CAMBRIDGE INTERNATIONAL EXAMINATIONS

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MARK SCHEME for the March 2015 series

0455 ECONOMICS

0455/22 Paper 2 (Structured Questions), maximum raw mark 90

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1 (a) **Using information from the extract, explain whether India experienced a recession or economic growth in 2013. [2]**

Economic growth (1) as GDP increased (1).

Note, also accept: not possible to tell (1) as data on quarters is not given (1).

(b) **Explain two ways a central bank could try to stop a fall in the international value of its country's currency. [4]**

- Buy the currency (1) using reserves/foreign currency (1).
- Raise the rate of interest (1) to increase demand for the currency/reduce supply of the currency/attract hot money flows (1).
- Impose/increase exchange controls (1) to limit the availability of foreign currency to buy imports (1).

(c) **Using information from the extract, explain what is likely to have happened to the price of gold in India in 2013. [3]**

Likely to have risen in price (1).

Evidence given in support of a rise in price (up to 2 marks):

- tax raised on imports of gold (1) higher tax would raise costs/decrease supply/shift the supply curve to the left/be likely to have been passed on to consumers(1);
- Indian rupee depreciated (1) raised price of imports (1).

(d) **Using Table 1, comment on the relationship shown between the change in world GDP and India's export revenue. [4]**

- A largely positive relationship (1) positive relationship between 2010 – 2012 (1) over most of the period was accompanied by an increase in demand for Indian products (1) expected relationship as higher world income would increase demand for exports (1).
- There are exceptions to the general trend/inverse relationship 2008 – 2010 (1) example fall in world income in 2009 but rise in Indian exports/rise in world income in 2010 but fall in Indian exports (1) may be due to a time lag (1).
- Indian exports rose at a faster rate than world GDP (1) particularly after 2010 (1).
- Other factors influence demand for a country's exports (1).

Note: two trends with examples may gain full marks but a purely descriptive answer zero marks.

(e) **Explain two ways a government could try to increase investment. [4]**

- Lower the rate of interest (1) reduce the cost of borrowing to finance investment/increase consumer spending and so the incentive to invest (1).
- Reduce corporation tax (1) increase ability/willingness to invest (1).
- Reduce income tax/reduce indirect taxes/provide tax allowances (1) increase consumer spending and so profits/incentive to invest (1).
- Introduce investment subsidies (1) provide finance for investment/lower cost of investment/attract MNCs (1).
- Increase government spending to raise total demand (1) to stimulate firms to expand (1).
- Supply-side policies (1) such as education and training which raise productivity (1).
- Fix the exchange rate (1) to create greater certainty (1).
- Direct government spending on capital goods (1).

(f) Discuss whether governments should encourage households to borrow more. [5]

Up to 3 marks for why they should:

- encourage an increase in demand/spending (1) firms produce more (1) resulting in economic growth (1) lower unemployment (1);
- enjoy a higher standard of living (1) households can spend more than their income (1);
- enable households to spend more on education and health care (1) increase future earning potential (1).

Up to 3 marks for why they should not:

- households may get into debt (1) as a result lose houses/possessions (1) reduce spending in the future (1);
- higher spending may result in inflation (1) demand-pull inflation (1);
- may increase demand for imports (1) cause a current account deficit (1);
- an increase in demand for loans may push up the rate of interest (1) this may make it more difficult for the poor to borrow (1).

(g) Using information from the extract, explain the opportunity cost of exporting onions. [2]

- Selling on the home market (1) onions sold abroad cannot be sold at home/definition of opportunity cost (1).
- Producing another crop (1) resources to grow onions could have been used for other purposes/definition of opportunity cost (1).

(h) Discuss whether India is likely to be a net importer or a net exporter of onions in the future. [6]

Up to 4 marks for why it may be a net importer:

- exchange rate may rise (1) making price of exports higher/imports cheaper (1) making domestic products less competitive (1);
- low productivity (1) high costs per unit (1) low price competitiveness (1);
- export tax may continue (1) keeping export price high (1);
- bad weather may continue (1) crop may be affected by diseases (1) lowering supply (1).

Up to 4 marks for why it might be a net exporter:

- lower exchange rate (1) would make price of exports relatively cheaper/imports relatively more expensive (1) making domestic products more competitive (1);
- high level of supply (1) may lead to economies of scale (1) lowering costs per unit (1);
- tax on exports may be removed (1) lowering price of exports (1);
- incomes abroad may rise (1) leading to a rise in demand for onions (1);
- quality of onions grown may improve (1) due to improved farming methods/more productive labour force (1).

2 (a) Why do choices have to be made about how resources are used? [2]

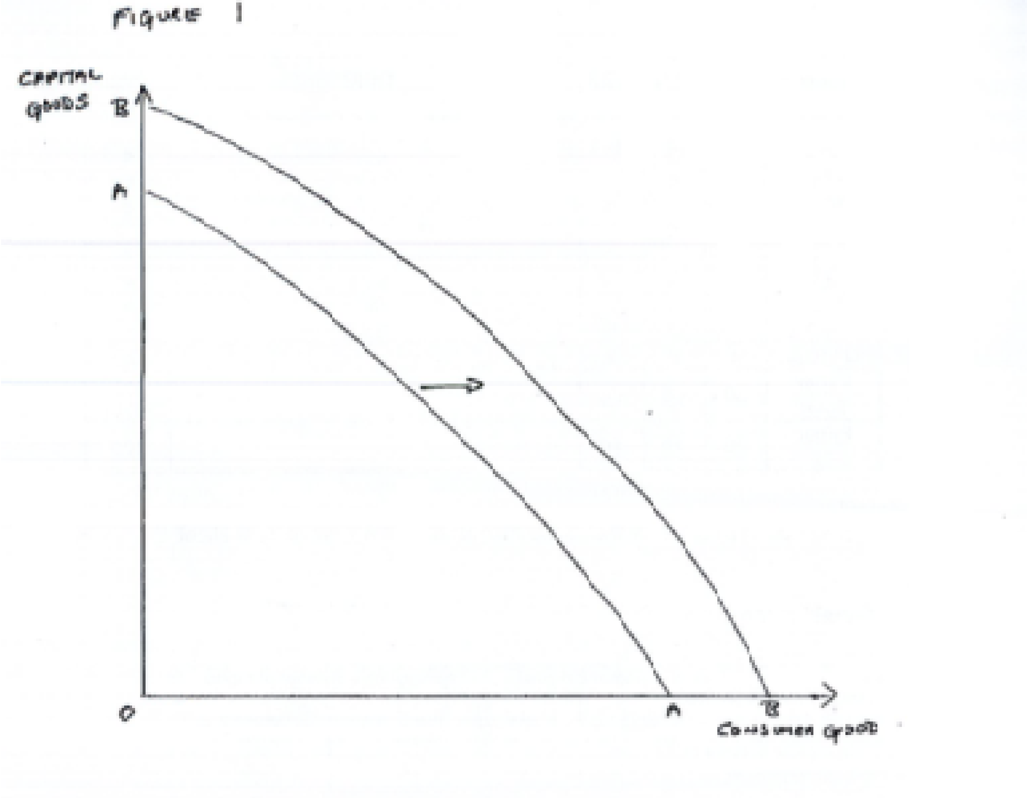
- Scarcity/resources are finite/limited (1) not all wants can be met/wants are unlimited (1).
- The use of resources involves an opportunity cost (1) not all wants can be met/wants are unlimited (1).

(b) Explain why price tends to move towards equilibrium over time. [4]

- If price is above equilibrium there will be a surplus (1) the surplus will drive down price/producers will lower price to get rid of the surplus (1).
- If price is below equilibrium there will be a shortage (1) the shortage will push up price/consumers will bid up price (1).
- Prices are signals (1) altering incentives to the market (1) causing producers and consumers to alter their behaviour (1).
- The price mechanism rations resources (1).

(c) Using a production possibility curve diagram, analyse the effect of an increase in land on an economy. [6]

Up to 4 marks for the diagram:



- axes correctly labelled (1);
- original curve/downward sloping line to the axes (1);
- new curve to the right of the original one (1);
- shift to the right clearly indicated either by an arrow or labelling (1).

Up to 2 marks for written explanation:

- land is a resource/factor of production or more resources will be available (1);
- the amount an economy can produce will increase/there will be an increase in productive capacity (1).

(d) Discuss whether devoting more of its resources to fishing would benefit an economy. [8]

Up to 5 marks for why it might:

- may allow an economy to specialise (1) in a product in which it has a cost/comparative advantage (1);
- may increase the output of the country/GDP (1) increasing incomes/living standards (1);
- may allow greater advantage to be taken of economies of scale (1) examples of economies of scale (up to 2);
- demand for fishing may be increasing (1) will raise revenue (1) reason why demand may be increasing e.g. greater awareness of health benefits (1);
- may increase exports of fish/reduce imports of fish (1) improve the position on the current account of the balance of payments (1);
- may build up a reputation for fishing (1).

Up to 5 marks for why it might not:

- risk that demand may fall (1) reasons why demand may fall e.g. rise in price/quality competitiveness of other economies (1);
- the country may be better at producing other products (1) this would result in a high opportunity cost of devoting more resources to fishing (1);
- may result in diseconomies of scale (1) examples of diseconomies of scale (up to 2);
- may result in overfishing (1) depleting fish stocks (1).

CBA would help in making such a decision (1) would benefit an economy if the social benefit exceeds the social cost/ would harm an economy if the social cost exceeds the social benefit (1).

3 (a) Define 'price elasticity of supply'. [2]

- A measure of the responsiveness of supply to a change in price/formula: percentage change in quantity supplied divided by percentage change in price (2).
- How price affects supply/change in supply divided by change in price (1).

(b) Explain why many firms try to maximise profits. [4]

- To provide an incentive/reward for entrepreneurs (1) profit is a payment for bearing risks/organising the other factors of production (1).
- To provide finance for investment (1) which will allow firms to grow (1) new capital equipment may reduce costs of production (1).
- To provide finance to pay dividends to shareholders (1) which may keep demand for shares high/raise price of shares (1).
- To compete with rival firms (1) the most profitable firms are likely to be able to gain a larger share of the market (1).

(c) Analyse what determines in which countries a multinational company produces. [6]

- Size of market (1) if demand for the product/s produced is high in the country (1) higher revenue may be earned (1).
- Costs of production (1) e.g. low wages/low raw material costs may attract multinational companies (MNCs) (1).
- Availability of raw materials (1) certain raw materials e.g. copper may be found in a small number of countries (1).
- Trade protection (1) MNCs may set up in a country to get round tariffs (1).
- Government subsidies (1) financial help may be given to companies setting up in some countries (1).
- Fewer government regulations (1) MNCs may set up in countries with fewer rules and laws (1).
- Skills of workers (1) highly skilled workers will produce products of a good quality (1).

Note: up to a maximum of 3 marks for a list-like approach.

(d) Discuss whether a government should regulate supermarket firms. [8]

Up to 5 marks for why it should:

- to prevent market failure (1);
- a supermarket may have monopoly power (1) which may drive up prices (1) reduce quality (1) reduce choice (1) make it difficult for small shops to enter the market/survive (1);
- supermarkets may not take into account external costs and external benefits (1) may e.g. disturb people living nearby by staying open for long hours (1);
- supermarkets may sell harmful products (1) to people who do not realise their effects e.g. cigarettes;
- supermarkets may exploit workers (1) e.g. making them work long hours (1) working in an unsafe environment (1).

Up to 5 marks for why they should not:

- complying with regulations may increase supermarket costs (1) reduce their output (1) lower employment (1);
- may discourage MNCs setting up in the country (1) may encourage firms to move overseas (1);
- may lead to inefficiency (1) may reduce responsiveness to changes in market conditions (1) may reduce innovation (1) may reduce choice e.g. to shop late at night (1) may be government failure (1).

4 (a) Define 'consumer prices index'. [2]

- A measure of the change in the price level/rate of inflation (1).
- A weighted measure or identification of another feature e.g. based on prices paid by households/prices of a basket of goods and services/uses a base year (1).

(b) Explain two functions of money. [4]

- Medium of exchange (1) enables people to exchange products/used to buy and sell products (1).
- Store of value (1) enables saving to occur (1).
- Unit of account/measure of value (1) enables the value of items to be compared (1).
- Standard of deferred payments (1) enables borrowing and lending to occur (1).

(c) Analyse how monetary policy can reduce the rate of inflation. **[6]**

- Deflationary/contractionary monetary policy may be used (1).
- A rise in the rate of interest (1) may reduce consumer expenditure (1) lower investment (1) as borrowing is more expensive (1) saving more rewarding (1) lower demand (1) reduce demand-pull inflation (1).
- A reduction in the money supply/reduction in the growth of the money supply (1) will reduce demand (1) lower demand-pull inflation (1).
- A rise in the exchange rate (1) will lower import prices and raise export prices (1) reduce costs of imported raw materials (1) put pressure on domestic firms to lower costs (1) reduce cost-push inflation (1).

Note: up to a maximum of 3 marks for a list-like approach.

(d) Discuss whether deflation always harms an economy. **[8]**

Up to 5 marks for why it might:

- consumers may reduce the amount they spend (1) in expectation that prices will be lower in the future (1) this may reduce firms' output (1) lower investment (1) increase unemployment (1) lower economic growth (1);
- increases the burden of debt (1) the amount people will have to pay back will have more purchasing power (1).

Up to 5 marks for why it might not:

- it will increase purchasing power if incomes do not fall (1);
- it may increase the value of savings (1) and lenders may gain if the money they are repaid will have a higher value (1);
- if it results from advances in technology (1) costs of production will fall (1) may make the country's products more internationally competitive (1) increase exports and reduce imports (1) improve current account position (1) raise employment (1) increase output (1).

5 (a) Define 'fertility rate'. **[2]**

- Average number of children (1) a woman gives birth to (1).
- The number of children born per 1000 women (1) of child bearing age (1).

(b) Explain two reasons why a country may have more males than females in its population. **[4]**

- Higher immigration of males/higher emigration of females (1) more men may come to live in the country in search of employment/more women may emigrate e.g. in search of employment (1).
- Longer life expectancy of males (1) e.g. males may receive more and higher quality health care (1).
- More boys born than girls (1) with similar infant mortality rates (1).

(c) Analyse why the pattern of employment in a country may change over time. [6]

- Changes in the pattern of demand (1) income levels may change (1) tastes may alter (1).
- Changes in government policy measures (1) e.g. the government may subsidise certain industries encouraging them to expand (1).
- Decrease in the role of the government in the economy (1) reducing public sector employment (1).
- Emergence of rival industries in other countries (1) leading to some industries declining (1).
- Advances in technology (1) creating new jobs (1).
- Changes in education (1) creating new skills/influencing proportion of younger workers (1).
- Changes in social attitudes (1) resulting in more women in the labour force (1).
- Rise in retirement age (1) resulting in more older workers (1).
- Firms/workers wanting more flexibility (1) resulting in more part-time jobs (1).
- Change in laws/rise in relative income in the country (1) attracting more migrant workers (1).
- Improvement in facilities/change in social attitudes (1) enabling more people with disabilities to work (1).
- Changes in business opportunities (1) influencing the number of people self-employed (1).
- Change in laws/minimum wages (1) influencing the proportion employed in organised and unorganised sectors of the labour market (1).
- As countries become more developed (1) employment in the primary sector/agriculture tends to decline (1) employment in the secondary sector/manufacturing at first increases and then tends to decline (1) employment in the tertiary sector/services increases (1).

Note: up to a maximum of 3 marks for a list-like approach.

(d) Discuss whether a government should aim for an unemployment rate as low as 0.5%. [8]

Up to 5 marks for why it should:

- result in high output/GDP (1) high incomes/high living standards (1);
- lead to high government tax revenue (1) this could be spent on e.g. education/health care (1);
- cause low government spending on unemployment benefits (1) reduce opportunity cost/allow tax revenue to be spent on other items (1);
- full employment is one of the main aims of government policies (1).

Up to 5 marks for why it should not:

- 0.5% is usually regarded as being below full employment/difficult to achieve (1) always likely to be some frictional unemployment (1);
- at 0.5% unemployment, the level of demand is likely to be high (1) economy operating at full capacity (1) may cause inflation (1) demand-pull inflation (1) may also drive up wages due to a shortage of labour (1) cost-push inflation (1);
- higher level of demand may increase demand for imports (1) causing a current account deficit (1).

6 (a) Giving an example, define the factor of production 'land'. [2]

Example (1) Natural resources/gifts of nature (1).

(b) Explain two reasons why a country may have a low GDP per head. [4]

- Low level of investment (1) leading to low output/high costs of production (1).
- High proportion of the labour force employed in agriculture (1) fluctuations in supply/low value added/demand not rising in line with income (1).
- Low levels of education (1) low productivity (1).
- High rate of unemployment (1) low output (1).
- High population growth/high population relative to GDP/low GDP relative to population (1) resources have to be devoted to e.g. looking after children/GDP per head is GDP /population (1).
- A proportionately large informal sector (1) with economic activity undeclared (1).
- Importing more than exporting (1) net exports making a negative contribution to GDP (1).
- Low aggregate demand (1) caused by e.g. contractionary fiscal policy (1).
- High proportion of population are economically inactive (1) plus example/not contributing to GDP (1).
- Lack of resources (1) resulting in low output (1).

(c) Analyse how a rise in tax rates may influence poverty. [6]

- A rise in progressive taxes (1) taking a higher proportion of the income of the rich (1) may reduce relative poverty (1) may increase absolute poverty (1) as may reduce the incomes of the poor (1).
- A rise in regressive taxes (1) taking a higher proportion of the income of the poor (1) may increase relative (1) and absolute poverty (1).
- Tax revenue may be used to help the poor (1) e.g. provide benefits/housing/education/ health care (1) lower absolute poverty (1).
- A rise in indirect taxes will increase price of products (1) a rise in direct taxes will reduce disposable income (1) which may mean the poor will not be able to afford basic necessities (1) lower demand may increase unemployment (1).
- A rise in direct taxes may reduce the incentive to work (1) increasing unemployment (1).

Note: up to a maximum of 3 marks for a list-like approach.

(d) Discuss whether a fall in GDP may reduce living standards. [8]

Up to 5 marks for why it might:

- if GDP falls and the population stays the same or increases (1) GDP per head will fall (1);
- lower incomes may reduce the goods and services people can buy (1) lowering material living standards (1);
- a fall in GDP may indicate higher unemployment (1) the unemployed are likely to have low incomes (1);
- a fall in GDP may reduce tax revenue (1) lowering availability and quality of public services (1);
- a fall in GDP may reduce the amount of health care/education people can enjoy (1) lower living standards indicated by lower HDI value (1).

Up to 5 marks for why it might not:

- if population falls by more than GDP (1) GDP per head may rise (1);
- incomes may fall but working conditions may improve (1) working hours may decline (1) environmental conditions may improve (1);
- incomes may fall but life expectancy may increase (1) quality of education may rise (1);
- the distribution of income may become more even (1) this may mean that the living standards of many people may rise (1);
- if there is deflation (1) people may be able to buy more goods and services (1).

7 (a) Define 'developed country'. **[2]**

- A country with a high GDP per head/high income (1).
- A country with high living standards/long life expectancy/high savings ratio/high levels of education/high levels of health care/a high proportion of workers employed in the tertiary sector/high productivity (1).

(b) Explain two economic reasons why someone may decide to work in another country. **[4]**

- Higher wages abroad (1) leading to higher living standards (1).
- Better working conditions (1) e.g. longer lunch breaks/better health and safety conditions (1).
- Greater chance of promotion (1) leading to higher income (1).
- Greater opportunity to follow a particular career (1) more job opportunities (1).
- Opportunity to gain experience in another country (1) skills gained may increase job opportunities/income when return home (1).

(c) Analyse how a more educated labour force could reduce a country's current account deficit on its balance of payments. **[6]**

- A more educated labour force is likely to be more skilled (1) and so more productive (1) leading to lower costs of production (1) may make domestic products more price competitive (1) increase exports and lower imports (1).
- A more educated labour force may produce higher quality products (1) make domestic products more quality competitive (1) increase exports and lower imports (1).
- A more educated work force could be more innovative (1) more entrepreneurial (1).

(d) Discuss whether a country's exchange rate should be determined by market forces or by the government. **[8]**

Up to 5 marks for market forces:

- an exchange rate determined by the demand and supply of the currency (1) is a floating exchange rate (1);
- should automatically move the current account position to a balanced position (1) if e.g. a deficit, exchange rate will fall (1) lowering export prices and raising import prices (1);
- avoids the need for reserves to influence the exchange rate (1) foreign currency can be used for other purposes (1);
- avoids the exchange rate being a policy objective (1) can pursue other policy objectives (1) e.g. can alter the interest rate to influence the price level (1).

Up to 5 marks for the government:

- a fixed exchange rate is maintained by the government/central bank (1) buying and selling the currency (1);
- promotes certainty (1) this can enable firms to plan ahead (1) may encourage investment (1);
- the rate may be set low (1) to increase economic growth/employment (1);
- the rate may be set high (1) to reduce inflation (1).

Note: up to a maximum of 3 marks for a list-like approach.