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Cambridge International General Certificate of Secondary Education

MARK SCHEME for the May/June 2015 series

0455 ECONOMICS

0455/23 Paper 2 (Structured Questions), maximum raw mark 90

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1 (a) Using information from the extract, identify <u>three</u> reasons why Lesotho is considered to be a developing country. [3]

One mark each for **three** of the following:

- low GDP per head
- number of people living on less than US$2 a day
- children experiencing malnutrition
- subsistence farming
- large primary sector
- large number of workers working abroad
- lack of investment

(b) (i) Using information from Fig. 1, describe what happened to output in Lesotho between 2008 and 2009. [2]

Output increased (1) more slowly. (1)

(ii) Using information from Fig. 1, explain in which year output was highest in Lesotho. [2]

2013 (1) as output increased each year. (1)

(c) Using information from the extract, explain why the supply of diamonds is price inelastic. [3]

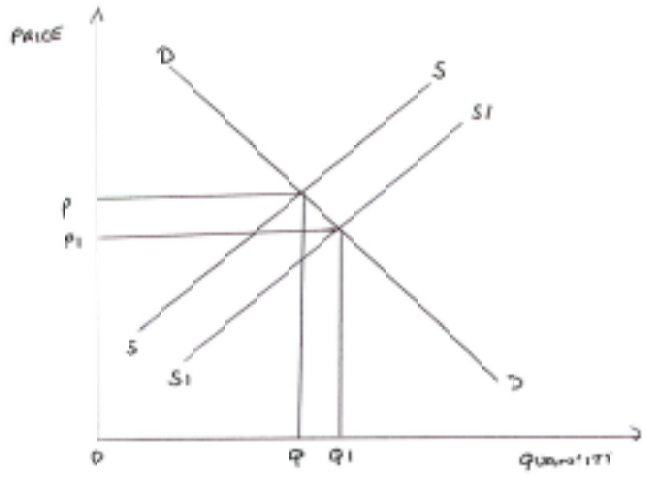
- deposits of diamonds have to be located (1)
- it takes time to open new mines (1)
- it takes time to extract diamonds (1)
- this means that supply cannot be adjusted quickly (1) due to a change in price (1)

(d) Analyse how a subsidy to farmers may affect the market for food [5]

- a subsidy is a payment/government help to encourage production (1)
- a subsidy is similar to a reduction in costs of production/makes production less expensive (1)
- it allows investment in capital (1)
- it will cause an increase in supply (1)
- supplying more food will reduce price (1)
- a lower price will cause demand to rise/an extension in demand (1)

Although a diagram is not required, award 3 marks for an accurately drawn diagram.

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- axes and curves accurately labelled (1)
- shift of the supply curve to the right (1)
- original and new equilibriums identified (1)

(e) Discuss whether Lesotho would benefit from more of its people working abroad. [5]

Up to 3 marks for why it might:

- wages are higher abroad (1) they may send more income home (1) Lesotho residents will be able to spend more on goods and services (1) may help to reduce poverty in the country (1)
- it will make a positive contribution to the current account/reduce the country's current account deficit (1)
- it may reduce unemployment in the short run (1) if emigrants had been unemployed before leaving (1) reduce costs of unemployment benefits (1)
- more workers may later return to the country bringing more skills with them (1) thus reducing training costs for firms in Lesotho (1) bring more ideas about production methods and products (1) this could increase productivity (1)

Up to 3 marks for why it might not:

- more skilled workers may emigrate (1) this will reduce productivity (1) raise firms' costs (1) reduce international competitiveness (1) lower output/economic growth (1) cause unemployment (1)
- fewer people working in Lesotho would reduce output/spending (1) reduce tax revenues (1) less available for government spending on e.g. hospitals (1)
- the absence of skilled workers may discourage multinational companies setting up in the country (1) this would reduce potential output (1)
- the absence of skilled workers may make it difficult to open new mines/increase the size of the tourist industry (1)
- more workers may leave dependants behind (1) this will increase the dependency ratio (1) tax revenue will fall (1) government spending on support of dependants may rise (1) this will involve an opportunity cost (1)
- workers may spend (all) of their income whilst abroad (1)
- Lesotho may become too dependant on other countries for employment (1)

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(f) Explain <u>two</u> reasons why governments impose tariffs. [4]

- to improve the current account position (1) a tariff would raise the price of imports/make imports less price competitive (1)
- to raise revenue (1) the revenue could be used to finance e.g. education (1)
- retaliation (1) other countries may also be imposing tariffs (1)
- to stop the import of harmful products (demerit goods) (1) prevent external costs to country (1)
- protect sunrise/sunset industries (1) prevent (short term) unemployment (1)

(g) Discuss whether a rise in China's Gross Domestic Product is likely to reduce Lesotho's current account deficit. [6]

Up to 4 marks for why it might:

- a higher Chinese GDP may mean that more Chinese tourists will go to Lesotho (1) this will contribute to Lesotho's trade in services (1) which is part of the country's current account position (1)
- a higher Chinese GDP may also result in China buying other goods and services from Lesotho (1)
- a higher Chinese GDP may increase the profits of Chinese firms (1) this may provide them with the finance to invest in Lesotho (1) Chinese multinationals in Lesotho may contribute to its exports (1)

Up to 4 marks for why it might not:

- a higher Chinese GDP may have resulted from China selling more exports to South Africa (1) may reduce Lesotho's exports to South Africa (1)
- a higher Chinese GDP will mean Chinese tourists would have more money to spend (1) this may encourage Chinese tourists to take more luxury holidays in other countries (1)
- if China's population rises (at the same rate) (1) then GDP per head will be unchanged (1)
- Chinese people may choose to save their extra income rather than spend it (1) and so not spend any more on imports from Lesotho (1)

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2 (a) Define 'inflation'. [2]

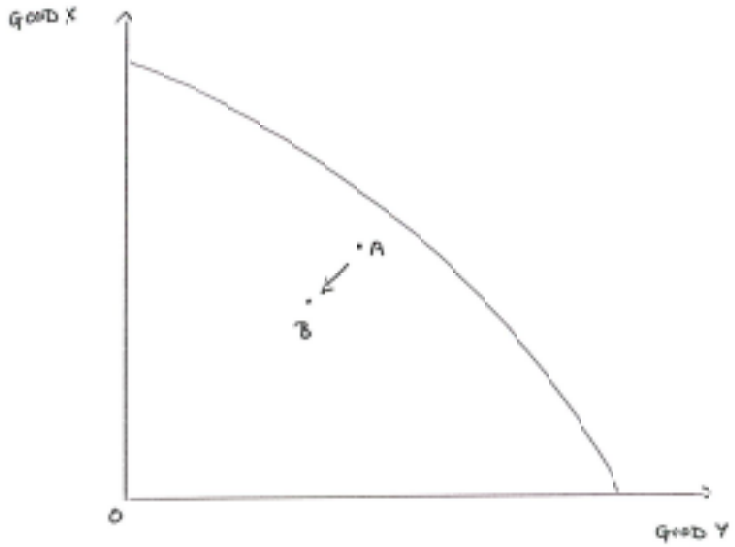
A sustained /over time (1) rise in the price level (prices). (1)

(b) Explain why government spending on unemployment benefits involves an opportunity cost. [4]

- opportunity cost is the (next) best alternative (1) forgone. (1)
- spending on unemployment benefit will reduce a government's ability to spend on another item/the tax revenue used to spend on unemployment benefit cannot be spent on another item (1) for instance, health care (1)

(c) Using a production possibility curve diagram, analyse the effect of an increase in unemployment on a country's output. [6]

Up to 4 marks for the diagram:



- axes correctly labelled (1)
- original curve/downward sloping line to axes (1)
- production point moved nearer to the origin (1)
- direction of change in the production point indicated (1)

Up to 2 marks for written explanation:

- unemployment means resources are unused / the economy is not at full capacity (1)
- with unemployed resources, a country will be producing further inside/moving inside its production possibility curve (1)

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(d) Discuss whether a rise in unemployment will cause a fall in inflation. [8]

Up to 5 marks for why it might:

- a rise in unemployment will reduce incomes (1) with lower incomes, people will spend less (1) lower demand will reduce demand-pull inflation (1)
- with a rise in unemployment workers are easily replaced/there is now a large pool of workers (1) the increased supply of labour (1) will force down wage rates (1)
- a rise in unemployment may discourage workers from asking for wage rises (1) weaken the power of trade unions (1) lower wage rises will mean that firms' costs of production will increase more slowly (1) this may reduce cost-push inflation (1)

Up to 5 marks for why it might not:

- demand may still rise despite an increase in unemployment (1) government spending or exports may be increasing (1)
- a rise in unemployment reduces national output (AS) (1) increasing inflationary pressures (1)
- other costs of production could be rising (1) for instance, raw material costs (1) for instance, a fall in the exchange rate may increase the price of imported raw materials (1)
- a rise in unemployment could mean fewer skilled workers (1) this lowers productivity (1) causing average costs to rise for firms (1)
- trade unions may still press for wage rises despite an increase in unemployment (1)
- inflation can lead to people expecting prices to rise faster in the future (1) this can lead them to act in ways that cause inflation (1) they may buy more products now (1) ask for wage rises (1)
- people may receive an income in unemployment benefits (1) and still spend the same amount as before

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3 (a) Define 'regulation'. [2]

Rules/laws/controls (1) which are designed to influence the behaviour of firms/people. (1)

(b) Explain how resources are allocated in a market system. [4]

- market forces (supply and demand) influence the allocation of resources (1) through the price mechanism (1)
- resources are privately owned in a market system (1) with little/no government influence (1)
- the profit incentive (1) encourages firms to produce what consumers demand (1)
- a rise in demand for a good or service (1) will increase price (1) encouraging more resources to be allocated to producing it (1)

(c) Analyse the causes of market failure. [6]

- market failure arises when markets are inefficient/right products are not produced in the right quantities (1)
- abuse of market power (1) monopoly (1) may result in output being restricted (1) high price charged (1) low quality (1)
- decisions based on private costs and benefits/failure to take into account external costs (negative externalities) and benefits (1) results in under-consumption and over-consumption of some products (1) leading to inefficient over-production and under-production (1)
- lack of information (1) causes consumers and producers to make inefficient choices (1) harmful products may be over-consumed (1) beneficial products may be under-consumed (1)

Note: reward (3 marks maximum) references to merit, demerit and public goods but the terms are not required.

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(d) Discuss whether an economy will benefit from its forests being cut down. [8]

Up to 5 marks for why it might:

- generate income/raise GDP (1) raise living standards (1)
- increase production of e.g. paper (1) increase employment (1)
- increase exports (1) improving the current account position (1)
- the price of wood may fall in the future (1) so advantage of the wood might need to be taken advantage of now (1)
- government tax revenue will increase (1) which could be used to e.g. subsidise new industries (1)
- the land could be used for other purposes e.g. housing (1)
- clearing forests for roads/rail could make transportation of goods easier (1) reducing the average costs of firms (1)

Up to 5 marks for why it might not:

- will exhaust the supply of wood and other products from the forest (1)
- conserving the forests will enable future generations to benefit from the income (1)
- cutting down forests could cause external costs/negative externalities (1) e.g. noise pollution/environmental damage (1)
- the price of wood may be higher in the future (1) if demand for the product increases (1)
- conflict between different groups/stakeholders (1) could lead to increased police costs (1)
- will damage (eco) tourism (1) reducing export of services (1)

Note: do not expect but reward discussion of the use of cost-benefit analysis for up to 2 marks.

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4 (a) Identify two influences on the amount people save. [2]

One mark each for **two** influences:

- (disposable) income
- wealth
- rate of interest
- expectations of future price rises/falls
- proportion of household income spent
- confidence
- tax incentives
- strength of financial institutions
- age structure of the population
- extent of social provision e.g. state pensions
- social attitudes

(b) Explain why cash (notes and coins) is money. [4]

- cash is money as it carries out the functions of money (1)
- cash acts as a medium of exchange (1) generally accepted as payment for products (1)
- cash acts as a store of value (1) people can save their cash in order to use it in the future (1)
- cash acts as a unit of account/measure of value (1) price of products is expressed in terms of the cash needed to purchase them (1)

(c) Analyse the possible effects of an increase in bank lending on economic growth. [6]

- increase in bank lending may increase spending by households (1) the higher demand may encourage firms to produce more (1) economic growth arises when output increases (1)
- more loans may be given to firms e.g. to start new businesses (1) the bank loans may be used to finance expenditure on capital goods/more resources(1)
- more investment will raise productive capacity/potential economic growth (1) this will increase total output/GDP
- more lending can lead to inflation (1) this could damage economic growth (1)
- consumers could borrow to buy more imports (1) reducing economic growth (1)

Note: do not expect, but reward explanation of multiplier effects for up to 2 marks

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(d) Discuss whether the poor are more likely to borrow than the rich. [8]

Up to 5 marks for why they might:

- lower income (1) may mean the poor have to borrow to buy basic necessities (1)
- the poor may be more inclined to get into debt (1) so may borrow to cover debt repayments (1)
- the poor may have to borrow to cover medical costs (1)
- the poor may have to borrow to educate their children (1)
- the poor are more likely to need to borrow for large purchases e.g. furniture (1)
- the poor are less likely to have savings to enable purchases (1)
- as a proportion of income the poor may borrow more (even if they do not in absolute terms) (1)

Up to 5 marks for why they might not:

- banks may be reluctant to lend to them (1) because they are worried they will not be repaid (1)
- banks may charge a higher interest rate (1) to those who they think may be a high risk (1)
- the poor may lack the ability/confidence they will be able to repay loans (1) as they may not expect their incomes to rise (1)
- the poor may be reluctant to borrow because of previous bad experience of being in debt (1)
- it depends on whether the poverty is absolute or relative (1)
- the poor are less likely to have a bank account / access to borrowing (1)

Note: accept an answer based on why the rich may borrow more, but not if the same points are also covered in reverse.

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5 (a) Define 'private limited company'. [2]

- in the private sector (1)
- sells shares/is a joint stock company (1)
- the shares are not (usually) traded on a stock exchange (1) only sold to known individuals (1)
- has limited liability (1)
- the owners/shareholders vote for a board of directors (1)

(b) Explain <u>two</u> influences on what factors of production a firm uses. [4]

- the type of product produced/size of the firm (1) for instance, producing nuclear power is capital-intensive (1)
- the productivity of factors of production (1) if, for instance, labour becomes more skilled, a firm might become more labour-intensive (1)
- the availability of factors of production (1) in some countries there may be a shortage of oil or people of working age (1)
- the relative cost of factors of production (1) if capital is relatively expensive, labour-intensive methods of production may be used (1)

(c) Analyse how an increase in the size of a firm can increase its profit. [6]

- the increase in size may have resulted from the firm selling more products/increasing output (1) if revenue rises by more than costs, profit will increase (1)
- a larger firm may be able to take greater advantage of economies of scale (1)
- fall in average costs (1) e.g. buying, managerial, technical, risk bearing (2)
- a firm may have grown in size by merging/taking over rival firms (1) this will give it greater market power (1) allowing it to push up price (1)

Note: a maximum of 4 marks for only discussing economies of scale.

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(d) Discuss whether an economy would benefit from a foreign producer setting up in the country. [8]

Up to 5 marks for why it might:

- increase GDP (1) raise living standards (1)
- create new jobs (1) lower unemployment (1) less spent on benefits (1)
- pay higher than local wages (1)
- bring new knowledge and skills (1) boosting productivity (1)
- pay (corporation) taxes (1) increasing government revenue (1)
- increased (inward) investment (1)
- creates competition for domestic firms (1) making them cut costs/become more efficient (1)
- contribute to the country's exports (1) improve the current account position (1)
- sell more cheaply in the country (1) as lower transport costs (1)
- country benefits from improved infrastructure (e.g. roads) built by foreign producer (1)
- creates demand for products of local firms e.g. components (1)

Up to 5 marks for why it might not:

- may drive local producers out of business (1) so not adding to GDP, employment, etc. (1)
- may create external costs (1) e.g. pollution (1) may set up in the country to get round regulations at home (1)
- top jobs may be taken by workers from the MNC's home country (1) jobs created for locals may be unskilled (1)
- profits earned from the firm may be sent home (1) so not benefiting the home economy (1)
- it may have powerful influence on the government (1) reducing budget revenues by demanding tax relief/subsidies (1)

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6 (a) Define 'horizontal integration'. [2]

A merger/takeover between firms (1) producing the same product at the same stage of production. (1)

(b) Explain <u>two</u> characteristics of perfect competition. [4]

- many buyers and sellers (1) so no one buyer or seller can influence price (1)
- no barriers to entry and exit (1) so any new firm can start producing the product/nothing which makes it difficult for a firm not currently making the product from starting to make it/no restrictions on firms in the industry stopping producing the products (1)
- firms are price takers (1) their supply is such a tiny proportion of total supply that changes in it will have no effect on price (1)
- homogeneous product/all the products are the same (1) so the products of different producers are perfect substitutes for each other (1)
- perfect information (1) buyers and sellers are fully aware of price and profits earned in the market (1)

(c) Analyse how <u>two</u> supply-side policy measures could improve the performance of an airline industry. [6]

Up to 4 marks for any one policy measure analysed:

- privatisation (1) may introduce competition (1) increase profit incentive (1) encourage firms to be efficient/reduce costs (1)
- cut in corporation tax/tax incentives given (1) increase funds available for investment (1) improve technology (1) raise productivity (1) lower costs of production (1)
- Improved education and training (1) raise skills of workers (1) increasing productivity (1) lower costs of production (1)
- cut in income tax (1) increase the motivation of workers (1) raise productivity (1) lower costs of production (1)
- deregulation (1) removing laws and rules may reduce firms' costs (1) enabling them to invest more (1)
- subsidies (1) may encourage firms to invest in advanced technology, engage in research and development and/or train workers (1) lower costs of production/increase productive capacity (1)

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(d) Discuss whether price is likely to be higher in a monopoly than in a perfectly competitive market. [8]

Up to 5 marks for why it might:

- lack of competition (1) gives a monopoly market power (1) if profit maximisers (1) may push up price (1) by restricting supply (1)
- lack of consumer choice/consumers can switch to rival producers in a perfectly competitive market (1) an increase in demand raises price (1) which will encourage new firms to enter the industry (1) reducing price (1)
- demand is often inelastic, e.g. water (1) increased demand raises price by greater proportion (1)
- a monopoly may be experiencing diseconomies of scale (1) example of diseconomies of scale (1) this will raise average costs of production (1)

Up to 5 marks for why it might not:

- a monopoly may be able to take advantage of economies of scale (1) example of economies of scale (1) with lower average costs, price may be lower (1) whilst still enabling a monopoly to enjoy high profits (1)
- with high profits, a monopoly may be able to spend more on research and development/new technology (1) this can reduce costs of production (1) enabling a monopoly to charge a lower price (1)
- a monopoly may be state-owned (1) it may choose to charge a low price to ensure everyone can afford it (1)
- private sector monopolies may not be profit maximisers (1) they may charge a lower price (1) in order to grow the business (1)
- monopolies may still face overseas competition (1) keeping prices down (1)

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7 (a) Define 'exchange rate'. [2]

The price (value) of a currency/how much a currency is worth (1) in terms of another currency/currencies. (1)

Note: allow 1 mark for an example e.g. £1 = $2.

(b) Explain <u>two</u> benefits of a floating exchange rate system. [4]

- no need to keep reserves of foreign currencies (1) as the central bank will not be buying the currency to support its value (1)
- the exchange rate should move automatically/it is self-correcting (1) to eliminate a current account deficit/surplus (1)
- allows a government to concentrate on other aims e.g. full employment (1) as interest rate changes/foreign exchange dealings do not have to be undertaken (1)
- market forces determine the exchange rate (1) equilibrium price will be achieved (1)

(c) Analyse the effect of a rise in unemployment on living standards in a country. [6]

- higher unemployment reduces the income of the unemployed (1) the unemployed will not be able to buy so many goods and services (1)
- unemployment involves an opportunity cost (1) output will be lower than possible (1)
- the unemployed may experience health care problems (1) this would put a burden on health services (1)
- higher unemployment may increase crime (1) crime and the fear of crime lowers the quality of people's lives more resources e.g. prisons, have to be devoted to tackling crime which involves an opportunity cost (1)
- the unemployed may not be able to afford to educate their children (1) less educated people tend to enjoy a lower quality of life (1)
- spending on unemployment benefits (1) means less money for e.g. hospitals (1)

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(d) Discuss whether coal miners are likely to be paid more than car assembly workers. [8]

Up to 5 marks for why they might:

- demand for the labour of coal miners might be higher (1) because demand for coal may be increasing whilst demand for cars may be falling (1)
- the supply of coal miners may be lower (1) due the skills/qualifications needed (1) and the greater physical risks/dangers involved (1) and non-wage benefits enjoyed by car workers being higher (1)
- coal miners may have more bargaining power than car workers (1) this may be because e.g. a higher proportion of coal miners belong to a union (1)
- coal mining may provide essential energy for a country and be subsidised by the government (1) lower costs will enable firms to pay coal miners more (1)

Up to 5 marks for why they might not:

- some coal miners may be in less promoted posts than some car workers (1)
- it might be easier to substitute workers with capital in the coal industry (1) making demand for labour more wage elastic in the coal industry (1)
- the average age of coal miners may be lower than the average of car workers (1) making the workers less experienced (1)
- the coal industry may be declining whilst the car industry may be increasing (1) this may alter relative demand (1)
- car workers may be more skilled (1) these skills may be in higher demand (1)

Up to 3 marks for an appropriate diagram showing either case

Note: accept an answer based on why car workers may be paid more than coal miners.

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