

Chapter 2 The allocation of resources, specialisation and trade

Answers to Knowledge checks

- 2.1** Economists use the term ‘utility’ when referring to consumer satisfaction from consuming a good or service.
- 2.2** We would expect consumers to buy less of a good if the price increases.
- 2.3** Almost every economy in the world operates as a mixed economy, as markets are used to allocate resources in an environment influenced by government action. The extent of government intervention varies substantially between economies. The UK is one example of how this happens.
- 2.4** Matthew would produce 12 bracelets and Sophie would make 18 pots, so between them they produce a few more pots but far fewer bracelets.
- 2.5** Possible disadvantages of over-specialisation are that individual workers find the work to be tedious, so become bored and careless. Over-specialisation may also cause inflexibility and vulnerability.
- 2.6** If there is no commodity that can act as a medium of exchange, transactions would have to be carried out through barter, which is highly inefficient.

Answers to Exercises and Case studies

Exercise 2.1

Incentives are important in economics and may take various forms. This may come through the prices at which products are sold, but there are other incentives that may be effective — these will be analysed as your study of economics progresses.

- a** An increase in the price of alcohol could be an incentive for consumers to buy less alcohol. This could be achieved by increasing the tax on alcoholic drinks. An alternative approach would be to convince drinkers of the adverse health effects of drinking alcohol. This is discussed in Chapter 10 in the book, in the context of taxes on tobacco.
- b** Pharmaceutical firms could be encouraged to produce more medical drugs if they could charge a higher price, or perhaps if they received a subsidy that reduced their costs.
- c** A higher wage paid to plumbers would be an incentive for more people to train as plumbers. Reducing the price of such training might also help.
- d** It is more difficult to see how changing a price could bring about an improvement in air quality in cities, as there is no price charged for breathing air. However, if the problem arises from pollution produced by firms, then charging firms for the pollution that they cause would be an incentive for them to use cleaner production techniques.
- e** An incentive that could help to reduce the number of cars using the roads during peak hours would be to charge drivers for using the roads during those hours.

Exercise 2.2

The relative merits of market and centrally planned economies primarily relate to the way in which resources are allocated in a society. Central planners face the logistical nightmare of directing the way in which resources are allocated to alternative uses in order to produce the goods and services that match consumer needs and desires. A market system allows prices to provide signals to producers and consumers that bring about an appropriate allocation, but future

chapters will explain how markets may not always bring about the ideal outcome. You could benefit from exchanging ideas with your fellow students on the arguments in this context.

Case study 2.1

Singapore

- a** On the face of it, the Singapore government did seem to intervene quite a lot in the development of the economy. This was a one-party state that exerted control over both the media and wages. The government was active in providing housing and infrastructure for business. This was certainly not an economy in which a free market dictated the allocation of resources.
- b** However, there are also indications that markets were allowed to operate. Businesses were given incentives to be enterprising and foreign investment was encouraged. It would seem that the government provided a secure environment in which business could flourish and the economy become highly competitive. Although not apparent in the passage, although wages were controlled this was done in a way that enabled markets to work, in the sense that wage levels were raised to reflect the high skill levels of workers, which in turn reflected investment in education. Personal freedom was sacrificed in order to allow the economy to develop rapidly.

Singapore used strong central planning to stimulate economic growth, but in a way that helped markets to work, rather than trying to override them.

Answers to end-of-chapter questions

A Multiple-choice questions

- 1** c. The level of satisfaction that a consumer gains from consumption
- 2** d. A mixed economy
- 3** a. Exchange

B Knowledge and understanding questions

- 4** An incentive is something that motivates an economic agent to behave in a certain way, for example profit may be an incentive for a business.

A full explanation of an incentive	2 marks
A vague or partial explanation of an incentive	1 mark

- 5** Differences may include:

- Fewer government officials are needed in a market economy compared with a planned economy (1 mark) because the government does not play a part in market decisions (1 mark).
- The main incentives are different in a market and a planned economy (1 mark). In a planned economy the incentive is social welfare whereas the main driver in a market economy is likely to be self-interest or profit (1 mark).

Two differences explained	4 marks
One difference explained AND one difference identified	3 marks
One difference explained OR two differences identified	2 marks
One difference identified	1 mark

6 The role of the government in a market economy is to provide the following:

- A basic framework of property rights
- A basic legal framework

A full explanation of the role of the government in a market economy	2 marks
A vague or partial explanation of the role of the government in a market economy	1 mark

7 A barter system operates without money so that transactions in goods and services rely on direct exchange.

An explanation of a barter system AND a relevant example	2 marks
An explanation of a barter system	1 mark

C Stimulus response question

8 a The division of labour is a process whereby the production procedure is broken down into a sequence of stages, and workers are assigned to particular stages.

A full explanation of the division of labour	2 marks
A vague or partial explanation of the division of labour	1 mark

b

AO1 Knowledge	1 mark
AO2 Application	1 mark
AO3 Analysis	3 marks
AO4 Evaluation	3 marks

Knowledge (1 mark) is likely to include:

- Scarcity
- Opportunity cost

Application (1 mark) is likely to include:

- Uses of Katie and Sahdat's time — plastering and painting

Analysis (3 marks) is likely to include:

Analysis that specialisation will reduce the overall time/resources needed to decorate the house, for example:

- Reduction in time needed
- Reduction in wasted resources (from poor work)
- Increased quality

Evaluation (3 marks) is likely to include:

Evaluation that specialisation may not reduce the time/resources needed to decorate the house, for example:

- Boredom, leading to poor work

- Are the tasks of painting and plastering equal in terms of skill and time?
- Does Katie have an aptitude for plastering? Does Sahdat have an aptitude for painting? Will it lead to resentment?

A judgement of the extent to which specialisation may address the problem of scarcity for Sahdat and Katie.