

Answers

UNIT 1, page 7

1.1.1

1. Explain what is meant by the 'economic problem'.

The economic problem exists because people have infinite or unlimited wants but there are only limited or finite resources to satisfy those wants. As a result of this situation, choices have to be made.

2. Explain why choice is so important in economic decision making.

Economic resources have different possible uses so a decision has to be made about the use of these resources, and the existence of scarcity makes choice inevitable.

1.1.2

To what extent do you think clean air can be regarded as a free good?

A free good is one that is not scarce in relation to the demand for it, therefore no price is charged for it. Air is often given as an example of a free good. It is abundantly available so there is no sacrifice involved in using it and there is no opportunity cost. People have as much access to air as they want. One person can enjoy air without stopping others from enjoying it too. There is no need, therefore, to charge a price for it. However, given the amount of environmental pollution in the world, it is debateable whether clean air is an example of a free good. If clean air is regarded as relatively scarce in relation to the demand for it, a choice will need to be made, that is, it has an opportunity cost. In such a situation, clean air could be regarded as an economic good, in which case a price will need to be paid in order to obtain it.

1.2.1

1. Define the meaning of the factors of production land and labour.

Land is used to describe the gifts of nature, or natural resources, used in the production process. Labour is used to describe the human resources used in the production process, referring to both physical work and intellectual work, sometimes referred to as human capital.

2. Explain what is meant by capital as a factor of production.

Capital is generally used to refer to human-made aids to production, such as machinery, tools and equipment.

3. Describe how the factor of production enterprise is rewarded.

The factor of production enterprise is rewarded by profit. Enterprise involves the taking of risk, and the reward for taking such a risk is called profit.

1.2.2

1. Distinguish, with the use of examples, between the geographical and the occupational mobility of factors of production.

Geographical mobility refers to the ability of factors of production to move from one area to another. An example is the movement of labour from one city to another. Occupational mobility refers to the ability of factors of production to move from one use to another. An example is the change in the use of land from agricultural to manufacturing production.

2. Describe the possible influences on the mobility of factors of production.

A major influence on the geographical mobility of land will be the extent of the funds available to finance reclamation projects that will be very expensive. Also, the availability of funds will be an important influence on the occupational mobility of land from one use to another.

A major influence on the geographical mobility of labour will be the willingness of governments and businesses to provide financial support to workers willing to move from one area to another. Better information about vacancies in different areas could also have an impact. A major influence on the occupational mobility of labour will be the extent to which governments provide and financially support a range of retraining initiatives.

The geographical mobility of capital will be influenced by the funds available to businesses who want to move machinery and equipment from one area to another. The extent of the occupational mobility of capital will depend on how easy it is to use capital equipment in different industries.

The geographical mobility of entrepreneurs can be influenced by the extent to which they are aware of the profit-making opportunities in different parts of a country or in different countries. The extent of the occupational mobility of entrepreneurs will be influenced, for example, by the availability of sources of support and of networking opportunities, enabling them to learn about different occupational areas and industries.

1.2.3

Describe what could influence the quantity and quality of labour in an economy.

The quantity of labour in an economy will be influenced by various population factors: its birth rate, its death rate and the extent of net migration. However, its labour force will also be influenced by changes in its school leaving age, changes in its retirement age and changes in its attitude towards women working.

The quality of labour in an economy can be improved by government initiatives in education and training, increasing its school leaving age and encouraging more people to attend higher education courses.

1.3.1

Explain, using an example, how opportunity cost can occur when a choice is made.

Opportunity cost, that is, the next best alternative that is foregone when a choice is made, occurs when a choice is made between different possible alternatives. For example, a government may decide to increase its expenditure on education and the opportunity cost of such a decision is that it may have to reduce its expenditure on defence.

1.3.2

Explain, using an example of each, how opportunity cost can be applied to decisions taken by (a) workers and (b) governments.

- (a) If a worker takes a decision to work extra hours, the opportunity cost of this decision is the next best alternative that is given up. This could be hours of leisure, such as time spent playing football.

- (b) If a government, with only a limited amount of revenue, decides to spend more money on healthcare, the opportunity cost could be the money that might otherwise have been spent on education.

1.4.1

Calculate how many thousand kilograms of sugar are produced when the production of bananas is (a) 75 thousand kilograms, (b) 50 thousand kilograms and (c) 25 thousand kilograms.

- (a) 12
(b) 25
(c) 38

1. Explain what is shown by a production possibility curve.

A production possibility curve shows the combinations of goods that can be produced in an economy at a particular time, using all the available resources. An economy can produce many different products. A production possibility curve simplifies this by showing the production of just two types of goods.

2. Analyse the difference between a straight line and a curved production possibility curve.

A production possibility curve can be drawn as a straight line when the economic resource used, for example, land, is identical. However, this is not always the case, and if land is more suitable for growing certain crops rather than others, the curve needs to be drawn as a curve and not as a straight line. The curve will be steeper as it gets near to the two axes because the production of one crop will involve a greater sacrifice of the other.

1.4.2

Explain why some production points may exist under a production possibility curve.

Some production points may exist under a production possibility curve because such points show a situation where economic resources are not being used to their maximum potential, that is, there is an inefficient allocation of resources and some of the resources are unemployed.

1.4.3

Draw a production possibility curve and use it to illustrate the concept of opportunity cost.

The diagram should look like Figure 10 on page 20 of *Exam Success in Economics for Cambridge IGCSE® & O Level*. If some agricultural land is converted to tourism, which would be shown as a change from T1 to T2, the opportunity cost would be shown by the distance between A1 and A2 on the horizontal axis.

1.4.4

1. Distinguish between a movement along a production possibility curve and a shift of a production possibility curve.

A movement along a production possibility curve involves opportunity cost, that is, if more is produced of one product, less will be produced of another product. However, when there is a shift of a production possibility curve, this means that there has been a change in the quantity and/or resources in an economy. For example, if there is an increase in the quantity and quality of resources involved in the production of two types of product, the curve will shift to the right and it will be possible to produce more of both products.

2. Explain what could cause a shift to the right of an economy's production possibility curve.

An economy's production possibility curve will shift to the right if there is an increase in the quantity of land, labour, capital and enterprise available, and/or if there is an increase in the efficiency or productivity of the land, labour, capital and enterprise.

UNIT 2, page 30

2.1.1

Identify some economic choices that you have made over the last three months.

The student will identify some microeconomic decisions that he or she has taken as an individual or a consumer over the last three months.

2.1.2

1. Explain, with the use of examples, the distinction between microeconomics and macroeconomics.

Microeconomics is defined as the study of relatively small-scale units, markets and decisions taken by individuals within an economy. Microeconomic decisions are made on a relatively small scale by a business or a firm, by an individual or by a consumer.

Macroeconomics is defined as the study of relatively large-scale units, markets and decisions taken by groups of individuals within an economy. Macroeconomics is concerned with aggregate decisions, such as the total level of consumer spending or government spending over a period of time. Macroeconomic decisions are made on a relatively large scale by groups of consumers, groups of producers or firms, exporters and importers, the government, the financial sector and international government bodies and non-government organisations.

2. Which of the following is an example of microeconomics? Decisions taken by:

(a) A consumer

2.2.1

1. Study a street market in your city, town or village. What is being bought and sold? Who are the buyers and sellers? Are the prices changing?

Research to be carried out by the student.

2. Explain how a market can move from a state of equilibrium to a state of disequilibrium and back to a state of equilibrium.

When a market is in a state of equilibrium, demand will be equal to supply and there is no tendency to change.

However, changes in market forces could end this state of equilibrium in a market and bring about a state of disequilibrium. Changes could come from the buyer or consumer. For example, there could be a change in consumer tastes and preferences or there could be a change in consumer incomes. Changes could also come from the seller or supplier. For example, there could be a change in the weather, affecting the supply of agricultural products, or the development and application of new technology could increase the efficiency of producers, so that more could be made from a given number, or even fewer, resource inputs.

The term 'disequilibrium' refers to a state where there is a tendency to change. In this state of change, the demand for products will not be equal to the supply of products at a given time. Changes in market forces will lead to a rise or a fall in price of products. When a market is in disequilibrium, prices will change. These price changes will act as market signals and the economic resources will be reallocated until demand is again equal to supply and equilibrium is then restored to the market.

2.2.2

1. Explain how the basic economic problem leads to decisions being taken about the allocation of scarce resources in an economy.

The economic problem creates three important questions about determining resource allocation. These are what to produce, how to produce and for whom to produce.

These three fundamental questions about determining resource allocation come about because of the basic economic problem of unlimited wants exceeding limited resources.

2. State, with the use of examples, the three key questions.

What to produce: for example, whether to produce agricultural products or manufactured products.

How to produce: for example, whether to concentrate on the use of human resources (labour-intensive production) or to concentrate on the use of machinery and equipment (capital-intensive production).

For whom to produce: for example, will the products be distributed to people on the basis of need or on the basis of ability to pay?

2.2.3

Explain how scarce resources are allocated in a market.

Scarce resources are allocated in a market through market signals. These signals operate through what the economist Adam Smith described as an 'invisible hand'. This stresses that if consumers and suppliers are allowed to decide what to buy and what to sell, prices will settle at a level that benefits both buyers and sellers.

The price mechanism is the way in which the three key allocation questions of what to produce, how to produce and for whom to produce are answered. This price mechanism refers to the way in which decisions made by buyers and sellers in an economy interact to determine the allocation of scarce resources. Resources in an economy are therefore reallocated as a result of price changes and these price changes are the result of the interaction of the market forces of demand and supply. For example, resources are moved away from those products that are less popular and moved towards those products that are more popular.

2.3.1

1. Explain what is meant by effective demand.

Demand is defined as the willingness and ability to buy a product at a given price at a given time. The idea of effective demand stresses that it is not just simply that people would like to buy a particular good or service; this want needs to be supported by the money to purchase the good or service, that is, there needs to be not only a want or need, but also an ability to satisfy that want or need in a monetary sense.

2. Analyse why a demand curve is usually downward sloping from left to right.

A demand curve is usually shown as a downward sloping line from left to right because higher prices lead to lower quantities of a product being bought, and lower prices lead to higher quantities of a product being bought.

2.3.2

1. Explain what causes a movement along a demand curve for a product.

When the price of a product changes, there will be a movement along the demand curve for the product. It is only a change in the price of a product that can cause such a movement along a demand curve.

2. Distinguish between an extension in demand and a contraction in demand for a product.

If there is a fall in the price of a product, there will be a movement down the demand curve and a rise in the quantity demanded. This is known as an extension in demand.

If there is a rise in the price of a product, there will be a movement up the demand curve and a fall in the quantity demanded. This is known as a contraction in demand.

3. Which of the following could cause an extension in demand?

(b) A fall in price

2.3.3

1. Collect data from the people in your class on the demand for a product at different prices and then add (or aggregate) the data to produce the demand for the product of the whole class.

Research to be carried out by the student.

2. Distinguish between individual and market demand.

It would be possible to produce an individual demand schedule for a particular product. This would show how many items of a product a person would be willing and able to buy at different prices. However, this would not be very useful as a market is made up of many individuals. It would be better to produce a demand schedule for many individuals. This would give a better idea of the level of market demand for a particular product at different prices. In order to arrive at this market demand schedule, the demands of many individuals can be added together.

3. Explain, using an example, what is meant by aggregation.

The process of adding together the demand of a number of individuals in a market is known as aggregation. The activity carried out by the student to answer Apply task 1 in this section is an example of this.

2.3.4

1. Distinguish between income and disposable income.

The amount of income that people have to spend on goods and services is known as their disposable income. Not all income is available to spend. For example, some money may have been taken by the government in the form of taxation.

2. Distinguish, using an example of each, between the effect of an increase in income on the demand for normal goods and for inferior goods.

An increase in income usually leads to an increase in the demand for products and, in this case, they are known as normal goods. With normal goods, an increase in income will shift the demand curve to the right. An example of a normal good is a car. However, in some cases, an increase in income could lead to a decrease in demand for products and, in this case, they are known as inferior goods. With inferior goods, an increase in income will shift the demand curve to the left. If someone needs to buy a product to use as a main mode of transport, an example of an inferior good is a bicycle.

3. Explain, using examples of each, the difference between a substitute and a complement.

A substitute is a product that is in competition with another product, for example, tea and coffee. A complement is a product that is used in conjunction with another product, for example, tea and milk.

4. Which of the following could cause a demand curve to shift to the left?

(a) A fall in income

2.4.1

Describe the relationship between the quantity supplied of a product and its price.

A supply curve is usually shown as an upward sloping line from left to right, showing that higher prices lead to higher quantities being supplied and that lower prices lead to lower quantities being supplied.

2.4.2

1. Explain what causes a movement along a supply curve for a product.

A movement along a supply curve for a product is caused by a change in the price of that product. Everything else is assumed to be kept constant.

2. Distinguish between an extension in supply and a contraction in supply for a product.

If there is a rise in the price of a product, there will be a movement up the supply curve and a rise in the quantity supplied. This is known as an extension in supply.

If there is a fall in the price of a product, there will be a movement down the supply curve and a fall in the quantity supplied. This is known as a contraction in supply.

2.4.3

Distinguish between individual and market supply.

An individual supply schedule for a particular product would show how many items a producer would be willing and able to sell at different prices. However, this would not be very useful as a market is often made up of many firms. It would be better to produce a supply schedule for many producers. This would give a better idea of the level of market supply for a particular product at different prices. In order to arrive at this market supply schedule, the supply totals of individual firms can be added together. This process of adding together the supply of a number of firms in a market is known as aggregation.

2.4.4

1. **Distinguish between those factors that will cause a supply curve to shift to the left and those factors that will cause a supply curve to shift to the right.**

An increase in production costs will shift a supply curve to the left whereas a decrease in production costs will shift a supply curve to the right. Unfavourable changes in physical conditions will shift a supply curve to the left and favourable changes in physical conditions will shift a supply curve to the right. An increase in taxation will shift a supply curve to the left but a decrease in taxation will shift a supply curve to the right. A reduction in a subsidy will shift the supply curve to the left and an increase in a subsidy will shift a supply curve to the right. If there is a reduction in the extent of joint supply, this will shift the supply curve to the left but if there is an increase in the extent of joint supply this will shift the supply curve to the right.

2. **Which of the following could cause a supply curve to shift to the right?**

(a) A favourable change in physical conditions

2.5.1

Explain what is meant by a market clearing price.

The equilibrium price in a market is often referred to as the market clearing price. This is because at this price, the quantity demanded is equal to the quantity supplied and so consumers and producers are satisfied with this price. No products will remain and this is why it is called the market clearing price.

2.5.2

1. **Explain what is meant by a situation of market disequilibrium.**

The term 'market disequilibrium' refers to a state where there is a tendency to change. In this state of change, the demand for products is not equal to the supply of products at a given time. Changes in market forces will lead to a rise or a fall in the price of products. A market is more likely to be in a state of disequilibrium than a state of equilibrium because demand and supply conditions are continually changing.

2. **Explain how a market moves from disequilibrium to equilibrium.**

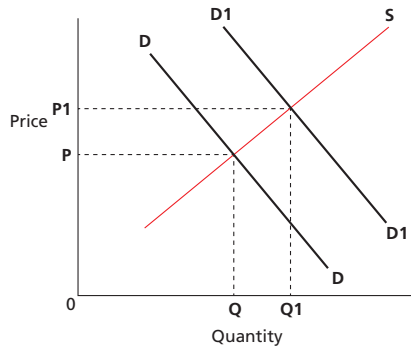
If a price in a market is above the equilibrium price, firms will not be able to sell all of the products they are trying to sell. In this situation, the disequilibrium is in the form of a surplus where supply exceeds demand. This is known as a situation of excess supply. In order for a state of equilibrium to be restored in this market, the price will need to fall until it is at a point where demand is equal to supply.

If a price in a market is below the equilibrium price, consumers will not be able to buy all of the products they want to buy. In this situation, the disequilibrium is in the form of a shortage where demand exceeds supply. This is known as a situation of excess demand. In order for a state of equilibrium to be restored in this market, the price will need to rise until it is at a point where demand is equal to supply.

2.6.1

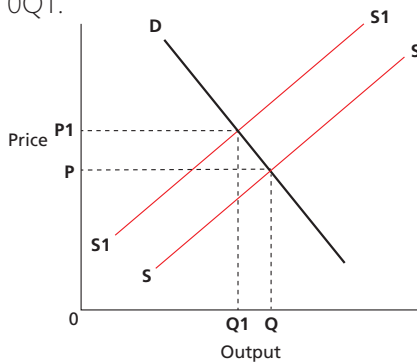
1. Explain, with the aid of a diagram, the effect of a shift of a demand curve to the right on equilibrium price and equilibrium quantity in a market.

If a demand curve shifts to the right, from DD to D_1D_1 , there will be a rise in equilibrium price from OP to OP_1 and a rise in equilibrium quantity from OQ to OQ_1 .



2. Explain, with the aid of a diagram, the effect of a shift of a supply curve to the left on equilibrium price and equilibrium quantity in a market.

If a supply curve shifts to the left, from SS to S_1S_1 , there will be a rise in equilibrium price from OP to OP_1 and a fall in equilibrium quantity from OQ to OQ_1 .



2.7.1

1. Define price elasticity of demand.

Price elasticity of demand is defined as the responsiveness of the quantity demanded of a product to a change in the price of that product.

2. Explain why price elasticity of demand is represented by a minus figure.

Price elasticity of demand is always a minus figure. This is because an increase in price leads to a fall in demand and a decrease in price leads to a rise in demand. There is therefore an inverse relationship between the change in price and the change in the quantity demanded, although the minus sign is often omitted.

2.7.2

1. Explain what is meant when the price elasticity of demand for a product is described as inelastic.

Inelastic demand is a situation when the quantity demanded of a product changes by a smaller percentage than the change in price.

2. Which of the following correctly describes price elasticity of demand?

(c) Percentage change in demand divided by percentage change in price

2.7.3

Explain why the price elasticity of demand for a necessity is relatively inelastic.

If a product is a necessity, the price elasticity of demand will be relatively inelastic because of its importance to consumers, that is, if it is something that they cannot do without, they are likely to be less responsive to price changes.

2.7.4

Explain what a firm should do, in terms of possible price changes, to increase revenue when selling a product with elastic price elasticity of demand.

If a firm wants to increase its revenue, it will reduce the price of its products when the demand for them is relatively elastic because the gain in revenue from selling more units will be greater than the loss in revenue from charging a lower price for each unit sold.

2.7.5

Explain, using examples, why knowledge of price elasticity of demand is useful for governments aiming to maximise tax revenue.

A government is likely to take price elasticity of demand into account when making decisions about which products to tax and by how much. For example, if it wanted to discourage consumption of a certain product, such as alcohol or cigarettes, by raising the tax on such products, the policy is likely to be more successful if price elasticity of demand for such products is relatively elastic. However, if the aim of such a policy is to raise the money received from taxation, the policy is likely to be more successful if price elasticity of demand for such products is relatively inelastic.

2.8.1

Explain what is meant by the term 'price elasticity of supply'.

Price elasticity of supply is defined as the responsiveness of the quantity supplied of a product to a change in the price of that product.

2.8.2

Explain what is meant when the price elasticity of supply of a product is described as elastic.

The price elasticity of supply of a product is described as elastic when supply changes by a larger percentage than the change in price. The figure for price elasticity of supply will be greater than 1.

2.8.3

Explain why the price elasticity of supply of agricultural products is often more inelastic than the price elasticity of supply of manufactured products.

Agricultural products can often take a long time to grow, longer than it takes to produce manufactured products. Also, agricultural products cannot be stored for long periods of time, unlike manufactured products.

2.8.4

Explain, using examples, why knowledge of price elasticity of supply is useful for producers.

Knowledge of price elasticity of supply is useful for producers because if they are able to increase price elasticity of supply, they will be able to benefit from an elastic price elasticity of supply. They will aim to change supply as quickly as possible in response to a change in price. In this situation, their profits are likely to be higher.

2.9.1

1. Distinguish between the private sector and the public sector in an economy.

The private sector consists of small, medium and large firms that are independently owned. The main aim of these businesses is to make a profit. They respond to market signals that are indicated by consumers through the price mechanism. The public sector consists of enterprises owned by the government. These will vary from one country to another, but in many countries rail services, bus services, oil, gas and electricity industries and the central bank are owned by the government. Government departments, such as the tax department, are also part of the public sector.

2. List some examples of the private sector and the public sector in your country.

Research to be carried out by the student.

2.9.2

1. Outline the key features of a market economic system.

The key features and characteristics of a market economic system include the bringing together of buyers and sellers and the allocation of scarce economic resources through decisions taken by buyers and sellers. The answers to the three key questions of what to produce, how to produce and for whom to produce are obtained through the operation of the price mechanism and through giving appropriate signals. There will be a relatively important role for the private sector (firms and consumers) and a relatively restricted role for the public sector (government).

2. To what extent would you describe your country's economy as a market economic system?

Research to be carried out by the student.

2.10.1

1. Explain what is meant by market failure.

Market failure exists when there is an inefficient allocation of resources in an economy. For example, such inefficiency would occur when a market does not always produce a desirable output. It can include the underproduction of merit goods, the overproduction of demerit goods and the non-production of public goods.

2. Distinguish, using examples of each, between a public good and a merit good.

A public good is one that is provided to the whole of a society by a government and is funded out of taxation. Examples include street lighting, police and defence. It would be impossible, or at least very difficult, to charge a price for such services as it would be difficult to exclude those who had not paid. This gives rise to the free rider problem; a free rider is someone who consumes a product or service without paying for it, and so this is why these goods are provided by the public sector and not the private sector.

A public good is characterised by two key characteristics. It is non-rival, that is, the consumption of a public good by one person does not reduce the possibility of it being consumed by another person. It is non-excludable, that is, no one can be excluded from consuming the public good. A public good can also be regarded as non-rejectable because it would be difficult to reject, for example, defence or street lighting.

A merit good is one that exists as a result of information failure. Consumers do not have all the information needed to fully understand that a merit good can have substantial benefits, both to themselves and to the wider society, and so such goods tend to be underproduced and underconsumed. Examples of a merit good are education, health care and vaccinations. A merit good is an example of a private good, not a public good.

3. Which of the following is a merit good?

(c) Education

2.10.2

1. Explain what is meant by a negative externality.

External costs refer to the costs to third parties, that is, those people affected by the decisions of others but who were not involved in taking the decision themselves. This effect is sometimes referred to as a spill-over effect. In the case of an external cost, it is known as a negative externality. An example of market failure is where an economic decision does not sufficiently take negative externalities into account, such as when an economic decision leads to pollution and degradation of the environment.

2. Explain how there could be an abuse of monopoly power in a market.

A market may fail when there is a lack of competition between firms and one firm dominates a market. The dominant firm is called a monopoly. In this situation, the firm may abuse its monopoly power, and take advantage of the lack of competition, by increasing the price and reducing the quantity of its output.

2.10.3

Explain how market failure can lead to a misallocation of resources in an economy.

Market failure has a number of consequences. One of these is in respect of the overconsumption of demerit goods. Demerit goods are those considered to be unhealthy or damaging to both individuals and to society as a whole, such as alcohol and tobacco. As a result of information failure, people consuming demerit goods are consuming more than they would if they knew the likely effects of such consumption. As a result of this overconsumption, there is a misallocation of resources because too many resources are being allocated to the production of demerit goods.

Another consequence is the overproduction of goods with external costs. For example, production of certain products may lead to a high level of pollution, but this production will still go ahead because the producer is only concerned with private benefits and costs, not external benefits and costs. The true benefit and cost to the community is shown by the social benefit and the social cost, but producers only take into account private benefits and private costs. As a result of this overproduction, there is a misallocation of resources.

The consequences of market failure do not include only the overconsumption and overproduction of demerit goods and goods with external costs. They also include the underconsumption of merit goods. Merit goods are those considered to have substantial benefits, both to the individuals consuming them and to the wider society. Examples include education and health care. As a result of underconsumption of merit goods, there is a misallocation of resources because too few resources are being allocated to their production.

Another consequence of market failure is that there will be underproduction of goods with external benefits. For example, the establishment of a factory will create jobs not only in the factory, but also in firms supplying parts to the factory, but this will not be considered by the factory owners because they are only concerned with private benefits, not external benefits. As a result of underproduction of goods with external benefits, there is a misallocation of resources because too few resources are being allocated to their production.

2.11.1

Distinguish between a market economic system and a mixed economic system.

A market economic system is one that allocates scarce economic resources through decisions taken by buyers and sellers operating through the price mechanism. There will be a relatively important role for the private sector (firms and consumers) and a relatively restricted role for the public sector (government). A mixed economic system, or mixed economy, combines elements of the market economic system with a degree of government intervention and ownership. In such an economy, both the private sector and the public sector play a key role.

2.11.2

1. Analyse the advantages and the disadvantages of a government establishing a maximum price in a market.

A government may believe that a market price is too high and that many consumers are unable to buy a product. This will be a particularly serious problem if the product is an essential item. The government could therefore decide to impose a maximum price in the market below the equilibrium price. This would have the advantage of making the product cheaper for everybody. However, the quantity supplied will be less than the quantity demanded and so a shortage will have been created in the market as a result of the excess demand.

2. Describe the advantages and disadvantages of privatisation.

Privatisation refers to the process of selling off state-owned enterprises to transfer their ownership from the public sector to the private sector. The advantage of privatisation is that it is likely to encourage greater efficiency and competition in a market. The disadvantage, however, is that in order to make a profit, costs of production need to be reduced and this can lead, for example, to some of the workers losing their jobs.

3. Which of the following statements is correct?

- (a) A minimum price is set above the equilibrium price

UNIT 3, page 81

3.1.1

1. Define the term 'money'.

Money can be defined as anything that is widely and generally accepted and used to exchange for goods and services.

2. List the denominations of money in your country.

Research to be carried out by the student.

3. Explain why money is preferable to barter as a means of exchange.

Before money was used, people would use barter to exchange products, often in the form of animals such as goats and chickens. This required two or more people to directly exchange products, but it was limited by the fact that to work effectively, it required two people making a trade to want and to be willing to exchange what the other had to offer. This was known as a double coincidence of wants. Money is preferable because it avoids the need for a double coincidence of wants.

4. Which of the following is not a function of money?

- (a) A means of portability

3.1.2

1. Write a short summary of the main functions carried out by the central bank of your country.

Research to be carried out by the student.

2. Choose a commercial bank that operates in your country. Describe the main services that it provides to firms and households.

Research to be carried out by the student.

3.2.1

1. Distinguish, with the use of examples, between a need and a want.

Some spending is on essential items that are necessities, for example, basic foodstuffs. These can be regarded as needs. Other spending is on less essential or non-essential products that can be regarded as wants, for example, a new computer game.

2. Explain what is meant by a country's savings ratio.

The proportion of income that is saved is called the savings ratio.

3. Which of the following is likely to lead to an increase in the savings ratio?

- (d) An increase in the rate of interest

3.3.1

1. Explain what is meant by an overtime payment.

This is an additional payment for hours worked above the basic contracted number of hours. The hours worked as overtime are usually paid at higher than the normal hourly rate, for example, time and a third.

2. Explain, with the use of examples, what is meant by a fringe benefit.

A fringe benefit is an additional advantage of working for a particular employer. There are many examples of fringe benefits, including subsidised housing, payment of school fees, a company car, subsidised transport, reduced prices for company products and subsidised meals.

3. Which of the following is an example of a wage factor?

(b) Commission

3.3.2

1. Explain what is meant by a derived demand.

The demand for labour is not a demand for the labour itself, but for what the labour can produce. This is why the demand for labour is known as a derived demand. The demand for labour therefore comes from producers seeking workers to produce products in combination with the other factors of production.

2. Explain what can influence the relative bargaining power of different workers.

Wage rates vary between different markets because of the relative strength of the demand and supply factors. Workers producing more expensive products are likely to receive higher wages than those producing less expensive products. Demand for workers will be influenced by demand for the products.

If the demand for products is relatively inelastic, workers producing these products are likely to receive higher wages. If the demand for products is relatively elastic, workers producing these products are likely to receive lower wages. The supply of labour will be determined by the number of people with the necessary skills, qualifications and experience. When workers with these skills are scarce, for example, doctors, the supply of labour will be relatively inelastic and these workers are likely to receive higher wages. When workers with these skills are plentiful, for example, hospital porters, the supply of labour will be relatively elastic and these workers are likely to receive lower wages. When workers require no skills or qualifications, for example, hospital cleaners, the supply of these workers will be extremely elastic and so their wages are likely to be very low.

3.3.3

Analyse why female workers are sometimes paid less than male workers.

The wages paid to workers should reflect their skills, qualifications and experience so there should not be a wage gap between male and female workers. Such a gap does exist though, despite the existence of equal pay legislation in many countries. It is called the gender wage gap. However, sometimes female workers may be less skilled, less qualified, less experienced, less likely to be in a trade union and more likely to be in part-time employment compared to men, so it is very likely that they will be paid on average less than men. Also, female workers are more likely to have had a break in their employment than male workers, usually to have children and bring up a family, and this can explain wage differences. It is also possible that the wage differential is not due to any of these factors but to the existence of discrimination in the workplace.

3.3.4

1. Define the term 'specialisation'.

Specialisation can be defined as the process whereby individuals, firms and economies concentrate on producing those products in which they have an advantage. It therefore involves concentrating on a particular task. As a result of focusing on what is done best, there should be an increase in production.

2. Which of the following is an advantage of division of labour for a worker?

(b) A worker may be able to earn higher wages

3.4.1

1. Explain what is meant by collective bargaining.

Collective bargaining refers to the process of negotiation between representatives of the workers and representatives of the employers on issues such as pay and working conditions. This negotiation can take place at a local, regional or national level.

2. Analyse the factors that determine whether one trade union is more powerful and influential than another.

Some trade unions are more powerful and influential than others. This is because of a number of factors, including the number of members, the proportion of workers in an industry in a particular trade union, the financial strength of a trade union and the ability of a trade union to get publicity for its views and actions.

3.4.2

Analyse how firms can benefit from trade union activity.

Firms can benefit from trade union activity because it is better to deal with representatives of many workers than to deal with workers individually. Once an agreement has been reached with the trade unions, the employers know that usually this agreement will be respected.

3.5.1

Explain the different ways in which the relative size of a firm can be measured.

The relative size of firms can be used as a way of classifying firms into small, medium and large firms. Firms can be classified by their relative size in four different ways. They are: the number of workers employed by a firm; the value of output or sales over a period of time, for example, one year; the percentage share of a market controlled by a firm; the value of the capital employed by a firm, that is, the value of its assets.

3.5.2

Explain two advantages and two disadvantages of a small firm.

One advantage of small firm is that it is usually very flexible; it can supply what customers want and provide a quality service based on good relationships with customers. This can make small firms more effective than large firms. A second advantage is that small firms provide goods and services to the local economy. For example, local shops can sometimes exist in areas where larger firms do not operate. One disadvantage of a small firm is that small firms are usually unable to benefit from the cost advantages that large firms have, that is, they are not able to benefit from economies of scale. A second disadvantage is that they can sometimes find it difficult to raise sufficient capital to finance the expansion of the firm.

3.5.3

1. Explain why a firm might wish to grow in size.

Firms may wish to grow in size for a number of different reasons. They may be able to reduce the costs of production by benefiting from economies of scale. They may be able to gain a larger share of a market. They may be able to develop new and improved products. They may be able to sell to new markets, perhaps in other countries. They may become stronger and more secure as a result of growth. In all these cases, firms may be able to increase their profitability.

2. Which of the following is an example of internal growth?

(b) Franchise

3.5.4

Distinguish, with the use of examples, between forward vertical integration and backward vertical integration.

When the vertical integration is forward, a firm will merge with another firm at a later stage of production. An example would be a car manufacturer merging with a firm with car showrooms.

When the vertical integration is backward, a firm will merge with another firm at an earlier stage of production. An example would be a tea producer merging with a tea plantation.

3.5.5

Distinguish, with the use of examples, between internal economies of scale and external economies of scale.

Internal economies of scale are the cost advantages that a particular firm gains from its own increase in output. There are many different examples of internal economies, including technical, financial, managerial, commercial and risk-spreading economies.

External economies of scale are the cost advantages that all firms in an industry gain. Examples include economies in relation to transport, education, suppliers, amenities and associated services.

3.6.1

Explain what can influence the demand for factors of production.

The demand for factors of production is determined by a number of influences. The demand for the product is an important influence on the demand for factors of production (land, labour, capital and enterprise). These factors are not demanded for their own sake, but for what they can contribute to the production process. This gives rise to the idea of a derived demand and this is why the demand for factors of production is influenced by the demand for the product.

The price of different factors of production is an important influence on the demand for factors of production. If the price is lowered, it is likely to lead to a rise in demand for the factor.

The availability of different factors of production to meet the demand is important. Another key influence is each factor's productivity. The productivity of a factor refers to the output produced per factor of production per period of time and the demand for the more productive, more efficient, factors will be greater than the demand for the less productive factors. For example, if capital is more productive than labour, firms will adopt capital-intensive rather than labour-intensive methods of production.

3.6.2

Analyse why one firm might decide to use a labour-intensive form of production and another firm a capital-intensive form of production.

Labour-intensive production will be advantageous to a firm in a country with a large population because there will be an abundance of labour, making the cost of labour relatively low. However, capital-intensive production will be used by a firm where there is not an abundance of highly skilled labour and so the wages and salaries of such people will be relatively high. Capital-intensive production will also be preferred if there is a tradition of industrial relations disputes which could mean that labour would frequently go on strike.

3.6.3

Explain the difference between production and productivity.

Production refers to the use of economic resources to contribute to the creation of a final product whereas productivity refers to the output per factor of production per period of time.

3.7.1

Which of the following is an example of a variable cost?

(c) Raw materials

3.7.2

Explain the shape of the average fixed cost curve.

The average fixed cost curve shows how fixed costs change as the output of a firm is increased. It is calculated by dividing the total fixed costs of production by the number of units produced. The greater the output of a firm, the more the fixed costs will be spread over the output. The average fixed cost curve will fall very steeply to begin with at relatively low levels of output, but will then fall more slowly at relatively high levels of output.

3.7.3

Distinguish between total revenue and average revenue.

Average revenue is the price charged per unit of a product. Total revenue is the average revenue multiplied by the number of units sold, that is, it is the total receipts received by a firm from its selling activities.

3.7.4

Explain what is meant by profit maximisation.

Profit can be defined as the reward for risk taking. It is the amount of money that remains after all costs have been subtracted from the revenue received by a firm. Many firms will have not just profit as their main objective, but profit maximisation. The profit maximising output for a firm is where there is the greatest difference between total revenue and total cost.

3.8.1

Describe the assumptions of a competitive market.

The theory of perfect competition is based on a number of assumptions. It assumes that there is a large number of firms competing with each other in the market and that there are many buyers, as well as sellers, in the market. It assumes that each firm produces an identical, uniform or homogeneous

product and that there is perfect knowledge in the market, with everybody knowing what other firms are producing and selling and at what price. It assumes that there are no barriers to entry into, and no barriers to exit from, the market. Another assumption is that each firm in the market is a price taker, that is, the firm accepts whatever price is determined by the forces of demand and supply in the market, and that there are no transport costs. The theory also assumes that firms aim to maximise profits and that they have access to the same technology.

3.8.2

Describe two characteristics of monopoly.

One characteristic of a monopoly is that the monopoly firm is a price maker, rather than a price taker as in perfect competition, influencing the price in the market through its dominant position. A second characteristic is that the monopoly firm can make profits over and above normal profit in both the short run and the long run. These are called supernormal profits.

UNIT 4, page 127

4.1.1

Find an example of what the government in your country does at the local, national and international level.

Research to be carried out by the student.

4.2.1

Find out the following data for your country: the rate of economic growth, the rate of unemployment, the rate of inflation and the current account balance of the balance of payments.

Research to be carried out by the student.

4.2.2

Explain why there could be a possible conflict between full employment and stable prices.

If a government had the goal of full employment, the level of demand in the economy would be high, possibly higher than the level of supply. In this situation, the excess demand in the economy would pull up prices, causing demand-pull inflation. It would therefore be difficult for a government to achieve a situation of stable prices.

4.3.1

1. Distinguish between a budget surplus and a budget deficit.

A budget surplus is where public revenue is greater than public expenditure, that is, there is more money coming in than going out. A budget deficit, on the other hand, is where public expenditure is greater than public revenue, that is, there is more money going out than coming in.

2. Explain why governments spend money in an economy.

Governments spend money in an economy for a variety of different reasons. It could be to influence economic activity. For example, a government could decide to increase its spending in order to stimulate the level of total demand in an economy and to bring about a higher level of economic growth. It could be to reduce market failure. For example, a government may decide to spend

on public goods because these would not be provided by the market sector, such as defence and police. A government may also decide to spend on merit goods that would be underproduced and underconsumed in a market economy because of the existence of information failure, such as education and health care. A government could aim to promote equity. For example, a government could decide to provide benefits to those that are not so well off in a society through a system of social welfare. In addition, a government may need to pay interest on money borrowed; the total debt of all money borrowed is called the national debt.

4.3.2

Analyse three reasons for a government levying taxation in an economy.

A government could levy taxation in an economy in order to influence economic activity. Changes in taxation can have an impact on the level of demand in an economy. For example, if there is a reduction in taxation, it will help to stimulate economic activity. A second reason is to discourage the consumption of demerit goods. These are goods that are overproduced and overconsumed in an economy because of the existence of information failure, such as alcohol and tobacco. A third reason could be to redistribute income. Taxation can be used by a government to bring about greater equity in the distribution of an income in an economy, such as by taxing richer people more than poorer people and using this money to finance benefit payments to the poor.

4.3.3

Which of the following is an example of an indirect tax?

(d) Value added tax.

4.3.4

Describe three qualities of a good tax.

Firstly, taxes should be economical to collect. The cost of administering a tax should be relatively low in relation to the revenue obtained from the levying of the tax. Secondly, taxes should be predictable. Taxpayers and the government should be able to predict with some degree of certainty what taxes will be paid and how much will be received by a government from the taxes. Thirdly, taxes should be flexible. They should be capable of being changed if there is a change in the level of activity in an economy, for example, to take account of a situation of economic boom or economic slump.

4.3.5

Distinguish between the positive and the negative impact of taxation.

Taxation has a potentially positive impact in an economy. For example, the money raised from taxation can be used to finance merit goods such as education, and public goods such as defence. However, it also has a potentially negative impact in an economy. For example, disposable income will be less than gross income (income before tax) and so people will have less money to spend than would otherwise be the case.

4.3.6

Give three reasons for government spending and three reasons for government revenue.

Government spending can be to pay for merit goods such as health care, public goods such as the police, and to pay the wages and salaries of those who work for the government. Three reasons for government revenue are to pay for government expenditure, to repay money borrowed and to pay interest on money being borrowed.

4.3.7

Explain how a government could use deficit financing to increase the level of demand in an economy.

A government could pump more money into an economy with the aim of increasing output and employment. This expansionary fiscal policy, known as deficit financing, is used when an economy is in a state of recession. For example, subsidies can be given to firms experiencing financial difficulties and/or taxes can be reduced to encourage consumers to spend more money.

4.3.8

Distinguish between discretionary fiscal policies and automatic stabilisers.

Fiscal policy measures may impact on government macroeconomic aims in two ways. Discretionary fiscal policies are one-off policy changes and adjustments designed to achieve a specific objective or purpose. For example, a business tax may be decreased in order to stimulate business enterprise. Automatic stabilisers are changes that come about automatically in an economy. For example, in a recession the proportion of taxes paid by taxpayers is likely to fall so that their disposable income is maintained. In contrast, in a boom the proportion of taxes paid by taxpayers is likely to rise so that the growth of income is limited, making it less likely that there will be a high rate of inflation.

4.4.1

1. Distinguish between a narrow money supply and a broad money supply.

The money supply is the quantity or stock of money in an economy at a given time. A narrow money supply includes notes, coins and current accounts held in commercial banks. This measure focuses on money that is mainly used as a medium of exchange. A broad money supply also consists of notes, coins and current accounts held in commercial banks, but includes money deposited in deposit accounts as well. This measure focuses not only on money mainly used as a medium of exchange, but also on money that is used as a store of value.

2. Explain how monetary policy operates in an economy.

Monetary policy operates in an economy through changes in interest rates, changes in the money supply and changes in foreign exchange rates. If the objective of monetary policy is to reduce the rate of inflation in an economy, there will be an increase in the rate of interest and a decrease in the money supply. There could also be an increase (or appreciation) in the foreign exchange rate, which would make the cost of imported raw materials and component parts cheaper.

4.4.2

Which of the following is an example of a contractionary monetary policy?

- (d)** An increase in the rate of interest

4.5.1

1. Explain what is meant by supply-side policy.

Supply-side policy refers to a number of measures designed to create a more efficient and flexible economy, with an increased productive capacity. These policy measures are intended to increase the quantity and/or quality of the factors of production.

2. Describe two examples of a supply-side policy measure.

One example of a supply-side policy is expenditure on education and training. Investment in education and training schemes will help to make workers more productive and efficient. Investment in training will have a more immediate impact on potential supply, as workers develop new skills, but investment in education will be likely to have a more long-term impact.

A second example of a supply-side policy is labour market reform. Measures to reduce the power of trade unions, such as their power to limit the supply of workers to keep wages above the market rate, could help to make the labour market more flexible and more responsive to changes in market conditions, especially in terms of making workers more occupationally and geographically mobile.

4.5.2

Analyse the advantages and disadvantages of improving education as a supply-side policy measure.

The advantage of improving education as a supply-side policy measure is that it will help to make workers more productive and efficient. This should help an economy to produce a higher level of output than would otherwise be the case. However, there is likely to be a time lag before the improvement begins to show an enhancement of efficiency and such a policy will be very expensive.

4.6.1

1. Define economic growth.

Economic growth is the increase in the national output of an economy over a period of time, usually measured through a change in gross domestic product (GDP). GDP is the total value of all that has been produced within a country's geographical boundaries over a given period of time, such as a year.

2. Explain what is meant by a per head or a per capita GDP figure.

A per head or a per capita GDP figure means the GDP of a country divided by the population of the country.

4.6.2

Explain how total demand in an economy could fall.

Total demand in an economy could fall for four main reasons. The first is that consumer expenditure could decline due to a fall in consumer confidence, for example, as a result of falling property prices or a rise in unemployment. A second reason is that investment could decline due to a fall in business

confidence, for example, following a financial crisis or a rise in interest rates. A third reason is that the government could significantly reduce its spending, turning a budget deficit into a budget surplus. Finally, there could be a rise (or appreciation) in the exchange rate, which could lead to a fall in the demand for exports.

4.6.3

Distinguish between actual economic growth and potential economic growth.

Actual economic growth refers to a movement from within the production possibility curve of an economy to a position on, or closer to, the production possibility curve, resulting from the better use of the existing resources. Potential economic growth refers to a shift to the right of the production possibility curve of an economy, resulting from a greater quantity and/or quality of resources.

4.6.4

1. Explain what is meant by the idea of a sustainable approach to economic growth.

The contrast between the costs and benefits of economic growth can be seen in relation to the use or conservation of resources. The use of resources can make a significant contribution to economic growth, but natural resources are finite in supply and will eventually run out. This is why there needs to be a conservation of resources. Therefore, there needs to be a sustainable approach to economic growth, taking into account the needs of future generations as well as those of the present generation.

2. Discuss the costs and benefits of economic growth in your country.

Research to be carried out by the student.

4.6.5

Analyse how fiscal, monetary and supply-side policies can be used to promote economic growth in a country.

Expansionary fiscal policies can be used to promote economic growth in a country. For example, there could be an increase in government spending and/or a lowering of tax rates. The effect of both of these policies would be to lead to an increase in spending and a lowering of unemployment. The effectiveness of such policies would depend on the extent of the changes. The more that government spending is increased and the more that taxation is decreased, the greater the effect will be.

Expansionary monetary policies can also be used to promote economic growth. For example, there could be a reduction in the interest rate, lowering the cost of borrowing and encouraging spending by consumers and firms. The effectiveness of this policy would depend on the extent of the reduction in the interest rate and the degree of sensitivity of consumers and firms to interest rate changes. There could also be an increase in the money supply, such as through quantitative easing, to stimulate economic growth, but although this might be effective it could have an inflationary effect in an economy. There could also be a devaluation of the foreign exchange rate, making exports cheaper in foreign markets, but the effect of this policy would depend on the price elasticity of demand for exports.

Supply-side policies can be used to promote economic growth. For example, subsidies could be given to encourage research and development, firms could be privatised, deregulation could be encouraged and corporation taxes on the

profits of firms could be lowered. Such policies usually take time to become effective, so in the short run they would be less effective, but in the long run they could be extremely effective.

4.7.1

Define the term 'labour force'.

The labour force in an economy consists of both the employed and the unemployed.

4.7.2

Discuss why, in many countries, there has been an increase in the proportion of women in the labour force.

There are a number of possible reasons for the increase in the proportion of women in the labour force in many countries. In many countries there have been changes in attitudes towards the idea of women working and there has also been a decline in discrimination on the basis of gender. In many societies there has been an increase in the proportion of women going into higher education and receiving qualifications, and this has helped them to find employment.

4.7.3

Define the unemployment rate.

The unemployment rate is the number of people unemployed divided by the total number in the labour force.

4.7.4

Distinguish between frictional, structural and cyclical unemployment.

Frictional unemployment occurs when the labour market does not work as smoothly as it should. It is the result of a mismatch between the demand for and the supply of labour. For example, it may be because workers do not have the skills that employers are looking for.

Within the category of frictional unemployment, there are three forms of unemployment. Search unemployment occurs when workers who have lost their jobs are in the process of searching for new ones, but are finding it difficult because there is too little information available about vacancies. Casual unemployment occurs when people are out of work between periods of employment, for example, actors. Seasonal unemployment occurs when workers are only demanded at certain times of the year, such as workers in the building, agriculture, and leisure and tourism industries.

Structural unemployment occurs when there are more long-term changes in an economy and these changes can affect specific industries, geographical regions and certain occupations. For example, as an economy develops, there is a move away from employment in the primary and secondary sectors towards employment in the tertiary sector and as a result of such economic change, many workers in the primary and secondary sectors become unemployed.

Within the category of structural unemployment, there are two forms of unemployment. Regional unemployment is concentrated in particular regional areas. Technological unemployment is where workers lose their jobs as a result of advances in technology.

Cyclical unemployment occurs on a larger scale than structural unemployment and is associated with movements in the trade cycle. Such unemployment results from a substantial fall in total demand that affects an economy as a whole. This is why it is also known as demand deficient unemployment.

4.7.5

Explain how unemployment can cause a negative multiplier effect in an economy.

Unemployment can cause a negative multiplier effect in an economy as follows. As spending in an economy falls, this will reduce the income of all economic activities. Unemployment means that the output of goods and services will be lower than it would otherwise be, causing an economy to be operating within its production possibility curve, leading to a lower standard of living. Also, if fewer people are working and spending, the government will receive less income from taxation, both direct and indirect, and may need to pay out more money in the form of benefits to the unemployed.

4.7.6

Discuss the factors that can determine the likely effectiveness of policies to reduce unemployment in an economy.

The effectiveness of policies to reduce unemployment in an economy will depend on a number of possible factors. One factor will be whether the government has identified the type and cause of unemployment in the economy correctly. Another factor will be whether a government has correctly identified which skills need to be increased in order to bring about a reduction in unemployment. A third factor is whether industries will use subsidies in an appropriate way to increase the employment of workers. Finally, the effectiveness of a policy to reduce unemployment will depend on whether a government has accurately calculated by how much to increase the total demand in an economy. If the government underestimates the amount, the policy will not have a significant effect on the reduction of unemployment, but if it overestimates the amount, the policy could have an inflationary effect on the economy.

4.8.1

Distinguish between inflation and deflation.

Inflation refers to an increase in the general level of prices in an economy over a period of time. Deflation refers to a decrease in the general level of prices in an economy over a period of time.

4.8.2

Explain how a consumer prices index is constructed.

There are a number of different elements involved in the construction of a consumer prices index. First, a base year needs to be selected. This is given a figure of 100 and all price levels in subsequent years are compared to this base year. Then a basket of products needs to be selected. This refers to a basket of typical goods and services purchased by an average or typical family in an economy and this is arrived at through surveys of household expenditure. Then weights need to be calculated. Families do not spend an equal proportion of income on different products, that is, a relatively higher proportion of income is spent on some products than others and so weights are given to reflect these spending patterns and the proportion of income spent on different items in the basket. Finally, a weighted price index is constructed, which involves multiplying the weight for each item by the price index of that item.

4.8.3

Distinguish between demand-pull and cost-push inflation.

Demand-pull inflation occurs in an economy when total demand is greater than total supply and this has the effect of pulling up the general level of prices. For example, when people have more money to spend, their level of demand for goods and services is likely to rise. There is a situation of excess demand in an economy that cannot be met by supply. This situation is likely to occur as an economy reaches, or is close to, full employment. One particular form of demand-pull inflation is monetary inflation where the excess demand in an economy is caused by an excessive growth of the money supply.

Cost-push inflation occurs in an economy as a result of an increase in production costs, with firms passing on these increases in costs to consumers in the form of rising prices. These increases in the costs of production can come from various causes, such as raw material costs, energy costs, wage and salary costs and the cost of land.

4.8.4

Discuss the consequences of inflation and deflation for savers.

Savers will find that during a period of inflation, savings lose their real value, that is, the purchasing power of the money saved will have fallen. Savers will therefore be discouraged from saving. However, savers will find that during a period of deflation, savings increase their real value, because the general level of prices has fallen, and so savers will be encouraged to save.

4.8.5

Explain how deflation could be controlled in an economy.

A government is not likely to be too concerned about good or benign deflation, caused by an increase in total supply in an economy, but it is likely to be concerned about bad or malign deflation caused by a decrease in total demand in an economy. In such a situation, a government would be likely to use expansionary fiscal policy. Examples are reduced taxation, increased government expenditure, and/or expansionary monetary policy, such as reduced interest rates and/or increased money supply. The effectiveness of policies to reduce deflation in an economy would depend on a number of possible factors. One of these would be whether deflation had existed for some time, as interest rates would be likely to be relatively low already so there may be little scope to reduce them any further. Another factor would be confidence in the economy; this would be likely to be relatively low and so cuts in tax rates may not encourage households and firms to increase their spending.

UNIT 5, page 175

5.1.2

Explain why living standards are higher in some countries than others.

One country's economy may be more successful in its production activities than another, especially when levels of productivity are compared. Standards of living in different countries will also depend on the quality of the education and health care facilities provided. Some countries will have higher levels of capital investment than others, leading to the use of more advanced technology. Countries will vary in terms of infrastructure, such as transportation and communication. Another factor is that some countries will have a greater abundance of natural resources than other countries, for example, oil.

5.2.1

Explain the link between old age and poverty.

Old age is often closely associated with poverty, especially in those countries that do not pay pensions to older people. Many people who live below the poverty line in a country are old. In many countries, a growing proportion of people are living longer and yet many of these people have no income.

5.2.2

Explain how progressive taxation can redistribute income in a country.

Progressive taxation refers to taxes that not only take a higher amount of tax from the more highly paid, but take a higher proportion of their income in tax. Progressive taxation will have the effect of redistributing income from the rich to the poor because the money received from this taxation can be used to finance a variety of benefit payments to the poor.

5.3.1

Distinguish between immigration and emigration.

Immigration refers to the number of people moving into a country in a given time period whereas emigration refers to the number of people moving out of a country in a given time period.

5.3.2

Explain why death rates vary between countries.

Death rates are usually higher in developing countries than in developed countries. There are a number of possible reasons for this. Countries will vary in terms of the quality of, and access to, health care. There is usually better medical care in developed countries than in developing countries, although medical advances have had the effect of bringing down the death rate in most countries, whether they are developed or developing. Some countries may have better arrangements in relation to inoculation against diseases. A better diet is likely to cause a fall in death rates and countries vary greatly in terms of knowledge about the importance of diet and nutrition. The quality of food and water can vary enormously between countries and this is likely to influence differences in death rates. Incomes tend to be lower in developing countries than in developed countries, which may make it more difficult for people to be able to afford to pay for medical care. For example, the drugs to combat and treat malaria and HIV/AIDS are very expensive. Also, developing countries tend to have fewer doctors, nurses and hospital beds per head of the population than developed countries.

5.3.3

Discuss the effects of an increase in a country's population size.

A country will be able to make more effective use of its economic resources as long as it is underpopulated, that is, below its optimum size. If the population size increases, there will be an increase in the number of potential workers and if the rise in the labour force is caused by the net immigration of skilled and qualified workers, this will lead to an increase in both the quantity and quality of workers. There will also be more potential consumers and so there will be an increase in the size of markets. Firms will be able to benefit from this, both in terms of increased revenue and reduced costs. This extra demand for goods and services could lead to an increase in investment, improving the technological efficiency of production in the country.

However, there may also be some possible disadvantages of an increase in the size of a country's population. If the increase in population is greater than the increase in output, then there will be a fall in living standards because there will be a reduction in GDP per head or per capita. If a country becomes overpopulated, that is, above its optimum size, it could mean that there is not enough output to satisfy the people. For example, in terms of agriculture, there could be a famine, which would have enormous negative effects on a country's ability to feed its population. Increases in population size could lead to overcrowding, putting pressure on education and housing. There could be significant negative environmental effects, such as in relation to pollution and the depletion of non-renewable resources. In addition, it may be that the increase in population leads to a rise in unemployment with many people unable to find employment.

5.4.1

Distinguish between economic development and economic growth.

Economic growth refers to the increase in the national output of an economy over a period of time, usually measured through a change in GDP. Economic development is a wider term than economic growth that takes into account the expansion of social and economic choices and the increase in self-esteem.

UNIT 6, page 190

6.1.1

1. Explain how factor endowments can affect the relative efficiency of different countries.

Resources are distributed unevenly around the world. Countries with superior resource allocation need to make use of this advantage. Superior resource allocation can be seen in terms of superior factor endowments that enable countries to be more efficient at producing certain products than others. This superiority can come about as a result of the availability of natural resources, a favourable climate, knowledge and experience and fertility of soil and this will give such countries a comparative advantage over other countries. For example, this could lead to cheaper production methods as a result of certain countries specialising in producing products that they are best at producing. There will be less wastage and production can be as efficient as possible, reducing the cost of production.

2. Explain the main advantages and disadvantages of specialisation at a national level for consumers.

There are a number of advantages of specialisation at a national level for consumers. It enables production to take place at a relatively low cost and this could lead to consumers being charged relatively low prices to buy products. Consumers also have access to a greater variety of high-quality products from around the world and so consumers have a greater choice of products.

However, there may also be disadvantages of specialisation at a national level for consumers. If a country concentrates on producing what it is good at producing, and leaves other countries to produce what they are good at producing, it could lead to consumers having to import a large number of products to meet their needs.

6.2.1

Analyse the benefits and costs of a multinational that has located in your country or a country of your choice.

Research to be carried out by the student.

6.2.2

Explain the benefits of free trade for firms.

Firms will be able to specialise in what they do most efficiently and this should give rise to economies of scale with more output produced at a lower cost per unit. Firms will also be encouraged to take advantage of a wider range of ideas in terms of the products to make and the use of advanced technology to make them. Firms will employ more workers and a wider range of workers to produce the goods and services required. Firms will also be able to benefit from a wider range of sources of raw materials and component parts.

6.2.3

Which of the following methods of protection involves the imposition of a tax?

(d) Tariff

6.2.4

Explain how protection can lead to a reduction in economic efficiency.

Protectionism can lead to a reduction in economic efficiency because it can lead to less-efficient firms surviving whereas without protection these firms would go out of business.

6.3.1

Explain what is meant by a floating exchange rate.

A floating exchange rate refers to a system whereby the value of a currency is allowed to move up and down in response to changes in the demand for and the supply of a currency.

6.3.3

Explain the effects of a depreciation of the foreign exchange rate of a currency on both exports from a country and imports into that country.

Exports from a country become less expensive to customers in other countries and so easier to sell. Exporters are likely to sell more and make more profit. The value of exports increases.

Imports from other countries become more expensive, including raw materials and finished goods. Customers will find these products more expensive to buy and so the producers will sell less and make less profit. The value of imports decreases.

6.4.1

Explain what is meant by the balance of trade in goods and services account.

The balance of trade in goods and services account is the account that shows the balance of trade in exported and imported goods and services.

6.4.2

Explain the impact of a current account deficit on the GDP of an economy.

A regular deficit in the current account of an economy will lead to an increase in debt, which will need to be repaid. Part of the GDP will need to be set aside to pay this debt, leaving less for consumption and investment.

6.4.3

Describe one policy that could be used to try and reduce a current account surplus.

If a country had a current account surplus, restrictions on imports coming into the country could be reduced, making it more likely that the demand for imports would rise. This is likely to be effective in reducing a current account surplus, but it could have negative side effects. For example, if more imports are being demanded, this could lead to a reduction in the demand for domestic products and therefore a rise in the level of unemployment in the economy.