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ECONOMICS **0455/21**

Paper 2 Structured Questions **May/June 2016**

MARK SCHEME

Maximum Mark: 90

Published

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1 (a) Using information from the extract, identify two characteristics of monopoly. [2]

- High barriers to entry and exit (1)
- A sole producer (1)
- Gain total control of the market (1)

(b) Calculate the total output of car parts in US$ in 2013. [3]

- US$396.8 bn Accept US $396 bn or US $397 bn or US $3.968253968x10^{11} (3)
- Correct working i.e. US $250 bn x 100/63 (2)
- US$250 bn is 63% of the total (1)

(c) Explain, using information from the extract, why wages in the UK car industry fell in 2008. [2]

- A recession occurred in the UK in 2008 (1). Falling GDP may reduce demand for cars (1). Demand for labour falls (1)

(d) Using information from the extract, explain two merits of a market system. [4]

- Consumer sovereignty (1) consumers having the power to decide what is produced / firms allocate resources according to consumer demand (1) results in greater choice for consumers (1)
- Firms respond to price changes (1) bring in new methods of production (1) may lower costs / are more efficient / competitive (1)
- May encourage innovation (1) improve quality (1) due to the profit motive (1)

(e) Analyse two reasons, referred to in the extract, why a decrease in employment may increase labour productivity. [4]

- Less skilled workers may lose their jobs (1) they may have relatively low productivity (1).
- The industry may become more capital intensive (1) machines replacing workers / more capital equipment per worker enables workers to produce more output (1).

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(f) Discuss whether a declining industry should be protected by the government. [5]

Up to 3 marks for why it should:
- Will save jobs / prevent unemployment (1) this can prevent living standards falling (1) prevent government spending on unemployment benefits rising (1) prevent loss of tax revenue (1) give workers time to find other jobs (1)
- Will stop real GDP / output falling (1) avoid a recession / fall in economic growth (1).
- Will assist exports / reduce imports (1) positive effect on Balance of Payments on current account (1)
- Industry may be a strategic industry (1) such industries are important for the survival of the country (1).

Up to 3 marks for why it should not:
- An inefficient use of resources (1) involves an opportunity cost (1) resources would be better devoted to infant industries / expenditure on health and or education (1).
- May provoke retaliation (1) other countries may impose trade restrictions (1) this may raise the cost of other firms/make it difficult for them to sell abroad (1).
- Industry becomes too dependent on government support (1) making it less competitive (1)

(g) Using information from the extract, explain two functions of commercial banks. [4]

- Provide loans (1) interest will be charged on these / enable households and firms to borrow (1).
- Enables customers to save (1) provides a secure place/pays interest (1).

(h) Discuss whether small car manufacturing firms can compete with large car manufacturing firms. [6]

Up to 4 marks for why they might:
- Small firms can specialise in luxury models (1) cater for a small market (1). May provide specialist parts for bigger firms (1)
- Small firms can provide a specialised product (1) build cars to suit individual customer needs (1).
- Small firms may be subsidised / have taxes reduced by the government (1) reduce costs of production (1).
- Large firms may experience diseconomies of scale (1) example (1) giving small firms a cost advantage (1).
- May experience external economies of scale (1) example (1).

Up to 4 marks for why they might not:
- Average costs may be higher (1) as large firms may experience economies of scale (1) example (1).
- Large firms may have brand loyalty (1) well known/high spending on advertising (1) high spending on research and development (1)
- Large firms may force small firms out of the market (1) by lowering prices (1)

NOTE: MAX of 4 marks if no mention of car manufacturing.

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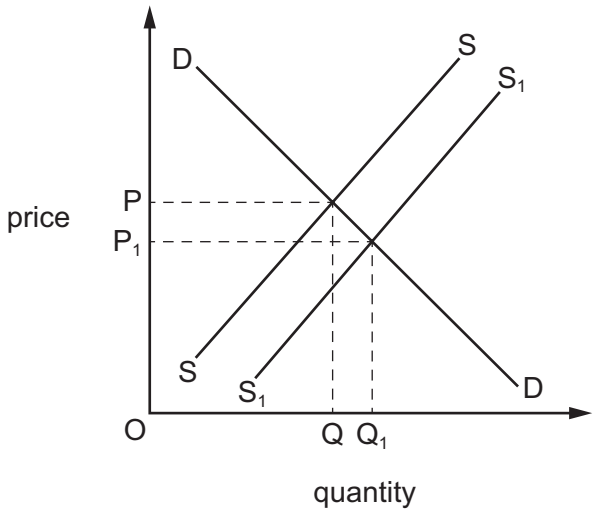
2 (a) Define 'an indirect tax'. [2]

A tax on spending / goods and services / consumption (1) the burden of the tax can be moved on to someone else (1) example (1)

(b) Explain how a cut in the rate of corporation tax could result in an increase in tax revenue. [4]

- A lower tax will increase the profit firms can keep / lower the cost of production (1) encourage them to increase output (1) increasing employment (1) pay higher wages (1) direct tax revenue would rise (1).
- Spending / consumption may increase (1) more revenue from indirect taxes (1).

(c) Using a demand and supply diagram, analyse the effect of removing an indirect tax on the market for the product. [6]



Up to 4 marks for the diagram:
- axes correctly labelled – price and quantity or P and Q (1)
- demand and supply curves correctly labelled (1)
- supply curve shifted to the right (1)
- correct equilibriums identified either by a line drawn to both axes or equilibrium points clearly identified e.g. E and E1 (1).

Up to 2 marks for written comments:
- removing an indirect tax effectively reduces costs of production (1)
- A greater supply will lower price (1).

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(d) Discuss whether an increase in taxes will reduce inflation. [8]

Up to 5 marks for why it might:
- Increases in income tax (1) will reduce disposable income (1) spending may fall (1) lower demand will reduce demand-pull inflation (1).
- Increases in corporation tax (1) reduces profits firms can keep (1) reduces demand for capital goods/investment (1).
- Increases in indirect taxes (1) will reduce spending (1) lowering demand-pull inflation (1)

Up to 5 marks for why it might not:
- Consumers and firms may respond by reducing saving (1) rather than spending (1).
- Higher indirect taxes and corporation tax (1) increase costs of production / higher prices (1) may cause cost-push inflation (1).
- Higher income tax may encourage workers to press for wage rises (1) increasing costs of production (1) causing cost-push inflation (1).

3 (a) Identify two functions of money. [2]

1 mark each for any two of the following:
- medium of exchange / means of payment
- store of value
- unit of account/measure of value
- standard of deferred payment.

(b) Explain two reasons why household borrowing may increase. [4]

1 mark for identifying a reason and 1 mark for explaining:

- The rate of interest may fall (1) making it cheaper to borrow (1).
- Incomes may fall / prices may rise / inflation (1) so people may borrow to purchase basic necessities (1).
- People may become more optimistic about the future (1) more confident that they will repay loans (1).
- The price of housing may fall (1) encouraging people to take out mortgages (1).
- Increase in family size (1) creates a greater need to borrow to support more children (1)
- The cost of health care/education may increase (1) requiring people to pay more for the services (1).

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(c) Analyse three ways in which international trade differs from internal trade. [6]

1 mark for identification of a difference and 1 mark for analysis:

- International trade usually covers greater distances (1) which increases the cost of transport (1) may take longer for delivery (1).
- International trade means a bigger market than the internal market (1) and more competitive (1) enabling firms to gain economies of scale (1)
- Internal trade involves using the same currency (1) international trade may involve two or more currencies (1) increasing transaction costs (1).
- International trade means a wider range of goods & services (1) this gives consumers greater choice (1)
- Trade restrictions may be imposed on products traded internationally (1) raising costs of production (1).
- Tastes and cultures may differ (1) requiring differences in products offered (1).
- Regulations may differ (1) requiring adjustments in products (1).
- Languages may differ (1) e.g. incurring costs of translation (1).

(d) Discuss whether an increase in exports will increase the exchange rate. [8]

- The exchange rate is the price of a currency (1)

Up to 5 marks for why it might:

- An increase in exports may increase export revenue (1) this will increase demand for the currency (1) higher demand pushes up the price of the currency (1) raising the value of a floating exchange rate (1) which is determined by market forces (1).

Up to 5 marks for why it might not:

- Exports may increase but export revenue may not (1) more exports may be bought for a lower price (1) and so demand for the currency will not rise (1).
  (1) An increase in exports may be offset by an increase in imports / lower interest rate (1) or government intervention by selling domestic currency (1) so demand and supply of the currency will increase (1) which may leave the exchange rate unchanged (1).

4 (a) Why may less wheat be the opportunity cost of producing more milk? [2]

- Opportunity cost is the cost of the (next) best alternative foregone (1).
- Land / resources used for growing wheat may be used to keep cows (1) reducing the amount of wheat that can be produced (1).

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(b) Explain two reasons why the supply of a product may be price-inelastic. [4]

1 mark for each reason identified and 1 mark for explanation:

- It may take time to produce the product (1) this means that it will take time to adjust supply in response to a change in price / example of a product that it takes time to produce (1).
- It may not be possible to store the product (1) this means that it cannot be taken out of storage when price rises / products cannot be put into storage when price falls (1).
- It may be costly to adjust supply (1) e.g. it might be necessary to build new factories and this may discourage firms from adjusting supply (1).
- The supply of a natural resource may become limited (1) e.g. gold maybe close to depletion (1)

(c) Analyse how an increase in exports could increase a country's employment rate and inflation rate. [6]

- An increase in exports may mean a higher total demand (1). Higher demand may encourage firms to increase their output (1) to produce more products firms may take on more workers (1) reducing cyclical unemployment (1).
- Higher demand may cause demand-pull inflation (1). A higher demand for workers may push up wages (1). Higher demand for raw materials may push up the price of raw materials (1). Costs of production may increase (1) causing cost-push inflation (1).

Note: a maximum of 4 marks for analysis of the effect on either the employment rate or the inflation rate.

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(d) Discuss whether the average cost of production always decreases when a firm increases the total output that it produces. [8]

Up to 5 marks for why it might:

- The firm may experience economies of scale (1) total cost will rise by less than total output (long run average cost may fall as output increases) (1).
- The firm may experience buying/purchasing economies of scale (1) may be offered a discount price when buying raw materials in bulk (1).
- The firm may experience technical economies of scale (1) larger, more cost efficient technological equipment may be purchased to produce a higher output (1).
- The firm may experience managerial economies of scale (1) specialist staff may be employed when output is high (1)
- The firm may experience financial economies of scale (1) as output increases, it may be able to borrow more cheaply / or sell its shares at a lower price (1)
- The firm may experience R & D economies of scale (1) the R & D expenditure can be spread over a higher output (1).
- The industry may also be growing in size (1) enabling advantage to be taken of external economies of scale (1).

Up to 5 marks for why it might not:

- The firm may experience diseconomies of scale (1) total cost may rise by more than total output (long run average cost may increase as output increases) (1).
- The firm may experience diseconomies of scale (1) this may make the firm slower to respond to changing market conditions / more difficult to keep costs down (1).
- The firm may experience communication problems (1) ideas may not be communicated or may be misunderstood (1).
- The firm may experience poor industrial relations (1) e.g. strikes may increase costs of production (1).
- External diseconomies of scale may occur (1) e.g. pushing up the costs of production (1).
- Allow up to 2 marks for a correctly labelled average cost diagram which shows economies and diseconomies of scale as an alternative to describing average costs rising / falling as output increases

5 (a) Define 'market failure'. [2]

- Where the market forces of demand and supply (1) do not achieve efficiency (1)
- When social costs are greater than social benefits (1) example of external cost e.g. monopoly or external benefit e.g. merit or public goods (1)

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(b) Explain how government regulation may reduce market failure. [4]

- Regulation involves rules and laws (1).
- Firms may be banned (1) from producing products that create external costs (1) example such as water pollution (1).
- Firms may be fined (1) if they create external costs (1) example e.g. air pollution (1).
- Consumers may be banned from consuming products that create external costs (1) or where there are high private costs (1) some of which people are unaware of (1) example e.g. cigarettes (1)
- Consumption of some products that have external benefits (1) and/or high private benefits (1) some of which people are unaware of (1) may be made compulsory (1) e.g. primary school education (1).

(c) Analyse the effect of a decrease in resources on government economic aims. [6]

- Fewer resources will make it more difficult to achieve economic growth (1) there will be fewer factors of production to produce goods and services (1) output may fall or rise more slowly (1).
- Fewer resources may increase costs of production (1) supply may fall by more than demand/there may be a shortage of e.g. raw materials (1) cost-push inflation may occur (1).
- Natural disasters (1) can lead to cost push inflation (1) loss of employment (1) government expenditure exceeding government income (1)
- The current account may move into a deficit/larger deficit (1) as exports may decline (1) while e.g. food may have to be imported (1).
- Destruction of factories may reduce unemployment opportunities (1) which may increase unemployment (1) but more workers may be needed to e.g. rebuild factories (1).

(d) Discuss whether the social benefits of building flood defences will exceed the social costs involved. [8]

Up to 5 marks for a discussion of why social benefits maybe greater:

- Social benefits are private benefits plus external benefits (1).
- Explain private benefits (1) e.g. greater employment, greater revenue for firms, protection of homes / reduction in high risk of flooding (up to 3)
- Explain external benefits (1) e.g. increase in house prices in the area, greater tourism, reduced cost to emergency services and benefit payments (up to 3)

Up to 5 marks for why social costs maybe greater:

- Social costs are private costs and external costs (1).
- Explain private costs (1) e.g. cost of land, raw material labour and buildings, may only be a low risk of flooding (up to 3)
- Explain external costs (1) e.g. pollution, destruction of wildlife habitats, opportunity cost of resources (up to 3).

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6 (a) Identify two reasons why workers go on strike. [2]

1 mark for each of two reasons identified e.g.:
- to gain higher wages / to resist wage cuts
- to improve working conditions
- to resist job losses.

(b) Explain two disadvantages of a decrease in a country's export revenue. [4]

- May increase a current account deficit / reduce a current account surplus (1) export revenue is part of the current account / export revenue is a credit items (1).
- May increase unemployment (1) exporting firms may reduce their output (1) which would lower demand for workers (1).
- May reduce economic growth (1) exporting firms may reduce output (1) can lose tax revenue from lower exports / lower output (1)

(c) Analyse how a fall in a firm's revenue may influence its spending on capital goods. [6]

- A fall in revenue may reduce a firm's profit (1).
- Lower profits will reduce the funds (1) a firm has to reinvest / spend on capital goods (1).
- Lower profit will reduce the incentive to spend on capital goods (1) the expected return will be lower (1).
- Lower revenue / profit may make it more difficult for a firm to borrow (1) sell shares (1) to finance spending on capital goods (1).
- Lower revenue may make a firm realise it needs to cut costs of production (1) improve quality of products (1) and this may require the firm to buy new capital equipment (1).
- If the fall is the result of a strike the firm may seek to replace labour by capital equipment (1).

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(d) Discuss whether an increase in a country's labour force will increase income per head. [8]

Up to 5 marks for why it might:

- A larger labour force may enable greater advantage to be taken of division of labour/specialisation / economies of scale (1) this can reduce average costs of production (1) as workers can concentrate on what they are best at (1) can be trained more quickly (1) reduces the amount of capital equipment needed (1) lower costs may increase sales at home and abroad (1) increasing output and raising incomes (1).
- A larger labour force may reduce the dependency ratio (1) a higher proportion of workers to non-workers will increase income per head (1).
- A larger labour force will enable successful firms to expand (1) this will increase GDP (1).
- Multinational companies may be attracted to set up in the country by a larger labour force (1) this may result in a rise in wages (1).

Up to 5 marks for why it might not:

- Population may increase by more than the labour force (1) this will increase the dependency ratio (1).
- The labour force may increase but demand for labour may not (1) so the unemployment rate may increase (1) so income divided by population may fall (1).
- The quantity of the labour force may increase but the quality of the labour force may fall (1) productivity may decline (1) reducing output and incomes per head (1).
- An increase in the labour force may increase competition in the labour market (1) lowering wages (1).

7 (a) What is meant by a production possibility curve? [2]

- A curve that shows the maximum output of two types of products / combination of two products (1) that can be made with given resources/technology (1) it shows opportunity cost (1)
- Allow 1 mark for some understanding shown about potential maximum output
- Allow up to 2 marks for a diagram which is explained – with correct labelling (1) and correct curve (1)

(b) Explain, giving examples, two factors of production used in the tourism industry. [4]

- Labour which is human effort (1) e.g. tourist guides (1).
- Land which is natural resources (1) e.g. beaches (1).
- Capital which is human-made goods and services used in production (1) e.g. hotels (1)
- Enterprise which is risk bearing and decision making (1) e.g. may be undertaken by the owner of a hotel (1).

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(c) Analyse why doctors are paid more than nurses. [6]

- Doctors need higher qualifications (1) take longer to train (1) reduces supply (1) makes supply more inelastic (1).
- Doctors are more skilled (1) more productive / efficient (1) in higher demand (1).
- Doctors may have a more powerful professional organisation / trade union (1) giving them greater bargaining power (1).
- Doctors maybe a different gender to nurses (1) discrimination may occur (1)

(d) Discuss whether living standards are always lower in developing countries than in developed countries. [8]

Up to 5 marks for why they might be:

- Developing countries tend to have lower income per head / greater poverty (1) reducing the goods and services their people can buy (1).
- Developing countries tend to have higher population growth (1) this can increase the dependency ratio (1) reducing resources available to e.g. improve housing conditions (1)
- Developing countries tend to have lower life expectancy (1) health care tends to be less readily available / lower quality (1).
- Developing countries tend to have a lower standard of education (1) children likely to have fewer years at school / attend university / gain well paid employment / more productive (1)
- Developing countries tend to have more people employed in the primary sector (1) work in the primary sector tends to be more physically demanding/lower paid (1).

NOTE: Accept the reverse argument why living standards are always higher in developed countries.

Up to 5 marks for why they might not be:

- Some people in developed countries may experience lower living standards (1) as income may be unevenly distributed / there is relative poverty (1).
- Working hours may be lower in developing countries (1) which increases leisure time (1).
- The informal economy may be greater in some developing countries (1) meaning that output may be higher (1).
- Obesity may be more of a problem in developed countries (1) reducing the health of the population (1).
- Some jobs in the primary sector are well paid (1) e.g. in the oil industry (1).

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