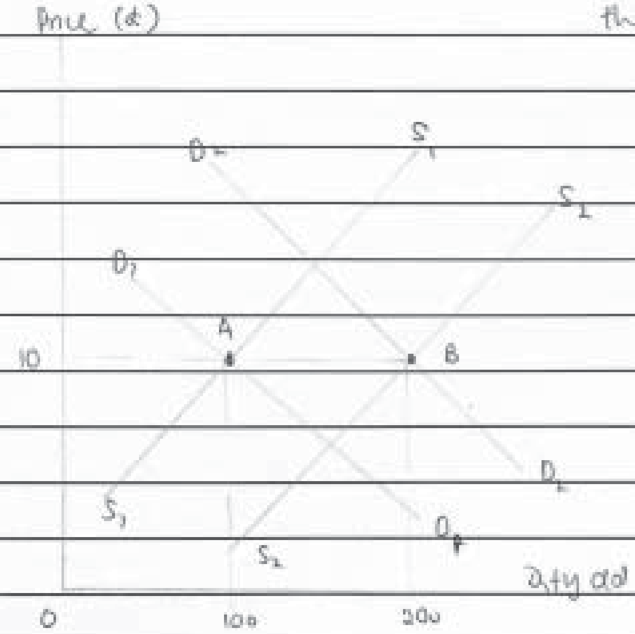
Analysing the supply side of the electronic devices, the increase in supply in the market by be significant by the increase in price. Price has fallen! This is seen by the expansion of supply curve as ~~demand~~ price ~~expands~~ rises. This is because a rise in price may be a form of incentive for producer to produce more.



As price rise supply expands despite there is a fall in demand.

[Turn

Supply too may shift leftwards due to other reasons other than price. There may be ~~an~~ a development in technology that occur in the electronic device market for instance, that causes supply to shift right. Supply defined as the quantity ~~~~ of a good that producers are willing and able to supply at various prices per period of time, ceteris paribus.



At point A, the initial equilibrium of the demand and supply which may be 50 years back when technology was not well developed. But as technology ~~changes~~ andvanced and the the consumer preferences favour the electronic devices, there is an increase in both demand and supply. Thus, a new equilibrium formed at point B. ✓✓ S+D 2

Despite the shift in ~~bothe~~ both curves, the price remain unchanged as it is proven there are other contributing factors other than price that effect the sales of electronic goods. This may be due to change in technology mainly and the change in consumers taste. Advertisement also contributed in this ~~broto~~ drastic evolution. Another factor from the supply side ~~and~~ that affect the demand is the business strategy and management. For example, the new CEO of Apple corporation, Steve Jobbs, had managed to boost the sales of Apple product ~~$~~ a few times more than previous years.

Government policy to encourage the usage of technology also contributed to ... ales of electronic goods. As the usage of information technology is encouraged in ~~students~~ education and globalisation, government may subsidise the devices for schools and offices, which increases sales of the device. ✓ 1

2 + 6 (Max) 8

2+6 8

Examiner comment

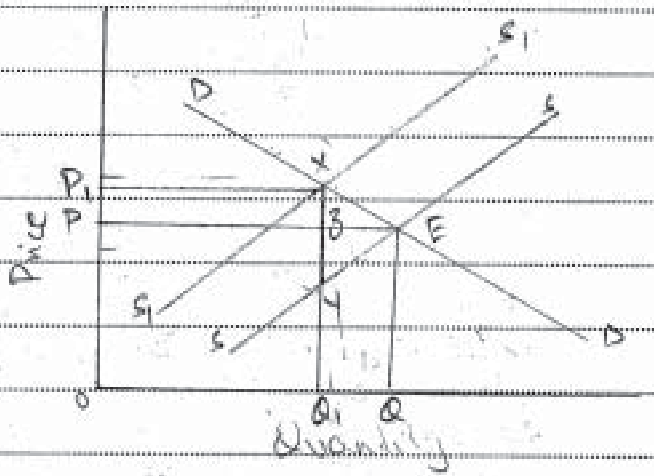
This candidate clearly identifies two reasons for the imposition of an indirect tax. Each is explained clearly. Although the second reason identified has the effectiveness of the tax examined, the first reason does not consider this aspect of the question. The question clearly states that effectiveness should be considered, so marks are lost and the mark awarded less than it could have been.

Mark awarded = 8 out of 12

Example candidate response

Ans:- There are a number of reasons why a government may use protectionism such as high tariffs, quotas or increase the amount of indirect taxes.

Demand pull inflation is a major reason. It is defined as the rise in demand for goods which causes the prices ~~#~~ to inflate, that is to say, too much money chasing too few goods. With a large amount of money in the hands of people their demand for luxuries tends to increase. This hype in the buying of unnecessary items causes the prices to rise thus resulting in inflation. With the introduction of a ~~taxes~~ tax the prices of such goods increase. The increment in the cost of production causes the producers to reduce their supply that causes a rise in prize thus lowering their quantity demand. In addition to this, luxuries ~~have~~ an elastic demand. So, if the price rises the quantity demand decreases The people who still continue to buy such expensive luxuries pay large sums of tax to the government which adds to their revenue which can be spent on economical development.

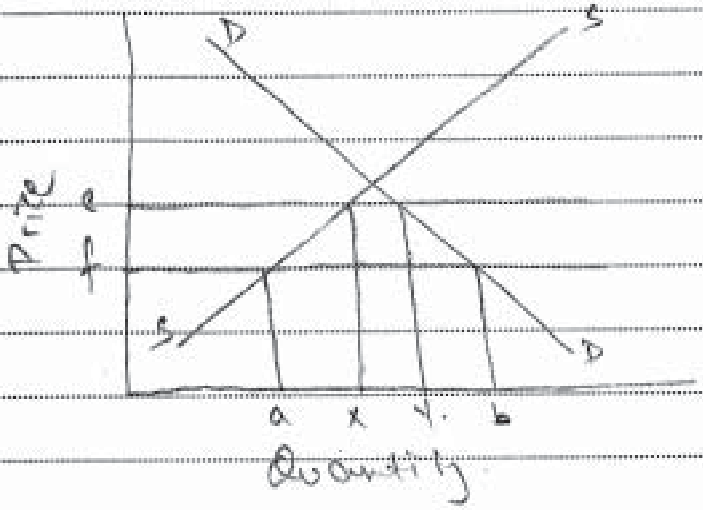


The graph shows the original ~~quantity demand~~ equilibrium at E with price P and quantity Q. As a tax of XY is imposed the price rises to P_1 reducing the quantity demanded to Q_1. As the demand is ~~x~~elastic most of the tax (XY) is borne by the ~~consumer~~ producer. XZ is by the consumer and ZY by the producer.

~~A balance of pay~~

A trade account deficit is another major reason. The trade account comprises of all the visible and invisible ~~the~~ imports and exports of a country. As ~~ff~~ the goods ~~ar~~ produced in foreign countries are cheaper and of a better quality people tend to ~~buy~~ import the goods rather than consuming the local production. The increase in unnecessary imports may causes a balance of trade deficits leading to a balance of payment deficit thus depleting the countries foreign reserves. This causes depreciati... ...ountry's currency

~~the~~ currency leading to unemployement, inflation etc. Hence, by taxes the prices rise causing the demand for goods to decrease. Those who still consume pay taxes to the government increasing their revenue, making economic development possible.



The graph shows the imports ~~and exports~~ getting affected. The gap between demand and supply is filled through imports. With a tax of ef the demand for imports falls to xy. This is due to rising prices.

Hence the imposition of taxes will cause a major effect to the economy. It will benefit it, making the economy prosperous.

1 + 1 + 3 = 5

Examiner comment

Candidates were asked to identify two possible reasons for the imposition of an indirect tax. This candidate is unclear on the possible reasons. The reference to demand-pull inflation is confused. There seems to be a recognition that indirect taxes can raise revenue, but this is not developed. Similarly, the explanation of a trade account deficit is not fully clear. In terms of effectiveness, it is correct to refer to the price elasticity of the taxed profit, but this candidate does not apply the concept successfully. The answer also fails to define or explain, ‘indirect tax’.

Mark awarded = 5 out of 12

Example candidate response

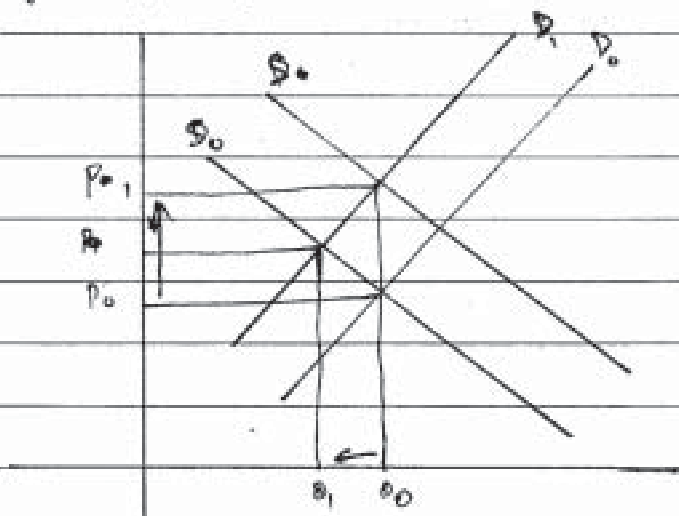
The Government might increase indirect taxes due to following reasons

(i) ~~To~~ In order to decrease the ~~mo~~ demand of ~~M~~ such goods

Reason?

(ii) In order to prevent itself from budget deficit.

By increasing the indirect tax on firms producing such goods. firms may pass this tax to the customer and may charge high prices and hence it will reduce demand ; however it also depends on the elasticity of demand of that particular good if the good has elastic demand a small increase in price will lead to a large decrease in quantity demanded and if the product has inelastic demand a large ~~in~~ increase in price will lead to a small increase in quantity demanded. the Likely effectiveness of such a policy can be increasing investment as fewer amount of money will be spend on luxury items or this may ~~t~~ increase the saving depending on the interest rate.



less quantity will be demanded on high prices and less will be supplied on high prices

The increase in indirect tax may result the individual with the higher disposable income at the end of month ?
As fewer amount of money will be spent on luxury items and this may lead to better standard of living
By increase the tax it also provides more equal ~~dis~~ distribution of income

The govt may increas indirect taxes in order to ~~achieve~~ prevent it self from budget deficit / revenue
By increasing the ~~do~~ taxes it will limit the wants of consumer and this will redure the aggregate demand of consumers which means imports are less and exports will be high. ~~as well as budget~~ and this will result in budget sorplus
however in a long rung currency of the country may depriciate. Because continuous budget suplus will make the ~~exports~~ imports ~~expensive for oth~~ exports expensive and imports will be less ~~ep~~ expensive which will result in depriciation of currency 3

0+2+1 3

Lacks real engagement. 4

4

Examiner comment

This candidate identifies two valid reasons for an increase of an indirect tax, although one reason is not expressed very well. The supporting analysis is confused however and fails to answer the question set. The diagram is incorrect and there is considerable irrelevance. This suggests that the candidate lacked the necessary knowledge and understanding to attempt this question.

Mark awarded = 3 out of 12

Question 4(a)

Explain why the successful operation of the division of labour depends upon the use of money. [8]

Mark scheme

Explain why the successful operation of division of labour depends upon the use of money. [8]

Division of labour involves dividing the production process into a series of stages. This leads to more specialised outputs which are not necessarily final products. Trading these in a barter system would be difficult, inefficient and probably impossible. Money, anything that is generally acceptable as a means of payment, can act as a medium of exchange and a unit of account, so enabling trade to take place and making division of labour effective.

Understanding of division of labour and money	4 marks (one only 3 max.)
Explanation of the link between the functions of money and trade	4 marks

Example candidate response

Modern day production is based upon the principle of division of labor. Division of labor is a process which is accompanied by specialisation where the workers do that tasks they are good at. This is time saving and efficient. The division of labor has been further promoted by the use of money as a medium of exchange.

In old times when the concept of money was not introduced, people used to rely on barter system to carry out their daily transactions. A farmer would take his sack of wheat and go into the market to buy some tools in return. Barter was tedious and time consuming and depended upon the double coincidence of wants. It discouraged division of labor and specialisation because people only exchanged complete goods eg: A worker who specialised at making wheels couldn't exchage them for a sack of wheat, he could only get wheat if he had a whole cart not just the wheels. Thus barter discouraged division of labor.

With the advent of the use of money as

the medium of exhange the concept of division of labor became more common. A chair manufacturer who used to make 5 chairs a day now made 20 chairs a day by employing division of labor. Workers can now do the tasks they are best at and get paid for them.

Successful operation of division of labor depends upon the use of money because money makes the process of economic transactions smooth by eliminating the double coincidence of wants. The employer does not have to pay his workers different commodities eg: If division of labor was in barter then the employer would have to reward one worker with wheat, the other with rice and so on. Whereas, now with the general acceptability of money workers can be paid simply in money because it is now a medium of exchange and a unit of account and they can buy the commodities they desire what that wage they earned.

Also the use of money as a measure of money has allowed employers to effectively measure the productivity of labor in monetary terms, whereas in barter this was not possible

To get an accurate quantitative/measure of a labors work.

Thus money is essential in the successful operation of division of labor. 4+4

8

8

Examiner comment

This candidate explains both the division of labour and money as a medium of exchange. The answer goes on to explain how money facilitated exchange through the removal of barter and the necessity of a double coincidence of wants. This encouraged growth and the division of labour. Each concept together with the link between them is explained ensuring full marks.

Mark awarded = 8 out of 8

Example candidate response

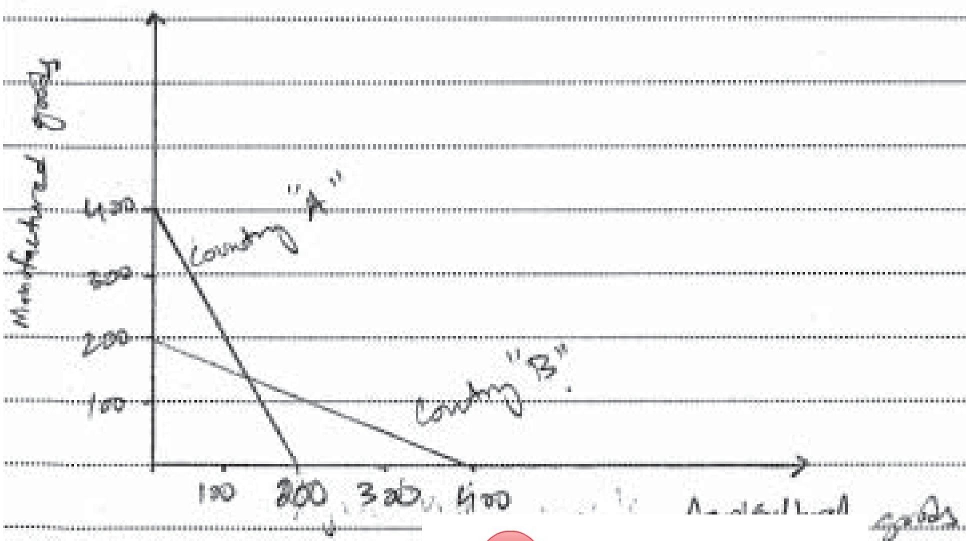
Q4)
(a)

= (17)

Answer) The use of money has a significant impact on the successful operation of an economy. Money is a medium of exchange, a method of account and a store of value. Within the economy and in the international sector, the exchange of goods and services takes place using money. Labour is a factor of production and is very vital for production in an economy. All economies benefit from the factor endowment and the amount of resources they have for production of goods. This benefit that the economies derive can be maximized if resources are used in a way they are best suited for and this leads to specialization.

Division of labour is a part of specialization process to increase the productivity and thus the benefits derived from it. This also contributes to an efficient use of resources present in an economy, as less resources are now wasted. Specialization has benefits both domestic and international. When looking from the domestic point of view, the production process increases and so does the productivity when labour is specialized. Productivity refers to the output per worker per given resources per time. For a manufacturing industry for example, if all workers work together at all stages, the process would take much ~~longer~~ longer time compared to each worker doing his designated task. Division of labour also leads to labour efficiency. An old saying states that too many cooks spoil the broth. Same is the case here, if all of the work force works at each stage together, problems arise and this may effect the quality if not the quantity of the product produced.

For the International sector, the concept of division of labour and specialization is rather a vast one. This takes into account the whole country specializing to produce goods that the resources of the country are best suited for. This increases the benefits from trade and also the efficiency as less resorces are wasted. This phenomena can be explained using the comparative advantage theory. For two countries with fixed amount of resources, the resorces might be well suited for producing one good in the market but not the other. Take for example manufactured goods and agricultural goods. Since opportunity cost ratios differ between the countries, it will be well suited for both countries to specialize in the production of the best suited good and then trade with each other to maximize the benefits. Comparative advantage is shown on the graph below.



After the production of goods by division of labour, ~~the~~ to maximise the gains, the goods are traded on the international market. For this, the main determinant is money, as it is the medium of exchange. The price of one currency in terms of another currency is refered to as exchange rate. One country purchases the goods of another country in the international market and this exchange of goods continues on a vast level leading to all the countries involved getting the benefits.

Hence it can be seen that successful operation of division of labour or in other words specialisation depends upon the use of money.

5

Examiner comment

This candidate explains in some detail the division of labour and identifies this as an aspect of specialisation. Money is also identified as a medium of exchange. This scores highly. Unfortunately, the candidate scores very few marks for the second part of the mark scheme. There is very little on the link between the use of money and the growth of the division of labour and trade.

Mark awarded = 5 out of 8

Example candidate response

Section B.

4 a). Division of labour means that divide labour into each process of ~~a~~ the production of a good. It will increase the productivity because ~~each worker will~~ of ~~not~~ no wastage of time. And it will increase the quality of the goods. But the workers may ~~fe~~ feel ~~bored~~ boring because ~~of~~ doing the same thing ~~all~~ every day, they might lose motivation. Also, the independency of workers are not strong, if one worker is ~~abe~~ absent, ~~all the process~~ the production line will stop. Workers only have single skill, it will increase the unemployment.

Uses of money means the functions of money. First, medium of exchange, it will be used when the country has the domestic and international trade. Second, store of value, such as saving the money in the bank. Third, measure of value, to evaluate the value of goods and services. The last one is standard of deferred payment.

The successful operation of the ~~division~~ division of labour depends upon the use of money, because one of the ~~dis~~ disadvantages of ~~dis~~ division of labour is that the workers will feel boring, then the company may increase the wage for the worker, ~~who~~ ~~makes~~ that is the workers will have the wage motivation and the the productivity of the company increase. This method depends upon the functions of money (measure of value and something else).

very basic

3

3

Examiner comment

This is a very poor answer that does not go far beyond a very basic grasp of the two central concepts. The candidate gives a very brief definition of the division of labour but there is little accompanying explanation or attempt to illustrate the process through examples. The answer also contains some irrelevant comment on the disadvantages of the division of labour. This is followed by a list of the functions of money. Again this is far too brief. The candidate fails to display any idea of the link between the two concepts.

Mark awarded = 3 out of 8

Question 4(b)

Discuss whether it is the behaviour of producers, consumers or governments that is most likely to cause inflation. [12]

Mark scheme

Discuss whether it is the behaviour of producers, consumers or governments that is most likely to cause inflation. [12]

Inflation is a sustained rise in the general price level and is measured by the CPI or RPI. Each of the groups can contribute to inflation although in different ways. Producers may increase prices to raise profit levels or to respond to higher import prices (cost push); consumers may increase their spending and reduce their saving raising AD (demand pull); governments may increase the money supply (monetary inflation), lower direct taxation and run budget deficits (demand pull) and raise indirect taxation (cost push inflation); they may also manipulate the exchange rate. Candidates can argue for any group although government influence may be most widespread.

For a definition of inflation	1 mark	
For an understanding of different types of inflation	6 marks	(10 marks max.)
Analysis of the influence of different groups	6 marks	
Discussion of the relative impact of the groups	4 marks	

Example candidate response

Inflation is: persistant rise in general price level - Inflation can be of different type
(1) Galloping inflation ~~[illegible]~~ (5% – 10%)
(2) walking inflation ~~[illegible]~~ (10% to 20%)
(3) hyper inflation (In 100's and 1000's)
(4) creeping inflation (1% – 5%)

Inflation cause general price level to rise ~~[illegible]~~ ~~[illegible]~~ which can eventually cause money to lose its value of money. Inflation can be due to behavior of producer (~~demand pull~~ cost push inflation) consumer (~~cost push~~ Demand pull inflation) or government (monetary inflation)
~~Inflation ~~

Demand pull inflation is when Aggregate demand in economy rises due to increase consumer spending, increased ~~sp~~ government spending on Merit good, low interest rate resulting in capital investments, all these will result in increase in aggregated demand in an economy, too much export earning and little import payment. technological growth resulting in more production

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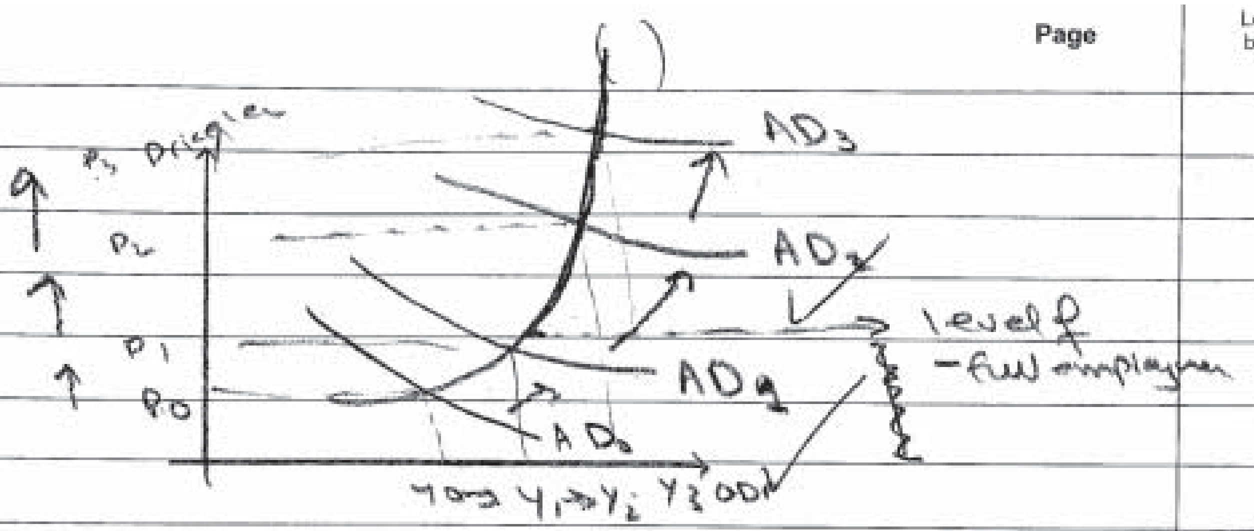
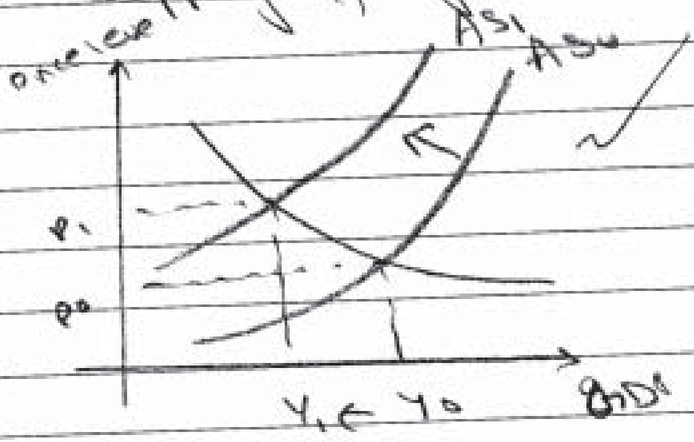


Increase in aggregate demand will result in increase in price level along with increase in National income however this is only possible uptill point of full employment after which increase in Aggregate demand will increase price level ~~P_2 P_3~~ but not National income. Demand pull inflation is due ~~to~~ pattern of spending of ~~p~~ cosumers.

Cost push inflation is ~~[illegible]~~ initiated by rising ~~price~~ cost and sustained by rising price of goods – Cost push inflation can be caused by

(1) Increase in price of raw material (expensive cost of production)
(2) Increase in wage rate (trade union)
(3) Increase in price of imported raw material caused by increase in prices in other countries
(4) Govt increased ~~do~~ indirect taxes.

These will result in increased cost of production and decrease in profit margin for producer who will cut back on the ~~the~~ production and supply of goods.



decrease in supply has caused rise in price level and fall in National income and employment rate.
when inflation and unemployment coexist they are called stagflation.
This type of inflation is caused by production patterns of producer.

Monetary inflation, monetarist believe that inflation is only caused when government allows too much money supply in an economy.
According to ~~the~~ theory of Mon

$MV = PT$

M = supply of money
V = velocity of money circulation
P = Price level
~~T =~~

Monetarist believe that rate at which money changes hands is fairly constant hence

M ∝ P

~~M∝~~ Price level(P) is directly proportional to supply of money that the govt allows. Increase in supply of money will result in increased spending, aggregated demand rise, increased aggregate demand will cause prices to rise and eventually causing cost push inflation

~~then~~ ~~therefore (if case 2)~~ Hence they claim that ~~it~~ only reason of inflation is money supply in an economy.

In conclusion, I would say that inflation is caused by different behavior ~~purchases~~ of all three, producers, consumers and government, different patterns of sale and purchase and government policy interact to cause general price level to rise in an economy.

1+6+3+1

12

11

20

~~19~~

Examiner comment

This answer provides a good definition of inflation which gains credit. There is also a strong analytical framework based upon demand-pull, cost-push and monetary explanations of inflation. These gain full marks as per the mark scheme. There is also an analysis provided of the relative influence of consumers, producers and the government linked to these explanations. The candidate also concludes that it is the interaction of all three agents that causes inflation. This is an acceptable conclusion at this level.

Mark awarded = 12 out of 12

Example candidate response

b) Inflation means the continuous increase in the price levels of goods and services in the economy over time. There're three causes of inflation: demand pull inflation, cost push inflation, and money supply inflation.

WS Demand pull inflation is when the total demand of goods and services increase a lot, the prices of goods and services increase and then, it cause the demand pull inflation. It is the behaviours of consumer to cause inflation. The inflation will cause the cost of living increase and the living standard decrease of people. Also, the unemployment will increase. The government will using laws such as indirect ~~gooc~~ taxes on goods, especially the goods will inelastic demand and elastic supply, then

~~people~~ people will pay more tax and the consumption will decrease, and the demand of goods and services will decrease.

Cost push inflation is when the cost of production of a good or service is very high, ~~then~~ the producers will increase the price to gain more profit. Then it will cause the cost push inflation. It is the behaviour of producers to cause the inflation. The ~~inflation will~~ high domestic inflation will cause the ~~exports more expensive and~~ imports more cheaper, then people will prefer to buy the imports instead of local produced goods. The local companies may fail. To ~~so~~ solve this situation, the government will give a subsidy to producers to encourage the production. ~~and then the~~ The the cost will decrease and the price will decrease, the inflation will reduce.

Money supply is the government gives money to the consumers to encourage the consumption. It will cause the demand of goods and services increase and the prices increase. Then it will lead to the ~~an~~ inflation. It is the behaviour of the government to cause the inflation. The high domestic inflation will cause the exports less competitive, then the demand for exports decrease and the demand for imports increase, it might lead to a balance of payment deficit for the country. Then the government will take some actions to deal with balance of payment deficit and the inflation. The government may use the expenditure switching policy to reduce the BoP deficit that is ~~switch~~ switch the expenditure on imports to the local ~~produc~~ companies.

7

Overall, I think the ~~behaviour~~ behaviours of ~~produ~~ consumers, producers and governments will ~~all~~ cause the inflation.

1+3+3 lacks focus 10

10

Examiner comment

The candidate starts with a definition of inflation. This gains some credit. The answer then lists and gives a brief explanation of demand-pull, cost-push and monetary explanations of inflation. Each is generally satisfactory, although lacking in depth and reference to economic frameworks. These gain credit, but the main weakness of the answer is the limited focus on the behaviour of producers, consumers and governments. This means that a full discussion of which is most likely to cause inflation is not provided and this leads to the very weak conclusion and a disappointing mark.

Mark awarded = 7 out of 12

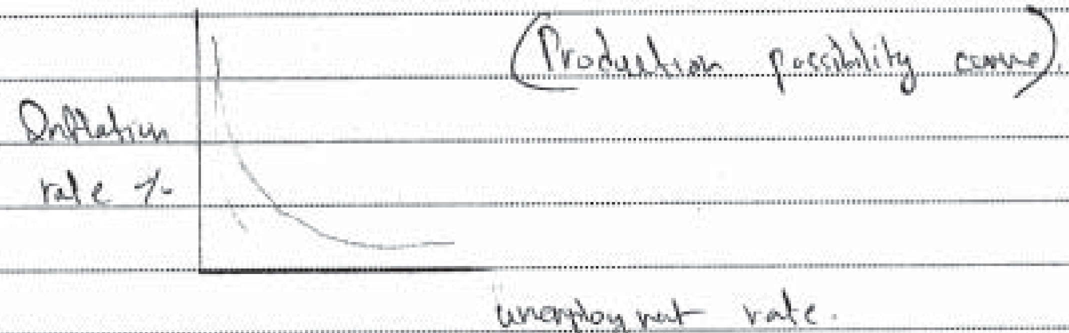
Example candidate response

Inflation is a general and persistent rise in price levels of all goods and services. Inflation can be caused by demand pull inflation, cost push inflation and monetarist view.

Our government, producers and consumers all three in a way contribute to a continuing rate of inflation. Government could remove direct taxes and so people would have an increase in income leading to demand pull inflation. They could allow unrestricted printing of money supplying excess money to people leading to inflation. ~~thus~~ of the monetarist ~~according to~~ view. They could lower interest rates as well

If the government starts encouraging borrowing and lending of money from banks that will increase demand pull inflation. ~~Indirect~~ Indirect taxes could be removed or lowered leading to cost push inflation.

Producers could encourage inflation if they start using capital intensive methods ~~which~~ which will lead to unemployment.



The above diagram is an production possibility curve showing how the rate of inflation and unemployment reacting.

If producers start giving up and stop producing goods in their country this will make ~~companies~~ rely more on imports worsening balance of trade and causing inflation.

Consumers should give more importance to ~~home~~ home produced goods.

~~So~~ therefore from the above possibilities it can be concluded that consumers, producers and government do cause inflation but they are not the only reason. If ~~Inflation~~ ~~value~~ inflation compared to our country increases in countries abroad compared to our own country can be saved from inflation. Expensive cost of raw materials is also a cause to inflation. The value of money ... led.

Producers have to pay high wages to workers when trade unions interfere. Hence leading to inflation again. Producers setting high prices to gain maximum profit could also create inflation. 5

$1+2+1+1$ 5

Touches on a number of relevant ideas but does not develop these.

11 11

Examiner comment

This candidate is aware of how the government might cause inflation, but this is presented as a few isolated points and is not developed within a conceptual framework. Similarly, reference is made to producers and consumers, but without the conceptual framework, the candidate is unable to develop the answer to gain a good mark.

Mark awarded = 5 out of 12

Paper 4

Emerging economies and the way out of a recession

During the recession of 2009 several economists forecast that some emerging (fast developing) economies would perform better than the developed economies. One indicator of this, they said, was the strength of the exchange rate of the currency of some emerging economies against the US dollar. For example, between November 2008 and July 2009, the Brazilian currency rose 11.4% against the dollar and the Indonesian currency rose 10.2%. Another indicator was the forecast growth rate in GDP as shown in Table 1.

Table 1: Forecast growth rate in GDP for selected countries

Forecast Growth Rate in GDP		
	2009 %	2010 %
US	–2.7	+1.4
UK	–3.5	+0.3
Germany	–4.3	+0.3
Japan	–6.5	+0.4
Hong Kong	–5.9	–0.3
China	+6.0	+7.0
Singapore	–7.5	+1.9
Brazil	–1.5	+2.7
Columbia	–1.0	+1.5
India	+5.0	+6.4
Indonesia	–1.3	+0.6

Emerging economies are often dependent on exports to achieve an increase in GDP. Some economists suggested that it would be better for their economic growth if these countries were to concentrate on domestic demand rather than exports.

China, in particular, they said could lead the world out of the recession if it relied increasingly on domestic demand. Indeed, the Chinese government encouraged a shift from export-led industries to programmes aimed at improving the Chinese infrastructure in order to create jobs and thus increase consumption of Chinese goods. Banks were encouraged to make borrowing easier in order to create more credit for consumers and businesses. The government started a massive fiscal stimulus and increased its forecast of GDP to a growth rate of 8.3% in 2009 and 10.9% for 2010 (previous forecast figures were 6.0% and 7.0% as in Table 1).

However, other economists do not accept that there should be an emphasis on domestic demand. They argue that trading links are the strongest evidence of the emerging economies' ability to grow. They state 'no emerging market that adopted an export-led growth model has subsequently needed to break away from it – including China'. China's exports as a percentage of GDP are 32% compared with only 13% for the US. Smaller Asian countries are even more dependent on exports; Singapore's ratio of exports to GDP is 234%, Hong Kong's is 169%. It will be difficult for economies such as these to increase domestic demand and reduce their dependence on export-led growth.

(Source: Financial Times: June 12 2009. *Table source: Economist p105 April 18–24 2009)*

Question 1(a)

Explain what is meant by GDP. [3]

Mark scheme

The Gross Domestic Product (GDP) measures the value of economic activity within a country. Strictly defined, GDP is the sum of the market values, or prices, of all final goods and services produced in an economy during a period of time. [3]
(For stating Gross Domestic Product 1 mark only)

Example candidate response

Q1 a) GDP
- stands for gross domestic product.
- It is the monetary value given to ~~of~~ all the goods and services produced within the geographical limits of a country in one year.
Gross National Product = GDP + net income from abroad
⇒ GDP = GNP − net income from abroad.

3

Examiner comment

This candidate had an understanding of the meaning of GDP, and stated that it was for a given time period and expressed as a monetary value.

Mark awarded = 3 out of 3

Example candidate response

1a) GDP is the total value of goods and services produced by the factors of production in the country. It is said to be the national income of a country. Gross domestic product is the summation of consumption, investments, government spending, and net exports (GDP = C+I+G+(X−M))

2

Examiner comment

This candidate gave an explanation of GDP but omitted to state it was for a given period.

Mark awarded = 2 out of 3

Example candidate response

1a GDP stand for Gross Domestic Product. ~~It determine~~ A ~~high~~ country with high GDP is ussually indicate a rich country, while country with low GDP tend to be poor country. GDP shows the ~~good and~~

Examiner comment

This candidate gave a poor explanation which did not include any reference to monetary value nor to a time period.

Mark awarded = 1 out of 3

Question 1(b)

The article says that banks were encouraged to make borrowing easier.
Explain what this might mean and why the government might have thought this was necessary.
[3]

Mark scheme

It means more available credit, easier to get; or credit at lower interest rates. This would be likely to increase national income by the multiplier process. (A descriptive reference to the process is sufficient; there is no need to use the actual term) [3]

Example candidate response

b) The statement means that the banks would allow individuals & and firms to borrow money more easily by lowering the interest rate. This would allow more credit for consumers and businesses and hence increase domestic consumption and investment. Since consumption and investment are components of the GDP, the GDP would thus increase, indicating economic growth. 3

Examiner comment

This candidate clearly explained the meaning of the phrase and the reason why easier borrowing might be necessary to stimulate economic growth.

Mark awarded = 3 out of 3

Example candidate response

(b) ~~A~~ in a period of recession, the consumption level goes down. More of saving ~~Sharpet~~ is being done. As they are in a period of recession, unemployment is high. So by encouraging borrowing from bank, will lead to investment in the country where employment will increase. When the employment will increase then ~~they~~ there will be more consumption. Thus little by little it will be the way out of recession.

Examiner comment

This candidate attempted to answer the question but the answer did not direct itself explicitly to the phrase which should have been explained. Instead the answer began by describing what happens to consumption in a recession.

Mark awarded = 1 out of 3

Example candidate response

b) In order to create more credit for consumers and business. Thus the government started a massive fiscal stimulus and increased its forecast of GDP to a growth rate of 8.3% in 2009 and 10.9% for 2010 which means with the bank borrowing there had been a marked increase of 2.6% in the GDP.

Examiner comment

This candidate mentioned credit but did not answer the question about what the phrase meant nor why the government might wish to increase credit.

Mark awarded = 0 out of 3

Question 1(c)

Is there enough evidence in the article to support the view that there has been an improvement in the economic situation of emerging economies? [6]

Mark scheme

Use the figures for specific exchange rates, and figures for GDP – expect to see examples of emerging/developing countries compared with developed countries. But they are only selected countries, and for only two years and they are projections not actual figures. Exchange rate figures may mean exports become more difficult to sell. [6]
[Maximum 4 for one side of the argument only]

Example candidate response

c) The table ~~s~~ shows future growth rate in GDP of different countries, in which all the emerging economies have an increase in ~~their~~ GDP. Also the article says that the exchange rates of emerging economies increased with respect to $US.

However, increase in GDP doesnot show that the economic situation has become better. Due to

- population : a greater rise in population than GDP means that economic situation is worsening.
- inflation : Rise in GDP may have caused demand pull inflation or the rate of inflation is high.
- Quality of life : increase in GDP doesnot tell us about the quality of life.
- Unemployment may have increased ~~due to rise~~

So, there is ~~evidence~~ not sufficient evidence to support the view that there has been an improvement in economic situation of developing economies.

C4

Examiner comment

This candidate used the information in the article to illustrate an improvement in the economic situation of the countries but also suggested reasons why this information was not sufficient to draw a definitive conclusion.

Mark awarded = 4 out of 6

Example candidate response

No, there is not enough evidence. It is stated that emerging economies are often dependent on exports to achieve an increase in GDP, but no exact evidence ~~amount~~ is given. Besides, exchange rate ~~for~~ of the currency for other emerging economies against the US dollar is not given, only ~~the~~ figures of Brazil and Indonesian currency given, the indicator was not enough to show an improvement.

2

Examiner comment

This candidate mentioned that emerging countries are often dependent on export-led growth and did suggest that the information about this was not sufficient to indicate whether there had been an improvement in their economic situation. However, there was no mention of other indicators which might prove useful, nor much mention of other information in the article.

Mark awarded = 2 out of 6

Example candidate response

(c) No. There was no evidence shown on the rate of inflation ~~of on~~ in each country. An increase in inflation will lead to an increase in prices of goods and services. Inflation will tend to increase ~~the~~ GDP of a country. A country will high inflation such as Japan will show a faster growth rate in GDP compared to a country with lower inflation rate such as Indonesia. There was also no evidence shown on the balance of payment of each country. Some countries rely on exports for economic growth while some rely on domestic demand. The balance of payment of a country will show the reliability of exports ~~in~~ in order to allow economic growth. There was also insufficient evident ~~to show~~ on the exchange rate. GDP is calculated in the currency of its own country. The value of exchange rate fluctuates from day to day. Therefore, the value of the GDP of each currency in a currency may be inaccurate.

1

Examiner comment

This candidate wrote about the level of inflation and the balance of payments. Although these two indicators might be used to consider whether there was an improvement in the economic situation of a country they were not relevant to the article given in the question which did not contain any statistics for these indicators.

Mark awarded = 1 out of 6

Question 1(d)

Identify the **two** policy approaches suggested by economists in the article and discuss whether there is a conflict between them. [8]

Mark scheme

An increase in domestic demand to encourage growth and export-led growth. 2 marks
Conflict? Different approaches but same aim of growth 2 marks
increase exports improves balance of payments and increases injections and GDP; increase domestic demand will also increase injections and help increase GDP. No conflict. 2 marks
Increase domestic demand may increase incomes and increase imports which may need to be offset by further export growth. A possible conflict. 2 marks
[8]

[A general description of fiscal and monetary policy; 2 maximum]

Example candidate response

d) The first policy approach suggested by economists is growth by increased domestic demand which was utilised in China in order to improve Chinese infrastructure and create jobs, thus increasing the consumption of goods. The second policy suggested is ~~the~~ growth by exports. They state that ~~developed economies~~ emerging economies such as Hong Kong and Singapore have an extremely high ratio of exports to GDP and ~~are~~ ~~heavilly~~ rely heavily on exports to achieve economic growth.

A conflict exists between these two growth-achieving policies. If an economy were to adopt a domestic demand based policy it would have to impose protectionism measures to prevent imports from competing with the sale of domestic goods. This could potentially reduce future international competitiveness of that country if the domestic firms take advantage by hiding behind these measures and not expand. Conversely, a country that relies heavily on exports to grow can face a shortage in the domestic market if ~~exports~~ goods are exported excessively. Furthermore, the revenue generated by these goods depends on the ~~elasticity~~ demand elasticity of the goods.

However, the conflicts between the two policies can be nullified if a government strikes the right balance between the two policies. It is possible to export in large quantities yet be able to provide enough protectionism to allow local industries to expand and become a competitor in the international market in the future. 6

Examiner comment

This candidate identified the two policies mentioned in the article as the need to support an increase in domestic demand or the need to support export-led growth. The answer was then directed to the second part of the question which asked whether there was a conflict between the two aims. Although there was a statement in the last paragraph which refers to a way to lessen any conflict, the answer could have been improved by further comment on the possible similarities between the two policies.

Mark awarded = 6 out of 8

Example candidate response

(d) Two policy are fiscal policy and monetary policy. If ~~contractionary~~ expansionary fiscal policy is used, tax will be reduced but increase in government spending. While ~~contractionary~~ expansionary monetary policy is lower down interest rate and increase in money supply. If countries were to concentrate on domestic demand rather than exports, then expansionary fiscal policy will help to increase domestic demand because a lower tax means people will have more disposable income to spend, thus aggregate demand will be higher. While, countries to concentrate more on trading links, can be increased by expansionary monetary policy, because lower interest rate people will tend to spend more thus, thus aggregate demand higher. An increase in money supply will lead to a drop in exchange rate of currency, export will increase. No conflict between them, since ~~intr~~ reduce in tax and interest rate will help both achieve domestic demand and trading links.

3

Examiner comment

This candidate's main emphasis was to say that the two policies were fiscal and monetary policy rather than that which is in the article which are a decision to concentrate on domestic demand or on export-led growth. However, the answer did try to relate fiscal and monetary policy to domestic demand and export-led growth so there was some relevant material in the answer.

Mark awarded = 3 out of 8

Example candidate response

(d) The policy approaches suggested by economists are expansionary monetary policy and contractionary monetary policy. During recession, expansionary monetary policy ~~to~~ will cause a decrease in interest rates. This will cause ~~an~~ ~~increase in investment, economic activity will increase, unemployment will decrease which lead to an increase in price where inflation occur.~~ decrease in cost of borrowing which allow income of consumers to increase. When income increases, aggregate demand will increase leading to an increase in price. This will cause inflation. During inflation, contractionary monetary policy will increase interest rates. An increase in interest rates will cause an increase in cost of borrowing which allow income of consumers to fall. This will cause aggregate demand to fall leading a decrease in price. When prices of goods and services decrease, economic activity will fall which leads to unemployment. In expansionary monetary policy, unemployment is cured, however it leads to inflation. In contractionary monetary policy, ~~as~~ inflation is cured, however it leads to unemployment. Therefore, there is a conflict between the two policies.

Examiner comment

This candidate wrote about contractionary and expansionary monetary policy. The answer bore little relation to the information in the article which considered the wisdom of supporting an increase in domestic demand against an increase in export-led growth.

Mark awarded = 1 out of 8

Question 2

The use of cars causes market failure. To achieve an efficient use of resources it would be better if governments intervened to affect both the production and the use of cars.

Explain the meaning of the terms 'market failure' and 'the efficient use of resources' and analyse whether economic theory can be used to support this argument. [25]

Mark scheme

Candidates need to explain the two terms, market failure and the meaning of the efficient use of resources, and then consider the argument. Market failure can be explained by reference to possible excessive profits, the need for very large investments, the existence of externalities and of merit goods, and of the need for public goods. Economic efficiency should be explained in terms of productive and allocative efficiency.

Government intervention can be through regulation, taxation or subsidies.

There are negative and positive externalities from car use. Negative externalities include pollution. Positive externalities include less crowded public transport with greater comfort; benefits from the expenditure of the tax receipts. Unlike other positive externalities where subsidies have been used, it has never been suggested that subsidies ought to be used to increase the positive externalities from private car use. Any subsidies given are used to make alternative public transport more attractive. However, taxes have been used to decrease negative externalities. Taxing the use of cars is usually presented in the context of negative externalities to achieve allocative efficiency. Taxing production might not result in productive efficiency. [25]

L4 For a thorough explanation of both efficiency and market failure and a competent discussion of the role of the government in promoting efficiency overcoming market failure. A reasoned conclusion should be presented [18–25]

L3 For a competent explanation with either a more limited comment on both efficiency and market failure (perhaps concentrating on productive efficiency) or a full explanation of one but little comment on the other. The role of the government will be discussed in a more limited way but a conclusion should still be presented. [14–17]
(L3 maximum if there is no mention of production and use of cars)

L2 For an undeveloped explanation of efficiency/market failure with very little discussion of the role of the government. Mention of the government will be descriptive rather than in the form of a discussion related to efficiency/market failure. It is likely there will be no conclusion. [10–13]

L1 For an answer which shows some knowledge but does not indicate that the question has been fully grasped, or where the answer contains irrelevancies and errors of theory. [1–9]

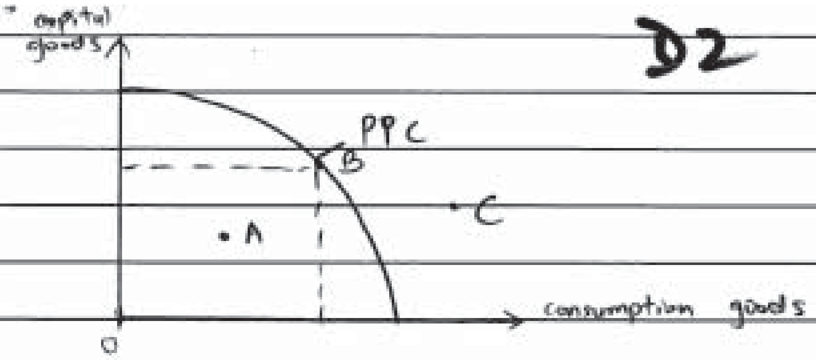
Example candidate response

2 Cars are modern means of transport and it is inevitable that everyone relies on it to travel from one place to another. However production and usage of cars may not be beneficial to the whole economy as it causes pollution and depletion of natural resources. There will be market failure and inefficient allocation of resources.

Market failure refers to an inefficient allocation of resources where there exists negative externalities, under-provision of merit goods, non provision of public goods and even imperfect markets. Negative ~~externalies~~ externalities include ~~air~~ pollution and traffic jam. Under provision of merit goods exist due to lack of information while public goods are not provided because of free rider problem. Free rider problem means a situation where ~~nobody~~ everybody is waiting for somebody else to produce a public good for the benefit of the whole economy. Imperfect markets are markets which do not produce at allocative and productive efficient points.

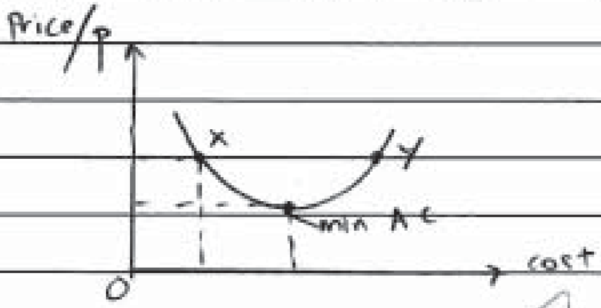
Efficient allocation of resources include allocative efficiency and productive efficiency. Allocative efficiency occurs when price equals marginal cost which means ~~pro~~ there is production of goods and services according to demand and supply of the economy. Productive efficiency occurs when price equals to minimum average cost where ~~pro~~ production takes place at its lowest cost. In other words, efficient allocation of resources refers to an economy producing at its production possibility ~~cure~~ curve (PPC) and the three economic problems of for whom to produce, how to produce and what to produce have been solve.

D2



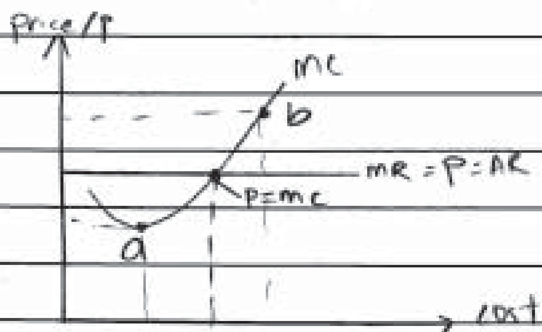
At point A, there is an under-utility of resources and production is inefficient. At point B, there is efficient allocation of resources and at point C, there is not enough resources to produce at that point. Production is unattainable.

~~Alloca~~ Productive efficiency is where P = minimum AC



If production is at x, then productive efficiency is not achieved and output has to be increased and price lowered so that cost of production is at minimum AC. If it is at y, then price has to be lowered and output decreased.

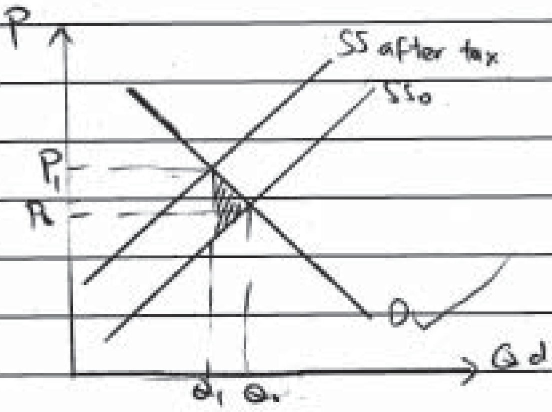
Allocative efficiency is where P = MC (marginal cost)



The point where P equals to mc is allocatively efficient and points a and b are not allocatively efficient. Price and output ~~of~~ drops price and output at a is too low.

However, according to principle of Pareto optimality, Pareto efficiency states that when someone is better off, another will be worse off. For example, when John is able to enjoy more goods, Ali will be worse off than before. Therefore, government intervention may be necessary to achieve efficient allocation of resources.

Ways of government intervention in production and use of cars include regulation, taxes etc. The government intervenes so that pollution caused by usage of cars is reduced. Methods of intervention include imposing road tax. For example, Malaysian government ~~have~~ have increased the amount of road taxes and price of tolls ~~so the~~ to discourage frequent use of cars and encourage the use of trains and other public transports so that air and noise pollution can be reduced. Air pollution is a form of negative externality.



In the diagram above, when road taxes exist, the supply of car will decrease as cost of using cars have increased. Therefore, the quantity of cars on the road will decrease from Q_0 to Q_1 and cost of using cars increase from P_0 to P_1. ~~However~~ However, government intervention can cause dead weight loss as shown in the shaded region. Deadweight loss or welfare of consumers

The government should also intervene so that there is no exploitation of natural resources in production of cars. This ~~means~~ that would ensure that the current and future generations are able to consume enough resources. The government ~~ne~~ sets regulations in production of cars such that only firms which obtain approval and licences from the government are able to produce cars. For example, the government of Malaysia only issue licences to Perodua and Proton ~~to~~ for production of cars. However, this will cause imperfect market structure where only two large firms are involved in production of cars, i.e. ~~Oligopoly market will exist and~~ duopoly market will exist and consumer welfare may be compromised due to high prices and low output of a duopoly firm. The workings of the 'invisible hand' — price mechanism will also be affected.

Besides, the government intervenes so that quality of cars produced are high and consumers are not exploited. This is because consumers usually lack complete information when buying cars. So, the government monitors the production of cars by carrying spot checks in car factories. The government also made it compulsory for car manufacturers to do multiple test runs before launching the product so that money spent on buying cars are worth it. For example, ~~Toyota company~~ the Malaysian government sends officers to do spot checks ~~x~~ in car ~~manu~~ factories so that ~~there is not~~ production of cars are smooth and there are no faulty engines being used in production. However, ~~implementation of~~ there may be loopholes and transparency problem as some enforcement officers do not carry out the duty properly.

As a conclusion, government intervention is necessary to reduce market failure. However, ~~true~~ it does not mean that there will b… …on of resources and

~~and~~ an economy free of market failure. The analysis above is at ceteris paribus and in reality, government intervention is a much more complex process.

L4

20

Examiner comment

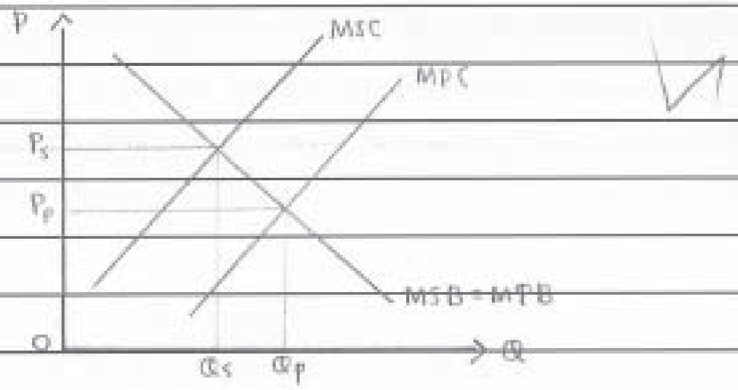
This candidate gave a good answer which referred to both the analytical theory of market failure and to the application required in the question relating to cars. A reasoned conclusion was presented. The answer fell within the band 18–20 in the general comments at the start of the mark scheme.

Mark awarded = 20 out of 25

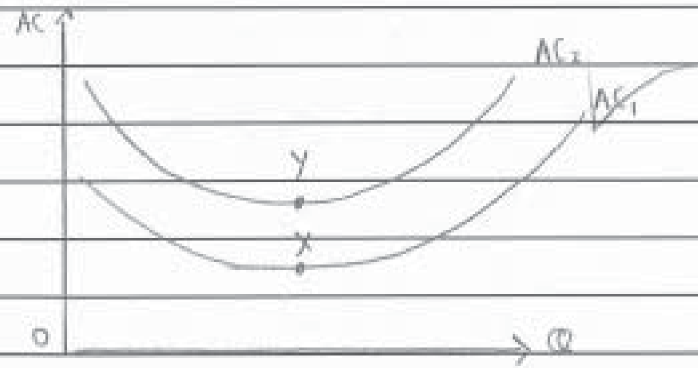
Example candidate response

2. Market is considered to be fail when there is non-provision of public goods, under-provision of merit goods and over-provision of demerit goods. Externalities are ~~cost~~ the cost ~~of~~ or benefit incurred by a third party of a production or consumption of a good or service. There are two types of externalities namely positive externalities and negative externalities.

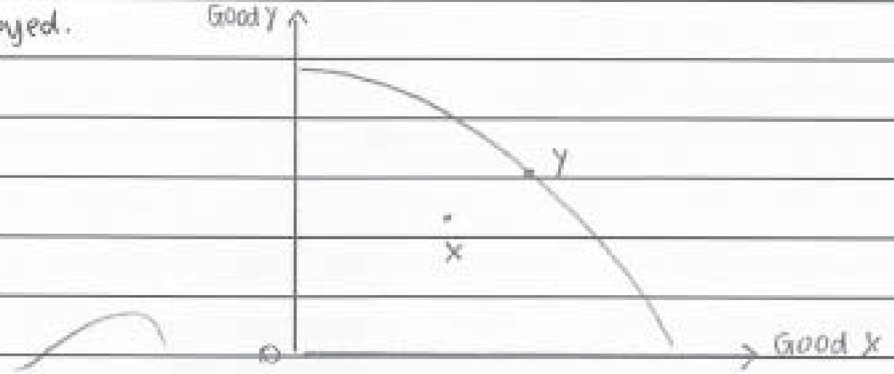
The use of cars are known as negative externalities. Negative externalities occur when marginal social costs (MSC) exceeds marginal private costs (MPC). As the good is produced more than the socially optimum level, it is said to be overproduced and this causes a low price the good. The use of cars are said to be negative externalities as ~~a~~ cars ~~an~~ emits carbon monoxide into the air, which causes air pollution. The third party will incur the external cost. ~~Marginal~~ Social costs can be found by adding ~~marginal~~ private cost with ~~ma~~ external costs.



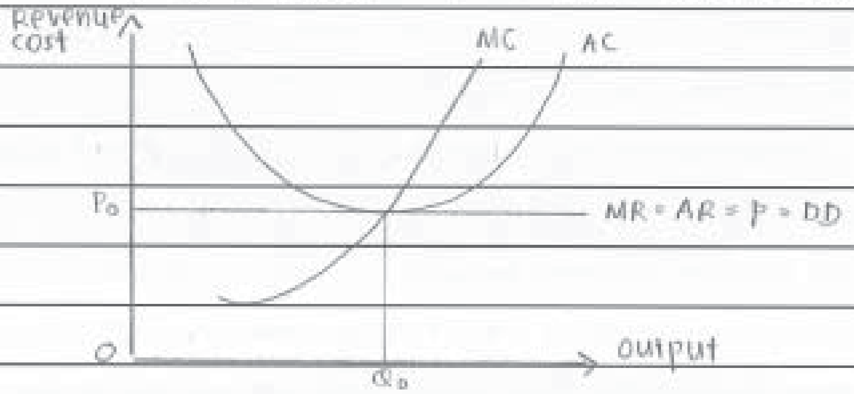
Economic efficiency can be achieved when there is productive efficiency and allocative ~~effect~~ efficiency. Productive efficiency occurs when goods and services are produced at the least possible cost.



Productive efficiency can be achieved by producing goods and services on the lowest possible cost which is AC1. Secondly, it should produce on the lowest point of the lowest average cost curve. This is known as technical efficiency. Productiv[...] achieved by producing goods and services right on the production possibility curve. The diagram below shows that point X is productive inefficient as the resources used can produce more goods. Point Y shows that it is productive efficient as resources are fully employed.

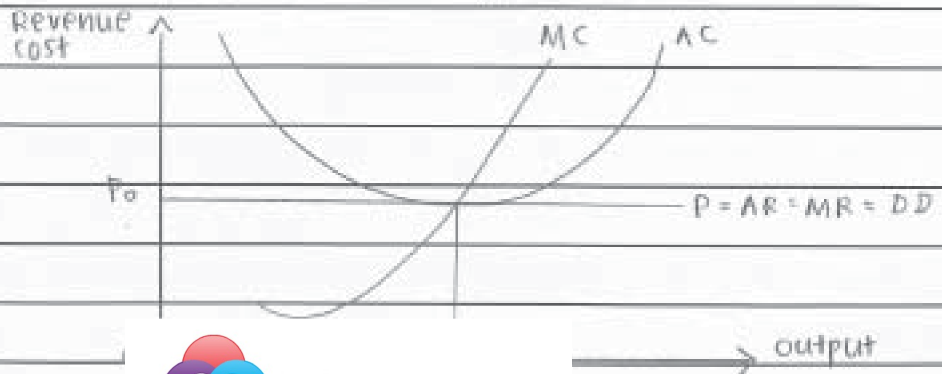


Competition allows productive efficiency to occur as firms will produce goods at the lowest possible cost. In perfect ~~compet~~ competition, productive efficiency is achieved.

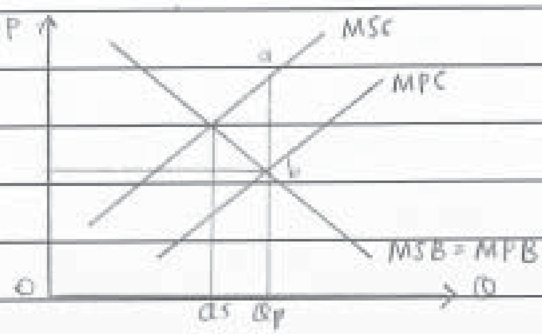


Allocative efficiency occurs when the right products are produced with the right amount of resources. Therefore allocative is achieved when price is equals to marginal cost (P = MC). When goods are produced at 2 units, it is allocative inefficient, as price exceeds marginal costs (P > MC). When goods are produced at 5 units, it is allocative inefficient as marginal costs exceed price (P < MC). It will be allocative efficient when goods are produced at 3 units as P = MC.

Units	1	2	3	4	5	6
P	4	4	4	4	4	4
MC	2	3	4	5	6	7



To achieve economic efficiency and avoid market failure, government intervention is needed. Government should impose tax of ab as ~~to~~ shown in the diagram below to ~~a~~ correct market failure.



An imposition of tax will decrease the production of cars which would in turn decrease the amount of carbon monoxide emitted.

Government can enforce regulations such as peak hour charges. An amount of money to be paid for those who drive on the road during peak hours.

Government will also produce public goods and merit goods as public goods are not provided by the private sector and merit goods are few provided by the private sector.

An imposition of income tax ~~will~~ by the government will reduce disposable income of consumers. This will decrease the consumption of consumers. Government can also increase the interest rates of commercial banks. This will increase cost of borrowing which lead to ~~an~~ a reduction of consumers taking car loans. Imposing duty imports can also reduce consumption of cars. Car duties will increase prices of imported cars. This will lead to a fall in consumption of cars, which reduces pollution.

L3 15

Examiner comment

This candidate had a reasoned account of market failure in terms of public goods, merit goods and externalities. There was also an explanation of productive and allocative efficiency. The weakness of this answer was that there was little on the role of government intervention and even less on the application to cars. Both government intervention and an application to cars were required by the question.

Mark awarded = 15 out of 25

Question 3

(a) Discuss whether demand schedules and budget line diagrams are similar in the way they represent the effect of

(i) a rise in the price of a good

(ii) a rise in a consumer's income. [12]

(b) Analyse what is meant by the equi-marginal principle of consumer demand and whether it can be linked to the derivation of a market demand curve. [13]

Mark scheme

(a) A rise in the price of a good: a demand schedule has price and quantity of one good bought against price; budget line diagrams have quantities of two goods – price is not on the axis; one cannot tell how demand will change with budget line unless you also show preference lines.

A rise in a consumer's income: similarity, both move parallel out for a rise in income; but cannot tell what will be bought unless have supply line – with demand – or preference lines with budget line. [12]

L4 For a sound discussion indicating the similarities/differences [9–12]

L3 For an accurate explanation but with a less clear comparison [7–8]

L2 For a general undeveloped explanation with little comparison. [5–6]

L1 For an answer which has some basic correct facts but includes irrelevancies and errors of theory [1–4]

(b) Analysis of equi-marginal principle which underlies an individual demand curve. The sum of individual demand curves form the market demand curve. Whether individual utilities can be added is debatable. [13]

L4 For a reasoned discussion linked to more than one good and clearly structured answer with a conclusion [9–13]
[Low L4 maximum if there is no mention of market demand]

L3 For a fair discussion but undeveloped answer but still with a conclusion [7–8]

L2 For a limited attempt which does not clearly determine the equilibrium position for more than one good and no conclusion. [5–6]

L1 For an answer which has some basic correct facts but includes irrelevancies. Errors of theory or omissions of analysis will be substantial. [1–4]

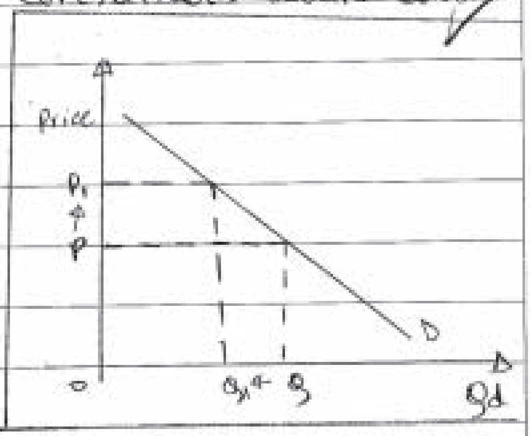
Example candidate response

3a

(i) Demand ~~st~~ schedule is the graphical representation of changes in quantities that consumers would demand or would want to purchase ~~and~~ at different prices at a certain period of time. It is ~~rated~~ used for ~~only~~ ~~only good~~ to represent the demand for only one good.

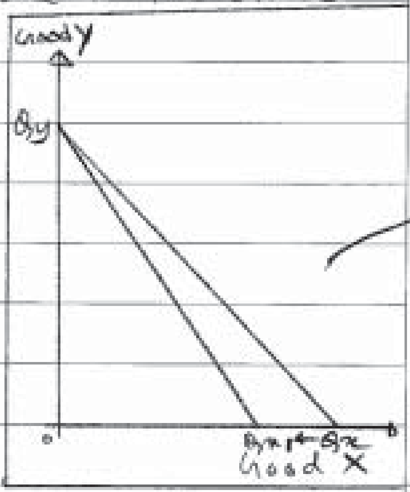
Budget line is the graphical representation of ~~with the~~ different possible combinations of ~~go~~ two goods that consumer ~~will~~ can purchase with their fixed income. ~~It~~ As consumer wants are restricted to be fullfilled by the income they earn and the price of product, it is important to produce a budget line as in to shows how two goods, ~~will be~~ in what combination, will be purchased.

(ii) (i): A rise in price of product In case of demand schedule lead to ~~shan~~ a change in quantity along the curve. As the price rises consumers would demand the good less ~~as~~ than before.



As in figure on the right, show the demand schedule ~~for~~ for a good, with Quantity demanded in the x-axis and price in the y-axis. It is shown that a rise in Price from P to P1 will lead to a fall Q to Q1.

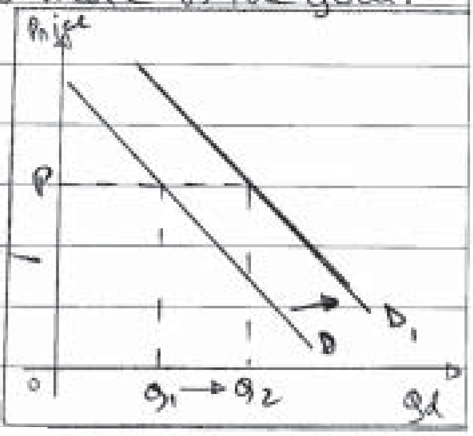
This will be also the same case for Budget line as the quantity demand for the ~~god~~ good will fall as the price rise. However since ~~it is the~~ Budget line shows the demand of one good in compare to the other it would be represente in the same way. The figure shows, good X ~~x~~ is x-axis and ~~a~~ good Y ~~y~~ in the y-axis. Before the rise in prise for good x, the Quantity demand ~~was~~ is Qx after the rise it pivoted at ~~Qy~~ Qy and fell to Qx₁. However ~~w~~ there could also be a rise in quantity demanded



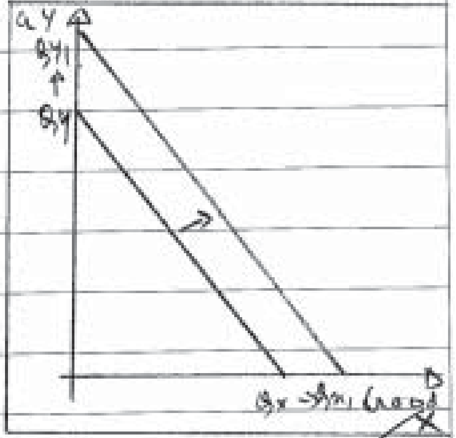
for good Y as a rise in good X would lead to consumer demanding less of good X and possibly substitute it with good Y.

For both the demand schedule and Budget line the fall in quantity demand of the good that rise in price is because consumer would substitute the good which appear costly, to the good which appear cheap in compare this is referred to substitutiona effect.

(ii) A rise in eincome ~~for~~ would lead to a ~~change in~~ shift in ~~demand~~ curve to left in ~~for~~ both the ~~goods~~ diagram for demand schedule and budget line, ~~and~~ as an increase in income would allow consumer to spend more, so they would purchase ~~8~~ more of the good. The figure shows a demand curve, with Qd in x-axis and Price in y-axis. ~~the~~ there, the rise in income shifted the curve to left. It means for the same Price, P, more Quantity is demanded, i.e Q_1 to Q_2.



Similarly in the case of Budget line the curve shifts to left meaning that ~~bot~~ ~~con~~ both the Good can be purchased more than before without sacrificing the other as there is an increase in Income. In the ~~dia~~ figure of budget line it is shown by an increase in Qd of the good, ie. Qy to Qy1 and Qx to Qx1 if rose.



This refers to the income effect for both the diagram, as an increase in income leads to increased disposable income for the consumers.

clf

12

3 b Consumers derives a happiness or satisfactory when they consume a ~~pa'~~ ~~god~~ good, it is referred to the utility of a ~~goo~~ consuming a good. Marginal Utility is the increase in satisfaction derived from the consumption of extra one unit of the good. However, this ~~Unit~~ Marginal Utility tends to fall as consumer consumption increases. This is known as diminishing marginal utility. As consumers ~~are~~ earn fixed income, they would want to utilise the income in a way that will maximise the utility derived from all the goods consumed with that ~~income~~ income. ~~They~~ It is the equi-marginal principle of consumer demand, ~~as they~~ and is represented as,

$$\frac{MU_A}{P_A} = \frac{MU_B}{P_B} = \frac{MU_C}{P_C} \dots\dots = \frac{MU_N}{P_N}$$

MU is the Marginal Utility, P is the Price and A, B, C ... N ... the different goods purchased with the ~~fixed~~ income. ~~It~~ This shows that the ~~Ut~~ Utility derived from an extra Unit of good in compare to its price, is equal for ~~the~~ all the goods that the consumer purchases with its income.

This principle can be used to derive ~~the~~ demand curve of a good. As, if the price of a good A, let assume, rises then $\frac{MU_A}{P_A}$ value, will be less than the others. This would lead to less consumption of good A, so as to ~~a~~increase its MUA. This is all ~~the~~ case ~~for~~ seen in market demand curve, as a rise in price leads to a fall in quantity demanded. However, as consumer reduces the consumption of good A and ~~subs~~ instead increases the consumption of the other good, ~~ine~~ reducing their MU(Marginal ~~Uti~~ Utility), untill the equi-marginal principal is, of consumer demand is met. Thus the principal can be used to derive the ~~d~~ a market demand curve, by ~~analy~~ analysing the changes in Quantity demanded with changes in price.

?

market unclear

C4 10 22

Examiner comment

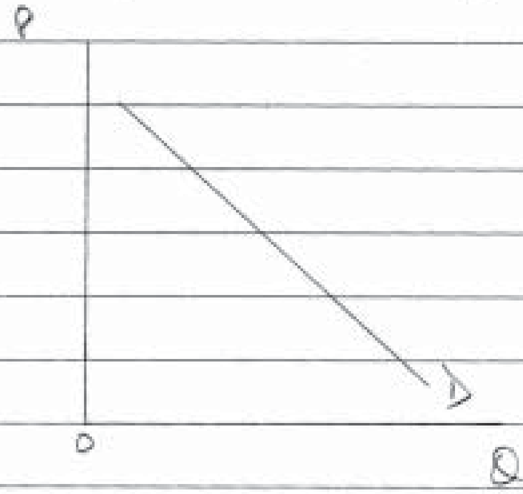
In section a) this candidate gave a clear explanation of both a demand line and a budget line. Changes in price were demonstrated correctly on both types of curve with a clear comparison. Income changes were correctly shown as indicating a similar movement on both types of curve. In section b) the candidate explained the meaning of the equi-marginal principle and discussed its link to a consumer's demand. The answer could have been improved if the last part of the question which asked about a market demand curve had been more clearly discussed. Mention was made of a market demand curve but the explanation surrounding this was really related to an individual consumer's demand curve.

Mark awarded = 22 out of 25

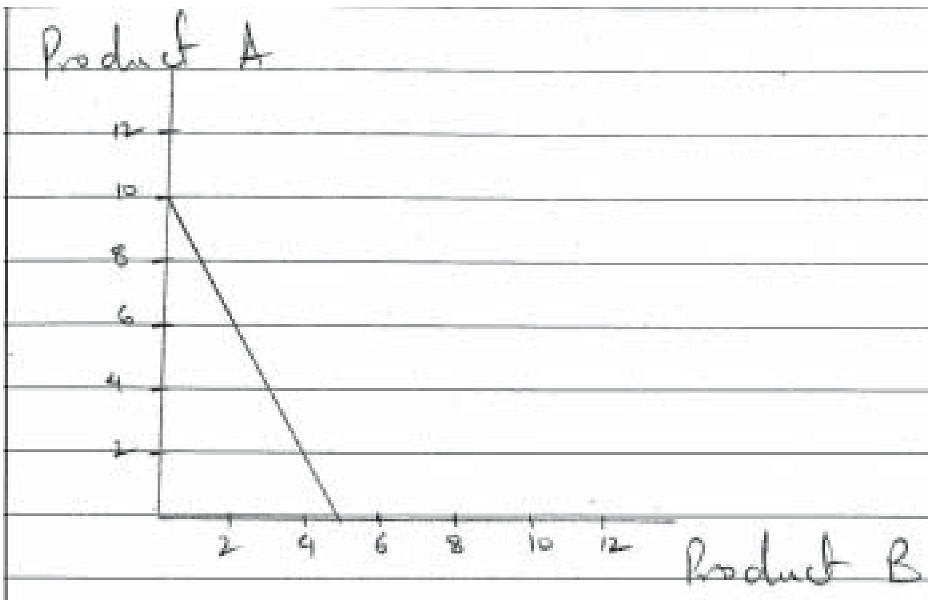
Example candidate response

Q3,

a)i, The demand curve shows the relationship between price and quantity demanded of a product. It is downward sloping as price and demand have an inverse relationship i.e if price increases demand decreases and vice versa.



The budget line illustrates the quantity of two goods that a consumer could by with the amount of given income/resources. For example income is $ 1000 and the are two goods, A and B which cost $100 and $200 the budget line would be as follows

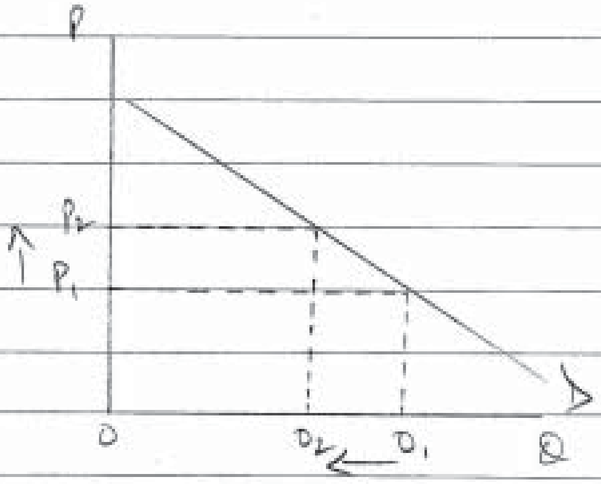


R.W

$\frac{1000}{100} = 10$

$\frac{1000}{200} = 5$

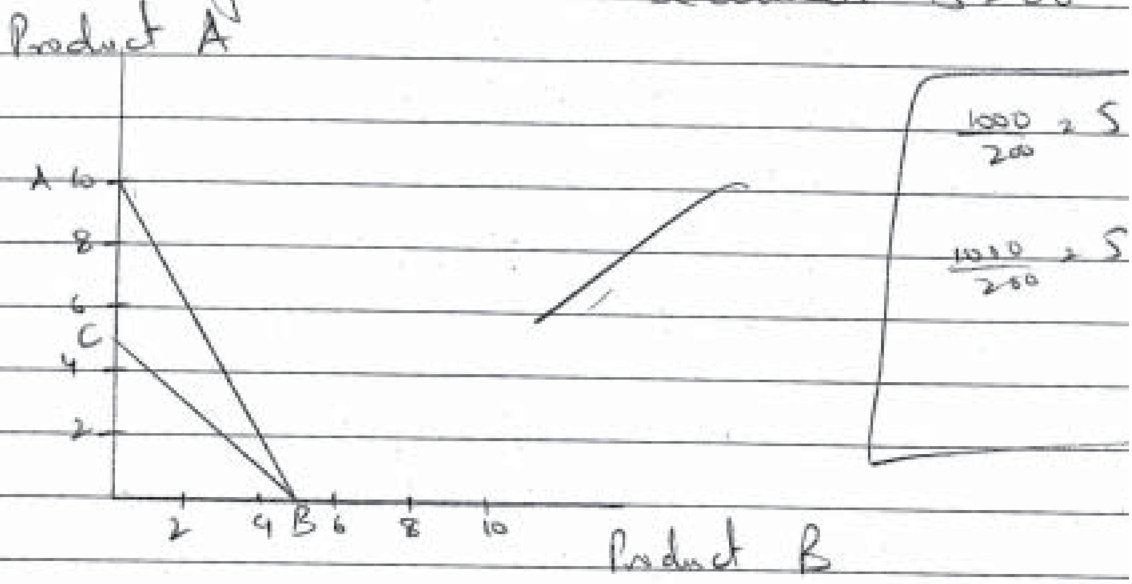
The When there is increase in the price of a good, the will be movement along the demand curve i.e



As the price increased from P_1 to P_2, the quantity demanded decreased from Q_1 to Q_2. However the degree of change would depend upon the elasticity of demand.

Whereas when price of one good

increase, there will be a partial shift in the budget line e.g Price of good A also becomes $200

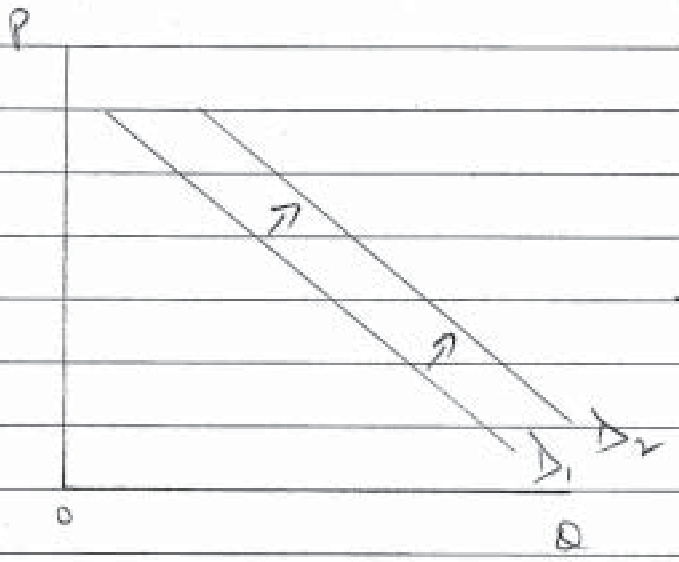


Previous budget line was AB while new budget line is CB.

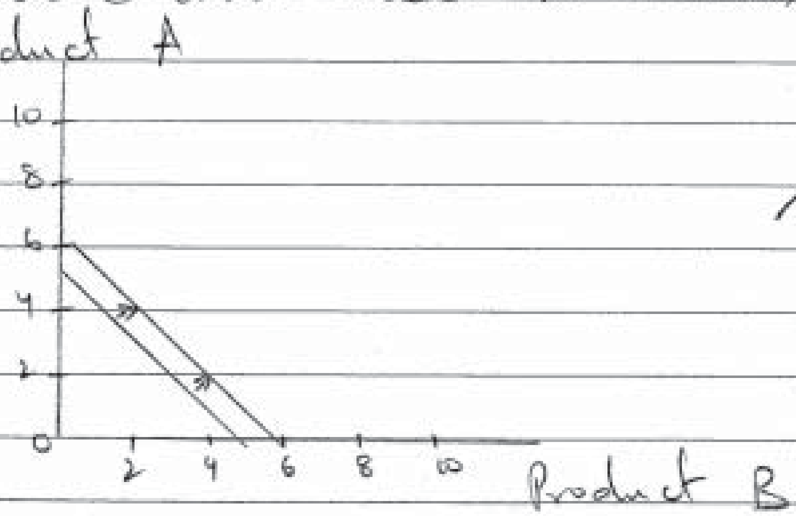
Hence the effect of a rise in price is not same for budget line and demand curve as budget line shifts (partially for one and completely ~~for~~ for both) to show an increase in price whereas there is only movement along demand curve.

ii, As the consumer income increases the demand also increases (curve shifts rightwards). Same is the case for budget line, as the income increases, the budget line would shift rightward.

Effect on demand curve:



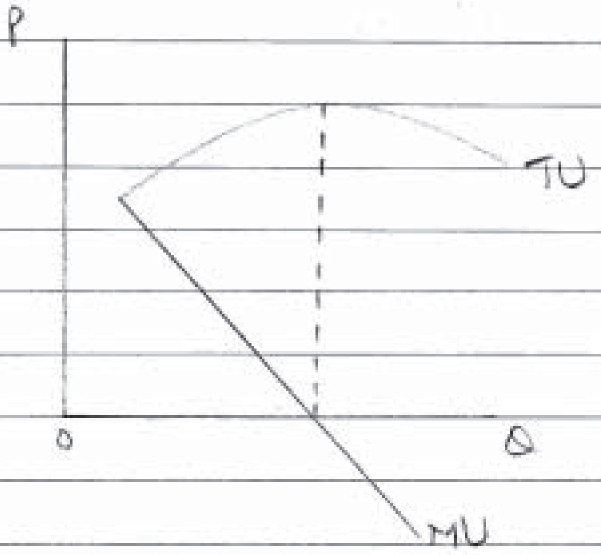
Effect on budget line: (taking the example from part (i) let the prices be $200 for both goods and income increases to $1200)



However if other factors also increase simultaneously, the relative effect would have to be considered. c4 ? 9

explicit comparisons.

b) It is suggested by some economists that the 'demand' curve actually reflects the marginal utility of a product rather than total utility. This is why it is downward sloping (marginal utility decreases as quantity purchased is increased). This is the diminishing marginal utility theory. It guides the consumer how utility from a single good can be maximised. It is the point where marginal utility (MR) is 0. i.e



This theory only guides the consumer regarding the maximisation of utility from a single product and does not explain how the total utility from all the goods can be maximised with the help of given resources. For this another theory exists known as the law of equi-marginal utility. It states that when marginal utility of different goods is equal, total utility is maximum.

Consumer equilibrium = $MU_A + MU_B$

It can be said that the law of diminishing marginal utility can be linked to the derivation of demand curve however it is not sure whether same is the case for law of equi-marginal utility as there is no solid evidence.

L3 7

16

Examiner comment

This candidate gave a clear explanation of the meaning of a demand curve and a budget line in section a). For a price change the shift along a demand line and a pivot about a point on one axis for the budget line were indicated. Income changes were shown as a parallel shift in both the demand and budget lines. This section of the answer could have been improved if there had been more of an explicit comparison between the demand curve changes and the budget line changes. The reader was left to conclude which were similar and which were different. Section b) was a weaker section and although marginal utility was discussed the answer did not really explain the principle of equi-marginal utility and its link to a demand curve.

Mark awarded = 16 out of 25

Example candidate response

(a). A rise ~~of~~ in the price of a good do effects the demand schedules and ~~bridger~~ budget line diagrams. ~~a~~ From ~~a~~ the demand curve in the demand graph, it is clear that the demand curve is move downward, which axis-y is price of a good and axis-x it the ~~qua~~ quantity of demand. When the price of a good is increasing the demand ~~witll~~ will drop. Because ~~pro~~ consumers will to buy another similar good ~~to the~~ which is lower price to replace ~~the the the~~ the ~~or~~ ~~high~~ one with ~~higher~~ higher price. For example when ice-cream's price increased, ~~the~~ consumers willing to eat yogurt ~~ratham~~ rather than ice-cream, which caused ice-cream surplus.

However, a rise in a consumer's income may effect the demand schedules and budget line diagrams ~~and~~, in aggregate demand it calls income distributions ~~effect~~. effect. It is because the income of consumer increase, it gives ~~the~~ consumers the abilities to demand their needs ~~for~~ especially in the labor force.

Diol.

U e

L1

(b) The demand curve and aggregate demand curve are totally different, which demand curve is based on individual demand ~~ba~~ but aggregate demand curve is aggregation. Demand in the market means ~~a~~ the abilities of consumers to buy goods but aggregate demand means the total of output in demand.

The equi-marginal principle of consumer demand means the equilibrium of the profit of consumer demand, which can be linked to the derivation of a market demand curve. ~~The~~ The market demand curve in another words is aggregate demand curve. ~~It~~, and the aggregate demand curve is ~~most~~ moving downward. There are ~~4 eff~~ four ~~to~~ effect causing the aggregate demand curve move downward equally.

?

First, ~~a~~ the income distribution is one of the effect. ~~of aggregate demand~~ Consumers usually ~~p~~ demand according to their income abilities compare with the price level. ~~Se~~ secondly, is the real balance effect. Third is foreign trading effect, and lastly investment effect.

3
~~4~~

7

C1

Examiner comment

This candidate gave a descriptive answer which did not contain any diagrams. In section a) the description of the change in the demand line with respect to a price change was reasonable but there was no real explanation of the change in a budget line due to a price change of a good. The changes caused by an increase in income were not explained. In section b) although there was a reference to the fact that the market demand was an aggregate, there was no explanation of the equi-marginal utility principle of consumer demand.

Mark awarded = 7 out of 25

Question 4

(a) Discuss whether it is always advantageous for a firm to grow in size. [12]

(b) Explain the economic theory of profit maximisation for a firm and consider whether firms are likely to follow this theory in fixing their price and output. [13]

Mark scheme

(a) Discussion of possible reasons for growth including large market demand, economies of scale, possible future profits, with a contrasting comment on reasons why it might not be advantageous to grow in size; diseconomies of scale, small market demand, specialised products/services. Allow a wider interpretation which discusses effects on consumers and in the economy. [12]

L4 For a sound discussion with contrasting explanations. [9–12]

L3 For an accurate explanation but with an emphasis on one side – possibly of economies of scale only. [7–8]

L2) For a general undeveloped explanation. [5–6]

L1 For an answer which has some basic correct facts but includes irrelevancies and errors of theory [1–4]

(b) Explanation of the theory of profit maximisation. Candidates should then consider not only whether it is possible to calculate marginal revenue and marginal cost to achieve profit maximisation but also whether the firm might have alternative aims. Sales maximisation, behavioural, managerial, satisficing, market share aims might be mentioned. [13]

L4 For a reasoned discussion and clearly structured answer with a conclusion [9–13]

L3 For a fair discussion but undeveloped answer mentioning either only one part of the question or both parts but only limited mention of alternative aims, but still with a conclusion [7–8]

L2 For a limited but acceptable attempt to consider the question with very limited development of either part and no conclusion. [5–6]

L1 For an answer which has some basic correct facts but includes irrelevancies. Errors of theory or omissions of analysis will be substantial. [1–4]

Example candidate response

a) Large-scale production is often said to be advantageous for a firm due to the benefits that come with expanding productive capacity. This is not, however, always the case as sometimes growth of a firm may bring about negative effects.

One of the most commonly cited reasons to support growth of a firm is the benefit of gaining economies of scale. This refers to a situation in production where the average cost of production decreases while the output level increases. In figure 1, this is shown from output level Q to Q_1. As output rises, the long-run average cost decreases.

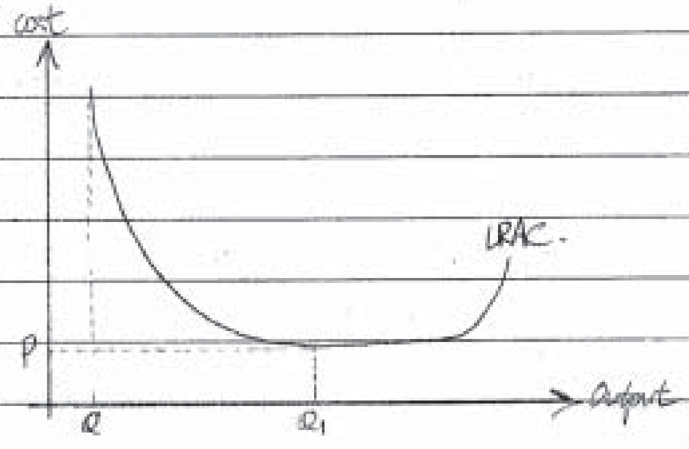


Fig. 1

This can be due to technical economies of scale, where capital and labour are used to achieve their maximum productivity levels, managerial economies of scale, which encourages specialization in job roles and functions and so on. Firms functioning with large-scale production can be said to enjoy lower average costs, which is an advantage for firms to engage in price competition as prices can be lowered without losing the profit margins. This is a benefit for consumers, as lower prices would increase spending power. Also, if prices do not fall, then firms with the benefit of economies of scale would be able to gain more profits and would be more likely to gain abnormal profits. This is also a benefit as it enables firms to invest in research and product innovation, providing an advantage in terms of non-price competition that also benefits consumers with better quality.

Economies of scale can generally be seen as an improvement in ~~terms~~ of efficiency as firms' costs are minimized and the use of resources is maximized. In these ways, large-scale production may be advantageous and firms' growth would be positive for the market.

However, this is not always the case as output levels above Q, in figure 1 show diseconomies of scale as firms find it increasingly difficult to manage production beyond a certain level. This decreases efficiency and results in wastage of resources.

Also, firms may become monopolies if growth is allowed to continue without sufficient competition. Monopoly situations can result in consumer exploitation as the lack of substitutes can cause firms to have total market control and raise prices excessively. Monopolies are also likely to be inefficient as the lack of competition reduces the incentive to minimize costs in order to maximize profits. Monopoly situations can result in a lack of choices for consumers and this would be seen as undesirable, especially if consumers lose sovereignty altogether in the market.

Exceptions may occur in the case of natural monopolies, where high sunk costs and costly technology or infrastructure may encourage a firm's growth to cater for ~~the~~ more of the market. This is because it may be better for the allocation of scarce resources if infrastructure and capital are not duplicated by having many small firms supply the same product. ~~If a firm is~~

In conclusion, there are advantages to a firm's expansion of productive capacity, but there may also be disadvantages. It is necessary to examine the market conditions in each situation and the ~~relevant~~ possible effects should be evaluated before determining how advantageous it would be for a firm to grow in size.

L4 9

b) Profit maximisation refers to a firm's objective to maximise profits in the production of a good or service, obtaining the highest possible profit margin. This is often illustrated as being the most common goal for many private firms. The maximum profits for a firm are obtained at the point where MC = MR, or where firms' marginal cost is equal to the marginal revenue generated by the extra unit produced. At this point, firms are on the verge of making a loss with the next unit of production.

Firms are said to aim for profit maximisation in order to gain more returns for the entrepreneur or shareholders. Also, in some firms it would be ideal to gain more profits in the hopes of earning abnormal profits that can then be reinvested or used for research and development or innovation purposes. This would then increase a firm's ability to compete in a non-price manner and improve the quality of output or improve the productivity of capital and labour through technological advances and training.

However, not all firms may engage in profit maximisation all of the time, depending on the circumstances of the firm and its position in the market and industry. Particularly for firms that have just entered a market, they may choose to maximise sales instead in order to more firmly establish their position and control of market share. This results in firms settling for a profit margin below the maximum attainable profit level in favour of increasing their clientele or consumer base, possibly through setting lower prices. It is worth noting that firms will rarely go to the point of being unable to sustain variable costs in the short run, indicating that in the long-run, profit maximisation may after all be the most commonly pursued objective for a firm. In the case of a new entrant in a market or industry, the firm is less likely to concern itself with profit maximisation if it is a firm that is able to diversify and cross-subsidise its goods. This refers to a firm's ability to sustain losses for the production of a good or service due to its preestablished position and higher profit margins for another good or service, again indicating that to some extent, profit maximisation is likely to play a

4b) part in firms' decisions regarding the level of output and price setting.

Profit satisficing may also play a role, albeit less frequently. This refers to decisions made most often by staff at the managerial level, where there is no incentive to increase revenue or profits beyond a predetermined level (usually the minimum returns to the shareholders) as it does not affect the wage rate of the workers involved. In these cases output and price are likely to be moderately deviating from the profit-maximising point of MC = MR.

In figure 2, MC = MR is shown as the profit-maximising level of output at quantity Q and price level P. The sales-maximising level of output is likely to be closer to MC = AR while the profit-satisficing level is likely to be lower or less than P and Q.

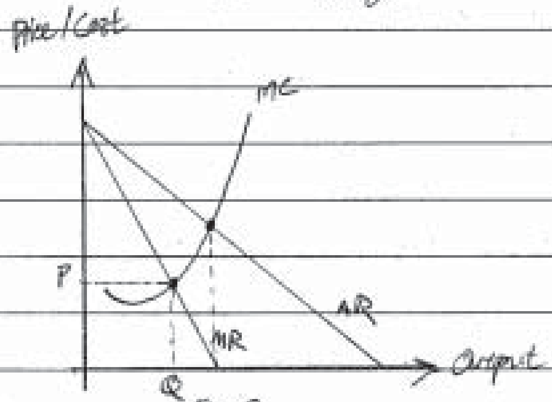


Fig. 2

The objectives of a firm differ between firms and markets, depending on such factors as competition, shareholders' roles, market conditions and the position of the firm, but it can be said that a large fraction of firms will emphasize profit maximization at some point if not most often during its operations.

cf 10 19

Examiner comment

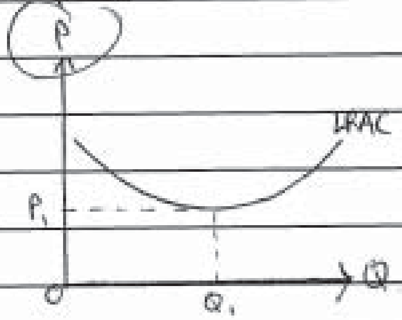
This candidate gave a good response to section a) which contained an explanation of the advantages of growth through economies of scale, the disadvantages caused by diseconomies and the undesirability of some monopolies. Profit maximisation was discussed in section b) but there was also a discussion of alternative aims of a firm including non-price competition, maximisation of sales, increasing market share, cross-subsidisation, satisficing, all of which might need to be balanced against the desire to gain maximum returns for shareholders.

Mark awarded = 19 out of 25

Example candidate response

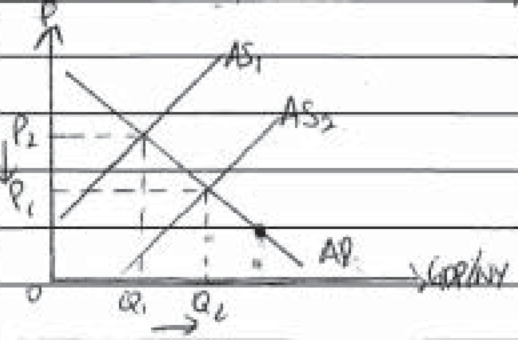
4) a) Firms in an economy can expand through external integration and internal integration. By internal integration, firms can expand ~~into~~ by increasing the number of branches in an economy while external integration can be divided into forward integration or backward integration. Forward integration ~~is~~ occurs when a firms expand into a different sectors of industry which ~~he~~ takes place after its existing sector while backward integration occurs when a firm expand into a sector ~~which~~ before its initial sector in the industry. For example, ~~Volkw~~ Volkswagen and BMW merged into a single company recently.

By expanding ~~a firm~~ a firm will be able to derive advantages as well as disadvantages. ~~They~~ One of the most significant advantages of large company is economies of scale. Economies of scale occurs in the long run where firms will be able to produce outputs at minimum cost. In other words, firms will be productive efficient.



Based on the diagram, as a firm expands in size, the firm will be able to produce Q_1 quantities at P_1 which is the lowest point of the long run average curve graph. When a firm experience economies of scale, various sectors such as financial will ~~be easier~~ have lower cost to the company. For example, large firms such as Tesco Supermarket will be able to obtain loans or financial aid easier as investors ~~or~~ will have high confidence towards the company as the risk bearing of the investors ~~to~~ will be lower. Compared to investing in small retail ~~sh~~ shop supermarkets. ~~Advertising~~ Specialisation can also take place when firms experience economies of scale, hence decreases costs such as time and thus, increase productivity of the firms.

Besides that, ~~as the firms starts is producing at~~ as a firm ~~expe~~ produces output at its minimum cost, the profit margin of the firm will increase. ~~as its revenues will be higher~~. The increase in profits earned by the firm can be used for research and developments as well as investments to further increase the ~~output~~ productivity as well as the quality of the goods and services produced. By doing so, consumers will also be able to have a wider range of goods and ~~services~~ services to chose firm. ~~Furthermore, as the~~ ~~Furthermore, the employment~~



~~Furthermore, as the output or productivity~~

Furthermore, the employment level might ~~will~~ also increase due to the increase in profit earned by the firm. Hence, the national income as well as the gross domestic product of an economy will increase from Q_1 to Q_2 as the supply increases from AS_1 to AS_2.

As firms expands in size, consumer loyalty can also be gained. In other words, ~~the low price of goods and services of the firm~~ the firms can also gain market share in an economy. With the lower price charged on goods and services produced in an economy, consumers will be able to enjoy goods and services at lower prices, hence improving the standard of living of the ~~count~~ country. As ~~the~~ a firm obtain market share in the industry, less advertising will be needed as consumers loyalty are already obtained. For instance, ~~Tesco Supermarket~~ BMW will ~~not~~ need to advertise much as ~~consumers~~ it has already gained trust and market share due to its quality and the cars performance.

However, as firms expand, more space capacity will be needed, ~~for~~ hence increasing its ~~manufacturing as~~ buildings or premises. ~~By doing so, more lar~~ Large compounds will be needed and as the ~~increase~~ output increases, more resources will be used, ~~causing~~ increasing the possibility of exploitation of resources. The non-renewable resources such as petroleum ~~that~~ cannot be renewable, hence might decrease the availability of these resources for future generations. In other words, sustainable growth cannot be achieved.

Moreover, as a firm grows in size, there can be diseconomies of scale such as problems of coordination or communication. This causes time lag, ~~causing~~ affecting the ~~use~~ efficiency of the firm. There might also be alienation of staffs as a firm grows, causing demotivation of workers, causing a decrease in productivity.

As firms expand in size, ~~there~~ the firm might act as a monopoly market, where quantity of goods produced are reduced and the price charged on goods and services increases. This is because due to investment in research and development, the quality of goods produced by the large firms might be of better quality compared to the small retail shops, causing an inelastic demand of goods. With this, the price ~~of~~ can be charged higher to obtain higher revenue and profits. Along with this, the ~~[illegible]~~ small companies which do not [illegible] might shut down due to ~~pr~~ extreme price cuts to com[illegible]

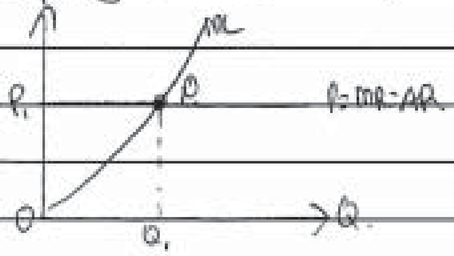
In conclusion, ~~as a firm~~ there are disadvantages and advantages that can occur as a firm expands. However, ~~it~~ it is able to control the ~~damages of di~~ damage of disadvantages by government intervention such as maximum ~~pr~~ and minimum prices as well as subsidies to infant ~~ins~~ industries. Quotas on access to resources can also be imposed to maintain sustainable growth in the ~~[illegible]~~ economy.

L3

8

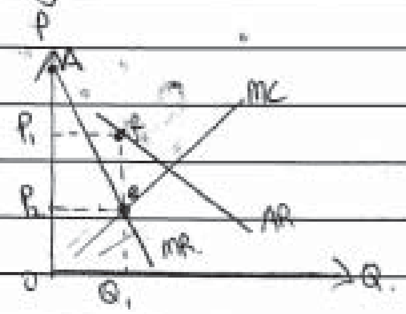
4)b) • Profit maximisation for a firm can be achieved when the marginal cost/ curve equals to the marginal revenue curve. This is because since marginal cost is the ~~difference in~~ additional cost of producing an additional unit $\left(\frac{\Delta \text{ Total cost}}{\Delta \text{ Quantity}}\right)$, it can be said that it is the supply curve of a firm. Marginal ~~revenue curve is upw~~ revenue curve is said to be the additional revenue generated by an increase of a unit of sales of the firm $\left(\frac{\Delta \text{ Total profit}}{\Delta \text{ Quantity}}\right)$. Hence, it ~~can~~ be taken to be the demand curve of the firm. ~~Marginal revenue curve is downwards sloping as the increase in price will generate lower demand by consumers due to substitution effect where consumers will switch to relatively cheaper substitutes~~

Hence, firms will produce according to profit maximisation to obtain ~~to~~ their maximum possible revenue. However, it differs for the type of market structure in an economy. In perfect competition market, the firms are price takers, hence the marginal revenue will be perfectly elastic as the price are equal at various outputs. Therefore, the average



revenue, marginal revenue curves are the same as price. Based on the graph, MC cuts MR at point e where firms produce at Q_1 ~~at~~ P and set a price at P_1.

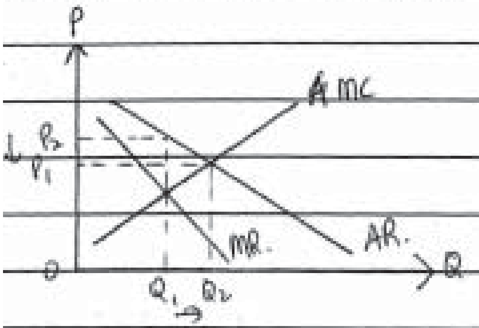
In monopoly and monopolistic markets, firms will ~~ch~~ charge higher price at lower quantity because of the inelastic demand of consumers. Due to product differentiation in



monopolistic markets, the marginal revenue and average revenue graph is downwards sloping while in monopoly, the inelastic demand due to monopolisation causes the marginal revenue / and average revenue graph to be downwards sloping. In this case, monopolistic firms and monopoly firm ~~will~~ are ~~the~~ price setter.

Based on the graph, the MC curve cuts the MR curve at point e where the quantity produced is Q_1 ~~at~~ and price charged at P_2. However, due to inelastic demand and being price setters, the firms charge a higher price at P_1 instead of P_2 to obtain higher revenue, converting consumer surplus of area AP_2e into revenue.

It is different in ~~contestable~~ contestable markets as they have free entry and exit into an industry. Since the cost of entry and exits are minimal or zero, contestable firms are able to charge lower prices and producing more goods.



In a non-contestable market, the profit-maximising output is at ~~P_2~~ Q_1 where price charged on goods at P_2. However, in ~~a~~ contestable market, a firm is able to increase outputs at ~~lower price~~, Q_2 and charge price of goods at P_1. Based on the graph, contestable markets ~~increase its~~ produces more output and charge lower prices compared to ~~a~~ non-contestable firms. This is known to be marginal cost pricing.

Besides that, some firms might also charge low prices on goods and services to force other companies out of the industry. This is known as predatory pricing. Only firms ~~without the~~ with consumer loyalty will be able to resist price cuts. As a firm decreases the price, it will attract consumers from other ~~con~~ firms due to substitution effect. However, this will only happen if the demand for the good is elastic. ~~Entry predatory~~ After ~~the~~ price wars, the firm will be able to monopolise the industry.

In conclusion, firms might not follow profit maximisation as it ~~varies with~~ depends on the ~~the~~ situation and intention of the firms.

L3 7

15

Examiner comment

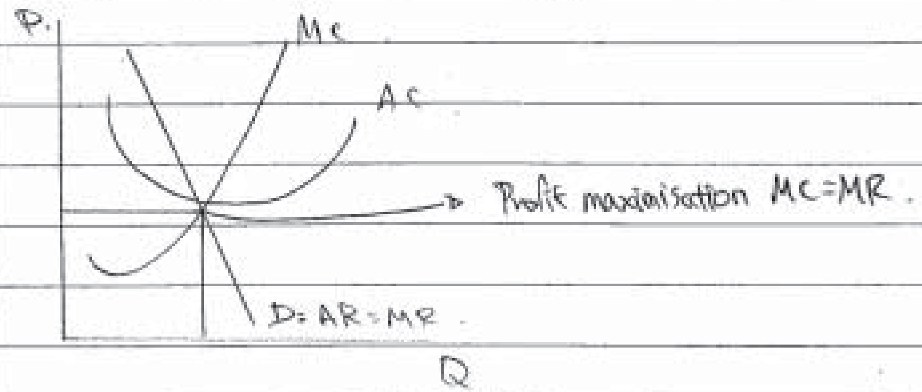
This candidate gave a reasonable answer which could have been improved in section a) if there had been further development of economies of scale and/or of the reasons why it might be advantageous for small firms to exist in their own right, rather than concentrating on the lack of managerial control as a firm seeks to grown. An improvement could have been achieved in section b) if there had been further discussion on the alternative policies that a firm might use. Mention was made of contestable markets and predatory pricing but the answer could have been developed with a mention of sales maximisation, behavioural aims or satisficing.

Mark awarded = 15 out of 25

Example candidate response

a). ~~It may be advantegeous, if a firm is competing in a perfectly competitive market where firm achieve abnormal profit, as a result of profit maximisation~~

It may be advantegeous, if a firm is competing in perfectly competitive market where profit maximisation, MC=MR occurs.
Since in Perfectly competitive market, P=MC, therefore MC=MR, so P=MR. price is equal to marginal revenue, means firms achieve short run abnormal profits. This abnormal profits can be direct to R & D, which may innovate the production process resulting the firm to experience economies of scale, ~~where~~ which is reducing average cost as size of firm grows.



It may be disadvantegeous, as firm achieve abnormal profits, competitors may enter the market, resulting the price to be fall, therefore firm cannot achieve abnormal profit in the long run, but normal profit. Then they may not be able to invest sufficient amount of fund to R&D, and may not experience economies of scale, but ~~possibley~~ possibly diseconomies of scale, as firm grows in size, but they may not find innovative method to reduce average cost.

L1

4

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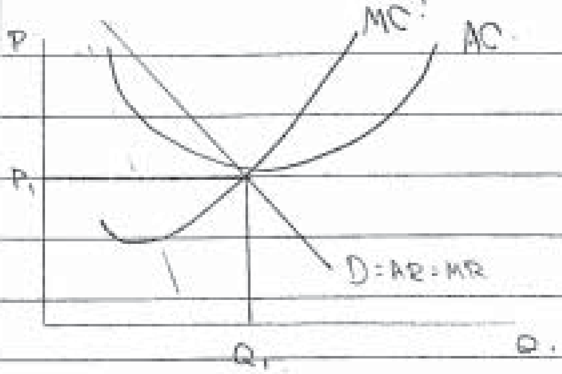
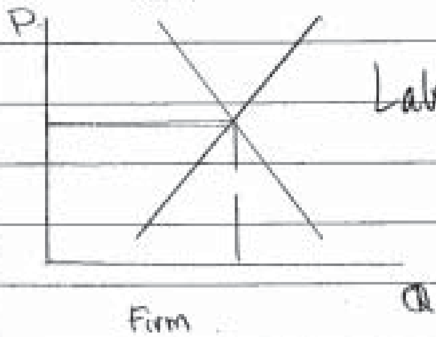
b) Profit maximisation is a point where MC = MR, as shown in the diagram



~~In the short run, they achieve abnormal profits, which attract firms to enter the market, this shifts industry~~

In the short run, they achieve abnormal profits, which attract firms to enter the ~~market~~, this shifts industry ~~ex supply~~ curve outwards resulting in price to fall, ~~~~ this continues until firms earning normal profits in the long run. If only normal profits are earned, then firms exit the market, so industry supply curve shifts ~~~~ inward, again in the long run, firms achieving normal profits only. Therefore as a result, firms maximising profit earns normal profits in the long run.



Labels! ∴ Industry curve shown above.

~~They~~ Firms in oligopoly may collude to generate greater profits, fixing price at which abnormal profits are generated and give quotas to each firm. But this may be break up easily, if one firm cheat to generate even greater profits by exceeding ~~~~ production quotas and charging higher prices.

L1

4

8

Examiner comment

This candidate began the answer to part a) by explaining profit maximising in perfect competition and only briefly mentioned diseconomies of scale. Some of this information was repeated for section b). The diagram in section b) lacked the correct labels and although there was a brief mention of oligopoly there was no real explanation of the theory of profit maximisation and no discussion of alternative aims which a firm might follow.

Mark awarded = 8 out of 25

Question 5

In imperfect competition, labour markets can lead to worker exploitation in terms of the wage rates they receive compared with wage rates in perfect competition. Discuss this opinion. [25]

Mark scheme

Candidates should explain the economic theory of wage determination (marginal revenue product) and compare the situation in perfect and imperfect competition. The theory indicates that wages are lower in an imperfect labour market especially if there is monopsony. The extent of the reduction varies depending on whether the labour market is considered with a perfect or imperfect product market. However, the comparative reduction in wage rates may be corrected, at least in part, by the strength of unions or by government legislation. [25]

L4 For a thorough explanation of the analysis of wage determination with a clear comparison of the two markets and a comment on trade unions and/or government policy. [18–25]
(14–17 for demand and supply only with institutional factors and/or government policy)

L3 For a competent explanation of the two markets but with a limited discussion and application.
(10–13 for demand and supply) [14–17]

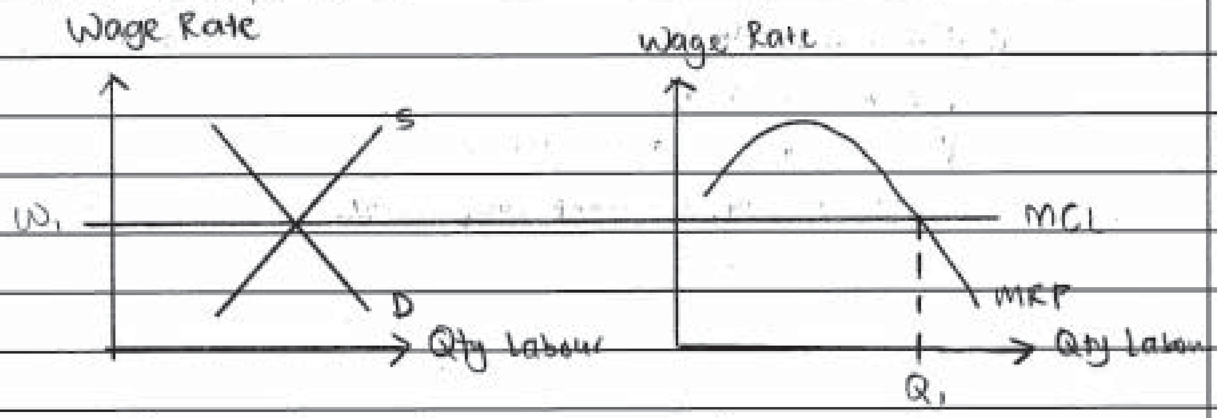
L2 For a correct but undeveloped explanation with only brief application [10–13]
(6–9 for demand and supply)

L1 For an answer which contains inaccuracies and only a few correct points [1–9]
(1–5 for demand and supply only)

Example candidate response

Whether labour markets under imperfect competition lead to worker exploitation in terms of wage rates they receive compared to wages in perfect competition is highly subjective and dependent on an analysis of the presence of a monopsonist, trade unions and government intervention in an imperfect market.

Firstly, under perfect competition, the MRP theory best explains how wages are determined in the market. Here, the wages of workers are dependent on their Marginal Revenue Product (MRP). MRP, in essense, is the amount of additional revenue a firm would earn by employing an additional unit of worker. Since firms under perfect competition are profit maximisers, firms will higher workers up to the point where MRP is equivalent to the marginal cost of ~~labour~~ (MCL) as illustrated in the graph below. [Graph 2]

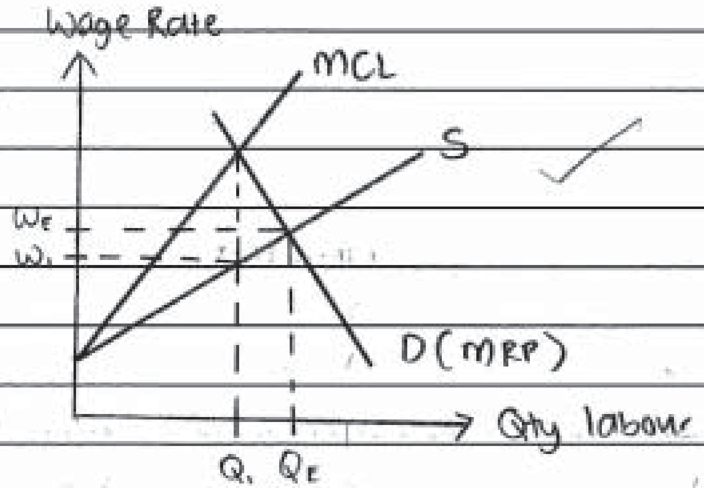


Graph 1 : market Graph 2 : Firms

Since under perfect competition buyers (firms) and sellers (workers) are price takers, the wage rate is set by the interaction of demand and supply in the market. The reason that the graph for the individual firm is represented is to distinguish between perfect and imperfect competition. It is assumed that under perfect competition, all workers are homogenous. Hence, the cost of hiring an additional unit of worker to the firm is constant. There is no exploitation of workers in terms of wage rate under perfect competition as a firm who offers a ~~...~~ wage rate lower than the market rate would have no worker wanting to work for them given the unlimited buyers (... the market wage.

There are several reasons as to why there could be exploitation in terms of wage rate under imperfect competition. In the presence of a monopsonist, wages are often much lower than what they would have been under perfect competition. ~~A monops~~ This is because a monopsonist has an upward sloping supply curve and even steeper marginal cost of labour curve. The reason for this is that a monopsonist would have to increase the current wage rate in order to attract more labour into the market.

To add a definition, a monopsony exists when there is only a single buyer in the market. This is illustrated by the diagram below:



Graph 3

Being a profit maximiser, a monopsony would hire workers up to the point where MCL = MRP. As observed from the diagram above, workers are paid a much lower wage rate ~~than~~ (W_1) than the market equilibrium (W_E). Hence, one might conclude that under a monopsony, workers are indeed exploited and paid lower wages. The reason a monopsony is able to do so is because that since it is the sole buyer of labour in the market, workers have no choice but to accept the lower wage rate.

Conditions however, are not too dire when a trade union enters the picture. Trade unions (another key characteristic of imperfect labour markets) serve the purpose of collectively representing workers in negotiating wage rates with employers. This is because collect... ...e bargaining power exerts a significantly b... ...than the individual bargaining with an employer can. The entrance of a trade union in a situation of monopsony is as illustrated below.

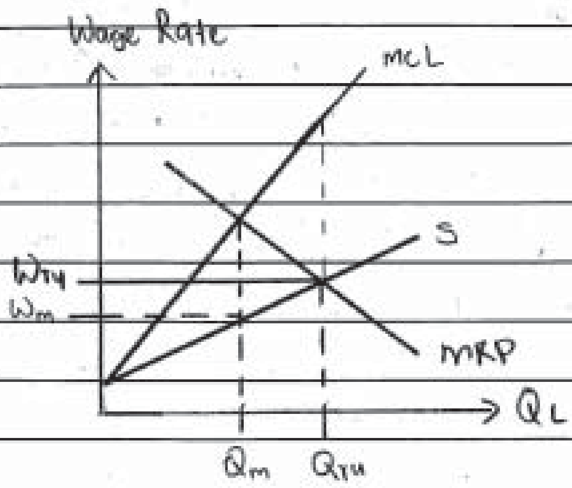
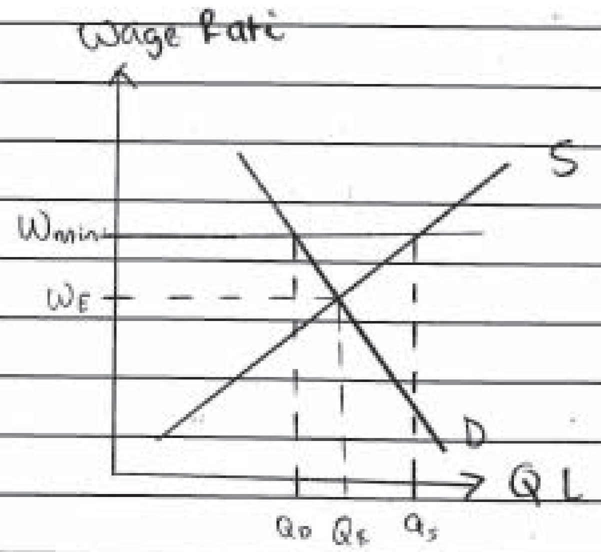


Diagram 4

Here, the trade union has successfully negotiated a higher wage rate for workers than the monopsonist had initially offered. ~~Hence,~~ ~~one mig~~ The wage rate the monopsonist offered (Wm) ~~which~~ has now increased to WTU. In this instance, the trade union had negotiated ~~the~~ a wage rate equivalent to the market equilibrium. However, a trade union with higher bargaining power would be able to demand an even higher wage rate. This would depend ~~on~~ factors like the union density and substitutability of labour. In essence though we might derive from here that it is possible for wage rates to be higher than the market equilibrium (and hence perfect competition) under circumstances of imperfect competition.

Intermediately, we can conclude that a monopsony drives wages lower than what they would be under perfect competition. However, with the presence of a trade union, wages could potentially be much higher.

Besides this, there is no government intervention under perfect competition. Imperfect competition, on the ~~and~~ other hand may evoke government legislature such as minimum wage requirements that could drive up wages. This is ~~illustrated~~ illustrated in the graph that follows.



Graph 5

The government could set the minimum wage above what the market would have. Hence, this would drive the wage higher than what it would have been under perfect competition (Wmin > WE).

~~There are numerous~~

While intuitive wisdom suggest that exploitation may occur under imperfect competition, the introduction of a minimum wage or trade union may set the ~~price~~ wage rate higher than what it would have been under perfect competition. These efforts, however, are highly controversial as in some instances (Graph 5), they could result in an increase in unemployment (QS > QD).

L4 21

Examiner comment

This candidate gave a very clear explanation of the determination of wages in perfect competition through the market demand and supply. This analysis was then contrasted with that which applies to imperfect competition. A discussion of the influence and power of a monopsonist, a trade union and a minimum wage determined by a government then followed. A concluding paragraph drew attention to the difference that may occur between perfect and imperfect markets when trade unions and minimum wage regulations exist.

Mark awarded = 21 out of 25

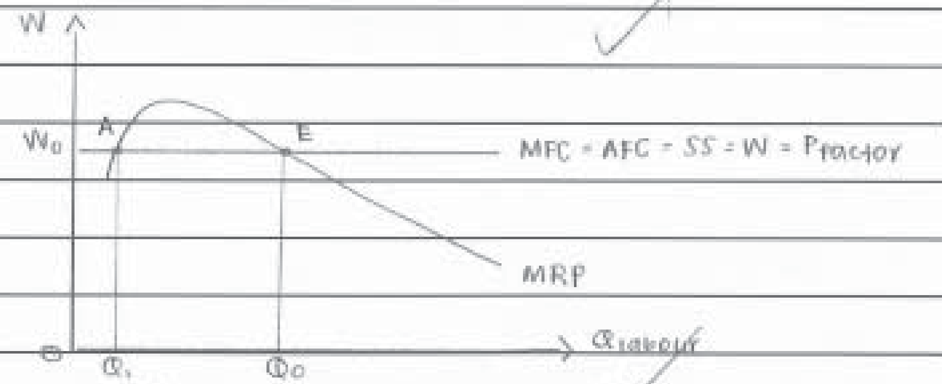
Example candidate response

5. Labour is derived demand. ~~An increase~~ For example, an increase in the demand for property houses will lead an increase in property development. Thus, this will lead to an increase in the demand for construction workers.

Marginal revenue product (MRP) is used to indicate the demand for labour. MRP is obtained by multiplying marginal physical product with marginal revenue. (MRP = MPP × MR). MPP is the additional output produced by employing an additional worker. MR is the additional generated by employing an additional worker. MRP is known as the additional revenue of a product produced by employing an additional worker.

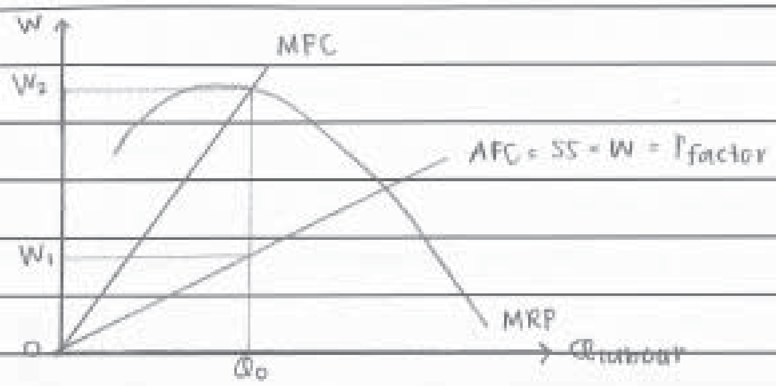
There are assumptions for MRP. There are perfect and imperfect in goods market and factor market. ~~All variab~~ Perfect in the goods market indicates that the demand for labour is a horizontal line where DD = P = MR = AR. Imperfect in the goods market indicates that the demand for labour is downward sloping. All variable factors are homogenous. It is due to the law of diminishing marginal return. Firms are ~~set~~ to operate in order to achieve maximum ~~prod~~ profit.

Wages are determined where MRP = MFC, MFC is the additional cost of employing an additional worker. The diagram below shows wage determination in the perfect market.



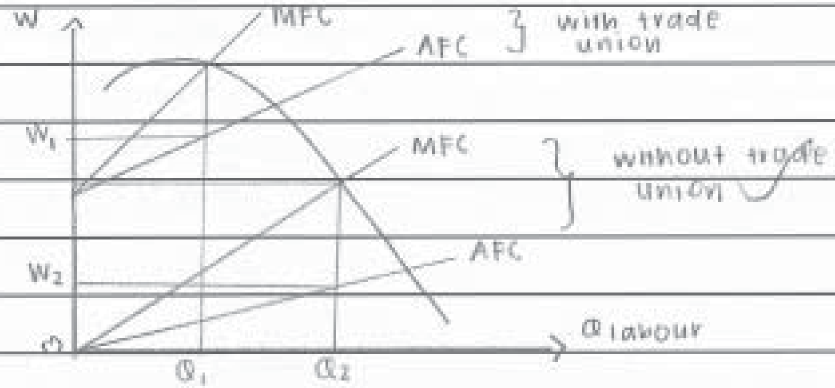
The supply curve of the labour is horizontal as labour and firms ~~#~~ both have perfect knowledge. The equilibrium is at point E where wages are at W₀ and quantity of labour is at Q₀. Point A cannot be the equilibrium point as MRP ~~not~~ continues to rise. When MRP > MFC, firms will employ more workers until it reaches an amount of Q₀ labours.

The diagram below shows ~~the imperfect~~ wage determination in the imperfect market.



The supply curve of labour is upward sloping as both labours and firms have imperfect knowledge. Wage is determined where MFC = MRP, which is where wages are at W_2. However, firms do not have to pay W_2 to get Q_0 amount of labours. It only needs to pay the labour at W_1. This is due to the imperfect knowledge of the workers on the availability and types of jobs. Workers are being exploited at they should be paid at W_2 but instead are being paid at W_1. This is due to the fact that in ~~when there is exploitation of workers,~~ imperfect market, monopsonist are the price setters. ~~w~~

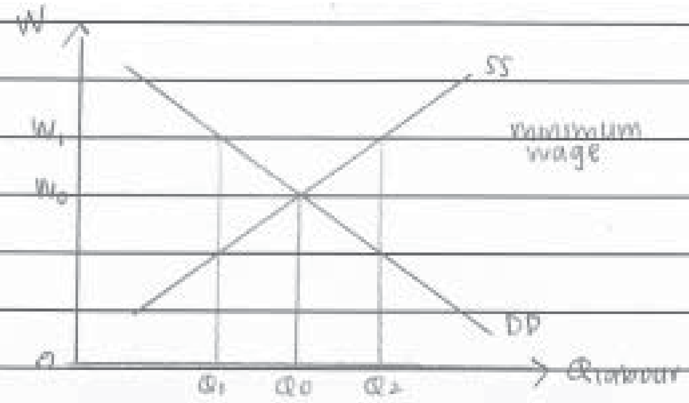
When there is exploitation of workers, there will be the presence of trade union and government. Trade union will helps workers to talk terms with the firm in order to increase their wages.



The diagram above shows the difference in wages when there is a presence of trade union. With trade union, wages of labour are at W_1 whereas wages of labour are at W_2 without trade union. Trade union will also help labours seek for working benefits such as medical benefits and overtime pay.

Government intervene by setting minimum wages of the labour. This with allow a decrea:

c8



It also ~~dem~~ depends on the elasticity of demand and the elasticity of supply.

L3 17

Examiner comment

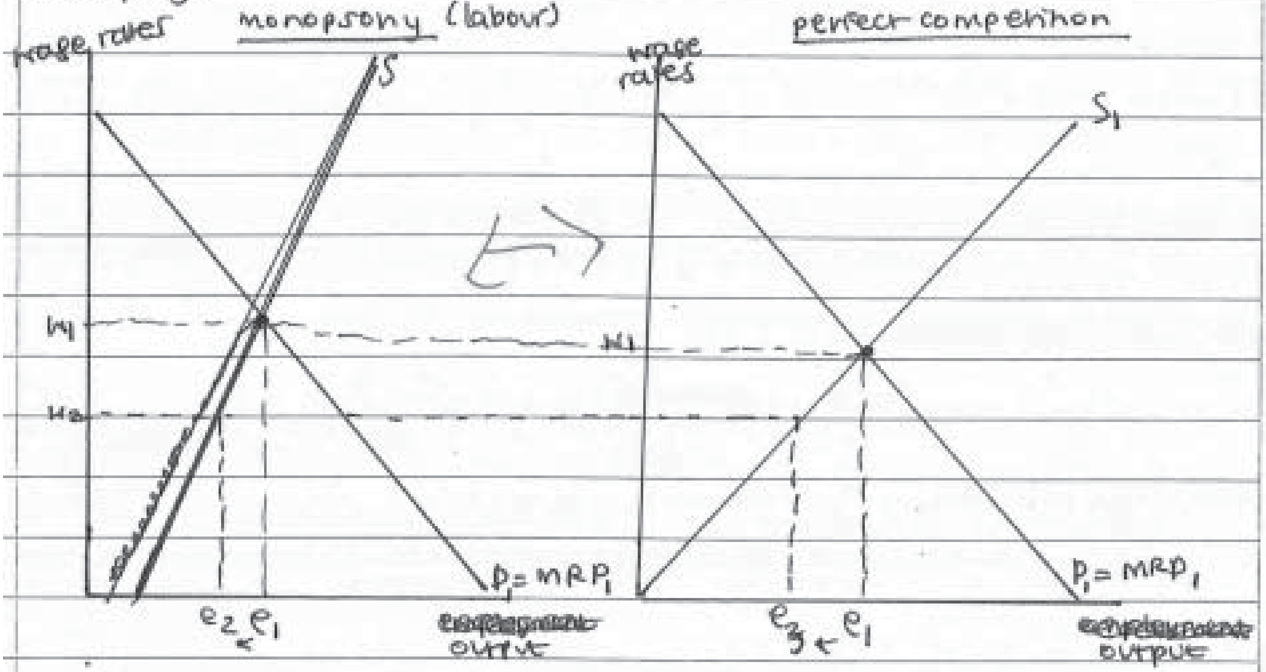
This candidate gave an explanation of the analysis involving marginal revenue product theory but with less development than is required for a very good answer. For example, the candidate did not clearly indicate how the wage which was used by a firm in perfect competition was determined by the demand and supply in the market.

Mark awarded = 17 out of 25

Example candidate response

In imperfect competition, which may manifest itself in the form of monopolistic competition, oligopoly, monopsony, duopoly, or monopoly, the notion of fair wages is often debated because such imperfect markets are thought to distort equal wage determination and exploit workers.

The comparison may be held between a perfectly competitive market structure and a ~~monopoly~~ monopsony, as well as a monopoly.



A monopsony is, essentially, a monopoly buyer of labour. It is one buyer for many sellers which is why the supply in a monopsony for labour is significantly more inelastic than that of the supply in a perfectly competitive labour market. This means that, while equilibrium wage is at W1, a monopsony, being profit maximising, may hire workers at W2 without an incredible decrease in output whereas in perfect competition, where demand is equal to the marginal revenue product of a worker, a wage decrease would result in a great loss of output, which will stop firms from blank

reducing wages. ~~The~~ This ~~is~~ insures that wages in a perfectly competitive market do not exploit the workers, as they are determined by the demand and supply for labour. A monopsony, however, must also be careful with its wage setting power, as if its wage rates go below the transfer earnings level of wage for too many workers, the amount of workers available to the firm will sharply decline. In imperfect competition, there ~~is~~ are also the presences of discrimination and imperfect knowledge, or assymetric information between the employer and worker, which leads to the exploitation of workers because they are not given the opportunities their MRP requires with discrimination against ~~[illegible]~~ female employees, for example, employers may pay them lower wages than men in the same occupation. This is not possible in a perfectly competitive market where there is no discrimination and perfect knowledge, as well as occupational mobility / geographical mobility. ~~[illegible]~~ Immobility contributes to the wage setting power of ~~[illegible]~~ monopsonies as labourers often have no choice but to work at lower wage rates as their skills are not transferrable or they are not able to move to a location with more opportunities. There are all ~~[illegible]~~ characteristics of an imperfect market competition ~~[illegible]~~ which distort wage rates and exploit workers. Workers may also be exploited if their wages are below the real wage rate so that they operate under a 'money illusion'.

In a monopsony and a monopoly, labour is often not paid the wage rate ~~[illegible]~~ its marginal revenue product commissions and ~~the~~ imperfect competition in such market structures lacks the equity of perfect competition which ensures fair wages so the opinion is largely correct, if somewhat inevitably. Firms in oligopolies, duopolies, and monopolies, with wage setting power, do not seek to retain fairness amongst their workers.

10

L2

Examiner comment

This candidate gave a descriptive answer. The diagrams were not clearly labelled and there was confusion between perfect and imperfect competition. There was only passing reference to marginal revenue productivity, the analysis of which was omitted, no reference to trade unions nor to government intervention in the form of minimum wage legislation or regulation.

Mark awarded = 10 out of 25

Question 6

(a) An increase in investment will raise national income but an increase in the desire by consumers to save will reduce national income.

Explain why this is the case. [12]

(b) To increase national income, interest rates should be lowered; indeed lowering interest rates is the only policy available to increase national income.

Discuss whether you support this opinion. [13]

Mark scheme

(a) Candidates should explain the different effects of an injection of investment and a withdrawal through saving by use of the multiplier process. Possible use of 'paradox' of thrift idea. [12]

L4 For a sound explanation with good application and a clear understanding of the principles involved. [9–12]

L3 For an accurate explanation of the multiplier but with a more limited contrast of the difference between the investment and saving. [7–8]

L2 For a general explanation probably in descriptive form. [5–6]
[Maximum L2 if there is no mention of the multiplier]

L1 For an answer which has some basic correct facts but includes irrelevancies and errors of theory [1–4]

(b) Candidates should analyse how lowering interest rates might help increase national income through increased investment or increased spending and then discuss whether lowering interest rates is the only policy available. [13]

L4 For a sound discussion with good explanation of the analysis of interest rate changes and a consideration of alternative fiscal measures with a conclusion [9–13]

L3 For a competent comment but with limited development of the analysis or undeveloped alternative policies and a weaker conclusion. [7–8]

L For a brief explanation and with a weak discussion of interest rates or weak alternative policy measures with no conclusion. [5–6]

L1 For an answer which has some basic correct facts but includes irrelevancies. Errors of theory or omissions of analysis will be substantial [1–4]

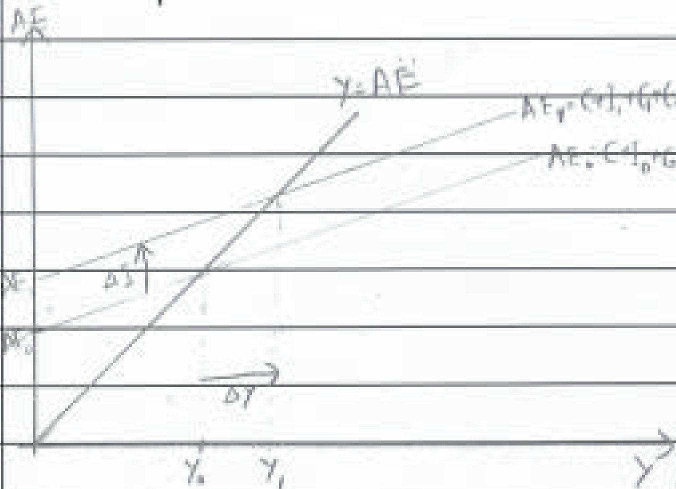
Example candidate response

6a) Consumption and investments are two important components in measuring the national income of an economy. These two components are part of the aggregate expenditure of an economy and contribute to the gross domestic product (GDP). The circular flow of income indicates that a change in consumption and investments can cause a change in national income due to change in aggregate expenditure. This can be proven by the formula

$$AE = C + I + G + (X - M)$$

where C is consumption, I is investments, G is government spending, X is exports and M is imports.

We can show the changes in national income due to investments by drawing diagrams as well as including the multiplier effects. Investments are spendings ~~mad~~ by firms in a certain capital so that the firms would be able to produce a larger quantity of goods and services in the future. For example, a firm invests in a plot of land to build a factory so that production can be increased. Investments consist of autonomous investment ~~&~~ and induced investment, ~~the latter a~~. ~~Investments~~ Investments are usually fixed in volume, so the change in investments would cause the aggregate expenditure (AE) curve to shift upwards.

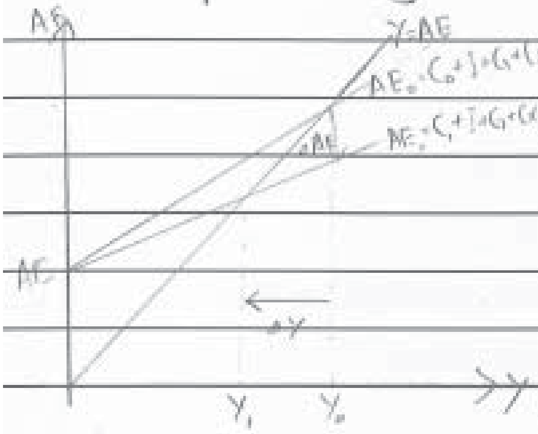


In the diagram, an increase in investments would cause the AE curve to shift from AE_0 to AE_1. As a result, national income would increase from Y_0 to Y_1. We can note that the increase in Y is larger ~~A~~ than the increase in aggregate expenditure. This is due to the multiplier effect which states that a small change in aggregate expenditure leads to a larger change in national income. This can be represented by $\Delta Y = k \Delta AE$ where k is the multiplier and $k \geq 1$,

$$k = \frac{1}{MPS + MPM + MPT}$$

MPS is the marginal propensity to save, MPM is the marginal propensity to import and MPT is the marginal propensity to tax. Therefore, an increase in investments would cause a larger increase in national income.

On the other hand, an increase in savings would cause national income to decrease. To understand this, we must note that saving is the alternate option to consuming and at a fixed income, ~~&~~ consumption decreases as savings increase. (MPS + MPC = 1). A desire to save by consumers causes the MPC (marginal propensity to consume) of consumers to decrease. This causes the gradient / slope of the AE curve to become more shallow since the MPC represents the gradient of the AE curve.



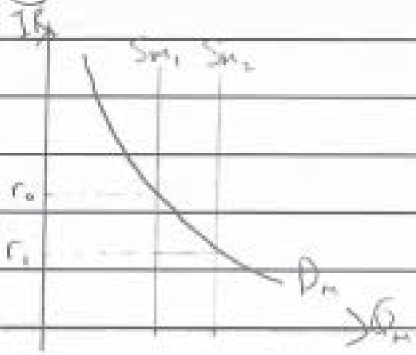
When consumption ~~[illegible]~~ decreases, the AE curve would shift from AE_0 to AE_1, downwards. The result is that national income would decrease from Y_0 to Y_1. Again we must note that the multiplier effect takes place when this happens as the decrease in national income (ΔY) is significantly larger than the decrease in aggregate expenditure (ΔAE).

As we can see, changes in components of the aggregate expenditure can lead to a larger change in the national income. ~~However~~, Hence, economists and governments can implement policies to contract or expand the economy using the effect of the multiplier when necessary. However, the multiplier value is different for every economy and it is not easily measured in reality. Furthermore, there is a possibility that the multiplier value is less than one, making policies inefficient. Therefore, ~~a~~ research must be done before policies to contract or expand the economy can be carried out.

L4 10

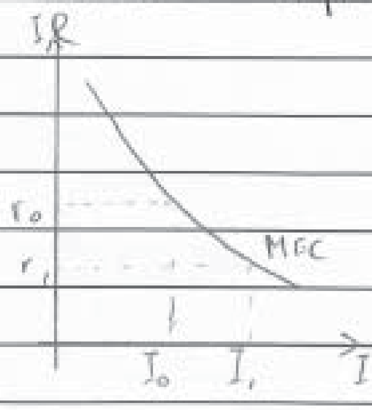
6 b) Keynesian economists stress upon the importance of interest rates in an economy. Interest rates are crucial in the money market as well as the goods market as it determines the money supply in an economy as well as the number of investments made, both of which are factors ~~are~~ influencing national income. There have been arguments about whether controlling the interest rate is the best way to increase national income.

The effect of lowering the interest rates to increase national income can be explained using the monetary ~~market~~ transmission mechanism. In a money market, interest rates are determined by the demand and supply of money. Suppose the central bank increases the money supply, this would cause a rightward shift of the money supply curve, causing the interest rate to decrease.



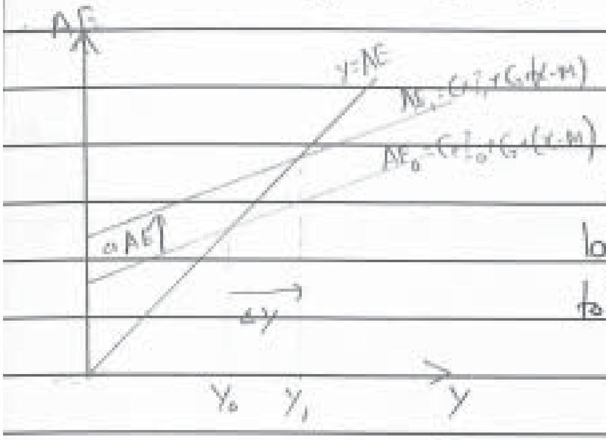
The money supply increases from S_{M_1} to S_{M_2}, causing the interest rate to decrease from r_0 to r_1.

Interest rates are the most important factor influencing investments. This is because firms wanting to invest would require large amounts of capital and would need to borrow these funds from banks. If the interest rate were high, there would be less incentive for firms to borrow as they would have to pay back more. A fall in interest rates would prompt investments by firms.



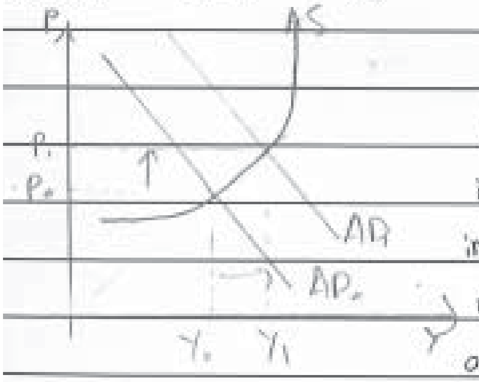
In the diagram, MEC is the marginal efficiency of capital. When interest rates decrease from r_0 to r_1, the ~~eque~~ value of investments made would increase from I_0 to I_1 as firms tend to invest more.

Investments are a part of the aggregate expenditure. An increase in investments would cause an increase with the aid of the multiplier effect, cause a significantly large increase in national income.



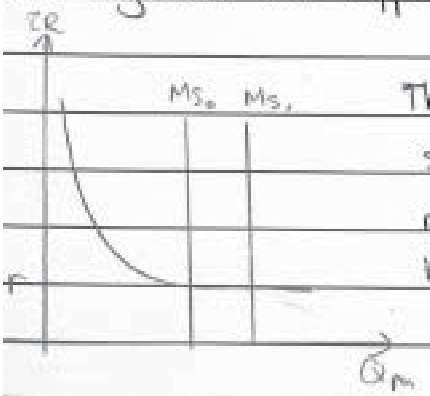
In the diagram, when investments increase, aggregate expenditure would increase from AE_0 to AE_1. This would result in a significantly larger increase in national income (Y_0 to Y_1) due to the multiplier effect.

Indeed, the reduction of interest rates would increase national income, and also promote growth. However, a reduction in interest rates can also result in inflation. This is because the aggregate demand in an economy would increase without the aggregate supply shifting.



In the diagram, when aggregate demand increases from AD_0 ~~to~~ to AD_1, at ceteris paribus, the national income increases from Y_0 to Y_1, but the general price level increases from P_0 to P_1. This signals inflation. If this were to happen in the long run, there could be hyperinflation as the aggregate supply is stagnant.

Besides that, the action of reducing interest rates would be ineffective if the liquidity trap was operative. The liquidity trap occurs when the demand for money is horizontal, thus ~~changing~~ increasing the money supply would not cause the interest rate to decrease. The liquidity trap occurs during times of strife such as natural disasters and large scale war happening, or during a recession such as the Great Depression.



The diagram shows the liquidity trap. Although the money supply has been increased from Ms_0 to Ms_1, the interest rate remains unchanged at r. Investments would not increase and national income would not either. L3 8

18

In conclusion, although lowering the interest rate ~~does~~ is an effective method to expand an economy, it is not the only policy available to increase national income. ~~Oth~~ Fiscal policies such as reducing tax rates and increasing government spending can help increase the national income, as well as supply side policies such as the Reagan income tax cuts in the 1980's. These policies can increase national income without causing inflation. The government should carefully review a policy and consider its effects on the economy before implementing that policy.

Examiner comment

This candidate gave a clear and reasoned account of the process of the multiplier in section a) with a conclusion on how an increase in investment or an increase in savings might affect the level of national income. There was a good account in section b) of the link between a change in interest rates and a change in investment. The weakness of the answer in section b) was that although the candidate began the final paragraph with the words 'in conclusion', the paragraph was really a very brief list of possible alternative policies to the use of interest rates. No development of these policies was given. The candidate did not, therefore, develop the answer to deal with the second part of the quotation in the question nor did the candidate draw a conclusion about the argument presented in the question. Overall, however, this was still a good answer.

Mark awarded = 18 out of 25

Example candidate response

9. An increase in investment ~~would mean~~ by the government or a firm refers to an injection of money into the economy. When, for example, a firm invests, it hires more factors of production. One main factor of production it hires would be labour. As a firm hires more labour, employment in the industry increases, causing increases in disposable income of the workers in the industry. According to the theory of the multiplier, ~~the in~~ a proportion of increased income recieved would be spent on consumer goods by the ~~consumer~~ worker. This spending would then become income for another firm/worker, and the proportion they spend on ~~[illegible]~~ goods/services would become income for another person. The multiplier, therefore refers to the number of times money is used in an economy. To calculate the value of the multiplier, we use the formula $\frac{1}{1-MPC}$ where

MPC = marginal propensity to consume, i.e. the proportion of money spent on an extra dollar earned by a person. ~~An injection, therefore adds to the circular flow of income between households and firms~~ An increase ~~in income would normally lower the value~~ in injections, and therefore incomes, would normally lower the value of the ~~margin~~ MPC, as when more income is earned, ~~while~~ the proportion spent on ~~ext~~ an extra dollar earned would fall. When the value of the MPC falls, the value of the multiplier increases. ~~This causes the number~~ This means that the extra $100 earned ~~to~~ by workers of the particular industry would have a much larger effect on the income within the economy, as money is rolled over more times. This causes an increase in real national income.

On the contrary, the desire for a consumer to save refers to a withdrawal from the circular flow of income between households and firms. This withdrawal causes money to be lost from the econ[illegible] goods and

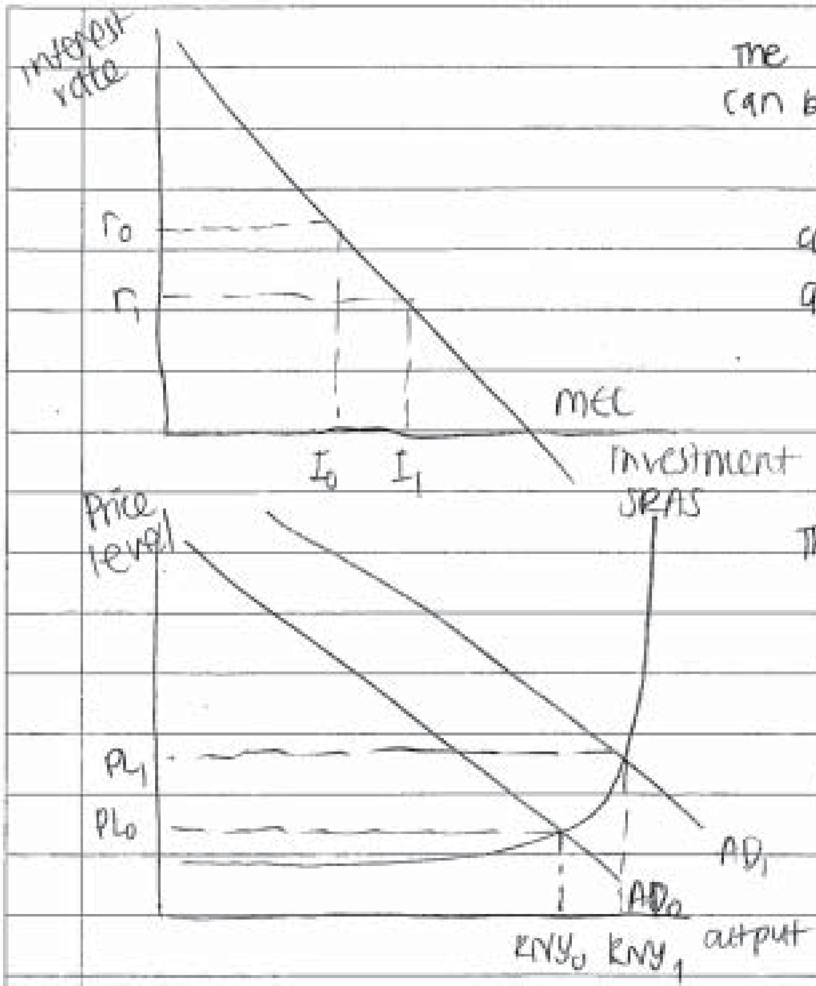
Leave blank

services. The marginal propensity to save (1 − MPC) refers to the proportion of money an individual saves for an extra dollar earned. An increase in the marginal propensity to save (MPS) would decrease the value of the multiplier, hence $\frac{1}{MPS}$. A decrease in the mutiplier value would mean that the $100 money is not being used ~~to~~ as many times, due to ~~to~~ households saving a larger proportion. This causes a decrease in real national incomes because less people are recieving portions of the extra income earned. ~~and therefore will face~~ ~~lowered~~

L3

7

b. Interest rates can be used to increase national income. This is because a fall in interest rates would lower the costs of borrowing for consumers and firms. Consumers would benefit from cheaper loans and cheaper mortgage repayments which would increase their ~~der~~ descretionary income (less money needed to pay for mortgages). The households will become more attracted to spending than to saving, as savings would not give good returns and therefore leads to a higher opportunity cost. ~~This increase this leads to an incr~~ When firms can borrow more cheaply, they are more likely to invest. ~~as it is set~~ Investment would lead to increased real national income, as mentioned in question A. ~~Both of th~~ Both increases in consumer spending and increase in investment would contribute to higher levels of aggregate demand.



The increase in investment can be shown via the marginal efficiency of capital diagram, where as interest rates fall from r_0 to r_1, investment increases from I_0 to I_1.

The increase in aggregate demand would lead to a move along the short run aggregate supply curve. Real national incomes would increase from RNY$_0$ to RNY$_1$.

Although the lowering of interest rates could have the potential of increasing ~~A~~ aggregate demand and therefore real national incomes, there are also other policies that would also lead to increases in national incomes.

An example could be a reflationary fiscal policy, where taxes are reduces and government benefits and ~~investment~~ spending increases. ~~Given that a high tax rate reduces a workers~~ The removal of taxes ~~[illegible]~~ would allow for increased discretionary income, and therefore consumer demand for goods and services would increase. ~~The~~ increased government spending would also produce income for ~~a cert~~ ~~certain wo~~ workers in certain industries, for example infrastructure. The multiplier effect would then allow real national income to increase, as these workers spend their ~~marginal~~ extra income. A reflationary fiscal policy would therefore also shift aggregate demand outwards and cause

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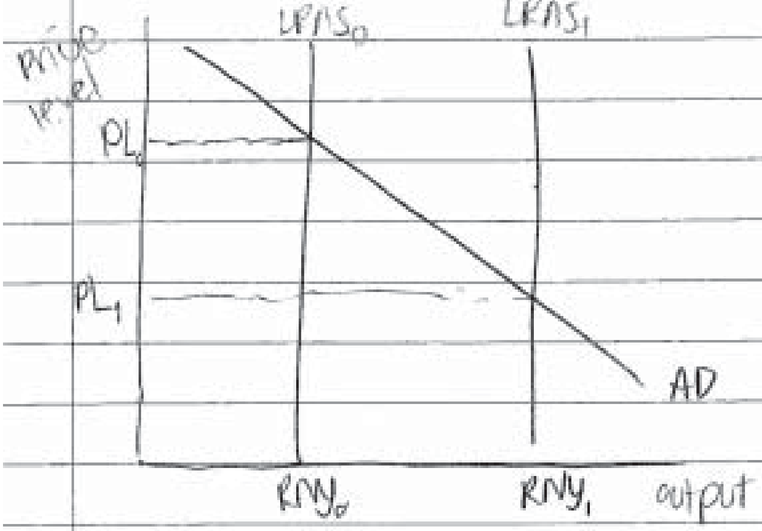
real national incomes to increase, while the multiplier would also take effect.

Another example would be the use of supply-side policies that aim to shift the long run aggregate supply curves to the right. This could include provision in education and training, so that workers have increased marginal revenue products that will determine their wages. ~~Of~~ Other supply side policies could be to remove taxes ~~and distortions in the labour market, so that wo~~ so that workers have more incentive to work and earn more income. The ~~sup~~ shifted LRAS would cause real national income to rise from RNY_0 to RNY_1.



Therefore, lowering interest rates may be a possible way to increase national income, but it is not the only way. There are other policies that will ~~give these also achieve~~ the aim for example fiscal and supply-side policies. The increase in real national income will be greater if these policies are used in combination with the others.

L3

8

15

Examiner comment

This candidate gave a correct response to both sections of the question. The weakness of the answer was not that it was incorrect but that it lacked development and discussion. Section a) could have given a fuller explanation of the multiplier process and section b) could have dealt more with alternative policies to interest rate changes.

Mark awarded = 15 out of 25

Question 7

(a) As an economy develops, the relative importance of different sectors of production changes. Explain, with examples, why the pattern of employment might change as an economy develops. [12]

(b) Discuss whether increases in economic growth are necessarily beneficial to an economy.[13]

Mark scheme

(a) The usual division of production is into primary, secondary and tertiary sectors. Developing economies move from a dependence on the agricultural sector through industrialisation. Along with this there is a growth in the service sector – industries relying on IT, call centres, tourism. The changes reflect changes in demand, income, urbanisation, government policy, comparative advantage and competitiveness. [12]

L4 For a clear explanation of why the relative importance of the productive sectors of the economy might change with good illustration or examples [9–12]

L3 For a less developed explanation with fewer examples [7–8]

L2 For a more general descriptive account with lack of comment on the causes of the change and with few examples [5–6]

L1 For an answer which has some basic correct facts but includes irrelevancies. Errors of theory or omissions of analysis will be substantial. [1–4]

(b) Economic growth involves greater production measured by changes in GDP/GNP. This could cause an increase in the standard of living, improved health, education and employment opportunities. There may be disadvantages. Poor working conditions, the growth of externalities, the careless depletion of resources. There may also still be questions of inequality in the distribution of income or whether the increased GDP is spent on things which might not give direct benefit e.g. military research. [13]

L4 For a discussion of the overall effect of growth on development presenting both positive and negative aspects with a conclusion. [9–13]

L3 For an analysis of the contribution of growth to development but with a concentration on either the positive or the negative aspects with a conclusion. [7–8]

L2 For a more descriptive account without much evaluation and without a conclusion. [5–6]

L1 For an answer which has some basic correct facts but includes irrelevancies. Errors of theory or omissions of analysis will be substantial [1–4]

Example candidate response

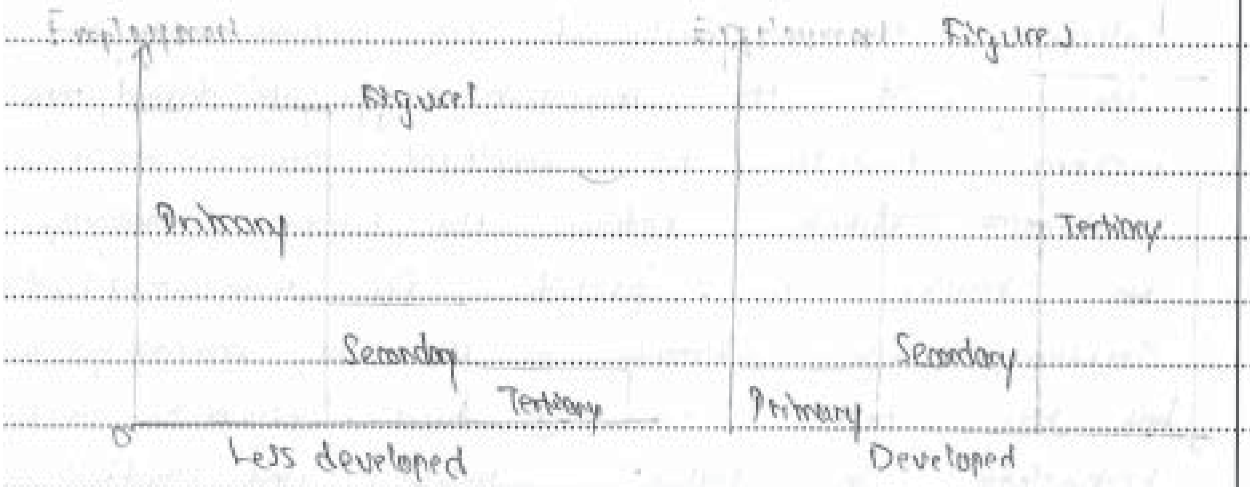
(d) As an economy develops, the economy is more prone to encounter economic growth and become an emerging economy. When a developing economy encounters economic development is starts moving towards developed economies by experiencing the same benefits as higher GNP, higher standard of living and better life. When an economy grows, the relative importance of different sectors like the primary, secondary and tertiary sector involvement will change.

An ~~develo~~ economy in the phase of development will start to focus more attention onto tertiary sector, with relatively more ~~focus to~~ ~~focus~~ focus to manufacturing sector and very less importance to primary sector. This is because the economy feels it is better off and people start to consider the primary sector as an inferior one with manual occupations such as fisherman, gardening. ~~they~~ The primary sector is more likely to become mechanised with modern equipment like cranes in sugar cane fields and large fishing vessel to reduce labour.

Secondly, in the manufacturing sector, more importance is given to capital intensive production rather than labour intensive. More robotisation and automation is likely to benefit all. Also, when the economy develops, more ~~fo~~ foreign investors like multinational companies [illegible] set up huge

~~man~~ manufacturing firms to produce for local market and ~~domestic~~ for exportation. Thus, Coca-Cola setting its plant and machinery in Mauritius has benefitted many locals in terms of job. Also, these foreign firms along with foreign direct investment bring their ~~expertise~~ expertise which makes the host economy more efficient. This is likely to increase the exportation causing a Balance of payment surplus.

Thirdly, employment in the tertiary sector in terms of doctors, accountants and other white collar ~~ce~~ jobs increase. This is because improvement in an economy in terms of human capital in the field of education and ~~polytechnique~~ polytechnique institutes make the local citizens literate. They prefer to get employed in these service sectors because of higher pay, less manual ~~pt~~ and physical effort and less risk to life. This can be shown as follows:



A ~~develop~~ country experiencing development will approach figure 2 in terms of its different sectors.

10

L4

(b Economic growth is a very complex phenomenon which cannot be brought down to a single definition easily by economists. Some economists describe economic growth as an increase in the real per capital income of the citizens of an economy usually accompanied by an improvement in net welfare. According to Ragnar Nurkse, economic growth has much to do with human endowment, social factors, political factors and history. Additionally, economic growth is shown by an outward shift in the production ~~possib~~ possibility curve of an economy. Increase in economic growth is not an unmixed blessing and have both its positive and negative aspects of an economy.

To begin, an increase in economic growth means the population is better off and is earning higher income. Thus, they will demand more goods and services to enjoy a higher standard of living. Therefore, the economy has to increase production to satisfy the wants of the consumers. ~~with~~ To cope with the increase in aggregate demand, more workers have to be employed cause a rise in employment which reduces the burden of constantly ~~be~~ having to provide for unemployment benefits. However, for example in Mauritius, economic growth ~~has~~ has been cause ~~d~~ by a rise in the use of technology in textile industries and therefore there is non-pregnant jobs. This as been termed by economists as the "catalytic crisis syndrome".

Furthermore, an increase in economic growth is beneficial as when more people are employed, they are more liable to pay taxes. Thus, the ~~tax~~ revenue of the government increases enabling it to finance more projects and ~~increase~~ ~~t~~ increase economic development in terms of infrastructure. However, if the government increases the tax threshold, less tax revenue will be ~~obter~~ obtained.

Increases in economic growth are beneficial as people enjoy a higher standard of living. There is less stressful life as more facilities are available for their leisure time. Also, economic growth entails that the economy is a favourable place for potential investment. Thus, foreign investors will be attracted to bring Foreign Direct Investment because of business optimism ~~pe~~ prevailing in the economy. This further improves national income.

~~Economic gr~~ ~~Economic growth means. Economic growth~~

Write on both sides of the paper

Nothing is to be written in this margin

However, economic growth involves some serious drawbacks. Economic growth refers to increased production of goods and services which imply more pollution and external costs. These external costs reduce the economic welfare of the citizens of the economy. Also, economic growth implies higher standard of living which brings along the "rich-man diseases" such as diabetes, hypertension, and cholesterol due to increased consumption. Thus, the extra income from economic growth goes to medical ~~treat~~ treatment. ~~Along~~ Also, economic growth can be disastrous when there is inequality of distribution prevailing in an economy. For example, in Saudi Arabia, the ~~St~~ rich Sheiks appropriates all the income leaving ~~no~~ others neither better off nor worse-off. This can lead to revolts by the middle-class persons and tension in the economy will discourage investors to invest. Also, economic growth can be due to the production of more capital goods than consumer goods. In countries like India where more producer goods is produced, the country enjoys economic growth but the ~~pop~~ population does not benefit. A rise in economic growth ~~a the time when I~~ ~~...~~ it makes people better off and they start demanding for imported goods. A rise in imports will definitely worsen the Balance of payment of the economy which may reduce the economy to be indebted. ~~Economic growth may make the citize~~

L4

9

19

Examiner comment

This candidate gave a clear explanation in section a) of the differing importance of the industrial sectors as an economy develops and consumers' expenditure and job aspirations change. In section b) the candidate gave a well-structured answer. It began with the beneficial changes caused by economic growth but this was balanced by a consideration of the drawbacks of economic growth in terms of pollution, changes in income distribution and changes in health, and possible discontent in the population because the economic growth had been fuelled by the production of capital goods which the population did not use.

Mark awarded = 19 out of 25

Example candidate response

(a) The sectors of production involves primary, secondary and tertiery ~~(the services sector)~~. Primary sectors are ~~major~~ majorly agriculture production or raw material minding. ~~Sector~~ Secondary sectors involves ~~manufacturing~~ machinary manufactory. The tertiery sectors ~~are~~ are considered as services sector.

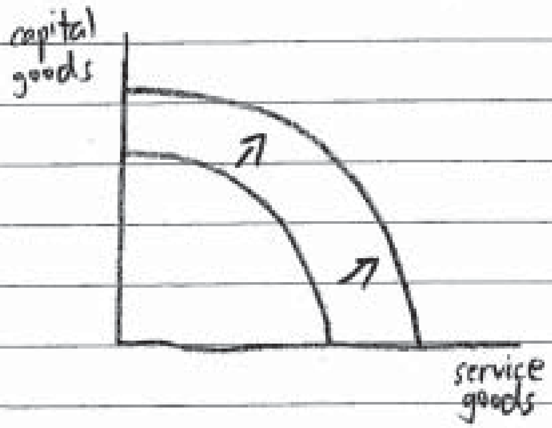
When economy was not developed, the country is majorly rely on primary sectors, with only few secondary, but almost no service sectors, because they have limited capital input to operate machins or services. As economy develops, the amount of capital available increase, they no longer have to rely on their primary sectors, ~~the~~ because land and labour are not the only factors of production they have. So the amount of primary sectors contribute to overall economy will be lower. ~~En~~

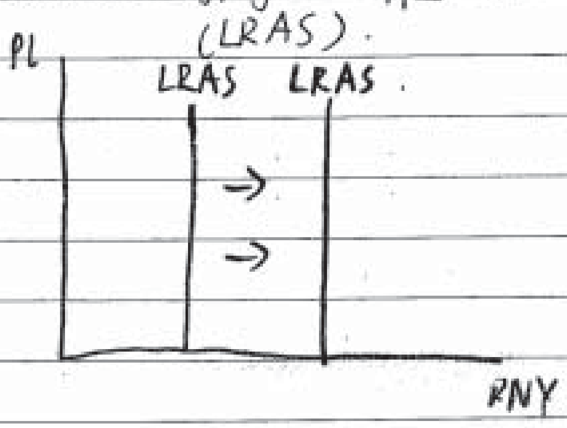
In short run, the manufactorying sectors will increase their contribution as they have more capital input, but in long run, it will move to the service sector, because they can purchase the primary or secondary product from aboard, but improves the goods and services within the country, to improve the living standard. Also, there is a forth sector where it is for technology developing, ~~as~~ a better technology can improve the ~~ec~~ economy growth.

The example of this is ~~t~~ between USA and ~~Africa~~ Africa. USA is a well developed country while Africa ~~we~~ is not well developed. USA often buy the raw materials ~~or other~~ such as diamond, iron or other resources from Africa, which is in primary sector. But the service provided in USA is super excellent compared to Africa. The reason for change in employment partterns are usually because of people wants a better living standard, and also a easy ~~job~~ and safe job. raw material mining or other primary sector's jobs are very tiring and have a risk of dangerous. Also the service sector requires high education and good skills, which is only able to generate very well in developed countries. L2

6

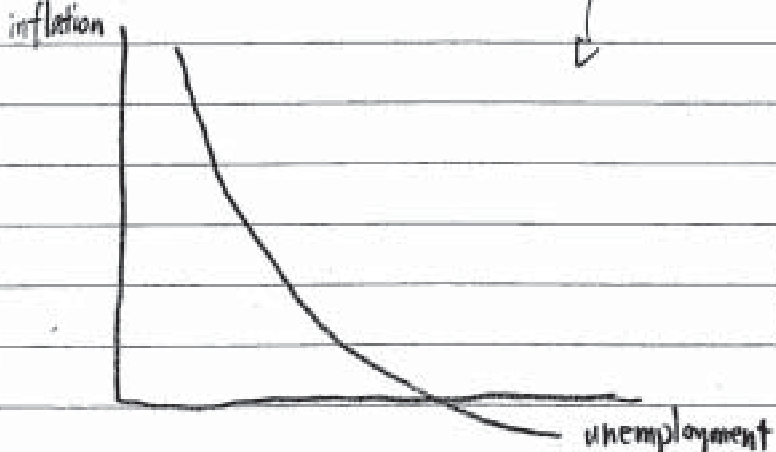
(b) Economic growth is the long term expansion of productive ~~cap~~ capacity in an economy. The rate of economic growth is measured in increasing in real GDP. It can be shown on PPF and Long Run ~~AS curve~~ Aggregate Supply curve (LRAS).





The economic growth result in shift out in PPF and shift out in LRAS. It has a lot of benefits. Firstly, people are having better living standard because of higher income and better ~~serv~~ service ~~produc~~ provided. ~~The health car~~ For example: the increased health care is able to longer people's life expectancy. Also during economic growth, consumers are having high confidence, therefore consumption and investment will increase which lead to increase in national income. The technology will also improved in order make better quality product or better infrastructure to make people's life ~~more~~ easier and more enjoyable.

~~Hower~~ However there are ~~several~~ some drawbacks. First of all, the environmental concern. The resources are running out because of higher production, more pollution and waste created which can affect people's health. Also the ~~extinct~~ extinction of species because of increasing deforestation and ~~lead to people animal~~ make animals ~~homelet~~ homeless. Secondary, economic growth can result in more income inequalityies because most of increasing GDP is resulted by rich people, while poors remain poor. It could cause a lot ~~socie~~ social problems such as crime. Last but not the least, from the phillip's curve, we can know that economic growth cause inflation, the graph is shown below:



~~The~~ economic growth will result in less unemployment, so people's average income will increase, so lead to higher AD. ~~therefore~~ Business will facing an increasing pressure on wage, therefore they will pass the cost to consumers. All the firm also want to increase their profit margin, so they will rise the price.

In conclusion, economic growth is necessarily beneficial to an economy, but the severaral negative effect should not be

Leave blank

ignored. Government must intervene ~~the~~ and introduce some policy such as supply side policy, to ~~improve the [illegible]~~ ~~[illegible]~~ reduce the negative effect on economy. L3

8

14

Examiner comment

This candidate referred to the change in the importance of the proportion of people employed in different industrial sectors in section a) and considered some of the possible advantages and drawbacks of economic growth in section b). The weakness of the answer was that both sections, although correct, lacked development with either further explanation or discussion.

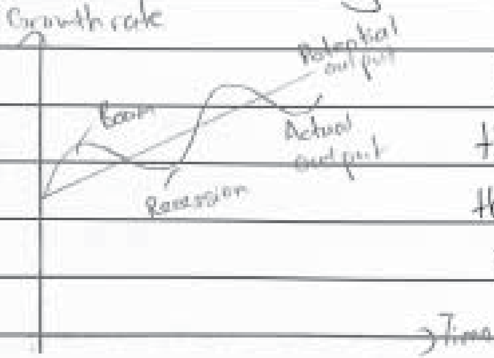
Mark awarded = 14 out of 25

Example candidate response

7a) The development of an economy can lead to changes in its structure in terms of goods and services produced as well as the growth and contraction of different sectors. This can cause the employment rates ~~a~~ in an economy to change drastically. Whatever the case of economic development, unemployment is avoidable, as there will definitely be some people who will be unemployed.

As the structure of an economy changes, the importance of different sectors in an economy changes as well. However, ~~in this~~ the mobility of labour cannot possibly keep up with this change as mobility depends largely on human capital and human capital takes time to be instilled. As a result, many labourers who are unfamiliar with the change in economic structure would find themselves unable to contribute and laid off work. This is known as structural unemployment. The Industrial Revolution in ~~the~~ Great Britain is a classic example of this. As the country moved from dependence on agriculture to manufacturing, farmers began to become unemployed as they were not familiar with the processes of the manufacturing industry. This resulted in a period of time where there was large scale unemployment. Fortunately, this form of unemployment can be overcome if people are willing to increase human capital by undergoing training and education.

The growth of an economy is not as smooth as we would like it to be. There are times when an economy experiences a ~~big~~ huge expansion (boom) and times when the economy faces recession. This instability of the economy



cause the employment trend to follow it. During the times where the economy experiences a boom there is very little unemployment. However, during the recession, unemployment would be very high. This is known as cyclical employment. An example of this is the financial crisis in 2008 where a large number of people in the United States faced unemployment. Since then, employment rates have been improving with the recovery of the economy.

In conclusion, the pattern of growth of an economy very much affects the state of ~~an economy~~ employment in an economy. Since one of the macroeconomic goals is to achieve full employment, the presence of unemployment is seen to be a scourge in the economy. Unfortunately, it is impossible to achieve full employment in an economy, but the right policies can bring the employment rate close enough to full employment.

L1 4

7b) Economic growth is probably the most important of all the economic goals of the macroeconomy. Growth is seen as a prestegious thing in the eyes of all governments. To economists, growth is the sustained increase in the ~~national income of~~ overall standard of living in a country. There are many benefits of economic growth to an economy.

Economic growth indicates a higher standard of living of a country's ~~of~~ population. Since economic growth is indicated as the increase in gross domestic profit (GDP) of a country, it also means that the GDP per capita of ~~a~~ the economy is higher, indicating that the population is better off due to an increase in real income. ~~However, this~~ The population is able to purchase more goods and services. However, the usage of economic growth ~~f~~ as an indicator of the standard of living is a flawed method because it does not take into account the income distribution gap between the rich and poor. India for example has one of the highest GDP's in the world. However, the income gap between India's rich and poor is very large. ~~I GDP there~~ Growth therefore does not necessarily mean a higher standard of living. A better measurement is the Human Development Index.

Economic growth also promotes employment in an economy. As an economy grows, different sectors of the economy would expand and diversify as well. This would create job opportunities for the population and hence increase the employment rate. However, the increase in employment and growth conflicts with the objective to keep inflation low, as employment and inflation have an inverse relationship. It is not possible to have low inflation rates and yet ~~be~~ have high employment rates as well.

Economic growth can also boost the competitiveness of an economy internationally. ~~Wh~~ With growth, more money can be invested into research and development to produce goods and services at a lower cost. This would enable countries to sell and export their goods at lower prices, allowing countries to export more and thus improve the balance of trade of that country. ~~However, this could also~~

In conclusion, economic growth is beneficial but at the same time harmful to an economy. The government needs to implement suitable policies to ensure that the five macroeconomic goals do not conflict with each other and can be achieved.

L3 7

11

Examiner comment

This candidate gave a relatively undeveloped answer to section a) which dealt with structural and cyclical unemployment. Although mention was made of a shift between sectors in the industrial revolution in Great Britain the idea of a change in the relative importance of different sectors as a country develops was not elaborated. The answer to section b) had a good structure to it; both the advantages and disadvantages of economic growth were mentioned. The weakness of the answer was that these changes were not developed nor discussed at any length. This was a pity as there was a clear attempt to balance one side of the argument about economic growth against the other.

Mark awarded = 11 out of 25

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