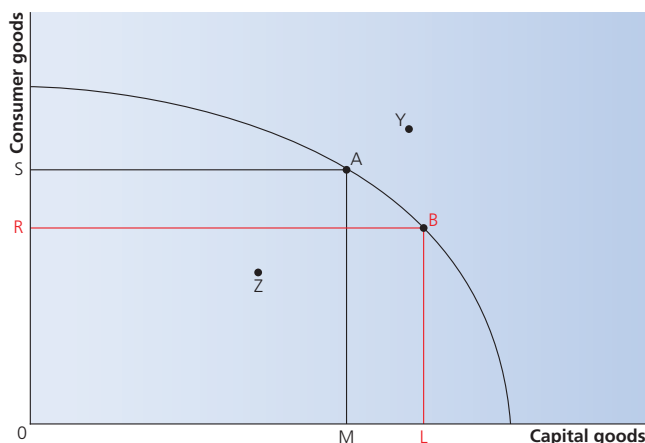


Now test yourself answers

Chapter 1

- 1 It implies that other variables are being held constant. Therefore, it enables predictions to be made on the basis of the model assuming nothing else changes.
- 2 Because it is impossible to conduct laboratory experiments involving economic behaviour.
- 3 a), c) and e) are positive statements because these can be verified by reference to data.
a) and d) are normative statements because they are subjective and based on value judgements.
- 4 Scarcity: infinite wants but finite resources.
- 5 a) Land because copper is a natural resource, which is included in the economic definition of land.
b) Enterprise because the woman has taken the risks to start a business.
c) Capital because machinery is used to make other goods.
d) Labour because the person is working for a business to make goods and services.
- 6 Five robots.
- 7 No resources are sacrificed in their use, so the opportunity cost is zero.
- 8 a) Capital good
b) Consumer good
c) Consumer good/service
d) Capital good



- 9 a) At Z there will be unemployed resources because this point is not on the PPF.
b) LM capital goods.
c) Increase, because more and more capital goods would have to be sacrificed to produce extra consumer goods.
- 10 Future economic growth would decrease.
- 11 a) An outward (rightward) shift because productivity would increase the productive capacity of the country.

- b) An inward shift on the PPF because productive capacity would have decreased.
- c) This would cause an outward shift in the PPF because the extra capital would enable output per worker to increase.
- d) This represents an increase in the working population causing an increase in the productive capacity of the country. Therefore, the PPF would shift outwards.
- 12 Increased profit because the division of labour would increase productivity and reduce costs.
- 13 The demand for specialist products makes it very difficult to increase specialisation. Specialisation is best suited to the production of mass-produced goods, which enables the job to be broken down into small tasks.
- 14 Money enables a person to work in a highly specialist job. They can then use the money they are paid to buy other goods and services.
- 15 Private ownership of resources, profit motive, competition between firms, prices determined by the forces of supply and demand.
- 16 State ownership of resources.
- 17 Consumer sovereignty is the power of consumers to determine what is produced by their preferences. Firms respond to consumer demand by producing the goods and services that consumers buy.
- 18 There is freedom to own resources. Those who own resources are likely to earn more income than those who do not own resources.
- 19 There is no profit motive and no competition.

Chapter 2

- 1 The amount demanded at given prices over a certain period of time.
- 2 Contraction in quantity demanded.
- 3 a) Increase: a rightward shift in the demand curve.
b) Decrease: a leftward shift in the demand curve.
c) A rightward shift in the demand curve for houses because the substitute, rented accommodation, has increased in price.
d) Decrease: a leftward shift in the demand curve because it is more expensive to repay the loan on buying a house.
- 4 It will eventually decrease.
- 5
$$PED = \frac{\% \text{ change in quantity demanded}}{\% \text{ change in price}}$$
$$= \frac{2}{-20} = -0.1$$
- 6
$$PED = \frac{-10}{20} = -0.5.$$
 Therefore, demand is inelastic.
- 7 a)
$$PED = \frac{-10}{20} = -0.5.$$
 This implies that demand is price inelastic.

- b) $PED = \frac{-15\%}{10\%} = -1.5$. This implies that demand is price elastic.
- c) $PED = \frac{6\%}{-6\%} = -1.0$. This implies that demand is unitary elastic.
- 8 Price elastic demand because consumers can easily switch to buying alternative goods.
- 9 a) Inelastic demand because the fall in quantity demanded must be proportionately less than the price increase.
- b) Elastic demand because the fall in quantity demanded must be proportionately more than the price increase.
- c) Demand is unitary elastic because the increase in price must have caused an exactly proportionate fall in the quantity demanded.
- 10 Yes.
- 11 Positive because liquid soap and soap bars are substitutes.
- 12 a) $-9\% \div -3\% = +3$. This implies that new cars are a normal good (the result is positive) and that demand is income elastic (the fall in income has led to a more than proportionate decrease in demand).
- b) $-2\% \div +5\% = -0.4$. Therefore, soya is an inferior good because the result is negative.
- c) $+2\% \div +10\% = +0.2$. Therefore, demand for oranges is income inelastic (the result is between 0 and +1).
- 13 Demand for electric cars is likely to be much more income elastic and price elastic than for petrol.
- 14 Contraction of supply.
- 15 a) Leftward shift of the supply curve because higher wages would increase production costs.
- b) Rightward shift of the supply curve because there is a fall in production costs.
- c) Leftward shift of the supply curve because less coffee will be available.
- 16 $4\% \div 20\% = 0.2$. Therefore, supply is inelastic since the result is between 0 and 1.
- 17 Perfectly inelastic.
- 18 Inelastic because tomatoes are perishable and cannot be stored and there is a long growing period.
- 19 It is possible that the supply of butter would be elastic if there were stocks available in refrigerated warehouses.
- 20 Excess supply because the quantity supplied will be greater than the quantity demanded.
- 21 Market forces would cause an extension of demand and a contraction in the quantity supplied.
- 22 a) The supply curve will shift to the left causing a rise in the price of foreign holidays and a fall in quantity.
- b) The demand curve will shift to the right causing a rise in price and a rise in the quantity.
- c) The supply curve will shift to the right causing a fall in price and an increase in quantity.

- d) The demand curve will shift to the left causing the price and quantity to fall.

- 23 If there was an increase in demand then the market price would rise and builders would find it more profitable to build houses.
- 24 Profit.
- 25 Reduce it.
- 26 An *ad valorem* tax is a percentage of the price of the product/service and causes the supply curve to shift to the left and become steeper.
- A specific tax is a set amount per unit and causes the supply curve to shift to the left, parallel to the original supply curve.
- 27 Consumers.
- 28 Demand would need to be inelastic.

Chapter 3

- Externalities, non-provision of public goods, information gaps.
- A non-smoker in the same area as the smoker may inhale smoke.
- No. Social costs are the sum of private costs and external costs.
- Private costs: raw materials, wages, cost of fertiliser to the farmer.
External costs: waste discharge into river, loss of income to fishermen.
- External benefit of consumption.
- Private benefits: extra salary from doing an apprenticeship, job satisfaction.
External benefit: a higher rate of economic growth.
- Private goods are excludable, i.e. it is possible to prevent everyone else from consuming the product, and rivalrous, i.e. consumption by one person means that less is available for others.
- Because it is impossible to exclude people from consuming the product.
- By the use of detectors to ensure that those using televisions have a licence.
- A dentist usually has much greater knowledge and information about a person's teeth and dental hygiene than the patient. Consequently, it is possible that a patient may be given unnecessary treatment, e.g. a filling.

Chapter 4

- An *ad valorem* tax would cause the supply curve to shift to the left and become steeper.
- It implies that the producer has to bear the cost of the pollution, so causing the negative externality to be internalised by the producer causing it.
- It would cause the supply curve for solar energy products to shift to the right, so causing the price to fall. This would move production and consumption towards the socially optimal level.
- There would be a shortage.

- 5 To provide an incentive for farmers to increase production of wheat. Farmers would now know how much they would receive for the production of each kilo of wheat.
- 6 The government can issue permits to pollute up to a certain limit. Those companies using clean technology can sell them to those using dirty technology. Over time, the number of these permits could be reduced, forcing up their price and so providing a greater incentive for firms to invest in new technology.
- 7 Non-excludability, non-rivalrous.
- 8 Without information, consumers and producers would not be able to make rational decisions and choices.
- 9 It may be very difficult and expensive to enforce laws and regulations designed to reduce pollution. Further, finding proof that a firm is responsible for pollution might not be possible without sufficient evidence.
- 10 Costs of administration.
- 11 Further away from the socially efficient level of output.
- 12 Could result in a shortage of accommodation because landlords might withdraw property from the market and demand might increase.
- 9 Because pensioners are unlikely to spend their incomes in the way calculated by the CPI. For example, an elderly person confined to home is likely to spend more on heating and food than the average person.
- 10 No. If it is a one-off fall in prices then it is neither general nor sustained and it is only one item that is included in the CPI. However, it could be a cause of deflation because when oil prices fall the cost of production falls for most firms and this is likely to cause firms in general to reduce their prices.
- 11 a) Cost-push inflation
b) Demand-pull inflation
- 12 If it is caused by rising consumer demand then firms are likely to benefit from higher revenues and profits.
- 13 It falls by 3%.
- 14 The Claimant Count records people who are eligible to receive welfare payments from the state — this excludes a large number of people who may be seeking employment. The ILO measure is based on a survey that calculates those out of work over the last 4 weeks and ready to start work within 2 weeks, so it is a much broader measure.
- 15 The unemployed are out of work whereas the underemployed are working but are seeking more hours of work. Underemployment may also refer to those doing a job for which they are overqualified.
- 16 No — unemployment could be rising at the same time as employment if there is an increase in the working population caused, for example, by an increase in the number of people entering the workforce at the age of 18 or an increase in immigration.
- 17 There might be an increase in people who decide to retire early. Some people may be discouraged from trying to get a job if the unemployment rate is very high.
- 18 Structural unemployment.
- 19 Its productive capacity would fall — from Theme 1, this could be analysed in terms of a leftward shift in the PPF.
- 20 Higher-skilled workers are likely to be paid more, so poverty should decrease.
- 21 If the unemployed are offered training courses then there may not be a loss of skills.
- 22 It is an import because money is flowing out of the country.
- 23 The current account includes not only the balance of trade (i.e. value of goods and services exported minus the value of goods and services imported) but also the primary balance and the secondary balance.
- 24 Cause a deterioration in the balance of trade — as real incomes rise people buy more goods and services, including imports.
- 25 Many car components are imported and many cars produced in the UK are for the export market.

Chapter 5

- 1 A recession refers to two consecutive quarters of negative economic growth. The characteristics tend to be lower living standards, increasing unemployment and many firms going out of business. From the government's point of view there tends to be more spending (on benefits) and reduced tax receipts.
- 2 Population in Country A may be much higher than in Country B. Therefore, Country B's GDP per person may be higher.
- 3 No, real GDP would not have changed because GDP has increased by the same % as the rate of inflation.
- 4 GDP at PPP eliminates price differences between countries whereas nominal GDP does not.
- 5 It might mean that in Country A people are working longer hours, have shorter holidays or live in much more crowded and polluted cities, for example.
- 6 Happiness takes into account the quality of life rather than the income alone. Government policy can have a significant impact on happiness, for example, by spending money on sporting and leisure facilities. Happiness may be associated with a more productive economy.
- 7 a) Deflation
b) Disinflation
- 8 To ensure that the CPI provides an accurate measure of the rate of inflation by weighting more heavily those items important in consumers' expenditure than those that form a small proportion of consumers' expenditure.
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Chapter 6

- 1 Consumption.
- 2 There will be a movement back along the AD curve — a contraction in AD.
- 3 The AD curve would shift to the left, i.e. there would be a decrease in AD.
- 4 Disposable income would fall.
- 5 Consumption would fall.
- 6 Consumption is likely to increase because lower interest rates reduce the cost of borrowing. In practice, however, other factors might be more important, such as consumer confidence or disposable income.
- 7 A firm purchasing robotic equipment, expenditure on computers by a business.
- 8 Higher real incomes are likely to lead to a rise in consumer expenditure. In turn this is likely to lead to more than proportionate increase in investment via the accelerator effect (the latter concept is not required in this specification).
- 9 Fall because business confidence would fall.
- 10 There would be a fall because it would be more difficult for businesses to secure loans for investment.
- 11 Rise because more people would be claiming welfare benefits.
- 12 If real incomes fall then consumer expenditure would fall, resulting in a fall in demand for imports. Therefore, the net trade balance would improve.

Chapter 7

- 1 It implies that real output in the whole economy will be higher as the price level rises.
- 2 a) The AS curve would shift to the left because costs of production would have risen (assuming no change in productivity).
b) The AS curve would shift to the right because costs of production have fallen.
- 3 It implies that resources are fully employed.
- 4 The AS curve would shift to the left because the price of imported raw materials would have increased.
- 5 It would cause the LRAS curve to shift to the right because a larger working population would mean that the productive capacity of the country would have risen.

Chapter 8

- 1 \$10 trillion because, according to the circular flow, output = income = expenditure.
- 2 a) Income
b) Wealth
- 3 It will decrease.
- 4 Real output will decrease because withdrawals from the circular flow have risen.
- 5 4, because: $K = \frac{\Delta Y}{\Delta J} = \frac{120}{30} = 4$

- 6 GDP would fall — there would be a downward multiplier effect. This could result in an increase in unemployment and a fall in the rate of inflation.
- 7 $MPC = \frac{\Delta C}{\Delta Y} = \frac{1500}{2500} = 0.6$
- 8 The value of the multiplier will rise.
- 9 $MPM = \frac{\Delta M}{\Delta Y} = \frac{160}{400} = 0.4$
- 10 The multiplier will fall from 3.33 to 2.
- 11 $K = \frac{1}{MPW} = \frac{1}{0.5} = 2$
- 12 An injection has a multiplier effect on real output so the injection will lead to a larger rise in GDP.

Chapter 9

- 1 A rightward shift in the LRAS curve.
- 2 Growth will increase because there is an increase in productive capacity.
- 3 Actual growth will increase because exports are an injection into the circular flow.
- 4 The level of GDP has risen by 2% but it has increased at a slower rate than previously when the growth rate was 3.2%.
- 5 Negative output gap.
- 6 No — a technical recession is defined as two successive quarters of negative economic growth.
- 7 During a boom unemployment is likely to fall because aggregate demand is increasing rapidly.
- 8 With economic growth, real incomes are rising and so firms should be benefiting from higher sales, revenues and profits. This may mean that workers benefit from higher wages.
- 9 Economic growth might be achieved at the expense of longer working hours and shorter holidays. Also, there might be an increase in external costs, e.g. pollution, which results in a lower quality of life.
- 10 Increase in tax revenues, so enabling it to reduce its fiscal deficit. Alternatively it might use the higher tax revenues to improve public services or to reduce income inequality by increasing welfare benefits to the poor.

Chapter 10

- 1 A balanced government budget implies that tax revenues are equal to government expenditure; a balance of trade equilibrium implies that the value of goods and services exported are equal to the value of goods and services imported.
- 2 It would cause consumption to increase (because the reward for saving has decreased and the cost of borrowing has decreased).
It would cause investment to increase (because the reward for retaining profits has decreased and the cost of borrowing has decreased).
It would cause a rise in exports and a decrease in imports (because the fall in interest rates would cause a fall in the exchange rate).
- 3 QE will lead to a rise in the money supply.

- 4 Increase taxes and reduce government expenditure.
- 5 2% (as at 2020).
- 6 Cause real output to fall because the wage cuts would cause consumption to fall.
- 7 a) QE has the effect of increasing the money supply and reducing interest rates. These factors are likely to cause a rise in AD and so cause inflationary pressure to increase.
b) The government followed a contractionary fiscal policy, so depressing AD.
- 8 If the economy reaches the full employment level of real output then any further stimulus to the economy is likely to be inflationary.
- 9 Expenditure on new apprenticeships and other vocational qualifications such as 'T' levels.
- 10 If the level of AD is very low and the economy is operating on the perfectly elastic part of the AS curve then supply-side policies are unlikely to be effective.
- 11 The Phillips curve shows a trade-off between unemployment and inflation. The implication is that if you are prepared to forgo one you can achieve success in controlling the other.
- 12 It would improve it because a contractionary fiscal policy implies higher taxes and/or cuts in government expenditure, which would reduce AD — including the demand for imports.
- 13 Because expansionary fiscal policy measures have to be financed by borrowing. Increased demand for loanable funds puts up interest rates.
- 14 Firms need to pay for resources, which they then transform into goods and services that they can then sell. The time taken to transfer the resources into receipts for payment means that firms need to borrow.
- 15 Interventionist supply-side policies are likely to increase the budget deficit because they might involve increased government expenditure, e.g. on education and infrastructure.

Chapter 11

- 1 Low start-up costs, local market, personal service.
- 2 To be able to buy in bulk and, therefore, at lower prices.
- 3 Private sector firms are owned by individuals or, in the case of joint stock companies, shareholders; public sector firms are owned by the state.
- 4 Internal growth — or organic growth — is when a firm grows through expanding itself without acquiring another firm. External growth occurs when a firm acquires another firm or merges with another business.
- 5 To benefit from economies of scale; to increase market share.
- 6 a) Forward
b) Backward
- 7 Lack of finance for expansion; owner wishes to retain control.

- 8 Increased dividends because business is now more profitable.

Chapter 12

- 1 No. Revenue is maximised when $MR = 0$ whereas profit maximisation is the output at which $MC = MR$.
- 2 The output at which there is the greatest difference between total revenue and total cost, or the output at which $MC = MR$.
- 3 It is revenue maximising, which is rational because the costs become irrelevant when the stock has to be thrown away. The seller should make as much money as possible, ignoring the marginal cost in this specific example.
- 4 To gain market share so that it can establish itself.
- 5 The firms might have other objectives apart from short-run profit maximisation. If the owners can be kept happy with a certain amount of profits then other goals can be worked on.

Chapter 13

- 1 For a price-taking firm, the demand curve is perfectly elastic, so when the quantity sold increases by each successive unit, the total revenue will increase at a constant rate.
- 2 £40
- 3 £30
- 4 The firm should raise the price. Total revenue will rise because the price rise will cause a smaller percentage change in quantity demanded.
- 5 Normal profit is built into the cost curve. So if $AC = AR$ or $TC = TR$, you know that the firm is operating at normal profit.
- 6 Total variable cost.
- 7 A fixed cost because business rates do not vary with output.
- 8 Yes — as long as marginal cost is below average cost, average cost will be falling.
- 9 Because it assumes that there is at least one fixed factor of production.
- 10 Rising.
- 11 Lowest point on the AC curve.
- 12 In the short run there is at least one fixed factor of production whereas in the long run all resources are variable.
- 13 Internal economies occur when the firm gets larger, and external economies occur when the industry gets larger.
- 14 Risk-bearing.
- 15 Increases by 8 times, that is $2 \times 2 \times 2$.
- 16 It should decrease output, which means the long-run average costs will fall.
- 17 It would benefit all firms in the industry.
- 18 Increase output.
- 19 Revenue is maximised.

Chapter 14

- 1 Allocative efficiency.
- 2 A firm that is X-inefficient would not be able to survive because its costs and prices would be higher than those of other firms.
- 3 Infinity — the demand curve facing a perfectly competitive firm is perfectly elastic.
- 4 If there are supernormal profits in the short run, they will be eroded away by new entrants in the long run, and if there is a loss in the short run then firms will leave in the long run.
- 5 Yes, it would carry on in the short run if it is covering AVC and making a contribution to the fixed costs. In the long run, the firm would leave the industry because all costs are variable.
- 6 In perfect competition goods are homogeneous; in monopolistic competition goods are differentiated.
- 7 No, because there are no barriers to the entry of new firms.
- 8 Interdependence means that the actions of one firm, e.g. changing its price, will have an impact on the other firms in the industry who may also change their prices.
- 9 The largest five firms have a market share of 90%.
- 10 It is overt collusion because it is openly asking a question about future prices. However, it is not guaranteed that the firms will act on the information and it might be very hard to detect this.
- 11 If there are large firms who are not part of the cartel, it might be difficult for the cartel to maintain a high price.
- 12 Limit pricing.
- 13 It is assumed in the model that there are barriers to the entry of new firms.
- 14 Because monopolists might exploit consumers by charging high prices, so reducing consumer surplus.
- 15 No — it would make it impossible to charge different prices to different submarkets.
- 16 To increase profits.
- 17 It falls continuously.
- 18 Monopoly power means that a firm has power over consumers, and monopsony means a firm has power over its suppliers.
- 19 No, because contestability means that new firms could enter the market.
- 20 Sunk costs are irretrievable costs and so they make markets less contestable.

Chapter 15

- 1 The demand for labour will increase.
- 2 Reduce the supply of labour.
- 3 Geographical immobility of labour.
- 4 Increase in wage rate of workers in hotels and restaurants in the UK.
- 5 Flexibility — worker only employed when they are needed; reduction in costs and, therefore, higher profits.

- 6 Workers may become more productive; firms might be able to absorb extra costs.
- 7 Workers subject to maximum wages might get other benefits, e.g. private healthcare insurance.
- 8 Training may be inappropriate to the skills needed by employers.
- 9 It would make demand for labour more elastic.
- 10 It would make supply of labour less elastic.

Chapter 16

- 1 It could lead to less investment in green energy.
- 2 Competition can lead to lower prices and more choice for consumers.
- 3 Deregulation makes it easier for new firms to enter the market.
- 4 To prevent consumers being exploited by private monopolies; to ensure that a product/service is supplied if the private sector cannot produce the good/service profitably.
- 5 Symmetric information in this context means that the regulator knows as much about the business as the firm that it is trying to regulate. Asymmetric information means that the firm knows more and can shield information from the regulator.

Chapter 17

- 1 Increased protectionism; higher labour costs in developing countries.
- 2 Increases speed of communications and reduces the cost of communications, so encouraging firms to source materials from other countries. Also, firms can access world markets more easily by advertising on the internet; it is easier for consumers to buy goods from other countries.
- 3 A country might become too dependent on imports of goods of strategic importance; loss of jobs in countries that are not internationally competitive.
- 4 Absolute advantage implies that one country can produce more of a product than another country. Comparative advantage means that a country can produce a product at a lower opportunity cost than another country. Even if Country A can produce more of all products than Country B, specialisation and trade will still be beneficial if Country B has a relative or comparative advantage in one of the products.
- 5 Yes, if it specialises in the product(s) in which it has a comparative advantage.
- 6 No — neither country would have a comparative advantage in any product.
- 7 Advantages: more choice; lower prices and, therefore, increased consumer surplus.
Disadvantages: consumers may face less choice in the long run if domestic firms are unable to compete and so go bankrupt. In turn, this might imply that workers in the domestic industries are made redundant.

- 8 Change from inward-looking strategy to outward-looking strategy, leading to more foreign direct investment (FDI).

FDI combined with low labour costs leading to development of manufacturing industries and increased exports.

Rising real incomes in emerging and developing economies, creating extra demand for goods produced in developing countries.

- 9 a) Terms of trade = $\frac{120}{110} \times 100 = 109.09$
 b) Terms of trade = $\frac{110}{90} \times 100 = 122.2$
- 10 Living standards will fall because more must be exported to gain a given quantity of imports.
- 11 The key characteristic of trading blocs is free trade between member countries.
- 12 Both have free trade between members but a customs union has a common external tariff on goods from outside the union.
- 13 These terms are usually applied when considering trading blocs. Trade creation relates to increased trade with other countries following the removal of trade barriers. Trade diversion occurs when trade barriers are imposed. This usually means trade flows being diverted from low-cost producers to high-cost producers.
- 14 Because there is a restriction on trade for countries outside the customs union.
- 15 Because dumping causes an artificial distortion of comparative advantage.
- 16 To allow its infant industries to develop and reach a size that will enable firms to benefit from economies of scale. In turn, this will enable the firms to compete internationally.
- 17 Consumers will have less choice and higher prices.
- 18 Easier to protect industries without breaking WTO rules.
- 19 Reasons include: to prevent dumping; to protect jobs; for strategic reasons, e.g. dependence on other countries for key drugs; to correct a balance of trade deficit.
- 20 The other elements of the current account could be in surplus, i.e. the trade in services balance, the primary account balance, the secondary account balance.
- 21 a) Visible import: outflow from the trade in services balance, which is part of the current account. Negative effect on balance of payments.
 b) Fall in trade in services balance. Negative effect on the current account of balance of payments.
 c) In the short-run there will be an outflow from financial account. Negative effect.
 d) Visible export: inflow into the trade in goods balance, which is part of the current account.
 e) Outflow from the current account under the 'investment income' balance. Negative effect on balance of payments.

- 22 Demand-side policies relate to those that affect aggregate demand. Either fiscal or monetary policy may be used.

Fiscal policy: to reduce a current account deficit, public expenditure could be reduced or taxes increased. Both of these would reduce aggregate demand within the country and so cause a fall in consumption and a fall in imports.

Monetary policy: an increase in interest rates would increase the incentive to save. In contrast, there would be less incentive to borrow because a higher rate of interest would be payable on loans. Again, the overall effect would be to decrease imports.

However, it should be noted that an increase in interest rates could cause an increase in the value of the country's currency, which would cause a fall in competitiveness of its goods (because the foreign currency price of exports would increase and the price of imports would decrease).

- 23 Could be a result of export-led economic growth; allows for an increase in reserves of foreign currency that may be used to buy capital goods in the future.
- 24 Appreciate.
- 25 It would rise because speculators would be confident about the future of the country's economy.
- 26 The central bank could reduce interest rates to make it less attractive for foreigners to place surplus cash balances in the country's banks.
- 27 If the sum of the price elasticities of demand for imports and exports between 0 and -1.
- 28 It could cause the unemployment rate to rise because an appreciation of the currency will make the country's goods less competitive.
- 29 a) Increase
 b) Increase
 c) Decrease
 d) Increase
- 30 The price of the country's costs and prices would be low relative to other countries and their quality relatively high.

Chapter 18

- 1 No. It is possible for there to be significant falls in absolute poverty while relative poverty is increasing. Remember that relative poverty involves making a comparison with others in that country, so even if a country has a very high GDP per head, there will always be people in relative poverty and that level could be increasing.
- 2 An increase in welfare benefits from the government; a decrease in unemployment.
- 3 The Lorenz curve would move further away from the 45° line.
- 4 Inheritance: inherited assets are a major source of inequality.

Ownership of assets, e.g. property: those owning property have enjoyed substantial increases in their wealth in most countries over the last 50 years.

- 5 The owners of resources are likely to earn higher incomes and be able to accumulate wealth more easily than those who do not own resources.

Chapter 19

- 1 It is fairly narrow. For example, it does not include any measure of inequality.
- 2 Supply and demand are very price inelastic, so any shift in either the supply or demand curve would cause a significant price change.
- 3 The demand for these products is likely to be income elastic, so demand for them (and their price) in developed economies is likely to rise as real incomes increase.
- 4 With low incomes, the marginal propensity to consume would be high because people would tend to spend much of any increase in their incomes. Consequently, savings would be low so that funds for investment would be limited.
- 5 A shortage of foreign exchange would mean that there would be insufficient funds for importing capital goods or essential raw materials and oil or healthcare products. In turn, it may be difficult for the country to achieve economic growth and generate tax revenues, which could be used to improve education (and literacy rates), healthcare (and life expectancy), and improvements in access to clean water etc.
- 6 A higher population may mean that there will be a larger workforce (at least in the future), so increasing the productive capacity of the country. A disadvantage is that the population may be growing faster than the country's GDP so GDP per capita would fall.
- 7 To service the debt, i.e. to make interest payments on the debt, the country will have to pay in foreign currency, meaning that there is less available for purchasing capital goods, oil, food etc.
- 8 This would improve human capital — making the workforce more productive, so helping to increase economic growth.
- 9 If an economy is open to trade, it is more likely that transnational companies will invest in the country. This will generate economic growth and, with higher real incomes, development might occur, e.g. in terms of improved education and healthcare. Removal of trade barriers will mean that foreign firms might undercut domestic firms causing them to close down.
- 10 The inability of potential entrepreneurs to access funds from the banking system; or absence of a readily available financial system with the ability to extend credit.
- 11 The internet.
- 12 To reduce price fluctuations.

- 13 There will be an increasing proportion of the population in urban areas which may mean there are too few workers in rural areas for farming. Inequality is likely to increase because earnings in manufacturing are likely to be higher than those in the agricultural sector.

There are likely to be increased levels of pollution and environmental degradation.

- 14 Demand for tourism is critically dependent on the state of the world economy because demand is income elastic. Demand for tourism in some countries may be seasonal, so foreign currency earnings fluctuate between seasons. It may have adverse effects on the environment if, for example, agricultural land is used for hotels, roads and other facilities for tourists.
- 15 They are guaranteed a set price for what they produce so helping them to plan investment and production.
- 16 Countries may come to rely on aid and not adopt policies that enable them to become self-sufficient.
- 17 Aid is the free transfer of resources from one country to another. FDI is investment by a TNC in another country whose shareholders expect to make a profit from the investment.
- 18 Provide short-term finance to enable them to finance the current account deficit. The IMF will usually impose conditions when a loan is made.

Chapter 20

- 1 To provide finance; they enable investors to buy and sell shares easily, so encouraging people to buy them.
- 2 The foreign exchange market.
- 3 By reducing asymmetric information.
- 4 Act as lender of last resort.
- 5 To prevent excessive risk taking by the banks (the moral hazard issue). Without regulation banks might make risky loans, knowing that the government would bail them out.

Chapter 21

- 1 Capital expenditure is investment, e.g. in new roads or hospitals, whereas transfer payments are transfers of income from one group (e.g. high-income earners) to another group (e.g. low-income earners).
- 2 One major expense was the furlough scheme under which the government paid 80% of a worker's wages for several months. This covered over 9 million workers.
- 3 The UK has an ageing population so it is expected that expenditure on state pensions and also on the NHS will increase. (Elderly people tend to make much greater demands on the NHS than younger people.)

- 4 Crowding out could cause a fall in investment. In turn this may reduce productivity.
- 5 With a progressive tax, the proportion of income paid in tax rises as income rises, whereas with a proportional tax, the proportion of income paid in tax remains constant as income increases.
- 6 Corporation tax.
- 7 Disincentive effects may mean that workers withdraw from the workforce, do less overtime, or move to another country (tax exiles). The Laffer curve may be used to illustrate the effects of changes in tax rates on tax revenues.
- 8 An increase in income tax rates would reduce disposable income and so cause a reduction in consumption (including a reduction in imports). Therefore, the trade in goods balance would improve.
- 9 Incomes would become more uneven because expenditure on these items would form a larger part of the income of those on lower incomes than those on higher incomes.
- 10 Discretionary fiscal policy.
- 11 During a period of rapid economic growth, incomes will be rising so tax revenues will be increasing. Therefore, the public finances will be improving. Also spending will increase so tax receipts from indirect taxes will increase.
- 12 This is likely to increase the fiscal deficit because government expenditure on state pensions and other benefits will increase, along with expenditure on healthcare. If fewer people are working then tax revenues (especially from income tax and national insurance) will decrease.
- 13 If it is being used to finance increased investment; if it is being used to stimulate aggregate demand during a severe recession.
- 14 With an increasing national debt, there will be an increase in the amount of interest that has to be paid servicing it. Therefore, the opportunity cost may be new hospitals or schools. These would have to be sacrificed to pay the interest.
- 15 Higher taxes and reduced public expenditure could cause a fall in aggregate demand and a fall in real output. With lower GDP, tax revenues could fall, for example if there is a significant increase in unemployment.
- 16 To reduce poverty there could be an increase in means-tested benefits.
To reduce inequality, the progressiveness of the tax system could be increased by raising the higher rates of income tax.
- 17 Subsidies or tax breaks towards investment for firms so that they can improve the quality of their products; improvements in training schemes to enable the workforce to produce better-quality products.
- 18 Cut in interest rates; more quantitative easing; reflationary fiscal policy, e.g. reduction in VAT or income tax; increased public expenditure.
- 19 Transfer pricing.
- 20 Uncertainty, e.g. about how long it will last or the level of unemployment that may result.
Inaccurate information, e.g. the estimates of GDP are likely to be very unreliable because firms may not complete surveys if they are closed.
Risk of taking measures that may have undesirable consequences, e.g. inflation.