

*The sample answers suggest what you could write and what would be relevant to include in your own answers. You would not need to include all the points in order to achieve a good answer.*

## Section 1: The basic economic problem

### Chapter 1: The nature of the basic economic problem

#### Answers to activities

##### Activity (page 3)

The three basic economic questions are: what to produce, how to produce it and for whom to produce it. For a private firm producing running shoes and striving to earn a profit, the answers to these questions might be:

- What to produce? Running shoes.
- How to produce it? Efficiently (getting maximum output from resources), to be able to charge competitive prices to attract customers.
- For whom to produce it? Customers who are willing and able to pay for running shoes; for example, people who run as a hobby or professionally and people who have enough income to afford running shoes.

##### Activities (page 3)

- 1** The goods and services provided by the public sector will vary between countries but may include: fire services, police services, ambulance services, hospitals, schools, healthcare clinics, libraries, museums, parks, litter bins, rubbish/refuse collection, street lights, road signs, roads, bridges, public transport, swimming pools and sports facilities.
- 2** The goods and services which are free to individuals and those that must be paid for will vary between countries. They are free of charge to the end user but are paid for by taxpayers.  
Goods and services which are free to individuals could include: libraries, roads, parks, hospitals, schools, litter bins, and fire, ambulance and police services.
- 3** The goods and services which could be provided by a private firm as well as by the public (government) sector will vary between countries.  
Examples include: hospitals, schools, roads, museums, refuse/rubbish collection, health clinics, swimming pools and sports facilities.

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Aims	Government-funded swimming pool	Private health and leisure club
1	To provide a service to the general public.	To make a profit.
2	To cater for the needs of all sectors of society regardless of an individual's income, e.g. may offer discounted entrance fees for the elderly and children.	To cater for middle-/higher-income earners as membership fees tend to be high.
3	The swimming pool will hire out its facilities to school groups and sports clubs.	The private health and leisure club will allow only members and their guests to use its facilities.
4	Available for all members of the public to use.	The number of members is restricted so that the club remains exclusive.

### Activities (page 4)

1 Answers will vary for each student, but may include:

- Needs: food, water, shelter, warmth, clothes, human contact.
- Wants: smartphone, pens, pencils, books, toys, computer, streaming services, haircuts, internet access, restaurant meals, cinema tickets, makeup, football.

2 Student's own answer.

3 Student's own answer.

4 Student's own answer. Examples of goods or services that may be in short supply in an economy could include: land, fuel, housing and fresh water.

The shortage occurs due to the basic economic problem, i.e. people have unlimited needs and wants, yet the resources to meet those needs and wants are scarce.

### Activity (page 4)

Examples of goods that are limited in supply (economic goods) could include:

- Primary sector goods, e.g. fresh flowers, carrots, rice, oil, gold, copper.
- Manufactured goods, e.g. cameras, cars, hairdryers, footballs.

Goods that are unlimited in supply (free goods) could include seawater, sand, air and intellectual property if ideas and inventions are not patented.

## Sample answers to practice questions

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### Practice questions: multiple choice (page 4)

**1 Correct answer: D** Scarcity of resources [1 mark]

The basic economic problem is about making the best use of scarce resources (land, labour, capital and enterprise) in order to satisfy the needs and wants of society. Hence, Option D is the correct answer.

**2 Correct answer: C** Seawater [1 mark]

Unlike economic goods, free goods are those in unlimited supply, so are not traded and have no opportunity cost. An example is seawater. Other examples include air, sand and sunshine (in certain parts of the world)

## Sample answers to chapter review questions

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### Chapter review questions (page 5)

- 1 Economics is the study of how scarce resources are allocated to satisfy the unlimited needs and wants of individuals, governments and firms in an economy.
- 2 A need is a good or service that is essential for survival; a want is a good or service that is not necessary for survival but is demanded by economic agents to fulfil their desires.
- 3 The basic economic problem is concerned with how best to allocate scarce resources in order to satisfy people's unlimited needs and wants.
- 4 Economic agents are households (private individuals in society), firms that operate in the private sector of an economy and the government (the public sector of an economy).
- 5 The three fundamental questions that all economies face are: what to produce, how to produce it and for whom to produce it.
- 6 Goods are physical items, such as tables, cars, toothpaste and pencils, whereas services are non-physical items, such as haircuts, bus journeys, telephone calls and internet access.
- 7 Economic goods are limited in supply, whereas free goods (such as air and seawater) are unlimited in supply, and hence, there is no opportunity cost in terms of their output.

## Section 1: The basic economic problem

### Chapter 2: The factors of production

#### Answers to activities

##### Activities (page 7)

- 1 The resources (factors of production) required to deliver an International GCSE Economics lesson could include:
  - Land – the raw materials used to deliver a lesson, e.g. wood for the paper and textbooks used in the lesson, or the physical land that the school is built on.
  - Labour – teachers and non-teaching staff (e.g. caterers, cleaners, technicians, security and administrative staff).
  - Capital – tables, chairs, board marker pens, textbooks, computers and projectors.
  - Enterprise – senior leadership team (e.g. principal and vice principals) to make strategic decisions about how the school is run.
- 2 Given the interdependence and the context-specific nature of the factors of production, it is not possible to definitively state which factor is the most important for economic activity overall. The importance of each factor varies with the type of economic activity, the industry, the country in question and the state of technological progress.

##### Activity (page 7)

- a Possible answers for the four factors of production being required for the construction of roads could include:
  - Land – raw materials needed to build roads, e.g. asphalt, cement, gravel.
  - Labour – construction workers, supervisors.
  - Capital – machinery and vehicles, e.g. excavators, forklift trucks, motor graders, tipper trucks, cranes.
  - Enterprise – leadership team, e.g. chief engineers and project managers.
- b Possible answers for the four factors of production being required to provide haircuts to clients could include:
  - Land – raw materials to produce the shampoos and other essentials in a hair salon, plus plenty of water for washing hair.
  - Labour – shampooists, stylists, colourists, receptionists.
  - Capital – scissors, hairdryers, combs, brushes, curling aids, hairsprays, gels, shampoo, conditioner, hair clips.
  - Enterprise – owner(s) of hair salons, salon managers, stylists.

### Activity (page 8)

Student's own responses based on the countries selected. Students could use the following resources to investigate global employment opportunities:

- <https://news.gallup.com/topic/migration.aspx>
- [www.migrationpolicy.org/article/top-statistics-global-migration-migrants](http://www.migrationpolicy.org/article/top-statistics-global-migration-migrants)

## Sample answers to practice questions

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### Practice questions: multiple choice (page 9)

**1 Correct answer: D** Natural resources [1 mark]

Natural resources are an example of land resources, not capital resources.

**2 Correct answer: B** An increase in the national minimum wage [1 mark]

An increase in the national minimum wage will tend to raise the labour costs for a business because higher hourly wage rates will need to be paid. This will tend to raise the average wage rate (or cost) of labour.

## Sample answers to chapter review questions

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### Chapter review questions (page 9)

- 1 Factors of production are the resources required to produce a good or service.
- 2 The four factors of production are land, labour, capital and enterprise.
- 3 Rent, wages and salaries, interest and profit are the various rewards for factors of production.
- 4 Income is the collective name for the four returns on factors of production.
- 5 Causes of changes in the quantity and quality of factors of production could include: changes in the costs of factors of production (e.g. a change in the minimum wage); government policies (e.g. taxes and subsidies); technological progress; net migration of labour; improvements in education and healthcare; unfavourable weather conditions.

## Section 1: The basic economic problem

### Chapter 3: Opportunity cost

#### Answers to activities

##### Activity (page 11)

Answers will vary, but the major components of government spending in a country are typically national defence, healthcare, education, transportation and social welfare.

##### Activities (page 11)

- 1 Answers will vary, as both quantitative and qualitative factors are needed in economic decision-making.
- 2 Opportunity cost is very likely to apply to decisions about post-16 and university education, as students will be sacrificing other opportunities, e.g. gap-year experiences, apprenticeships or full-time employment.

##### Activity (page 12)

The costs of the government building a new airport could include environmental damage, noise pollution and congestion. The benefits of the government building a new airport could include employment opportunities (job creation), increased tourism spending and improved infrastructure in the economy. The opportunity cost of building an additional airport terminal could include, for example, public housing for low-income families that the same government funds could have been used for.

#### Sample answers to practice questions

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##### Practice question: structured question (page 11)

By producing an extra 5 units of wheat, the farmer gives up 10 units of corn [1]. Hence the ratio is 5:10, i.e. the opportunity cost of producing 1 unit of wheat is 2 units of corn [1].

*Maximum of 2 marks.*

##### Practice questions: multiple choice (page 12)

- 1 **Correct answer: C** \$195 [1 mark]

By deciding to keep the console, Juke is giving up the second-hand value, i.e. \$195. The answer is not Option D, because this was the opportunity cost when Juke was originally deciding between buying this particular console or a different games console.

- 2 **Correct answer: C** The other projects that could have been undertaken had the motorway not been built [1 mark]

Opportunity cost is the cost of the next best opportunity forgone when making economic decisions. In this case, the decision to build a new motorway means that other projects have been forgone.

## Sample answers to chapter review questions

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### Chapter review questions (page 12)

- 1 Opportunity cost is the cost of the next best opportunity forgone when making economic decisions.
- 2 The opportunity cost of a student studying International GCSE Economics is the other International GCSE subjects that could have been studied, e.g. History or Geography.
- 3 Consumers have limited resources (such as money), so they have to make choices, resulting in opportunity costs.
- 4 Workers have limited capacity/ability, as they cannot do everything. So, they tend to specialise, thereby giving up other career or job opportunities.
- 5 Producers cannot produce everything, as they have limited resources and funds, so they need to choose what to produce and how to produce it, thereby giving up other opportunities.
- 6 By funding a particular project or department (e.g. a new airport or healthcare initiative), the government forgoes the opportunity to spend that money on another project or department (e.g. new motorways or expenditure on education).

## Section 1: The basic economic problem

### Chapter 4: Production possibility curve diagrams

#### Answers to activities

##### Activity (page 16)

- a** The production possibility curve of Bangladesh will shift inwards from  $PPC_1$  to  $PPC_2$  because the flooding causes loss of crops, damage to homes and disruptions to methods of transportation.
- b** The student should label a point within the production possibility curve. At this point, say Point A, some of the factors of production are idle (unemployed).
- c** The student should label a point outside the production possibility curve. This point, say Point B, is unattainable.

##### Activity (page 16)

An outwards shift of the production possibility curve is not always good for the economy. It depends on the composition of the increased output, e.g. greater spending on the military and weapons would not always be good for the economy as a whole.

It also depends on how the additional output is distributed, e.g. do the rich simply get richer, or do the poor receive their share of the additional output?

#### Sample answers to practice questions

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##### Practice questions: multiple choice (page 14)

- 1 Correct answer: A** A reduction in barley production from  $B_2$  to  $B_1$  [1 mark]

To increase production of wheat from  $W_2$  to  $W_1$ , Country Y has to reduce the production of barley from  $B_2$  to  $B_1$ . This is because the production possibility curve represents the maximum amount of wheat and barley that can be produced at each level of output, with all resources used efficiently.

- 2 Correct answer: D** Point F [1 mark]

At this point, it is possible to increase production within the economy without incurring any opportunity cost, i.e. it is possible to simultaneously increase the production of both wheat and barley.

##### Practice questions: multiple choice (page 16)

- 1 Correct answer: A** A natural disaster in the economy [1 mark]

A natural disaster is likely to reduce the productive capacity of the economy, thereby limiting its potential output. Options B and C will shift the production possibility curve (PPC) outwards, while Option D is caused by moving away from a particular point *on* the PPC.

- 2 Correct answer: B** A shift from producing more of Good A to producing more of Good B  
[1 mark]

Explanation: A movement along the PPC occurs when the production of one good (or service) is increased while the production of the other good (or service) is reduced, due to the economy's scarce resources.

### Practice question: structured question (page 16)

- a** Students should draw two points on the same PPC. The initial point should be closer to the capital goods axis [1], while the new point should be closer to the consumer goods axis, indicating a movement along the PPC [1].

*Maximum of 2 marks.*

- b** The reallocation of resources results in a movement along the PPC from producing more capital goods to producing more consumer goods [1]. This reallocation of resources does not change the PPC itself but changes the combination of goods produced [1].

*Maximum of 2 marks.*

- c** In the long term, deciding to reallocate resources from the production of capital goods to consumer goods might reduce the investment in capital goods [1], potentially slowing down future economic growth due to less capital accumulation [1] and lower productive capacity [1].

*1 mark for setting out the potential long-term impact.*

*1 mark for suggesting the effect of the impact on economic growth.*

*Maximum of 2 marks.*

## Sample answers to chapter review questions

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### Chapter review questions (page 16)

- 1** The productive capacity of an economy is the maximum combination of goods and services which can be produced in an economy.
- 2** A PPC diagram shows the maximum combination of the amounts of goods and services that can be produced in an economy, per period of time.
- 3** Producing more units of one good or service means having fewer units of another. This creates movement along the PPC.
- 4** For an economy to be operating on its PPC, all factors of production must be used (i.e. there are no unemployed resources) and all resources must be used efficiently.
- 5** A movement along a PPC occurs when an economy reallocates resources to produce more of one good (or service) and less of another, without changing the total resources or state of technology.
- 6** The causes of an outward shift of a PPC are improvements in the quantity and/or quality of factors of production.

## Section 2: The allocation of resources

### Chapter 5: The role of markets in allocating resources

#### Answers to activities

##### Activity (page 19)

Brazil and Vietnam are the world's two largest coffee producers, so the impact of an increase in the price of coffee is likely to be very significant. The coffee exporters in these countries are likely to gain from the higher price in the short run, as long as world demand for coffee does not drop significantly due to the higher price, especially as demand from Asia has risen. Domestic households are likely to lose from the higher price as they need to pay more for their coffee.

#### Sample answers to practice questions

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##### Practice question: multiple choice (page 20)

**Correct answer: D** Why should production take place? [1 mark]

Production takes place to fulfil people's needs and wants in a market economy (or any economic system). Hence, *why* production should take place is not a key economic question.

##### Practice question: structured question (page 20)

Prices are determined in a market system by the interacting forces of demand (consumers) [1] and supply (producers) [1]. Prices are determined when the demand for and supply of a product are equal (in equilibrium) [1]. At this position, the market is cleared of any shortages or surpluses [1].

*Maximum of 4 marks.*

#### Sample answers to chapter review questions

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##### Chapter review questions (page 21)

- 1 A market is any place where buyers and sellers engage in trade.
- 2 The market system is the method of allocating scarce resources through the market forces of demand and supply.
- 3 Market equilibrium exists when the demand for a product matches the supply, so there is no excess demand (shortage) or excess supply (surplus).

- 4 Market disequilibrium occurs if the price for a product is too high (resulting in excess supply, or a surplus) or too low (resulting in excess demand, or a shortage).
- 5 The three key economic questions that all economies must address are what, how and for whom should production take place.
- 6 Buyers and sellers in a market play a vital role in the allocation of resources by collectively determining what, how and for whom production should take place.

## Section 2: The allocation of resources

### Chapter 6: Demand

#### Answers to activities

##### Activity (page 22)

- a** Answers will vary according to the product chosen, e.g. imported cars, textbooks or jewellery. The factors that affect the demand for the product are likely to include price, income, advertising, availability of substitutes and government policies (e.g. taxes, subsidies or regulations).
- b** Answers will vary, but students should justify their answer when citing which factor is the most important.

##### Activity (page 25)

- a** Student's own responses, which are likely to include Bangkok, Hong Kong, Tokyo, Singapore, Beijing, Paris, London, Rome, Barcelona, Dublin, Istanbul, Madrid, Amsterdam.
- b** The purpose of the activity is to engage the student's understanding and application of demand theory.

##### Activity (page 25)

- a** There is a contraction in demand: an increase in the price of Apple smartphones causes less demand for them.
- b** There is a rightwards shift in the demand curve for Apple smartphones: an increase in the price of Samsung smartphones causes greater demand for Apple smartphones.
- c** Assuming Apple smartphones are normal (luxury) goods, an increase in consumer incomes should shift the demand curve for Apple smartphones to the right.
- d** A successful advertising campaign promoting Samsung's latest smartphones should cause the demand curve for Samsung smartphones to increase. Consequently, the demand curve for Apple smartphones should shift to the left, as more consumers choose to buy Samsung smartphones.

#### Sample answers to practice questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

##### Practice questions: multiple choice (page 25)

- 1** **Correct answer: C** The inverse relationship between the price of a good or service and the quantity demanded of that product [1 mark]  
The law of demand states that, as the price of a good or service rises, the quantity demanded will fall. This inverse relationship exists because fewer people are willing and able to buy the product as the price increases.

**2 Correct answer: A** A higher level of demand at all given price levels [1 mark]

A rightwards shift of the demand curve shows that customers are willing and able to buy more of the product at each price level. This might be due to changes in non-price factors, not just because of a successful advertising campaign (Option B). Other factors could have caused this shift, such as higher levels of household income.

## Sample answers to chapter review questions

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### Chapter review questions (page 26)

- 1** Demand is the willingness and the ability of customers to pay a given price to buy a good or service.
- 2** The higher the price of a product, the lower its demand tends to be, and vice versa. This is the law of demand.
- 3** One reason for the inverse relationship between price and quantity demanded is, as the price of a good or service falls, the customer's real income rises – that is, with the same amount of income, the customer is able to buy more of the product at lower prices. A second reason is, as the price of a good or service falls, a larger number of customers are able to pay, so they are more likely to buy the product.
- 4** The main determinants of demand are price, income, habits/tastes, substitutes and complements, advertising, government policies (e.g. taxes, subsidies and regulations) and the economy (e.g. recession or boom), as well as the weather and demographics.
- 5** A movement along a demand curve is caused by a change in price, whereas a shift in a demand curve is caused by a change in non-price factors.
- 6** A contraction in demand means a fall in the quantity demanded for a product following an increase in its price. An extension in demand means an increase in the quantity demanded for a product following a fall in its price.
- 7** Market demand is the sum of all individual demand for a particular product.
- 8** A fall in quantity demanded occurs when the price of a product increases; a fall in demand is caused by a leftwards shift of the demand curve as a whole.

## Section 2: The allocation of resources

### Chapter 7: Supply

#### Answers to activities

##### Activity (page 27)

**a/b** Most markets, shopping streets and shopping malls have more stalls, shops and outlets that cater specifically for women than men. This is due to the greater demand from female customers than male customers to do shopping (more frequently and for longer periods of time). (The reasons for this might include the fact that more women have to shop for entire families.) Studies in Europe and America have shown that the average amount spent by women in shopping areas is greater than that of men, so profit-seeking firms will cater for those who are willing and able to spend more money. Ask students to compare this finding with what they have found. Does the same principle apply to their country/city/region?

##### Activities (page 27)

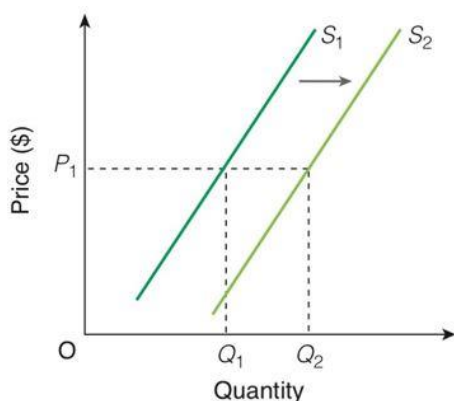
- 1 Student's own responses. The purpose of the activity is to engage the student's understanding and application of supply theory.

##### Activity (page 30)

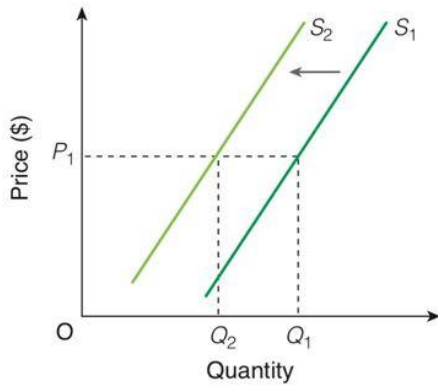
The discussions are likely to include consideration of a significant leftward shift of the supply curve for most goods and services in Japan, due to the devastation caused by the earthquake. There is likely to be a delay in the output of manufactured products, such as cars, even in towns not directly affected by the natural disaster.

##### Activities (page 30)

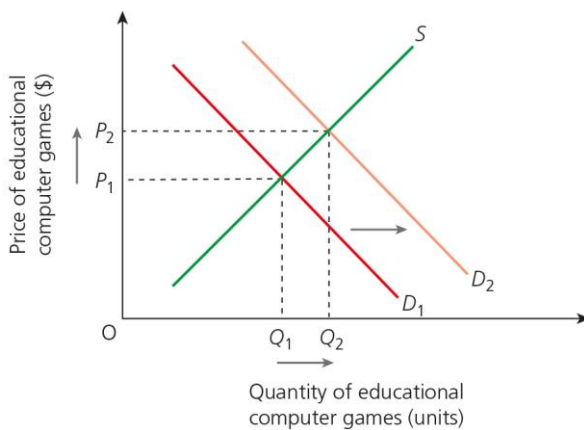
- 1 **a** There is a rightwards shift in the supply curve because the subsidies lower the costs of production for the producers of educational computer games, thus lowering the price for consumers.



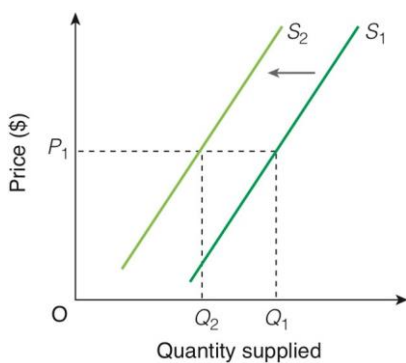
- b** Costs of production increase (as more is paid in commission to the creators and distributors of educational computer games), so the supply curve for educational computer games shifts to the left.



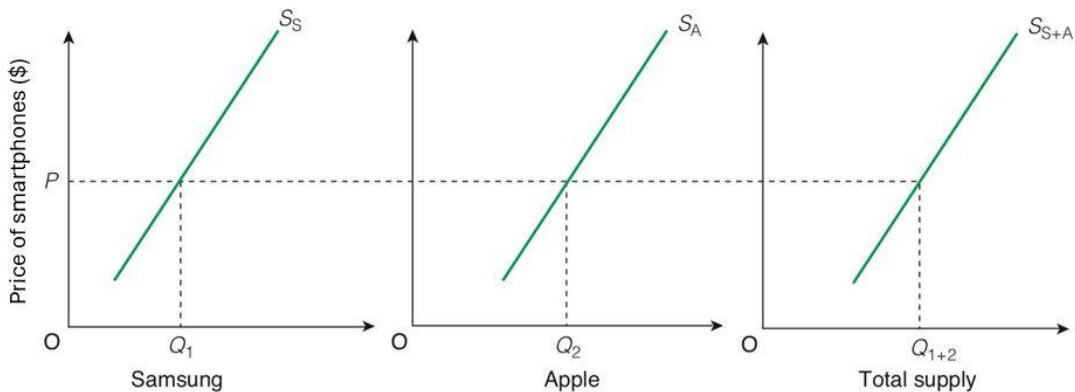
- c The introduction of a 15 per cent sales tax (on all computer games) increases costs of production, so the supply curve for educational computer games shifts to the left (as for the graph in **1b**), *ceteris paribus*.
- d The technological advances (in the production of educational computer games) shift the supply curve to the right (as for the graph in **1a**). This lowers the market price and increases the quantity traded, *ceteris paribus*.
- e The increase in demand for educational computer games from schools causes the demand curve to shift from  $D_1$  to  $D_2$ . This increases the market price and the quantity supplied, *ceteris paribus*.



- 2 a** The Chinese government raising the minimum wage for factory workers by 20 per cent increases the cost of labour, thereby shifting the supply curve in the goods market to the left (due to higher costs of production).



- b** A severe drought reduces the supply of vegetables, thus shifting the supply curve to the left (as for the graph in **2a**), *ceteris paribus*. This leads to the increase in the price of vegetables in France.
- c** New technology at Tata Motors increases the productive capacity of the company, thus shifting the supply curve to the right.
- d** The US government subsidies help to reduce the costs of production for electric vehicle manufacturers, thus shifting the market supply curve to the right (as for the graph in **2c**).
- e** The launch of a new smartphone by Samsung increases the overall market supply of smartphones. Therefore, the market price will tend to fall as more firms supply rival Apple's products on the market.

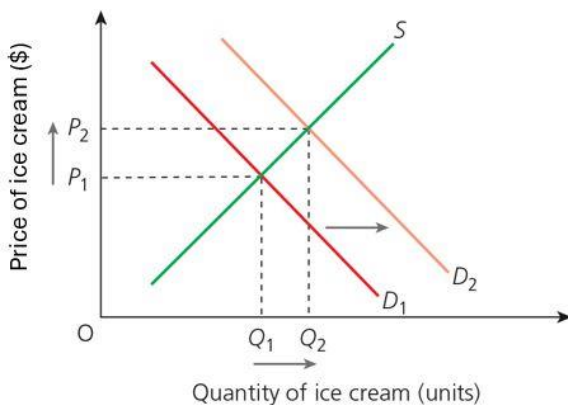


## Sample answers to practice questions

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### Practice question: structured question (page 30)

The higher demand for ice cream from  $D_1$  to  $D_2$  results in a higher market price [1]. This causes an extension in supply, thereby increasing market supply from  $Q_1$  to  $Q_2$  [1].



*Up to 2 marks for correctly setting out how an increase in the price of ice cream affects the market supply curve.*

*Up to 2 marks for an accurate and fully labelled diagram.*

*Maximum of 4 marks.*

### Practice questions: multiple choice (page 31)

**1 Correct answer: D** The positive relationship between the price of a good or service and the quantity supplied of that product [1 mark]

The law of supply states that, as the price of a good or service rises, the quantity supplied will also rise. This positive correlation exists because more firms are willing and able to supply the product as the price increases.

**2 Correct answer: C** An increase in production costs for suppliers [1 mark]

A leftward shift of the market supply curve for a good or service shows that firms are less able and/or willing to supply the product at each price level. This is due to the higher costs of production, and hence lower profit margins for the suppliers.

## Sample answers to chapter review questions

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### Chapter review questions (page 31)

- 1 Supply is the ability and willingness of firms to provide goods and services at given price levels.
- 2 The supply curve is upward sloping because, the higher the price of a product or service, the greater the ability and willingness of firms to supply it.
- 3 The main determinants of supply are price, time period, production costs, weather, taxes, subsidies, innovations and opportunity costs.
- 4 The higher the price, the greater the amount supplied, and vice versa. This is the law of supply.
- 5 A contraction in supply is a fall in the quantity supplied of a product following a fall in its price. An extension in supply is an increase in the quantity supplied of a product following an increase in its price.
- 6 Individual supply is one firm's supply of a particular product. Market supply is the sum of all individual firms' supply of a particular product.
- 7 A movement along a supply curve is caused by a change in the price of a product, whereas a shift in a supply curve is caused by a change in non-price factors that affect the supply of a good or service.
- 8 Any of the factors (except price) identified in question 3 above are the causes of shifts in the supply curve.

## Section 2: The allocation of resources

### Chapter 8: Price determination

#### Answers to activities

##### Activity (page 34)

- a** The equilibrium price is \$20 (as this is the price level where the quantity demanded equals the quantity supplied).
- b** At  $P = \$10$ ,  $Q_d = 60,000$  and  $Q_s = 20,000$ , so there is excess demand of 40,000 units.
- c** At  $P = \$40$ ,  $Q_d = 0$  and  $Q_s = 80,000$ , so there is excess supply of 80,000 units.

##### Activities (page 35)

- 1** Student's own responses. Responses should include explanation of the meaning of the European Union's (EU's) Common Agricultural Policy (CAP) for EU farmers and its purpose, i.e. a method of government intervention used by the EU to encourage agricultural output by subsidising its farmers. As the policy encourages agricultural output by subsidising it, and the governments of the EU offer to buy any surplus output, it inevitably leads to excess supply.
- 2** Student's own responses, based on their research findings. Answers are likely to consider the impact of low supply (a shortage of housing in these cities) alongside high demand (e.g. due to migration of the population to large cities, such as London and Tokyo).

#### Sample answers to practice questions

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##### Practice question: multiple choice (page 32)

**Correct answer: D** Rules and regulations are imposed to correct market failures, such as the over-consumption of demerit goods [1 mark]

The free market forces of demand and supply operate under the price mechanism, in the absence of rules and regulations imposed by the government.

##### Practice question: multiple choice (page 34)

- a** **Correct answer: A** Excess demand [1 mark]

There is excess demand of 1,000 units per week because  $Q_d = 7,000$  units per week whereas  $Q_s = 6,000$  units only.

- b** **Correct answer: B** 8,000 units [1 mark]

At a price of \$30, there is excess supply of 2,000 units per week (as  $Q_s = 8,000$  units but  $Q_d = 6,000$  units only). Hence, over four weeks, suppliers will accumulate 8,000 units of unsold inventory.

**Practice question: structured question (page 35)**

- a** Supply is the ability and willingness of firms to provide goods and services [1] at given price levels [1].

*Maximum of 2 marks.*

- b** An accurately drawn and labelled demand and supply diagram should show a leftward shift of the supply curve [1] due to the reduced harvests that resulted in a shortage of avocados [1], and a downward-sloping demand curve for avocados [1]. The shortage of avocados will cause the market price to rise [1]. Hence, the diagram should show a higher equilibrium price and lower equilibrium quantity supplied.

*Maximum of 4 marks.*

- c** Analysis of the reasons why the global demand for avocados may have increased might include:
- Higher incomes of households in the USA, Europe and the People's Republic of China [1] mean consumption increases, as people in these countries have more disposable income [1] and hence there is greater demand for avocados (and other produce) [1].
  - Successful advertising of avocados [1] as being part of a healthy diet and lifestyle [1] increases consumer demand.
  - There is greater availability of fruit and vegetables, such as avocados [1], perhaps due to regulations encouraging freer international trade [1], so more consumers have access to avocados [1].
  - Lower-priced complementary goods, e.g. lettuce and other ingredients used in salads or guacamole (an avocado-based dip) [1], boost the demand for avocados [1].

*Up to 4 marks for application to the context.*

*Up to 2 marks for justified reasoning.*

*Maximum of 6 marks.*

## Sample answers to chapter review questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Chapter review questions (page 35)

- 1** The price mechanism is the economic system of relying on the market forces of demand and supply to allocate resources.
- 2** The key features of the price mechanism are no government intervention in economic activity; the allocation of resources is based on the demand for and supply of goods and services; the existence of competition in markets; incentives for households and firms.
- 3** Market equilibrium is the situation where the demand for a product matches the supply, so there is no excess demand (shortage) or excess supply (surplus).
- 4** Equilibrium price is the price at which the demand curve for a product intersects the supply curve for the product. The market is therefore cleared of any excess demand or supply.

- 5 Market disequilibrium is the situation where the price for a product is too high (resulting in excess supply, or a surplus) or too low (resulting in excess demand, or a shortage).
- 6 Excess demand is where the market price is below the equilibrium price, thus creating a shortage in the market. Excess supply is where the market price is above the equilibrium price, thus creating a surplus in the market.
- 7 Surpluses occur when the price is set above the equilibrium or market price.
- 8 Shortages occur when the price is set below the equilibrium or market price.

## Section 2: The allocation of resources

### Chapter 9: Price changes

#### Answers to activities

##### Activity (page 37)

Student's own responses.

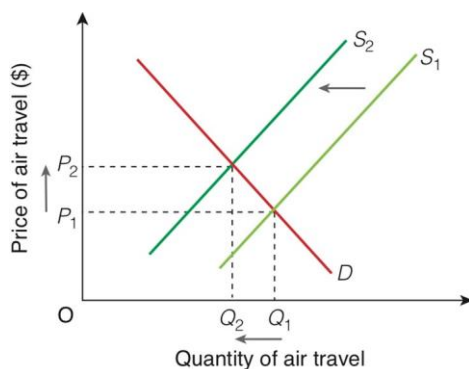
For Australia, some of the measures include:

- Government-sponsored anti-smoking TV adverts.
- Graphic health warnings – health warnings on cigarette packets occupy 30 per cent of the front and 90 per cent of the back of the packet, with a graphic image (detailed visual) on both the front and back.
- Plain packaging – all tobacco products must have plain packaging, in order to make the product less attractive to smokers. The appearance of all cigarette packs is standardised, including the colour of the pack, with the brand name printed in a standard font and size. No logos are allowed.
- Smoke-free cars – it is illegal to smoke in a car/motor vehicle.
- Taxation on cigarette and tobacco products – higher taxes imposed on cigarettes mean that the price of a packet of cigarettes will increase. Excise duties on tobacco products increase in March and September each year under Australian laws.

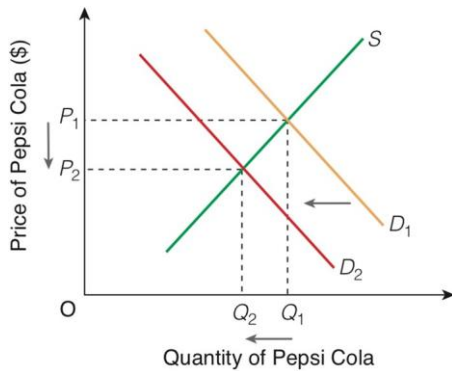
All of the above government actions are likely to reduce the demand for cigarettes.

##### Activity (page 38)

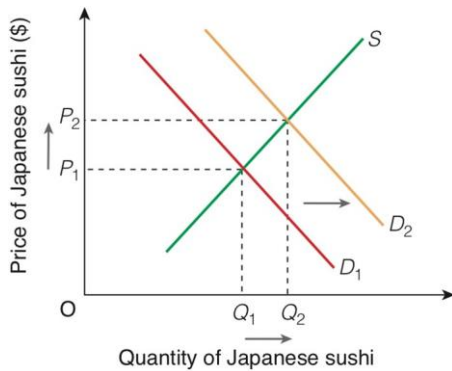
- a** Higher fuel taxes increase the costs of production for airlines, shifting the supply curve to the left, *ceteris paribus*. This causes the market price for air travel to increase, thereby causing a contraction in the demand for air travel.



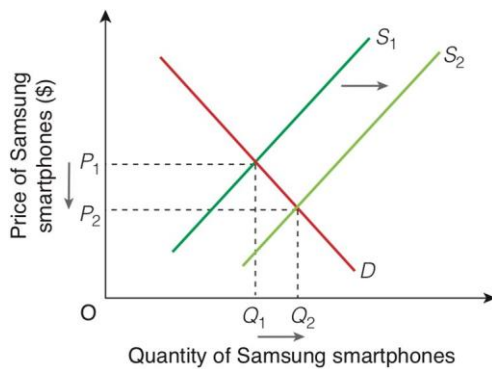
- b** There is a leftwards shift in the demand curve for Pepsi Cola, i.e. there is lower demand for Pepsi Cola due to the fall in price of rival Coca-Cola, *ceteris paribus*.



- c** The successful marketing campaign should shift the demand curve for Japanese sushi to the right, *ceteris paribus*. It will force prices up, and increase the quantity traded. Customers are willing and able to pay more due to the health benefits of eating rice and fish.



- d** The supply curve for Samsung smartphones will shift to the right, due to the improved productivity in the firm's factories. This reduces the equilibrium price and increases the quantity traded, *ceteris paribus*.



## Sample answers to practice questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Practice question: structured question (page 38)

- a** Demand refers to the willingness *and* ability of customers to pay a given price [1] to buy a good (such as LEGO® toys) or a service [1].

*Maximum of 2 marks.*

- b** Explanations might include:
- a wider customer base [1], as previously boys mainly accounted for the sales of LEGO® toys [1]
  - the \$40 million global marketing of LEGO® Friends [1], which proved to be more effective than the company expected [1]
  - higher levels of income [1], leading to parents spending more money on toys such as LEGO® Friends [1].

*Up to 2 marks for each (×2) correct reason for the higher-than-expected demand for LEGO® Friends toy construction bricks.*

*Maximum of 4 marks.*

### Practice questions: multiple choice (page 39)

- 1 Correct answer: A** An increasing number of drivers buy electric-powered cars [1 mark]

If more drivers switch to electric-powered cars, there will be lower demand for petrol, *ceteris paribus*.

- 2 Correct answer: C** Higher cost of fertilisers [1 mark]

The higher cost of fertilisers increases the overall cost of production for farmers, so the supply curve shifts to the left. Option A affects the demand curve, not the supply curve. Options B and D shift the supply curve to the right.

- 3 Correct answer: C** A reduction in income tax rates [1 mark]

Lower income taxes give people more disposable income, so they are more likely to buy smartphones. Option A, assuming laptops are substitutes, would mean lower demand for smartphones. Sales taxes (Option B) affect the supply curve, not the demand curve. Option D causes a movement along the demand curve, not a shift in demand.

- 4 Correct answer: B** Higher levels of disposable income [1 mark]

Higher levels of disposable income mean that individuals will have more money to spend, thus increasing the demand for goods and services. Options A, C and D are most likely to shift the demand curve to the left.

## Sample answers to chapter review questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Chapter review questions (page 40)

- 1 Changes in any non-price factors that affect the demand and/or supply of a good or service cause a change in the equilibrium price and quantity traded for any given product.
- 2 Sales taxes shift the supply curve to the left, thereby raising the equilibrium price and reducing the quantity traded.
- 3 Favourable weather conditions shift the supply curve to the right, putting downward pressure on the equilibrium price and increasing the quantity of agricultural output.
- 4 The student should state three of the following non-price factors that can shift the demand curve for a given product: changes in income, habits and tastes, quality, advertising and the price of substitutes or complements.
- 5 The student should state three of the following non-price factors that can shift the supply curve for a given product: changes in costs of production, the weather/climate, time and government policies (e.g. taxes, subsidies and regulations).

## Section 2: The allocation of resources

### Chapter 10: Price elasticity of demand

#### Answers to activities

##### Activity (page 45)

The economic reasons for governments around the world regularly raising the taxes on tobacco, alcohol and petrol may include:

Tobacco, alcohol and petrol are demerit goods and cause a negative impact on society. Governments may wish to reduce consumption of these goods and therefore apply high taxes to them, to raise prices to reduce consumption. Demand for the goods may be inelastic and the increase in price will be less than the decrease in consumption. The government will therefore collect a large amount of tax revenue. Taxation on the goods sends a message to consumers that the goods are harmful to society, which may deter consumption.

##### Activity (page 47)

Student's own responses. Suggested points for discussion:

- Volkswagen (VW) produces a wide range of motor vehicles, including passenger cars, trucks and light commercial vehicles. The price elasticity of demand for each type of vehicle may vary depending on factors such as brand perception, quality and substitutes available in the market.
- If VW is able to establish brand loyalty, then the demand for VW cars may be relatively price inelastic. This means that customers who change or upgrade their vehicle choose to stick with the VW brand, so price becomes less of an issue in the decision-making process.
- For VW's luxury brands such as Audi, Bentley, Lamborghini and Porsche, the price elasticity of demand is likely to be relatively low due to their status as high-end cars with a loyal customer base. These luxury vehicles often have price inelastic demand, meaning that changes in price have a relatively small impact on the quantity demanded.
- The number of substitute cars available for mainstream cars would suggest that the price elasticity of demand for VW's mainstream passenger cars and commercial vehicles is more price elastic. Hence, VW will use non-price strategies, such as advertising and promotions, to attract and retain customers for its cars. For example, VW could focus on the build quality and durability of its models such as the VW Golf and Polo.

##### Activity (page 50)

Suggested points for discussion on peak and off-peak pricing strategies:

- Firms, such as hotels and airlines, use peak and off-peak pricing strategies to maximise their revenue.
- Airline tickets and hotels tend to be more expensive in school holidays because demand at that time is price inelastic and families will pay the higher prices because they can only travel during the holidays.

- During off-peak times, prices of airline tickets and hotels tend to be lower as demand is price elastic, so lower prices act as an incentive for people to travel during these times. For example, budget airlines may have departure times very early in the morning or very late at night. Such times are inconvenient for many people but prices are low enough to attract some customers.
- Conditions for peak and off-peak pricing strategies are: peak and off-peak markets have different elasticities of demand, the firm has a degree of monopoly power, the markets are separate and it is not possible to buy in one market and sell in another.
- Other examples include:
  - Travel on trains in the morning rush hour (before 9.30 a.m.) may be more expensive than after 9.30 a.m.
  - Morning or lunchtime shows at cinemas and theatres tend to be cheaper than evening shows.
  - Drinks and food in bars and restaurants may be cheaper between 4 p.m. and 7 p.m. ('happy hour'), that is, the period between lunch and dinner.
  - Airline ticket prices in the morning for domestic flights between cities are more expensive than flights later in the day, as they cater for the inelastic demand of business travellers.
  - Florists charge higher prices during special occasions, such as Valentine's Day and Mothers' Day, as they cater for the highly price inelastic demand on these days.

## Sample answers to practice questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Practice question: structured question (page 42)

- a** The price elasticity of demand for pineapples is likely to be price elastic [1]. This is because there are plenty of substitutes [1], such as bananas, oranges, melons and other fruits. The (market) demand for pineapples is unlikely to be habit-forming [1], so again, buyers are likely to be highly responsive to changes in the price of pineapples [1].

*Maximum of 4 marks.*

- b** Tobacco products are habit-forming (addictive) [1], so are likely to be price inelastic [1]. For smokers (who make up the market demand for tobacco products), there are few, if any, close substitutes for tobacco as a product [1], hence the quantity demanded is relatively unresponsive to changes in price [1]. If the price of cigarettes does not take up a large proportion of the typical individual's or household's income [1], changes in price are unlikely to affect significantly the demand for tobacco products. An increase in the price of tobacco for a low-income earner may cause a decrease in the quantity demanded for tobacco as it may take up a relatively larger proportion of their income [1] and therefore, for a low-income earner, the demand for tobacco products may be more price elastic [1].

*Maximum of 4 marks.*

- c** Overseas holidays tend to account for a large proportion of an average individual's or household's income [1]. Therefore, the demand for overseas holidays tends to be relatively price elastic [1]. In addition, holidaymakers can choose cheaper alternatives [1], such as

domestic holiday destinations. This makes the demand for overseas holidays more responsive to changes to price [1].

*Maximum of 4 marks.*

- d** Textbooks are bought by teachers and students. If these textbooks are popular and a requirement for the specific course [1], demand will be price inelastic [1] because customers will need to buy the product even if prices rise. In addition, textbooks tend to be a one-off purchase [1], accounting for an insignificant proportion of the typical household's monthly income [1], so many customers will not be too responsive to a change in price [1]. However, if there are plenty of alternative good-quality textbooks available on the market, customers will become more responsive to price differentials [1].

*Maximum of 4 marks.*

**Note:** there is more than one possible answer to the above questions. Answers that take an alternative approach but show good reasoning and substance should be awarded accordingly. For example, students might give a balanced answer, such as pineapples being relatively price inelastic due to the small proportion of the typical individual's or household's income that is used to buy the fruit.

### Practice questions: structured questions (page 45)

- 1 a**  $\% \Delta Q = (875 - 850)/850 \times 100 = 2.94\%$   
 $\% \Delta P = (24 - 25)/25 \times 100 = -4\%$  [1]  
 Price elasticity of demand (PED) =  $2.94/-4 = -0.735$  [1]

*1 mark for showing working out.*

*1 mark for the correct answer.*

*Maximum of 2 marks.*

- b** The price elasticity of demand (PED) for rice is price inelastic [1] (relatively unresponsive to changes in price) [1].

*Maximum of 2 marks.*

- 2** Possible reasons why the demand for rice is price inelastic in countries like India, Vietnam and China include:
- Rice is a staple food [1] in these countries, thus part of people's daily food intake, i.e. there is no real substitute [1] for rice in these countries/cultures.
  - The price of rice is relatively insignificant [1] compared to the income of the average person in these countries, so people are less sensitive to price changes [1].
  - It would take time for people to change their customary habits and tastes in seeking an alternative food product [1] if there were a continual rise in the price of rice. Hence, PED for rice in these countries is inelastic, at least in the short run [1].

*Up to 2 marks for each (×2) correct reason.*

*Maximum of 4 marks.*

**Practice question: multiple choice (page 47)****Correct answer: B** Electricity [1 mark]

PED of 0.3 (or  $-0.3$ ) means the demand is price inelastic. The product is therefore likely to be a necessity and lack substitutes. Hence, the most likely option is electricity.

**Practice question: structured question (page 50)**

**a**  $\% \Delta Q = (1,350 - 1,215) / 1,215 \times 100 = 10\%$

$$\% \Delta P = (4 - 4.6) / 4 \times 100 = -15\% [1]$$

$$\text{Price elasticity of demand (PED)} = 10 / -15 = -0.67 [1]$$

1 mark for showing working out.

1 mark for the correct answer.

Maximum of 2 marks.

**b** Total revenue before price change =  $\$4 \times 1,350 = \$5,400$

$$\text{Total revenue after price change} = \$4.60 \times 1,215 = \$5,589$$

$$\text{Change in total revenue} = 5,589 - 5,400 = +\$189$$

1 mark for showing working out.

1 mark for the correct answer.

Maximum of 2 marks.

**c** Explanations of how knowledge of price elasticity of demand can be of use to Sharma Fabrics include:

- Knowing that the price elasticity of demand for its product is price inelastic ( $-0.67$ ) [1], Sharma Fabrics can increase its price knowing that total revenue will increase (by \$189) [1].
- Knowledge of the price elasticity of demand can also inform Sharma Fabrics about the extent to which the firm has market power [1], e.g. if demand becomes more price elastic owing to more competitors in the market, the firm may need to improve the marketing of its products to attract more customers [1].

Up to 2 marks for each ( $\times 2$ ) correct explanation.

Maximum of 4 marks.

## Sample answers to chapter review questions

The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.

**Chapter review questions (page 50)**

**1** Price elasticity of demand (PED) is a measure of the extent to which demand for a product changes due to a change in its price.

It is calculated using the formula:

$$\frac{\text{percentage change in quantity demanded}}{\text{percentage change in price}}$$

- 2 If firms have products with price inelastic demand, an increase in price will increase total revenue because the percentage decrease in quantity demanded will be less than the percentage increase in price.

If firms have products with price elastic demand, a reduction in price will increase total revenue because the percentage increase in quantity demanded will be greater than the percentage decrease in price.

3



- 4 The key determinants of PED are: time, habits, addictions, taste, fashion, percentage of income spent on the good/service, whether the good is a necessity, availability of substitutes, price of substitutes, the degree of substitution, costs of switching, and durability.
- 5 Knowledge of PED helps consumers to determine whether they can take advantage of price discrimination. For example, theme parks charge adults different prices from children and they also offer discounts for families and annual pass holders. Old-age pensioners can benefit from cheaper prices on public transport. Tax on demerit goods may discourage consumers from buying harmful goods.
- 6 Knowledge of PED enables producers to determine their pricing strategies (to maximise sales revenues). For example, if a producer has many substitutes for its goods, it may use non-price strategies to attract customers.
- 7 Workers can use their knowledge of PED to negotiate wages. For example, if demand for the product they produce is price inelastic, then a larger wage increase can be negotiated as consumers are less sensitive to an increase in the price of the product the workers produce.
- 8 Knowledge of PED helps governments to determine their tax policies (to maximise tax revenues). For example, the government can impose heavy taxes on demerit goods, such as petrol and cigarettes. Taxing price inelastic products ensures the government can collect large sums of tax revenue without really affecting the overall demand for the product (so there is minimal impact on sales revenues and jobs).

## Section 2: The allocation of resources

### Chapter 11: Price elasticity of supply

#### Answers to activities

##### Activity (page 53)

Student's own responses, which may cover the following:

- a** The price elasticity of supply (PES) of smartphones is likely to be price elastic. Producers mass produce these, so they can adjust supply quickly according to the level of market demand.
- b** The PES of organic vegetables is likely to be price inelastic. These products take longer to harvest than genetically modified or conventionally produced vegetables.
- c** The PES of fresh flowers is likely to be price inelastic due to the time it takes to grow fresh flowers. The weather can also have a large impact on the PES of fresh flowers.
- d** The PES of hotel buildings and related facilities is likely to be price inelastic as it will often take several years to construct hotels.
- e** The PES of Ferrari cars is likely to be highly price inelastic as it takes longer to build such luxury, often hand-made, cars than mass-produced cars.

##### Activity (page 55)

Students will also draw diagrams to illustrate their answers:

- a** Bananas – low PES due to the time needed to grow bananas. External factors, such as climate, weather conditions and crop infestations, can also reduce the supply of bananas.
- b** Fresh bread – high PES because of the short production process and the short shelf life requiring daily production. The technology and equipment for baking bread are relatively simple and widely available (so increasing production does not require significant investments or time). These factors enable bakeries to quickly and efficiently increase or decrease the supply of fresh bread in response to price changes.
- c** Computers – high PES due to the capital-intensive technologies used to mass produce computers. Large computer manufacturers produce millions of computers each year. Using specialised machinery means they can change the level of output (supply) very easily.
- d** Coal – very low PES due to the (very long) time needed for these fossil fuels to be produced. An increase in the price of coal will do very little to increase the supply of coal, at least in the short term.

## Sample answers to practice questions

The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.

### Practice question: structured question (page 51)

- a** Price elasticity of supply (PES) is calculated using the formula:

$$\frac{\text{percentage change in quantity supplied } (Q_s)}{\text{percentage change in price } (P)}$$

$$\% \text{ change in } Q_s = (120 - 110) / 110 \times 100 = 9.09\%$$

$$\% \text{ change in } P = (1.45 - 1) / 1 \times 100 = 45\% \text{ [1]}$$

$$\text{PES} = 9.09 / 45 = 0.2 \text{ [1]}$$

1 mark for showing working out.

1 mark for the correct answer.

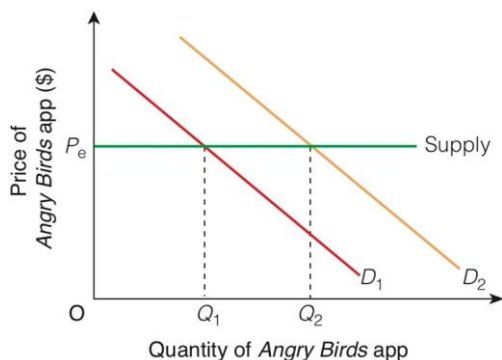
Maximum of 2 marks.

- b** The PES value of 0.2 indicates that the supply of mangoes is highly price inelastic [1]. This is because suppliers in Country X are unable to supply more produce despite a significant increase in price due to the time it takes to grow more mangoes [1].

Maximum of 2 marks.

### Practice question: structured question (page 54)

- a** Award up to 4 marks for a diagram that shows axes correctly labelled [1], a perfectly price elastic supply curve [1], a rightward shift in the demand curve (from  $D_1$  to  $D_2$ ) [1], and a higher quantity of *Angry Birds* (app downloads) demanded (from  $Q_1$  to  $Q_2$ ) [1].



Award up to 2 marks for a written explanation: The supply curve for *Angry Birds* games is perfectly price elastic [1] because Rovio can supply an extra unit of output at zero cost [1]. There is no additional cost of production because customers simply download the games app [1].

Maximum of 6 marks.

- b** Analysis might include:

PES measures how responsive Rovio is to changes in the price of its games [1]. Given the digital nature of *Angry Birds*, PES is perfectly price elastic [1]. This means that Rovio can quickly increase or decrease the supply of the game in response to price changes without

incurring significant additional costs [1]. The value of PES in this case is important as it means Rovio can respond almost instantaneously to changes in demand [1].

For example, the value of PES allows Rovio to offer promotions, discounts and special offers without worrying about inventory constraints as there is no physical stock of its games [1]. This can boost sales volume and overall revenue instantaneously [1]. Even if the price were to increase, the high value of PES means Rovio could supply more copies without any significant delay or cost [1]. Furthermore, regular updates to *Angry Birds* can be provided without significant delays, keeping the customer base engaged and increasing the game's lifespan and sales revenue potential [1].

*Up to 4 marks for application to the context.*

*Up to 2 marks for justified reasoning.*

*Maximum of 6 marks.*

## Sample answers to chapter review questions

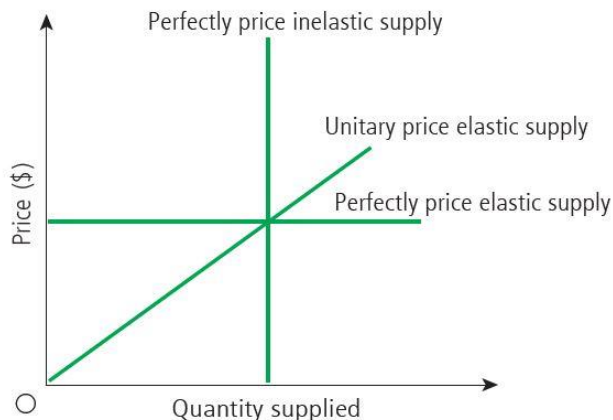
*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Chapter review questions (page 55)

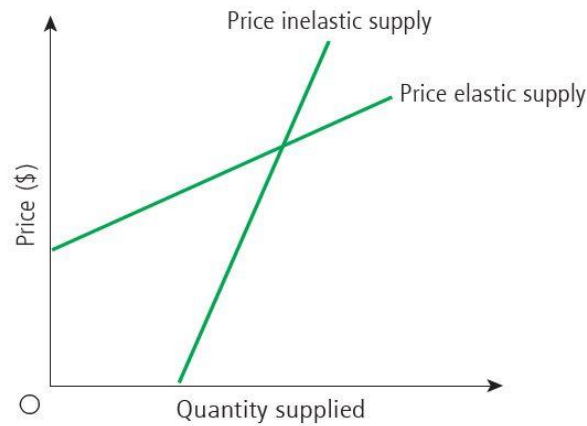
- 1 PES stands for price elasticity of supply. It measures the degree of responsiveness of the quantity supplied of a product following a change in its price.
- 2 PES is calculated using the formula:

$$\frac{\text{percentage change in quantity supplied}}{\text{percentage change in price}}$$

- 3 Perfectly price elastic supply is shown as a horizontal supply curve; unitary PES is shown by a supply curve that starts at the origin; perfectly price inelastic supply is shown by a vertical curve that intersects the  $x$ -axis.



- 4 Price elastic PES is shown by a supply curve that intersects the  $y$ -axis. Price inelastic PES is shown by a supply curve that intersects the  $x$ -axis.



- 5 The key determinants of PES are: spare capacity, stock (inventory) levels, number of firms in the industry, state of technology, ease/cost of factor substitution, the time period under consideration.
- 6  $PES = 0$  means supply is totally unresponsive to changes in price (perfectly price inelastic);  $PES = 1$  means supply matches the percentage change in price (unitary price elasticity);  $PES = \infty$  means supply only exists at one price level (perfectly price elastic), i.e. supply is independent of the price.
- 7 Perfectly elastic supply means firms can easily increase output due to spare capacity and/or high stock levels, without putting any pressure on costs of production. Perfectly inelastic supply means there can be no more output, even if prices rise, i.e. supply is at its capacity (maximum limit).
- 8 Possible reasons for why supply is generally less responsive to changes in price in the short term include production constraints (time lags), capacity utilisation (no spare capacity) and resource availability (the lack of suitable resources, including skilled labour).
- 9 Possible reasons for why supply is generally more responsive to changes in price in the long term include technological advancements, greater production capacity, economies of scale and resource mobilisation (greater factor mobility).

## Section 2: The allocation of resources

### Chapter 12: Market economic system

#### Answers to activities

##### Activity (page 57)

Student's own responses, depending on what they are able to research for the various countries in Table 12.1. Students are likely to find that there is a high degree of correlation (positive relation) between a country's real GDP per capita and its level of economic freedom.

##### Activity (page 58)

Student's own responses. Some pointers that students might find useful are:

- [www.packaging-gateway.com/features/pester-power-protecting-children-from-junk-food-marketing/?cf-view](http://www.packaging-gateway.com/features/pester-power-protecting-children-from-junk-food-marketing/?cf-view)
- [www.brandhome.com/home/bla/pester-power/](http://www.brandhome.com/home/bla/pester-power/)
- <https://natwest.mymoneysense.com/parents/articles/dealing-with-pester-power/>

#### Sample answers to practice questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

##### Practice questions: multiple choice (page 58)

**1 Correct answer: A** Market economic system [1 mark]

In a free market system, individuals and firms are incentivised to pursue their own best interests, as dictated by the market forces of demand and supply. The price mechanism decides what, how and for whom production should take place.

**2 Correct answer: B** Incentives to work [1 mark]

The market economic system creates incentives for firms and individuals to work. Firms are incentivised by the profit motive and individuals have the potential to earn unlimited wealth. Hence, this economic system helps to encourage economic growth in a country. Options A, C and D involve government intervention in the market, so are part of a mixed economic system.

#### Sample answers to chapter review questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

##### Chapter review questions (page 59)

- 1** An economic system is the structure of the economy and how it is organised in terms of how best it allocates scarce resources and addresses the three fundamental economic questions of what, how and for whom production should take place.

- 2 The two main types of economic system are market (or free market) and mixed.
- 3 The key features of the market economic system are: a system that relies on the market forces of demand and supply to allocate resources; relies on the private sector for economic activity; economic agents driven by incentives (e.g. wages, salaries and profits).
- 4 The advantages of operating a market economy are: efficiency (due to competitiveness of markets); freedom of choice; incentives to produce and work.
- 5 The disadvantages of operating a market economy are: income and wealth inequalities; environmental issues; social hardship; wasteful competition.

## Section 2: The allocation of resources

### Chapter 13: Market failure

#### Answers to activities

##### Activity (page 62)

a Private benefits may include:

- government and private businesses receive income from tourists
- government receives tax revenue from private businesses
- tourists learn about the history and culture of Peru.

External benefits may include:

- increase in living standards in the region
- improvements in roads, communication technologies, railways and infrastructure
- increase in employment opportunities and incomes.

External costs may include:

- air and water pollution caused by more people visiting the region
- degradation of Machu Picchu
- loss of local culture
- destruction of natural environment and depletion of resources
- overcrowding.

Private costs may include:

- costs to private businesses of running tours, hotels, restaurants, trekking companies.

b Students should choose a popular tourist destination in their country and research the social costs and benefits of tourism. They can try to judge the short-term and long-term consequences of tourism and decide whether costs outweigh benefits or vice versa.

##### Activity (page 62)

- **Dental health check-ups** create social benefits because they can resolve dental problems and prevent them causing long-term health problems. Regular dental health check-ups contribute to the overall health of society because the population will be healthier, people will take fewer days off work due to sickness, and they are therefore more productive.
- **Art museums** create social benefits because they provide leisure and educational opportunities for the whole of society if the museums are free or cost a small amount to visit. Visits to art museums may contribute to the wellbeing of people as well as providing inspiration and educational opportunities for all members of society. Art has historically always been an important part of every society.
- **Consumption of soda/fizzy drinks** creates social costs because over-consumption can lead to obesity, diabetes, poor dental health and other health-related problems that can put a strain on

the health service and mean that people may have to take more days off work because of poor health. This will lower the productivity of an economy.

- **Overuse of antibiotics** creates social costs because bacteria become resistant to the antibiotics, which then become less effective against bacterial infections. Bacterial infections may arise that are resistant to antibiotics and cannot be treated, posing a threat to society, especially the very young, very old and those with reduced immunity to diseases.
- **A person using a phone while driving** creates social costs because they may not be focusing on driving and may cause an accident.
- **Single-use plastic bags** cause social costs because plastic is not biodegradable and adds to landfills or may end up in the ocean, causing major environmental problems.
- **Reusable straws** create social benefits because they prevent the use of single-use straws which add to landfill and are non-biodegradable.

### Activity (page 62)

Private costs of smartphones	Private benefits of smartphones	External costs of smartphones	External benefits of smartphones
Purchase price	Online maps	Excessive screen time	Self-education
Monthly fee for internet and phone access	Calculator	Distraction, leading to accidents	Online working
Data-roaming charges	Educational resources	Cybercrime	Government forms and facilities can be accessed online instead of in-person
	Online banking and shopping	Cyberbullying	

### Activity (page 65)

Student's own responses.

Drones can cause noise pollution and visual pollution, and they can invade people's privacy. On the other hand, they can provide instant aerial images of land and buildings, and may cut costs when surveying areas. Drones can also help emergency services with rescue missions.

### Activity (page 65)

Examples of market failure caused by the oil spill in the Philippines

External costs include:

The oil spill spread over 75 miles of ocean and had a major impact on the lives of 21,000 families who relied on the ocean for food and livelihood. The environmental damage to the ocean caused loss of marine life and damage to natural habitats. The spillage may affect 20 areas of biodiversity in the region, which could cause long-term damage to ecosystems.

Local communities relied on fishing for income and food. Many therefore suffered loss of business, e.g. fishers could no longer catch fish, tourism in the area decreased, and hotels, restaurants and local attractions experienced a loss of business and therefore employees lost their jobs. The increase in unemployment may have caused a decrease in spending on goods and services in shops and businesses in the area. The government paid people to clean up the damage but the compensation does not match the level of income earned before the spill. People face a decrease in living standards.

Economic concepts include: scarcity of resources, social costs of transporting oil are greater than the private costs because of damage to the environment. There are spillover effects to third parties of extracting and using oil and therefore there is market failure.

There is a decrease in economic activity in the area caused by a loss of income from fishing and tourism. People therefore face lower standards of living.

## Sample answers to practice questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Practice question: structured question (page 63)

Flood defence systems are non-excludable [1] because it is impossible to prevent somebody from benefiting from them. They are also non-rivalrous [1] because there is no competition for the flood defence system [1]. A person or business benefiting from the flood defence system will not have any impact on the amount of flood barriers available for others [1].

*Maximum of 4 marks.*

### Practice questions: structured questions (page 64)

**1** Public goods are non-excludable and non-rivalrous in consumption, e.g. street signs [1]. It is impossible to prevent somebody from using a street sign, and if a person reads a street sign, the street sign is still there for everybody else to use [1].

Merit goods are under-produced and under-consumed in society [1]. A government provides services such as education and healthcare for people because if these services were left to the market mechanism to provide they would be under-consumed, as not all members of society would be able or willing to pay for education and healthcare [1].

Merit goods are excludable and rivalrous, unlike public goods [1]. For example, if a person is using a hospital bed, then another person cannot use the bed. It is also possible for a hospital to exclude somebody from using its services because they do not live in the area [1].

*Up to 4 marks for correctly setting out the difference between public goods and merit goods.*

*Maximum of 4 marks.*

**2** Analysis of the reasons why a government might choose to provide public goods and merit goods includes:

- A government may choose to provide public goods and merit goods because they both provide social benefits [1].
- Examples of public goods include street signs, road markings, traffic lights, lighthouses, street lighting, national defence and flood barriers [1].

- As public goods are non-excludable, it is impossible to charge a person for taking advantage of them and therefore they cannot be provided in a free market [1], i.e. there is market failure as markets fail to allocate resources efficiently [1]. Governments therefore step in and provide these essential goods and services [1], and people are charged indirectly through tax revenue [1].
- A government may choose to provide merit goods, such as education, healthcare, parks, sport and leisure facilities, and museums [1] to society because if provision of such services were left entirely to the private sector, the price charged to consumers to use the service would probably exclude a proportion of society from consuming the service [1].
- Merit goods provide external benefits to society [1] as they lead to a better educated, more highly skilled and healthier workforce [1], which will increase the overall productivity of the economy [1].
- Merit goods are also provided by the private sector in most economies and therefore consumers have a choice [1].

*Up to 4 marks for application to the context.*

*Up to 2 marks for justified reasoning.*

*Maximum of 6 marks.*

### Practice question: multiple choice (page 66)

**Correct answer: B** Museum [1 mark]

Museums are merit goods, rather than public goods. Museums are rivalrous (there is a maximum capacity) and often excludable (many museums charge for entrance).

## Sample answers to chapter review questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Chapter review questions (page 66)

- 1 Market failure occurs when the market forces of demand and supply are unsuccessful in allocating resources efficiently and cause external costs or external benefits. Examples include: merit, demerit and public goods, exploitation of monopoly power, negative and positive externalities.
- 2 Three examples of market failure are noise pollution, litter and cigarette smoke.
- 3 External costs are the negative side-effects of production or consumption incurred by third parties for which no compensation is paid. Social costs are the true (or full) costs of consumption or production to society as a whole, i.e. the sum of private costs and external costs. Private costs are the costs arising from the consumption or production of a good or service which are incurred by an individual, firm or government.
- 4 External benefits are the positive side-effects of production or consumption experienced by third parties for which no money is paid by the beneficiary. Social benefits are the true (or full) benefits of consumption or production, i.e. the sum of private benefits and external benefits. Private benefits are the benefits arising from the consumption or production of a good or service which are experienced by an individual, firm or government.

- 5 Public goods are goods and services that are non-excludable and non-rivalrous and which are a cause of market failure as there is a lack of a profit motive to produce them.
- 6 Merit goods are goods or services which when consumed create positive spillover effects in an economy. Demerit goods are goods or services which when consumed cause negative spillover effects in an economy.
- 7 The social benefits of public provision of education are: greater human capital; increased skills of the workforce can lead to greater productivity in the economy and economic growth; a higher level of education can lead to increased incomes and higher standards of living.
- 8 Without government control, certain private sector firms could grow to become monopolies and exploit their market power by charging higher prices or reducing supply. In general, profit-maximising monopolists lack incentives to be competitive, so create inefficiencies in the market.
- 9 Governments provide public goods such as street lighting and lighthouses because the private sector (the market) fails to provide them: the private sector cannot charge people for using public goods. If the government did not step in there would be a missing market, and essential goods and services would not be provided to society.
- 10 Single-use plastics are over-consumed by individuals and business organisations. They create external costs and therefore costs to society. Examples of such external costs include plastic pollution, health hazards, waste management costs and impact on the natural environment. Private individuals and business organisations do not pay the external costs to society of the pollution caused by consumption of single-use plastics.

## Section 2: The allocation of resources

### Chapter 14: Mixed economic system

#### Answers to activities

##### Activity (page 68)

Student's own responses.

Students could discuss the merits of government versus private sector provision of certain goods or services. Alternatively, students could consider the merits of being well paid for certain professions (in a free market economy).

##### Activity (page 73)

Possible responses could include impacts on employment; ineffective government knowledge; ability of government to collect tax revenues (not possible if alcohol is banned); the consumption of limited amounts of alcohol plays a role in certain traditional practices in some cultures.

##### Activity (page 73)

Student's own responses, which may vary between countries. Examples could include:

- compulsory use of seat belts in cars
- compulsory schooling for a number of years
- compulsory vaccinations
- restrictions on where people can smoke
- ban on talking on mobile phones or eating and drinking whilst driving
- restrictions on whether or where alcohol can be purchased
- minimum age for alcohol, cigarettes and gambling
- minimum age for driving

##### Activity (page 74)

The aim of the activity is to encourage students to think critically in order to assess the effectiveness of the measures taken by the government in students' home countries. Examples of measures may include:

- laws about the legal minimum age for purchasing cigarettes
- laws governing where people can smoke
- public health warnings on cigarette packets
- shocking images on cigarette packets showing potential and long-term effects of smoking
- education programmes in schools informing young people about the negative impacts of smoking
- tax on cigarettes to increase the purchase price in an attempt to decrease sales.

## Activities (page 76)

- 1 Student's own responses. Discussions should focus on economic arguments for and against privatisation of a country's postal and telecommunications services.
- 2 Student's own responses. Discussions should focus on economic arguments for and against privatisation of educational services provided by schools and universities.

## Sample answers to practice questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Practice questions: structured questions (page 67)

- 1 In a mixed economy, both the private and public sectors allocate resources [1]. The public sector provides both public goods (e.g. street lighting and national defence) and merit goods (e.g. education and healthcare services) [1]. Private individuals and firms, driven by profit, supply goods and services in the private sector [1], e.g. groceries, clothing, furniture, outbound tourism, hair cuts and cars [1].

*Maximum of 4 marks.*

- 2 Whether education should be funded by the government depends on several factors and viewpoints, including the following:
  - The economic system that a country operates – for example, a free market economy will have more private sector education, offering services to those who are willing and able to pay.
  - The perceived benefits of education – in countries where the culture values education highly, it will get more funding from both the government and private sector providers. Education brings about positive externalities (side-effects) for society, although these vary between countries.
  - The size of the government budget – a government running a huge budget deficit is less able to fund educational services.
  - Opportunity cost – if the government deems education to be of lower importance (priority) than other items of government spending (e.g. healthcare, public transport, protection of the environment and rectifying the problems of unemployment), then government funding for education will be lower.

Award marks according to the following mark scheme:

Level	Description	Marks
Strong answer	Excellent knowledge and understanding of relevant economics concepts, using appropriate terminology in context. Detailed discussion of whether education should be funded by the government. Students who develop <b>three</b> viewpoints in a considered way, with well-justified reasoning, including why alternative viewpoints are rejected, should be rewarded with the top marks in the band.	6–8

Moderate answer	Good knowledge and understanding of relevant economics concepts, using appropriate terminology in context. Detailed discussion of at least <b>one</b> viewpoint. Judgement with some justification/evaluation of choices made. Students should be rewarded with top marks in the band if there is discussion of <b>two</b> viewpoints in detail.	3–5
Weak answer	Limited knowledge and understanding of relevant economics concepts in context. Limited ability to discuss whether education should be funded by the government, with little or no expression of viewpoints. Students who state <b>one</b> viewpoint and give a reason for coming to their decision should be rewarded with the top mark in the band.	1–2
	No creditable response.	0

### Practice question: structured question (page 71)

- a** An external cost of driving a car is a cost endured by third parties [1], e.g. air pollution, noise pollution, congestion and visual pollution caused by a traffic jam [1].

*Maximum of 2 marks.*

- b** Stakeholders of the congestion charge include pedestrians, car drivers, local residents, local businesses, bus drivers and people who work in the area. Analysis of the advantages and disadvantages for any two of these stakeholders might include the following.

#### **Pedestrians and local residents**

The congestion charge may make it easier for pedestrians and local residents to cross the road [1] and there should be less air pollution due to the reduced amount of traffic [1]. Public transport, e.g. buses, should be able to run more efficiently without traffic jams [1]. However, local residents may face higher costs when driving into central London [1]. There may be knock-on effects [1] on local residents if businesses see a decline in trade due to the congestion charge [1]. There may also be social disadvantages [1], as friends and family will find it more difficult to visit people living in central London [1].

#### **Car drivers**

If car drivers are prepared to pay the congestion charge, they should be able to travel more quickly and easily [1] in central London as there will hopefully be less congestion [1]. Parking within central London [1] should be easier due to the decreased number of cars [1]. However, if drivers need to access central London by car, the private costs to the driver will increase [1]. The congestion charge is a regressive tax [1] and will affect those on a low income more than those on a high income [1]. The areas outside central London may become more congested [1] as drivers choose not to enter central London and park outside the congestion charge area [1].

#### **Local businesses**

For local businesses, the congestion charge may result in less air and noise pollution [1]. The area may become more attractive to users of public transport [1] and this may increase trade for local businesses [1]. However, local businesses may have fewer customers [1] if people avoid the area due to increased costs of access [1]. They may lose trade to businesses located outside central London [1] as customers choose not to travel inside the congestion zone [1]. They may also face higher transport costs [1] for the goods and services they require for their business.

**People who work in the area**

People working in the area may experience less congestion in central London [1], which will result in less air pollution and less noise pollution [1]. Public transport, e.g. buses, should be able to run efficiently without traffic jams [1]. However, workers may face higher costs for driving into central London [1] and their journey to work may become longer [1] if they need to drive and then take public transport [1].

*Up to 3 marks for the advantages and disadvantages of the congestion charge for each (×2) relevant stakeholder.*

*Maximum of 6 marks.*

- c** The congestion charge may be a short-term solution because:
- Higher costs lead to fewer cars entering central London.
  - The congestion charge raises revenue for the government.
  - Fines imposed for non-payment of the congestion charge may deter people from not paying the charge.

The congestion charge may be a long-term solution because:

- The short-term success may lead to a long-term solution as people change their driving habits and may choose not to drive into central London.
- The congestion charge may make many people choose public transport over driving.
- There may be a cultural shift away from cars to public transport or cycling, which cause fewer external costs.
- Awareness is raised about the negative impact of driving cars into central London and, in the long term, people may choose greener methods of transport.
- On the other hand, the congestion charge may not be effective in changing people's driving habits and drivers may simply get used to paying the charge.
- Drivers may visit shops and businesses outside of central London instead of within central London. This may result in congestion in these areas and a decrease in sales revenue for shops within central London.

Award marks according to the following mark scheme:

Level	Description	Marks
Strong answer	Excellent knowledge and understanding of relevant economics concepts, using appropriate terminology in context. Detailed discussion of whether the congestion charge is a long-term or short-term solution to the problem of traffic congestion in London. Students who develop both viewpoints in a considered way, with well-justified reasoning, including why the alternative viewpoint is rejected, should be rewarded with the top marks in the band.	6–8
Moderate answer	Good knowledge and understanding of relevant economics concepts, using appropriate terminology in context. Detailed discussion of at least <b>one</b> viewpoint. Judgement with some justification/evaluation of choices made. Students should be rewarded with top marks in the band if there is discussion of <b>two</b> viewpoints in detail.	3–5

Weak answer	Limited knowledge and understanding of relevant economics concepts in context. Limited ability to discuss whether the congestion charge is a long-term or short-term solution to the problem of traffic congestion in London, with little or no expression of viewpoints. Students who state <b>one</b> viewpoint and give a reason for coming to their decision should be rewarded with the top mark in the band.	1–2
	No creditable response.	0

## Sample answers to chapter review questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Chapter review questions (page 78)

- 1 A mixed economic system is a combination of government-controlled resource allocation and a market economic system.
- 2 The advantages of operating a mixed economic system are that the government provides services for everyone while most other goods and services are competitively marketed. Producers and workers have incentives to work hard, to invest and to save. The disadvantages are that public sector activities must also be funded by taxes, and consumers still pay higher prices due to the profit motive of private sector businesses.
- 3 A maximum price occurs when the government sets a price below the market equilibrium price in order to encourage consumption. Governments use this price control system in order to make goods and/or services more affordable, e.g. rent controls.
- 4 A minimum price occurs when the government sets a price above the market equilibrium price in order to encourage output of a certain good or service. Governments use this price control system in order to encourage the supply of goods and/or services, e.g. minimum wages to create incentives to work.
- 5 Indirect taxation causes higher production costs, so forces the price to increase, thereby contracting demand.
- 6 Subsidies encourage firms to produce more. The subsidy reduces a firm's costs of production and/or encourages individuals to consume more, as the price is lower with a subsidy.
- 7 Rules and regulations may help to control economic activity in certain markets, e.g. for the purchase and consumption of alcohol, tobacco and petroleum.
- 8 Privatisation is the transfer of the ownership of assets from the public sector to the private sector, so they can be run more efficiently. It allows for increased competition, and private sector businesses have the incentive to improve efficiency, as they need to remain competitive. Nationalisation is the purchase of private sector assets by the government. This can protect employment and promote economic stability in key industries.
- 9 Quotas are government-imposed limits on the quantity of a good or service that can be produced, consumed or traded. They are used to correct market failures and to conserve natural resources.

## Section 3: Microeconomic decision-makers

### Chapter 15: Money and banking

#### Answers to activities

##### Activities (page 81)

- 1 Students are likely to include the *purpose* or *use* of money in modern society, e.g. to facilitate international trade and exchange. Money is also a powerful means of motivating the workforce.
- 2 Methods of payment used may include:
  - digital wallets, such as Apple Pay, Samsung Pay, Alipay, WeChat
  - cheques
  - cash
  - credit/debit cards
  - cryptocurrency
  - Unified Payments Interface and QR code payments
  - Buy Now Pay Later (BNPL)
  - prepaid cards
  - Autopay.

##### Activities (page 83)

- 1
  - a The high rates of inflation were caused by the global decrease in oil prices, causing demand for the bolívar to fall. Venezuela was highly dependent on revenue from oil exports and the drastic fall in the value of the currency meant that the cost of imports rose rapidly. People started to leave the country, taking their savings with them. Foreign firms departed, which further decreased demand for the currency. The government printed money in order to try to reduce its economic problems. Venezuelans converted savings into other currencies such as the US dollar to protect the value of their savings. The printing of money and conversion of savings into other currencies caused the supply of the bolívar to increase. The combination of an increase in the supply of and decrease in demand for the bolívar caused its value to fall.
  - b Venezuelans converted their savings from the local currency to US dollars in an attempt to preserve the value of their savings. This caused a further decrease in the value of the bolívar. A parallel (informal market) for US dollars has been created. The US dollar is the preferred currency as a unit of account and a store of value. Venezuelans may prefer to use currencies from other nations because they have lost confidence in their own currency.
- 2 Students are likely to consider the main functions of money when tackling this activity. For example, milk is not a store of value. Cloth is divisible but not a universally accepted (recognised) medium of exchange, as not everyone wants cloth. Fish is difficult to divide, so makes a poor unit of account. Cigarettes are not widely accepted, i.e. non-smokers would have little use for cigarettes.

### Activity (page 83)

Students are likely to consider the main functions of money when tackling this activity and the need for a double coincidence of wants when bartering. They may also consider the needs and wants of people in their country to be complex, making bartering more complicated.

### Activity (page 84)

Facts about the role of the central bank may include the following:

- monetary authority that oversees and manages the money supply and the banking system of the nation
- responsibility for overseeing monetary policies
- responsibility for the nation's entire money supply
- role in manipulating interest rates to affect the economy
- the sole issuer of bank notes and coins
- the government's bank
- the bankers' bank
- the lender of last resort.

### Activities (page 86)

1 Reasons for central banks providing financial bailouts to commercial banks include:

- to prevent huge job losses and socioeconomic failures on a mass scale
- to prevent people losing their life savings
- to prevent a 'run on the bank', which occurs when all depositors request withdrawal of their savings at the same time, leading to bankruptcy
- banks operate payment systems for businesses and shops, and if that mechanism stops, then the economy will grind to a halt
- if a bank closes, there will be a loss of confidence in the banking system and this pessimism may spread to other banks in the system, which in turn may collapse.

Reasons against central banks providing financial bailouts to commercial banks include:

- Commercial banks should be able to prevent bankruptcy and should not take unnecessary risks.
- Use of government funds to bail out banks has a huge opportunity cost.
- The cost of the bailout may be very high – perhaps a large proportion of the GDP of a country.
- It is not fair for taxpayers' funds to be used to bail out banks when it is the responsibility of owners and managers to make sure that the bank remains solvent.
- Banks should not take unnecessary risks that lead to bankruptcy.

2 Students' own posters.

## Sample answers to practice questions

The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.

### Practice question: structured question (page 83)

- a** Bartering is the act of swapping items in exchange for other items [1] through a process of bargaining and negotiation, due to the absence of money in the economy [1].

Maximum of 2 marks.

- b** Analysis, with reference to the functions of money, of why bartering is an ineffective method of trading might include:
- **Medium of exchange** [1] – not all items used for bartering are widely recognised or accepted as a medium of exchange [1]. Someone may have a camel to trade while another person has a necklace, but neither party may want what the other one has [1].
  - **Measure of value** [1] – how much is a camel worth in terms of the necklace [1]?
  - **Store of value** [1] – while the necklace can be stored for future use, storage is rather more difficult with the camel. As the camel becomes older, its value will drop [1].
  - **Standard for deferred payment** [1] – while a camel or necklace might be accepted as payment today, there is no guarantee that these items will be widely accepted as a standard for deferred payment to pay off debts in the future [1].

Up to 4 marks for application to the context.

Up to 2 marks for justified reasoning.

Maximum of 6 marks.

### Practice questions: structured questions (page 87)

- 1** Possible answers for one *primary* function of a commercial bank, such as ICBC or CCB, include:
- accepting deposits from their customers [1], e.g. private individuals, business customers and governments [1]
  - making advances (loans) to customers [1], e.g. overdrafts, loans and mortgages [1]
  - credit creation [1], which enables borrowers (or debtors) to gain purchasing power with the promise to pay the lender (or creditor) at a future time [1].

Students might select a *secondary* function of a commercial bank, such as:

- offering additional financial services [1], e.g. tax advice, foreign exchange and the buying and selling of shares [1]
- providing money transfer facilities [1], e.g. transferring money to pay various utilities bills or to an overseas bank account [1].

Maximum of 2 marks.

- 2** Explanations of two key functions of central banks, such as the People's Bank of China, might include:

- The People's Bank of China is the sole issuer of banknotes and coins [1], i.e. it is the only authority that can print banknotes and mint coins in China. This helps to bring uniformity to China's monetary system and improves public confidence in it [1].
- It is the government's bank [1] – the People's Bank of China operates as a banker to the Chinese government, e.g. making payments for items of government expenditure and managing public sector debt [1].
- It is the bankers' bank [1] – the People's Bank of China acts as the bank for other banks in the country, overseeing the cash reserves of commercial banks such as ICBC and HSBC [1].
- It is the lender of last resort [1] – the People's Bank of China will lend to the banking system during financial emergencies, thereby stabilising the country's banking system [1].

Up to 2 marks for each ( $\times 2$ ) correct key function of central banks.

Maximum of 4 marks.

### Practice questions: multiple choice (page 88)

**1 Correct answer: B** Portability [1 mark]

Portability is a *characteristic* of money, whereas the other options are *functions* of money.

**2 Correct answer: A** Bartering [1 mark]

Bartering describes the act of swapping items in exchange for other items in the absence of money.

## Sample answers to chapter review questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Chapter review questions (page 88)

- 1 Money is any commodity that can be used as a medium of exchange for the purchase of goods and services, e.g. banknotes and coins.
- 2 Banknotes and coins (collectively called legal tender), gold, bank account deposits and central bank reserves are various forms of money.
- 3 Medium of exchange, unit of account, standard of deferred payment and store of value are the key functions of money.
- 4 Durability, acceptability, divisibility, uniformity, scarcity and portability are the main characteristics of money.
- 5 The central bank of a country is the monetary authority that oversees and manages the economy's money supply and the banking system.
- 6 Central banks have four key functions: the sole issuer of legal tender, the government's bank, the bankers' bank and the lender of last resort.
- 7 A commercial bank is a retail bank that provides financial services to its customers, e.g. savings, bank loans and mortgages. A central bank does not provide banking services to individuals or firms.

- 8 Functions of commercial banks include accepting deposits, making (approving) advances, credit creation and a range of other banking services (e.g. cheque clearance, foreign exchange dealings, money transfer facilities and online banking).

## Section 3: Microeconomic decision-makers

### Chapter 16: Households

#### Answers to activities

##### Activities (page 91)

USA:

- Personal disposable income saw a steady rise over the period 2014–2024, from approximately \$13,000 bn to over \$20,000 bn. A significant fluctuation occurred in the period between 2020 and 2021 due to the impact of the COVID-19 pandemic, where disposable income increased to a record high of nearly \$22,000 bn but then fell.
- Consumer spending rose steadily throughout the period, reaching close to \$16,000 bn by 2024.
- This suggests that there is a positive relationship between the two variables (real personal disposable income and consumer spending).

Japan:

- Personal disposable income increased moderately over the period 2014–2024, from approximately ¥400,000 to ¥465,000; however, there were many severe fluctuations within the period, ranging between approximately ¥950,000 and ¥300,000.
- Consumer spending wasn't vastly different at the beginning and end of the period at just below ¥300,000 bn, but showed a high degree of fluctuation from a high of approximately ¥305,000 bn in 2019, and a low of approximately ¥275,000 bn in 2020.
- This also suggests that there is a positive relationship between the two variables.

UK:

- Personal disposable income overall showed a steady rise in the period 2014–2024, from approximately £310,000 m to just over £325,000 m. However, there were some fluctuations within the period. It dipped in 2020 due to the COVID-19 pandemic and then rose again to follow an overall upward trend.
- Consumer spending rose a little each year from 2014 to 2020, then dipped because of the COVID-19 pandemic to £265,000 m in 2020. It increased to approximately £345,000 m by late 2021 and has remained almost constant since then despite disposable income rising.
- This also suggests that there is a positive relationship between the two variables but that possible lack of confidence in the UK economy from 2021 until 2024 has prevented consumer spending from increasing.

##### Activity (page 93)

a Discussion points could include:

- Yoshie's consumer spending would decrease as she is repaying the loan and there would be a negative wealth effect as her property would be worth less than she paid for it.
- Yoshie's savings would decrease as she has less disposable income to save and is repaying the loan.

- Yoshie would not borrow any more money as she needs to repay her current debt.
- b** Possible options for repaying the mortgage include:
- selling the property and repaying the loan
  - continuing to repay the loan and living in the apartment
  - continuing to repay the loan, living in the apartment and selling the apartment when the value of the property has increased.

### Activity (page 94)

Age	Spending	Saving	Borrowing	Dissaving
16–25	High	Low	Low	–
26–35	Moderate	Moderate	High	–
36–45	Moderate	High	High	–
46–65	Moderate	High	Low	–
66 onwards	High	Low	Low	Yes

### Activity (page 97)

Possible costs (limitations) could include high interest charges on mortgage payments; burden on society to work to save for a deposit to secure a mortgage and to pay it off, and the pressures associated with doing so; instability due to fluctuating interest rates; possibility of house prices falling (negative equity).

Possible benefits (advantages): in the long term, owning your own home is cheaper than renting; house prices can increase (capital growth); financial security of owning your own home without anxiety/stress of rents increasing or being evicted by the landlord.

## Sample answers to practice questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Practice question: structured question (page 95)

- a** Answers for how spending patterns in the UK might be different from those in less economically developed countries, such as Bangladesh, could include:
- The chart (Figure 16.6) shows that family spending in the UK on transport, recreation and culture is high at approximately £145 per week. This suggests that people may own a car and have time and money to fund recreational and cultural activities [1]. In a less economically developed country, such as Bangladesh, families may have less disposable income so less money may be spent on transport, recreation and culture [1].
  - In the UK only about £14 per week is spent on healthcare and education, but in Bangladesh these services may not be available for free [1] and so a greater percentage of families' income may be spent on health and education [1].

*Maximum of 2 marks. Award full marks only if reference is made to the chart.*

- b** Reasons why spending on education and health is a small proportion of overall spending in the UK might include:
- Healthcare and education are provided by the public sector and therefore are free to UK citizens [1], so families do not need to spend large amounts on these services [1].
  - People are generally healthy [1] and therefore do not need to spend large amounts on healthcare [1].

*Up to 2 marks for each (×2) valid reason.*

*Maximum of 4 marks.*

- c** A person on a low income may spend a higher proportion of their income on food because it is a necessity [1].

### Practice question: structured question (page 98)

- a** Two reasons why borrowing might have increased in Canada are:
- The house prices increased, causing buyers to have to borrow more money to buy property [1].
  - An increase in house prices encouraged people to borrow against the value of their property [1].

*1 mark for each (×2) valid reason.*

*Maximum of 2 marks.*

- b** Analysis of the effect on the economy of a high ratio of borrowing to disposable income might include:
- A large amount of disposable income must be spent repaying the debt [1].
  - Interest has to be paid on the debt [1], which further decreases disposable income [1].
  - High debt repayments lead to less spending on goods and services [1] as people have less funds left after essentials have been purchased and debt repaid [1].
  - Economic growth may fall and unemployment rise [1] because of lower consumption [1].
  - People may default on the debt [1], which means that banks and other lenders face smaller profits [1].
  - Banks and lenders may not have many funds to lend to other businesses [1] because of low savings and bad debts [1].

*Up to 4 marks for application to the context.*

*Up to 2 marks for justified reasoning.*

*Maximum of 6 marks.*

- c** Reasons why some people spend more of their income than others include:
- Income (level of earnings) – high-income earners will spend a smaller proportion of their income than low-income earners.
  - Age (stage of life) – young people may spend a large proportion of their income because they have no dependants and are spending more on leisure and recreation.
  - Older people may spend more of their income because they have a family to support.

- People aged over 65 spend their income and their savings (they dissave) as they are no longer working and thus earning a wage.
- Culture/size of household – larger households spend more of their income than smaller households.
- In some cultures, people tend to save to purchase expensive items, such as cars and washing machines, rather than borrow to buy them. In other cultures, people buy expensive items by borrowing to buy them and paying back over a period of time.
- Confidence – if people feel confident about the future, e.g. during a boom, they will spend rather than save.
- Interest rates – if interest rates are low there is less incentive to save money in a bank account. People may spend rather than save.

Reasons why some people save more of their income than others include:

- Income (level of earnings) – high-income earners are able to save a higher proportion of their income than low-income earners.
- Age (stage of life) – people aged 30–65 have to save a proportion of their income for retirement. People with families may save for their children’s education.
- People aged over 65 and in retirement tend not to save as they are spending their savings.
- Culture – people’s attitude to savings may cause some to save rather than spend and borrow.
- Some countries offer only small retirement pensions and therefore people have to save for their retirement.
- Confidence – if people feel less confident about the future, e.g. during a recession or pandemic, they may save rather than spend.
- Interest rates – if interest rates are high, there is more incentive to save money in a bank account. People may save rather than spend.

Award marks according to the following mark scheme:

Level	Description	Marks
Strong answer	Excellent knowledge and understanding of relevant economics concepts, using appropriate terminology in context. Detailed discussion of <b>why</b> some people spend more of their income and others save more of their income. Students who discuss <b>three</b> reasons for spending and <b>three</b> reasons for saving, in context and with well-justified reasoning, should be rewarded with the top marks in the band.	6–8
Moderate answer	Good knowledge and understanding of relevant economics concepts, using appropriate terminology in context. Detailed discussion of at least <b>one</b> reason why some people spend more of their income and others save more of their income. Judgement with some justification/evaluation of choices made. Students should be rewarded with top marks in the band if there is discussion of <b>two</b> reasons in detail.	3–5
Weak answer	Limited knowledge and understanding of relevant economics concepts in context.	1–2

	Limited ability to discuss <b>why</b> some people spend more of their income and others save more of their income. Students who state and justify one reason should be rewarded with the top mark in the band.	
	No creditable response.	0

## Sample answers to chapter review questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Chapter review questions (page 99)

- 1 The main factors that affect the level of consumer spending in an economy are: level of disposable income (which depends on income levels and tax rates); interest rates (which impact on savings and borrowing); wealth; price levels (inflation); age; size of household; and business and consumer confidence levels.
- 2 A young family with two children under the age of 5 will have different spending patterns, e.g. food, clothing and toys for children, with minimal savings due to the high costs of raising children. They might have borrowed money to purchase a property. A pensioner may have less disposable income as they are retired, but they are unlikely to have many, if any, financial burdens.
- 3 Low-income earners spend a greater proportion of their income on necessities, and have a lower savings ratio. High-income earners can afford to save more *and* spend more on both necessities and luxuries.
- 4 It is possible for wealthy people simultaneously to spend more, save more and borrow more (e.g. in order to purchase more property).
- 5 Higher interest rates tend to reduce consumer spending and increase the incentive to save, but they reduce the level of borrowing (due to the higher costs involved).
- 6 The main determinants include: income levels; interest rates; tax rates; consumer and business confidence levels; attitudes towards savings and borrowing (culture); age of person.
- 7 The determinants for question 6 also affect the level of borrowing in an economy.
- 8 Personal circumstances might be the reason for one person saving more of their income than another, e.g. family size, age, stage in career, affordability, and attitude towards saving and borrowing.

## Section 3: Microeconomic decision-makers

### Chapter 17: Workers

#### Answers to activities

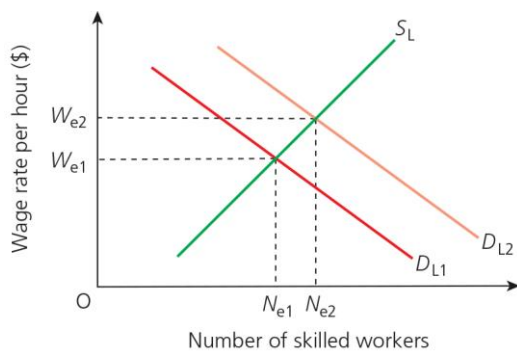
##### Activity (page 101)

Student's own responses.

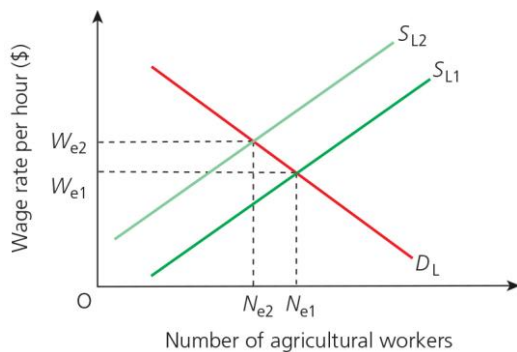
Reasons may include salary, non-financial benefits, career prospects, running their own business, satisfaction gained from employment, family business, enjoying the level of challenge and responsibility.

##### Activity (page 105)

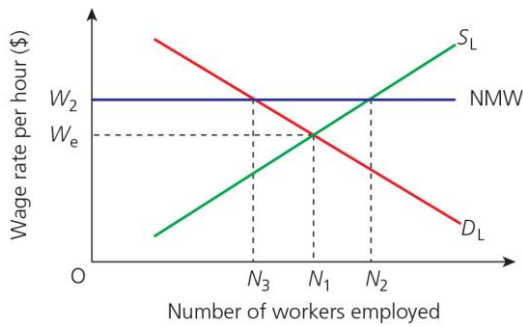
- a** The higher demand for skilled labour in the technology sector shifts the demand for labour curve from  $D_{L1}$  to  $D_{L2}$ , which results in an increase in the equilibrium wage rate per time period from  $W_{e1}$  to  $W_{e2}$ .



- b** A decrease in the supply of labour in the agricultural sector due to rural–urban migration will cause the supply of labour curve to shift from  $S_{L1}$  to  $S_{L2}$ . This results in fewer agricultural workers in the labour market, which therefore increases the equilibrium hourly wage rate from  $W_{e1}$  to  $W_{e2}$ .



- c** A government-imposed minimum wage ( $W_2$ ) that is set above the equilibrium wage rate in the retail sector ( $W_e$ ) will tend to cause an expansion in the supply of labour ( $S_L$ ) to  $N_2$  and a contraction in the demand for labour ( $D_L$ ) to  $N_3$ . Hence, there will be an initial surplus supply of labour in the market ( $N_2 - N_3$ ).



### Activities (page 106)

- 1 Younger workers have less experience and may be less qualified than those over 21. Wages tend to increase with experience. Employers may hire younger workers due to their cheaper cost, which gives younger workers valuable work experience.

Possible reasons why the national minimum wage (NMW) is lower in Hong Kong than in Australia include:

- The cost of living in Hong Kong could be lower than in Australia (at least in theory).
- The NMW has only been in existence in Hong Kong for a few years (it was introduced in May 2011) and is set at a very low rate so as not to increase unemployment.
- The Australian government may be more committed to redistributing income and wealth than the Hong Kong government and therefore the NMW is higher there than in Hong Kong.
- The NMW in Australia may need to be higher than welfare payments to encourage people to work instead of relying on welfare benefits.
- Trade unions in Australia may be more powerful than in Hong Kong and may have forced the government to enforce a higher NMW.

- 2 Student's own answers.

### Activity (page 108)

The government statistics site for each country should provide data on earnings. The aim of the exercise is for students to find real-life examples of wage differentials and to use their understanding of economic theories to explain these differentials.

#### Skilled versus unskilled

Skilled workers should earn more than unskilled workers.

#### Male versus female workers

In most sectors and types of employment, students should find that females, on average, earn less than males.

#### Private sector versus public sector

There is an informative article from the BBC on the public–private sector pay debate: ‘What’s the gap between public and private sector pay?’ by Anthony Reuben, 13 December 2022, BBC News website.

In some countries, public sector workers earn less than private sector workers, but in some economies (e.g. the UK and Hong Kong) this trend has been reversed and some public sector workers may earn more than private sector workers. Possible reasons include:

- Some public sector workers have been employed by the public sector for many years and are therefore senior civil servants who have protected jobs and very good pensions.
- Some public sector jobs have been contracted out to the private sector and these tend to be lower-paid jobs.
- Social workers, nurses and lower-ranking police are not among the higher-paid public sector workers.
- Poor economic performance in some economies has decreased private sector pay.

### **Primary versus secondary versus tertiary sectors of production**

Figures will vary between countries.

- Many tertiary sector workers are low paid (e.g. shop workers, cleaners, bus drivers, taxi drivers, administrative workers, kitchen assistants and restaurant workers).
- Manufacturing jobs can be both low and high skilled.
- Agricultural workers are often low paid.

### **Activity (page 110)**

This activity is designed to promote discussion around:

- inequality of income and wealth
- lack of regulation of the financial industry
- ability of the private sector to reward people with extremely high wages and use such wages to attract high-calibre staff
- aims and objectives of firms in the financial services sector.

### **Activity (page 113)**

This activity is designed to promote discussion about global skills shortages and occupational and geographical mobility.

### **Activities (page 114)**

- 1 Information about earnings can be found at sources such as [www.forbes.com](http://www.forbes.com)
- 2 Possible reasons for any differences in the earnings include:
  - People are rewarded for their individual talents and because their talents are inelastic in supply.
  - Film production companies want particular film stars to act in their films to attract viewers and therefore use high wages to attract these film stars.
  - A celebrity's popular status can enable them to demand higher wages.

## Sample answers to practice questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Practice questions: structured questions (page 110)

**1** Reasons why the potential earnings of an individual tend to fall after the age of about 60 may include:

- After the age of about 60, an individual may choose to work fewer hours or may reduce their level of responsibility in preparation for retirement [1], and therefore their earnings may decrease [1].
- After the age of about 60, workers may retire (early) [1], and therefore their earnings will decrease as they no longer have earnings from working [1].

*Maximum of 2 marks.*

**2** Explanations for how educational attainment impacts upon earnings of an individual may include:

- According to Table 17.5, higher education levels increase potential earnings [1]. Mean income for those workers with less than a high school diploma was \$708 [1], whereas mean income for those workers with a professional degree was \$2,206 [1].
- Those with higher levels of qualifications tend to be in shorter supply [1] and therefore can command higher salaries [1].
- It takes a long time to acquire professional qualifications and master's and doctoral degrees, so the elasticity of supply of such workers is inelastic [1]. Higher earnings are also used to compensate for the opportunity cost of study to acquire these qualifications and skills [1].

*Up to 2 marks for each explanation. Award full marks only if reference is made to the data in Table 17.5.*

*Maximum of 4 marks.*

### Practice question: structured question (page 113)

**a** Reasons why there is a global shortage of doctors and nurses may include:

- Doctors and nurses have to train to become qualified, which takes significant time [1].
- In some cases, people have to fund these qualifications and this may deter some people from undertaking such careers [1].
- The world's population is increasing and therefore more doctors and nurses are required [1].
- The skills of doctors and nurses cannot be easily replaced by machinery to cope with the increased demand [1].

*1 mark for each (×2) relevant reason.*

*Maximum of 2 marks.*

**b** Reasons why nurses trained in the Philippines may relocate to take advantage of training opportunities might include:

- The pay in other countries may be greater than that in the Philippines [1] and therefore nurses may relocate for financial reasons as they can earn more money overseas [1].
- There may be an oversupply of nurses in the Philippines, making it hard for nurses to find a job [1] and they may relocate to other countries where more jobs are available [1].
- There may be better working conditions in another country [1] and nurses may relocate to develop their career [1].
- Standards of living may be higher overseas than in the Philippines [1] and nurses may relocate for a better quality of life [1].

*1 mark for each economic reason.*

*1 mark for the impact of each economic reason.*

*Maximum of 4 marks.*

- c** Analysis of how countries can attract individuals to professions in which they have a shortage of workers might include:
- Offering an attractive package of wage and non-wage factors [1] which may be better than that in their home country [1].
  - The package may include flights home for the individual and their family [1], housing, healthcare and other non-financial benefits [1].
  - Offering challenging jobs with high levels of responsibility [1] and good career prospects [1].
  - The rewards package may attract high-quality individuals but may also attract those who are taking advantage of higher standards of living [1] and who may not be suitably skilled [1].

*Up to 4 marks for application to the context.*

*Up to 2 marks for justified reasoning.*

*Maximum of 6 marks.*

### Practice questions: multiple choice (page 114)

- 1 Correct answer: C** National minimum wage [1 mark]

The national minimum wage is legislation by the government, stipulating the lowest wage rate that an employer has to pay their employees per time period.

- 2 Correct answer: D** Work may become repetitive and boring [1 mark]

When workers specialise through the division of labour, work can become repetitive and therefore rather boring.

## Sample answers to chapter review questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Chapter review questions (page 115)

- 1 Wage factors are financial aspects of a job that incentivise people to work. Non-wage factors are non-financial aspects of a job that influence people's choice of work.
- 2 Fringe benefits are additional perks (benefits) of a particular job, over and above the wage or salary, e.g. paid holidays.
- 3 Wages are usually determined through the forces of demand for and supply of labour for a particular occupation.
- 4 Demand for labour is the number of workers that firms are willing and able to hire at a given wage rate. Determinants include the equilibrium wage rate; qualifications, skills and experience of workers; relative bargaining power of trade unions; and government legislation such as minimum wage laws.
- 5 Derived demand is labour (or any other factor of production) that is not demanded for itself but for the goods and services it is used to produce.
- 6 The supply of labour is everyone in an economy who is of working age and is both willing and able to work at different wage rates. Factors that affect the supply of labour include the equilibrium wage rate, duration of training and qualification, and population size.
- 7 After a certain wage rate (that is deemed high enough by workers), some people would rather work fewer hours and enjoy more leisure hours.
- 8 In a market economy, wages are determined by the market forces of demand for and supply of labour.
- 9 A national minimum wage can create incentives to work, especially for those with low skills, thereby increasing the supply of labour. However, it can raise labour costs for businesses, so the demand for labour may fall.
- 10 Firms may not be able to pay the legal minimum wage, so higher labour costs can lead to redundancies or job losses.
- 11 Demand and supply factors influence differences in earnings between workers, e.g. desirability of the skills set of the employees; length of training and experience required; differences between primary, secondary and tertiary sectors; differences between male and female workers (including discrimination); and difference between those in the private and public sectors.
- 12 The mobility of labour refers to the movement of workers between occupations and geographical areas.
- 13 Specialisation and the division of labour help workers to become expert at what they do, thereby improving labour productivity and overall efficiency.

## Section 3: Microeconomic decision-makers

### Chapter 18: Firms

#### Answers to activities

##### Activities (page 117)

**1 Capital:** sewing machines, tools and sewing equipment to make clothes, and shop premises to sell the clothes.

**Enterprise:** the skills necessary to organise the design and production process successfully and to motivate workers so they work to the best of their ability.

**Labour:** people to produce the clothes, work in the shop and perform the administrative tasks, including bookkeeping and processing online orders.

**Land:** the cotton fabric, wool and thread required to make the clothes.

**2 a A manufacturer of smartphones:**

Activity/sector	Examples of goods/services required
Primary	Metal for components, copper for wiring and oil to make plastic
Secondary	Production of mobile phones, purchase of components for phones from other manufacturers (e.g. batteries, circuit boards and memory cards)
Tertiary	Advertising agency, transport company to deliver the phones from the factory to the retail shops, banking and insurance

**b A coffee shop:**

Activity/sector	Examples of goods/services required
Primary	Milk, tea, coffee and other ingredients
Secondary	Production of food and drinks for customers, purchase of ingredients from other manufacturers
Tertiary	Advertising agency, banking, insurance, interior design, electricians, plumbers, painters and decorators

**c A shop selling kitchen equipment:**

Activity/sector	Examples of goods/services required
Primary	Raw materials to make the kitchen equipment (e.g. clay, metal, oil for plastics, wood)
Secondary	Manufacture of raw materials into finished kitchen equipment
Tertiary	Advertising, insurance, accountancy services, banking, transport to deliver products to shop and interior design of shop

**d A sheep farmer:**

Activity/sector	Examples of goods/services required
Primary	Sheep, water, workers to tend to the sheep, pasture/grass
Secondary	Enclosures and buildings for looking after sheep, tools for shearing sheep
Tertiary	Vets to vaccinate the sheep and tend to them when they are ill, and transport to take the sheep to market

**Activity (page 118)**

Student's own answers depending on country. Students could consult a site such as [www.statista.com](http://www.statista.com)

**Activities (page 125)**

- 1 a** The aim of this activity is for students to see economies of scale in action.
  - Students should be able to see purchasing economies of scale in action, e.g. if rice is bought in larger quantities, the price per gram falls.
  - The same principle can be applied to the service sector, e.g. a large Coca-Cola in McDonald's is better value per ml than a regular size, whilst three scoops of ice cream bought as one item in cafés tend to be cheaper than three individual scoops. Retailers use this strategy to entice customers to buy more in order to benefit from greater value for money.
- b** Student's own responses.
- 2 a** The aim of the exercise is for students to recognise that only large firms with access to financial resources can afford to spend large amounts on advertising and therefore take advantage of marketing economies of scale.
  - Students should realise that only large public limited companies or multinational companies tend to advertise on billboards and on the television, advertising products such as fast food, electronics and designer clothing.
  - In some countries this may not be the case, but the firms will still tend to be large and profitable.
- b** The firms will tend to be large, often public limited companies and multinationals.
- c** Public limited companies and multinationals are large enough to benefit from economies of scale.

## Sample answers to practice questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

**Practice question: structured question (page 127)**

- a** Explanations of two types of internal economies of scale which could be achieved through the takeover of Slack by Salesforce might include:
  - Risk-bearing economies of scale could be achieved as the new firm now has customers covering different market segments [1]. The market share of the business has increased and

this spreads risk because if sales decrease in one segment of the market, the effect may be balanced by sales from another segment of the market [1]. The combined market of Salesforce and Slack means that the companies are now in a better position to compete with Microsoft.

- Marketing economies of scale could be achieved [1] because only one marketing department would be needed to cover the marketing aspects for the entire firm [1].
- Financial economies of scale could be achieved [1] because a larger firm may be able to get bank loans more easily than a smaller firm and at lower interest rates [1].
- Specialisation and division of labour could be achieved and the labour costs of the combined firm may fall [1] as it does not need to hire the same number of workers to run the financial, production and marketing aspects of the business as the firms did when they were separate [1].

*Up to 2 marks for each (×2) valid type of internal economy of scale.*

*Maximum of 4 marks.*

**b** Explanations of two diseconomies of scale which may occur after the takeover might include:

- The workers may find it difficult to have a sense of belonging in a large firm, which may lead to a lack of motivation and reduced productivity [1]. Workers may look for another job [1], which may increase labour turnover and average costs may rise [1].
- Communication issues may arise when a firm becomes too large [1]. There may be too many parts of the business to control and communicate with effectively [1], and decision-making may be slow due to the number of people in the communication chain [1]. This may lead to increased costs of production [1].
- The merger between Salesforce and Slack created a clash of cultures [1]. This led leaders from each of the businesses to leave their jobs. This may have caused communication and managerial issues [1], which could slow down decision-making. Recruitment costs may rise and average costs may increase.

*Up to 2 marks for each (×2) valid diseconomy of scale.*

*Maximum of 4 marks.*

**c** The merger may benefit employees as the firm may increase in size and possibly result in more opportunities for training and gaining experience. The firm may experience economies of scale, which lead to lower costs and possibly increased profits that may be passed onto employees in the form of higher wages. However, the merger may result in a clash of cultures, and workers may feel alienated and may leave the firm. Workers within a large organisation may find it difficult to have a sense of belonging in the firm, which may lead to a lack of motivation and they may leave the firm. The firm may cut duplicate roles within the organisation: workers may therefore lose their jobs. Whether the merger benefits employees depends upon the role of the individual workers in the organisation and whether the organisation expands, contracts or the worker is replaced. Some workers may have greater training opportunities, others may not. Cultural change may be beneficial for some workers and not others. Some workers may not like the changes and may leave the business. The leaders of Slack and Salesforce both left their jobs.

Award marks according to the following mark scheme:

Level	Description	Marks
Strong answer	Excellent knowledge and understanding of relevant economics concepts, using appropriate terminology in context. Detailed discussion of whether or not the merger between Salesforce and Slack will benefit employees. Students who develop both sides of the argument in a considered way, with well-justified reasoning, including why the alternative viewpoint is rejected, should be rewarded with the top marks in the band.	6–8
Moderate answer	Good knowledge and understanding of relevant economics concepts, using appropriate terminology in context. Detailed discussion of at least <b>one</b> viewpoint. Judgement with some justification/evaluation of choices made. Students should be rewarded with top marks in the band if there is discussion of <b>two</b> viewpoints in detail.	3–5
Weak answer	Limited knowledge and understanding of relevant economics concepts in context. Limited ability to discuss whether or not the merger between Salesforce and Slack will benefit employees, with little or no expression of viewpoints. Students who state one viewpoint and give a reason for coming to their decision should be rewarded with the top mark in the band.	1–2
	No creditable response.	0

### Practice question: multiple choice (page 128)

**Correct answer: A** Availability of skilled labour [1 mark]

The skilled labour in a particular region is available for all firms operating in that area, so it is considered to be an external, rather than internal, economy of scale.

## Sample answers to chapter review questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Chapter review questions (page 128)

- 1 Primary refers to industries involved with the extraction of raw materials; secondary refers to manufacturing; tertiary refers to the services sector.
- 2 The private sector refers to economic activity of private individuals and firms. Its main aim is to earn profit for its owners. The public sector refers to economic activity directly involving the government, such as the provision of state education and healthcare services. Its main aim is to provide a service.
- 3 The benefits of small, rather than large, businesses is a reason why so many small firms exist. See the answer to question 4.

- 4 Advantages:** few legal formalities; incentives to work (keep any profits earned); opportunity to be your own boss; easier to manage smaller businesses. They can provide a more personalised service, react more quickly to customer needs and serve a niche market.

**Disadvantages:** limited start-up capital; represent higher risks to investors and lenders; higher statistical chance of business failure; lack of continuity if owner is absent; inability to benefit from economies of scale.

- 5** Selection of five of these reasons why average total costs may decrease as the firm increases in size: financial, marketing, bulk-buying, managerial, risk-bearing, technical, and research and development economies of scale.
- 6** Horizontal mergers occur when two or more firms in the same economic sector of industry integrate.

Vertical mergers occur when integration takes place between two firms from different economic sectors of industry.

Conglomerate mergers occur when two or more firms from unrelated areas of business integrate to create a new firm.

- 7** Internal economies of scale are economies of scale that arise from the internal organisation of the business, e.g. financial, bulk-buying and technical economies of scale.

External economies of scale are economies of scale that arise from factors outside of the firm, e.g. the location of the firm, proximity to transport and the availability of skilled workers.

- 8** As a firm gets bigger, it may experience diseconomies of scale, such as communication problems. This may lead to delays in decision-making. Staff may feel demotivated in a large, impersonal organisation, and this may lead to decreased productivity.

## Section 3: Microeconomic decision-makers

### Chapter 19: Firms and production

#### Answers to activities

##### Activity (page 130)

Answers are likely to consider a range of factors such as:

- Cheaper labour costs in China, Brazil, India, Malaysia and Mexico than in the USA (Apple) and in Japan (Sony).
- Specialisation and mass production at the Foxconn plants, which help to achieve huge economies of scale, further reducing the average costs of production for Apple and Sony.
- Apple and Sony choosing to locate production near their growing customer base (in China, Brazil and India).

##### Activity (page 132)

Answers will vary according to the student's opinions – economics can help explain why there are such large wage differentials in the sports industry, but ethics are important when considering the inequalities created by these wage differentials.

##### Activities (page 136)

- 1 Students must investigate the jobs that artificial intelligence (AI) has replaced and will continue to replace, and the jobs which will be difficult to replace. An internet search will help them to get started.
- 2 AI is important for the survival of firms because:
  - AI can increase the productivity of a firm, which causes average costs to fall and thus increases the profitability and survival of the firm.
  - High productivity helps firms to achieve economies of scale, thus improving competitiveness, profitability and survival.
  - Firms need to use AI to keep up with their rivals. It is inevitable that AI will replace certain business processes.
  - Firms need to train workers to use AI. They also need to ensure workers have knowledge of the industry so they can check AI-created data to ensure that it is correct.
  - However, certain industries and occupations cannot be replaced by AI, such as personal services like hairdressing, manicures and massage. Restaurants will need skilled chefs and serving staff. Coaches, teachers and psychologists respond to their clients and provide an important personal touch. AI can help them with their work.

##### Activity (page 137)

Student's own responses.

The suggestions could be used for a classroom display, or even forwarded to the Senior Leadership Team at the school!

## Sample answers to practice questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Practice question: structured question (page 132)

- a** Labour-intensive production occurs in industries where the cost of labour is proportionately higher than the cost of other factors of production [1]. Examples include education [1] and legal services [1].

*Maximum of 2 marks.*

- b** Firm A's labour costs account for 55% (30,000/55,000) of its total costs [1], whereas Firm B's labour costs account for 43% (60,000/140,000) [1]. Hence, labour costs account for a larger proportion of total costs at Firm A [1], so Firm A is more labour intensive than Firm B [1].

*Maximum of 4 marks.*

### Practice question: structured question (page 133)

- a** Explanations of the benefits of capital-intensive technologies in the provision of educational services might include:
- There are potentially huge cost savings in the form of technological economies of scale [1] for firms that provide such educational services, e.g. video conferences for teacher training can reach a large audience at minimal cost [1].
  - Capital-intensive technologies can also make access to education easier for many people [1], e.g. the use of e-books is generally cheaper than buying physical textbooks [1].
  - Productivity can improve [1], e.g. the use of laptops, data projectors and the internet have transformed how teaching and learning take place in the classroom [1]. AI can instantly adapt existing resources to meet the needs of individual students [1]. AI can also help teachers to be more creative, allowing them to produce resources quickly and efficiently [1]. Technology allows learning to take place remotely, and students can choose when to learn [1].

*Up to 2 marks for setting out each (×2) valid benefit.*

*Maximum of 4 marks.*

- b** There are potential advantages in using more technology in education, such as:
- lower average costs in the long run (economies of scale), partly due to the higher productivity that technology can bring about
  - increased learning opportunities, e.g. students can use a variety of ways to present their answers/homework
  - interactive teaching and learning – through the use of technology – can make education more accessible, relevant and fun for learners
  - learning opportunities for students from around the world – students can learn without having to leave their homes
  - AI may help teachers to improve and accelerate marking and feedback for students. This will provide teachers with more time to work with students individually and potentially improve learning outcomes

- AI can help teachers to create adaptive learning resources and personalised learning strategies to meet the varying needs of students.

Despite the potential advantages, the drawbacks of using technology (and hence the benefits of using labour-intensive methods) include:

- reduced opportunity for teachers to provide effective, two-way, face-to-face feedback to students
- reduced benefits of social interactions between teacher and students
- reduced benefits of social interactions between students and their peers
- technological glitches or breakdowns, e.g. corrupt files, no internet access or crashed computers
- health implications of using educational technologies without social interactions with others and without opportunities for physical activities such as sports, dance and drama productions
- distractions caused by online learning, as students can access other websites
- AI is a tool. Resources created by AI need to be checked by expert teachers to ensure that they are suitable for the students.

Conclusion:

Technology, including AI, could replace some of the labour-intensive activities of teaching and learning but this depends upon the quality of the resources and technology introduced, how students respond to them, the nature of the courses and qualifications the students are working towards and training provided to teachers for using and creating resources. It also depends on the attitude and aptitude of the students and their individual learning styles.

Award marks according to the following mark scheme:

Level	Description	Marks
Strong answer	Excellent knowledge and understanding of relevant economics concepts, using appropriate terminology in context. Detailed discussion of whether technology could ever replace the traditional labour-intensive nature of teaching and learning. Students who develop both sides of the argument in a considered way, with well-justified reasoning, including why the alternative viewpoint is rejected, should be rewarded with the top marks in the band.	6–8
Moderate answer	Good knowledge and understanding of relevant economics concepts, using appropriate terminology in context. Detailed discussion of at least <b>one</b> viewpoint. Judgement with some justification/evaluation of choices made. Students should be rewarded with top marks in the band if there is discussion of <b>two</b> viewpoints in detail.	3–5
Weak answer	Limited knowledge and understanding of relevant economics concepts in context. Limited ability to discuss whether technology could ever replace the traditional labour-intensive nature of teaching and learning, with little or no expression of viewpoints.	1–2

	Students who discuss one viewpoint and give a reason for coming to their decision should be rewarded with the top mark in the band.	
	No creditable response.	0

### Practice question: structured question (page 135)

**a** Labour productivity for the two firms:

- Sales per worker at Sharma Realty =  $\$3.95\text{m} \div 8 = \$493,750$  [1]
- Sales per worker at Urvashi Realty =  $\$3.8\text{m} \div 10 = \$380,000$  [1]

*Maximum of 2 marks.*

**b** Reasons why it might be difficult to decide whether Sharma Realty or Urvashi Realty is the more productive firm may include:

- Sharma Realty has higher productivity as measured by sales per worker [1]. The average salesperson at Sharma Realty sells an extra \$113,750 worth of real estate [1].
- But Urvashi Realty might be considered to be more productive as each salesperson sold a greater number of units in the same time [1]:
  - Sharma Realty sold 10 units with 8 sales staff: a rate of 1.25 unit per worker [1]
  - Urvashi Realty sold 14 units with 10 sales staff: a rate of 1.4 properties per worker [1].
- Thus, the choice of measurement of productivity can determine how efficient firms are interpreted to be [1].

*Up to 2 marks for application to the context.*

*Up to 2 marks for justified reasoning.*

*Maximum of 4 marks.*

### Practice question: multiple choice (page 136)

**1 Correct answer: B** Greater number of people in the labour force [1 mark]

A greater number of people in the workforce does not necessarily mean that they are productive. In fact, workers can become more inefficient if a larger workforce leads to miscommunication and coordination problems.

## Sample answers to chapter review questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Chapter review questions (page 137)

**1** The demand for the factors of production needed to make a product is directly proportional to the demand for the product because they have a derived demand. The price of the factors of production will have an impact on the demand for them. For example, if labour costs increased, firms may look at ways to replace labour with technology or machinery. The availability of the factors of production will influence whether goods and services can be produced for a reasonable price. The productivity of the factors of production will affect the efficiency of production and therefore their demand.

- 2 The demand for factors of production is a derived demand because workers are only demanded for the goods and services they help to produce.
- 3 Labour costs account for the largest proportion of costs in labour-intensive production; capital costs are the greatest proportion of costs for capital-intensive output.
- 4 Factors that determine whether firms are capital intensive or labour intensive are: costs of the various factors of production; the size of the market; the objectives of firms.
- 5 Production is the total output of goods and services in the production process.  
Productivity is a measure of efficiency found by calculating the amount of output per unit of a factor input, e.g. output per worker or output per machine hour.
- 6 Higher productivity boosts the competitiveness of the country, generates greater output and can help to keep costs and prices down.
- 7 The main influences on productivity are: investment expenditure; innovation; skills and expertise of workers; entrepreneurial spirit; the degree of competition in the economy.

## Section 3: Microeconomic decision-makers

### Chapter 20: Firms' costs, revenue and objectives

#### Answers to activities

Activities (page 140)

1

Output (units)	Fixed costs (\$)	Variable costs (\$)	Total costs (\$)	Average total cost (\$)
20	500	40	540	27.00
30	500	75	575	19.17
40	500	120	620	15.50
50	500	250	750	15.00

Hence, the output level with the lowest average total cost of production is 50 units, where the total average cost is \$15.00.

- 2 a Total cost increases by \$20,000 for each additional batch of 1,000 batteries produced. Hence, the average variable cost of production is  $\$20,000 \div 1,000 = \$20$  per battery.
- b Since total cost increases by \$20,000 for each additional batch of 1,000 batteries produced, when there is no output, the monthly total fixed cost is \$50,000.

c

Output level (batteries)	Total cost (\$)	Average total costs (\$)	Average fixed costs (\$)
1,000	70,000	70.00	50.00
2,000	90,000	45.00	25.00
3,000	110,000	36.67	16.67

- d The average total cost of production falls from \$70.00 per battery to just \$36.67, i.e. Juke Engineering experiences economies of scale (falling unit costs of production following increased output). The change in average total costs equals \$33.33.

Activities (page 143)

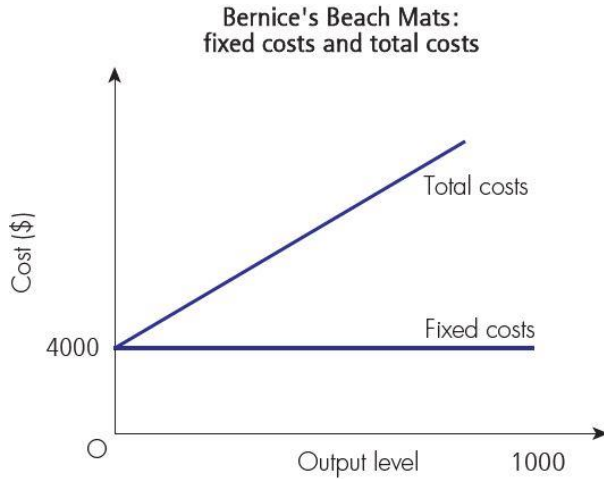
- 1 a Fixed costs of production are those that do not change when the level of output changes, e.g. Bernice's Beach Mats may have to pay rent of \$4,000 per month, irrespective of how many beach mats it produces.
- b  $\$4,000 + (\$7 \times 1,000) = \$11,000$
- c  $ATC = \$11,000/1,000 = \$11$

d  $TR = \text{price} \times \text{quantity} = \$15 \times 1,000 = \$15,000$

$AR = TR/\text{quantity} = \$15,000/1,000 = \$15$

Average revenue (AR) = price of mat

e



2

Units sold (pizzas per week)	Sales revenue (\$)	Total fixed costs (\$)	Total variable costs (\$)	Total cost (\$)	Profit or loss (\$)
0	0	2,400	0	2,400	-2,400
300	3,600	2,400	1,500	3,900	-300
500	6,000	2,400	2,500	4,900	1,100
1,000	12,000	2,400	5,000	7,400	4,600

3 a Advertising costs do not change with the level of output. Hence, advertising costs are an example of fixed costs for the company.

b Fixed costs = advertising + rent + salaries = \$9,400

c Total variable costs =  $\$25 \times 400 = \$10,000$

Total fixed costs = \$9,400

Hence, total costs = \$19,400

d Average total cost = Total cost  $\div$  output  
 $= \$19,400 \div 300 = \$64.67$

**Activity (page 144)**

a

Output (units)	40	60	80	100
Total costs (\$)	1,200	1,500	1,900	2,300
<b>Total revenue (\$)</b>	<b>1,200</b>	<b>1,800</b>	<b>2,400</b>	<b>3,000</b>

- b** 100 units of output is where maximum profit is gained: \$700

<b>Output (units)</b>	40	60	80	100
<b>Total costs (\$)</b>	1,200	1,500	1,900	2,300
<b>Total revenue (\$)</b>	1,200	1,800	2,400	3,000
<b>Profit (\$)</b>	<b>0</b>	<b>300</b>	<b>500</b>	<b>700</b>

### Activity (page 144)

Student's own responses.

The objectives of private sector firms are likely to include profit maximisation, increased market share, higher sales revenue, corporate social responsibilities (including fair trade, environmental packaging), increased productivity and improved competitiveness. Cooperatives will have different objectives, as will not-for-profit organisations, such as charities.

## Sample answers to practice questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Practice question: structured question (page 144)

- a** Revenue refers to the money a firm receives from selling its products [1]. For example, The Body Shop gets its revenue from selling shampoo, conditioner and similar products [1].

*Maximum of 2 marks.*

- b** Arguments in favour of social welfare objectives of business creating profitability:
- Some consumers are attracted by social objectives and will stay loyal to a business, such as The Body Shop, that has social objectives. This may generate sales and may lead to more profits.
  - An increasing number of consumers are motivated to buy goods from businesses that have social objectives, and this could increase sales revenue and may lead to increased profitability.
  - The Body Shop used environmentally friendly packaging and ingredients in its products, and this may have attracted consumers to buy the products despite higher prices. This may lead to increased profitability.
  - Consumers who are interested in social objectives are sometimes happy to pay higher prices. This may lead to increased profitability.
  - The reduce, reuse and recycle philosophy can create lower production costs as The Body Shop strives for efficiency in production. This may lead to increased profitability.

Arguments against social welfare objectives of business creating profitability:

- The social objectives caused higher costs and therefore lower profits.
- The Body Shop is known for its social objectives and therefore if it tried to compromise by using cheaper ingredients it would not be fulfilling its objectives. Customers may find out and the reputation of The Body Shop could be impaired, leading to lower sales and profitability.

- Often, natural ingredients cost more than synthetic ingredients; therefore, social objectives might be more important than the objective of survival. This may lead to lower profitability.
- Inflation caused running costs in the USA, Canada and the UK to increase. These were not necessarily costs incurred to fulfil the social objectives.

The Body Shop faced a lot of competition from firms selling similar products. Many firms in the industry produce natural products, in environmentally friendly packaging. The decrease in customers may have caused the problem of survival rather than the pursuit of social objectives.

### Conclusions

Whether the social objectives led to increased profitability is affected by the number of firms in the industry, the size of competitors, the quality of competitors' products, the price of competitors' products and the cost of raw ingredients.

Award marks according to the following mark scheme:

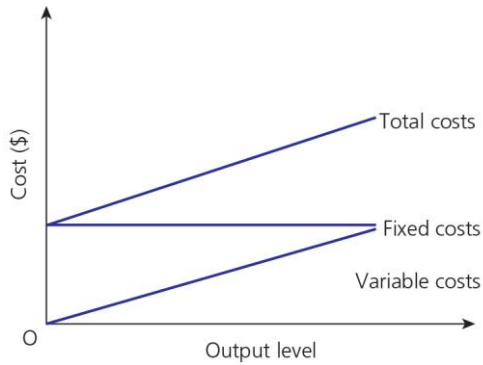
Level	Description	Marks
Strong answer	Excellent knowledge and understanding of relevant economics concepts, using appropriate terminology in context. Detailed discussion of whether or not social welfare objectives of business create profitability. Students who develop both sides of the argument in a considered way, with well-justified reasoning, including why the alternative viewpoint is rejected, should be rewarded with the top marks in the band.	6–8
Moderate answer	Good knowledge and understanding of relevant economics concepts, using appropriate terminology in context. Detailed discussion of at least <b>one</b> viewpoint. Judgement with some justification/evaluation of choices made. Students should be rewarded with top marks in the band if there is discussion of at least <b>two</b> viewpoints in detail.	3–5
Weak answer	Limited knowledge and understanding of relevant economics concepts in context. Limited ability to discuss whether or not social welfare objectives of business create profitability, with little or no expression of viewpoints. Students who discuss one viewpoint and give a reason for coming to their decision should be rewarded with the top mark in the band.	1–2
	No creditable response.	0

## Sample answers to chapter review questions

The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.

### Chapter review questions (page 144)

1



- 2 Fixed costs remain the same, irrespective of the level of output. Variable costs change with the level of output.
- 3 Average total cost of production will fall if a firm gains from economies of scale, but it will rise if the firm experiences diseconomies of scale.
- 4 Total revenue is the aggregate amount received by a firm from the sale of its goods or services. Average revenue refers to the typical price received from the sale of a good or service.
- 5 Possible objectives that a business might have include survival, social welfare, growth and profit maximisation.
- 6  $TC = TFC + TVC$   
 $ATC = TC/Output$   
 $AFC = TFC/Output$   
 $AVC = TVC/Output$
- 7 Firms need sufficient money/profit in order to survive, otherwise they will go out of business.
- 8 Profit maximisation is the (main) goal of most firms, i.e. to gain as much profit as possible.
- 9 Growth helps firms to maximise profits.
- 10 Having social welfare as a goal can help firms to improve their image and sustain their business. The wellbeing of the society in which a firm operates is also crucial for the firm's own survival.

## Section 3: Microeconomic decision-makers

### Chapter 21: Types of markets

#### Answers to activities

##### Activity (page 150)

For consumers, choice is an illusion. In reality, one firm is producing and selling the goods and prices might be kept artificially high. Consumers are unaware of who owns the brands and stores, and this may lead to consumers wasting time comparing prices.

The business itself benefits from higher prices, a high market share and reduced costs because of ownership of supply and distribution chains. It hinders other firms from entering the industry.

Other firms in the industry have to be innovative and efficient to survive. They have a smaller market share than the dominant firm and may be at risk of being taken over by it. New firms may face barriers to entry which are too high to overcome.

The economy may suffer due to less innovation and fewer jobs being created. There may be job losses if some smaller and less efficient firms close down. New firms will not enter the market. A misallocation of resources may arise.

##### Activities (page 152)

- 1 Student's own responses.
- 2 Student's own responses. Whether governments should intervene to prevent mergers and acquisitions really depends on the specific industry and country being investigated. Examples to investigate may include: the US government versus Apple; the blocking of a merger between fashion houses Capri and Tapestry in the USA.
- 3 A two-sided argument needs to be provided, taking into consideration whether the monopolist acts in the public's best interest. For example, the market power of the tobacco firms in the UK means they create huge barriers to entry whilst producing demerit goods – but is it better to have competition in such an industry? Another type of monopoly may offer a good level of service, e.g. Google. But Google also collects data from users and this may have negative consequences in terms of personalised advertising and Google owning all our personal information and intellectual property through cloud computing.

Mergers between large businesses limit choice, potentially raise prices and lower the quality of the good or service provided. In the example from South Korea given in the case study, the combined firm could have become the sole employer of teachers. They could lower wages and also reduce other working conditions. Smaller tuition firms might not be able to survive and this would have negative consequences. The government has a responsibility to promote competition and protect consumers from dominant firms.

## Sample answers to practice questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Practice questions: structured questions (page 148)

**1** Possible indicators of a bubble tea shop in an area operating in a competitive market are:

- A bubble tea shop using a range of pricing strategies to compete, including discounts, which lowers prices to customers
- A bubble tea shop using an extensive range of non-pricing strategies to compete, e.g. loyalty schemes, delivery services, level of customer service, product differentiation, branding, different flavours and different packaging, which customers can benefit from
- Customers have plenty of choice
- Prices of bubble tea sold in different shops are likely to be very similar.

*Award up to 2 marks for two indicators.*

*Award the remaining marks [4] for analysis and justified reasoning.*

*Maximum of 6 marks.*

**2** Whether or not consumers benefit from the competitive strategies used by bubble tea shops depends on the number of firms in the industry, the degree of competition, the size of the firms, whether any firms dominate the market and the levels of knowledge consumers have about the products and pricing strategies.

Reasons consumers benefit from competitive strategies used by bubble tea shops could include:

- Lower prices – Fierce competition encourages price reductions and promotional offers, making bubble tea more affordable for consumers.
- Greater choice – Due to competition, bubble tea shops introduce unique flavours, healthier options and customisable drinks to attract customers, enhancing consumer choice.
- Improved quality and service – To gain a competitive edge, bubble tea shops invest in better ingredients, faster service and enhanced customer experiences.
- Increased convenience – Competition leads to more bubble tea outlets, better locations and online ordering options, making it easier for consumers to access their favourite drinks.

Reasons consumers may not benefit from competitive strategies include:

- Unethical marketing practices – Intense competition can lead bubble tea shops to use misleading advertising and promotions or shrink portion sizes while keeping prices the same (to maintain their profit margin), thereby reducing actual value for money.
- Focus on cost-cutting – To stay competitive, some bubble tea firms might compromise on the quality of the ingredients or use artificial additives, affecting product healthiness.
- Market saturation – Too many similar bubble tea shops can make it difficult for consumers to differentiate between options, leading to confusion and choice overload for consumers.
- Unfair pricing tactics – Some larger businesses may engage in unfair trade practices, such as using low prices to eliminate smaller competitors, thus eventually reducing consumer choice once their market dominance is established.

Note that students can make any conclusion (consumers do benefit overall from competitive strategies or consumers do not always benefit from competitive strategies) so long as this is fully justified.

Award marks according to the following mark scheme:

Level	Description	Marks
Strong answer	Excellent knowledge and understanding of relevant economics concepts, using appropriate terminology in context. Detailed discussion of whether or not consumers benefit from the competitive strategies used by bubble tea shops. Students who develop both sides of the argument in a considered way, with well-justified reasoning, including why the alternative viewpoint is rejected, should be rewarded with the top marks in the band.	6–8
Moderate answer	Good knowledge and understanding of relevant economics concepts, using appropriate terminology in context. Detailed discussion of at least <b>one</b> viewpoint. Judgement with some justification/evaluation of choices made. Students should be rewarded with top marks in the band if there is discussion of at least <b>two</b> viewpoints in detail.	3–5
Weak answer	Limited knowledge and understanding of relevant economics concepts in context. Limited ability to discuss whether or not consumers benefit from the competitive strategies used by bubble tea shops, with little or no expression of viewpoints. Students who discuss one viewpoint and give a reason for coming to their decision should be rewarded with the top mark in the band.	1–2
	No creditable response.	0

### Practice questions: structured questions (page 151)

- 1** Barriers to entry are the obstacles that prevent firms from entering a market [1]. Examples include: high set-up costs [1], government regulations [1], market dominance [1] and the extent of customer loyalty to existing firms [1].

*1 mark for a correct definition.*

*1 mark for any correct example of a barrier to entry.*

*Maximum of 2 marks.*

- 2** Advertising expenditure can act as a barrier to entry because smaller firms trying to enter the market will not be able to compete [1] with the larger, more established firms [1]. For example, only very large firms would be able to afford the average cost [1] of a 30-second advert during the Super Bowl, at \$7 million per advert. In addition, effective advertising from the existing firms is likely to lead to high brand recognition [1] and customer loyalty [1]. This can create further barriers to entry [1].

*Maximum of 4 marks.*

### Practice questions: multiple choice (page 153)

- 1** **Correct answer: A** Firms supply homogeneous goods. [1 mark]

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There is only one firm in a monopoly market, so products are not homogeneous – this is a feature of competitive markets rather than monopoly markets.

- 2 Correct answer: A** Firms supply differentiated goods. [1 mark]

Firms in competitive markets produce identical goods. It means that the products are excellent substitutes for one another.

- 3 Correct answer: C** Low entry barriers [1 mark]

There are high/extreme barriers to entry in a monopolistic market.

- 4 Correct answer: C** Having the financial resources for research and development [1 mark]

Monopolies can earn large profits, which can be used to fund research and development.

## Sample answers to chapter review questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Chapter review questions (page 153)

- 1** Market structure is the key characteristics of a particular market (or industry), such as the number and size of firms in the market, the degree and intensity of price and non-price competition, and the nature of barriers to entry.
- 2** Barriers to entry are the obstacles that prevent firms from entering a market. Examples are the existence of intellectual property rights, large advertising budgets of existing firms and legal constraints to prevent wasteful competition.
- 3** Competitive markets are those with an immense degree of competition between firms, where there are many firms in the industry, none of which has any significant market power to influence the market supply or demand. Firms are price takers, and barriers to enter and exit the industry are low.
- 4** The effects of competitive markets are more competitive prices, higher-quality products, greater choice and lower profits than firms in less competitive markets.
- 5** A monopoly is a market structure where there is only one supplier of a good or service, with the power to affect market supply and prices.
- 6** The main characteristics of a monopoly are a single supplier in the market, being a price maker, imperfect knowledge and high barriers to entry.
- 7** The potential to supply larger quantities and at lower prices, having the financial resources for research and development, and the elimination of wasteful competition are the advantages of monopoly.
- 8** The potential to exploit customers through higher prices and limited supply, high entry barriers to limit competition, imperfect knowledge which can lead to irrational customer decision-making, and a lack of innovation due to the absence of competition are the disadvantages of monopoly.

## Section 4: Government and the macroeconomy

### Chapter 22: Government macroeconomic intervention

#### Answers to activities

##### Activity (page 160)

Student's own answer – the purpose of this task is to get students to think critically about the intentions of international agreements, such as the Paris Agreement, including the difficulties/challenges countries face in meeting these agreements.

##### Activity (page 160)

Student's own answers, depending on which Sustainable Development Goal they have chosen. Encourage students to justify their choice with economic arguments.

##### Activity (page 161)

Student's own responses. Encourage students to consider how crises such as the COVID-19 pandemic may challenge traditional economic theory in the context of macroeconomic objectives.

#### Sample answers to practice questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

##### Practice question: structured question (page 157)

The total number of people classified as unemployed = 8% of 30 million [1] (not everyone of working age is both willing and able to work) = 2.4 million [1].

*Maximum of 2 marks.*

##### Practice question: structured question (page 158)

- a** The inflation rate is an economic indicator of the cost of living in an economy [1] as measured by the consumer price index [1].

*Maximum of 2 marks.*

- b** Although the rate of inflation was highest in the first year (2.5%) and lowest in the second year (1.7%), prices were highest in the third year as there has been inflation throughout the period [1]. Although the rate of inflation fell in the second year, this only means that prices in general rose at a slower pace – prices were still higher on average [1].

*Maximum of 2 marks.*

## Practice questions: multiple choice (page 159)

- 1 Correct answer: B** A sustained increase in the general price level, over a given period of time [1 mark]

Inflation is a measure of the rise in the general price level, over a given period of time. Option A describes deflation. Option C describes economic growth. Higher interest rates (Option D) are a possible cause of inflation.

- 2 Correct answer: C** An increase in the rate of inflation [1 mark]

High unemployment results in lower spending in the economy and is associated with an economic recession. Hence, it is unlikely that the general price level will be rising.

- 3 Correct answer: C** Higher general price level [1 mark]

Inflation is likely to be the result of economic growth, rather than a cause of growth.

## Sample answers to chapter review questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

## Chapter review questions (page 161)

- 1** The general role of a government is to improve the general welfare of its people.
- 2** The six macroeconomic aims of government are economic growth, full employment or low unemployment, stable prices or low inflation, balance of payments stability, redistribution of income, and environmental sustainability.
- 3** Economic growth is the annual increase in the level of national output. It is measured by the annual percentage change in gross domestic product (GDP).
- 4** Unemployment occurs when people are willing and able to work and are actively seeking employment, but are unable to find work. The unemployment rate calculates the percentage of the labour force that is unemployed. It is measured using the formula:  

$$\frac{\text{number of unemployed people}}{\text{number in the labour force}} \times 100$$
- 5** Inflation is the sustained rise in the general level of prices of goods and services over time, as measured using a weighted price index (consumer price index), which measures the change in prices of a representative basket of goods and services consumed by the average household.
- 6** The balance of payments is a financial record of a country's transactions with the rest of the world for a given time period, usually one year.
- 7** Earnings are credits, while expenditures (such as buying imported goods) are debits.
- 8** Countries try to avoid a persistent deficit on their balance of payments because a country cannot continually spend more than it earns.
- 9** Governments aim to redistribute income to achieve a fairer or more equitable distribution of income and wealth in the economy.
- 10** Governments care about environmental sustainability due to the growing recognition of the long-term economic impacts of environmental degradation, such as climate change.
- 11** Achieving one macroeconomic objective may come at the price (or opportunity cost) of achieving another objective, thus creating a conflict between macroeconomic aims.

## Section 4: Government and the macroeconomy

### Chapter 23: Fiscal policy

#### Answers to activities

##### Activities (page 165)

Student's own responses. Encourage students to use a range of methods to present the findings of their investigations, such as classroom poster displays. The visual stimulus can also be used as a revision tool for other students in the class.

##### Activity (page 166)

Student's own responses.

Furlough schemes are government initiatives designed to prevent mass unemployment during economic downturns by temporarily subsidising workers' wages. For example, during the COVID-19 pandemic, the UK government allowed businesses to claim 80% of employees' wages up to £2,500 (approximately \$3,167) per month. These schemes help stabilise economies by maintaining employment levels and supporting consumer spending during periods of major economic disruption. However, such schemes are extremely costly and not sustainable in the long run.

##### Activity (page 167)

Tax	Direct	Indirect
Airport tax		✓
Capital gains tax	✓	
Carbon tax		✓
Corporation tax	✓	
Customs duties		✓
Excise duties		✓
Income tax	✓	
Inheritance tax	✓	
Stamp duty		✓
Tariffs		✓
VAT or GST		✓
Windfall tax	✓	

## Activity (page 168)

a

Income level (\$)	Tax rate (%)	Amount of tax paid (\$)
10,000	0	First \$10,000 is tax free = \$0
10,001–40,000	10	Next \$30,000 is taxed at 10% = \$3,000
40,001+	15	Remaining \$35,000 is taxed at 15% = \$5,250
Total tax:		\$8,250

b Average tax rate =  $(\$8,250 \div \$75,000) \times 100 = 11\%$

## Activities (page 169)

- 1 a Tax B is progressive (10% tax on \$10,000 compared to 18% tax on \$25,000).  
 b Tax C is proportional (10% charged at all income levels).  
 c A regressive tax charges those on lower incomes a higher proportional tax rate, e.g. Tax A charges those earning \$10,000 tax of 10% but those earning \$20,000 only 5%. By contrast, a proportional tax charges all income earners the same percentage tax rate (10% in the case of Tax C).

2

Tax system A Regressive		Tax system B Proportional		Tax system C Progressive	
Tax/income	Tax paid (%)	Tax/income	Tax paid (%)	Tax/income	Tax paid (%)
900/4,500	20	1,500/10,000	15	800/8,000	10
1,800/10,000	18	3,000/20,000	15	3,000/20,000	15
2,800/20,000	14	4,500/30,000	15	11,250/45,000	25

## Activity (page 171)

Examples of plastics used in everyday life include water bottles, food containers, bin bags, smartphone covers, storage boxes, packaging for medicines, computer accessories, sports equipment, toys, gloves, furniture, lunch boxes and carrier bags.

Methods to reduce plastic use could include education (about the dangers/demerits of using plastics), social marketing campaigns (to encourage people to reduce, reuse and recycle), subsidising the use of alternative materials that are more sustainable and environmentally friendly (e.g. glass or wood) and encouraging businesses to reduce excess packaging (and hence waste).

## Activity (page 171)

Student's own responses.

Students might also consider the advantages and disadvantages of zero-rate taxes on income and company profits.

## Sample answers to practice questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Practice question: structured question (page 164)

- a** A budget deficit is the shortfall between the government's annual tax receipts (and other sources of revenue) and its annual spending [1]. The negative difference equals the amount the government has to borrow to meet the shortfall [1].

*Maximum of 2 marks.*

- b** The budget deficit is  $\$865\text{bn} - \$897\text{bn}$  [1] =  $\$32\text{bn}$  [1]

*1 mark for showing working out.*

*1 mark for the correct answer.*

### Practice question: multiple choice (page 164)

**Correct answer: C** Increasing the highest rate of progressive income tax [1 mark]

A government wanting to reduce its budget deficit could increase the highest rate of progressive income tax. This should, all things being equal, increase government tax revenues from the highest income earners in the economy.

### Practice question: structured question (page 167)

- a** An indirect tax is a levy imposed on expenditure [1], e.g. VAT (value added tax) or GST (goods and services tax) [1].

*Maximum of 2 marks.*

- b** Analysis of the advantages for countries that do not impose sales taxes includes:
- Goods and services are relatively cheaper without the sales tax [1], so the cost of living tends to be lower for the country's citizens [1].
  - Relatively lower prices can also encourage consumption and investment expenditure [1], thus boosting total demand in the economy [1].
  - It can give domestic firms a competitive advantage [1], e.g. zero sales taxes in Saudi Arabia, Gibraltar and Qatar [1] compared to sales taxes of 20% in the UK and 25% in Denmark, where prices will tend to be higher [1].

Analysis of the disadvantages for countries that do not impose sales taxes include:

- Opportunity cost of lost/potential tax revenues [1] that could be gained from having a sales tax [1].
- Sales taxes can act as a form of price control [1] as the free market does not always allocate resources efficiently [1], e.g. alcohol, cigarettes and petroleum [1] would be over-consumed without government intervention [1].
- Sales taxes can also be used to alter the pattern of consumption [1], e.g. higher sales taxes on petrol/fuel motor vehicles [1] means that hybrid and electric cars have become increasingly popular [1]. In most countries, there is no taxation on the provision of public transport [1].

- The absence of a sales tax might mean that other, direct taxes have to be higher [1]. Higher direct taxes can cause disincentives to work [1], thus having negative consequences on the economy [1].

*Up to 4 marks for application to the context.*

*Up to 2 marks for justified reasoning.*

*Maximum of 6 marks.*

### Practice questions: structured questions (page 171)

**1 a** Explanations of how taxes can be used to reduce the rate of inflation might include:

- An increased sales tax results in higher prices for consumers [1] and hence lower levels of consumption expenditure in the economy [1].
- Other taxes, such as income tax or corporation tax [1], can also be used to lower the level of consumption and investment expenditure in the economy [1].
- The reduced levels of consumption and investment [1] dampen any effect of demand-pull inflation [1] in Japan.

*Up to 2 marks for each explanation.*

*Maximum of 4 marks.*

**b** Analysis of how an increase in taxation might conflict with macroeconomic objectives of the Japanese government may include:

- Higher taxes can create disincentives to work [1] and reduced levels of consumption [1] and investment [1]. This can therefore conflict with the Japanese government's aim of economic growth [1].
- Higher taxes can also increase costs for firms [1], leading to a negative impact on profits [1] and hence employment [1].
- Higher taxes can also reduce the international competitiveness of Japan [1], thus damaging its balance of payments account [1].
- If taxes are **too** high, disincentives to work [1] and disincentives to invest [1] can actually cause deflation [1] in the economy, rather than stable prices.

*Up to 4 marks for application to the context.*

*Up to 2 marks for justified reasoning.*

*Maximum of 6 marks.*

**2 a** Explanations of how a reduction in VAT from 17.5 to 15 per cent might help to reduce the effects of a recession may include:

- A reduction in VAT would lead to increased consumption [1] as prices would be relatively lower [1].
- Consumer and business confidence levels would be higher [1] as consumption should increase [1] following a fall in the general price level [1].
- International competitiveness would improve [1] as prices are lower on average [1].
- Overall, these impacts of a reduction in VAT would mean that total demand should rise [1], thus boosting the economy out of recession [1].

*Up to 2 marks for each explanation.*

*Maximum of 4 marks.*

- b** Analysis of the impacts of the increase in VAT to 20 per cent may include:
- Prices were higher in the UK due to the 20% tax [1], thus raising the cost of living [1] and negatively affecting consumers [1].
  - Consumption of goods and services was reduced due to the 20% tax [1], thus negatively impacting on economic growth [1] and employment [1].
  - The competitiveness of the UK economy was reduced [1] in relation to countries that charge lower sales taxes [1], e.g. the VAT rate in New Zealand is 15%. [1].
  - Potentially higher government revenue is needed [1] to fund its escalating debts [1].

*Up to 4 marks for application to the context.*

*Up to 2 marks for justified reasoning.*

*Maximum of 6 marks.*

### Practice questions: structured questions (page 173)

- 1** Explanations of why expansionary fiscal policy can cause a budget deficit for the government might include:
- Tax cuts [1], used to stimulate the economy [1], result in the government receiving less tax revenues [1].
  - Increased government spending [1], e.g. on social welfare benefits [1] and national defence [1], depletes the funds in the government's budget [1].
  - Hence, the combination of increased spending and less revenue [1] will eventually cause a budget deficit for the government [1].

*Up to 2 marks for each explanation.*

*Maximum of 4 marks.*

- 2** Analysis of how fiscal policy can be used to promote long-term economic growth may include:
- Tax cuts [1] lead to higher disposable incomes [1] and hence increased consumption [1] in the economy.
  - Tax cuts [1] can improve businesses' liquidity position [1] and hence help with job creation in the long term [1]. Lower corporation tax [1] can attract foreign direct investment [1] into the country, thus improving its international competitiveness [1].
  - Increased government spending [1] stimulates aggregate demand [1] and hence boosts economic growth [1].

*Up to 4 marks for application to the context.*

*Up to 2 marks for justified reasoning.*

*Maximum of 6 marks.*

## Sample answers to chapter review questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Chapter review questions (page 174)

- 1** The government budget is the government's financial plans in terms of planned revenues (mainly tax revenues) and expenditure (such as healthcare, education and welfare payments).
- 2** A budget deficit occurs when government spending exceeds its revenue, and a budget surplus is the opposite.
- 3** Reasons for government spending include: to provide essential services (e.g. education and healthcare), to correct market failures, to encourage output (by subsidising certain industries or providing grants to certain firms) and to redistribute income and wealth.
- 4** Reasons for taxation include: to redistribute income and wealth, to discourage the consumption and production of certain goods or services, to protect domestic firms from foreign competition and to raise government revenue to fund government spending.
- 5** Taxes can be classified as direct, indirect, progressive, regressive or proportional.
- 6** Direct taxes are imposed on incomes; indirect taxes are imposed on spending.
- 7** Progressive taxes impose a larger percentage tax rate for higher-income earners.  
Regressive taxes impose a greater proportion on lower income earners.  
Proportional taxes charge the same rate for different income earners.
- 8** Tax avoidance is the legal act of minimising payment of taxes, such as by avoiding spending on items with a large sales tax. Tax evasion is the illegal act of not paying the correct amount of tax, perhaps due to a firm under-declaring its corporate profits.
- 9** Fiscal policy is the use of taxes and government spending to affect macroeconomic objectives such as economic growth and employment.
- 10** Expansionary fiscal policy involves more government spending and lower taxes to expand the economy, and contractionary fiscal policy is the opposite.
- 11** Expansionary fiscal policy can be used to encourage economic growth and lower unemployment. Contractionary fiscal policy is used to reduce inflationary pressures, which could otherwise cause unemployment problems.

## Section 4: Government and the macroeconomy

### Chapter 24: Monetary policy

#### Answers to activities

##### Activity (page 178)

Student's own research findings.

Answers are likely to focus on Japan's striving to achieve economic growth via negative or extremely low interest rates. Low interest rates should encourage savers to withdraw their money from the bank and spend it. They also mean that debtors pay less interest on loans they have.

There may also be some consideration of external shocks which made low interest rates a priority for the Japanese economy, e.g. the oil crisis of the 1970s, deflation in the country (which lasted for almost 15 years), the global financial crisis of 2008, the aftermath of Japan's worst natural disaster (earthquake and tsunami) in March 2011, strict lockdown laws during the COVID-19 pandemic, low domestic consumption, an ageing population, price controls on energy and wheat, and low wage increases.

#### Sample answers to practice questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

##### Practice question: multiple choice (page 178)

- 1 Correct answer: B** Capital investment in research and development [1 mark]

This is an example of a supply-side policy rather than monetary policy.

##### Practice questions: structured questions (page 178)

- 1** Explanations of how monetary policy can be used to influence the level of economic activity might include:
- Interest rates can be increased [1], as part of tight monetary policy, to contract the economy [1] if there are inflationary pressures (and vice versa) [1].
  - The money supply can be increased [1] during times of economic downturn to improve liquidity [1] in the economy (although this may have inflationary effects).
  - Countries can buy their currencies on the foreign exchange market [1], thereby decreasing supply [1] and allowing the currency to appreciate [1] to deflate the economy [1] during times of rapid economic boom and overspending on exports [1].

*Up to 2 marks for each explanation.*

*Maximum of 4 marks.*

- 2 Explanations of how the interest rate policy can help a country to control its inflation rate might include:
- With higher interest rates, households and firms with outstanding mortgages have higher interest payments to make [1], and thus are left with less disposable income to spend [1].
  - With higher interest rates, savers have more of an incentive to deposit their money in banks [1], and so are more likely to save their money [1]. This reduces the level of consumption in the economy [1], thus easing its inflation rate [1].
  - Higher interest rates also tend to lead to a higher exchange rate [1], thus causing a reduction in the demand for the country's exports [1].

*Up to 2 marks for each explanation.*

*Maximum of 4 marks.*

## Sample answers to chapter review questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Chapter review questions (page 178)

- 1 Money supply is the amount of money in the economy at a particular point in time, e.g. coins, banknotes, bank deposits and central bank reserves.
- 2 Monetary policy refers to the use of interest rates, exchange rates and the money supply to control macroeconomic objectives and to affect the level of economic activity. The three policy measures are: controlling the money supply, the manipulation of exchange rates and the use of interest rate policy.
- 3 Loose monetary policy is used to expand the economy (perhaps due to a recession), whereas contractionary monetary policy is used to constrain it (perhaps to avoid inflationary pressures).
- 4 In general, lower interest rates help to stimulate consumption and investment spending in the economy.

## Section 4: Government and the macroeconomy

### Chapter 25: Supply-side policy

#### Answers to activities

##### Activities (page 183)

Various answers are possible, depending on the student's choice of country. Look for evidence (such as key facts, figures and statistics) to support the student's claims.

##### Activity (page 184)

Student's own responses based on the five countries they choose to investigate. The main purpose of this task is to get students to think like economists when trying to establish links between theory and empirical evidence.

#### Sample answers to practice questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

##### Practice question: multiple choice (page 184)

**1 Correct answer: C** Progressive income tax policies [1 mark]

Progressive income tax policies are an example of fiscal policy. Deregulation (Option A) helps to make markets more efficient. Investment in human capital (Option B) helps to increase productivity and national output. Tax reforms to create incentives to work (Option D) also help to boost the economy's productive capacity.

##### Practice questions: structured questions (page 184)

**1** Supply-side policies are long-term measures to increase the productive capacity of the economy [1], leading to an outward shift of the production possibility curve [1].

*Maximum of 2 marks.*

**2** Examples of supply-side policies include education [1], training [1], infrastructure spending [1], tax reforms [1], privatisation [1] and deregulation [1].

*1 mark for each (×2) example of a supply-side policy.*

*Maximum of 2 marks.*

**3** Analysis of how supply-side policies can help to achieve any *two* macroeconomic objectives might include:

- To achieve economic growth [1] – supply-side policies aim to shift the aggregate supply (or production possibility curve) of the economy outwards to the right [1]. This means an increase in the economy's productive capacity [1] and hence its prospects for achieving higher levels of national output [1], thus leading to economic growth [1].

- To achieve stable prices [1] – while demand-side policies can boost economic growth, they tend to cause inflationary pressures in the economy [1]. With supply-side policies, national output is able to match any increases in aggregate demand [1], thus dampening inflationary forces [1].
- To achieve low unemployment [1] – supply-side policies ultimately help to improve the efficiency and competitiveness of firms [1]. Therefore, in the long run, job creation [1] will help the government to achieve its macroeconomic goal of low unemployment [1].
- To achieve a healthy balance of payments [1] – as supply-side policies, such as improved education and training [1], help to increase the international competitiveness of an economy [1], there is likely to be a boost in export sales and earnings [1]. This helps to improve the country's balance of payments [1].

*Up to 4 marks for application to the context.*

*Up to 2 marks for justified reasoning.*

*Maximum of 6 marks.*

## Sample answers to chapter review questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Chapter review questions (page 185)

- 1 Supply-side policy is the long-term measures used to increase the productive capacity of the economy, leading to an outward shift of the production possibility curve.
- 2 The main supply-side policy measures are education and training, infrastructure spending, labour market reforms, lower direct taxes, deregulation, incentives to work, incentives to invest and privatisation.
- 3 Investment in education and training improves labour productivity, thereby increasing the economy's productive capacity.
- 4 Labour market reforms enhance economic flexibility by allowing firms to adapt more efficiently to changing market conditions. For example, reducing employment protection laws makes it easier for firms to hire and dismiss workers based on demand, improving resource allocation. Wage flexibility ensures that firms can adjust labour costs according to market conditions, maintaining competitiveness while preventing excessive unemployment. In addition, promoting diverse employment contracts, such as part-time or temporary work, enables firms to meet labour needs more effectively while providing workers with greater job opportunities. These reforms contribute to a more dynamic economy by reducing structural unemployment, improving productivity and fostering innovation. By ensuring that labour markets operate efficiently, economies become more resilient to external shocks, supporting long-term economic growth and employment.
- 5 Lower taxes create incentives to work and invest because households can earn more after-tax (disposable) income, and firms have more retained profit to use for investment purposes.
- 6 Deregulation is the reduction or removal of barriers to competitive markets.

- 7 Enterprise zones are special areas, designated by the government, with special concessions (e.g. tax exemptions and subsidies/grants) created to grow the economy.
- 8 Privatisation promotes competition as private firms wish to maximise profits and are more efficient, thereby increasing output in the economy (and hence its productive capacity).
- 9 Examples of how supply-side policies can be used to achieve macroeconomic aims:
  - sustainable growth – e.g. cuts in corporation tax
  - full employment/low unemployment – investment in training and education
  - stable/low prices – investment in infrastructure to increase the long-term productive capacity of the economy
  - balance of payments stability – increase productivity to keep prices competitive and therefore improve demand for exports
  - redistribution of income – cut income taxes for those on lower incomes and raise income taxes for those on higher incomes
  - environmental sustainability – invest in renewable energy.
- 10 The main criticism of supply-side policies is the very long time lags between implementing the policies and reaping the benefits.

## Section 4: Government and the macroeconomy

### Chapter 26: Economic growth

#### Answers to activities

##### Activity (page 190)

- a Government spending on infrastructure and training programmes for the unemployed helps to boost the productive capacity of the economy in the long run. Infrastructure spending is capital investment and training programmes are investments in human capital. Hence, such spending is regarded as investment expenditure.
- b The spending by foreign tourists represents export earnings because Mauritius received the money from foreign visits.
- c Investment, as a key component of aggregate demand, can have a huge impact on the level of a country's economic growth. There is also a direct correlation between the level of business confidence (in the economy) and the amount of investment, and hence its importance in the level of economic growth.

##### Activity (page 191)

Student's own research. [www.ourworldindata.org](http://www.ourworldindata.org) is a good source of information.

There seems to be a positive correlation between an economy's share of the world's GDP and its CO<sub>2</sub> emissions.

Flaws in the statistics may include problems of measuring CO<sub>2</sub> emissions and collecting data, CO<sub>2</sub> and GDP per capita being artificially high due to a country having a small population or being artificially low because of a large population. Statistics are always backward-looking and may be inaccurate. Different countries may use different methods of measurement.

##### Activity (page 192)

Student's own findings and responses. Students might want to revisit the topic of market failure (Chapter 13) before tackling this activity.

Findings might include:

- Over time depletion of fish stocks will have a negative impact on the fishing industry as there will be fewer fish to catch.
- This will affect future employment in the fishing industry and related industries.
- This will cause structural unemployment and may cause unemployment in countries' fishing regions.

##### Activity (page 194)

The three general policies for reducing unemployment are fiscal policy, monetary policy and supply-side policies. Students might want to look at Chapters 23, 24 and 25 before tackling this activity.

- 1 Fiscal policy**, e.g. reduction in tax rates and increase in government spending. A reduction in tax rates may encourage people to go back to work as they have to pay less income tax. Firms may hire more people as they have less tax to pay and therefore costs are reduced. Government spending on large infrastructure projects may create jobs in the short term and in the long term may make the economy more productive and attract foreign direct investment, which may lead to job creation.

Issues with fiscal policies include:

- The government may have a budget deficit and therefore no funds to finance additional spending. It may be spending large sums on welfare payments to the unemployed.
- High levels of unemployment mean that less income tax revenue is collected. This reduces funds available for spending. Government spending on short-term projects may only reduce unemployment in the short term. Governments may need to borrow to fund spending and such borrowing may increase the national debt.

- 2 Monetary policy**, e.g. a decrease in interest rates to encourage borrowing and spending, and investment in the economy. This may increase demand for goods and services, and therefore demand for labour to produce the goods and services.

Issues with monetary policies include:

- Interest rates may already be low and therefore a further decrease may have no effect on spending.
- Lower interest rates may lead to inflation.
- Very high rates of unemployment usually mean that levels of business and consumer confidence in the economy are low. A reduction in interest rates will not have any effect on spending because consumers and firms are saving and not spending due to the uncertain future.

- 3 Supply-side policies** seek to increase competition, productivity and innovation to promote economic growth and reduce unemployment in the long run. Examples include government funding to encourage education and training. A reduction in corporate taxes may encourage risk-taking and foreign direct investment in the economy.

Issues with supply-side policies include:

- They take a long time to be effective.
- Education and training require government funds and there may be no jobs for the newly trained workers.
- Lowering tax rates reduces tax revenue for the government.

## Sample answers to practice questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Practice question: structured question (page 188)

Australia 1,724 bn/26.97 mn = \$63,922 [1]

Cambodia 31.77 bn/16.94 mn = \$1,875 [1]

*Maximum of 2 marks.*

*Accept the correct figure without the \$ sign.*

**Practice question: structured question (page 191)**

- a** Economic growth is the annual increase in the level of national output [1], as measured by the annual percentage change in real gross domestic product (GDP) [1].

*Maximum of 2 marks.*

- b** Explanations of how investment in India helps to boost its economic growth might include:
- Foreign direct investment [1], from foreign firms wishing to open factories in India, creates jobs [1], spending [1] and economic growth [1] in India.
  - Investment itself is a component of aggregate demand [1], so an increase in domestic investment, e.g. government spending on infrastructure, will tend to increase the level of GDP and hence economic growth [1].
  - Investment, if effective, will increase the economy's productive capacity [1] (an outward shift of its production possibility curve). This helps to improve the economy's productivity [1] and competitiveness [1], thereby increasing India's long-term economic growth.

*Up to 2 marks for each explanation.*

*Maximum of 4 marks.*

**Practice question: structured question (page 194)**

- a** The social costs of economic growth in Cambodia include:
- The external costs [1] to society caused by the increased construction of roads [1], hotels [1] and factories [1].
  - The construction has led to destruction of natural wildlife habitats, such as mangroves [1], and depletion of fish stocks due to overfishing [1].
  - The increased number of tourists may further impact the natural environment in a negative way [1], e.g. damage to ecosystems [1].

The social benefits of economic growth in Cambodia include:

- The increase in tourism increases the exports [1] of Cambodia and the income of local shops and businesses [1], which will increase economic growth [1].
- Private benefits [1] of income obtained from tourism [1].
- Private benefits of increased trade [1] due to better access to roads and improved transport links [1].
- Private benefits to individuals of income from employment [1].

*Up to 2 marks for identifying relevant social costs.*

*Up to 2 marks for identifying relevant social benefits.*

*Maximum of 4 marks.*

- b** The potential long-term benefits of economic growth in Cambodia include:
- Increased income for individuals and businesses, as measured by the 17.8% decrease in the number of people living in poverty.
  - The increase in income can be spent on goods and services or saved, and an increase in savings can lead to an increase in investment.

- This may lead to higher standards of living for a wide range of people.

The potential long-term costs of economic growth in Cambodia include:

- The negative impact on the environment in terms of loss of natural vegetation and wildlife habitats.
- The development of hotels and guest houses may bring too many people into the area, which requires sewerage and disposal of the excess waste produced.
- An increase in tourism may damage the local culture as businesses try to cater for foreign tastes.

Overall, the increase in living standards may outweigh the damage to the environment because many people may be able to improve their quality of life. Development may be managed in a sustainable way.

Award marks according to the following mark scheme:

Level	Description	Marks
Strong answer	Excellent knowledge and understanding of relevant economics concepts, using appropriate terminology in context. Detailed discussion of the potential long-term impacts of economic growth in Cambodia and whether the benefits outweigh the costs. Students who develop both sides of the argument in a considered way, with well-justified reasoning, including why the alternative viewpoint is rejected, should be rewarded with the top marks in the band.	6–8
Moderate answer	Good knowledge and understanding of relevant economics concepts, using appropriate terminology in context. Detailed discussion of at least <b>one</b> viewpoint. Judgement with some justification/evaluation of choices made. Students should be rewarded with top marks in the band if there is discussion of <b>two</b> viewpoints in detail.	3–5
Weak answer	Limited knowledge and understanding of relevant economics concepts in context. Limited ability to discuss the potential long-term impacts of economic growth in Cambodia and whether the benefits outweigh the costs, with little or no expression of viewpoints. Students who discuss one viewpoint and give a reason for coming to their decision should be rewarded with the top mark in the band.	1–2
	No creditable response.	0

## Sample answers to chapter review questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Chapter review questions (page 195)

- 1** Real GDP refers to the value of national income (GDP) that is adjusted for inflation.
- 2** Economic growth is the annual increase in the level of national output. It is measured by the annual percentage change in GDP.
- 3** Causes of economic growth depend on the quality and quantity of a country's factors of production, e.g. factor endowments, the labour force, labour productivity and investment expenditure. Increased demand can also cause economic growth.
- 4** Positive consequences include improved standards of living, decreased unemployment and increased tax revenues. Negative consequences include damage to the environment, inequalities in income and wealth, risk of inflation and resource depletion.
- 5** A recession occurs in the business cycle when there is a fall in GDP for two consecutive quarters of a year.
- 6** The business cycle (or trade cycle) describes the fluctuations in the economic activity of a country over time, creating a long-term trend of economic growth in the economy.
- 7** Real GDP is the value of national income (GDP) adjusted for inflation to reflect the true value of goods and services produced in a given year. It is a key measure of a country's economic growth and standard of living as real GDP indicates the level of the national income after adjustments for inflation. *Ceteris paribus*, the larger the real GDP for a nation, the higher its standard of living tends to be.
- 8** Expansionary fiscal policy, loose monetary policy and supply-side policies are the main policies used to promote economic growth.

## Section 4: Government and the macroeconomy

### Chapter 27: Employment and unemployment

#### Answers to activities

##### Activity (page 200)

Student's own responses.

Students might opt to tackle this activity for a specific country of their choice or present their work for a variety of countries.

##### Activities (page 200)

Student's own answers depending on their choice of country. Encourage students to determine trends in their findings.

#### Sample answers to practice questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

##### Practice questions: structured questions (page 198)

**1** Unemployment rate =  $5\text{m}/(40\text{m} + 5\text{m}) \times 100$  [1] = 11.11% [1]

*Maximum of 2 marks.*

**2** Unemployment rate = 7.5%

Working age population = 26 million

Unemployed total =  $26 \text{ million} \times 0.075$  [1] = 1.95 million people [1]

*Maximum of 2 marks.*

**3 a** The unemployment rate = 5%, i.e.  $x$  number of people out of a working population of 75.7 million people =  $3.785\text{m}/75.7\text{m} = 5\%$  [1]

Hence, the number of unemployed people in Nigeria is **3.785 million** [1].

*Maximum of 2 marks.*

**b** Reasons why Nigeria's youth unemployment of 8.6 per cent in 2023 was higher than its average unemployment rate of 5 per cent might include:

- Nigeria's large population of young people [1] may find it difficult to get jobs [1] as the supply of young, inexperienced workers is greater than the demand [1].
- Gender inequalities [1] resulting in low female participation rates [1] may result in young women being unemployed.
- As most people are employed in primary sector industries [1], there are limited growth and employment opportunities [1].

- Young workers have no experience [1] and firms may prefer older and more experienced workers [1].

*Up to 2 marks for setting out each (×2) valid reason.*

*Maximum of 4 marks.*

**4 a** Explanations of why it might be difficult at times to know the exact rate of unemployment in a country may include:

- Time lags in collecting unemployment data [1].
- Data collection is time consuming and requires government funding [1]. This may not be a priority of the government of a country [1].
- The data collected are only estimates and not exact [1].
- Unreported or illegal employment activities [1].
- Different interpretations of ‘unemployment’ and therefore how it is measured [1], e.g. are part-time workers unemployed [1]? Does this depend on how ‘part-time’ they are? What is classed as the ‘working age’ in different countries [1]? The International Labour Organization (ILO) has four different ways to calculate the unemployment rate [1].

*Up to 2 marks for each valid explanation.*

*Maximum of 4 marks.*

**b** Analysis of the possible consequences of low unemployment for the Bangladeshi economy might include:

- With low unemployment, there are higher rates of economic growth [1] as the employed have greater spending power [1], thus boosting aggregate demand in the economy [1].
- Low unemployment brings improved standards of living in the economy [1].
- Low unemployment brings increased pressure on the general price level [1], i.e. inflationary pressures are likely to mount [1] with the higher employment levels.
- Wages are likely to rise [1] in response to the higher levels of demand for labour [1].
- A shortage of available labour [1] will also tend to raise the average wage rate [1].

*Up to 4 marks for application to the context.*

*Up to 2 marks for justified reasoning.*

*Maximum of 6 marks.*

### Practice question: structured question (page 203)

**a** Unemployment occurs when people of working age are both willing and able to work [1] but cannot find employment [1].

*Maximum of 2 marks.*

**b** Analysis of the ways in which the UK government could reduce unemployment caused by technological advances such as AI and machine learning might include:

- Incentives could be given to retrain staff [1], e.g. funding could be provided to retrain supermarket cashiers [1] to work in other departments such as the bakery, delicatessen, stock control or customer service [1].

- Tax breaks and/or subsidies could be given [1] to encourage businesses to hire new workers [1].
- Funding for education, retraining and skills training could be given [1] to help the technologically unemployed to find employment in other industries [1].
- Government spending could be increased, leading to job creation [1], e.g. on construction and infrastructure projects [1].

*Up to 4 marks for application to the context.*

*Up to 2 marks for justified reasoning.*

*Maximum of 6 marks.*

### Practice question: multiple choice (page 203)

**Correct answer: D** There is no agreement on the measurement of unemployment [1 mark]

The general way to measure unemployment is the International Labour Organization (ILO) method, which allows for international comparisons of unemployment figures between countries.

## Sample answers to chapter review questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Chapter review questions (page 203)

- 1 Unemployment is the non-use of an economic resource, usually in the context of labour, i.e. those who are willing and able to work but are unable to find employment.
- 2 The International Labour Organization (ILO) measures unemployment using the Labour Force Survey (LFS).
- 3 The unemployment rate is calculated using the following formula:  

$$\frac{\text{number of unemployed}}{\text{workforce}} \times 100$$
- 4 Employment is a macroeconomic objective of all governments because unemployment is a waste of economic resources, and employment is required for economic growth and sustainable economic development.
- 5 The main causes (or types) of unemployment are frictional, structural, seasonal and cyclical unemployment.
- 6 Four consequences of high unemployment in an economy are: personal pressures (e.g. stress and low self-esteem); pressures on society (e.g. family and friends, crime rates, falling house prices); loss of international competitiveness; loss of tax revenues.
- 7 Fiscal, monetary, protectionist and supply-side policies are the four main government policies that can be used to reduce domestic unemployment.
- 8 Three supply-side policies that can be used to reduce unemployment are investment in education and training, reducing labour market regulations and creating incentives to work.

## Section 4: Government and the macroeconomy

### Chapter 28: Inflation

#### Answers to activities

##### Activity (page 211)

Student's own responses.

Economic strategies are likely to be any combination of demand-side policies (fiscal and monetary policies) and supply-side policies (such as research and development, education, training, deregulation and labour market reforms). Depending on the size of the class, this activity can work just as well with slightly larger groups of four or five.

##### Activity (page 215)

Student's own responses.

Those living in Kuwait and Saudi Arabia, for example, would have very different answers from those living in Singapore or Taiwan. Stakeholders could include suppliers (of oil), consumers, car manufacturers and governments.

#### Sample answers to practice questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

##### Practice question: structured question (page 206)

- a** The inflation rate is an economic indicator of the cost of living in an economy [1], as measured by the consumer price index [1].

*Maximum of 2 marks.*

- b** Although the rate of inflation was highest in the first year (2.5%) and lowest in the second year (1.7%) [1], prices were highest in the third year as there has been inflation throughout the period [1]. Although the rate of inflation fell in the second year, this simply means that prices rose at a slower pace [1] – prices were still higher on average [1].

*Maximum of 4 marks.*

##### Practice questions: structured questions (page 209)

- 1 a** Rate of inflation =  $((129.15 - 123)/123) \times 100 = 5.0\%$   
**b** Consumer price index =  $130 \times 1.03 = 133.9$   
**c** Inflation rate =  $((135 - 125)/125) \times 100 = 8\%$

Hence, the price of the basket of goods and services =  $1,200 \times 1.08 = \$1,296$

*For each question part, award 1 mark for the correct answer and 1 mark for showing appropriate working.*

- 2 a** A consumer price index (CPI) is used to calculate the rate of inflation [1]. It measures changes in average prices of items in a representative basket of goods and services for the average household in the economy [1], over time.

*Maximum of 2 marks.*

- b** The weight for housing is 30, so the typical household in Country Y spends 30% of its income on housing costs [1]. However, it only typically spends 20% of its income on food and 10% on clothing [1]. The weights are used to represent the percentage of the average household income [1] spent on these items, clearly showing that more is spent on housing than the other two items [1].

*Maximum of 4 marks.*

### Practice questions: multiple choice (page 211)

- 1 Correct answer: A** Higher interest rates to make borrowing more difficult [1 mark]  
Higher interest rates tend to reduce aggregate demand, due to the higher costs of borrowing and greater incentive to save. Hence, this is unlikely to cause demand-pull inflation.
- 2 Correct answer: A** A reduction in indirect taxes [1 mark]  
A cut in indirect taxes will reduce costs for businesses, rather than increase the costs. An increase in demand for exports (Option B) will cause higher costs for firms that need to export their goods overseas. Options C and D also increase costs for firms.

### Practice question: structured question (page 211)

- a** The rate of inflation was highest around Q1 of 2022 [1] and lowest in mid-2017 [1].

*Maximum of 2 marks.*

- b** Demand-pull inflation is a cause of inflation [1], triggered by higher levels of aggregate demand [1] in the economy driving up the general price level. Whilst cost-push inflation is also a cause of inflation [1], it is triggered by higher costs of production [1] forcing up prices. Demand-pull inflation is regarded as less threatening as it is associated with economic growth [1], whereas cost-push inflation is associated with lower levels of national output [1] (due to higher costs of production).

*Up to 2 marks for explaining cost-push inflation.*

*Up to 2 marks for explaining demand-pull inflation.*

*Maximum of 4 marks.*

- c** Analysis of why the COVID-19 pandemic might have caused India's inflation rate to rise may include:
- COVID-19 will have caused supply chain disruptions [1], thereby causing India's inflation rate to rise due to increased production costs [1].
  - There may have been a surge in demand [1] for essential goods, such as healthcare products and personal protective equipment [1].
  - Lockdowns and trade restrictions limited the supply of goods and services [1], leading to higher prices as demand outstripped supply [1].
  - Increased government spending to support the economy during the pandemic [1] may have led to higher money supply in the economy, thereby contributing to inflation [1].

- There may have been imported inflation [1]. Global supply chain disruptions and increased international shipping costs during the pandemic will have raised the prices of imported goods, contributing to overall inflation in India [1].

*Up to 4 marks for application to the context.*

*Up to 2 marks for justified reasoning.*

*Maximum of 6 marks.*

### Practice question: structured question (page 214)

Year	Inflation rate (%)	Wage increase (%)	Real wage increase (%)
	A	B	B – A
1	2.5	3.0	+0.5
2	3.1	3.5	+0.4
3	2.9	3.1	+0.2

- a** The largest increase in real wages occurred in Year 1, when workers received a 3% pay rise and inflation was 2.5% [1], i.e. the average worker enjoyed a 0.5% real wage increase [1].

*Maximum of 2 marks.*

- b** Workers received a 3.1% nominal pay rise in Year 3, and although this is less than the 3.5% received in Year 2, the worker received more nominally, overall [1]. In both years, the real pay rise is positive as the nominal wage increase is greater than the inflation rate [1].

*Maximum of 2 marks.*

### Practice questions: structured questions (page 214)

- 1 a** Deflation is the sustained fall in the general price level in an economy over time [1], i.e. the inflation rate is negative [1].

*Maximum of 2 marks.*

- b** Deflation is shown by a negative inflation rate [1] and the graph suggests that Japan has suffered deflation for parts of the past 10 years [1], i.e. all areas below 0% inflation in the graph [1]. For example, Japan suffered deflation for most of 2016 and from around September 2020 to September 2021 [1].

*Maximum of 4 marks.*

- 2 a** Explanations of why prices in Iran were generally higher in April 2024 than in April 2023 might include:

- The rate of inflation remained positive during this period [1], despite the rate of change falling from 55.5% in April 2023 to 30.9% in April 2024 [1].
- The reduced government subsidies for food and fuel [1] would have caused prices to increase [1], thereby driving inflation up in Iran [1].
- The international sanctions imposed on Iran [1] caused a depreciation in the value of the rial [1], causing the price of vital imports to rise (imported inflation) [1].

*Maximum of 4 marks.*

- b** Reasons why the Iranian government might aim to control the level of inflation in its economy may include:
- To maintain price stability in the economy [1]. This can have a large impact on consumer and producer confidence levels [1], and hence affect the economic wellbeing of the nation [1].
  - Inflation causes an increase in the cost of living [1], thus creating social hardship for many people if it is not controlled [1].
  - Inflation, if not controlled [1], could damage the international competitiveness of the Iranian economy [1].

*Up to 2 marks for setting out each (×2) valid reason.*

*Maximum of 4 marks.*

- c** Analysis of how some Iranians are likely to have been more affected than others by double-digit inflation rates might include:
- The reduction in the food subsidies [1], which was a major cause of inflation [1], would have a greater negative impact on low-income earners [1].
  - Similarly, the significant fall in real incomes [1] will affect low-income earners more than wealthy members of the Iranian economy [1].
  - Exporters would find it increasingly difficult to compete in international markets [1] due to the 30%+ inflation rates [1].
  - Savers would see the real value of their savings decline rapidly [1].
  - Employers may face increasing pressures from employees for increased wages [1] due to the real decline in their income [1].

*Up to 4 marks for application to the context.*

*Up to 2 marks for justified reasoning.*

*Maximum of 6 marks.*

## Sample answers to chapter review questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Chapter review questions (page 216)

- 1 Inflation is a sustained rise in the general level of prices of goods and services over time, as measured by a consumer price index (CPI).
- 2 The Consumer Price Index is a weighted index of consumer prices in the economy over time. It is used to measure the cost of living for an average household.
- 3 Weights are used in the calculation of the CPI to represent the relative importance of items in the average household basket of goods and services.
- 4 A base year is the starting year when calculating a price index.
- 5 Demand-pull inflation and cost-push inflation are the two key causes of inflation.
- 6 The main consequences of inflation are menu costs and shoe leather costs, and various impacts on consumers, savers, borrowers, lenders and workers on fixed incomes.

- 7 Deflation is the sustained fall in the general price level in an economy over time, i.e. the inflation rate is negative.
- 8 Fiscal, monetary and supply-side policies can be used to deal with inflation.

## Section 5: Economic development

### Chapter 29: Living standards

#### Answers to activities

##### Activity (page 220)

The website <http://hdr.undp.org/en/composite/HDI> gives the component parts of the Human Development Index (HDI) for each country.

- *Country A:* Australia. It has very high human development, with real gross national income (GNI) per capita of \$49,257, life expectancy of 83.7 years, 12.7 mean years of schooling and 21.1 expected years of schooling.
- *Country B:* Russia. It fits the description of very high levels of human development, with 12.4 mean years of schooling, 15.7 expected years of schooling, life expectancy of 70.1 years and approximately \$26,992 GNI per capita.
- *Country C:* Vietnam. It has medium human development, with life expectancy of 74.6 years, 8.5 mean years of schooling, 13.1 expected years of schooling and low real GNI per capita of \$10,814.
- *Country D:* Ethiopia. It has low human development, with life expectancy of 65.6 years, 2.4 mean years of schooling, 9.9 expected years of schooling and a low real GNI per capita of \$2,369.

##### Activities (page 220)

- 1 The top ten countries as measured by the HDI can be found at:  
<http://hdr.undp.org/en/composite/HDI>
- 2 Student's own answers. They may raise the following points:
  - There are limitations in using the HDI to measure living standards.
  - Qualitative factors – the HDI ignores qualitative factors affecting living standards, such as gender inequalities and human rights.
  - Income distribution – the HDI does not take account of the inequitable distribution of income in the economy, and thus is a less accurate indicator of living standards for the 'average' person.
  - Environmental issues – the HDI ignores environmental and resource depletion resulting from economic growth.
  - Cultural differences – although the HDI is a composite indicator, it ignores cultural differences and interpretations of the meaning of 'standard of living'.

## Sample answers to practice questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Practice questions: multiple choice (page 222)

**1 Correct answer: C** Population size [1 mark]

Population size is not a measure of living standards. Countries with large populations, such as the USA, can enjoy high standards of living for the average person, but so can countries with small populations, such as Luxembourg and Macau. The other three options are part of the HDI, so do measure standards of living.

**2 Correct answer: A** Higher real GDP per head means the average citizen can buy more goods and services. [1 mark]

On average, people are able to purchase more if their real GDP increases. Whilst Option B is partially true, there are other important indicators, such as healthcare and education (not necessarily only changes in price levels). Option C is incorrect as the labour force can actually be more productive if the population size increases. Option D is not correct as real GDP per head is not the only measure of living standards, e.g. many countries prefer to use the HDI.

## Sample answers to chapter review questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Chapter review questions (page 222)

- 1** Living standards refers to the social and economic wellbeing of individuals in a country at a particular point in time.
- 2** Real GDP per head is a measure of living standards that involves dividing a country's GDP by the size of the country's population adjusted for inflation. GDP per head is not adjusted for inflation.
- 3** The HDI is the United Nations' composite indicator of living standards in a country, comprising three dimensions of human development: education, healthcare and income.
- 4** The limitations of using the HDI as a measure of living standards include:
  - Qualitative factors**, e.g. the HDI does not take into account human rights and gender inequalities.
  - Income distribution**, e.g. increases in real GDP may not be shared equally by all members of society.
  - Environmental issues**, e.g. the HDI ignores environmental and resource depletion resulting from economic growth.
  - Cultural differences**, e.g. the HDI ignores cultural differences and interpretations of the meaning of standards of living.
- 5** Reasons include differences in productivity levels, population size, income inequalities, the distribution of national income, the general price level, the overall level of educational attainment, measures of freedom and regional differences in incomes.

## Section 5: Economic development

### Chapter 30: Poverty

#### Answers to activities

##### Activity (page 230)

Student's own answers based on their research and findings. Encourage students to use economic data as evidence in their reflections. Examples of possible sources include Trading Economics, the World Bank, the IMF, the OECD and the CIA Factbook.

#### Sample answers to practice questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

##### Practice question: structured question (page 224)

- a** Poverty exists when people lack adequate income and wealth to sustain a basic standard of living [1], i.e. they lack the resources to ensure sustainable livelihoods [1].

*Maximum of 2 marks.*

- b** Poverty is a concern for the US government because it creates many social and economic problems [1], such as the consequences of poor health [1], e.g. malnutrition (and therefore productivity losses) [1], deaths [1], crime [1], high unemployment [1], homelessness [1], social exclusion [1], welfare provision [1] and lost national output [1].

*Up to 2 marks for setting out why poverty is a concern.*

*Up to 2 marks for giving examples of the consequences of poverty.*

*Maximum of 4 marks.*

- c** The standard of living tends to be higher in developed countries than in developing countries because:
- Higher real GDP per capita helps people to meet their basic human needs and to purchase many of their wants.
  - Higher GDP can help to eradicate poverty in the economy.
  - It also ensures all households can access basic amenities such as water, electricity, telephone services and education.

However, the standard of living is not always higher in developed countries because:

- Striving for economic growth (and hence the perceived higher living standards) can cause stress and health problems.
- Money is not the only source of improved living standards; other factors include health, family, friendship groups, leisure hours, and political and economic freedom.
- Congestion, pollution and environmental damage in developed countries do very little for improved standards of living.

- It depends on the causes and consequences of economic growth, e.g. increased military spending, which causes an increase in GDP, does not necessarily improve people's standard of living.

Award marks according to the following mark scheme:

Level	Description	Marks
Strong answer	Excellent knowledge and understanding of relevant economics concepts, using appropriate terminology in context. Detailed discussion of whether the standard of living is always higher in developed than in developing countries. Students who develop both sides of the argument in a considered way, with well-justified reasoning, including why the alternative viewpoint is rejected, should be rewarded with the top marks in the band.	6–8
Moderate answer	Good knowledge and understanding of relevant economics concepts, using appropriate terminology in context. Detailed discussion of at least <b>one</b> viewpoint. Judgement with some justification/evaluation of choices made. Students should be rewarded with top marks in the band if there is discussion of at least <b>two</b> viewpoints in detail.	3–5
Weak answer	Limited knowledge and understanding of relevant economics concepts in context. Limited ability to discuss whether the standard of living is always higher in developed than in developing countries, with little or no expression of viewpoints. Students who discuss one viewpoint and give a reason for coming to their decision should be rewarded with the top mark in the band.	1–2
	No creditable response.	0

## Sample answers to chapter review questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Chapter review questions (page 230)

- 1 Poverty is a condition that exists when people lack adequate income and wealth to sustain a basic standard of living. Signs of poverty in the economy include famine, malnutrition, high unemployment, low incomes and high crime rates.
- 2 Absolute poverty exists when there is extreme outright poverty, i.e. income equal to or less than \$2.15 per day. Relative poverty is a comparative measure of poverty, referring to those who have a lower standard of living in comparison to the average member of society.
- 3 The main causes of poverty are unemployment, low wages, poor healthcare and illness, age, environmental factors (such as severe droughts or floods), low GDP per capita, low savings, low investment, high population growth, poor infrastructure, low productivity, poor healthcare provision, lack of education, corruption and instability in the economy.

- 4 Low prices and low profit margins hinder economic growth and development.
- 5 Economic growth, education, healthcare, welfare benefits, progressive taxes and a national minimum wage are the main policies that can be used to alleviate poverty and redistribute income in the economy.

## Section 5: Economic development

### Chapter 31: Population

#### Answers to activities

##### Activity (page 234)

Student's own responses. Consider comparing the different answers from students, and see who gets the closest to the official figure.

##### Activity (page 235)

Student's own responses. The results can be quite astonishing – and will make an interesting classroom display.

Reasons why such findings might be of interest to economists include:

- High costs might lead to lower birth rates and ageing populations.
- Consumption of items required by young people will affect expenditure patterns and this will impact providers of goods and services in the private and public sectors.
- The costs will affect how much governments have to spend on childcare, health and education.

##### Activity (page 238)

Student's own responses.

For the third part of this activity, it might be worthwhile reminding students to investigate the question from the perspective of an economist. A good starting point is to watch this video clip on YouTube: [www.youtube.com/watch?v=mRBT70\\_RIWM](http://www.youtube.com/watch?v=mRBT70_RIWM)

##### Activity (page 239)

Student's own responses.

A good website for obtaining population statistics is [www.populationpyramid.net/](http://www.populationpyramid.net/)

The following website provides a good animation of the population distributions of the ten most populous countries: [www.visualcapitalist.com/population-pyramids-compared/](http://www.visualcapitalist.com/population-pyramids-compared/)

#### Sample answers to practice questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

##### Practice question: structured question (page 238)

- a** The ratios for all age brackets (except 65 years and over; although the policy was only introduced in 1979) show there are more males than females [1]. This is likely to have been a result of the one-child policy, where Chinese families prefer, culturally, male offspring in order to carry on the family name and because they have higher earning potential, and some female babies have therefore been abandoned [1].

Maximum of 2 marks.

- b** Explanations of two economic implications for a country that has an uneven gender ratio may include:
- There will be a significant drop in population growth [1], with economic consequences in the long term, as the number of males considerably exceeds the number of females [1].
  - A significant gender imbalance can lead to labour shortages in certain industries [1], reducing productivity and economic output [1]. For example, a surplus of men may limit workforce diversity and innovation [1].
  - Family planning and marriage will become more problematic [1], causing instability in society [1].
  - There will be changes in consumer patterns and expenditure [1] (e.g. males versus females, and families versus individuals).

Up to 2 marks for setting out each ( $\times 2$ ) valid economic implication.

Maximum of 4 marks.

### Practice questions: structured questions (page 240)

- a** An explanation of one possible cause of the increase in the size of Nigeria's population might be:
- High fertility rates [1], perhaps due to limited access to family planning services in Nigeria [1].
  - Low mortality (death) rates [1].
  - Improvements in public health services [1], thus increasing the average person's lifespan [1].
  - Higher food production and improved food distribution [1], thus affecting nutrition, health and longevity.
  - Lack of sex education [1] about contraception [1] or the high cost of using contraception in the country [1].
  - Cultural or religious unacceptability of contraception in the country [1].
  - Children become a valuable source of labour and income [1], especially when parents become elderly [1].

Maximum of 2 marks.

- b** Explanations of two economic problems which could be associated with the increase in the size of Nigeria's population might include:
- Threats to the environment [1] due to rapid increases in economic activity [1], e.g. deforestation and fragmentation of land [1].
  - Competition for limited resources [1], e.g. food, housing, healthcare and education [1].
  - Poverty [1] due to there not being enough goods and services for the rapidly rising Nigerian population [1].
  - Urbanisation and its related problems [1], e.g. traffic congestion, pollution, housing shortages and higher demand for infrastructure (such as road and transport networks) [1].

- Increased borrowing and debt [1] for the country and/or increased government expenditure [1].
- Unemployment problems [1].

Up to 2 marks for setting out each ( $\times 2$ ) valid economic problem.

Maximum of 4 marks.

- c** Measures that the Nigerian government could use to overcome the problems of population growth in its country include:
- Investment in sex education and family planning services.
  - Subsidising birth control/contraception.
  - Reducing the economic benefits of having a larger family, e.g. the provision of state pensions will mean there is less of a need to rely on offspring.
  - Measures to boost investment and productivity in the economy.

Accept any other relevant measure that is clearly discussed.

Award marks according to the following mark scheme:

Level	Description	Marks
Strong answer	Excellent knowledge and understanding of relevant economics concepts, using appropriate terminology in context. Detailed discussion of <b>two</b> measures that the Nigerian government could use to overcome the problems of population growth in its country. Students who develop both sides of the argument in a considered way, with well-justified reasoning, including why the alternative viewpoint is rejected, should be rewarded with the top marks in the band.	6–8
Moderate answer	Good knowledge and understanding of relevant economics concepts, using appropriate terminology in context. Detailed discussion of <b>one</b> viewpoint. Judgement with some justification/evaluation of choices made. Students should be rewarded with top marks in the band if there is some discussion of at least <b>one</b> viewpoint.	3–5
Weak answer	Limited knowledge and understanding of relevant economics concepts in context. Limited ability to discuss <b>two</b> measures that the Nigerian government could use to overcome the problems of population growth in its country, with little or no expression of viewpoints. Students who discuss one viewpoint and give a reason for coming to their decision should be rewarded with the top mark in the band.	1–2
	No creditable response.	0

- 2 a** An ageing population occurs when the average (median) age of the population increases [1]. This is due to a combination of lower birth rates and longer life expectancy [1].

Maximum of 2 marks.

- b** Explanations of two causes of the increase in the percentage of people aged 65 and above in the UK might include:
- Improved healthcare since 1985 (when the median age was 35.4 years) [1], leading to a higher average life span [1].
  - Lower fertility and birth rates [1], reducing the average number of children per woman [1].
  - More women choosing to have children at a later stage of their lives [1] due to pursuing their professional careers [1].
  - The increasing opportunity cost of raising children [1], reducing the average number of children per woman [1].

*Up to 2 marks for setting out each (×2) valid cause.*

*Maximum 4 marks.*

- c** Analysis of the effects of an ageing population on **government expenditure and revenue** might include:
- Larger dependency ratio in the long run [1], i.e. a smaller tax base (fewer people paying income taxes) [1].
  - Increased government spending [1] on hospitals [1], healthcare [1] and housing [1].
  - Lower income tax revenues [1] if the dependency ratio increases [1].
  - Deteriorating fiscal position [1], due to the combination of falling tax revenues and rising government spending [1].
  - The extent to which these happen will depend on the median age [1] of the population (e.g. 35.4 or 42.2) and the rate of change in the average age [1].

Analysis of the effects of an ageing population on **economic growth** might include:

- Changing patterns of household consumption [1], e.g. elderly people might spend proportionately more of their money on healthcare products and services [1].
- Slower economic growth [1], partly due to a smaller workforce and lower productivity [1], and a subsequent fall in standards of living [1].
- A skills mismatch [1] in a fast-changing economic environment [1] – younger people tend to be more flexible [1] and both geographically and occupationally mobile [1].
- Again, the extent to which these effects will happen depends on the median age [1] of the population and the rate of change in the average age [1].

*Up to 3 marks for analysing the effects on government expenditure and revenue.*

*Up to 3 marks for analysing the effects on economic growth.*

*Maximum 6 marks.*

## Sample answers to chapter review questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Chapter review questions (page 241)

- 1 The three key factors that affect the rate of population growth are the birth rate, the death rate and the net migration rate.
- 2 Net migration rate = immigration rate – emigration rates for a country.
- 3 Social changes affect death rates, birth rates, gender ratios, age distribution and net migration rates, all of which have an impact on the population size and potential population growth. For example:
  - Death rates are lowered by better-quality education, healthcare, nutrition and sanitation.
  - Birth rates are lowered by education, access to contraception, the high costs of raising children and women choosing to pursue careers and therefore opting to have fewer children, and at a later stage in their lives.
  - Better job opportunities, lower taxes or moving to avoid civil unrest attract migrants and increase the net migration rates.
- 4 The economic consequences of an ageing population may include:
  - Increased government spending on pensions and healthcare as relatively more people will be claiming pensions and benefits.
  - Higher tax rates as fewer people are working, which could mean less incentives for people to work and firms to invest, leading to a fall in productivity and growth.
  - A shortage of workers, which could cause wage inflation.
  - Changing patterns of household consumption, e.g. elderly people might spend proportionately more of their money on healthcare products and services.
- 5 The dependency ratio is a comparison of the number of people who are not in the labour force with the number of people in active paid employment. A higher dependency ratio means increased costs of state pensions and healthcare. It is important because the higher the dependency ratio, the greater the tax burden on the working population to support those who are not economically active (people not in active paid employment).
- 6 The optimum population exists when the output of goods and services per head of the population is maximised. Governments strive to achieve an optimal population due to efficient resource use and resource allocation.
- 7 **The economy:** rapid population growth puts more pressure on an economy's scarce resources. This can lead to inflationary pressures or an increase in the demand for imports if the country cannot produce enough to meet the needs and wants of the population. For example, land in prime locations is scarce, so a larger population in these areas is likely to force land prices to rise. Inflation can cause problems for the economy and cause economic growth to slow.  
**The natural environment:** a rapid increase in the size of a population will also put strain on the environment. Non-renewable resources are depleted in the production process and the increased level of production also puts strain on the natural environment. For example, pollution and traffic congestion are by-products of overpopulated regions of the world.

## Section 5: Economic development

### Chapter 32: Differences in economic development between countries

#### Answers to activities

##### Activity (page 246)

Students could consider measurable (objective) indicators, such as literacy rates and average earnings for graduates and non-graduates.

##### Activity (page 247)

Student's own responses.

Starting points are the World Bank and IMF websites: [www.worldbank.org](http://www.worldbank.org) and [www.imf.org](http://www.imf.org)

Findings could be used for a classroom display or presented to the class if time permits.

#### Sample answers to practice questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

##### Practice question: structured question (page 243)

GDP per capita is calculated by dividing the GDP of a country by its population.

GDP per capita can be used to find the income level of the average person [1]. The higher the GDP per person, the wealthier the country tends to be [1]. Hence, the nation is more likely to be economically developed [1]. By contrast, a less economically developed country has a low GDP per capita [1]. For example, in Table 32.1, Indonesia has the lowest GDP per capita of \$4,074 [1]. Hence, Indonesia is less likely to be as developed as the other countries in the table [1].

*Up to 2 marks for application to the context.*

*Up to 2 marks for justified reasoning.*

*Maximum of 4 marks.*

##### Practice question: multiple choice (page 243)

**Correct answer: D** Longer working hours [1 mark]

Working longer hours is not necessarily productive, especially if employees feel tired and fatigued. The other options shift an economy's production possibility curve (PPC) to the right, thereby leading to economic development.

##### Practice question: multiple choice (page 246)

**Correct answer: D** Population growth rate [1 mark]

Population growth rates can differ regardless of the state of healthcare in an economy. There are non-health factors that affect the rate of population growth, such as the cost of raising children in a particular country.

## Sample answers to chapter review questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Chapter review questions (page 248)

- 1** Economic development is an intangible concept that considers both quantitative and qualitative variables that indicate an increase in the standard of living within a country.
- 2** In general, the higher the national income in a country, the more likely it is to develop economically.
- 3** Other factors that affect development are excluded from measures of national income (GDP), e.g. population size and environmental factors.
- 4** Productivity is a measure of efficiency found by calculating the amount of output per unit of a factor input, e.g. output per worker or output per machine hour. Differences in the quality and quantity of production resources affect the productivity rate in different countries. Countries with an abundance of high-quality resources, skilled labour, advanced technology and good infrastructure tend to have higher productivity rates. Conversely, countries that lack these factors often struggle with lower productivity.
- 5** Greater population growth rates, if uncontrolled, have a negative impact on economic development.
- 6** Savings are used to fund investment as banks lend the money from savers to firms that are borrowing to invest.
- 7** More economically developed countries tend to invest more in their education systems. Educational attainment and literacy empower workers to be more productive.
- 8** Economic wellbeing is positively affected by healthcare provision which increases life expectancy and reduces child mortality rates.
- 9** Natural resources are non-manufactured materials that are used in the production process. Examples include solar energy, wind energy, timber, fossil fuels (oil, coal and natural gas) and metal ores. They can be an important source of economic activity, opportunity and wealth. All industries rely on natural resources as factor inputs. For example, timber is used in construction, and metal ores are essential for manufacturing and infrastructure development. Countries rich in natural resources, such as oil-exporting nations, benefit from significant export revenues, job creation and trade opportunities, boosting their national income.

## Section 6: International trade and globalisation

### Chapter 33: Specialisation and free trade

#### Answers to activities

##### Activity (page 250)

Students are likely to discuss the importance of or need for increased specialisation as students advance in their studies. Whilst a primary school teacher can teach elementary level mathematics, for example, he or she probably will not have the required training, skills and experience to lecture postgraduate mathematics students at university.

##### Activity (page 252)

Student's own responses.

The answers are likely to consider a range of stakeholder perspectives, e.g. those of customers, employees, the local community and the government.

##### Activity (page 253)

Student's own responses.

Teachers may prefer to let students tackle this activity in small groups and present their findings to the class.

##### Activities (page 255)

- 1 Student's own responses – answers are likely to focus on the benefits of (or reasons for) international trade.
- 2 Student's own responses, depending on the chosen countries and sources of information used.

#### Sample answers to practice questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

##### Practice questions: structured questions (page 256)

- 1 a Possible problems for Brunei Darussalam in relying on oil exports may include a description of any one of the following points:
  - Economic vulnerability: Brunei Darussalam's over-reliance on crude oil and natural gas, which account for around 90% of its GDP, makes the country highly vulnerable to fluctuations in global oil prices [1]. A significant drop in oil prices, for whatever reason, can severely impact the economy's export revenues and economic stability [1].
  - Depletion of finite oil reserves: oil and natural gas are finite resources [1]. As reserves deplete over time, Brunei Darussalam will face the challenge of finding alternative

sources of export revenues [1]. Without diversification, the country may struggle economically once these finite resources are exhausted [1].

- Environmental impacts and sustainability concerns: heavy reliance on fossil fuel extraction and exports can lead to significant environmental degradation, including oil spills, air and water pollution, and the destruction of natural habitats [1]. These environmental issues can have long-term negative impacts on public health and biodiversity [1], and can also harm the country's global reputation [1].

*Maximum of 2 marks for one problem.*

- b** Explanations of reasons why countries such as Bangladesh and Brunei Darussaalam trade with each other may include any two of the following points:
- Specialisation: Bangladesh is one of the world's largest producers of rice and tropical fruits [1], while Brunei Darussalam excels in crude oil and natural gas production [1]. By specialising in the production of goods in which they have a competitive cost advantage, both countries can trade to benefit from each other's strengths [1]. Bangladesh can import cheaper oil and gas from Brunei, and Brunei can import cheaper rice and tropical fruits from Bangladesh, leading to more efficient resource utilisation [1].
  - Economic stability: trading with each other allows both countries to diversify their economic resources [1]. Brunei can reduce its over-reliance on oil by accessing agricultural products from Bangladesh [1], while Bangladesh can ensure a stable supply of energy resources from Brunei [1]. This diversification helps to minimise the risks associated with dependency on a single export product [1].
  - Market growth: by engaging in international trade, both countries can expand their markets beyond their domestic borders [1]. For Bangladesh, exporting agricultural products to Brunei opens up new markets and export revenues, which can drive economic growth [1]. Similarly, Brunei can boost its economy by exporting its oil and gas to Bangladesh, fostering mutual economic benefits [1].
  - Access to essential goods and services to meet domestic needs: international trade allows both countries to access goods that are not readily available or produced domestically in sufficient quantities [1]. Bangladesh can secure a stable supply of oil and natural gas, which are essential for its industrial and economic activities [1]. Similarly, Brunei can import necessary agricultural products to meet its nation's food requirements [1]. This exchange ensures that both countries can meet their domestic needs more efficiently and cost effectively [1].

*Up to 2 marks for setting out each (×2) valid reason.*

*Maximum of 4 marks.*

- c** Possible ways that Bangladesh's export of rice and tropical fruit helps its farmers to achieve economies of scale may include:
- Bulk production: exporting rice and tropical fruit leads to an increase in production volumes as farmers increase the scale of their operations to meet international demand [1]. Larger volumes of production enable farmers to spread their fixed costs over more units of output, thereby reducing the average cost of output [1].
  - Bulk purchasing economies: as farmers increase the scale of their operations, they can purchase factor inputs in bulk [1], obtaining discounts and reducing per unit costs of

production [1]. This bulk purchasing power contributes to the farmers' economies of scale [1].

- Specialisation economies: with increased demand, farmers can specialise in the cultivation of certain crops or agricultural products [1]. This enhances production efficiency and labour productivity, which contributes to lower production costs and higher crop yields [1].
- Technological economies of scale: higher export revenues provide farmers with the financial capability to invest in advanced agricultural technologies, such as modern irrigation systems [1]. These technologies improve productivity and reduce labour costs, contributing to economies of scale [1].
- R&D economies of scale: export-driven growth can encourage investments in research and development (R&D) [1]. This leads to innovative farming techniques and practices that enhance efficiency and increase output, which helps to reduce average costs of production [1].
- Quality inputs: access to superior factor inputs can lead to higher crop yields and better product quality [1]. Hence, access to large export markets often lead to lower per unit costs in international markets [1].

*Up to 4 marks for application to the context.*

*Up to 2 marks for justified reasoning.*

*Maximum of 6 marks.*

- 2 a** Specialisation refers to individuals, firms, regions or countries concentrating on the production of a particular good or service [1] and developing a comparative cost advantage in producing these goods and services [1].

*Maximum of 2 marks.*

- b** Explanations of why, during a recession, highly specialised firms are less likely to survive than diversified firms might include:
- Highly specialised firms do not have a variety of goods and services that they can rely on [1], which can be disastrous for such firms if the demand for their product suddenly declines in a recession [1]. For example, airlines, such as British Airways, that specialise in business class travel lost a large amount of money in the recession caused by the COVID-19 pandemic [1].
  - Firms that employ workers with highly specialised skills tend to face high labour costs [1], which they may be unable to afford in a recession if demand is dramatically reduced [1].
  - Diversified firms can also benefit from risk-bearing economies of scale [1].

*Maximum of 4 marks.*

- 3 a** Explanations of how the concept of specialisation can explain why nations trade with each other might include:
- There are cost advantages [1], perhaps due to a country's abundant resources [1]. As a result, productivity increases [1], thereby increasing the country's GDP and standards of living [1].
  - International specialisation makes better use of scarce resources [1]; no country can produce everything it wants or needs efficiently, i.e. it cannot be self-sufficient [1].

- International specialisation increases national output and global trade [1]. Therefore, firms are able to enjoy cost-saving benefits from large-scale operations [1].

*Maximum of 4 marks.*

- b** Analysis of the statement ‘specialisation in international trade always benefits nations’ might include the benefits of specialisation and trade, as highlighted in part **a** above, but there are potential drawbacks, including:
- Countries that overspecialise suffer the most during an economic downturn [1].
  - Adverse changes in demand for certain exports could wipe out much of a country’s GDP [1], thus severely harming the economy [1].
  - Protectionist measures [1] might be needed in order to safeguard domestic industries [1] from larger, more cost-efficient foreign firms that specialise in the production of certain products [1].

*Up to 4 marks for application to the context.*

*Up to 2 marks for justified reasoning.*

*Maximum of 6 marks.*

## Sample answers to chapter review questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Chapter review questions (page 257)

- 1 Specialisation by country is when a country concentrates on producing a particular good or service.
- 2 Examples of specialisation by country include Thai rice, Chinese steel, Indian tea, Vietnamese coffee, German cars, Japanese consumer electronics, Costa Rican pineapples.
- 3 Efficiency gains, higher labour productivity, increased productive capacity, economies of scale and improved competitiveness are the advantages of specialisation by country.
- 4 Possible overspecialisation, lack of variety for consumers, high labour turnover, low labour mobility and higher labour costs are the disadvantages of specialisation by country.
- 5 Free trade is international trade that takes place without protectionist measures (barriers to international trade).
- 6 Access to resources (choice), lower prices, efficiency gains and improved international relations are the advantages of free trade.
- 7 Job losses in certain industries, widening income inequality, potential exploitation of labour in low-income countries and damage to the environment are the disadvantages of free trade.

## Section 6: International trade and globalisation

### Chapter 34: Globalisation and trade restrictions

#### Answers to activities

##### Activity (page 262)

Student's own responses.

The aim of the activity is for students to investigate multinational companies (MNCs) in their own country and to use their understanding of MNCs to make a judgement about whether the benefits to the country outweigh the costs.

##### Activity (page 267)

Student's own responses.

The answers to the first two parts of this activity will be generic/similar, but the third part will depend on the evaluation skills of the student.

#### Sample answers to practice questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

##### Practice question: structured question (page 263)

**a** Explanations of the characteristics of a multinational company (MNC) might include:

- An MNC has its headquarters in one country and branches/shops or offices in more than one country [1]. Operating in different countries allows it to benefit from cheaper production facilities [1], lower rates of corporation tax [1], better trade conditions [1] and access to new markets [1].
- MNCs are usually large in size [1] and can benefit from economies of scale [1].
- MNCs are often internationally recognised brand names [1] and by operating in overseas markets can generate more profit by selling to a larger customer base [1].

*Maximum of 4 marks.*

**b** Analysis of the advantages for the UAE of MNCs locating their operations there might include:

- Employment opportunities for local citizens [1] in shops, hotels, engineering, law and accountancy firms [1].
- The MNC may become a customer of local firms [1], e.g. internet services, stationery for the firm, local suppliers of raw materials, and advertising [1].
- The MNC pays taxes on its profits to the government of the host country [1], increasing government revenues [1].

- Workers employed in the firm may learn new skills [1], which are transferable to other businesses in the UAE [1].
- The MNC may introduce new technology to the host country [1], transferring technological knowledge to other businesses in the UAE [1].
- Shops and hotels attract tourists to Dubai [1], which increases exports [1].
- Catering to the demand for international brands [1] results in a greater choice of goods and services for consumers in the UAE [1].

Analysis of the disadvantages for the UAE of MNCs locating their operations there might include:

- The employment opportunities may be for mainly unskilled jobs [1]; jobs for more skilled workers may be given to overseas workers from the host country rather than to locals [1].
- The MNC may use suppliers from its home country [1], limiting the economic opportunities for local suppliers [1].
- The MNC may be powerful [1] and influence the government to make decisions about, for example, road building and transport routes, which favour the MNC over local people [1].
- The government may use tax revenue to pay for grants to encourage MNCs to locate in the country [1], instead of spending the revenue on providing education and healthcare services for local people [1].
- The MNC may damage local culture [1], for example, with the dominance of global brands such as McDonald's and Starbucks [1].

Up to 4 marks for application to the context.

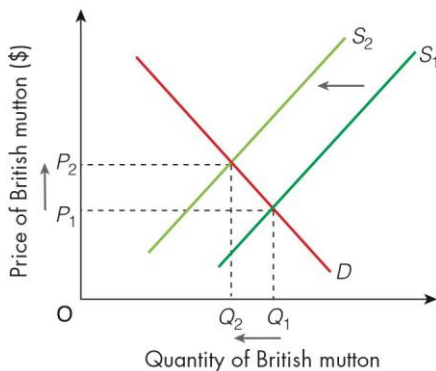
Up to 2 marks for justified reasoning.

Maximum of 6 marks.

### Practice questions: structured questions (page 264)

- 1 An accurately drawn and labelled diagram should show a leftwards shift of the supply curve [1], due to the tariff, which is a tax on imports, and a downward-sloping demand curve for British mutton [1]. The tariff results in an increase in the price of British mutton in overseas markets [1]. All other things being equal, the higher price will reduce the quantity of British mutton demanded [1].

Hence, the diagram should show a higher equilibrium price and lower equilibrium quantity.



Maximum of 4 marks.

2 The impacts of an import tariff on **producers** of British mutton may include:

- There will be higher production costs, which will lead to higher prices and/or falling demand.
- Thus, profits may decline (depending on the price elasticity of demand for British mutton).
- Profits might decline if foreign customers switch to buying relatively cheaper mutton produced in other countries.
- The loss in the competitiveness of British mutton producers can lead to job losses. This process must be managed by the producers, and compensation may need to be paid to the workers made redundant.
- It can force British mutton producers to become more efficient or to focus on non-price competition in order to compete in overseas markets.

The impacts of an import tariff on **consumers** of British mutton may include:

- As the price increases, consumers are forced either to pay higher prices or to purchase less British mutton.
- The higher price also means existing customers (in overseas markets) will have less real disposable income for the purchase of other products.
- Retaliation against the import tariff can cause further price hikes for consumers.
- Protectionism ultimately limits the degree of competition in an industry, thus harming customers as they have less choice but may need to pay higher prices.

Award marks according to the following mark scheme:

Level	Description	Marks
Strong answer	Excellent knowledge and understanding of relevant economics concepts, using appropriate terminology in context. Detailed discussion of the impacts of an import tariff on producers <b>and</b> consumers of British mutton. Students who discuss <b>three</b> impacts on producers and <b>three</b> impacts on consumers, with well-justified reasoning, including why alternative viewpoints are rejected, should be rewarded with the top marks in the band.	6–8
Moderate answer	Good knowledge and understanding of relevant economics concepts, using appropriate terminology in context. Detailed discussion of at least <b>one</b> impact on producers and <b>one</b> impact on consumers. Judgement with some justification/evaluation of choices made. Students should be rewarded with top marks in the band if there is discussion of at least <b>two</b> impacts in detail.	3–5
Weak answer	Limited knowledge and understanding of relevant economics concepts in context. Limited ability to discuss the impacts of an import tariff on producers <b>and</b> consumers of British mutton, with little or no expression of viewpoints. Students who discuss one impact and give a reason for coming to their decision should be rewarded with the top mark in the band.	1–2

	No creditable response.	0
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### Practice question: structured question (page 266)

a Reasons why countries use trade restrictions may include:

- Trade restrictions are used to help domestic producers compete against foreign competition [1], e.g. low-cost producers from China [1].
- Trade restrictions are used to safeguard strategic industries [1], e.g. the US car industry is highly important to the US economy [1].
- Trade restrictions are used to safeguard jobs [1], e.g. tariffs on Chinese tyres were used to protect jobs in the US tyre manufacturing industry [1].
- Trade restrictions are used to raise government revenue [1], e.g. from taxing the imports from China [1].

*Up to 2 marks for each (×2) reason. Award full marks only if reference is made to the information provided in the question.*

*Maximum of 4 marks.*

b Possible methods of trade protectionism that the USA could use include:

- Tariffs – these will raise the price of tyres from China, allowing US firms to compete *and* raise government tax revenues. However, this means US consumers pay higher prices and US firms are protected from the need to be more efficient/cost-effective.
- Quotas – these limit the number of tyres coming into the USA from China. Whilst this allows domestic firms to compete (perhaps), it does not necessarily give them a price advantage or make them more competitive against Chinese firms.
- Subsidies for US producers – this method is highly costly for the US government but will allow domestic firms to produce tyres at a lower cost, thus giving them a price advantage domestically and in overseas markets. Consumers may gain, but domestic taxpayers will lose out.
- Administrative barriers – these make it more difficult for Chinese tyres to enter the USA due to excessive paperwork and compliance laws (such as safety checks on imported tyres). Whilst this provides protection in the short term, the US could end up being flooded with tyres from China in the long run.

All forms of trade restrictions might spark retaliation from China.

Award marks according to the following mark scheme:

Level	Description	Marks
Strong answer	<p>Excellent knowledge and understanding of relevant economics concepts, using appropriate terminology in context.</p> <p>Detailed discussion of possible methods of trade protectionism that the USA could use.</p> <p>Students who discuss <b>three</b> possible methods in detail, in context and with well-justified recommendations, including why the alternative methods are rejected, should be rewarded with the top marks in the band.</p>	6–8

Moderate answer	Good knowledge and understanding of relevant economics concepts, using appropriate terminology in context. Detailed discussion of at least <b>one</b> viewpoint. Judgement with some justification/evaluation of choices made. Students should be rewarded with top marks in the band if there is discussion of at least <b>two</b> viewpoints in detail.	3–5
Weak answer	Limited knowledge and understanding of relevant economics concepts in context. Limited ability to discuss possible methods of trade protectionism that the USA could use, with little or no expression of viewpoints. Students who discuss <b>one</b> viewpoint and give a reason for coming to their decision should be rewarded with the top mark in the band.	1–2
	No creditable response.	0

## Sample answers to chapter review questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Chapter review questions (page 268)

- 1 Globalisation is the process by which the world's economies become increasingly interdependent and interconnected.
- 2 Multinational companies (MNCs) are organisations that operate in two or more countries.
- 3 Advantages of MNCs for both host and home countries: job creation, economies of scale (leading to lower prices for customers) and spreading of risks.  
Disadvantages of MNCs for both host and home countries: often unethical and cost-cutting practices, forcing domestic firms out of business, and potentially exploiting foreign governments (especially those in less economically developed countries).
- 4 Tariffs involve the use of taxation, whereas non-tariff barriers do not, e.g. quotas, subsidies and embargoes.
- 5 Advantages of trade restrictions: to protect infant industries and safeguard domestic jobs, to protect sunset (declining) industries, to protect strategic industries, to prevent dumping, to generate tax revenue, to tackle a balance of payments deficit, to restrict the import of demerit goods and to promote environmental sustainability.
- 6 Disadvantages of trade restrictions: market distortions and inefficiencies, higher production costs for domestic suppliers relying on imported supplies, and possible retaliation from foreign countries.
- 7 Free trade agreements allow the free movement of goods, services, capital and labour among member states. The reduction in tariffs and quotas for World Trade Organization (WTO) members makes it easier and more affordable for firms to import and export. Advances in transportation, such as container shipping, have lowered costs and increased efficiency in moving goods over long distances. The rise of e-commerce has created global marketplaces, further easing international trade. Multinational companies operate in numerous countries, facilitating trade, investment and technology flows across international borders.

- 8** Increased globalisation typically boosts trade by reducing restrictions; globalisation opens new markets and increases competition, driving innovation. Labour migration is often stimulated by globalisation, as workers move to areas with better job opportunities. Greater globalisation generally supports economic growth by facilitating market access, investment and technology transfer. Increased production and transport activities raise greenhouse gas emissions and contribute to climate change. Globalisation can widen income inequality, benefiting skilled workers and larger firms, while often disadvantaging low-skilled workers.

## Section 6: International trade and globalisation

### Chapter 35: Foreign exchange rates

#### Answers to activities

##### Activities (page 269)

- 1
  - a afghani = Afghanistan
  - b dong = Vietnam
  - c lek = Albania
  - d won = South Korea
  - e kwacha = Zambia
- 2 Student's own responses, but could include:
  - a peso = Mexico, Argentina, Uruguay, Chile, Cuba and Philippines
  - b real = Brazil, Iran, Oman and Yemen (the currency is spelt 'rial' in Iran, Oman and Yemen)
  - c pound = UK, Egypt, Syria and Lebanon
  - d franc = Switzerland, Burundi, Cameroon, Chad, Guinea and Madagascar
  - e dollar = USA, Australia, Brunei, Canada, Jamaica, New Zealand and Singapore

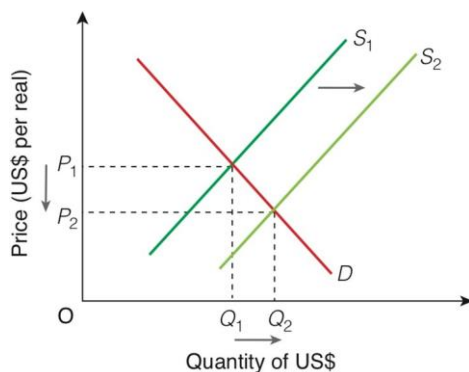
##### Activity (page 270)

Student's own responses.

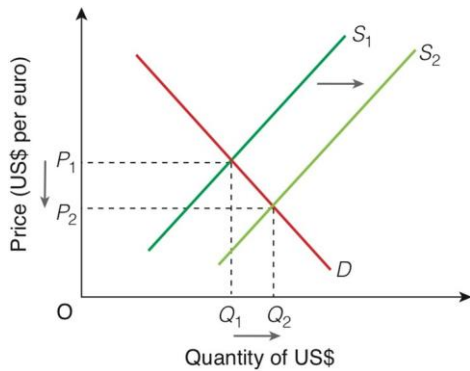
The content is likely to focus mainly on the benefits of a lower exchange rate for the economy, at least in the short run. Long-term consequences should be considered to assess the sustainability of such policy.

##### Activity (page 274)

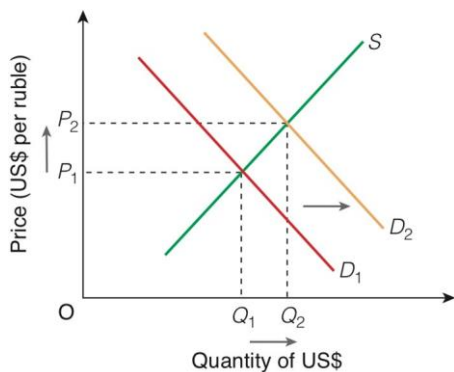
- a The USA will need to sell US dollars to buy the Brazilian currency (the real). This reduces the price of the US dollar relative to the real, i.e. there is a fall in the exchange rate.



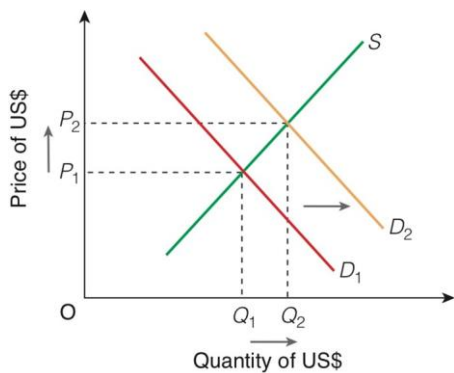
- b** The US tourists will need to buy the French currency (the euro). They sell US dollars to buy the euro, thus reducing the price of the US dollar relative to the euro.



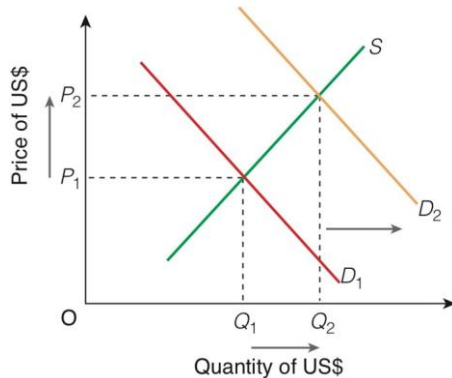
- c** Russian households and firms have to buy US dollars (to pay for the exported products from the USA), thus increasing the demand and hence price of the US dollar.



- d** A rise in the interest rate usually attracts 'hot money' and makes US dollar savings accounts more attractive to hold. So, more foreign investors and firms will demand the US dollar, forcing up the value of the currency.



- e The demand for US dollars from speculators will intensify (especially if people and firms expected the currency to rise), thus forcing up the value of the US dollar even further on the foreign exchange market.



## Sample answers to practice questions

The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.

### Practice questions: structured questions (page 269)

1  $1:6.5 = 65:422.5$  [1]

Therefore, the price of the textbook is CNY422.5 [1]

Maximum of 2 marks.

2  $0.65:0.75 = 1:1.15$  [1]

Hence, the exchange rate is GBP1 = EUR1.15 [1]

Maximum of 2 marks.

### Practice question: structured question (page 275)

- a Exchange rate is the price of one currency [1] measured in terms of other currencies [1].

Maximum of 2 marks.

- b Explanations of two advantages of a weak peso for the Argentinian economy might include:

- Cheaper export prices from Argentina [1] (due to the 'artificially low' value of the peso) lead to rising export sales [1] and a larger trade surplus for Argentina [1].
- Exporters gain from a price advantage over their US and other foreign rivals [1]. This can therefore help to create income and wealth in the Argentinian economy [1].

Up to 2 marks for each ( $\times 2$ ) valid advantage.

Maximum of 4 marks.

### Practice questions: structured questions (page 276)

- 1 An appreciation means that the value of the currency has increased [1]. An example is the US dollar rising in value against the Sri Lankan rupee (LKR) from \$1 = LKR115 to \$1 = LKR125 [1].

Maximum of 2 marks.

- 2 Analysis of the likely effects of a country's currency appreciation on its exports and imports might include:
- If, for example, the US dollar appreciates against the Sri Lankan rupee, the USA will sell fewer exports to Sri Lanka [1] as more rupees are needed to pay for US exports [1].
  - Americans are more likely to buy products from Sri Lanka as their currency is worth more [1], so imports become cheaper [1].
  - The extent of the impact of a currency appreciation will also depend on the price elasticity of demand (PED) [1] for both exports and imports, with a larger impact on exporters and importers if the PED is elastic [1].
  - If there is a fall in the value of net exports, the balance of payments will worsen for the USA [1]. However, this depends on the extent to which the USA trades with Sri Lanka (and other nations) [1].

Up to 3 marks for the likely effects on exports.

Up to 3 marks for the likely effects on imports.

Maximum of 6 marks.

## Sample answers to chapter review questions

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### Chapter review questions (page 276)

- 1 An exchange rate is the price of one currency measured in terms of other currencies.
- 2 A country's exchange rate is likely to increase following an increase in the demand for its exports.
- 3 A country's exchange rate is likely to drop following its government's decision to cut interest rates.
- 4 A floating exchange rate system means that the currency is allowed to fluctuate against other currencies according to market forces, without any government intervention.
- 5 Causes of exchange rate fluctuations include: changes in the demand for imports and exports; price levels (inflation); the degree of foreign direct investment; speculation in the foreign exchange market; the degree of government intervention.
- 6 Exporters tend to lose from a higher exchange rate, importers gain and customers gain.
- 7 Equilibrium foreign exchange rates are determined by the market forces of demand for and supply of currencies in the foreign exchange market.

## Section 6: International trade and globalisation

### Chapter 36: Current account of the balance of payments

#### Answers to activities

##### Activity (page 279)

Student's own responses.

Teachers might ask students to produce a poster of their findings, which could then be used as a classroom display.

##### Activity (page 279)

Transaction		Visible		Invisible	
		Export	Import	Export	Import
<b>a</b>	A German company purchases Indian-produced chemical products	✓			
<b>b</b>	American tourists fly to India on Air India			✓	
<b>c</b>	Indian supermarkets purchase French wine and cheese		✓		
<b>d</b>	The Indian government maintains foreign embassies overseas				✓
<b>e</b>	German tourists buy theatre tickets to see the latest Bollywood movie in Mumbai			✓	
<b>f</b>	The Indian government pays interest on its borrowing (debts)				✓
<b>g</b>	An Indian firm buys a fleet of lorries (trucks) from Japan		✓		
<b>h</b>	Global sales of books by Bhavik Sarkhedi, a best-selling Indian author	✓			

## Sample answers to practice questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Practice question: structured question (page 279)

- a** Invisible balance is a record of the export and import of services [1], such as banking, insurance, shipping and tourism [1], per period of time.

*Maximum of 2 marks.*

- b** Imports: 103 [1]  
Visible balance: -31 [1]  
Invisible balance: 13 [1]  
Trade balance: -18 [1]

*Maximum of 4 marks.*

### Practice question: structured question (page 280)

- a** The balance of trade is the sum of the trade in goods plus the trade in services: that is, visible balance + invisible balance [1]. It is the difference between a country's total export earnings and its total import expenditure, and is the largest component of a country's balance of payments [1].

*Maximum of 2 marks.*

- b** For much of the period shown, Greece has experienced a falling trade balance. Explanations for this might include:
- A deterioration in international competitiveness [1], leading to a fall in exports from Greece [1].
  - An appreciation of the currency (euro) [1], which reduces the demand for Greece's exports [1].
  - Higher prices of imported raw materials and essential products such as oil [1], so the net value of imports is higher [1].
  - Falling world prices of important exports for Greece, such as cheese, olive oil and cotton [1], leading to lower export earnings for the country [1], although this might depend on the price elasticity of demand for such products, so the net value of Greece's balance of trade is lower [1].
  - A decline in tourism revenues [1], due to declining incomes in other countries [1], or to the effects of extreme weather on tourist infrastructure, e.g. severe heatwaves in 2023 [1].

*Up to 2 marks for each (×2) possible cause of the trend in Greece's balance of trade.*

*Maximum of 4 marks.*

### Practice question: structured question (page 282)

- a** 2010 trade deficit: \$273,041.5m [1]  
2016 trade deficit: \$311,016.0m [1]  
2023 trade deficit: \$279,107.2m [1]

1 mark for two correct answers.

2 marks for three correct answers.

Maximum of 2 marks.

- b** Explanations of how it is possible that the USA has a persistent trade deficit with China even though the USA has reported record export sales to China might include:
- China is exporting far more to the USA than the USA is exporting to China (as measured by dollars of sales) [1], e.g. in 2023 Chinese exports were \$426,885.0m, while US exports were only \$147,777.8m [1].
  - This leads to a trade deficit [1], as even though the USA is exporting more to China (up from \$91,911.1m to \$147,777.8m) than it has ever done before, the value of its imports still exceeds its exports [1].

Maximum of 4 marks.

### Practice question: structured question (page 283)

- a** A current account surplus exists if a country exports more than it imports [1], due to a higher demand for exports and/or a lower demand for imports [1].

Maximum of 2 marks.

- b** Explanations of two consequences of Kuwait's continual current account surplus might include:
- There are greater employment opportunities [1] due to the higher demand for exports from Kuwait [1].
  - There are higher standards of living [1] as the country receives more foreign currency than it spends on imports [1], i.e. it has a higher income [1].
  - There are inflationary pressures [1] as more money enters the economy due to the higher demand for oil exports [1].
  - The value of the exchange rate is higher [1] due to the continually high demand for Kuwaiti exports, such as oil, making it subsequently more expensive for foreign buyers to import goods [1]. However, given the main export is oil – which is highly price inelastic – this might be very positive for the Kuwaiti economy [1].

Up to 2 marks for each ( $\times 2$ ) valid consequence.

Maximum of 4 marks.

### Practice question: structured question (page 284)

- a** A current account deficit occurs when a country spends more money than it earns (imports exceed exports) [1], i.e. more money leaves the economy than enters it from transactions with foreign households and firms [1].

Maximum of 2 marks.

- b** Explanations of the validity of the statement 'A current account deficit on the balance of payments is undesirable during a recession but is not really a problem during periods of economic growth' might include:
- During an economic boom, the economy experiences an increase in any combination of consumption expenditure, investment expenditure and government expenditure [1]. This

increased spending [1] can help to offset the net outflow [1] of money due to the current account deficit on the balance of payments.

- During a recession, however, total demand in the economy falls [1], so there is less expenditure [1] from households (consumption), firms (investment) and the government [1]. Combined with a current account deficit, this makes a highly undesirable situation [1].

*Maximum of 4 marks.*

### Practice questions: multiple choice (page 284)

**1 Correct answer: A** Debt (borrowing) [1 mark]

The current account is structured in four parts: trade in goods, trade in services, primary income and secondary income. Debt (borrowing) is not included in the current account.

**2 Correct answer: C** Overseas donations for domestic charities [1 mark]

Secondary income shows income transfers between residents and non-residents, arising from financial gifts between residents of different countries, such as overseas donations for charities in the domestic economy.

## Sample answers to chapter review questions

*The answers, marks awarded and comments that appear in this material were written by the authors. In examination, the way marks would be awarded to answers like these may be different.*

### Chapter review questions (page 284)

- 1 The balance of payments is a financial record of a country's transactions with the rest of the world for a given time period, usually one year.
- 2 Visible trade balance refers to trade in goods, whereas invisible trade balance refers to trade in services.
- 3 The balance of trade is the sum of the trade in goods plus the trade in services: that is, visible balance + invisible balance. The balance of trade is the largest section of the current account.
- 4 Primary income is investment income, whereas secondary income refers to income transfers (for which there is no corresponding output).
- 5 A current account deficit occurs when a country spends more money than it earns, i.e. imports exceed exports. A current account surplus exists if a country exports more than it imports.
- 6 Lower demand for exports and higher demand for imports are the two main causes of a current account deficit.
- 7 To deal with a current account deficit, a government might use fiscal policy, monetary policy, supply-side policies and trade protectionist measures.
- 8 Current account surpluses can be inflationary as more money enters than leaves the economy.