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Cambridge Ordinary Level

MARK SCHEME for the October/November 2015 series

2281 ECONOMICS

2281/23 Paper 2 (Structured Questions), maximum raw mark 90

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1 (a) Using information from the extract, calculate the number of people living in poverty in Rwanda in 2012. [2]

- 5.04 m or 5 040 000 (2)
- 42% of 12 m or 42 / 100 × 12 m (1)

(b) Explain how in a country such as Rwanda, an increase in government spending on education and healthcare could reduce poverty. [5]

- spending on education should raise the skills of workers (1) increase productivity (1) raise employment opportunities (1) increase earnings (1)
- spending on healthcare should increase productivity (1) reduce time away from work due to illness (1) enable people to work to a higher age (1) increase earnings (1)
- access a basic necessity (1) spending on education/healthcare would increase access to a basic necessity of life in today's society (1)

(c) Using information from the extract, explain <u>one</u> reason why the average age of Rwanda's population may increase in the future. [2]

- improved/increased healthcare (1) could reduce infant mortality and death rate/increase life expectancy (1)
- net inward migration (1) the average age of migrants may be higher than those originally born in the country (1)
- improved/increased education (1) could lead to better planning/reduction in birth rate

(d) Using Table 1, comment on whether economists would expect to see the relationship shown between the migration rate and the economic growth rates. [4]

- Yes, they would/it does support (1)
- Up to 2 marks for evidence from the table e.g. Macau with net immigration of +3.5 had the highest economic growth of 10.00% and South Africa with net migration of –6.2 had the lowest economic growth rate of 2.6%.
- Up to 2 marks for an explanation of the relationship e.g. high economic growth leads to higher inward migration because more jobs are available

(e) Using information from the extract, explain whether agriculture in Rwanda is capital-intensive or labour-intensive. [2]

- labour-intensive (1)
- little investment/farmers lack equipment (1)

(f) Discuss whether concentrating on products with inelastic demand will benefit farmers. [5]

Up to 3 marks for why it might:

- will be able to raise price (1) demand will fall by a smaller % (1) raise revenue (1)
- inelastic demand suggest a lack of competitors (1) gives farmers more market power (1)
- specialisation can increase efficiency (1) raise output (1)
- provides a steady source of income (1) even with changes in prices (1)

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Up to 3 marks for why it might not:

- Risk of demand decreasing (1)
- PED can change over time (1) may become more elastic in the long run (1)
- PED may not have been calculated accurately (1)
- Demand is influenced by more than price (1) e.g. the products may become less popular as income rises (1)
- Rwandans cannot afford to buy (1) if prices of staple products rise too much (1) which in the longer term could reduce farmers' income
- Farmers may concentrate on too narrow a range of crops (1) and could be adversely affected by poor weather (1)
- If prices become too high (1) this may result in imports (1) reducing the revenue to local farmers (1)

(g) Using information from the extract, explain <u>two</u> reasons why the price of food in Rwanda may fall. [4]

- Reduction in tariffs on imported food (1) directly reduces the price of some food items (1) increase competitive pressure on Rwandan farmers to keep price of food low (1)
- Increased productivity in farming (1) due to improved education/government policy measures (1) lower costs of producing food (1)

(h) Discuss whether an increase in borrowing by households and firms in a country will benefit its economy. [6]

Up to 4 marks for why it might:

- households may borrow to spend on their education or healthcare or the education or healthcare of their children (1) this may raise productivity (1) increasing international competitiveness (1) improving the current account position (1)
- firms may borrow money to invest (1) this may increase output (1) raise employment (1)
- increase in demand (1) leads to higher output (1) and reduced unemployment (1)

Up to 4 marks for why it might not:

- households may borrow to buy imported products (1) worsen the current account position (1)
- increase in spending may cause inflation (1) if close to or at full employment (1)
- households and firms who borrow may get into debt (1) firms may go out of business (1) households who get into debt will be able to spend less in the future (1)

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2 (a) Define 'average revenue'. [2]

Total revenue divided by (1) quantity sold/output (1)
Price (1)

(b) Explain <u>two</u> reasons why luxury products often have elastic demand. [4]

- take up a large proportion of people's income (1) means any change in price is significant (1)
- the purchase of luxury products can be postponed (1) not necessary to buy luxury products now/not a regular purchase/does not have to be purchased (1)
- some luxury products may have close substitutes (1) this would mean a rise in the price of the luxury product would cause consumers to switch to the substitute (1)

(c) Analyse how a perfume producer could make the supply of its product more price elastic. [6]

- price elastic supply (PES) means that a percentage change in price will cause a greater percentage change in supply/PES is greater than 1 (1)
- investing in new capital equipment (1) should mean firms have more productive equipment (1) speed up the production process (1) make supply more responsive to changes in price (1)
- increasing storage facilities (1) increasing the shelf life of the perfume (1) if price rises, perfume can be taken out of storage to meet the higher demand (1)
- improve supply chain (1) source from different countries/providers (1)

(d) Discuss whether a firm would make more profit from producing in a foreign market rather than exporting to that market. [8]

Up to 5 marks for why it might:

- cheaper transport costs (1) may be significant if the foreign market is large or a long distance from the country (1)
- may be able to hire workers at a lower wage rate (1) employ more productive workers (1) may be able to purchase cheaper raw materials (1)
- may have closer contact with foreign consumers (1) more awareness of changes in demand in the market (1) may overcome any resistance to foreign produced products (1)
- may gain government subsidies to set up in the country (1)
- may get round import restrictions (1) this would enable them to sell products more cheaply in the foreign market (1)
- locally based means better understanding of market (1) and can react more quickly to changes in demand (1)

Up to 5 marks for why it might not:

- having some of its production in a foreign market rather than producing it all at home may mean branches are smaller (1) may mean less advantage can be taken of economies of scale (1) for instance, technical economies of scale (1)
- there may be some problems co-ordinating the branches (1) this could raise costs of administration (1)
- a firm may be able to gain subsidies from its own government to export (1)
- costs may be higher in a foreign market (1) e.g. rent may be higher (1)
- higher costs of opening up production in another country (1) may reduce profits in the short run (1)

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3 (a) Define 'market economy'. [2]

- consumers determine what is produced/consumers are sovereign (1)
- resources are allocated by price mechanism/driven by market forces of demand and supply (1)
- absence of government intervention (1)

(b) Explain <u>two</u> external costs that could arise from people overeating. [4]

Up to 2 marks for defining an external cost:
- social costs minus private costs (1)
- harmful effects (1) imposed on third parties (1)

Up to 4 marks for relating concept to overeating:
- overeating can result in healthcare problems (1) this imposes a burden on the healthcare system (1) reducing healthcare resource available for those who do not overeat/rising tax payments on those who do not overeat (1)
- overeating can result in healthcare problems (1) reducing labour productivity (1) lowering quality and quantity of output (1)
- overeating can result in more litter (1) extra costs of collection/landfill/recycling (1) fewer resources for merit goods

(c) Analyse <u>three</u> reasons why the demand for chocolate may rise in the future. [6]

- a fall in price (1) increases willingness and ability to buy a product (1)
- a rise in income (1) increase ability of people to buy the product/chocolate is something of a luxury product (1)
- a rise in the price of a substitute e.g. sweets (1) people will switch away from the substitutes towards chocolate (1)
- a rise in population (1) more people to consume chocolate (1)
- an advertising campaign (1) making chocolate more popular (1)
- change in preferences/tastes (1) towards chocolate (1)

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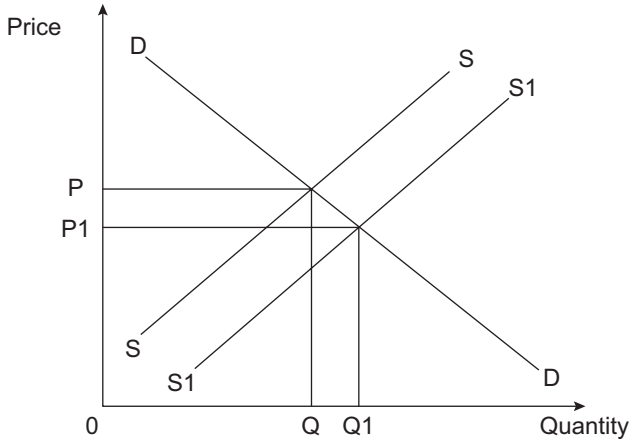
(d) Discuss whether a government subsidy to producers will reduce market failure. [8]

Up to 5 marks for why it might:

- a subsidy to producers is a payment designed to encourage production (1)
- it will reduce costs of production (1) increase supply (1) lower price (1) cause demand to rise (1)
- if there is under-consumption of the product/the product is a merit good, it can reduce market failure (1)
- if the product generates external benefits, a subsidy can reduce market failure (1)

Note: Accept an accurate diagram for 3 marks: correct labelling (1) shift in supply curve to right (1) new equilibrium shown (1)



Up to 5 marks for why it might not:

- producers may not pass on the subsidy to consumers (1) so demand may not rise (1)
- a subsidy given to products that are over-consumed (1) will make the market failure worse (1) by increasing supply and consumption of the product (1)
- a subsidy involves an opportunity cost (1) government revenue could be used for other purposes which might reduce market failure more (1)
- a subsidy may be ineffective (1) if wrong level of subsidy is applied (1)

4 (a) Define 'public limited company'. [2]

- sells shares to the general public (1)
- has limited liability (1)
- in the private sector (1)

(b) Explain <u>two</u> reasons for the differences in the size of firms in the same industry. [4]

- share of the market (1) firms that sell more products will be producing on a larger scale (1)
- age of the firm (1) firms that have just started in the industry are likely to be smaller (1)
- access to financial capital (1) firms that can borrow or sell shares more easily are likely to be larger (1)
- goal of owners (1) some owners may want to keep their firm small in order to maintain control and avoid stress (1)

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(c) Analyse why a firm may decide to change the proportion of capital and labour it employs. [6]

- a change in the relative price of capital and labour (1) if wages increase, firms may seek to employ more capital (1)
- a change in the productivity of resources (1) improved education, for instance, may increase the skills of workers (1) advances in technology (1) may rise the productivity of capital goods (1)
- availability of resources (1) difficulty of recruiting labour may encourage a firm to seek capital substitutes (1)
- government incentives (1) a government may provide tax incentives/subsidises to firm to spend on capital goods/hire workers (1)
- recession leads to firms laying off workers (1) as they are variable costs (1)

Note: A maximum of 3 marks for a static approach to analysis of why a firm may be capital or labour intensive.

(d) Discuss whether a large firm is likely to sell its products at a lower price than a small firm. [8]

Up to 5 marks for why it might:

- may be more able to take advantage of economies of scale (1) examples e.g. buying, technical, managerial, risk bearing due to lower average costs (up to 3) may be able to charge a relatively low price and still make a significant profit (1)
- a large firm may have captured most of the market and gained monopoly power (1) this may mean it has profit to spend on research and development/investment (1) lowering costs (1)
- a large firm may be a nationalised industry (1) may charge a low price in order to ensure everyone can afford it (1)

Up to 5 marks for why it might not:

- a small firm may be in a more competitive market (1) pressure from rivals to keep price down (1)
- a small firm is less likely to experience diseconomies of scale (1) e.g. less likely to experience problems with control and poor labour relations (1) as a result may experience lower average costs (1)
- a small firm may combine with other small firms to take advantage of some economies of scale (1) e.g. buying raw materials together/farms sharing a combine harvester (1)
- a small firm may be closer to its markets (1) reducing transport costs (1)
- a large firm may have monopoly powers/have a large share of the market (1) and therefore sell at a higher price due to lack of competition (1)

5 (a) Define 'labour'. [2]

- human effort/physical and mental effort/workers/workforce (1) used in producing goods and services (1)

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(b) Explain why a rise in employment would benefit trade unions. [4]

- more workers is likely to raise membership (1)
- will increase subscriptions/fees/revenue (1)
- likely to strengthen bargaining power (1)
- more difficult for employers to replace workers/employers more anxious to retain workers (1)
- higher employment is likely to raise demand (1) higher demand may increase firms' profits and so possibly their willingness to pay higher wages (1)

(c) Analyse how trade union action could cause inflation. [6]

- trade unions may press for higher wages (1) if successful would increase wage rates (1) this would increase costs of production (1) leading to cost-push inflation (1)
- trade unions might engage in strike action (1) this would increase firms' costs (1) leading to cost-push inflation (1)
- higher wages may increase workers' purchasing power (1) this could lead to higher demand (1) resulting in demand-pull inflation/a wage-price spiral (1)
- trade union action may restrict supply (1) lower supply may push up prices (1)

(d) Discuss whether inflation would cause unemployment. [8]

Up to 5 marks for why it might:

- inflation may make the country's products less internationally competitive (1) export prices may rise relative to import prices (1) this may reduce demand for the country's products (1) causing cyclical unemployment (1)
- if inflation is caused by rises in wages/increases in costs of production (1) firms may make workers redundant to reduce costs (1) higher costs may force firms out of business causing unemployment (1)

Up to 5 marks for why it might not:

- inflation rate may be below rival country's inflation rates (1) increasing international competitiveness (1) increasing demand for the country's products (1) reducing cyclical unemployment (1)
- a low level of demand-pull inflation/stable inflation (1) may encourage firms to expand (1) reducing unemployment (1)
- frictional and structural unemployment may fall despite inflation (1) if, for instance, information about job opportunities/labour mobility increase (1)

6 (a) Define 'quota'. [2]

- A limit/restriction (1) on imports/exports (1)

(b) Explain the structure of the current account of the balance of payments. [4]

- trade in goods (visibles)
- trade in services (invisibles)
- income flows (primary income)
- current transfers (secondary income)

1 mark for good explanation of each section

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- good explanation of two sections and identification of one other section (4)
- good explanation of two sections; or a good explanation of one section and identification of the other three sections (3)
- identification of four sections (2)
- identification of two/three sections (1)

(c) Analyse why it would be expected that a rising current account surplus would lead to an appreciation in the country's foreign exchange rate. [6]

- current account surplus involves more money coming into the country than going out (1)
- appreciation means a rise in the value of a currency (1)
- demand for the peso may be increasing (1) as more pesos would be being purchased to e.g. buy Argentinian exports (1) higher demand would tend to push up price (1)
- supply of the peso may be decreasing (1) as less pesos may be sold to e.g. buy imports (1) lower supply will tend to push up price (1)

(d) Discuss whether a government should try to prevent a depreciation in the country's currency. [8]

Up to 5 marks for why it should:

- a depreciation can cause inflation (1) price of imported raw materials will rise (1) increasing costs of production (1) causing cost-push inflation (1) firms lose competitive edge (1)
- may lower living standards (1) as people will not be able to afford to buy as many imports (1)
- to prevent a fall in the value of the currency a central bank may have to use reserves to buy the currency (1) would involve an opportunity cost (1) or raise interest rate (1) which could reduce demand (1) cause lower output/employment (1)
- currency may initially have been undervalued (1)

Up to 5 marks for why it might not:

- may improve the current account position (1) lower export prices may increase export revenue (1) higher import prices may reduce import expenditure (1)
- higher import prices may increase demand for domestically produced products (1) may increase output (1) and employment (1) higher demand for the country's products (1) may encourage firms to expand and take on more workers (1)
- currency may initially have been overvalued (1)

7 (a) Identify <u>two</u> influences on the amount households spend. [2]

1 mark <u>each</u> for <u>two</u> of the following:

- income/benefits
- wealth
- confidence
- rate of interest savings
- age structure
- taxation
- size of family/household

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(b) Explain why tax revenue may fall during a recession. [4]

- lower incomes (1) will mean less income tax revenue (1)
- firms are likely to earn less profit (1) so less corporation tax revenue (1)
- less spending (1) so less indirect tax revenue (1)
- government may decide to cut tax rates (1) to stimulate the economy (1)

(c) Analyse how a cut in government spending may reduce a country's HDI ranking. [6]

- lower government spending may reduce total demand (1) lower demand may reduce output (1) lowering GDP per head (1)
- lower government spending on healthcare may reduce the quality and availability of healthcare (1) reducing life expectancy (1)
- lower government spending on education (1) may reduce the years of education children will receive/mean and expected years of schooling (1)

(d) Discuss whether use of monetary policy will increase economic growth. [8]

Up to 5 marks for why it might:

- a cut in the rate of interest (1) may increase borrowing (1) reduce saving (1) increase spending/demand (1) encourage firms to produce more (1) stimulate investment (1) increase productive capacity (1)
- a rise in the money supply (1) may increase demand (1) encouraging firms to produce more (1)
- a devaluation of the currency (1) may increase demand (1) as export prices fall and import prices rise (1) encouraging firms to produce more (1)
- a sound monetary policy may increase confidence (1) which may increase investment (1) e.g. an inflation target (1) may encourage people and firms to believe inflation will be low (1)

Up to 5 marks for why it might not:

- a rise in the rate of interest (1) may discourage borrowing (1) increase saving (1) reduce spending/demand (1) encouraging firms to reduce output (1) reduce investment (1) reduce productive capacity (1)
- a reduction in the money supply (1) may reduce demand (1) encouraging firms to reduce output (1)
- a revaluation of the currency (1) may reduce demand (1) as exports prices rise and import prices fall (1) encouraging firms to produce less (1)
- an expansionary monetary policy may cause inflation (1) this may reduce output in the longer term as domestic products will be less internationally competitive (1)
- other policies might be more effective (1) example (1)
- the effects of monetary policy might be offset by other factors (1) e.g. a global recession (1)

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