Cambridge Assessment International Education

Cambridge IGCSE™

ECONOMICS **0455/22**

Paper 2 Structured Questions **May/June 2021**

2 hours 15 minutes

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You must answer on the enclosed answer booklet.

You will need: Answer booklet (enclosed)

INSTRUCTIONS

- Answer **four** questions in total:
  - Section A: answer Question 1.
  - Section B: answer **three** questions.
- Follow the instructions on the front cover of the answer booklet. If you need additional answer paper, ask the invigilator for a continuation booklet.
- You may use a calculator.

INFORMATION

- The total mark for this paper is 90.
- The number of marks for each question or part question is shown in brackets [ ].

This document has **8** pages. Any blank pages are indicated.

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Section A

Read the source material carefully before answering Question 1.

Source material: Chilean cherries

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Producing just a few products can be risky for a country.

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Fig. 1.1 Population pyramids of Chile and Haiti 2018

There is, however, evidence of market failure and inequality in how resources are allocated.

Answer all parts of Question 1. Refer to the source material in your answers.

1 **(a)** Calculate Chile's agricultural output in 2017. [1]

(b) Identify **two** disadvantages of a country specialising. [2]

(c) Explain **one** reason why demand for cherries is price-elastic. [2]

(d) Explain how Chile's population structure differs from Haiti's population structure. [4]

(e) Analyse why China buys most of its cherries from Chile. [4]

(f) Analyse why Chilean astronomers are paid more than Chilean farm workers. [5]

(g) Discuss whether or not Chilean consumers would benefit from more government intervention in the economy. [6]

(h) Discuss whether or not the Haitian economy would benefit from fewer of its people working in Chile. [6]

Note:

1(a) This question cannot be answered as the related reference material is not availabe.

1(b)

Specialization in a country may result in falling demand and the emergence of new competitors, while also leading to a decrease in supply or output due to factors such as diseases, natural disasters, bad weather, and rising costs.

1(c)
The demand for cherries is price-elastic because it is considered a luxury product that is not essential or a necessity, meaning consumers have the flexibility to reduce or eliminate their purchases if the price increases. Additionally, cherries have close substitutes available, so if the price of cherries rises, consumers may choose to switch to alternative fruits or products, further contributing to the price sensitivity of demand

1(d)
Chile and Haiti have distinct differences in their population structures. Firstly, Chile exhibits a higher proportion of its population aged over 65, indicating a relatively larger elderly population segment. In contrast, Haiti has a lower proportion of elderly individuals in its population. This disparity can be attributed to variations in healthcare, lifestyle, and socio-economic factors that impact life expectancy and population aging.

Secondly, Chile has a lower proportion of the population aged under 15, reflecting a smaller youth population compared to Haiti. This discrepancy can stem from differences in birth rates, access to education, family planning, and overall demographic dynamics. A higher proportion of young people in Haiti suggests a larger base of future labor force potential and presents unique challenges and opportunities for the country's development.

Furthermore, Chile is likely to have a lower birth rate and death rate compared to Haiti. Factors such as education, healthcare infrastructure, family planning initiatives, and socio-cultural norms can contribute to these contrasting demographic indicators. A lower birth rate in Chile may reflect a more developed and urbanized society, whereas Haiti's higher birth rate may be influenced by factors like limited access to contraception and cultural preferences.

Additionally, the population pyramids of Chile and Haiti reveal disparities in their economic and developmental profiles. Chile's population pyramid appears less pyramid-shaped and more constrictive, indicating a more balanced age distribution and a relatively higher level of development and income. In contrast, Haiti's population pyramid exhibits a more expansive and pyramid-like shape, reflecting a larger young population and a lower level of development and income.

Moreover, Chile demonstrates a lower dependency ratio, implying a smaller proportion of the population relying on the working-age population. This suggests a potentially higher level of economic productivity and a lesser burden on the workforce to support dependents. Conversely, Haiti's higher dependency ratio implies a larger proportion of the population dependent on the working-age segment, which can pose challenges for sustainable economic growth and social welfare.

Lastly, Chile has a larger population size compared to Haiti. The disparities in population size can influence factors such as resource allocation, infrastructure development, and economic planning. Additionally, the average age of the population is higher in Chile, indicating an older population structure, while Haiti has a lower average age, indicating a younger population with different demographic and societal implications.

Overall, these differences in population structure between Chile and Haiti reflect diverse demographic profiles, which can impact social, economic, and developmental aspects in each country.

1(f)

The disparity in wages between Chilean astronomers and farm workers can be analyzed based on several factors.

Firstly, most astronomers have a university degree, which reflects a high level of education and specialized training. The cost and duration of their training are often substantial, requiring significant investments of time and resources. This extensive training results in astronomers possessing advanced knowledge and skills, making them highly qualified for their profession. Their expertise and productivity contribute to their higher wages compared to farm workers.

Furthermore, astronomers are in short supply relative to the demand for their skills. The field of astronomy requires highly specialized knowledge and expertise, resulting in a limited number of professionals available in the job market. The combination of high demand for their services and a limited supply of qualified astronomers creates a situation of more inelastic demand and supply, allowing astronomers to negotiate higher wages due to their scarcity.

In addition, many astronomers work in the public sector, often employed by government-funded research institutions or universities. The public sector may have more financial resources and be more willing or able to offer higher wages compared to the private sector. Public sector workers, including astronomers, may also have stronger bargaining power through their affiliation with trade unions, allowing them to negotiate better compensation packages.

On the other hand, farm workers typically do not require extensive formal education or specialized training to perform their tasks. The agricultural sector often relies on a larger labor force, and the supply of farm workers is generally more elastic, meaning there is a larger pool of potential workers available. The larger supply of farm workers and their relatively lower skill requirements contribute to lower wages compared to the more specialized and in-demand field of astronomy.

Overall, the higher wages earned by Chilean astronomers compared to farm workers can be attributed to their higher qualifications, specialized training, scarcity in the job market, and the public sector's willingness to provide competitive compensation. These factors create a wage differential based on the skill level, productivity, and demand-supply dynamics in the respective professions.

APPROVED

By Smart Edu Hub at 3:06 pm, May 24, 2023

1(g)

The discussion of whether or not Chilean consumers would benefit from more government intervention in the economy involves considering various factors. Let's explore each point in detail:

Why they might benefit:

Market failure: If there is evidence of market failure, such as monopolies, information asymmetry, or externalities, government intervention can help correct these inefficiencies and ensure fairer outcomes for consumers.

Underproduction of merit goods: Merit goods, which have positive social benefits but may be under-produced by the private sector due to insufficient demand or profitability concerns, could be supplied more adequately through government intervention. This ensures that consumers have access to goods like education, healthcare, and public transportation, which may otherwise be under-consumed.

Overproduction of demerit goods: Demerit goods, such as harmful substances or activities, may be overproduced and over-consumed in the absence of government intervention. By implementing regulations, taxes, or restrictions, the government can discourage excessive consumption of such goods, protecting consumers from their negative effects.

External costs and benefits: The private sector often does not consider external costs, such as pollution, or external benefits, such as research and development spillovers. Government intervention can address these externalities by imposing regulations, taxes, or incentives, ultimately reducing costs for consumers and promoting the provision of beneficial services.

Provision of public goods: Public goods, which are non-excludable and non-rivalrous, may not be adequately produced by the private sector due to the absence of profit incentives. Government intervention can ensure the provision of public goods like national defense, infrastructure, and public parks, benefiting all consumers and addressing the issue of free riders.

Inequality and poverty: Government intervention can help mitigate inequality and alleviate poverty by implementing redistributive policies, social welfare programs, and targeted assistance to low-income consumers. This ensures that resources are directed towards producing goods and services that cater to the needs of the less affluent, preventing them from being excluded due to affordability concerns.

Government subsidies and price controls: The government can offer subsidies to certain sectors or control prices, particularly for essential goods and services. This can lower prices, making them more affordable for consumers and improving their overall welfare.

Regulation of monopoly power: Government intervention can prevent the abuse of market power by monopolistic entities, ensuring fair competition and protecting consumers from monopolistic practices that may lead to higher prices or reduced quality.

Investment in education: Government investment in education can lead to lower prices and higher quality of educational services, benefiting consumers by providing access to affordable and improved education.

Why they might not benefit:

Government failure: Government intervention can be subject to inefficiencies, bureaucracy, and lack of information. Poorly designed policies or inadequate implementation can result in unintended consequences and may not effectively address consumer needs or preferences.

Market forces and consumer sovereignty: Market forces, driven by consumer choices and preferences, can provide a wide array of products and services to cater to diverse consumer demands. In some cases, consumer sovereignty and the freedom to choose may be better served by market mechanisms rather than excessive government intervention.

It is important to consider these points holistically, assessing the specific context and the potential benefits and drawbacks of government intervention in the Chilean economy to determine its impact on consumer welfare.

1(h) Discuss whether or not the Haitian economy would benefit from fewer of its people working in Chile [6]

The discussion of whether or not the Haitian economy would benefit from fewer of its people working in Chile involves considering various factors. Let's analyze each point in detail:

Why it might benefit:

Low wages and unskilled labor in Chile: If wages are low in Chile for unskilled labor, Haitian workers returning to Haiti could potentially find higher-paying jobs or engage in entrepreneurial activities. This could contribute to the development of local industries and increase the income levels of workers.

Employment rising in Haiti: If employment opportunities are increasing in Haiti, retaining skilled workers who were previously migrating to Chile would allow the country to utilize their skills domestically. This could lead to enhanced productivity, innovation, and economic growth within Haiti.

Larger labor force and increased demand: With fewer people working in Chile, Haiti would have a larger labor force available domestically. This can stimulate economic growth by increasing total demand, GDP, and productive potential. It can also lead to improvements in living standards, as more people are employed and contribute to the economy. Additionally, a larger labor force may help boost exports and generate foreign exchange.

Increase in tax revenue and government spending: If more Haitians are employed within the country, there could be an increase in tax revenue, allowing the government to invest in essential sectors such as education, healthcare, infrastructure, and social programs. This can contribute to long-term development and improve the well-being of the population.

Reduced burden on the government: Fewer parents leaving behind dependent relatives to work in Chile would reduce the burden on the government to provide social support and assistance to these dependents. This can potentially free up resources that can be allocated to other development initiatives.

Job opportunities in other countries: If Haitian workers have the opportunity to find jobs in other countries aside from Chile, it can diversify their options and reduce dependence on a single destination. This can provide more flexibility and potentially open up avenues for higher-paying or more suitable employment.

Why it might not benefit:

Higher wages in Chile: If wages in Chile are higher than in Haiti, fewer remittances would be sent back to Haiti by emigrant workers. This could result in lower income levels and reduced spending capacity in the country, potentially affecting living standards and overall economic activity.

Reduction in money coming into the country: With fewer Haitian workers in Chile, there would be a decrease in the remittances sent back to Haiti. This could lead to a decline in the inflow of foreign currency, potentially increasing the current account deficit and impacting the country's balance of payments.

Job opportunities and unemployment: If job opportunities are more abundant in Chile compared to Haiti, the return of workers from Chile could lead to increased unemployment in Haiti. This could result in social and economic challenges, such as higher unemployment benefits costs and the need for higher taxation to support those without jobs.

Reduced opportunities for skill development: Working in Chile may provide Haitian workers with opportunities to gain new skills and knowledge. If fewer people migrate to Chile, there could be a reduction in the acquisition of these skills and a potential loss of expertise that could be brought back to Haiti for the country's development.

It is crucial to consider these points in the specific context of Haiti and assess the potential benefits and drawbacks of having fewer Haitian workers in Chile to determine the overall impact on the Haitian economy.

Section B

Answer any **three** questions.

Each question is introduced by stimulus material. In your answers you may refer to the material and / or to other examples you have studied.

2 Nearly one million people in Cairo, the capital city of Egypt, live in crowded, unhealthy housing. One reason why people lack basic necessities, including adequate housing, is unemployment. In 2019, nearly 10% of Cairo's workers did not have a job. Other citizens of Cairo live in luxury, in houses costing more than $1 million. Many of Cairo's rich adults grew up in rich families.

(a) Identify **two** basic necessities, other than housing. [2]

2(a)Two basic necessities other than housing are, food, water.
[you could also mention any of, clothing, healthcare and education.]

Section B

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(b) Explain how frictional unemployment differs from cyclical unemployment. [4]

2(b) Frictional unemployment refers to individuals who are temporarily unemployed because they are in-between jobs or are seeking better employment opportunities. This type of unemployment occurs due to factors such as individuals waiting for a higher-paying job, being seasonally unemployed, working on short-term contracts, or lacking information about available job vacancies. Importantly, frictional unemployment can exist even when the economy is at full employment and tends to self-correct over time.

For example, imagine a recent college graduate who is actively searching for a job that aligns with their qualifications and career goals. During this transitional period, the graduate is considered frictionally unemployed. Similarly, someone who is working on a short-term contract and is seeking their next job opportunity would also fall under frictional unemployment.

On the other hand, cyclical unemployment is caused by a lack of total demand in the economy. This type of unemployment occurs when there are more people seeking employment than there are job vacancies available due to a recession or economic downturn. Cyclical unemployment requires government intervention and economic stimulus measures to reduce it.

For instance, during a severe economic recession, many businesses may struggle, leading to layoffs and a significant increase in joblessness. This rise in unemployment would be classified as cyclical unemployment. It typically takes longer to recover from cyclical unemployment compared to frictional unemployment since it requires broader economic recovery.

Frictional unemployment can be reduced by an increase in labor mobility, meaning individuals have easier access to information about job openings, improved relocation possibilities, or enhanced job search assistance.

Conversely, cyclical unemployment cannot be easily addressed by labor market adjustments alone; it requires broader economic policies and measures to stimulate demand and promote job creation.

Additionally, frictional unemployment tends to be short-term in nature as individuals eventually find new employment opportunities or transition to better jobs.

In contrast, cyclical unemployment can be long-term, persisting until the economy experiences a sustained recovery and a revival in demand for goods and services.

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One reason why people lack basic necessities, including adequate housing, is unemployment. In 2019, nearly 10% of Cairo's workers did not have a job. Other citizens of Cairo live in luxury, in houses costing more than $1 million. Many of Cairo's rich adults grew up in rich families.

(c) Analyse why the children of the rich tend to become rich adults. [6]

2(c)The children of the rich often tend to become rich adults due to a combination of various factors, which can be analyzed in detail.

Children from affluent backgrounds often have access to high-quality education. They may not have to take part-time jobs or assist in family businesses while studying, allowing them to focus solely on their education. This enables them to become well-qualified, well-educated individuals with a high level of knowledge. With their strong educational background, they are more likely to develop highly sought-after skills, increasing their productivity and efficiency. As a result, they find it relatively easy to secure employment and obtain well-paid jobs. For instance, wealthy families can afford to send their children to prestigious schools and universities, providing them with excellent educational opportunities that enhance their future prospects.

The children of the rich often benefit from good healthcare, nutrition, and housing. They have access to quality healthcare facilities, which ensures their well-being and reduces the likelihood of health-related absences from school or work. Their upbringing in a stable and healthy environment allows them to focus on their education and career development without major interruptions. Additionally, their overall well-being contributes to their productivity and success. In contrast, individuals from disadvantaged backgrounds may face challenges related to inadequate healthcare, malnutrition, or substandard housing, which can hinder their educational attainment and future earning potential.

Children of affluent families often grow up with high expectations placed upon them. They are encouraged to strive for better jobs and pursue ambitious career paths. This mindset instills in them the motivation and drive to excel, increasing their chances of securing well-paying positions. They may also have access to professional networks and mentorship opportunities that help them navigate their career paths more effectively.

In some cases, the children of the rich may inherit property, businesses, or significant savings. This inherited wealth provides them with a financial advantage, as they have access to resources that can generate income without the need for extensive personal effort. This allows them to start their adult lives with a higher level of financial stability and security.

Wealthy parents often have connections with influential individuals, including bosses of major employers or professionals in high-paying industries. These connections can provide privileged access to lucrative job opportunities, internships, or mentorship programs. By leveraging these social connections, the children of the rich are more likely to secure high-paying positions early in their careers.

It is important to note that while these factors contribute to the likelihood of the children of the rich becoming rich adults, they do not guarantee it in every case. Individual talent, hard work, and personal circumstances can still influence outcomes. Nevertheless, the advantages provided by education, health, high expectations, inherited wealth, and social connections significantly increase the opportunities and potential for upward mobility among the children of affluent families.

2(d) Discuss whether a government should provide subsidies to families to spend on housing. [8]

The decision of whether a government should provide subsidies to families to spend on housing is a complex one, with various considerations on both sides of the argument. Let's examine the points supporting and opposing such subsidies:

Here is as to why a government might provide subsidies for housing:

'Increased spending power'. Providing subsidies to families for housing would increase their spending power. This would allow families to allocate more of their income towards housing expenses, potentially leading to improved living conditions and better access to suitable housing options.

'Increased quantity supplied' .Subsidies can incentivize the construction of more housing units by making it financially viable for developers. This increased quantity supplied can help address housing shortages and reduce the strain on existing housing infrastructure.

'Reduced povert' . Housing subsidies can give low-income families access to a basic necessity, reducing poverty and improving their overall living standards. By making housing more affordable, subsidies can alleviate the burden of high housing costs on vulnerable populations.

'Enhanced spending on other necessities' Housing subsidies may free up financial resources for families to allocate towards other essential needs such as education. This can contribute to improved educational opportunities for children, potentially breaking the cycle of poverty and promoting social mobility.

'Job creation and employment'. Providing subsidies for housing can stimulate the construction industry, leading to increased employment opportunities. The demand for housing construction and related services can create jobs, thereby reducing unemployment rates and enhancing labor market mobility.

'Improved housing quality and health'. Housing subsidies can be tied to quality standards, ensuring that subsidized housing meets certain criteria for safety and habitability. This can lead to an overall improvement in housing quality, subsequently benefiting the health and well-being of individuals and communities.

Here is as to why a government might not provide subsidies for housing:

'Affordability for the rich' . Subsidies directed towards housing may be seen as unnecessary for wealthier families who can already afford adequate housing without financial assistance. Allocating subsidies to those who are already financially well-off may be perceived as an inefficient use of public funds.

'Uncertainty of spending' There is a risk that some families may not utilize the subsidies specifically for housing purposes. They might allocate the funds to other non-housing expenses, diminishing the intended impact of the subsidies on improving access to affordable housing.

'Inflationary pressures' Increased demand for housing resulting from subsidies can lead to inflationary pressures in the housing market. This can drive up prices not only for housing but also for associated goods such as furniture and carpets. It is important to consider potential consequences on overall price levels and the affordability of related goods and services.

'Opportunity cost' Providing subsidies for housing requires financial resources, and the opportunity cost is the potential allocation of those funds to other critical areas such as healthcare, education, or infrastructure. Governments must carefully weigh the benefits of housing subsidies against the potential trade-offs in terms of foregone opportunities.

'Tax implication' Financing housing subsidies often requires raising taxes or redirecting funds from other areas of government spending. This can have implications for taxpayers and the overall fiscal health of the economy. Balancing the costs and benefits of subsidies is crucial to ensure an equitable distribution of resources

.

'Environmental impact' Increasing housing supply through the construction of new units can have environmental consequences, such as increased energy consumption, habitat destruction, or strain on natural resources. Governments need to consider sustainable practices and mitigate potential negative environmental impacts when implementing housing subsidy programs.

Ultimately, the decision to provide subsidies for housing should consider a careful evaluation of the specific socio-economic context, the potential benefits and drawbacks, and the availability of alternative policy measures to address housing affordability and accessibility.

3 Consumers in Uruguay are eating more processed foods. Factors of production, including enterprise, have responded to this change. Firms in the processed food industry have become more capital-intensive. All of Uruguay's industries were affected by the rise in its inflation rate, from 6.2% in 2017 to 7.7% in 2018.

(a) Define *enterprise*. [2]

3(a)Enterprise refers to the act of taking risks and initiating, organizing, and owning a business venture. It involves assuming the responsibility for key decision-making processes and coordinating the various factors of production, such as land, labor, and capital, to create goods or provide services. Central to enterprise is the profit motive, as entrepreneurs aim to generate profits as a reward for their efforts and to sustain the growth and success of their business.

3 Consumers in Uruguay are eating more processed foods. Factors of production, including enterprise, have responded to this change. Firms in the processed food industry have become more capital-intensive. All of Uruguay's industries were affected by the rise in its inflation rate, from 6.2% in 2017 to 7.7% in 2018.

(b) Explain the influence of opportunity cost on consumers' decisions. [4]

3(b)Opportunity cost refers to the value of the best alternative that is forgone or sacrificed when making a decision. It is the cost incurred by choosing one option over another and represents what could have been gained from the next best alternative.

When consumers make decisions, they often face limited income or time, which necessitates making choices among various options. Consumers cannot have everything they desire due to these limitations, leading to trade-offs and the consideration of opportunity costs. By choosing to allocate resources towards one product or activity, consumers may have to give up the opportunity to consume or engage in another product or activity.

For example, let's consider a consumer who has a limited budget and is deciding between purchasing a new smartphone or going on a weekend getaway. If the consumer chooses to buy the smartphone, the opportunity cost would be the enjoyment and experiences that could have been gained from the weekend getaway. Conversely, if the consumer decides to go on the weekend getaway, the opportunity cost would be the features and utility provided by the new smartphone.

In another scenario, a consumer with limited time is deciding between watching a movie or going for a hike. If the consumer chooses to watch the movie, the opportunity cost would be the enjoyment and physical activity that could have been experienced during the hike. Conversely, if the consumer decides to go for the hike, the opportunity cost would be the entertainment and storytelling provided by the movie.

Opportunity cost plays a crucial role in consumer decision-making as it forces individuals to assess the relative value and trade-offs associated with different choices. Consumers must consider the benefits and drawbacks of each option and determine which alternative provides the most desirable outcome given their limited resources. By understanding and evaluating opportunity costs, consumers can make more informed decisions and optimize their choices based on their preferences and constraints.

3(c) Analyse why a firm may become more capital-intensive [6]

Capital-intensive refers to a production process or industry that requires a significant amount of capital investment in the form of machinery, equipment, technology, or infrastructure relative to the labor input. In capital-intensive industries, a substantial portion of production costs is allocated to capital expenditures rather than labor costs. These industries rely heavily on sophisticated and expensive machinery or technological systems to carry out production processes efficiently and effectively. The use of capital-intensive methods often aims to increase productivity, improve product quality, reduce costs, and achieve economies of scale. Examples of capital-intensive industries include manufacturing, mining, telecommunications, and transportation.

A firm may become more capital-intensive due to various factors, which can be analyzed as follows:

'Cost considerations' . If the cost of capital falls or the price of labor rises, it may incentivize firms to invest in capital-intensive production methods. By substituting labor with capital, firms can lower their production costs, which can lead to increased price competitiveness. This, in turn, may result in higher profits for the firm. For example, advancements in automation technology may reduce the cost of capital equipment, making it more attractive for firms to invest in machinery instead of hiring additional labor.

'Technological advancement' . Advances in technology can enhance the quality and productivity of capital goods. By adopting more advanced and efficient machinery or equipment, firms can improve the quality of their products or services. This can lead to increased customer demand, creating a positive feedback loop where higher demand encourages firms to invest in even more capital-intensive production methods. For instance, the introduction of robotics and artificial intelligence has enabled firms to achieve higher levels of precision, speed, and consistency in their manufacturing processes.

'Quality control and waste reduction' .Capital-intensive production methods can help firms reduce human error, maintain consistent product quality, and minimize wastage. Automated systems can ensure greater precision and accuracy, resulting in fewer defects and less material wastage. This can contribute to cost savings and improved product quality, enhancing the firm's competitiveness in the market.

'Production stability' .Capital-intensive methods can provide greater stability and continuity in production. Unlike human labor, capital equipment does not require breaks or rest and can operate 24 hours a day. This reduces the risk of disruptions caused by factors such as industrial action, strikes, or employee absenteeism. Firms that rely heavily on labor may opt for capital-intensive approaches to mitigate these risks and ensure uninterrupted production.

'Labor shortages'. In situations where there is a scarcity of labor or difficulty in recruiting skilled workers, firms may opt for capital-intensive methods as an alternative. This can be particularly relevant in industries facing skills gaps or demographic challenges, where the availability of qualified labor is limited. Investing in capital equipment can help mitigate the impact of labor shortages and ensure the smooth operation of the firm.

'Government incentives' .Governments can influence the capital intensity of firms through various measures. For example, reducing taxes on capital goods or providing subsidies for their purchase can make capital investments more attractive. Additionally, lower interest rates can make financing for capital goods more affordable, encouraging firms to invest in such equipment.

Economies of scale: As a firm's output increases, it can benefit from economies of scale. By using more capital-intensive methods, firms can achieve higher levels of production and reduce the average fixed cost of capital per unit. This can lead to cost savings and improved efficiency, enhancing the firm's profitability.

In conclusion, firms may become more capital-intensive due to cost considerations, technological advancements, quality control objectives, production stability concerns, labor shortages, government incentives, and economies of scale. Each of these factors can drive firms to invest in capital goods and shift towards more capital-intensive production methods, ultimately impacting their competitiveness, productivity, and profitability.

3

(d) Define Discuss whether inflation harms a country's industries.

[8]

Inflation can have both positive and negative effects on a country's industries. Let's examine the reasons why inflation might harm industries and why it might not:

Why inflation might harm industries:

'Increased costs of production'. Inflation can lead to higher input costs, such as raw materials, energy, and labor. This can squeeze profit margins and reduce the competitiveness of industries, particularly those that rely heavily on cost control.
Example: A manufacturing company experiences an increase in the cost of raw materials due to inflation, which raises its production costs and lowers its profitability.
'Reduced competitiveness' . Inflation can make domestically produced goods more expensive relative to imports. This can lead to lower sales both at home and abroad if the industries cannot adjust their prices accordingly.
Example: A country's tourism industry suffers as inflation pushes up the prices of hotels, transportation, and other travel-related expenses, making it less competitive compared to destinations with lower inflation rates.
'Industrial relations challenges '. Inflation may create pressure for wage increases as workers seek to maintain their purchasing power. These wage demands can strain industrial relations and lead to conflicts between employers and employees.
Example: Rising inflation prompts workers in a manufacturing plant to demand higher wages to keep up with the increased cost of living. This puts pressure on the company's labor costs and can affect its profitability.
'Uncertainty and planning difficulties:' Rapid inflation can create uncertainty about future prices, making it challenging for industries to plan their production, investment, and pricing strategies effectively. Example: A construction company faces difficulties in estimating project costs and pricing due to high inflation, making it harder to plan and execute projects efficiently.
Discouragement of savings and investment: Inflation erodes the purchasing power of money over time. This can discourage individuals and businesses from saving, reducing the availability of funds for investment in industries.
Example: High inflation rates lead to decreased savings rates among households, limiting the availability of capital for businesses to invest in new equipment, research and development, or expansion.
'Tax implications' . Inflation can push companies into higher tax brackets, increasing their tax liabilities and reducing their after-tax profits.
Example: Rising inflation causes a company's profits to increase, pushing it into a higher tax bracket, resulting in a higher corporate tax burden.

Why inflation might not harm industries:

'Demand-pull inflation'. In some cases, inflation may be driven by increased demand for a firm's products or services. This can positively impact industries, leading to higher sales and increased profitability.
Example: Inflation accompanies a strong economic expansion, increasing consumer purchasing power and creating higher demand for automobiles, benefiting the automotive industry.

'Low and stable inflation' If inflation is low and stable, it allows industries to anticipate and factor it into their business decisions. This provides a more predictable environment for planning and investment.
Example: An economy experiences low and stable inflation, enabling industries to make informed decisions about pricing, production, and investment with confidence.

'Real cost reduction:'. Inflation can reduce the real cost of debt for industries with fixed-rate loans, as the nominal value of the debt erodes over time. It can also lower the real cost of wages if wages do not rise as fast as inflation.
Example: Inflation gradually reduces the real value of a company's outstanding loans, effectively lowering its debt burden and reducing interest expenses.

'International competitiveness' . If a country's inflation rate is lower than that of its trading partners, its industries may enjoy a competitive advantage in terms of relative price levels. Example: A country with lower inflation than its neighboring countries benefits from lower production costs, making its exports more price-competitive on the global market.

'Inelastic demand' Certain industries may have products or services with inelastic demand, meaning that consumers are less sensitive to price changes. In such cases, inflation may have a limited negative impact on sales.
Example: The pharmaceutical industry produces essential medications with inelastic demand, and even with inflation, the demand for these products remains relatively stable.

In conclusion, the impact of inflation on a country's industries is complex and can vary depending on factors such as the rate and stability of inflation, industry-specific characteristics, and the overall economic conditions. While inflation can harm industries by increasing production costs, reducing competitiveness, and creating uncertainty, it can also have positive effects in certain situations, such as increased demand, real cost reductions, and international competitiveness. The specific dynamics of each industry and the broader economic context play a crucial role in determining how inflation affects industries.

4 Turkey's birth rate is falling which is likely to reduce its supply of labour. However, improvements in the quality of labour and the increase in foreign multinational companies (MNCs) operating in Turkey (the host country to the MNCs) may help the economy avoid a recession. One reason why economists are worried that a recession may occur is an expected rise in the interest rate.

(a) Define *birth rate*. [2]

4(a) Birth rate is the number of live births per thousand individuals in a population during a specific year.

Explain two causes of an increase in the quality of labour in a country [4]

The quality of labor refers to the skills, knowledge, and productivity of the workforce. It plays a crucial role in driving productivity, enhancing competitiveness, fostering economic diversification, and promoting social development. A high-quality labor force leads to increased productivity, attracts investments, stimulates economic growth, and enables industries to meet the demands of a global market. Skilled workers contribute to innovation, technological advancement, and the creation of new industries. Moreover, labor quality improves individual well-being, reduces income inequality, and promotes inclusive growth. By investing in education, training, and skill development, countries can cultivate a high-quality labor force, leading to sustained economic growth and improved living standards.

There are several causes that contribute to an increase in the quality of labor in a country. Let's explore two of these causes in detail:

'Improvements in education' . When a country invests in improving its education system, it leads to individuals acquiring higher qualifications and knowledge. A well-educated workforce brings a range of benefits to the economy. They possess the necessary skills and expertise to perform tasks efficiently, adapt to new technologies and changes in the job market, and contribute to innovation and productivity.
Example: The government implements reforms to enhance the education system, such as curriculum improvements, teacher training programs, and the provision of educational resources. As a result, students receive a higher quality education, develop critical thinking skills, and gain relevant knowledge in their fields of study. When these well-educated individuals enter the labor market, they bring valuable skills and expertise, elevating the overall quality of the workforce.

'Improvements in training'. Training programs and initiatives aimed at upskilling and reskilling workers contribute to an increase in the quality of labor. By providing opportunities for workers to enhance their skills and stay updated with industry trends, countries can ensure a competent and adaptable workforce.
Example: Companies and industries collaborate with training institutions and organizations to offer specialized training programs. These programs focus on developing specific skills required in the industry, such as technical expertise, problem-solving abilities, or leadership skills. Workers who participate in these training programs acquire new competencies, which not only improve their individual performance but also contribute to the overall efficiency and quality of labor in the country.

These causes, improvements in education and training, are crucial in developing a skilled and knowledgeable workforce. However, it's important to note that other factors such as improvements in healthcare, increased pay, better working conditions, immigration of skilled workers, gaining experience, and specialization also play significant roles in enhancing the quality of labor. Together, these factors create a dynamic and competent workforce that drives economic growth and competitiveness.

4(c)Analyse how a rise in the interest rate could cause a recession.

A rise in the interest rate can have significant implications for an economy, potentially leading to a recession. The analysis below examines how an increase in the interest rate can contribute to a recession based on the provided points:

'Increased cost of borrowing'. When interest rates rise, borrowing becomes more expensive for individuals, households, and businesses. Higher borrowing costs discourage borrowing and reduce the willingness of individuals and businesses to take on new loans. This reduction in borrowing limits investment and spending, ultimately leading to a decrease in consumer expenditure and investment.

'Reduction in consumer spending'.With higher interest rates, individuals and households have less disposable income available for spending. This reduction in spending power can lead to a decrease in consumer expenditure, which in turn affects businesses' sales and profitability. Lower consumer spending contributes to a decline in aggregate demand, which is a key driver of economic growth.

'Decline in investment' .Higher interest rates can deter businesses from making new investments or expanding their operations. The increased cost of borrowing makes it more expensive for businesses to finance capital projects or undertake new ventures. This decline in investment can lead to reduced business activity, job losses, and a decrease in overall economic output.

'Unemployment and reduced employment' .As consumer spending declines and investment slows down, businesses may experience lower demand for their products and services. This can result in downsizing, layoffs, and a rise in unemployment rates. Increased unemployment further reduces consumer spending, creating a negative feedback loop that can deepen the economic downturn.

'Decreased total demand and GDP' .The combined effects of reduced consumer spending, lower investment, and rising unemployment contribute to an overall decrease in total demand within the economy. This decline in demand leads to a contraction in the output of goods and services, as measured by the Gross Domestic Product (GDP). If this decline in output persists for two consecutive quarters or six months, it meets the definition of a recession.

'Exchange rate effects' .A rise in interest rates can attract foreign investors to buy the currency of a country. This increased demand for the currency can strengthen its exchange rate. A stronger currency, in turn, makes exports more expensive for foreign buyers and reduces their demand. Simultaneously, it makes imports relatively cheaper, increasing domestic demand for imported goods. The combination of reduced exports and increased imports can negatively impact domestic industries, contributing to a recessionary environment.

In summary, a rise in the interest rate can cause a recession by increasing the cost of borrowing, reducing consumer spending and investment, leading to higher unemployment, decreasing total demand, and potentially triggering a decline in GDP. Additionally, exchange rate effects can further impact the economy by affecting trade dynamics. It is important for policymakers to carefully manage interest rates to avoid destabilizing effects on the economy and maintain stable growth.

(4d) Discuss whether or not MNCs improve the economic performance of the host countries in which they operate. [8]

The impact of multinational corporations (MNCs) on the economic performance of host countries is a complex and debated topic. To provide a comprehensive analysis, we will examine both perspectives using the given points:

Here is why MNCs might improve economic performance in host countries:

'Introduction of new technology and production method' . MNCs often bring advanced technology, expertise, and best practices to host countries. This can lead to the adoption of more efficient production methods, increased productivity, and economic growth. The transfer of technology and knowledge can enhance the competitiveness of local industries and contribute to overall economic development.

'Job creation and reduced unemploymen' . MNCs have the potential to generate new employment opportunities in host countries. The establishment of their operations can create jobs across various sectors, reducing unemployment rates and providing income for local communities. The presence of MNCs can also stimulate the growth of supporting industries and foster the development of local supply chains.

'Contribution to exports' .MNCs often engage in international trade, and their operations can boost a country's export performance. By producing goods and services for both domestic and international markets, MNCs can help reduce a country's trade deficit or increase its trade surplus, improving the balance of payments and supporting economic stability.

'Increased competition and efficiency' . MNCs bring competition to domestic markets, which can stimulate efficiency and innovation. Local firms may be prompted to improve their operations, upgrade their products and services, and enhance their overall competitiveness. This increased competition can lead to lower prices, improved quality, and greater efficiency, benefiting consumers and potentially lowering inflationary pressures.

'Tax revenue and government spending' . MNCs, through their business activities, generate tax revenue for host countries. This additional revenue can provide governments with the means to invest in critical sectors such as education, healthcare, and infrastructure, contributing to social and economic development.

Here why MNCs might not improve economic performance in host countries

'Displacement of domestic producers' . MNCs with significant market power may drive out domestic producers, particularly small and medium-sized enterprises. This can result in limited diversification of industries, leaving the country's output relatively unchanged and potentially creating dependence on foreign corporations.

'Limited local employment' . MNCs may have a preference for hiring workers from their home countries or recruiting skilled employees internationally, which can limit the job opportunities available to local populations. This can lead to concerns about unequal distribution of benefits and limited development of local human capital.

'Reliance on imports ' MNCs often bring capital equipment and raw materials from their home countries, reducing the potential benefits to local suppliers and industries. This reliance on imports can hinder the development of domestic supply chains and limit the spillover effects on the local economy.

'Resource depletion and environmental impact' .MNCs involved in industries such as mining or extraction of natural resources may deplete non-renewable resources in host countries. This can hinder long-term sustainable economic growth and have adverse environmental consequences, including pollution and ecological damage.

Low-skilled, low-paid jobs' While MNCs can create employment opportunities, there is a concern that these jobs may predominantly be low-skilled and low-paid. This can lead to issues of income inequality and limited upward mobility for local workers.

'Repatriation of profits' MNCs may repatriate a significant portion of their profits back to their home countries, reducing the amount of capital reinvested in the host country's economy. This outflow of profits can limit the potential benefits that MNCs bring to the local economy. \

'External costs' Some MNCs may cause external costs, such as pollution or environmental degradation, which can have negative impacts on the well-being of local communities and ecosystems. These costs may offset some of the potential economic benefits associated with MNC operations.

In conclusion, the impact of MNCs on the economic performance of host countries is influenced by various factors. While they can contribute to economic growth, job creation, technology transfer, and export expansion, there are also concerns regarding their effects on domestic producers, local employment, resource depletion, income inequality, and environmental sustainability. Policymakers need to carefully manage and regulate MNC activities to maximize the potential benefits while mitigating potential drawbacks, ensuring a balanced and sustainable economic development path for host countries.

APPROVED
By Smart Edu Hub at 3:05 pm, May 24, 2023

5(a) :Identify two functions of money.

5(a) The two functions of money are as a medium of exchange and a store of value.

5(b) Explain two reasons why commercial banks may want to merge. [4]

Commercial banks are profit-oriented financial institutions that accept deposits and provide loans to individuals, businesses, and governments. They offer a range of banking services, including savings and checking accounts, loans, credit facilities, and payment services. Regulated by central banks, commercial banks play a crucial role in the economy by facilitating economic growth, promoting savings and investments, and ensuring the smooth flow of funds.

Commercial banks may want to merge for several reasons that we shall discuss below:

'Greater market power/share'. Merging with another bank can give commercial banks the opportunity to increase their market power. By eliminating a competitor or acquiring their customer base, the merged entity can strengthen its position in the market. This enhanced market power allows the bank to offer a greater range of services, attract more customers, and potentially gain a larger market share.

'Opportunity for economies of scale' .Merging enables commercial banks to take advantage of economies of scale. By combining their operations, they can achieve cost efficiencies and lower production costs. This can lead to higher profitability and improved financial performance. For example, sharing resources such as automated teller machines (ATMs) across the merged entity can reduce operating costs.

'Expansion into new markets' Merging can provide the opportunity for a bank to expand its operations into new geographical regions or countries. By merging with a bank already operating in a different market, the merged entity can gain access to that market and its customer base. This allows the bank to diversify its revenue streams and potentially benefit from higher growth rates in new markets.

'Brand recognition and reputation:' Merging with a larger or more established bank can enhance brand recognition and reputation. Larger banks often have a stronger brand image and a wider customer base. By merging with such a bank, the smaller entity can benefit from the established brand and gain credibility in the market.

'Rationalization and efficiency ' Merging can enable banks to rationalize their operations and eliminate duplication. This leads to increased efficiency and cost savings. By streamlining processes, reducing redundant functions, and optimizing resource allocation, the merged entity can improve overall operational efficiency and achieve economies of scale.

'Survival and financial stability' .In some cases, commercial banks may choose to merge as a means of survival. If a bank is experiencing financial difficulties, merging with a financially stronger institution can help ensure its survival. By combining resources and leveraging the strengths of both entities, the merged bank can overcome financial challenges and improve its long-term viability.

It is important to note that the decision to merge is complex and influenced by various factors, including regulatory considerations, strategic objectives, market conditions, and financial considerations. Each merger is unique and may involve a combination of these reasons or additional factors specific to the banks involved.

5(c)

Foreign exchange rate represents the value of one currency in relation to another. It determines the cost of converting one currency into another for international trade. Changes in foreign exchange rates impact the competitiveness of exports and imports, influencing the profitability of businesses engaged in international trade. Exchange rate fluctuations affect the cost of imported goods, the value of foreign investments, and individual purchasing power in international transactions. Central banks and governments manage exchange rates to promote economic stability and support domestic industries.

A fall in a country's foreign exchange rate has several effects on employment:

'Lower price of exports' .When the foreign exchange rate declines, it reduces the price of exports in terms of foreign currencies. This makes the country's exports more affordable and competitive in international markets. As a result, there is an increase in the demand for these exports, leading to higher production levels. To meet the rising demand, firms may need to hire additional workers, thereby boosting employment.

'Raised price of imports' . Conversely, a fall in the foreign exchange rate increases the price of imports in terms of domestic currency. This makes imported goods relatively more expensive for domestic consumers. As a result, the demand for imports may decrease, and consumers may shift their preferences towards domestically produced goods that have become more price competitive. This increased demand for domestically produced goods can lead to expanded production and a greater need for labor.

' Increased total demand ' . The combined effect of lower export prices and higher import prices can lead to an overall increase in total demand within the country. As exports become more competitive and imports become relatively costlier, the demand for domestically produced goods and services tends to rise. This increase in total demand stimulates production across various industries, which, in turn, can create employment opportunities.

'Boost in firms' revenue and profits ' . A fall in the foreign exchange rate can result in higher revenue and profits for export-oriented firms. As export prices become more attractive to foreign buyers, the revenue generated from exports increases. This provides firms with greater financial resources and incentives to expand their operations and invest in new projects. The expansion of business activities often translates into the creation of new job opportunities.

Overall, a fall in a country's foreign exchange rate can increase employment by boosting exports, stimulating domestic production, and creating a higher demand for domestically produced goods and services. However, it's important to note that the impact on employment can vary depending on the specific characteristics of the country's economy, the strength of its export and import sectors, and other factors such as domestic policies and global market conditions.

5(d)

Advantages of keeping a firm small:

Flexibility and consumer focus: Smaller firms often have fewer layers of decision-making, allowing for more agility and responsiveness to market changes. They can adapt quickly to consumer demands and preferences, offering personalized attention and tailored products or services.

Personal attention: Small firms have the advantage of providing personalized customer service. They can build strong relationships with their customers, offering individualized experiences and addressing specific needs, which can lead to customer loyalty and repeat business.

Government subsidies: Small firms may be eligible for government subsidies or grants aimed at supporting small businesses. These financial incentives can help offset costs, promote growth, and provide a competitive edge.

Niche market concentration: Small firms can focus on specific niche markets and cater to specialized customer segments. By understanding the unique needs of their target market, they can differentiate themselves from larger competitors and build a loyal customer base.

Good labor relations: With a smaller workforce, it may be easier for small firms to maintain good labor relations. Close-knit teams can foster a positive work environment, encourage employee engagement, and promote loyalty and commitment.

Avoidance of diseconomies of scale: Small firms can avoid the potential disadvantages associated with large-scale operations, such as bureaucracy, coordination challenges, and inefficiencies. They can maintain a lean and efficient structure, reducing costs and improving overall productivity.

Disadvantages of keeping a firm small:

Limited economies of scale: Small firms may struggle to achieve economies of scale due to their limited size. They may face challenges in negotiating favorable terms with suppliers, accessing bulk discounts, or spreading fixed costs over a larger production volume, which can impact their cost competitiveness.

Competition from larger firms: Small firms may face intense competition from larger, more established competitors with greater resources and market presence. They may find it challenging to compete on price, marketing, or distribution channels, potentially limiting their market share and growth prospects.

Difficulty raising finance: Small firms may encounter difficulties in raising capital or accessing financing options. Financial institutions may perceive them as riskier investments, making it harder to secure loans or attract investors. Limited financial resources can constrain their expansion or investment opportunities.

Risk of acquisition: Larger firms may target small firms for acquisition, especially if they possess unique capabilities, technologies, or market positions. While acquisition offers opportunities for growth and market access, it also carries the risk of losing control and identity as the small firm becomes part of a larger entity. small can vary depending on the industry, market conditions, and specific circumstances. Each business must evaluate its unique situation to determine the optimal size and growth strategy.

Difficulty recruiting highly skilled workers: Small firms may struggle to attract and retain highly skilled talent due to the perceived career opportunities and benefits offered by larger corporations. Limited resources may restrict their ability to offer competitive salaries, training programs, or comprehensive employee benefits.

Vulnerability to demand fluctuations: Small firms with limited resources may be more susceptible to downturns or fluctuations in demand. They may lack the financial cushion to withstand prolonged periods of reduced demand or economic downturns, increasing their vulnerability to business failure.

It is important to note that the advantages and disadvantages of keeping a firm small can vary depending on the industry, market conditions, and specific circumstances. Each business must evaluate its unique situation to determine the optimal size and growth strategy.