

**Subject CT7 — Economics
Core Technical**

EXAMINERS' REPORT

April 2009

Introduction

The attached subject report has been written by the Principal Examiner with the aim of helping candidates. The questions and comments are based around Core Reading as the interpretation of the syllabus to which the examiners are working. They have however given credit for any alternative approach or interpretation which they consider to be reasonable.

R D Muckart
Chairman of the Board of Examiners

June 2009

Comments

Comments on solutions presented to individual questions for the April 2009 paper are given below.

- Q1–26.** *The multiple-choice questions were generally well answered apart from Q5 and 23 which were the questions most frequently answered incorrect.*
- Q27.** *Most candidates received some marks here however, only a few gained full marks. Many had the correct analysis but failed to take account of transfer payments.*
- Q28.** *Well answered.*
- Q29.** *Well answered but some diagrams of poor quality.*
- Q30.** *Generally well answered however, diagrams of varying quality and many did not identify producer surplus correctly.*
- Q31.** *This question proved to be a good discriminator. Many lost marks for incorrect identification of the market, no adjustment to scale, or incorrect identification of points and calculations. Some confused revenue maximization and profit maximization.*
- Q32.** *This question was well answered with accurate calculations.*
- Q33.** *This was a straightforward theoretical question from core reading. Nevertheless, this question was poorly answered.*
- Q34.** *Mixed results in response to this theoretical and applied question which proved to be a good discriminator. Many good answers but errors included failure to identify the market, poor diagrams, inability to distinguish between a short run and long run outcome.*
- Q35.** *Part 1 of this question was answered satisfactorily with good diagrams. Part 2 applied the theory of part 1 to the global problems of 2008 and responses were quite mixed here. Many did not use the model of aggregate demand and supply to analyse the problems or relate analysis to the theory or the diagrams produced for part 1.*

1	D
2	C
3	D
4	D
5	B
6	A
7	D
8	C
9	B
10	B
11	B
12	D
13	C
14	A
15	D
16	C
17	A
18	A
19	C
20	A
21	C
22	B
23	C
24	D
25	C
26	A

27 $Y = C + I + G + X - Z - T = 1,200,000(\text{£m})$

28 (i) The money multiplier is the ratio of change in M4 which results from a change in MO.

$$M4 = \text{money multiplier} \times \text{monetary base}$$

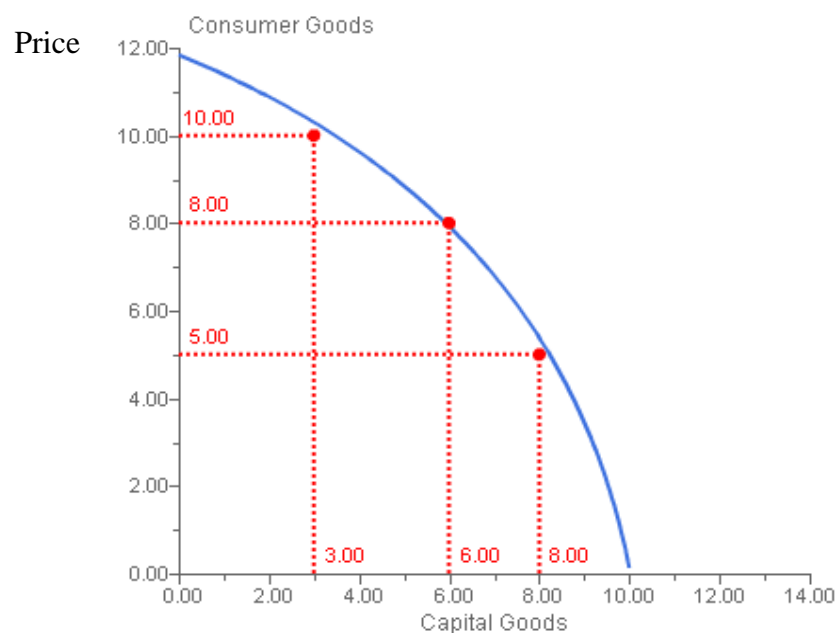
(ii) $m = 1 + c / r + c$

(iii) $m = \underline{\underline{2.14}}$

(iv) $\Delta M4 = m \times \Delta MO$

$$\Delta M4 = 2.14 \times 200 = \text{£}428\text{m}$$

29 (i)



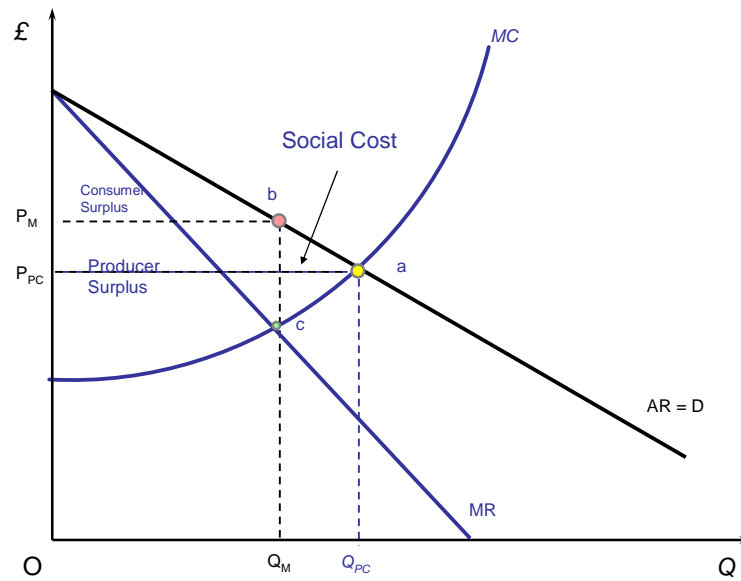
Note all quantities are multiples of 10.

- (ii)
- | | |
|---|-----|
| A | no |
| B | yes |
| C | no |
| D | no |

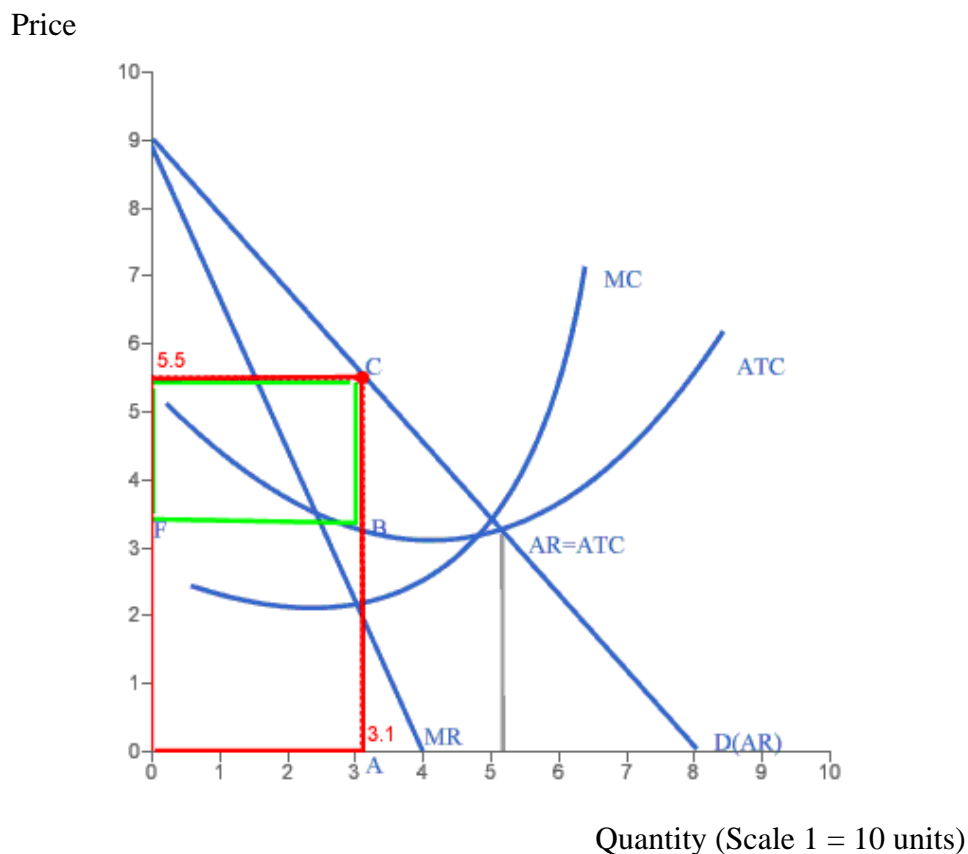
(iii) 30

30

Perfect Competition and Monopoly



- 31**
- (a) Monopoly if abnormal profit in long run or could be monopolistic competition in the short run.
 - (b) Profit max where $MC = MR$ output = 30–31 approx (point A on diagram below)
 - (c) Where $MR = 0$ output = 40
 - (d) Price = 5.5 approx
 - (e) Where $ATC = AR = 52$ approx.
 - (f) $TR = P \times Q$ area (Red Rectangle)



- 32**
- (i) The equilibrium level of national income is given by:

$$Y = C + I + G + X - M$$

$$Y = 0.6(1 - t)Y + 200 + 400 + 300 - 0.3Y$$

$$Y = 0.6(1 - 0.5)Y + 900 - 0.3Y$$

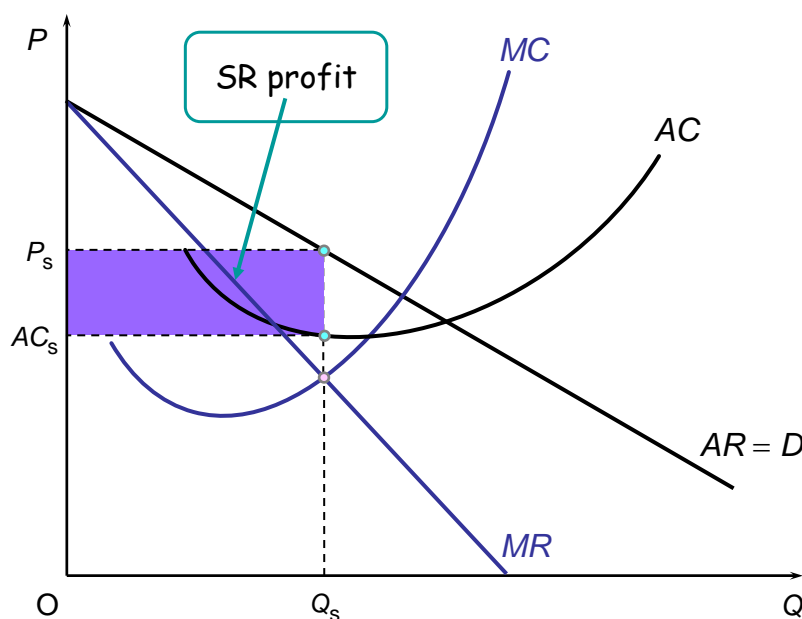
$$Y = 900$$

- (ii) $C = 0.6(1 - 0.5)Y = 270$

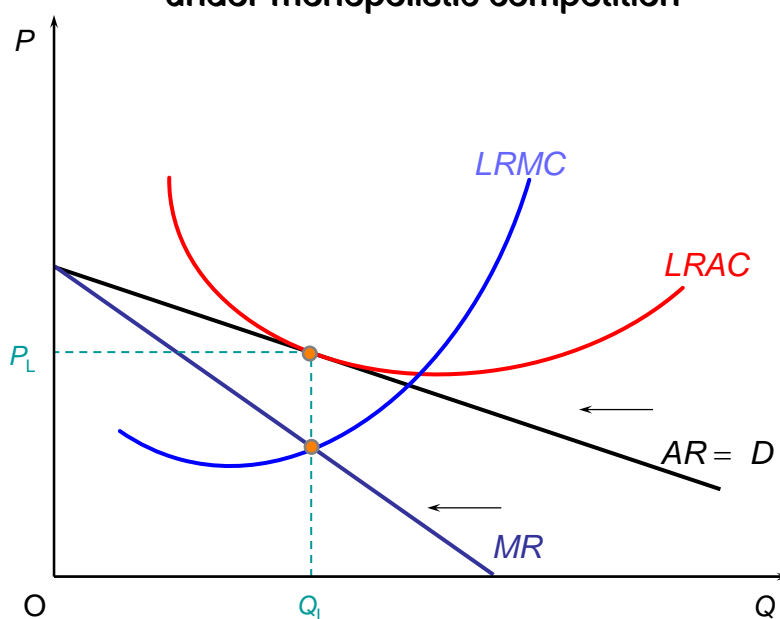
- 33** Capital
Land
Labour
Raw materials
Technical knowledge
Economic efficiency

- 34** (i) (a) Initial Equilibrium SR and LR diagrams Monopolistic Competition

Monopolistic Competition - short-run equilibrium

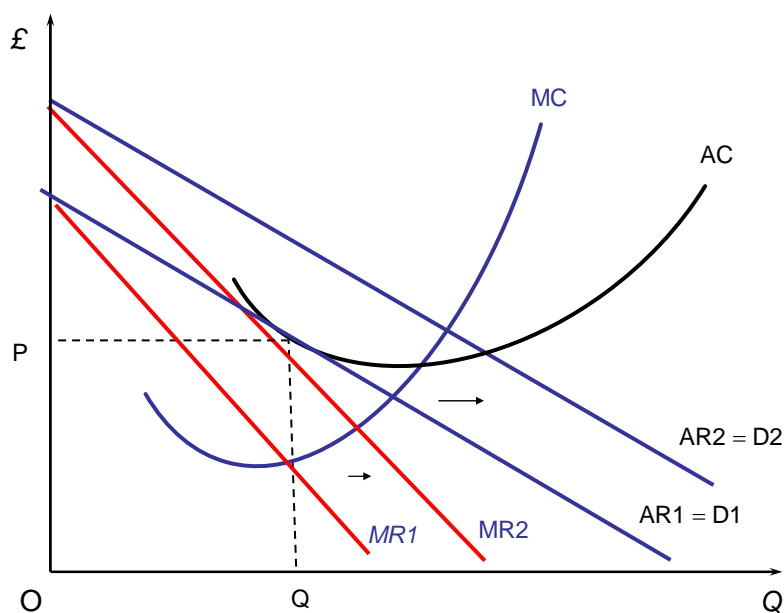


Long-run equilibrium of the firm under monopolistic competition



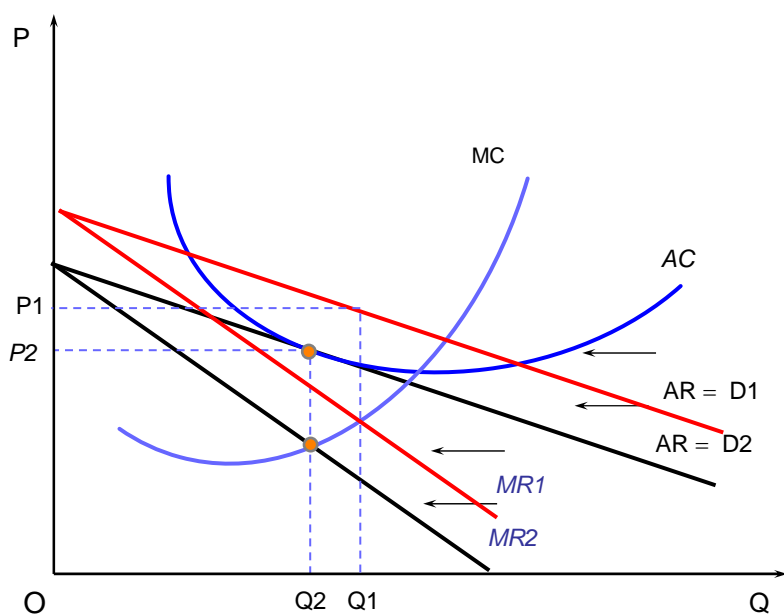
- (b) Should show Demand and MR curves shifting out to right D2 MR2.

Short Run Increase Demand



- (c) Should show Demand and MR shift in to left and tangency solution where normal profit made.

Long Run Equilibrium Restored

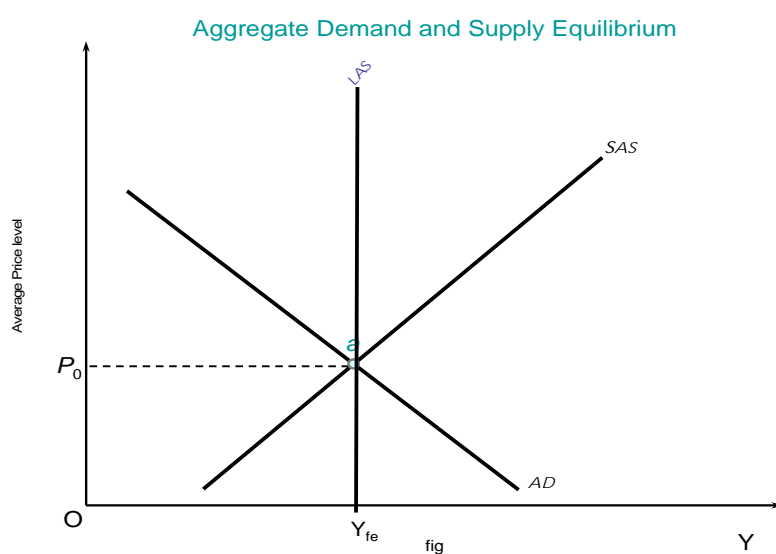


- (ii) Short Run = Increase in demand (number of restaurants does not change). Therefore each restaurant has a share of a bigger market. Demand curve and MR curve would shift out to right. Profit maximise where $MC = MR$ quantity traded and most likely price increases. Profits increase SR.

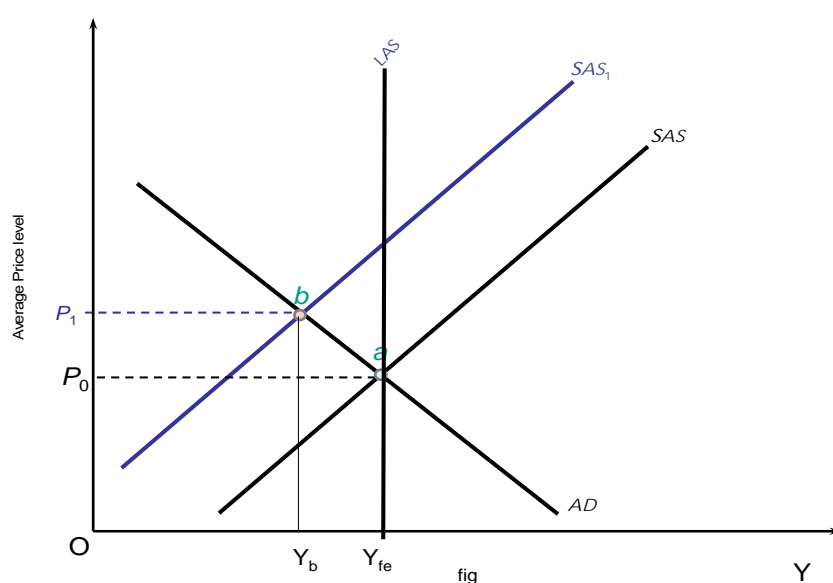
Long run more restaurants enter the market and each has a smaller share of total market – normal profit, tangency solution $LRAC = LRAR$.

35 (i) Diagram of AD , (MDS), SAS and $LRAS$

Horizontal axis labelled Y or National Income. Vertical axis labelled Average Price Level.



(ii)



Analysis should discuss rising prices falling output

Inflation

High commodity prices

Energy costs

Interest rates

Investment

Availability of credit

Slump in house building sector

Falling property prices

Unemployment

Wage negotiations

Growth forecasts

Business confidence

Recession

Policy Options should be discussed in relation to *AD AS* model.

Inflationary Policy Option

Stimulate Aggregate Demand

Monetary Policy – try to shift AD out to right by lowering interest rates
stimulating expenditure and investment

Fiscal policy – Increase government expenditure, shift AD to the right

Could result in inflationary spiral

Deflationary Policy Option

Maintain interest rates to curb inflation but could bring recession and high
unemployment

Do nothing Policy Option

Wait until economic downturn starts to impact on input prices

Costs – low growth, unemployment

END OF EXAMINERS' REPORT