UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS

GCE Ordinary Level

MARK SCHEME for the May/June 2011 question paper

for the guidance of teachers

2281 ECONOMICS

2281/22 Paper 2 (Structured Questions), maximum raw mark 80

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1 **(a)** An entrepreneur is a person who organises the other three factors of production/takes decisions (1) and, in doing so, takes a risk (1). [2]

(b) Main functions of a stock exchange:
- it helps companies sell their stocks or equities
- this helps them to raise finance
- it helps the public buy such stocks
- this buying and selling of shares through the stock exchange will produce a market price
- it provides an indicator of how generally an economy is doing (e.g. FTSE 100). [4]

(c) Possible reasons:
- an increase in the financial position of a producer so that it could fund development
- the financial incentives offered by the government to multi-national companies
- an increase in supply to match an increase in demand
- a decrease in cost. [2]

(d) Possible financial incentives:
- a tax break/holiday
- a lower rate of tax, e.g. Corporation Tax
- a grant
- provision of infrastructure. [4]

(e) Potential advantages:
- can bring employment to a country
- this will increase incomes
- and the standard of living/quality of life
- if unemployment falls, lower amount spent by government on benefits
- increase in exports with consequent effect on the balance of payments
- possible positive effect on currency.

Potential disadvantages:
- may be taking advantage of lower costs, and therefore seen as exploitative
- senior management often not from local country
- many of the jobs may be low-skilled ('screwdriver' jobs)
- a lot of the profits will return to home country.

A maximum of 5 marks if the answer is one-sided. [8]

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2 **(a)** A subsidy is:
- a payment made to a producer, e.g. by a government
- to help reduce the costs of production
- as a result producers will want to increase supply
- at every given price
- consumption is therefore encouraged
- although this could mean supporting an inefficient producer
- and so distort competition. [3]

(b) Diagram:
- axes are correctly labelled P and Q and curves are correctly labelled D and S (1)
- supply curve shifts to the right (1)
- equilibrium price falls and equilibrium quantity increases (1).

Explanation of the effect of a subsidy on equilibrium price and quantity – up to 3 marks. [6]

(c)
- what to produce?
- how to produce?
- for whom to produce? [3]

(d) Advantages of a market economy:
- allocation of resources through the price mechanism
- idea of an 'invisible hand'
- idea that equilibrium is a market clearing position
- efficiency is encouraged
- idea of consumer sovereignty.

Disadvantages of a market economy and therefore a need for government intervention, creating a mixed economy:
- may be high rate of unemployment
- prices may be too high for many people
- distribution of income and wealth very unequal
- merit goods under-consumed (don't need to use that term)
- demerit goods over-consumed (don't need to use that term)
- public goods not produced at all
- issue of externalities
- problem of lack of competition, e.g. as a result of monopoly
- need for consumer protection legislation.

A maximum of 7 marks if no conclusion is given. [8]

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3 **(a)** Factors affecting the demand for a product:

- the price of the product
- the price of substitute goods/services
- the price of complementary goods/services
- changes in income
- changes in tastes and preferences of consumers
- the impact of an advertising campaign.

A list-like answer can gain no more than 3 marks. [6]

(b) Explanation of PED:

- percentage change in the quantity demanded of a good or service divided by the percentage change in the price of the good or service
- different values from perfectly elastic, through elastic, unitary elastic, inelastic to perfectly inelastic
- explanation of mathematical figures for these from 0 to infinity. [6]

(c) Potential usefulness:

- link with revenue
- if PED is elastic, it would be better to reduce price to raise revenue
- if PED is inelastic, it would be better to increase price to raise revenue.

Application:

- the demand for many magazines will be elastic
- the demand for some magazines, however, will be inelastic
- these will be the more specialised magazines, appealing to more of a niche market
- some consumers might take out a regular subscription to a magazine, and here the demand is likely to be more inelastic compared with buying magazines in a shop.

Answers which discuss the potential usefulness of PED to firms in general, making no reference at all to magazines, can gain no more than 5 marks. [8]

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4 **(a)** Factors that can affect an individual's choice of occupation:

- wages/salaries
- bonuses/commission
- pension
- holiday entitlement
- proximity to home
- promotion prospects
- working conditions
- canteen/social facilities.

A list-like answer can gain no more than 3 marks. [6]

(b) This will depend on:

- experience
- skills
- training
- promotion.

A maximum of 3 marks if a candidate states that it is always true. [4]

(c) Benefits of a trade union to an individual:

- collective bargaining to improve pay
- working on behalf of members in terms of working conditions, pension entitlement
- protecting the rights of members, e.g. in a legal dispute
- acting on behalf of members in discussions with government. [4]

(d) Potential disadvantages:

- there might be industrial action
- powerful unions/industrial action could lead to disruption of the economy
- this could lead to a firm going out of business, causing an increase in unemployment
- this could affect output and damage reputation of country
- powerful trade unions could lead to higher wages
- making products uncompetitive in world markets.

Potential advantages:

- can work with employers, not always against them
- can work with government, e.g. to support legislation.

A maximum of 4 marks if entirely one-sided. [6]

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5 **(a)** Sole proprietor:
- unlimited liability
- may be difficult to raise finance
- the business is owned by one person only, so decision-making cannot be shared
- requires a lot of skills from one person.

A list-like answer can gain no more than 2 marks. [4]

(b) Possible reasons:
- to gain more finance as shares can be issued to more people
- shares are advertised and sold publicly
- there is an unlimited number of shareholders
- they can be quoted on the stock exchange
- this should enable the business to grow
- this would enable the firm to benefit from economies of scale. [6]

(c) Internal growth:
- increase in sales
- greater share of market.

External growth:
- horizontal integration
- vertical integration
- conglomerate integration.

An answer which only focuses on internal or external growth can gain no more than 3 marks. [4]

(d) Economies of scale:
- internal, e.g. technical, marketing, financial, risk-bearing economies
- external, e.g. available infrastructure, pool of skilled labour, local suppliers.

Diseconomies of scale:
- internal, e.g. poor communications, low morale
- external, e.g. congestion, higher transport costs.

Advantages of small firms:
- cater to tastes and preferences of consumers
- greater flexibility.

A maximum of 4 marks for a one-sided answer.

A maximum of 2 marks for an answer which focuses purely on economies of scale. [6]

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6 (a) Inflation can be defined as a persistent/sustained (1) increase (1) in the general/average (1) level of prices (1) over a given period of time (1). An answer which focuses on the decline in the purchasing power of money can gain no more than 2 marks.

There must be some reference to prices to gain all 3 marks. [3]

(b) Construction of RPI or CPI:
- selection of a representative basket of goods and services
- selection of base year
- this is given a value of 100
- allocation of weights to particular goods and services to reflect relative importance in basket
- idea of changes in the overall weighted average price of basket over a period of time. [7]

(c) Demand-pull inflation:
- too high a level of demand in the economy
- supply unable to meet demand. [4]

(d) Credit appropriate comment on a high rate of inflation.

Reasons for concern:
- leads to a fall in the purchasing power of money
- may undermine confidence in the currency
- rise in export prices may make goods uncompetitive abroad
- those on fixed incomes particularly badly affected
- value of savings could be eroded.

Not such a problem:
- could lead to higher profits for firms
- may encourage firms to expand
- borrowers may benefit.

A one-sided answer can gain no more than 4 marks. [6]

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7 **(a)**
- changes in real (1) GDP (1) per capita (1)
- changes in the Human Development Index which is made up of one-third standard of living (real GDP per capita), one-third longevity (life expectancy) and one-third knowledge (adult literacy and mean years of schooling). [6]

(b) Possible problems:
- hidden/underground economy
- issue of what is being produced (e.g. luxuries versus necessities)
- environmental consequences of production
- distribution of income and wealth
- other possible factors, e.g. class sizes, number of patients per doctor, quality of water. [6]

(c) Possible policies in relation to:
- fiscal policy
- education
- housing
- minimum wage
- health/diet
- increased food production
- irrigation
- sanitation
- birth control
- aid
- change in balance of industrial sectors.

Candidates need to offer a conclusion as to whether such policies are likely to reduce poverty to get a mark above 5. [8]

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