CAMBRIDGE INTERNATIONAL EXAMINATIONS

International General Certificate of Secondary Education

MARK SCHEME for the October/November 2013 series

0455 ECONOMICS

0455/21 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.

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Cambridge is publishing the mark schemes for the October/November 2013 series for most IGCSE, GCE Advanced Level and Advanced Subsidiary Level components and some Ordinary Level components.

1 (a) State two industries that have been growing in Oman. [2]

Two from the following:
- financial industry
- tourism industry
- education industry

(b) Describe two types of unemployment. [4]

Candidates could mention:
- structural (1) arising from the decline of particular industries and occupations (1)
- cyclical/demand-deficit (1) caused by a lack of total (aggregate) demand (1)
- regional (1) when industries decline in a particular area (1)
- technological (1) when advances in technology make particular occupations redundant (1)
- frictional (1) when workers are in between jobs (1)
- seasonal (1) when workers cannot find employment at certain times of year (1)
- search (1) when workers do not accept the first job on offer but spend time in pursuit of a good job (1)
- voluntary (1) workers not actively seeking employment (1)
- residual (1) workers who cannot get a job even during a boom period because of a lack of skills or disabilities (1)
- classical (1) when wages are not allowed to fall (1)

(c) Explain how fiscal policy can be used to support the development of a country such as Oman. [6]

Up to 4 marks for answers dealing with an increase in public spending:
- expenditure on education and training schemes/health care (1) raise labour productivity (1) reduce costs of production (1) raise the quality of products produced (1) increase demand for products made (1) increase incomes (1)
- grants and loans to encourage enterprise (1) increase output (1) increase employment (1) increase income (1)
- infrastructure development (1) examples of spending on infrastructure, e.g. road building, hospitals (1) reduce costs of production (1) increase output (1) increase income (1)
- increase in general government spending (1) increases total (aggregate) demand (1)

Up to 4 marks for answers dealing with a reduction in taxation:
- reduction in taxation (1) raise disposable income (1) increase demand (1) increase output (1) increase employment (1) increase income (1)
- tax holidays could be given (1) encourage multinationals to locate (1) increase output (1) increase employment (1) increase income (1)
- taxes on profits of companies could be reduced (1) encourage investment expenditure (1) increase output (1) increase employment (1) increase income (1)

(d) Discuss the extent to which spending on education and training will reduce the rate of unemployment in a country. [8]

Up to 5 marks for why it might reduce unemployment:

- raise workers' skills (1) make them more productive (1) make them more occupationally mobile (1) increase demand for their labour/make them more employable (1) reduce structural unemployment (1) increase incomes (e.g. teachers) (1) and so increase demand (1) multiplier effect (not on syllabus but candidates may use the idea) (1)
- creates jobs in education (e.g. teachers) (1)
- increases total (aggregate) demand (1) which increases employment (1)
- new skills acquired allow them to start their own business (1) this may require more employees (1)
- workers might become highly skilled (1) which could help them obtain jobs abroad (1)

Up to 5 marks for why it might not reduce unemployment:

- education and training may be of a poor quality (1) may be in areas that are not in demand (1)
- may not reduce cyclical unemployment (1) demand for workers will remain low if demand for products is low (1)
- higher spending on education and training may be offset by lower spending on health care (1) and so productivity may not increase (1)
- higher taxes to pay for the education (1) may reduce demand for goods and services (1) and so reduce the demand for labour (1) but the net effect of an increase in government spending and taxation would be to increase demand (balanced budget multiplier effect not on the syllabus but may use the idea) (1)
- higher spending may cause inflation (1) which could cause unemployment (1) (this link must be explained for one mark).
- it is a long term solution (1) by the time trained workers enter the labour market the skills required may have changed (1)
- there may be an opportunity cost (1) such as spending on public services which would create more jobs directly (e.g. armed forces) (1)

2 (a) Describe why economic decisions involve an opportunity cost. **[4]**

Up to two marks for definition:
Opportunity cost is the (next) best alternative (1) that is foregone (1)

Up to two marks for development
Resources are finite/limited in supply (1) if they are used to produce one product they cannot be used to produce another product (1) so a choice has to be made as to how resources have to be used (1) an example of this use of resources (1)

Reward but do not expect:
Economic decisions do not always involve an opportunity cost (1) e.g. employing the unemployed/using solar power/they might be free goods (1)

(b) Using a production possibility curve diagram, explain how it can show the concept of opportunity cost. **[6]**

Diagram:
Up to 3 marks:
- correct labelling of both axes (1)
- correct shape of curve (straight line or curve) (1)
- two points showing movement along curve/movement along axes (1)
- opportunity cost, with full employment of resources, must be on the PPC (1)

Explanation:
Up to 3 marks:
- PPC shows all possible combinations of the production of two goods (1)
- shows more of one product can be made only if less of another product is made (1) as a result of switching resources (1)
- shows if all resources are used to make one product, no units of the other product can be made (1)
- a move from inside the PPC outwards does not show opportunity cost (1)
- points outside the PPC are unattainable (1)

(c) Discuss the extent to which the concept of opportunity cost is only of use to governments. [10]

Up to 7 marks for why the concept of opportunity cost is of use to governments:

- governments have to decide how to spend tax revenue (1) e.g. if they spend revenue on education they cannot spend it on health care (1)
- governments face policy conflicts (1) e.g. if it decides to raise spending to reduce unemployment (1) it may cause inflation/lose control of price stability (1)
- governments know a rise in taxation will involve an opportunity cost for taxpayers (1) they will have to forgo spending or saving
- a rise in taxation may discourage MNCs from setting up in the country (1) result in loss of output/employment (1)

Up to 7 marks for why the concept of opportunity cost can be of use to firms, consumers and workers:

- firms have limited resources (1) firms have to decide what to produce (1) e.g. if a firm produces more of one model of car, it may have to produce less of another model (1) take into account profits that can be earned (1)
- consumers have limited income (1) have to decide how they spend their money (1) if they buy one product they may not be able to buy another product (1) take into account satisfaction/value for money (1)
- workers have limited time (1) have to decide what job to do (1) if they undertake one job they cannot do another job (1) take into account wage and non-wage factors (1)
- to show advantages of specialisation in international trade (1) because it shows how output and consumption can rise (1)

3 (a) **Describe what is meant by demand.** **[2]**

Demand is the willingness (1) and ability (1) to buy a product.

(b) **Using a demand and supply diagram, analyse the likely effect of an increase in advertising on the equilibrium price and equilibrium quantity of a product in a market.** **[6]**

Diagram:
- correct labelling of axes (1)
- shift of demand curve to the right (1)
- increase in equilibrium price (1)
- increase in equilibrium quantity (1)

Analysis:
- advertising may encourage people to buy more/switch from buying rival products/ become aware and start buying the product (1)
- effect of an increase in advertising on equilibrium price (1)
- effect of an increase in advertising on equilibrium quantity (1)

(c) **Describe the concept of price elasticity of demand.** **[4]**

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

Up to 2 marks for further development:
elastic demand has a value greater than 1 (1) inelastic demand has a value less than 1 (1) PED varies from perfectly elastic to perfectly inelastic (1) PED varies along the length of the demand curve (1)

(d) **Discuss the extent to which price elasticity of demand is of use to a business.** **[8]**

Up to 5 marks for why it might be useful:
- a business can appreciate how demand for its products will be influenced by a change in price (1)
- if PED is elastic, a fall/rise in price will cause a greater percentage rise/fall in demand (1) leading to an increase/fall in revenue (1)
- if PED is inelastic, a rise/fall in price will cause a smaller percentage fall/rise in demand (1) leading to an increase/fall in revenue (1)
- elastic PED may indicate that the business faces close substitutes for its products (1)
- inelastic demand may indicate the business has considerable market power (1)

Up to 5 marks for why it might not be useful:
- price is only one of a number of influences on demand (1) changes in the prices of other products (1) and income (1) can be significant
- PES should also be considered (1) e.g. demand may be elastic but may not be able to take advantage of a lower price, if PES is inelastic (1)
- In practice, it is difficult to determine PED (1) it may change over time (1)

4 **(a) Explain how money functions as (i) a unit of account and (ii) a standard for deferred payments. [4]**

Up to 2 marks for a unit of account:

- the price of an item can be measured in terms of how many units of currency it is worth. Money can, therefore, be used to place a value on an item (1). Prices are expressed in monetary terms; this function of acting as a unit of account (or measure of value) enables buyers and sellers to agree on what items are worth, relative to each other (1)

Up to 2 marks for a standard for deferred payments:

- this function of money enables borrowers to borrow money and pay it back at a future date (1); in this way, money allows people to borrow and lend and an agreement can be reached about the amount to be repaid in the future (1)

(b) Analyse the role that commercial banks can perform in an economy. [6]

Provision of:

- current accounts (1) allows customers to make and receive payments/money transmission services (1) e.g. by cheque, direct debits, debit cards (1)
- deposit/savings accounts (1) interest paid to savers (1)
- loans (1) interest charged on the full amount of the loan (1) may be used for a variety of purposes e.g. to buy a car (1) mortgages to buy a house (1)
- overdrafts (1) interest charged on the amount borrowed (1) may be authorised or unauthorised (1)
- foreign currency/travellers' cheques (1) used by people visiting other countries (1)
- financial advice (1) e.g. on purchase of shares (1)
- safe deposit facilities (1) e.g. to keep important documents (1)
- by lending money they can increase total consumer spending (1) in the economy and total investment by firms (1). (Do not reward reference to functions of central bank such as setting interest rates)

A list-like approach can gain no more than 3 marks

(c) Discuss whether the rate of interest is the only influence on a person's decision to borrow money from a bank. [10]

Up to 7 marks for the importance of the rate of interest:
- the rate of interest is the price (1) of borrowing money (1) reward for lending (1)
- a fall in the rate of interest will reduce the cost of loans/overdrafts (1) encouraging a rise in borrowing (1)
- a rise in the rate of interest will increase the cost of loans/overdrafts (1) encouraging a fall in borrowing (1)
- a person may take into account not only the current but also the expected future interest rate (1) less likely to borrow if the rate of interest is expected to rise (1) central banks change the interest rate to influence borrowing (1) e.g. to reduce the inflation rate it will raise the rate of interest (1)

Up to 7 marks for other influences on a decision to borrow money:
- the ability to repay loans/overdrafts (1) those with high income (1) or who are wealthy (1) are more likely to be able to repay
- the need for the loan/overdraft (1) e.g. someone in financial difficulty may need to seek a loan/overdraft (1)
- the availability of loans/overdrafts (1) a bank will not be willing to lend to someone it thinks will not be able to repay (1)
- future inflation (1) this may reduce the real cost of the loan/overdraft (1)
- confidence (1) a person may be more willing to borrow if she/he thinks her/his job is secure/income will rise (1)
- advertising by banks of the borrowing facilities that are available (1) increase awareness of the opportunities (1)
- social attitudes to borrowing money (1) a person may be reluctant to get into debt (1)
- in some countries banks are not allowed to charge interest (1) some religions prohibit usury (1)

5 (a) Describe <u>two</u> features of a partnership. [4]

- unlimited liability (although limited liability can sometimes operate) (1) so that the amount owners can lose is not restricted to money they have put into the business (1)
- unincorporated (1) partners share profits/losses (1)
- a relatively low maximum number e.g. 20 (1) restricts the business size (1)
- partners may specialise (1) so there is a sharing of skills/expertise (1)
- usually involves a legal document called a Deed of Partnership (1) setting out the terms of the partnership (1)

1 mark for a basic description of each feature and 1 mark for a development of the description

(b) Explain why a partnership might become a private limited company. [5]

- to benefit from limited liability (1) so that the amount that owners can lose is restricted to the amount they have put into the business (1)
- to expand by issuing shares (1) this raises more capital (1) allows the firm to expand its output (1)
- a private limited company usually has a higher maximum number of owners (1) and so will be able to benefit from economies of scale (1) example (1)
- to have a board of directors (1) which appoints a managing director who takes responsibility for running the business (1)

(c) Distinguish between internal and external economies of scale. [4]

Internal economies of scale
Up to 2 marks:
- advantages that a firm can gain from itself growing in size (1) in the form of lower average costs (1)
- one example e.g. buying, technical, financial, managerial, risk bearing (1)

External economies of scale
Up to 2 marks:
- advantages that firms can gain from the industry growing in size (1) in the form of lower average costs (1)
- one example e.g. skilled labour force, specialist markets, improved infrastructure, specialist supplies (1)

(d) Discuss whether all small firms will eventually become large firms. [7]

Up to 4 marks for why they might:

- if small firms respond to changes in consumer demand (1) they may increase sales (1) successful small firms will gain high profits (1) this can finance expansion (1)
- banks may be willing to lend to small firms (1) providing the finance for expansion (1)
- the government may provide subsidies for small firms (1) lowering their costs of production (1) increasing their supply (1)
- small firms may combine to take advantage of economies of scale (1) will lower cost of production (1) increase profits (1)

Up to 4 marks for why they might not:

- size of the market may be limited (1) demand for some products may be low (1)
- preference of owners/managers (1) it may be easier/less stressful to run a small firm (1)
- preference of consumers (1) people may want a personal service (1)
- difficulty of raising finance to expand (1) banks may be reluctant to lend to some small firms/charge them too high a rate of interest (1)
- market might be dominated by large firms (1) this creates barriers to expansion for small firms (1)

6 (a) **Describe what is meant by relative poverty.** **[4]**

Relative poverty:

- this is where people in a country are generally less well off than others (1) such as in relation to the quantity/quality of material goods (1) they are not able to participate fully in the normal activities of the country they live in (1)
- people who are relatively poor in one country (especially a developed country) may be quite well off compared to the poor in another country (1) (especially a developing country) (1)

(b) **Explain why a government may not always have accurate knowledge of the level of poverty in its country.** **[6]**

- the poor may not have a permanent address/may not appear on official statistics (1)
- the poor may be in subsistence agriculture (1) their output is not measured (1)
- often population statistics may be an estimate (1)
- relative poverty is particularly difficult to determine as the 'relativity' may be very subjective (1)
- there may be illegal immigration (1) which is hard to monitor
- the existence of the informal economy (1) some of the poor may be earning an income but do not declare it (1) to avoid paying tax and/or to ensure that benefits are not stopped or because the activity is illegal (1)
- remote areas (e.g. Amazon forest) may be hard to access (1)
- corruption among officials/bribes paid to ignore areas where wages are below the national legal minimum (1)

(c) Discuss whether encouraging multinational companies to locate in a country is likely to reduce significantly the extent of poverty there. [10]

Up to 7 marks for why it might:

- it may pay higher wages than domestic firms (1) this will reduce poverty among low wage workers (1)
- it may create new jobs (1) this could reduce unemployment (1) provide incomes (1)
- workers may gain new skills (1) raise productivity (1) increase long term earning potential (1)
- may contribute to improving infrastructure/schools/hospitals (1) which can improve the standard of living (1)
- may produce goods more cheaply (1) which the poor can afford to buy (1)
- will pay tax in that country (1) so the government can spend on things which benefit the poor (1)

Up to 7 marks for why it might not:

- some of the highly paid workers employed may come from the MNC country (1) local workers may be in low skilled/low paid jobs (1)
- MNCs may replace domestic firms (1) and so not add to employment (1)
- production may be capital rather than labour intensive (1)
- MNCs may not stay in the country for long (1) poverty may return to previous level when they leave (1)
- MNCs may avoid paying taxes in the country (1) reducing government revenue available to tackle poverty (1)
- MNCs may pay less than the minimum wage which local firms pay (1)
- MNCs may locate in certain parts of the country (1) not reduce poverty across the country (1)
- MNCs may deplete natural resources (1) reduce incomes in the country (1)
- MNCs may replace local labour with technology (1)

7 (a) Explain what is meant by free trade. [4]

- international trade which is not restricted by import controls (1) such as tariffs, quotas or other methods of trade protection (1)
- allows world output to be increased (1) when each country specialises in producing the goods and services they are best at producing/with the lowest opportunity cost (1)
- is encouraged by organisations such as the World Trade Organisation (1)
- can increase standards of living (1)

(b) Analyse how a tariff can be used as a method of trade protection. [4]

- a tariff is a tax/duty on imported products (1)
- increases costs of production (1)
- reduces supply (1)
- raises price (1)
- this should lead to a reduction in demand (1)
- the demand for the home produced products (substitutes) rises (1)

(c) Explain why a government might decide to protect a strategic industry in its economy. [4]

- a strategic industry is an industry which is of vital importance to an economy (1) such as defence or agriculture (1)
- these are industries which are essential for the survival of a country (1) the aim is to ensure consistency of supplies (1)
- a country that is dependent on imports of food and weapons faces the risk of supplies being cut off due to wars or natural disasters (1)
- a strategic industry might be an infant or declining industry (1) argument for supporting such an industry (e.g. employment) (1)

(d) Discuss whether the protection of an infant industry in an economy can be justified. [8]

Up to 5 marks for reasons why it might be justified:

- an infant industry is a new industry (1) and so may not be able to compete on equal terms with longer established foreign producers (1)
- protection may enable an infant industry to grow (1) and so take advantage of economies of scale (1) may increase GDP/output (1) and employment (1)
- once the industry can compete equally with foreign producers, the protection can be removed (1)

Up to 5 marks for reasons why it may not be justified:

- difficult to identify which new industries have the potential to be successful (1) may waste government expenditure (1)
- it may involve opportunity cost (1) with an example (1)
- industry may become dependent on protection (1) may become complacent/not forced to become more competitive (1)
- may provoke retaliation (1) foreign industries may complain about unfair competition/ seek to maintain competitive edge (1)