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O Level

Example Candidate Responses (Standards Booklet)

Cambridge O Level
Economics

2281

For examination from 2014

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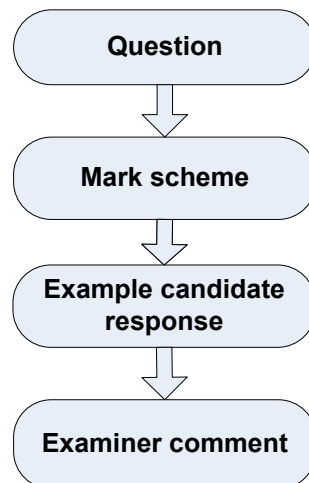
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Introduction

The main aim of this booklet is to exemplify standards for those teaching Cambridge O Level Economics (2281) 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 from Paper 2 to exemplify grades A, C and E. Each response is accompanied by a brief commentary explaining the strengths and weaknesses of the answers.

For ease of reference the following format has been adopted:



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 candidates have done to gain their marks and what they still have to do to improve their grades.

This booklet does not cover Paper 1 candidate responses as it is a multiple-choice question paper. The mark scheme provides sufficient detail and the candidate answers do not require examiner commentary to expand on why the marks were given.

Past papers, examiner reports and other teacher support materials are available on Teacher Support at <http://teachers.cie.org.uk>

Assessment at a glance

The assessment has two components, Paper 1: Multiple choice and Paper 2: Structured questions. Candidates must take both papers. Candidates receive grades from A* to G.

| | |
|---|---------------------------|
| Paper 1 Multiple choice | 45 minutes |
| Candidates answer 30 multiple-choice questions. Weighted at 30% of total available marks. | |
| Paper 2 Structured questions | 2 hours 15 minutes |
| Candidates answer one compulsory question, which requires them to interpret and analyse previously unseen data relevant to a real economic situation, and three optional questions from a choice of six. Weighted at 70% of total available marks. | |

Paper 2 – Structured questions

Question 1

1 The challenges facing Angola

Angola is one of the fastest growing economies in the world and also one of the most specialised. It had an average annual growth rate of 11% between 2002 and 2012. In 2010, the country's capital city, Luanda, was the most expensive capital city in the world. The average fare charged by the only taxi (cab) firm in the city was high at US\$50, and a standard house cost more than US\$1m to buy.

Oil production plays a key role in the economy. The country produces 1.9m barrels of oil a day and this is expected to double by 2020. There is the possibility that Angola could overtake Nigeria to become Africa's largest oil producer. The oil industry accounts for most of the country's output, provides 97% of its export revenue and 75% of government tax revenue.

Economists have expressed concern that the country is too dependent on oil. Sonangol, the state-owned oil enterprise, is seeking to diversify. It is already involved in banking and it also owns an airline and a football team. The government is trying to develop other industries. One of these is the diamond industry. World demand for diamonds increased in 2012.

The Angolan Government faces a number of challenges in promoting other industries. One of these is a lack of capital equipment in its manufacturing industries, and another is that much of its agriculture is in the form of subsistence farming.

The economy faces other problems and three of these are connected. They are a widening gap between the rich and the poor, a lack of education, and a rapidly growing population. Some people in the country are very rich but 35% of the population live in poverty. Half of the population have no access to health care, the infant mortality rate is one of the highest in the world, and life expectancy is one of the lowest. Most of the population only experience five years of education and a third of adults are illiterate. Between 2005 and 2010, the country had the eighteenth fastest growing population which might have influenced its level of average income – see Table 1.

Table 1: Population growth, Gross Domestic Product (GDP) and GDP per head in selected African countries in 2011

| Country | Population growth (annual % change) | GDP (US\$bn) | GDP per head (US\$) |
|--------------|-------------------------------------|--------------|---------------------|
| Angola | 2.92 | 120 | 6000 |
| Kenya | 2.58 | 72 | 1800 |
| Nigeria | 2.50 | 420 | 2600 |
| South Africa | 0.96 | 562 | 11 100 |
| Uganda | 3.24 | 47 | 1300 |

In 2012, Angola was experiencing an overall unemployment rate of 26% and an unemployment rate of 50% among the young. The Angolan Government was considering cutting taxes to reduce unemployment.

- (a) Why is the Angolan economy considered to be 'specialised'? [2]
- (b) Using information from the extract, explain why taxi (cab) fares were high in Luanda in 2010. [2]
- (c) Using information from the extract, draw a demand and supply diagram to show what is likely to have happened to the price of diamonds in 2012. [4]
- (d) Explain why countries with a high population growth rate may have a lower average income than countries with a lower population growth rate. [3]
- (e) Analyse whether the information in Table 1 supports the view that countries with a high population growth rate have a lower average income than countries with a lower population growth rate. [4]
- (f) Discuss whether an increase in a country's GDP will reduce poverty in that country. [5]
- (g) Using information from the extract, explain **two** reasons why labour productivity is low in Angola. [4]
- (h) Discuss whether a cut in taxes will reduce unemployment. [6]

Mark scheme

1 (a) Why is the Angolan economy considered to be 'specialised'? [2]

1 mark each for any of the following two:

- most of its output is oil/plays a key role in the economy/country too dependent on oil/dependent on oil/most of its resources are devoted to oil
- oil production accounts for 97% of its export revenue
- provides 75% of government tax revenue
- government trying to develop other industries/diversify

Note: no marks for produces 1.9m barrels a day/large quantity of oil/specialises in oil.

(b) Using information from the extract, explain why taxi (cab) fares were high in Luanda in 2010. [2]

1 mark for recognising there is only one firm/a monopoly.

1 mark for mentioning that the lack of competition enables firms to drive up price/firm is a price maker/price can be driven up because demand is inelastic.

(c) Using information from the extract, draw a demand and supply diagram to show what is likely to have happened to the price of diamonds in 2012. [4]

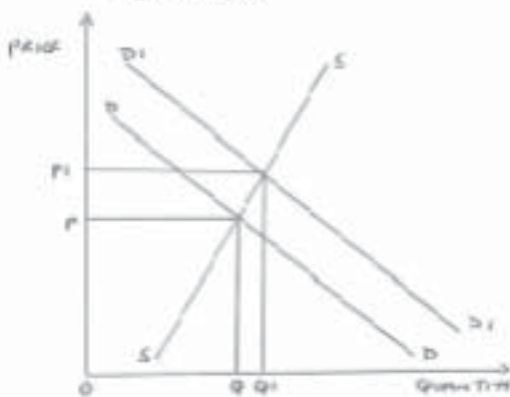
1 mark for axes correctly labelled – price and quantity or P and Q.

1 mark for demand and supply curves correctly labelled.

1 mark for demand curve shown shifted to the right.

1 mark for correct equilibriums identified either by lines drawn to both axes or equilibrium points clearly identified e.g. E and E1.

Figure 1(c)



(d) Explain why countries with a high population growth rate may have a lower average income than countries with a lower population growth rate. [3]

- May result in more dependants [1] due to rise in birth rate or fall in death rate [1].
- May mean fewer workers [1] if there is a high birth rate, there may be fewer parents in the labour force [1].
- A higher labour force may increase competition for jobs [1] may push down wages [1].
- There may not be enough vacancies [1] for increasing number of potential workers [1].
- Resources may be devoted to providing for the extra population [1] rather than expanding productive capacity [1].

- Population may grow more rapidly than GDP/average income is GDP divided by population [1].
- Population growth may be caused by low income [1].

Note: these points may be inter-linked. 3 marks may be awarded for one reason that is well developed.

(e) **Analyse whether the information in Table 1 supports the view that countries with a high population growth rate have a lower average income than countries with a lower population growth rate.** [4]

- Generally the information supports the view/ supports the view. [1]
- Uganda has the highest population growth rate and the lowest real GDP per head/Kenya's population growth rate is higher than Nigeria's and its income per head is lower. [1]
- South Africa has the lowest population growth rate and the highest real GDP per head. [1]
- Angola is an exception – second in both rankings. [1]

(f) **Discuss whether an increase in a country's GDP will reduce poverty in that country.** [5]

Up to 3 marks for why it might:

Up to 3 marks for: may generate more tax revenue [1] which can be used on spending on benefits [1] or on measures to reduce poverty in the long run e.g. education and health care [1].

Up to 3 marks for: high GDP may increase average incomes/living standards [1] higher incomes may enable people to spend more on basic necessities [1] such spending will reduce absolute poverty [1].

Up to 3 marks for: higher output will create jobs [1] this will reduce unemployment [1] with more in work absolute poverty will fall [1].

Up to 3 marks for why it might not:

Up to 3 marks for: income may be unevenly distributed [1] and so not every one may benefit from higher incomes [1] and so relative poverty may rise [1] even if absolute poverty falls [1].

Up to 2 marks for: real GDP may not have increased [1] need to adjust for inflation [1].

Up to 2 marks for: (real) GDP per head may not have increased [1] if population has risen by more than GDP [1].

Maximum of 3 marks for a list-like response.

(g) **Using information from the extract, explain two reasons why labour productivity is low in Angola.** [4]

1 mark each for two reasons identified:

- lack of capital equipment
- subsistence farming
- lack of education/high degree of illiteracy
- poor health care.

1 mark each for two reasons explained:

- workers will not be able to produce much if they are working with low amounts of capital
- subsistence farming tends to use poor quality resources
- poor education will mean workers are unable to work with advanced technology/will be less inventive/will lack skills
- poor health care may result in workers being off sick/being tired.

(h) Discuss whether a cut in taxes will reduce unemployment.

[6]

Up to 4 marks why it might:

Up to 3 marks for: a cut in income tax will increase disposable income [1] this may increase the incentive to work [1] a greater incentive may reduce voluntary/frictional unemployment [1].

Up to 3 marks for: a cut in corporation tax will increase the profit firms can keep [1] this may encourage firms to expand [1] and so take on more workers [1].

Up to 3 marks for: a reduction in income tax and indirect taxes will increase purchasing power [1] this may increase demand [1] and so cyclical unemployment may fall [1].

Up to 4 marks for why it might not:

Up to 3 marks for: firms may not spend extra profits on expansion [1] if they lack confidence [1] that they will sell the extra output [1].

Up to 3 marks for: consumers may not spend extra income [1] if they lack confidence [1] instead they may save the extra income [1].

Up to 3 marks for: tariffs may be cut [1] which may increase imports [1] and raise unemployment, at least, in the short run [1].

Up to 3 marks for: government spending may fall [1] due to less revenue [1] and as a result cyclical unemployment may stay unchanged/increase [1].

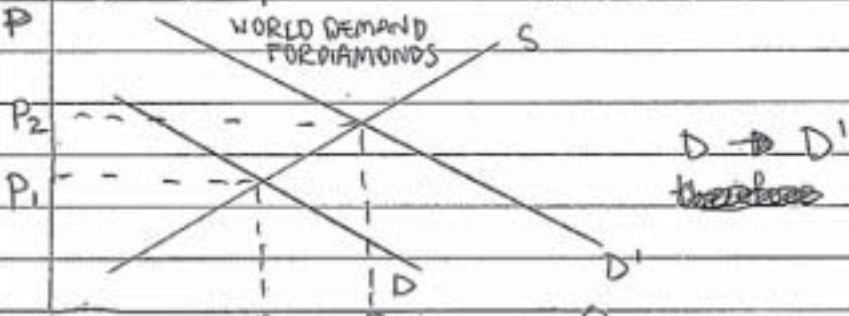
Up to 3 marks for: higher demand may cause inflation [1] may result in workers pressing for wage rises [1] firms may make workers redundant to cut costs [1].

Up to 3 marks for: a cut in taxes on firms may encourage firms to use more capital-intensive methods (1) resulting in lower demand for labour (1) causing technological unemployment (1)

Up to 2 marks for: frictional and structural unemployment may not fall [1] if unemployed workers are still occupationally and/or geographically immobile [1].

Maximum of 3 marks for a list-like response.

Example candidate response – grade A

| | | |
|---|---|--|
| 1 | a | The Angolan economy is considered to be specialised because most of the country's output depends on one good only, which is oil. |
| 1 | b | Taxi fares in Luanda were high in 2010 because there is only one taxi firm in the city, therefore there is a monopoly, which makes it possible for the firm to charge high prices because there are no other options. |
| 1 | c |  <p>Demand increased therefore Q from Q_1 to Q_2 therefore prices also increased from P_1 to P_2.</p> |
| 1 | d | Countries with a high population growth rate may have a lower average income than countries with a lower population growth rate because the total sum of incomes will have to be divided by a larger population to calculate the average income. also Also, population growth happens when birth rate increases and death rate decreases, increasing the dependency ratio, as less people will be working therefore average incomes will be lower. |
| 1 | e | Uganda, which has the highest ^{change} percentage of population growth amongst the listed countries has the lowest average income and South Africa, which has the lowest percentage and change of population growth has the highest average income so they support the view that countries with a high population growth rate have a lower by average income than countries with a lower population growth rate, but Angola's population growth (annual % change) is higher |

| | | |
|---|----|--|
| | | than Kenya and Nigeria's, to and its average income is still higher than theirs. |
| 1 | f | <p>The gross domestic product is the measure for the total output in a given area for a given time. If GDP increases it means there is a high output, which means high demand for the goods in the country. High ^{High} demand means more profit for firms so they might increase the their workforce and decrease unemployment and poverty. High the aggregate demand in a country also means higher tax revenues for governments which can be used to produce ^{produce} more public goods and services, such as health care and education is that will decrease poverty and living standards standards. However, an increase in GDP may not reduce poverty if only few people benefit, widening the gap between rich and poor even more. Also, if GDP increases without an increase in living standards (e.g. health care) and education, the poor will stay poor, and rich will not because of lack of productivity, caused by poor health, and lack of skills and qualifications necessary to find a job and earn income.</p> |
| 1 | g. | The population in Angola lacks education, necessary for people to learn more skills and qualifications to improve efficiency and thus productivity. They also lack healthcare, which means people will be ill more often and for longer periods of time, decreasing productivity. |
| 1 | h | A cut in taxes means firms will earn more profit because they will have a smaller tax on profits made and they might use that profit to |

| | | |
|--|--|---|
| | | Employ more workers, reducing unemployment. |
| | | Lower taxes on incomes means people will have more to spend on goods and services, increasing aggregate demand, so they will buy more |
| | | High demands means more profit for firms which will have need for an even larger workforce, decreasing unemployment. |
| | | There A cut in taxes will ^{may} have a multiplier effect. However, firms may not increase labour and use the extra profit to invest in different sectors such as new machinery. Demand may still remain low even if prices are lower because people still cannot afford them or because they want to save for future spendings and therefore firms may not earn more profit and might not hire more workers. |

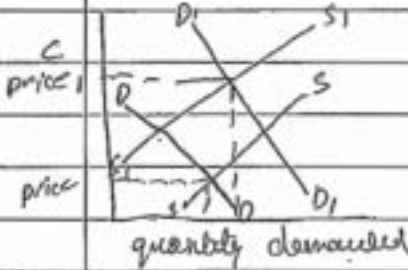
Examiner comment – grade A

- (a) The answer might have provided more evidence but it does note that most of Angola's output is oil. (1/2)
- (b) A brief but pertinent answer which recognises the significance of there being only one taxi firm in Luanda. (2/2)
- (c) An accurate and well-labelled diagram is produced here. As the question asks candidates to 'draw a demand and supply diagram to **show** what is likely to have happened to the price of diamonds in 2012' it was not necessary to provide written comments. (4/4)
- (d) A perceptive answer which recognises how average income is calculated and explains the impact that a high population growth rate may have on the dependency ratio. (3/3)
- (e) There is a good approach here to the question. The candidate's answer provides an accurate interpretation of the table to draw the conclusion that most of the evidence does support the view. It backs this up with relevant data and mentions an exception. (4/4)
- (f) This is again a strong answer. There are clear analytical links established between higher GDP, total demand, unemployment, tax revenue and poverty. The discussion then goes on to consider why an increase in GDP may not reduce poverty. This recognises that not everyone may benefit and that the poor may not be able to gain employment. (5/5)
- (g) Two relevant reasons are identified. The explanation is stronger on the lack of education but is just sufficient on health care. (4/4)

- (h)** This is good on why a cut in taxes may reduce unemployment, recognising the possible effect on the ability and incentive for firms to take on more workers to increase output. It starts examining the alternative possibility well by mentioning that firms may employ more machinery than workers. It comes close to making a relevant point about how people may not spend more but this could have been clearer. For example, it might have been linked to cuts in income tax rates or to what products the cuts in indirect taxes are affecting. (5/6)

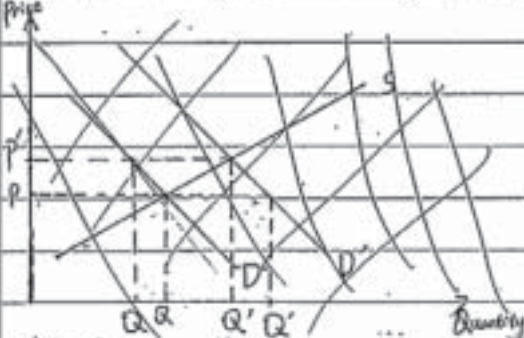
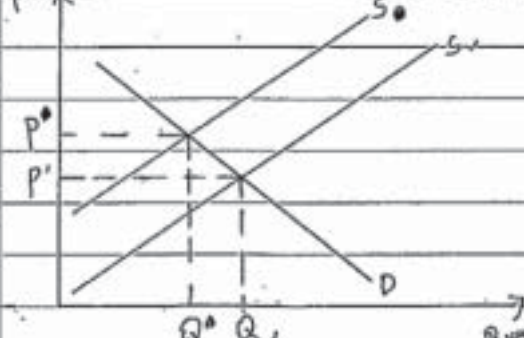
Total mark awarded = 28 out of 30

Example candidate response – grade C

| | | |
|---|---|--|
| 1 | a | <p>The Economy is Considered to be Specialized Since according to them they can double the output of oil from 1.9 million barrels, which means that they will be using their resources more efficiently as the labour is going to be more productive and only because of Specialization output can be increased</p> |
| | b) | <p>Since the Land is said to be said to be the most expensive capital in the world so along with other expenses such as housing & cost of operating a taxi also has to be high Since the operating charges are high the fares are also going to be higher</p> |
| |  | <p>Since the demand had increased the supply has also increased along with the price of the diamonds</p> |
| | d) | <p>Countries which have started having lower population growth rate have their population more educated and skilled which helps them get jobs with better pays and which increases the average income since the population has not been increased and the increased income of government is also divided between fewer people which also helps them to increase average income rate.</p> |

| | |
|----|--|
| e | <p>Yes, Countries with lower population growth change have their GDP higher and GDP per head as well as the labour gets more productive, and skilled and educated the population growth starts to fall, but then people who are extremely rich also help to increase the average income and in some countries inequality is usually more than others.</p> |
| f | <p>GDP is the measure of the total output of country when the GDP increases this means that more goods are produced and to produce more goods more labours are required or higher productive labours as well, when the GDP starts increasing. Sometimes when the GDP seems to be increasing investors can see better future and they want to expand by investing more and they employ more labours or increase wage rates to attract skilled labours which also increases the employment and when the gdp GDP increases along with employment the country's revenue also starts to increase which increases public sector expenditures to infrastructure and it further more boosts employment which helps to get out of poverty.</p> |
| g) | <p>The population rate is rising and people aren't educated and skilled which decreases their efficiency and labour productivity.</p> <p>The capital lacks in the country because of which companies cannot use machinery and equipment.</p> |

Example candidate response – grade E

| | | |
|----|----|--|
| 1. | a. | <p>Because Angola is one of the fastest growing economies in the world it had an average annual growth rate of 11% between 2002 and 2012. In 2010, the country's capital city Luanda, was the most expensive capital city in the world. For example the average fare charged by the only taxi firm in the city was to high at US \$50.</p> |
| 1 | b. | <p>Oil production plays the key role in the economy. The oil industry accounts for most of the country's output, provides 97% of its export revenue and 75% of government tax revenue. The taxi fares were high in Luanda in 2010 because the tax was so high so the tax increase, the price of oil increase and the oil industry accounts for most most of the country's output.</p> |
| 1 | |  <p>look at this demand and supply diagram. We know that.</p> |
| 1 | c. |  <p>look at this demand and supply diagram. We can see... In 2012 the demands increase so the price of diamonds decrease.</p> |
| 1 | d. | <p>Because countries with high population growth rate are all developing country this kind of country have high death rate and high birth rate and the most of the people in this country get a income as the primary factor. A lot of them are not unskill to labours so the GDP is low. but the country with a lower population growth.</p> |

| | | |
|---|----|--|
| | | rate have lower death rate and lower birth ^{infant mortality} rate and. This kind of country have more skill labour workers and lower re employment unemployment. |
| 1 | e. | Because the ^{people in the} country with a high population growth rate, most of them work at at the primary factor the income of primary factor is very low and most of the people in it are ^{are} unskill labours so the income in this kind of country is lower the countries with a lower population growth rate. |
| 1 | f | An increase in a country's GDP means the living standard of the this country's people become better than be before and the the average cost increase, the income increase, that means more pe and the unemployment decrease that means less people lived in hungry and pain level. so the pe her number of poor decrease, poverty reduce in that country. |
| 1 | g | Some people in the country are very rich but 35% of population live in poor poverty and half of the population have no access to health care. Most of the population only experience five years of education and a third of adults are illiterate. so most of people in this country are not healthy and un unskilled. so the labour productivity is low in Angola. |
| 1 | h | If the taxes reduce the price of goods will decrease too so people can use the same value of money to buy more things and more people can have the chances to study and more more people can have enough food and become healthy. so the unemployment will decrease too because of the decrease of taxes. |

Examiner comment – grade E

- (a) The candidate is lifting information from the extract but it is neither interpreted nor related to the question. (0/2)
- (b) Some of this answer would have been more relevant to question 1(a). Again, the answer does not directly answer the question. (0/2)
- (c) The axes and the demand and supply curves are labelled accurately. Unfortunately, the supply curve rather than the demand curve is shifted to the right. (2/4)
- (d) There is some awareness shown of the causes of a high population growth rate but there could have been more direct links established between a change in population and a change in average income. (1/3)
- (e) The candidate, unfortunately, does not answer the specific question set. There is no reference to the information in Table 1. (0/4)
- (f) This is a relevant answer but it is one-sided. The candidate recognises that living standards may rise due to higher income and that unemployment may fall. These points might have been developed further and the reasons why a higher GDP may not reduce poverty is not covered. (2/5)
- (g) This is a good answer. Two relevant reasons are identified and the reason why a lack of education leads to low productivity is explained. (3/4)
- (h) The answer starts quite well by recognising that lower taxes may reduce prices. The link to lower unemployment is not established and the answer does not cover any other points. (1/6)

Total mark awarded = 9 out of 30

Question 2

- 2 A number of economies are devoting more of their resources to the provision of health care. Due to the economic problem, this involves them having to make difficult choices.
- (a) What is meant by the 'economic problem'? [2]
- (b) Using a production possibility curve diagram, explain why choices have to be made as to how to allocate resources. [6]
- (c) Explain how resources are allocated differently in market and mixed economic systems. [4]
- (d) Discuss whether an economy would benefit from an increase in the provision of health care. [8]

Mark scheme

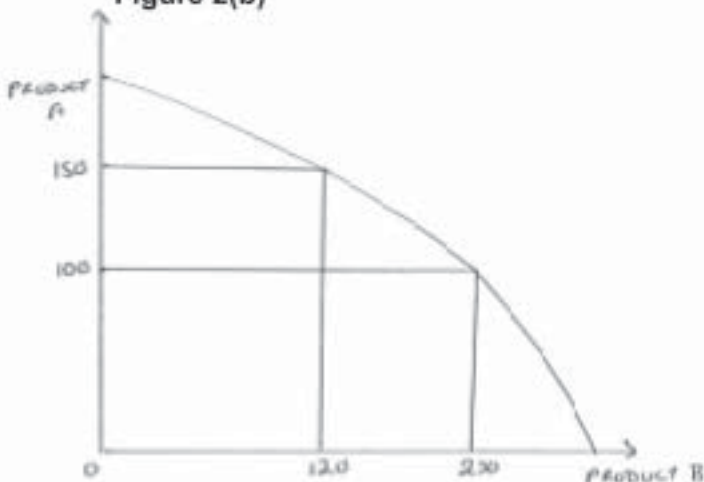
- 2 (a) **What is meant by the 'economic problem'?** [2]
2 marks for wants exceeding resources or wants are unlimited/infinite whilst resources are limited/finite or 1 mark for limited resources or scarcity.

- (b) **Using a production possibility curve diagram, explain why choices have to be made as to how to allocate resources.** [6]

Up to 3 marks for the diagram:

- 1 mark for axes correctly labelled in terms of two different products or types of products.
- 1 mark for curve or downward sloping line – drawn to the axes.
- 1 mark for showing a trade off.

Figure 2(b)



Up to 3 marks for written comments:

- definition of opportunity cost (1)
- recognition choice arises because of scarcity (1)
- example based on the diagram: if an economy produces e.g. 200 units of B it cannot produce 150 units of Product A (1)
- recognising that if an economy chooses to allocate more resources to making one product, it has to allocate fewer resources to another product/chooses to make more of one product it has to produce less of another product (2).

- (c) Explain how resources are allocated differently in market and mixed economic systems. [4]

Up to 3 marks on market economy:

1 mark for recognising that in a market economy the price system allocates resources.

1 mark for referring to the rate of demand and supply in a market economy/consumer sovereignty.

1 mark for role of the profit motive in a market economy.

1 mark for resources are allocated by the private sector/there is no government intervention.

Up to 3 marks on mixed economy:

1 mark for recognising the price system determines the allocation of some resources in a mixed economy.

1 mark for recognising that the government decides on the allocation of some resources in a mixed economy e.g. governments produce public goods, governments produce or subsidise merit goods and tax demerit goods.

1 mark for recognising there is both a private and public sector.

- (d) Discuss whether an economy would benefit from an increase in the provision of health care. [8]

Up to 6 marks for why it might:

Up to 3 marks for: likely to improve the health of workers [1] this should raise labour productivity [1] and so increase output/GDP [1].

Up to 3 marks for: possible reduction in birth rate [1] this may increase the labour force [1] and reduce dependency ratio [1].

Up to 2 marks for: likely to increase the quality of life/standard of living [1] which should increase life expectancy [1]

Up to 2 marks for: more people are likely to be employed in health care [1] this may reduce unemployment [1].

Up to 2 marks for: may make an economy a more attractive destination for FDI [1] which may provide a number of benefits e.g. advances in technology, higher employment [1].

Up to 6 marks for why it might not:

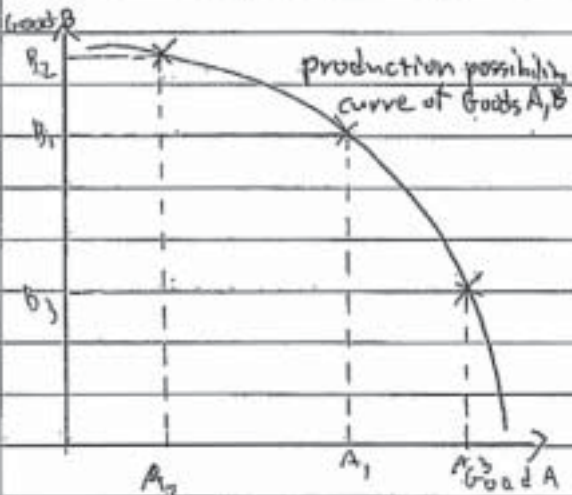
Up to 3 marks for: if resources are fully employed [1] it will involve an opportunity cost [1] e.g. fewer resources may be devoted to education [1].

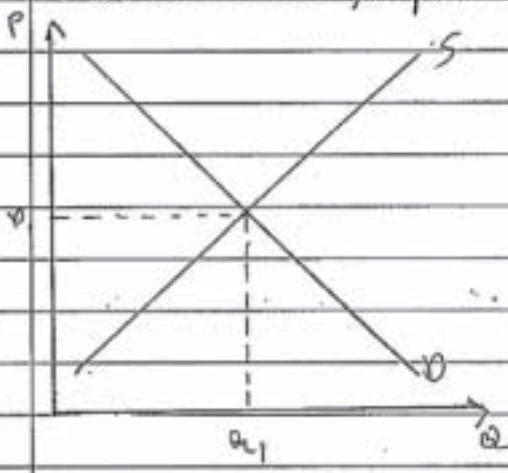
Up to 3 marks for: may reduce the death rate [1] this may increase dependency ratio [1] and increase the cost of pensions [1].

Up to 3 marks for: more health care may be provided but the quality may not rise [1] population may increase by more than the extra provision [1] inefficiency may rise [1].

Maximum of 4 marks for a list-like response.

Example candidate response – grade A

| | | |
|----|----|--|
| 2. | a. | The economic problem is that there is a scarcity in resources and an unlimited demands i.e. resources are finite whereas wants are infinite. |
| | b. |  <p>The production possibility curve shows us that there is an opportunity cost in allocating resources in an economy, this is the next best alternative for someone when choosing something. The curve</p> |
| | | Shows the maximum amount of resources available to a firm or an individual when allocating resources. They can use the amount of resources under or on the curve but can not above as resources are finite. The curve shows that if more resources are used in producing good B (at B ₂) then less resources are allocated to good A (A ₂). The opportunity cost here is the number of good A that could have been produced. Vice versa, if more of good A is produced (A ₃) less of good B is produced (B ₃). |
| | c. | In a market system, resources are allocated due to consumer sovereignty or in other words, consumers are the ones who decide what, how and whom to produce allocate resources in production. This is |

| | |
|--|--|
|  | <p>determined purely by the price mechanism as shown in the graph below with demand and supply where prices are determined. In other words, resources are only allocated to producing products that consumers want. However, in a mixed economic system, there is a certain level of government intervention. This is when the government has a level of control over the resources. As a result, allocation is not based purely on price mechanism but also on what the government decides to provide that may not be available in a market system e.g. public goods and merit goods. Negative externalities are also taken into account.</p> |
| <p>d. An increase in the government's provision of health care can be both beneficial and disadvantageous to an economy.</p> <p>In terms of benefits, firstly, an increase in provision of healthcare would significantly improve health aspects of the standard of living. This includes lower infant mortality rate, longer life expectancy, lower death rate and less number of people getting sick.</p> <p>This leads to the second benefit. If there are less people getting sick and more people living at a higher age, then there would be less people absent from work. This would increase labour productivity, leading to an increase in outputs by many firms, and the ultimately an increase in GDP hence stimulating economic growth.</p> | |

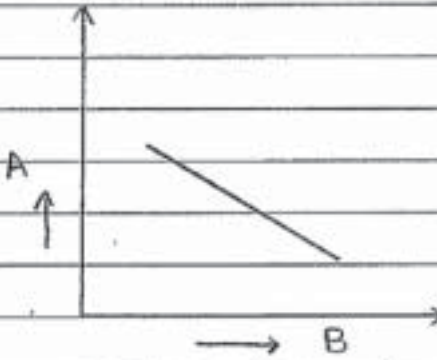
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|--|--|--|
| | | <p>Thirdly, provision of health related merit goods such as vaccination means more social benefits for people hence a better standard of living and a more economic use of resources.</p> <p>On the other hand, an increase in the provision of healthcare would result in opportunity cost that is the next best alternative forgone. This is because more government expenditure on healthcare means less money to be spent on other aspects of an economy. For example, the money could be spent on improving education hence, improving the skills and education of labour, stimulating future labour productivity. The money could be spent on building basic infrastructure such as roads or motorways which will not only provide employment opportunities but also reduce negative externalities like pollution from cars and traffic jams as well.</p> <p>Also, an increase in provision of healthcare may also mean taxing the population more heavily, thereby reducing disposable income. This reduces spending, halting economic growth.</p> <p>All in all, an increase in the provision of healthcare would benefit the <u>whole</u> economy only if the money spent on healthcare does not affect other areas of expenditure.</p> |
|--|--|--|

Examiner comment – grade A

- (a) A relevant description of the economic problem is provided. (2/2)
- (b) This is a good answer with strong written comments which explained well how a production possibility curve (PPC) shows how choices have to be made as how to allocate resources. Its only shortcoming is that the PPC is not drawn to the axes. (5/6)
- (c) A clear, well written answer which makes a good contrast between how resources are allocated in market and mixed economic systems. (4/4)
- (d) A well-structured answer which makes good use of relevant economic theory and concepts including opportunity cost and productivity in considering both the advantages and disadvantages of an increase in the provision of health care. (8/8)

Total mark awarded = 19 out of 20

Example candidate response – grade C

| | | |
|---|---|---|
| 2 | a | The economic problem is scarcity of resources. In the world, there are an unlimited amount of wants and needs. But, there are only limited number of resources so the economic problem is fulfilling ^{satisfying} these wants with limited resources. |
| 2 | b |  <p>Allocating resources are important so that they are utilised in the best way possible, in a way most beneficial for that economy. Taking two goods, A and B, you can see how resources allocation can change, and vary. If resources for A increase that means that more of A will be produced and less of B. This brings in opportunity cost, which is the next best alternative forgone or given up. In this case, the</p> |
| 2 | b | Opportunity cost is the production of B being higher. Resource allocation helps determine the best decisions for an economy. |
| 2 | c | In a free market economy, resources are all allocated by private owners and done by firms in the private sector with no government involvement for this determination, as are other elements such as production and investment. A mixed economy, consists the enlistment of both the private and state sectors so resource allocation is done by both sectors by which the economy is also directed. |

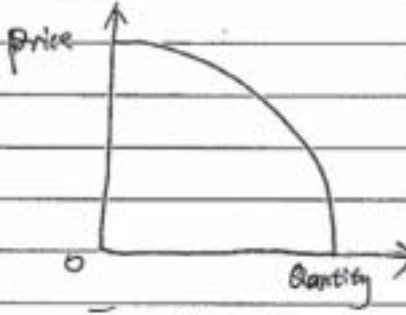
| | | |
|---|---|--|
| 2 | d | Provision of health care seems obviously beneficial, in which it is. An increase in it could stabilize the death rate and infant mortality rate of an economy. Also, just reducing sickness and disease can be beneficial for not only a specific person but the whole economy so that they are not infected. People would feel more safe and assured by more health care that their well-being is assured. However, in some ways, it can be a cost. An increase in the provision would cost a lot more to be facilitated so costs would increase. Plus, many poor people wouldn't be able to afford the severely high costs, giving them an unfair disadvantage and increasing chances of getting diseases if not medically treated properly. It depends on |
| 2 | d | the type of economy. A developing economy would benefit from more health care because they are more prone to diseases but levels of poverty occur higher in developing economies. |

Examiner comment – grade C

- (a) The answer recognises that the problem is that wants are unlimited whilst resources are limited. (2/2)
- (b) The diagram is not strong. It could have been taken to be a straight line production possibility curve if it had been drawn to the axes. The labelling of A and B is rewarded as two products as the text makes clear that these two letters refer to two distinct products. The written comments bring out the meaning of opportunity cost. The answer also touches on changing resource allocation although it might be more explicit on how fewer resources would be available to produce Good B. (3/6)
- (c) The comments here are relevant but more depth to the answer would have been useful. For example, in connection with a market economy, the role of the price mechanism might have been brought out and, in connection with a mixed economy, how resources are allocated by the two sectors might have been explained. (2/4)
- (d) This answer recognises how an increase in the provision of health care may improve the health of people but at a cost. It is, however, a rather generalised answer which does not include enough relevant economic concepts for a higher mark. The last points mentioned in connection with a developing economy are not adequately explained. Generally the answer requires more width and depth. (3/8)

Total mark awarded = 10 out of 20

Example candidate response – grade E

| | | |
|---|-----|---|
| 2 | (a) | The means are unlimited wants and limited resources |
| | (b) |  <p data-bbox="805 336 1444 705">Because when the allocate allow resources, maybe they will get the less resources or get more resource, so if the resources are less and less, the choice of they will decrease, but they can allocate more resources, the choice of them will rise</p> |
| | (c) | <p>In the market economic systems, the resources are allocated by the private person, because the market economic system controlled by people and personal, there are not the government controlled. In the mixed economic system on there are the governments and to the private personal, so the resource are allocated could by the personal and or by the government.</p> |
| | (d) | <p>Maybe yes. Because the health care is provision, so when somebody get iller, so they need the health care, so maybe the governments would benefit from that, for example, one person get the cancer, so that people need the medical of help the cancer, and these medical is very expensive, so it it can get benefits from that. However, it's maybe not. Because even if the health care is provision, and and when someone get the little iller, so maybe they doesn't need the health care and ^{and} they can get the great, so that the economy wouldn't benefit from that.</p> |

Examiner comment – grade E

- (a)** A brief but relevant description. (2/2)
- (b)** The diagram has the possible shape of a production possibility curve. The labelling is, however, that of a demand and supply diagram and no trade off is shown. The written comments are too vague. (1/6)
- (c)** The points might be clearer and more developed but the answer does recognise the difference in terms of the role of the government in the two types of economic systems. (2/4)
- (d)** Unfortunately, the answer lacks economic content. It is a very generalised discussion which does not even link to the possible effects on living standards and life expectancy. (0/8)

Total mark awarded = 5 out of 20

Question 3

- 3** Despite more cars being sold, world demand for bicycles is increasing. It has been estimated that the world price elasticity of demand for bicycles is -0.18 but this does vary between countries. The indirect taxes imposed on bicycles also differ between countries.
- (a) Define 'demand'. [2]
- (b) Explain **three** likely causes of an increase in demand for bicycles. [6]
- (c) Analyse why the demand for a product may be more price elastic in one country than in another country. [6]
- (d) Discuss whether a government should impose indirect taxes only on products with inelastic demand. [6]

Mark scheme

- 3 (a) Define 'demand'. [2]**
2 marks for the willingness and ability to buy a product or 1 mark for either willingness or ability to buy.
- (b) Explain three likely causes of increase in demand for bicycles. [6]**
- 1 mark each for three causes identified e.g.:**
- rise/fall in income (may be regarded as a normal or an inferior good)
 - rise in the price of other forms of transport
 - a greater desire to be fit/tastes
 - rise in population size
 - a successful advertising campaign
- 1 mark each for three explanations e.g.:**
- with higher incomes, people are more able to buy bicycles
 - cycling is a substitute for bus travel
 - cycling is used both for transport and for leisure
 - a larger population will mean there are more people to buy bicycles
 - a successful advertising campaign will persuade more people to buy bicycles.

Note: accept any valid reason which would shift the demand curve for bicycles to the right but do not accept a change in price or a change in supply of bicycles.

- (c) Analyse why the demand for a product may be more price elastic in one country than in another country. [6]

1 mark for bringing out the meaning of PED or elastic demand – defined or implied.

- differences in the closeness of substitutes [1] availability of close substitutes will make demand elastic [1]
- differences in the proportion of income spent on the product [1] the higher the proportion, the more elastic demand will be [1] note: also accept average income may vary in the two countries with demand being more inelastic in the richer country
- differences in what are considered to be luxuries and what are considered to be necessities [1] if the product is considered to be a luxury, demand is likely to be elastic [1]
- differences in the price of bicycles [1] demand will be more elastic, the higher the price [1].

Note: a maximum of 3 marks for identification of reasons.

- (d) Discuss whether a government should impose indirect taxes only on products with inelastic demand. [6]

Up to 4 marks for why it should:

- imposing taxes on products with inelastic demand will cause price to rise [1] demand will fall by a smaller percentage [1] and so is a good source of tax revenue [1] higher tax revenue can be spent on e.g. education and health care [1]
- a significant rise in price may be needed to reduce demand [1] of harmful products [1].

Up to 4 marks for why it should not:

- indirect taxes may be imposed on products to discourage their consumption [1] will be more successful if demand is price elastic [1] demand will fall by more than the rise in price [1] a government may want to discourage consumption of demerit goods (not necessary to use the term) [1] also may want to discourage consumption of imports [1] in practice it may be difficult to estimate PED (1).
- some products with inelastic demand are basic necessities (1) and so imposing indirect taxes on them will harm the poor (1) indirect taxes are often regressive (1).

Example candidate response – grade A

| | | |
|---|-----|---|
| 3 | a | Demand is the quantity of goods and services that consumers are willing and able to buy at the different price levels over time. |
| | b | Increase in demand for bicycles can be a reduction in income tax, consumers will have a higher level of income and disposable income, their spending power increases, consumers are more willing and able to purchase bicycles. |
| | | A increase in the price of substitutes of bicycles will increase bikes demand. For example, if the price of cars and public transport increases, this makes bikes more affordable in comparison to other other types of transport, so the demand for bikes will increase. |
| | | An increase in tastes and preferences towards bikes can be from a public government campaign for the use of bikes, to and advertises and promotes the use of bikes to for transport is healthy, so more people will want to travel with bikes because they are influenced by the mass advertisement. |
| | (c) | The demand of a good can be more price elastic in one country. Price elasticity of demand is the responsiveness ^{of quantity demanded} to a change in price. If the PED is lower than 1 it is inelastic, if it is bigger than 1 the product is elastic. In one country, a good can be more elastic, and have a greater responsiveness to a change in price due to some reason. Firstly, the good product can be a luxury or necessity. A necessity is a product the consumers |

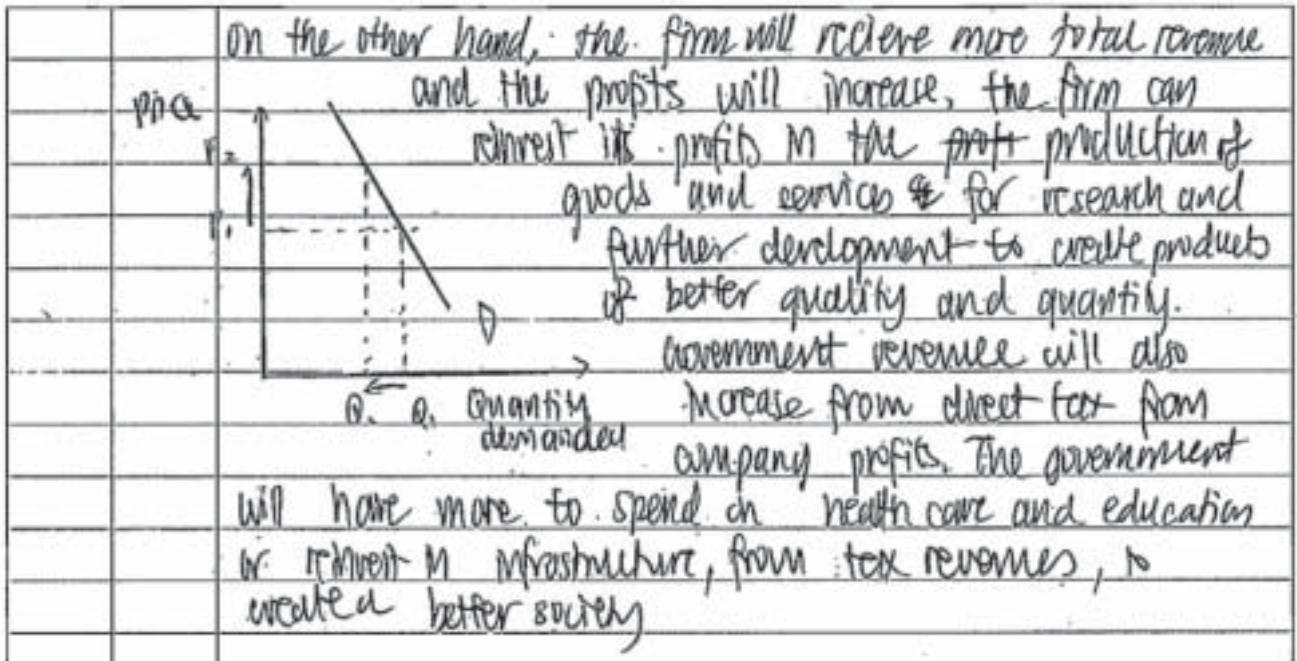
must buy on a every day bases, like toilet paper. They are relatively cheaper and the demand tends to be price inelastic. If the product is a luxury it will be price elastic because people consumers do not normally buy them, and is quick to switch to another product if the price is too high, examples like diamonds are price elastic.

If the good has many substitutes the price will be price elastic, because consumers can quickly search for an alternative if the price is too high, products like footwear has many substitutes. If it doesn't have a lot of substitutes, consumers will have a hard time finding replacements, so the product will be price inelastic.

If the goods take up a ~~high~~^{low} proportion of household income, it will be price ~~more~~ elastic.

(d) If the government It is relatively ~~cheaper~~^{cheaper} than cheaper than other needs, so people can choose to not buy it.

(e) If the government imposes indirect tax, like VAT or sales tax on inelastic goods, the ~~goods become~~ product becomes relatively more expensive, the price of the ~~set~~ product will increase. However, an inelastic demand ~~has~~ product has a small response to changes in price to quantity demanded, the quantity demanded from consumers will only decrease by a little if price increases. If the good is a demand good, the firm will receive a higher income revenue, which encourages other firms to produce demand goods, since their profits increase.



Examiner comment – grade A

- (a) A succinct and clear definition bringing out both the willingness and ability to purchase a product. (2/2)
- (b) The answer starts by explaining how a reduction in income tax can increase the ability of consumers to buy bicycles. The effect of the relative price of different forms of transport is well explained. A relevant reason is given for a change in tastes and preferences and it is explored. (6/6)
- (c) The answer starts with an accurate definition of price elasticity of demand and then goes on to analyse three relevant reasons for differences in elasticity in different countries. In each case, the candidate correctly analyses how the influencing factors affect the degree of price elasticity of demand. (6/6)
- (d) The effect of the impact of imposing taxes is explained in terms of price and quantity. This is followed by a confused discussion in relation to demerit goods and firms' revenues and profits. At the end the answer becomes relevant again by examining the effect on government revenue. (4/6)

Total mark awarded = 18 out of 20

Example candidate response – grade C

| | | |
|---|----|---|
| 3 | a) | Demand is the willingness and the ability for people to purchase goods and services that they need and want. |
| 3 | b) | An increase in demand may be caused by the increase in people income because as people disposable income increases their purchasing power increases as well and so they will be able to purchase more bicycles. |

| | | |
|--|--|--|
| | | Another reason would be price reduction. As I studied in demand and supply, demand would only increase if the prices of goods and services decreased. Another reason would also be that reduction in tax rates. If taxes were reduced then people's disposable income would increase and they would now be able to spend more on bicycles. |
|--|--|--|

| | | |
|---|-----|---|
| 3 | c.) | <p>Price elastic would depend only on the demand of consumers then sales towards the products. And that why is it very important for the business to do the PED test before they sell their products to see whether they are price elastic or price inelastic. In some countries people would demand demand would increase towards cars that would make prices more elastic whereas in some other countries demand would mostly increase towards bikes which would make cars less price elastic. (a number which is greater than 1 would be said elastic so businesses should decrease price and a number which is less than 1 is price inelastic in which business should increase prices to increase profits) as it said in the case the price of the bike is inelastic with is -0.8 but in other countries it may be elastic.</p> |
|---|-----|---|

| | | |
|---|-----|--|
| 3 | d.) | <p>Indirect taxes are taxes imposed on product, so people will pay tax as they buy products. Example would be VAT or excise duties. imposing indirect taxes only on products</p> |
|---|-----|--|

| | | |
|--|--|---|
| | | with inelastic demand may increase the government revenue because not only people would pay with incomes and enterprises & would pay for them but also children, housewives and old pensioners where they will all benefit from and the increase in public expenditure and people or business may not be that much effected as products are price inelastic, but there may also be drawbacks it would act like regressive taxation where poor people will pay higher and richer people will pay low proportion of their incomes and I think that the government should not only impose taxes on products that are inelastic I think that they should also impose them on harmful goods and services such as drugs, alcohol, cigarettes etc to reduce demand for them. |
|--|--|---|

Examiner comment – grade C

- (a) An accurate definition is provided. (2/2)
- (b) The answer starts well by explaining how an increase in income may increase demand for bicycles. It then, unfortunately, mentions a price reduction. This would cause an extension in demand rather than an increase in demand. The last reason given is essentially a repetition of an increase in purchasing power. (2/6)
- (c) This answer writes around the question. There is uncertainty shown about what is required and, as a result, some vague statements are made. There is a hint of awareness that cars may be regarded as more essential in some countries. Towards the end, the candidate is seeking to answer a different question i.e. how should a business use knowledge about price elasticity of demand. (1/6)
- (d) The answer makes some relevant points on both sides. It recognises that indirect taxes raise government revenue and may discourage consumption of e.g. alcohol. It also explains the extent of the effect on people and firms and the regressive nature of indirect taxes. Some points might be clearer, in particular, the comment on who pays indirect taxes. (5/6)

Total mark awarded = 10 out of 20

Example candidate response – grade E

| | | |
|---|---|---|
| 3 | a | Demand is the willingness of a person to buy a particular product. |
| | b | The likely cause that the demand for bicycles increased because people majority of people can afford by bicycle but not cars as cars is way more expensive than bicycle; By Bicycle are fuel-less which means that no need to fill up the fuel which indeed makes sure that there are less expense of bicycle than a car; The best thing among bicycle is that it can be driven by any age of person unlike to drive a car we need to have a license to ensure that we are instructed to how to drive a car |

| | | |
|---|---|--|
| 3 | c | The demand for product vary from country to country as their income is also different, e.g. if a country as Pakistan buys bikes more than car this can assure us that the demand for bikes in Pakistan is more this is due to the income people get in Pakistan but in United Arab Emirates (UAE) the average income is very high than the average income in Pakistan. So people in UAE drive big cars rather than driving a bike which means that the demand for bikes in UAE is less |
|---|---|--|

| | | |
|---|---|---|
| 3 | d | A government should not impose indirect taxes on products with in elastic as because the demand for that product is already low and if the government imposes tax on that product then the number of people who used to buy that product will reduce alot. Which further will make the firm close, which indeed will cause unemployment again |
|---|---|---|

Examiner comment – grade E

- (a)** This is a partial definition as the answer does not pick up on the ability to buy a product. (1/2)
- (b)** This answer would have benefited from focusing more on why demand for bicycles might increase rather than on why bicycles are demanded. More economics needed to be applied. (2/6)
- (c)** The influence of income on price elasticity of demand is identified but not explained. What the answer does is to explain how income influences demand rather than price elasticity of demand. (1/6)
- (d)** This is a limited answer. It recognises that demand will fall but does not mention that demand will fall by a smaller percentage than the rise in price. Indeed, this answer almost implies that demand will fall by a greater percentage. At the end there is some recognition that particular firms may be adversely affected. (1/6)

Total mark awarded = 5 out of 20

Question 4

- 4** The number of people employed in the banking sector in Turkey is increasing. The sector consists of a number of commercial banks, some of which are growing in size, and the Central Bank of the Republic of Turkey.
- (a) Describe **two** functions of a central bank. [4]
- (b) Explain **two** types of internal economy of scale that a growing bank can enjoy. [4]
- (c) Analyse how the spending pattern of high paid workers is likely to differ from the spending pattern of low paid workers. [4]
- (d) Discuss whether workers employed in banking are likely to earn more than workers employed in agriculture. [8]

Mark scheme

- 4 (a) Describe two functions of a central bank. [4]**
- 1 mark each for two functions identified e.g.:**
- issuing bank notes
 - banker to the government
 - banker to commercial banks
 - managing the national debt
 - lender of last resort
 - implementing monetary policy
- 1 mark each for two descriptions e.g.:**
- influences the money supply
 - operates an account for the government which enables it to receive revenue and make payments
 - commercial banks' accounts at the central bank enable them to make and receive payments between each other and to withdraw money

- issues government securities and pays interest on those securities
- will lend to commercial banks that find themselves in difficulty
- changes interest rates to control the exchange rate
- may adjust exchange rate to influence e.g. the current account position.

(b) Explain two types of internal economy of scale that a growing bank can enjoy. [4]

1 mark each for two types identified e.g.:

- managerial
- financial
- technical
- risk bearing.

1 mark each for explanations of the two types identified linked to banking e.g.

- a larger bank may be able to employ specialist workers such as accountants
- a larger bank may be able to sell its shares more easily and/or borrow more easily from other banks
- a larger bank may be able to use advanced technology and large scale capital equipment
- a larger bank may be able to offer a range of financial services so if one is unsuccessful, it will not have a significant impact on profits.

(c) Analyse how the spending pattern of high paid workers is likely to differ from the spending pattern of low paid workers. [4]

1 mark for high paid workers are likely to spend more in total.

1 mark for high paid workers are likely to spend a lower proportion of their income.

1 mark for high paid workers are likely to spend a higher proportion of their income on luxuries/spend more on luxuries.

1 mark for high paid workers are likely to spend a lower proportion of their income on necessities/less on necessities.

Note: accept an answer which is based on low paid workers e.g. low paid workers spend less in total.

(d) Discuss whether workers employed in banking are likely to earn more than workers employed in agriculture. [8]

Up to 6 marks for why they might earn more e.g.:

Up to 3 marks for: some bank workers are skilled workers [1] these are in low supply [1] high demand [1].

Up to 3 marks for bank workers may be difficult to replace [1] may be very productive [1] and so have inelastic demand [1].

Up to 2 marks for: bank workers may need high qualifications/better trained [1] and so have inelastic supply [1].

Up to 2 marks for bank workers may be in a professional organisation/trade union [1] and this will give them more bargaining power [1].

Up to 6 marks for why they might not earn more e.g.:

Up to 4 marks for: some workers in banking are low skilled [1] e.g. cleaners whilst some workers in agriculture are high skilled [1] so supply of some bank workers may be higher than some agricultural workers [1] and demand may be lower [1].

Up to 3 marks for: some agricultural workers are very experienced [1] pay tends to rise over time [1] due to promotion [1].

Up to 2 marks for: agricultural workers in a rich country may earn more than workers in banking in a poor country [1] earnings vary between countries [1].

Up to 2 marks for agricultural workers in some countries may be more likely to be in a union/labour organisation (1) and so may have more bargaining power (1).

Note: the question is a general one and so candidates do not have to refer to Turkey but those answers which mention that workers in banking in Turkey may be paid more because the industry is expanding should be credited.

Maximum of 4 marks for a list-like approach.

Example candidate response – grade A

| | | |
|----|----|--|
| 4. | a. | Central bank prints notes. Central bank is where country's notes are ordered to be printed. Central bank acts as a lender of last resort. That is, it may give money to the bank who are running into losses. |
| 4. | b. | The two types of internal economies of scale are manag managerial economies and technological economies. Managerial economies are where specialist staff is appointed to work in the bank so that produce services at low cost of production and gain higher profits. Technological economies means that they can use hi-tech technology to produce services at highest lowest cost of production. |
| 4. | c. | High paid workers spend more on clothing and luxury products than lower paid workers which spend most of the income in food and necessities. High Low paid workers spend more proportion of their income than high paid workers. Low paid workers can spend most of their income whereas high paid workers will not spend more in proportional but will definitely spend more in quantity than low paid workers. |

| | | |
|----|----|--|
| 4. | d. | <p>Workers employed in banking may earn more more than workers employed in agriculture because they are highly skilled workers. They are usually highly experienced as they have gone through many years of trainings. Workers employed in banking also have higher bargaining power and hence can claim for higher wage rise than workers in agricultural industry. Workers employed in banking will have higher reputation and self-worth than are lower in supply than agricultural workers in agricultural industry and hence they can get higher get paid higher. But in some countries, demand for financial services may not be developed and hence agricultural workers get paid more. People some people will be paid more working in agricultural industry may get paid more than banking workers in a banking industry because agricultural workers may get be more experienced than other workers. Workers in agricultural industry can be get paid more if the primary sector of industry is more developed than than tertiary sector. Also, if the country is specialised has expertise in agricultural products, workers in agriculture industry may be paid more than workers in banking industry.</p> |
|----|----|--|

Examiner comment – grade A

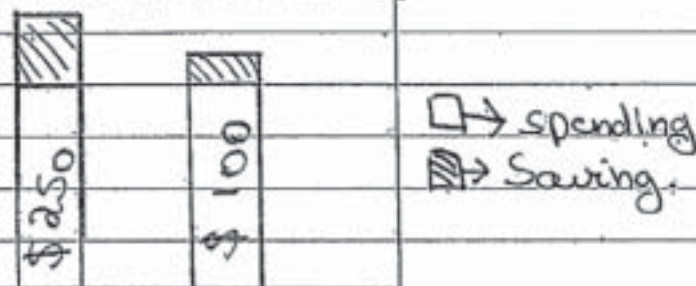
- (a)** The answer recognises two functions and describes the function of lender of last resort in enough detail. (3/4)
- (b)** Two internal economies of scale are identified. There is a brief link to how managerial economies of scale may benefit a bank. There is not, however, a sufficient link between technical/technological economies of scale and a growing bank. (3/4)
- (c)** A relatively brief answer but one which does bring out the differences in the spending patterns of the two groups in terms of the amount spent, the proportion spent and what the two groups buy. (4/4)
- (d)** This is a well-structured and pertinent answer. It recognises that bank workers are likely to be more skilled, better trained, may have stronger bargaining power and may be in more limited supply. The answer then does not just reverse these points. It recognises that in some countries, demand for financial services may be relatively low, some agricultural workers may be very experienced and the country may have more 'expertise' in agricultural production. (7/8)

Total mark awarded = 17 out of 20

Example candidate response – grade C

| | |
|-----|---|
| Q:4 | |
| | <p>a The central bank is the head bank of a country. It basically provides the country with all the money as it prints the currency. ② It decides the rate of interest the commercial banks should charge which cannot be change by anyone. ③ They hold the gold reserves for the country.</p> |
| | <p>b Economics of scale a bulk buying of raw materials which is makes the product cheaper reducing the average cost for a firm. Internal economies are scale run within the business. ① Technological economies: Technological economies are expenditure on technology to increase to output and productivity of a firm. ② Purchasing economies: The purchasing power of the firm will increase giving them for capital. ③ Financial economies: When a firm is benefiting due to financial operations capital which is a surplus.</p> |
| | <p>c A high paid worker will have a better or will spend spend more than a worker receiving a lower wage. A</p> |

person getting a high wage will spend more proportion of his income as he gets more money than a low paid worker. For example, a person earning \$100 in a week will spend 80% of his income on needs and probably save the 20%, but a person receiving \$250 in a week may spend 60% of his income on needs, 10% on wants. This shows the difference in proportion of spending.



d. Workers working in a bank are more likely to get a higher income than workers employed in agriculture. Workers in a bank have ① qualifications, ② Skilled task, ③ Experience. ④ The demand for workers in a bank is less therefore replacements may not be found easily and even if they are found they may be less productive at the task. Whereas people working or employed in agriculture will be getting a low income as no ① qualifications are required to perform the task, ② Non-skilled task, ③ Primary sector job, ④ The demand and supply for workers is high thus determining that many people can perform this task easily having no knowledge about

it.

Examiner comment – grade C

- (a)** The answer identifies three functions of a central bank rather than the two functions required. The time could have been more usefully spent explaining two functions. (2/4)
- (b)** Again the answer identifies but does not explain. Buying economies and financial economies of scale are mentioned but the answer does not explain how these could reduce a bank's average costs of production. The candidate did seem rather confused about the nature of financial economies. (2/4)
- (c)** The answer starts well by mentioning that high paid workers will spend more than low paid workers. Later in the answer there is some awareness shown that low paid workers spend more on necessities. The central part of the answer could be clearer as it seems to imply that the poor will spend a smaller proportion of their income which conflicts with the diagram drawn. (2/4)
- (d)** The answer recognises the influence of skills and qualifications. Mentioning that banking workers are more skilled and qualified than agricultural workers is, however, the same as stating that agricultural workers are less skilled and qualified than banking workers. There is some confusion between the demand and supply of bank workers although the answer is clear on the influence of a high supply in connection with agricultural workers. Overall the answer is somewhat narrowly focused. (3/8)

Total mark awarded = 9 out of 20

Example candidate response – grade E

| | | |
|---|---|--|
| 4 | a | Central banks mainly see the exchange rate and also keep them in control, all the money of individuals from the bank is stored in central bank; Central bank also issues new notes / currency, Central bank also handles the rate of exchange rate in the country. |
|---|---|--|

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|---|---|--|
| 4 | b | Technological / Technical economy: When the work is shifted to machine and the staff has to do less work |
|---|---|--|

| | | |
|---|---|---|
| 4 | c | The spending pattern of high paid workers is different because the amount of income they earn is more they will like to spend their money about as they may again get the same amount of money after a month. But the low paid workers spend their money very less. They mainly try to save all their money to use them when they are needing it. |
|---|---|---|

| | | |
|---|---|--|
| 4 | d | The workers employed at bank will be definitely will get paid more as they are skilled about and the work they do should have all their focus in it as giving money on checks / loan should have a proper information of the firm appointing the check or taking the loan and to do a banking job, people need about of knowledge. Whereas in agriculture the people are not much educated they don't need any skill or knowledge to do this work as it is very easy |
|---|---|--|

Examiner comment – grade E

- (a)** The issuing of new notes is identified and influencing the exchange rate is suggested. Unfortunately, neither of these functions are explained. (2/4)
- (b)** One type of economies of scale is identified i.e. technical. It is not explained how this would reduce the average costs of a growing bank. (1/4)
- (c)** The answer is too vague. There is also a tendency to exaggerate – for example, the idea that low paid workers ‘try to save all their money’. The tendency to exaggerate is seen in a number of answers at this level. (0/4)
- (d)** The points mentioned about skills and education are relevant. These could have been developed by examining the effects of differences in education and skills on the demand for and supply of labour in banking and agriculture. Overall the answer is limited in its coverage. (2/8)

Total mark awarded = 5 out of 20

Question 5

- 5 A Zambian copper mine is operated by a foreign multinational company. The company's main goal is profit maximisation. Its mine creates pollution in the area, which causes diseases and damages crops. Some economists have suggested that the economy would benefit from the mine being operated by the Zambian Government.
- (a) Define a 'multinational company'. [2]
- (b) Explain **one** goal a multinational company may have other than profit maximisation. [3]
- (c) Explain why pollution is an example of market failure. [5]
- (d) Discuss whether a mine operated by the government would be more likely to benefit an economy than one operated by a foreign multinational company. [10]

Mark scheme

- 5 (a) Define a 'multinational company'. [2]
- 2 marks for a company that produces in more than one country.
- 1 mark for any **one** of the following:
- has its headquarters in another country
 - operates in more than one country
 - has branches in more than one country
 - is usually a PLC (but may be a state run MNC).
- (b) Explain **one** goal a multinational company may have other than profit maximisation. [3]
- 1 mark for identifying a goal i.e.:
- growth/increased market share
 - sales revenue maximisation
 - profit satisficing
 - survival
 - improve the environment performance of the company.
- Up to 2 marks for explaining the goal e.g.
- an MNC may try to increase its size because it will make it more difficult for other firms to buy it [1] and because the salaries and managers may be linked to size [1]
 - an MNC may try to increase market share to reduce competition [1] and so gain a monopoly position [1]
 - achieving a high sales revenue may enable a firm to take greater advantage of economies of scale [1] and so reduce average costs [1]
 - an MNC may wish to keep shareholders happy (profit satisficing) [1] and to pursue a range of other objectives e.g. improving environmental conditions [1].

(c) Explain why pollution is an example of market failure. [5]

Up to 2 marks for defining market failure – where the market forces of demand and supply fail to achieve efficiency.

1 mark for recognising that pollution is an external cost/harmful impact on third parties.

1 mark for mentioning that market forces do not take into account external costs.

1 mark social costs will exceed private costs.

1 mark for mentioning that market prices do not reflect social costs/are too low.

1 mark for output will be too high.

(d) Discuss whether a mine operated by the government would be more likely to benefit an economy than one operated by a foreign multinational company. [10]

Up to 7 marks for why it might:

Up to 4 marks for: more likely to take into account social costs and benefits [1] rather than base decisions on private costs and benefits [1] as its main objective may be to benefit society [1] rather than maximise profit [1].

Up to 4 marks for: may have more funds to invest [1] can use tax revenue [1] this may enable it to expand production [1] and so raise employment [1].

Up to 3 marks for: may provide better pay [1] and working conditions for workers [1] e.g. shorter working hours [1].

Up to 3 marks for: may charge lower prices to domestic firms [1] lower costs of production [1] making them more price competitive [1].

Up to 2 marks for: unlikely to take profits out of the country [1] may use some of the profits to spend on e.g. education and health care [1].

Up to 7 marks for explaining why it might not:

Up to 5 marks for: may lack competitive pressure to be efficient [1] managers of the mine may think the government will not permit the mine to go out of business [1] as it would cause unemployment [1] so costs may not be kept low [1] may be a lack of innovation [1].

Up to 3 marks for: may lack funds to invest [1] government may have low tax revenue [1] will not be able to sell shares [1].

Up to 3 marks for: may lack expertise [1] government intervention may mean that it takes time to make decisions [1] and decisions may be distorted by political factors [1].

Up to 2 marks for: may be less likely to bring in new technology than an MNC [1] technology may be more advanced in other countries [1].

Maximum of 5 marks for a list-like response.

Example candidate response – grade A

| | | |
|---|---|--|
| 5 | a | Multinational company is one that produces/manufactures in more than one country. |
| 5 | b | One goal of a multinational company other than for profit maximisation is profit profit satisfaction, that is paying as a considerable amount of dividends to keep the shareholders of the company happy. |
| 5 | c | Pollution is an example of market failure as this is an external cost on the third party due to the market failing to be productive enough to not let this happen. This causes diseases and damages crops. This shows that the market was not efficient enough due to which it did not find any ideas to stop the pollution. This shows the market failed to be dynamically efficient. |
| 5 | d | A mine operated by the government would benefit more as: → The government will ensure safety and health standards of its workers. |

- It would give them good wages than the MNC's.
- It will cause less ~~pollution~~ pollution than the MNC's.
- It will always consider ~~the~~ social costs and social benefits, rather than private costs and private benefits like the MNC's.
- It will not charge high prices like the MNC's, even though it will be a monopoly.
- *However, a MNC's could benefit it to as:
 - MNC's will bring in new ideas and technology for mining.
 - It may let the government spend on other things like education and health care, which would be an opportunity cost, if it spent it on mining.
 - It would ensure greater efficiency to reduce its production cost.
 - It might be more productive to achieve its goals of growth, profit maximisation, etc.

~~However~~ However, as the government will not let the country's citizens be ~~exploited~~ exploited by the MNC's who will charge high prices and poor safety ~~and~~ standards, it is better if operated the mine rather than the foreign multinational company.

→ The government will aim for full employment & low inflation. It will ~~also~~ ensure that this mine operation can improve ~~country's~~ ~~country's~~ country's trade structure, whereas the MNC's will aim for its benefits ~~and~~ take account of private ~~cost &~~ cost & benefits and not bother ~~to~~ how it affects the economy, whereas the government will. The government

| | |
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| | also enters carries out a CBA, that is cost benefit analysis, to make sure that social cost don't exceed the social benefits. The government's makes sure it does well. But if MNC operates the mine, it has to pay tax to the governments, creating tax revenue, which can be used for economic growth. |
| | *The MNC will pay less wage in host country than home, but the government will pay enough wage for the workers to have a good real disposable income, income adjust for inflation. |

Examiner comment – grade A

- (a) The answer recognises the key point that a multinational company produces in more than one country. (2/2)
- (b) A brief answer which explains profit satisfying ('satisfaction') linked to the need to keep shareholders happy. (2/3)
- (c) The answer recognises that pollution is an external cost. It then seeks to link pollution to the failure to achieve efficiency. There could be rather greater clarity and more development. The reference to 'the market failing to be productive enough not to let this happen' is too vague. There could have been an analysis of the market price and output relative to the socially efficient levels. (3/5)
- (d) This initially appears to be in note form and is somewhat disjointed at the start. The points are, however, developed as the answer progresses. There is width in terms of both the government and a multinational company operating the mine with some depth. (9/10)

Total mark awarded = 16 out of 20

Example candidate response – grade C

| | | |
|---|-----|---|
| 5 | (a) | A 'Multinational company' is a company that operates and has branches outside of the origin of the company. |
| 5 | (b) | A Multinational company has many goals, one of them might be expansion. They would like to operate in much more countries and reduce unemployment. They create jobs for people. |
| 5 | (c) | A 'market failure' consists of the social costs of the economy being much greater than the social benefits. (Social costs > social benefits) which is also called uneconomic. Market failure arises when the firms and organisations don't have in mind of all the negative impacts producing some products can have an effect on the country, such as pollution. Pollution is considered a social cost. And since market failure is when the social costs, which are bad for society, are greater than the social benefits, which creates market failure. |
| 5 | (d) | A mine operated by the government might have more of a positive impact than if it were run by a foreign multinational company. A foreign multinational country might return and get the exchanged money to the origin of the multinational country. A mine operated by the government will try and employ many people to reduce unemployment and expand the mine to create more ^{total} revenue. The government will care more about the social benefits than costs. A foreign multinational company |

| | | |
|---|-----|--|
| 5 | (d) | <p>might not be thinking of all the social costs it is causing such as pollution and the killing of the beautiful habitat & environment it is destroying. The foreign company, might be their objective is maximize profit, and when that is in mind, the damaged don't matter to them.</p> <p>The government would benefit the economy better since that's their main goal, to make their country increase the living standards. The foreign multinational company; there there could be a possibility that they could leave any stop the business any time they want after all the mining resources are gone.</p> |
|---|-----|--|

Examiner comment – grade C

- (a) The answer shows some awareness of a multinational company by mentioning that it 'operates and has branches outside of the origin of the country'. To gain full marks, however, it needed to be more explicit in terms of the company producing in more than one country. (1/2)
- (b) The goal of growth is implied by reference to expansion. Although this goal is identified it is not explained. The reason why a multinational company may aim for growth is not brought out. The reference to creating employment links more to a benefit to an economy. (1/3)
- (c) The answer shows an awareness of the meaning of market failure in connection with social costs exceeding social benefits and firms not taking into account all the costs they impose. Towards the end of the answer there is some confusion between social costs and external costs – a confusion often shown. (2/5)
- (d) This is a clear, two-sided answer which makes a number of relevant points. The answer could, however, have included more points and more depth. For example, the impact of a multinational company closing down the mine could have been explored as could the impact of a multinational company sending profits back to the home country. (5/10)

Total mark awarded = 9 out of 20

Example candidate response – grade E

| | | |
|---|-----|---|
| 5 | (a) | A multinational company is a type of company which is involved in many different countries. |
| | (b) | One goal a multinational company may have other than profit maximisation would be being better than the local competitors. This is very important because they would want the economy to be ^{not} be dominated by them and not by the local competitors. |
| | (c) | Pollution is an example of market failure as it affects consumers in the market by causing diseases and also damages natural resources and crops. |
| | (d) | Both Multinationals there are ^{can} and a government of an economy can operate a mine. To begin with, if the government decides to operate a mine then they try to keep the price low for the economy to afford. They will not think of making profit by keeping high prices. So, they will not set up the mine where the population can cause harmful diseases and destroy natural resources. Multinationals would not care and set up the mine according to their best fitting. As their main aim is to maximise profit. But in contrast, Multinationals will need to hire employees and workers to run and operate the mine. This will |

| | | |
|--|--|---|
| | | create jobs for the people in economy and |
| | | hence decrease unemployment. Moreover, |
| | | Multinationals can invest the profit they |
| | | make in the economy and improve it. |
| | | Governments will not use the profits for the |
| | | economy. Lastly, due to the increase in em- |
| | | ployment and there will be an increase |
| | | in income as more people are working |
| | | and have a job. |

Examiner comment – grade E

- (a) The answer reveals some awareness of what a multinational company is but the reference to 'involved in many countries' is rather vague. (1/2)
- (b) The answer is moving towards the idea of increased market share but does not quite get there. The comment about 'being better than the local competitors', was too vague. (0/3)
- (c) This answer is based on general knowledge rather than economics. It identifies how pollution may harm an economy but does not mention that these are external costs. (0/5)
- (d) There is a reasonable start to the answer focusing on the goals of a government and a multinational company and how the effects on the environment may differ due to ownership. In the second part of the answer, however, the candidate does not establish why a multinational company is more likely to create employment and invest than a government. (4/10)

Total mark awarded = 5 out of 20

Question 6

- 6** In 2012, Mexico's monetary policy was successful in keeping the country's inflation rate low and stable. Fiscal policy measures, including a rise in government spending, contributed to a relatively high economic growth rate of 3.5% and a reduction in the country's unemployment rate.
- (a) What is meant by 'monetary policy'? [2]
- (b) Explain **two** reasons why governments aim for low and stable inflation. [4]
- (c) Analyse how an increase in government spending may cause economic growth. [6]
- (d) Discuss whether a reduction in a country's unemployment rate will always benefit an economy. [8]

Mark scheme

- 6 (a) What is meant by 'monetary policy'? [2]**
2 marks for reference to decisions on any two from interest rates, money supply and the exchange rate.
1 mark for reference to decisions on any one of the above.
- (b) Explain two reasons why governments aim for low and stable inflation. [4]**
- 1 mark each for two reasons identified:**
- to promote investment
 - to promote international competitiveness
 - to avoid lenders, workers with low bargaining power and other groups experiencing a fall in purchasing power
 - to protect savers
 - to prevent people losing confidence in using the currency as money
 - to prevent inflation causing unemployment.
- 1 mark each for two reasons explained:**
- low and stable inflation creates certainty/makes it easier to plan
 - if inflation rate is below that of rival countries, it can increase exports/reduce imports
 - if incomes rise by less than inflation, the amount that can be purchased will fall
 - savers will lose if inflation rate is higher than interest rate
 - may result in people resorting to barter/especially if there is hyperinflation
 - inflation can result in a loss in international competitiveness/reduce spending on domestic products.
- (c) Analyse how an increase in government spending may cause economic growth. [6]**
- An increase in government spending may result in:
- higher demand [1] which will encourage firms to expand their output [1]
 - higher government spending on education (1) may raise labour productivity [1] and so increase productive potential [1]
 - higher government spending on investment [1] will increase productive potential [1]
 - government subsidies to firms [1] reduces costs of production [1] encourages firms to produce more [1].
- Maximum of 2 marks for a list-like approach.

- (d) Discuss whether a reduction in a country's unemployment rate will always benefit an economy. [8]

Up to 6 marks for why it should:

Up to 3 marks for: a reduction in unemployment is likely to increase output [1] higher output should raise living standards [1] may reduce poverty [1].

Up to 3 marks for: may improve the current account position [1] if the rise in output is due to a rise in exports [1] and exports rise by more than imports [1].

Up to 3 marks for: lower unemployment may raise tax revenue [1] e.g. from income tax [1] higher tax revenue can enable a government to spend more on education and health care [1].

Up to 6 marks for why it might not:

Up to 5 marks for: lower unemployment may cause a shortage of workers [1] this shortage may push up wage rates [1] higher wages may increase costs of production [1] higher costs can cause cost-push inflation [1] more likely to occur if the economy is operating close to full employment [1].

Up to 4 marks for: lower unemployment may increase total (aggregate) demand [1] higher demand may push up prices [1] causing demand-pull inflation [1] more likely to occur if the economy is operating close to full employment [1].

Up to 3 marks for: lower unemployment may increase a current account deficit [1] higher incomes may increase demand for imports [1] higher demand may divert products from the export to the domestic market [1].

Up to 3 marks for: a reduction in the unemployment rate does not necessarily mean fewer people are unemployed [1] unemployment may have risen if the labour force has risen [1] by more than employment [1].

Up to 4 marks for a list-like approach.

Note: accept answers which discuss the possible effects of high unemployment will always harm an economy.

Example candidate response – grade A

| | | |
|----|-----|--|
| Q6 | (a) | <p>Monetary policy is a demand-side policy which gives the government chance to pursue their domestic aims. It's usually carried out by the central bank, to set the interest rate. For e.g. during an inflation, government would instruct the central bank to reduce increase the interest rate and cool down the inflation.</p> |
| Q6 | (b) | <p>Government aims for stable inflation because they want to control unemployment rate. As high rate of inflation can cause reduce in real value of currency and reduce the willingness for businesses to produce. With the aim of cutting cost, the businesses would lay off many workers which cause costs a massive unemployment. This can be another huge problem for government as well. Therefore, they want price stability to control the^{the} unemployment rate.</p> |

| | | |
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| Q6 | (b). | <p>They aim for stable and low inflation because they want a balance in trade. If the country has high rate of inflation with fast-rising and high level of price, then the products of the home country will be less competitive since less foreigners are willing to buy. With lower export, it might create a deficit in current balance of payment which is imbalanced. To control inflation can balance their trade.</p> |
| Q6 | (c). | <p>Increase in government spending could result in lower rise in total output of the economy as well as an increase in aggregate demand. The supply-side policy could include for e.g. A provision of training scheme, subsidies to businesses and increase spending in building public infrastructures.</p> <p>When government spends on</p> <ul style="list-style-type: none"> Providing public training scheme helps the labour to get skilled and more able to adapt to the other capitals used in production lines. It can lead to improvement in productivity as well as output, and helps reach economic growth. By giving grants and subsidies, businesses are able to reduce their production costs and they are more willing and encouraged to for e.g. Invest in new technologies and auto-mated production methods which can also stimulate the total output and create a rise in <u>GDPI</u> with <u>real</u>. Increase government spends money investing in building public facilities, it stimulates the employment rate and people are having stable incomes due to employment. The aggregate demand will rise as well as the total output needed in response. Therefore, economic growth is reached. |

| | | |
|-----|------|--|
| Q6, | (d). | <p>To some extent, reduction in an unemployment rate would benefit an economy; as it can rise the general living standard of the population. that With lower rate of unemployment, more people are able to have stable incomes. This helps them to purchase daily necessities and essentials. It also enables them to for e.g. afford health care and better education for their family. Therefore, reduce in unemployment can rise the general living standard of population.</p> |
|-----|------|--|

| | | |
|--|--|--|
| | | <p>In addition, reducing unemployment rate also increases the real GDP of this economy. With more people being employed, there will be more contributions to the total amount of goods and services produced. Increase in output could lead to increasing rate of economic growth, with rising government tax revenues as well.</p> |
| | | <p>However, it wouldn't benefit the economy in the long-term. With lower unemployment rate, more people would have disposable incomes and there will be a rise in the aggregate demand. In long-term, this will lead to a demand-pull inflation which could reduce the real purchasing power of money and cause economic problems again, like inflation.</p> |
| | | <p>In addition, with more people contributing to the output, there might be a rise in the export as well since the amount of the total output increased. Therefore, there might appear surplus on the trade balance of payment and disobey the government's aim of creating trade balance.</p> |

Examiner comment – grade A

- (a)** This is a clear and interesting answer. In terms of answering the specific question it is, however, somewhat narrow. It recognises that monetary policy is concerned with decisions on the rate of interest but does not bring out the other monetary policy measures. (1/2)
- (b)** The answer starts by identifying a relevant reason ‘to control unemployment’. It then goes on to provide a lucid explanation of how high inflation could cause unemployment. The second reason given is to achieve a balance on the current account of the balance of payments. This, again, is well explained, linking high inflation to a loss of international competitiveness and a reduction in exports. (4/4)
- (c)** The answer starts by recognising that an increase in government spending would increase total demand. This might have been developed further at this point. The answer, nevertheless, goes on to explore in sufficient detail how government spending could go on training and subsidies to firms. There are good links provided to productivity and costs of production. Overall this is a thoughtful and intelligent answer. (6/6)
- (d)** The answer starts well, indicating that it is going to be a discussion. It mentions that living standards are likely to rise and, unlike some answers, provides a good analysis of why. The effects on economic growth and tax revenue are also covered. The answer then examines the reasons why a reduction in a country’s unemployment rate will not always benefit an economy in just sufficient detail for full marks. (8/8)

Total mark awarded = 19 out of 20

Example candidate response – grade C

| | | |
|---|----|--|
| 6 | a) | The monetary policy basically means controlling and setting interest rates on borrowing, so that the incentive to pay back and borrowing would be balanced. It is set by the government and the central bank. |
| | b) | Low and stable inflation would get more people to spend more. This raises a country's GDP and puts them economically in a good position. The second reason would be that the government wants to ensure that the lower class can afford to buy essential needs in order for them to survive, if inflation rises many people would not be able to purchase many products that they need in order to have a better standard of living, as a result preventing inflation can allow more people to afford the things they need in order to live well. |
| | c) | The three main reasons in which government spending would increase ^{Economic} growth would be that they can subsidize small businesses or other industries and this would decrease levels of unemployment as more job offers and opportunities would be available if governments spend on businesses and help them expand. Secondly, governments can provide public services to people such as transport, and education, and this could potentially help levels of poverty ^{Poverty} decrease due to being able to afford education, and make others have more comfortable day-to-day essentials such as transport, that the government will provide. Also with the government spending on ^{on} the public sector, prices can be kept low in order for people to afford and people would be willing to spend more. Economic levels of the country increase by a lot, and governments can assure this by spending. |
| | d) | A reduction in a country's unemployment rate can have a significant effect on a country's economy. For starters, incomes will increase and as a result people would be more willing to spend |

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| | | and so GDP levels of a country would rise. Also there would be a larger middle class, which means most people in the country would have good standards of living, and average lives through their well being. For businesses, output is produced faster and more efficient and so more revenue is brought in for them as a result. This supplies more goods and services ^{services} of better quality to the market, keeping people happy. In the government's point of view, due to lower levels of unemployment and more people spending, the government can input taxes through their income or indirectly, and this can increase their own revenue and allow them to spend more on the good of the country through the public sector. Lower levels of unemployment can benefit all different stakeholder groups in an economy, and as a result, benefit the country as a whole in conclusion. : |
|--|--|---|

Examiner comment – grade C

- (a) The answer identifies one aspect of monetary policy, that is ‘controlling and setting interest rates’. (1/2)
- (b) The second reason identified is well explained. The first reason is, however, not established. It is not explained why low and stable inflation would get people to spend more and nor is it explained in comparison to what circumstance they would spend more. (2/4)
- (c) This answer identifies what the government could increase its spending on to promote growth. It does provide one link to economic growth in the form of higher spending but there needed to be more analytical links to economic growth. (3/6)
- (d) There are some good points on how a reduction in unemployment may benefit an economy. Higher income is linked to improved living standards and higher tax revenue is linked to increased government spending. The point about higher quality products, however, needs more explanation. The answer is also, one-sided, with the reasons why a reduction in unemployment may not always be beneficial not considered. (4/8)

Total mark awarded = 10 out of 20

Example candidate response – grade E

| | | |
|---|-----|--|
| 6 | (a) | Monetary policy is a type policy by the government to solve economic aims such as inflation and unemployment with a help of interest rate. |
| | (b) | Governments also for low and stable inflation as they do not want to the real value of money to increase, this is because if the real value of money increases people may not afford basic necessities goods. Moreover inflation also makes a certain group of in the economy poorer. Government absolutely don't want that as it affects the average income of a country. |
| | (c) | When there will be an increase in government spending it may cause economic growth due to many reasons. To begin with, when the government will spend more on improving education more people in the economy will get educated and become skillful. When they become skillful they will work and earn which will create economic growth. Secondly |
| | | If the government increases spending on hospitals and other service orientated businesses, it will provide more jobs to economy. This will tackle unemployment and thus lead to a economic growth. |

| | | |
|--|-----|--|
| | (d) | <p>when there is a reduction in a country's unemployment rate it benefits the economy by providing jobs to the people in the economy. Moreover it also raises income due to more people having jobs. In contrast, when most people in an economy have jobs the country needs to have enough firms and businesses to hire them. Added to, resources that can be poor communication between as there are so many employees and workers.</p> |
|--|-----|--|

Examiner comment – grade E

- (a) The candidate recognises that monetary policy involves the use of the rate of interest. (1/2)
- (b) This answer starts by including a confusion that was seen in a number of scripts. This is that inflation increases rather than reduces the real value of money. The last two sentences are, unfortunately, too vague. The 'certain group' is not identified and how inflation might affect 'the average income of a country' is not explained. (0/4)
- (c) This is a reasonable answer but more links to economic growth needed to be established. For example, how increased employment could increase output might have been analysed. (3/6)
- (d) This answer recognises that lower unemployment will increase incomes. This point is, however, not developed. The comments towards the end are too vague and the link between higher employment and poor communication is not established. (1/8)

Total mark awarded = 5 out of 20

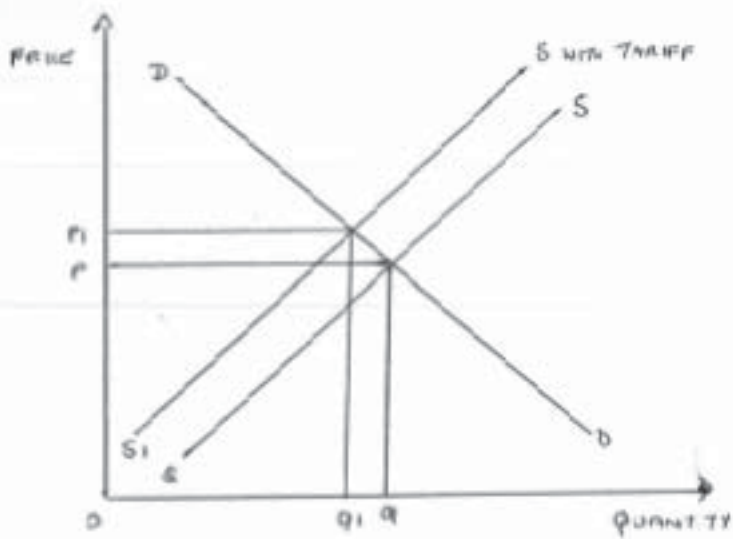
Question 7

- 7** In March 2012, the Indian Government increased the tariff on imports of gold. It did this to reduce the country's growing deficit on the current account of its balance of payments.
- (a)** Describe how a tariff could reduce imports. [4]
- (b)** Analyse **three** causes of a current account deficit. [6]
- (c)** Discuss whether a government should always be concerned about a growing current account deficit. [10]

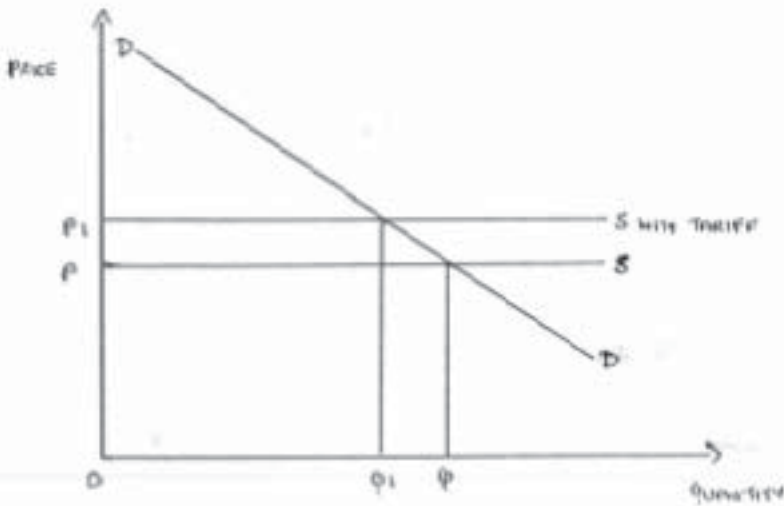
Mark scheme

- 7 (a) Describe how a tariff could reduce imports. [4]**
- 1 mark for recognising a tariff is a tax on imports.
 - 1 mark for a tariff increases importing firms' costs of production.
 - 1 mark for a tariff will reduce supply.
 - 1 mark for a tariff will raise price.
 - 1 mark for a tariff will reduce demand.
 - 1 mark for relevant reference to PED of imports.
- Note: Accept a diagrammatic approach showing supply decreasing, price rising and demand falling for 3 marks.

Figure 7(a)



OR



(b) Analyse three causes of a current account deficit.

[6]

1 mark for idea of the meaning of the current account/current account deficit.

1 mark each for three causes identified:

- high exchange rate
- inflation
- low productivity
- high costs of production
- low quality of domestically produced products
- low incomes abroad
- high incomes at home
- protectionism abroad
- lack of protectionism at home.

1 mark each for an analysis of three causes:

- high exchange rate would mean high export prices and low import prices
- inflation makes domestic products less price competitive
- low productivity of labour will raise wage costs/high prices of domestic products
- high costs of production e.g. raw material cost/results in high prices of domestic products
- low quality reduces demand for exports and raises demand for imports
- low incomes abroad may result in low demand for exports
- high incomes at home may lead to high demand for imports
- protectionism abroad e.g. tariffs make it difficult to export
- absence of protectionism at home may result in e.g. dumping.

(c) Discuss whether a government should always be concerned about a growing current account deficit. [10]

Up to 7 marks for why it should:

Up to 5 marks for: may indicate a poor economic performance [1] low demand for country's products [1] may be result of high inflation [1] poor quality products [1] low productivity [1].

Up to 3 marks for: will reduce total demand [1] and so may increase unemployment [1] and lower GDP [1].

Up to 3 marks for: may lead the country into debt [1] interest will have to be paid [1] this will involve an opportunity cost [1].

Up to 7 marks for why it should not:

Up to 5 marks for: may move later to a surplus [1] if imports are of raw materials [1] and capital goods [1] may be used to produce products to replace imports [1] and to be exported [1].

Up to 3 marks for: may be short term [1] especially if caused by falling incomes abroad [1] will be reduced when incomes rise [1].

Up to 2 marks for: may be a relatively small deficit [1] and/or may last for a short time [1].

Up to 2 marks for: there may be more serious macroeconomic problems [1] e.g. rising unemployment [1].

Maximum of 5 marks for a list-like response.

Example candidate response – grade A

| | | |
|-----|------|---|
| Q7 | (a). | A tariff is a ^{one} kind of trade barrier that is impose taxation on imported goods to make it more expensive. Therefore, there is a less demand for imports and as well as reduce amount of it. However , while protecting the home industries, there might be increasing demand for domestic products rather than imports. Therefore, imports are reduced and discouraged. |
| Q7 | (b). | Deficit means when there is more imports than exports in ^{trade} . One cause could be the appreciation of the domestic domestic currency. When the currency appreciates, it grows more expensive for others to purchase their exports, therefore exports reduce. And it grows cheaper for the home country to purchase imports, therefore import increases. Then there is a deficit on the balance of payment. |
| ... | | Another reason could be an increase decrease in the country's interest rate. This can result in an increase in aggregate demand since it makes it easier for customers to borrow. Therefore, the demand for imported goods could also increase creating an imbalance with overweighting imports. |
| | | The last reason could be that when domestic goods are uncompetitive. There might be lack of innovations and poor quality of the products existing in the domestic businesses. Customers might purchase more of imported goods for better quality and less exports would be made as well since there will be decreasing demand for uncompetitive goods. |

| | | |
|----|-----|---|
| Q7 | (c) | <p>On the one hand, the government should be concerned about a growing current account deficit since it causes unemployment. Deficit means less demand in exports and more in imports. With less exports, there will be less output needed in response and businesses need to lay off workers to reduce costs as they face a fall in sales. Therefore, unemployment could arise and the total GDP could reduce as well.</p> <p>In addition, deficit also causes imported inflation which causes damage to the country's imports. With higher demand in imported goods, the rising demand will lead to demand-pull imported inflation. The price level of the imported goods will be higher, as well. Therefore, a deficit could cause damage to the imports as well.</p> <p>However, the government doesn't need to be concerned in the long-run if they have a floating exchange rate. The deficit of the trade means there is ^{less} demand of the country's products and more supply in excess. This can shift the value of the currency to the left and the currency depreciates. Depreciation can therefore bring about a correction of the deficit since it's cheaper for other countries to buy their exports and they would have less imports as it's more expensive.</p> <p>In conclusion, government doesn't need to be worried since the currency is itself helps to correct the deficit and the problems caused by deficit as well.</p> <p>In conclusion, I think that government still needs to be concerned since there are countries which are still using fixed exchange rates and government intervention is needed largely. In addition, intervention can be effective in correcting deficit for e.g. in the case of India mentioned - the use of trade barriers.</p> |
|----|-----|---|

Examiner comment – grade A

- (a) The answer recognises the nature of a tariff and its effects on price and demand. It would have been strengthened by describing the effect on costs and/or supply. (3/4)
- (b) This is a strong answer. It starts by bringing out the meaning of a current account deficit. Although the candidate is effectively focusing on the causes of an increase in a current account deficit, the answer does clearly bring out the reasons why a country may have a deficit on the current account of the balance of payments. There is clear analysis of the effects of a rise in the exchange rate on exports and imports. It then provides an interesting analysis of the effect of a fall in the rate of interest and a lack of innovations. (6/6)
- (c) The answer tackles the question directly. The first paragraph provides good analytical links to the possible impacts on unemployment and output. There is reference to imported inflation although the point could have been established rather more. The answer then discusses why a government should not be concerned. There is a relevant discussion of how the deficit might be self-correcting with a recognition that this would not be the case if the country is operating a fixed exchange rate. (9/10)

Total mark awarded = 18 out of 20

Example candidate response – grade C

| | |
|---|--|
| 7 | a) Setting Setting a tariff on imports can make imports expensive and discourages to import goods and services from other countries and also increases demand for goods and services produced the the country. |
| | b) Imports are increasing - Exports are decreasing because of lower demand for goods and services, because of the other countries which provides goods for cheaper. - Export are decreasing Inflation is motivating to spend more on goods imported goods. |

| | | |
|--|---|--|
| | c | The government will be concerned about a growing deficit since it is increasing imports and the exports are decreasing, the government is then using its own stocks to pay off the debts or its revenue from tax which could have used elsewhere to benefit the economy, Subsidies and grants may increase decrease as the government has to pay off more debts. The country may even take loans from other organizations to pay off debts and then may have to pay back with interest later on which would even make the deficit worse. the The employment in the country may start to rise because of no demand for goods and services produced locally because imports would have become more cheaper because of trade surplus in some other country, the Exchange rate of the country would also fall because of a trade deficit, the government may have to sell of its assets to increase the exchange rate. |
|--|---|--|

Examiner comment – grade C

- (a) The answer recognises that a tariff may make imports more expensive and implies that demand for them may fall. A number of stages in the process are, however, omitted including the impact on supply. (2/4)
- (b) The answer starts by stating that imports are increasing and exports are falling. These movements would not necessarily mean that the country is experiencing a current account deficit. The answer then mentions that exports may be declining because the products are cheaper in other countries. This point might have been explored in more depth and two other causes needed to be identified and explained. (1/6)
- (c) There is a slip when it is mentioned that 'employment in the country may start to rise'. This can be taken as unemployment. There are a number of reasons mentioned as to why a government should be concerned about a growing current account deficit. These, again, might have been analysed in more depth. For instance, it might have been explained why the exchange rate may fall and the impact of a rise in unemployment. The answer is also one-sided. There is no discussion as to why a government should not be concerned about a growing current account deficit. Considering only one side in a discussion question limits the maximum marks available. (5/10)

Total mark awarded = 8 out of 20

Example candidate response – grade E

| | | |
|----|----|--|
| 7. | a. | Tariff could reduce imports because it will charged more money from company nor person who imported the good to India. If government charged a tariff of imported good, it will be more expensive than before and demand of imported good will decrease. If imported products is being reduced, current account's deficit will reduce and lead into base balance of payments. |
| 7. | b. | Causes of a current account deficit : → High imported product amount in the country. If country have too much imported products, it will make their current account deficit, because they not export equally with their import, and the figure of current account is not balance. income is higher ^{Outgoing} outgoing money is higher than incoming money. → Low tax revenue. If government doesn't charged taxes or tariff tariff of imported products, it will make big deficit at their account, because they can't get more tax revenue from imported products; and will be deficit at their current account. → |

| | | |
|----|----|--|
| 7. | c. | Government should always concerned about a growing current account deficit, because if current base account deficit continue to growing and worst than before, inflation rate at the country will be increase and lead into several economic problems, and the most problem is economy crisis. Foreign exchange of country's currency will be decrease and most of people will exchange their money, because their currency is not valuable. After that price of the products will increase and more interests that will make money unvaluable. So government should always concerned about a growing current account deficit and start to balance their current account to avoid some economic problems, specially economy crisis and high inflation. |
|----|----|--|

Examiner comment – grade E

- (a)** The answer implies a tariff will increase price and states that it will reduce demand. It might have brought out why price may increase in terms of the effects that a tariff would have on costs of production and supply. (2/4)
- (b)** The answer starts by giving some idea of the meaning of a current account deficit. It then suggests that a deficit might arise if tariffs are not imposed. This point might have been more clearly expressed and it needed development. Other causes are not covered. (2/4)
- (c)** The point about inflation is not established at the start. Imported inflation may occur but a growing deficit could also lower inflation by lowering aggregate demand and reducing the money supply. The answer then recognises that the growing deficit may reduce the exchange rate and explains why a government should be concerned about this. No other reasons for concern are covered. The answer is one-sided as it does not consider in what circumstances a government should not be concerned. (2/10)

Total mark awarded = 6 out of 20

Cambridge International Examinations
1 Hills Road, Cambridge, CB1 2EU, United Kingdom
Tel: +44 (0)1223 553554 Fax: +44 (0)1223 553558
Email: info@cie.org.uk www.cie.org.uk

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