CAMBRIDGE INTERNATIONAL EXAMINATIONS

International General Certificate of Secondary Education

MARK SCHEME for the October/November 2013 series

0455 ECONOMICS

0455/23 Paper 2 (Structured Questions), maximum raw mark 80

This mark scheme is published as an aid to teachers and candidates, to indicate the requirements of the examination. It shows the basis on which Examiners were instructed to award marks. It does not indicate the details of the discussions that took place at an Examiners' meeting before marking began, which would have considered the acceptability of alternative answers.

Mark schemes should be read in conjunction with the question paper and the Principal Examiner Report for Teachers.

1 (a) Define the term 'Gross Domestic Product'. [3]

Technically, Gross – before deduction for depreciation (1) Domestic – within the geographical boundaries of a country (1) Product – the total value of goods/services produced in an economy in a given period of time (1).

Accept general understanding e.g. it is the total output produced (1) in an economy (1) over a given period of time (usually a year) (1).

Candidates may also refer to the three methods of calculating it (output, income, expenditure) and the fact that it may be adjusted for inflation (a 'real' figure).

(b) (i) Give one example of each of the three industrial sectors. [3]

- primary sector: one example from agriculture, fishing, forestry, mining, etc. (1)
- secondary sector: one example from any type of manufacturing or construction, etc. (1)
- tertiary sector: one example from education, health care, transport, etc. (1)

(ii) Explain whether the change in the industrial sectors in Pakistan mentioned in the extract is the one normally expected to occur as a country develops. [3]

- fall in primary sector which is generally less productive (1)
- fall in secondary sector; part of general trend of deindustrialisation in economies (do not need to refer to that term) (1)
- rise in tertiary sector which is generally more productive (1)

Candidates can be rewarded for comment that this pattern is part of a general trend as economies grow and become more developed, but also reward explanations that suggest that there may be different patterns of change in different countries.

Credit answers that accurately use data from the extract.

(c) Explain how the use of monetary policy, through lowering interest rates and increasing the money supply, could be used to stimulate the rate of economic growth in a country. [5]

Up to 3 marks on the rate of interest:

- lowering of interest rates will make borrowing cheaper (1) will reduce the reward from saving (1) and therefore be likely to increase spending (1) and so increase demand and output (1)

Up to 3 marks on the money supply:

- increase in the money supply to make funds more available (idea of quantitative easing although do not need to refer to this term) (1) with more money people are likely to spend more (1) again contributing to an increase in demand and output (1)

(d) Discuss whether other policies, apart from monetary policy, might be more successful in raising the rate of economic growth in Pakistan. [6]

Up to 4 marks for why they may be more successful:
- fiscal policy through lowering taxes and/or increasing expenditure (1) higher government spending on schools and hospitals will directly increase output (1) lower income tax will increase disposable income (1) which may raise consumer expenditure (1) encouraging firms to produce more (1)
- supply-side policy measures are designed to increase the output potential of the country (1) education and training may increase productivity (1) subsidies/lower corporation tax may increase investment (1) privatisation may increase efficiency (1) deregulation can reduce firms' costs of production (1)
- some fiscal policy measures can increase both total demand but also total supply (1)
- supply-side policy measures can allow growth to occur over time (1) can allow growth to take place without inflation (1) can increase the economy's international competitiveness (1) improving the current account position (1)
- supply-side policies that remove trade restrictions (1) attract foreign investors which leads to increased capacity (1) higher output/income (1) and leads to economic growth (1).

Up to 4 marks for why they may be less successful:
- fiscal policy measures can take time to have an effect (1), e.g. takes time to pass the necessary legislation (1) and for people to respond to the changes (1)
- people and firms may not respond as expected to fiscal policy measures (1), e.g. if people lack confidence (1) they may not spend more as a result of a cut in tax (1)
- supply-side policy measures can take a very long time to have an effect (1), e.g. increased spending on education make take 10–15 years to have an impact on productivity (1)
- supply-side policy measures may not work (1), e.g. privatisation may lead to inefficiency in the case of a private sector monopoly (1)
- supply-side policy measures can be very expensive (1), e.g. raising the school leaving age (1)

2 (a) Using examples, define the factor of production, labour. [4]

- labour represents human effort/capital/contribution (1)
- the physical (1) and mental (1) contributions of employees to the production process (accept skilled and unskilled)
- any two examples of jobs, this could be specific examples of physical contribution, e.g. mining or car production (1) and mental contribution, e.g. teacher or lawyer (1)

(b) Explain why production is sometimes very labour-intensive. [6]

- very labour-intensive would mean there is a high proportion of labour relative to capital (1)
- labour may be in plentiful supply in the economy (1) and so is relatively cheap (1)
- other factors, e.g. capital, may be less available (1) perhaps because of expense (1)
- sometimes jobs require labour/good or service cannot be mass produced (1) e.g. car repairs as opposed to car production (1)
- the production of some goods and services requires personal attention (1) e.g. hairdressing (1)

(c) Discuss whether a worker should always be encouraged to join a trade union. [10]

Up to 7 marks for why should be encouraged:
- a trade union will provide a worker with more collective strength (1) this could be helpful in negotiating wage rises (1) improvements in worker conditions (1)
- a trade union may provide a member with a range of other benefits (1), e.g. training/ subsidised part-time education courses (1) in some countries trade unions provide members with unemployment benefits (1)
- a trade union may influence a government (1), e.g. to increase a minimum wage which workers can benefit from (1)

Up to 7 marks for why should not be encouraged:
- the trade union(s) in a particular industry may not be very powerful (1) especially if membership is low (1) and finance is limited (1)
- the cost of membership may be expensive (1)
- there may be difficulties in being a trade union member in some countries/some governments discourage trade union membership (1)
- industrial action can be disruptive (1) a worker may not receive an income while on strike (1) a worker may lose her/his job as a result of industrial action (1)

Maximum of 4 marks for a list.

3 (a) Analyse what might have caused the costs of production in the motorcycle industry to have risen significantly in recent years. [4]

Increase in costs of:
- raw materials/component parts (1), e.g. tyres (1)
- electricity (1)
- labour (1), e.g. mechanics (1)
- hiring/leasing/purchasing capital equipment (1), e.g. machines (1)
- indirect taxes (1), e.g. sales tax (1)

Answers which do not relate to the motorcycle industry can gain no more than 3 marks.

(b) Using a demand and supply diagram, analyse the effect of an increase in production costs in the motorcycle industry on the equilibrium price and the equilibrium quantity of new motorcycles. [6]

Up to 4 marks for the diagram:
- correctly labelled axes (1)
- shift of the supply curve to the left (1)
- increase in equilibrium price (1)
- decrease in equilibrium quantity (1)

Up to 2 marks for written analysis:
- to cover higher production costs, firms will require higher prices (1)
- effect of shift of supply curve to the left on equilibrium price (1)
- effect of shift of supply curve to the left on equilibrium quantity (1)

(c) Explain the concept of price elasticity of supply. [4]

Up to 2 marks for definition:
- the responsiveness of supply to a change in price/the percentage change in quantity supplied of a product divided by the percentage change in price (2)
- how price affects supply/change in supply divided by change in price (1)

Up to 2 marks for further development:
- elastic supply has value greater than 1 (1) inelastic supply has a value less than 1 (1) PES varies from perfectly elastic to perfectly inelastic (1) PES varies along the length of the supply curve (1) always positive (1)

(d) Discuss to what extent time is the main influence on the price elasticity of supply. [6]

Up to 4 marks for why it might be the main influence:
- at a particular moment in time, it may be very difficult (or impossible) to increase supply (1) supply may be relatively inelastic (1)
- the longer the period of time, the more responsive supply is likely to be to a price change (1) relatively elastic (1)

Up to 4 marks for discussion of other possible influences:
- the ease with which a product can be stored (1) the easier it is to store the product, the more elastic the supply will be (1)
- the availability of factors of production (1), e.g. supply may be inelastic in periods of full employment (1)
- the cost of adjusting supply (1), e.g. it is cheaper to adjust the supply of pens than the supply of ships (1)

4 (a) Describe <u>three</u> influences on spending, apart from changes in taxation. [6]

- the need/want for the products (1) distinction between necessities and non-essential products (1)
- disposable income/wealth (1) spending will be greater in amount when income/wealth is higher as purchasing power will be higher (1)
- anticipated inflation rate in the future (1) people will spend more when they expect prices to rise/or spend less if they think inflation will be eliminated (1)
- confidence (1) during boom times/when people expect employment to remain high they will spend more (1)
- interest rate (1) a high interest rate will discourage borrowing/encourage saving and so reduce spending (1)
- other factors affecting pattern of spending, e.g. married/single, age, time of year, e.g. Christmas, new technology – identification (1) development (1)

1 mark for a basic description of each influence and 1 mark for a development of each description.

(b) Explain how people's spending could be affected by changes in both direct and indirect taxes. [6]

Up to 4 marks for direct tax:
- increase in income tax would reduce disposable income (1) and so make spending less likely (opposite effect with a reduction in income tax) (1)
- change in tax bands would affect spending (1), e.g. if lower rate starts at a lower level of income; same applies if top rate starts at a lower level of income (1)

Up to 4 marks for indirect tax:
- increase in a sales tax (e.g. VAT or GST) would make products more expensive (1) and discourage spending (opposite effect with a reduction in indirect tax) (1)
- if a sales tax was taken off a product (e.g. zero-rated) (1) it would make products less expensive and encourage spending (1)

(c) Discuss whether a government should be concerned if people began to spend most of their money. [8]

Up to 5 marks for why should be concerned:
- high levels of spending could cause inflation (1) demand-pull inflation (1)
- people may not have sufficient savings (1) to cope with unexpected events (1) may get into financial difficulties and have to rely on the state (1)
- lack of savings could reduce funds for lacking/investment (1) which would reduce economic growth (1)
- people may spend more on imports (1) exports could be diverted to the home market (1) worsen the current account position of the balance of payments (1)
- if increased spending is on demerit goods (1) creates social costs (1)

Up to 5 marks for less of a concern:
- high levels of spending could encourage firms to increase their output (1) leading to economic growth (1) and a fall in unemployment (1) higher output could result in firms taking greater advantage of economies of scale (1) lower costs of production could make firms more internationally competitive (1)
- high levels of spending would increase tax revenue (1) both direct and indirect (1) this could be spent on, e.g. health care (1)
- high levels of spending may attract multinational companies (1) due to a larger market (1)
- raises additional tax revenue for the government (1) which can be spent on improving services/infrastructure (1)

5 (a) Describe the advantages and disadvantages of a sole proprietor business organisation. [4]

Up to 2 marks for advantages:
- owner is in complete control/takes all the important decisions (1)
- quick to make decisions/flexible (1)
- easy to set up/low start up costs/no complicated paperwork (1)
- all profits go to the sole trader (1)
- personal contact with customers/workers (1)

Up to 2 marks for disadvantages:
- owner does not have the legal protection of limited liability/the debt is unlimited (1)
- owner may have to work long hours (1)
- expansion can be very difficult due to lack of finance (1)
- lack of continuity (1)
- success may be limited by lack of skills of owner/poor health of owner (1)

(b) Explain the different goals that such a business organisation might have. [5]

- profit maximisation (1) trying to earn as much profit as possible (1)
- profit satisficing (1) keeping shareholders happy whilst pursuing some other goals/no shareholders to satisfy if sole proprietor (1)
- survival (1) especially during periods of low demand/recession (1)
- sales revenue maximisation (1) can make it easier to raise revenue/sell in bulk (1)
- growth (1) increase pay of managers/increase market power (1)
- ethical/community reputation (1) create a good image which can attract consumers (1)
- providing high quality goods and services (1) to retain customer satisfaction (1)

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

(c) Analyse <u>two</u> reasons for the different sizes of firms in an economy. [4]

- size of market/extent of demand (1) if there is a large demand, the firm is likely to be large (1) some firms are small because they are supplying a niche market (1)
- capital to finance expansion (1) some firms may find it easier to borrow from banks or sell shares (1)
- type of business organisation (1), e.g. sole trader v public limited company (1)
- preference of owner (1) an owner may not want the stress of running a larger company (1)
- age of the firms (1) firms tend to start relatively small (1)

1 mark for a basic analysis of each reason, and 1 mark for a development of the analysis of each.

(d) Discuss whether a monopoly is always in the best interest of consumers. [7]

Up to 4 marks for why it might:
- if large, it may enjoy economies of scale (1) this would reduce costs of production (1) which may lower prices (1)
- supernormal profits could be spent on innovation/research and development (1) raise the quality of products (1)
- may be more likely to innovate/spend on research and development (1) as know any profits earned can be protected (1)

Up to 4 marks for why it might not:
- lack of competition could result in higher prices (1) and lack of choice (1)
- output may be lower (1) supply restricted to drive up price (1)
- inefficiency may occur (1) the monopoly may not feel the pressure to keep costs down (1) or respond to changes in consumer demand (1)

Maximum of 3 marks for a list.

6 (a) Explain why the rate of population growth in some countries is greater than in others. [5]

- some countries have a higher birth rate (1) this may be because of, e.g. a high infant mortality rate/lack of availability of contraception/low cost of raising children/need for children to support parents in old age (1)
- some countries have a lower death rate (1) due to, e.g. better health care/housing/ nutrition (1)
- a birth rate that exceeds the death rate will lead to a natural increase in population (1)
- differences in fertility rates (1) if the fertility rate is below the replacement ratio, the population size will fall (1)
- differences in net migration (1) some countries experience net emigration whilst others have net immigration (1) due to, e.g. differences in incomes, job opportunities (1)

Alternatively allow up to 5 marks for a fully developed answer on any one of higher birth rate/lower death rate/net immigration.

(b) Explain what is meant when a country is described as being over-populated or under-populated. [5]

- Over-population occurs when the balance between population and resources is wrong (1) when there are too many people (1) relative to resources (1) output per head is lower than possible (1) the country would benefit from either a fall in population (1) or an increase in resources (1) a country could have a large area of land but may still be regarded as over-populated if there is a shortage of, e.g. capital (1)

or

- under-population occurs when the balance between population and resources is wrong (1) when there are too few people (1) relative to resources (1) output per head is lower than possible (1) the country would benefit from a rise in population (1) this would enable resources to be used to a greater extent (1) a country may have a small area of land but may still be regarded as under-populated if there is, e.g. unused natural resources (1)

Allow reference to both over-population or under-population where comments are not simply a mirror image.

Credit, but do not expect, reference to optimum population. Allow up to 2 marks for a correct diagram and 1 mark for explanation.

(c) Discuss whether the Human Development Index (HDI) is the best way of comparing the standard of living in different countries. [10]

Up to 7 marks for why it is:
- it includes GDP/GNI per head (1) but goes beyond this (1)
- it takes into account life expectancy (1) this reflects the quality of health care (1)
- it includes mean and expected years of schooling/adult literacy and school enrolment (1) this reflects access to education (1)
- it divides countries into very high, high, medium and low human development (1) it is measured from 0 to 1 (1)
- there is also an inequality HDI (1) which takes into account the distribution of income (1)

Up to 7 marks for why it is not:
- it does not take into account all relevant indicators (1) for instance it does not include effects on the environment (1) which is included in the ISEW measure (1) it does not include infant mortality (1) number of doctors per head (1) gender inequality (1) political freedom (1) other indicators (1)
- not all countries are included (1) due to a lack of accurate data (1)

7 (a) Explain why specialisation is an important aspect of international trade. [5]

- countries have different factor endowments (1)
- they should specialise in producing the products they are best at making/those which make the best use of these endowments (1)
- benefits from economies of scale can be obtained (1) so costs and prices can be lower (1)
- world output will increase (1) because of the greater efficiency of production (1) standards of living will rise (1)

(b) Describe the potential disadvantages of international specialisation. [4]

- a country can be vulnerable if it has to rely on imports to meet its needs (1) for instance, there may be a decline in the supply of a food product due to bad weather in the country from which it is sourced (1)
- less efficient industries will collapse (1) leading to an increase in unemployment (1)
- a country can be vulnerable to changes in world economic conditions (1) may be harmed by a world recession (1)
- a country can be vulnerable to volatility in exchange rate movements (1), e.g. exports may be reduced by a rise in the exchange rate (1)

(c) Describe the differences between a fixed and a floating exchange rate. [4]

Up to 2 marks for a fixed exchange rate:

- a fixed exchange rate is maintained by the government/central bank (1)
- it is maintained through intervention in the foreign exchange market, buying or selling the currency/changes in the interest rate to maintain a particular value (1)

Up to 2 marks for a floating exchange rate:

- the value is determined by the market forces of demand and supply (1)
- the value can change frequently due to changes in demand and supply (1), e.g. speculation/rate of inflation etc. (1)
- there is no need for a government/central bank to maintain a particular exchange rate (1)

(d) Discuss whether a floating exchange rate system is always preferable to a fixed exchange rate system. [7]

Up to 4 marks for why it may be preferable:

- a government/central bank does not need to hold foreign currency reserves (1) these can be used for other purposes (1)
- a government/central bank can focus on other policy objectives (1), e.g. a government/central bank can increase the rate of interest to reduce inflation (1) without worrying that it may raise the exchange rate (1)
- the exchange rate can move to offset a current account deficit or surplus (1), e.g. if there is a deficit the exchange rate can fall (1) causing export prices to fall and import prices to rise (1)

Up to 4 marks for why it may not be preferable:

- there can be a large degree of volatility (1) this can cause uncertainty (1) which makes it difficult to plan (1) this can discourage investment (1)
- it may reduce international trade (1) exporters and importers may be uncertain as to how much they will receive in payment and how much they will have to spend (1)
- there is no guarantee there will be a current account balance (1), e.g. the exchange rate can be influenced by speculation (1)