



Leaving Certificate Examination, 2002

Higher Level Economics

<p style="text-align: center;">MARKING SCHEME and NOTES for use with the Marking Scheme</p>
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- There is no suggestion that the enclosed notes to the marking scheme are exhaustive or definitively complete.
- Further relevant points presented by candidates will be marked and rewarded on their merits.
- The detail required in any answer is determined by the context and the manner in which the question is asked and by the number of marks assigned to the answer in the examination paper. Requirements may therefore vary from year to year.



Section A (100 Marks)

1. Economic development is defined as:

An increase in the level of income / standard of living / output / GNP per person in a country is accompanied by a change in the structure of society.

12 marks

Two policies, which might promote economic development

(i) Promote population control.

(ii) Improve basic infrastructure.

Provision of clean water & proper sanitation. Development of public housing.
Development of roads, power supplies etc.

(iii) Promote land/ agricultural reform.

Decrease emphasis on one crop - diversify production.
Try to spread ownership of land.
Improve production methods - modernise the agricultural industry.

(iv) Improve education.

Start with a basic literacy programme to improve literacy skills.
Provide primary education.

(v) Incentives for development of enterprise.

Try to foster a movement away from a dependency culture and encourage enterprise. Use borrowings to encourage enterprise so as to create sustainable employment.

(vi) State bureaucracy / corruption/ Spending on arms.

Try to reduce bureaucracy within state institutions/ Eliminate corruption - so that aid flows to those for whom it was intended/ Divert funds from arms spending to more urgent current requirements.

2 policies at 2 marks each = 4 marks.

2. FOUR steps involved in calculating a Composite Price Index:

Step 1: Choose a base year/period.

Step 2: Select those goods which are to be included in the index.

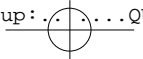
Step 3: Determine the price of each item in the base period.

Step 4: Calculate a Simple Price Index for each individual commodity.

Step 5: Attach a weight to each commodity i.e. the proportion of income spent on each commodity.

Step 6: Multiply the SPI for each commodity by its appropriate weight and add to get the resulting Composite Price Index.

16 marks



3. Occupational mobility of labour:

The ease of movement of a worker from one job to another.

8 marks

The factors, which influence occupational mobility include:

1. Level of education attained
2. Level of training available
3. Restrictions on entry to a particular occupation: legislation/trade unions/professional associations.
4. Degree of specialisation of the workers i.e. an unskilled worker may be more mobile.
5. State of the economy: high wages may attract workers into certain occupations.

2 factors x 4 marks each

4. THREE key ideas, which J.M.Keynes contributed to economic thought.

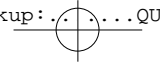
- (a) National income could reach equilibrium without reaching full employment.
- (b) The level of national output is demand determined.
- (c) He favoured government intervention in the economy.
The government can use fiscal policy to create full employment.
- (d) He did not accept the view of classical economists that a flexible rate of interest ensured that all savings were invested.
- (e) He stated that investment by entrepreneurs depended more on businessmen's expectations than on the rate of interest.
- (f) Investment could be less than savings and cause a leakage in spending which decreases national income and employment.
- (g) He utilised economic tools to explain his theories- the Multiplier, MPC, MPM etc.
- (h) He developed a liquidity preference theory / Savings theory.
- (i) He favoured a managed system of foreign exchange rates rather than the gold standard.

3 key ideas: 6 marks + 5 marks + 5 marks each

5. TWO benefits of non-price competition to consumers.

- (a) **Stability in prices:** non-price competition means unchanging prices for the consumer
- (b) **Better quality:** commodity; service; after sales service.
- (c) **Benefits of advertising / Sponsorship:** improved range/quality of service i.e. media.
- (d) **Consumer more informed:** advertising provides consumers with information.
- (e) **Consumer loyalty rewarded:** allows consumers get 'free' gifts.

2 benefits x 8 marks each



6. Tax avoidance:

Arranging ones affairs within the law, so as to minimise tax liabilities.

Tax evasion:

Reducing ones tax liabilities by making false returns, or no returns.

17 marks

7. (a) State the Diminishing Marginal Returns

10 marks

As more units of a variable factor of production are added to other (constant) factors of production the returns to the variable factor will eventually fall.

(b) The table below illustrates the Law of Diminishing Returns

Number of persons employed	1	2	3	4	5
Total Output, in units	12	27	47	63	73
Marginal Output, in units	12	15	20	16	10

4 correct figures x 1 marks each = 4 marks

State the point after which Diminishing Returns set in.

When the 4th person is employed/ After the 3rd person

3 marks

8. National Income

(i) MPC = 8 marks

(i) $\text{MPC} = \frac{300 \text{ (2m)}}{400 \text{ (2m)}} = 75\% = .75$ (4 marks for correct answer)

(ii) Multiplier = 9 marks

Method 1: $\frac{1^*}{1^* - (.75^* - .25^*)} = \boxed{2}$

4 figs. @ 1 mark each. Correct answer: 5 marks

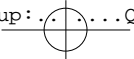
Method 2: $\frac{1^*}{.25 + 25^*} = \boxed{2}$

2 figs. @ 1 mark each. MPS = 2 marks. Correct answer: 5 marks

Method 3: Injections = €200. National Income ↑ by €400
So the multiplier = $\boxed{2}$

Injections: 2 marks / ↑ in Nat. Income: 2 marks. / Correct answer: 5 marks

17 marks



9. GNP and GDP

GNP rather than GDP is generally regarded as a better measure of average standard of living in Ireland because it takes account of:

Incomes earned by Irish factors of production abroad and returned to Ireland less those incomes earned by foreign factors of production in Ireland and sent out of Ireland.

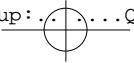
Or

Net / factor from the rest of the world and whether it is positive or negative.

Or

Net repatriation of profits / incomes and
The interest repayments on the foreign element of the National debt.

17 marks



Section B (300 Marks)

Question 1 Perfect Competition

(a) The assumptions underlying the theory of Perfect Competition.

1. There are many buyers in the industry.

- No individual buyer can influence, by his/her own actions, the market price of the goods.
- Each individual firm is a price taker.
- Each individual buyer acts independently.

2. There are many sellers in the industry.

- No individual seller can influence, by his/her own actions the market price of the goods.
- Each individual firm is a price taker.
- Each individual seller acts independently.

3. The goods are homogeneous.

- The goods, which are supplied by the producers, are exactly the same/ identical.
- Thus it is pointless for firms to advertise.

4. There is freedom of entry to and exit from the industry.

- Firms already in the industry cannot prevent new firms from entering the industry.
- No barriers to entry/exist within the industry.

5. Perfect knowledge as to profits and prices.

- In the market everyone concerned has perfect knowledge as to profits made by other firms in the industry.
- Consumers are fully aware of the prices being charged for the products.

6. Each firm tries to maximise profits.

- The aim of each firm is to produce that quantity where $MC = MR$.

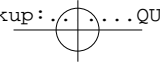
7. Firms face a perfectly elastic supply of factors of production.

- If a firm wants to increase output it can do so and acquire the necessary factors of production at the existing price i.e. a scarcity of factors of production will not arise, thereby pushing up price.

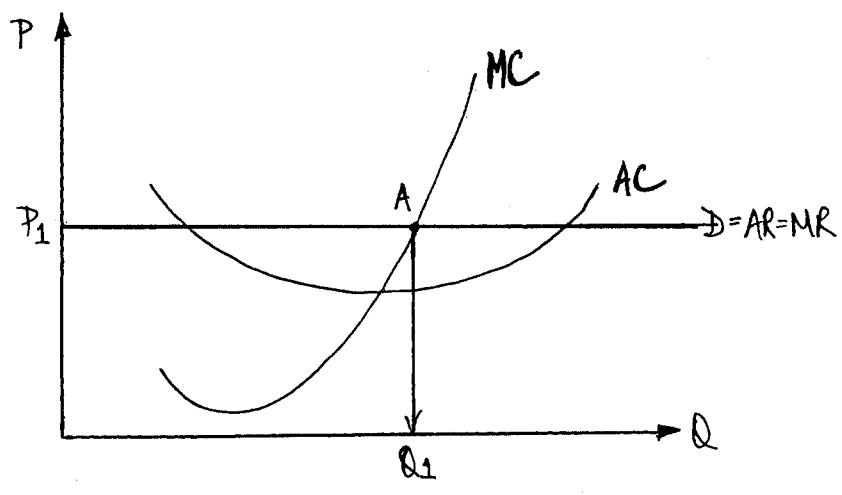
8. No collusion exists on the market.

- No collusion exists between buyers or sellers of the good. Buyers do not group together with other buyers or sellers do not group together with other sellers in order to influence the price at which the good is sold.

5 x 4 marks graded



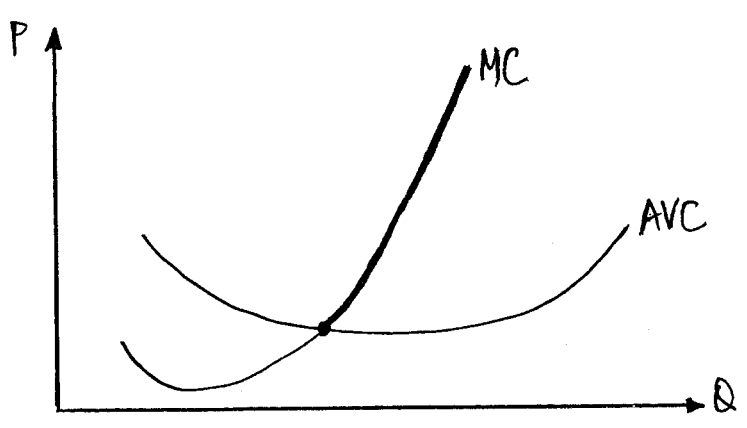
(b) (i) How a firm in Perfect Competition achieves short run equilibrium 10 marks



In the diagram above:

- the firm will produce where $MC=MR$, at point A, and produce Q_1
- the firm will sell this output at price P_1

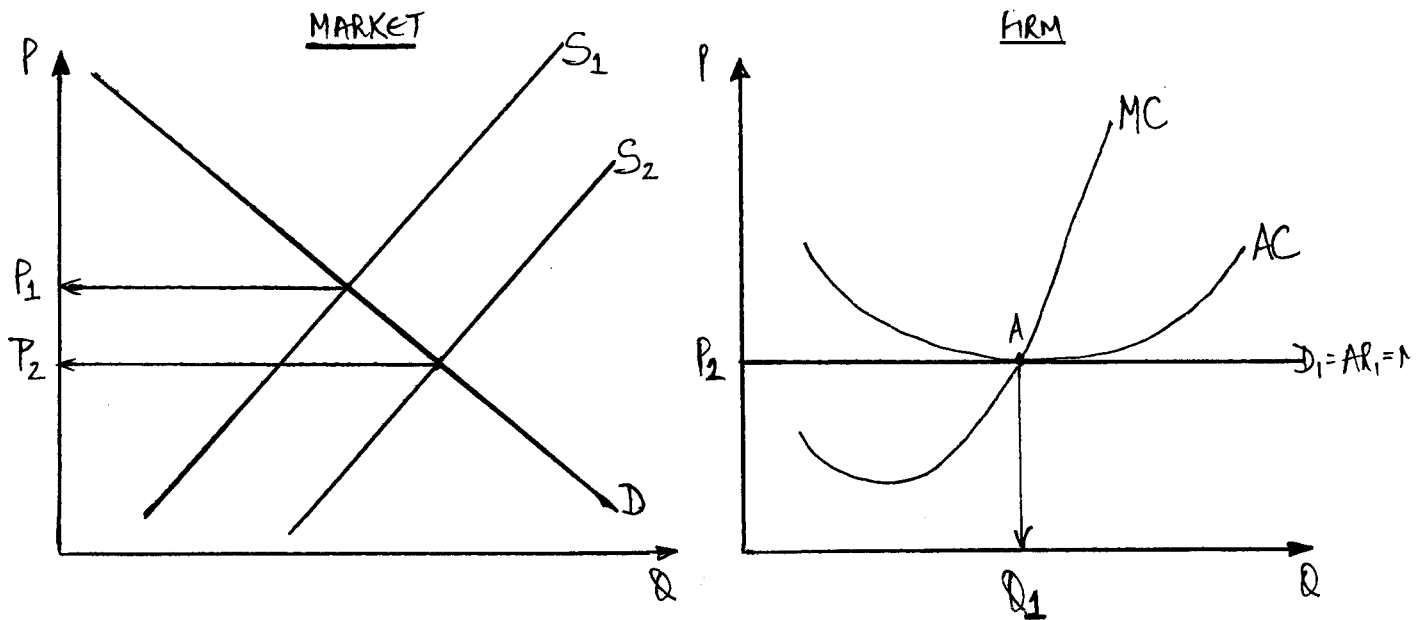
(ii) Derive and explain the short run supply curve of this firm. 10 marks



- The short run supply curve is that part of the Marginal Cost Curve above the lowest point of the Average Variable Cost .

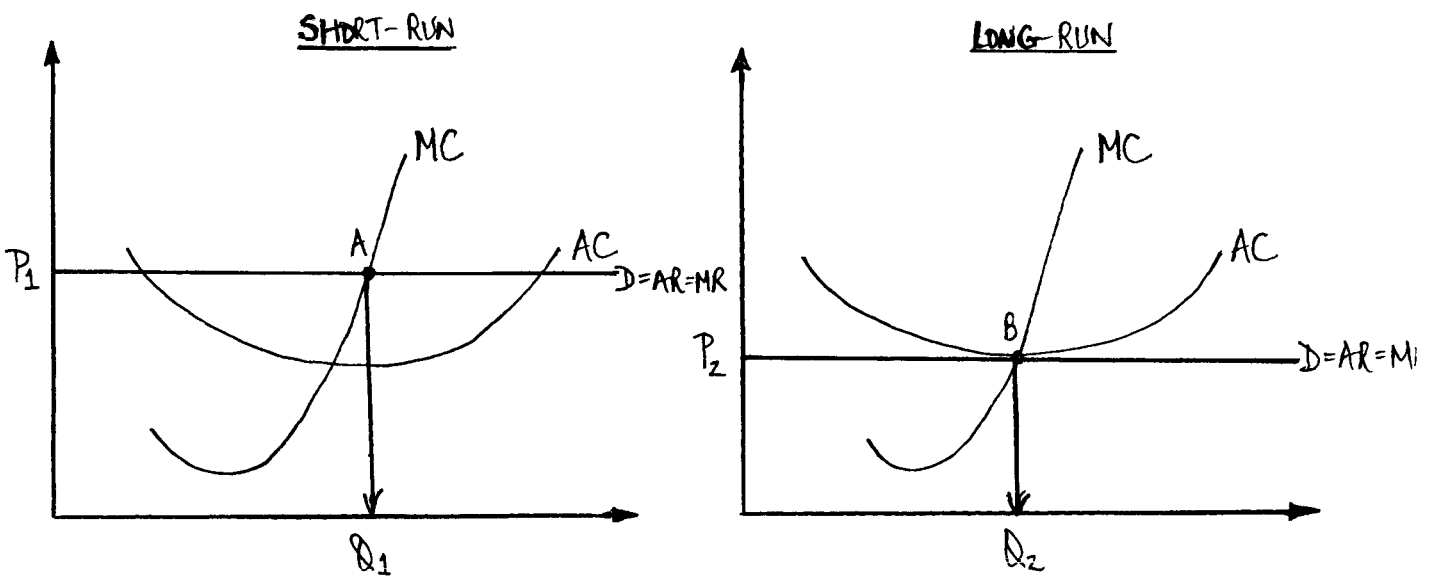
(c) Effect of entry of new firms into a industry earning SNP's 20 marks

**Option A -
Diagrams 10 marks/Explanation 10 marks**

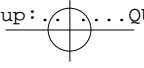


- The Supply Curve shifts to the right and the market price falls.
- This results in reduced SNP's or SNP's being eroded.

**OPTION B
Diagrams 10 marks/Explanation 10 marks**



- The S/C shifts to the right and the market price falls.
- This results in reduced SNP's or SNP's being eroded.



(d) Firms in Perfect Competition tend not to engage in advertising.

1. Homogeneous goods

Because the goods are identical, and no differences exist, there is no point in advertising.

2. Increased costs / no additional revenue

If a firm advertises it would increase its own costs and decrease its profits / gain no additional revenues for itself.

3. Benefits the entire industry

Advertising by a single firm would not just benefit this firm, but the entire industry.

2 reasons 8m + 7m graded

Question 2 COSTS

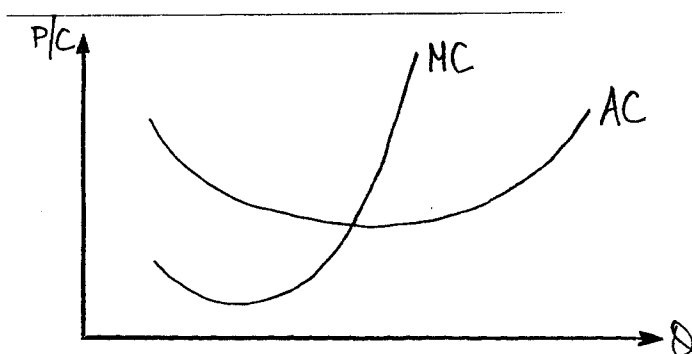
(a) (i) DIAGRAM : 10 MARKS

Cost /Price axis:

Quantity axis :

SRAC curve :

MC curve:



(ii) Relationship between AC and MC

10 marks

When $MC > AC$ then AC is rising :

When $MC < AC$ then AC is falling :

When $MC = AC$ then AC is at a minimum / constant.

(b) (i) 2 definitions x 4 marks each

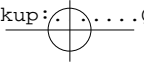
8 marks

Economies of Scale	Diseconomies of Scale
Result in a reduction in the AC of production as the firm/ industry increases its size of operation.	Result in an increase in the AC of production as the firm /industry increases its size of operation

(b) (ii) 2 definitions x 3 marks each

6 marks

INTERNAL	EXTERNAL
Forces within a firm, which lower its costs as the firm grows in size.	Forces outside a firm, which lower its costs as the industry grows in size.
Examples: 4 x 4 marks graded 2 Internal/External	
INTERNAL	EXTERNAL
<p><u>1. Increased use of specialised machinery</u> A firm may be able to buy/use more specialised equipment / machinery resulting in a reduction in unit costs.</p>	<p><u>1. Better infrastructure.</u> As roads / communications etc. improve, benefits will accrue to <u>all</u> firms.</p>
<p><u>2. Labour economies / greater specialisation of workers</u> If a particular job can be split into separate and distinct components, it may result in a reduction in costs.</p>	<p><u>2. Bulk purchasing of raw materials by the industry.</u> As an industry expands, firms require more materials and components. These may become cheaper as suppliers expand to meet increased demand.</p>
<p><u>3. Construction economies</u> Large plants cost less per cubic foot than smaller ones.</p>	<p><u>3. Development of specialist firms.</u> Some of the jobs, which a firm once performed may be, contracted out to specialist firms at reduced costs i.e. the supply of linen to hotels.</p>
<p><u>4. Buying economies</u> Larger quantities bought ⇒ bigger discounts</p>	<p><u>4. Development of separate research & development industries / units.</u> The costs of research may be shared between firms or with a public body like Teagasc.</p>
<p><u>5. Economies in distribution</u> Lower unit cost of delivery.</p>	<p><u>5. Suppliers of Machinery.</u> Manufacturers of machinery will be encouraged to design, develop and produce machines for expanding industry. These advanced machines will help reduce costs.</p>
<p><u>6. Financial economies</u> Larger firms may avail of the possibility of lower interest rates.</p>	<p><u>6. Development of Training Courses.</u> Workers in expanding industries may be provided with training courses by VEC's/ FÁS thus helping them become more efficient.</p>
<p><u>7. Managerial economies</u> As a firm grows, management costs may not grow in direct proportion to the growth in the firm.</p>	<p><u>7. Supports from Public Bodies.</u> Some public bodies help particular industries in general e.g. Bord Failte / FAS may help firms in the tourism industry.</p>
<p><u>8. Production Process economies.</u> A large firm may be able to run one process into the next without costly discontinuities.</p>	
<p><u>9. Indivisibility problem reduced.</u> If the volume of production increases the unit cost may be lower e.g. glass-making furnaces may operate around the clock to save costs of cooling and re-heating.</p>	
<p><u>10. Marketing economies</u> Savings in the cost of advertising e.g. NIKE advertising globally.</p>	
<p><u>11. Reduction in Waste.</u></p>	



Large firms, with more lines, may reduce waste.	
(c) The possible social costs & social benefits of the new roads being constructed in Ireland.	

Possible Social Benefits

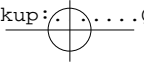
- 1) Traffic congestion:
With the new roads traffic congestion in an area may ease.
- 2) Less stress:
With fewer delays, stress for travellers may be reduced.
- 3) Shorter travelling times:
Better roads may make it possible for shorter commuting time to work/school.
- 4) Improvement of infrastructure:
With the infrastructure improving, attracting new industry may be easier.
- 5) Enhanced environment:
If the new roads by-pass towns it may allow the towns re-develop and enhance their physical environment to the benefit of all citizens.
- 6) Toll Roads / revenues :
If the roads are toll roads this will bring revenue to the government through VAT receipts and eventually ownership may pass to state.
- 7) Improved Safety:
Newer roads may improve safety and help reduce fatalities on roads.

Possible Social Costs

- 1) More pollution :
Greater noise and increased emissions for those who live in close proximity to the new roads.
- 2) Payment for the use of the road / Need for increased tax revenues:
If the roads are toll roads then all road users must pay for their use which until now had been at no cost.
- 3) Increase in land prices:
Land prices adjacent to those new roads may increase, causing difficulty to those who may wish to buy land.
- 4) Damage to the local environment:
The landscape through which the new roads are constructed may be disfigured.
- 5) Disruption to local communities
The new roads may affect the nature of the community life for existing communities.

4 points: 7 + 6 + 6 + 6 marks graded

Minimum of 2 Social Costs / Social Benefits.



Q3 Elasticity

(a)

(i) Income Elasticity of demand

Measures the percentage change in/responsiveness of the demand for one good caused by the percentage change in the consumer's income.

(ii) Cross Elasticity of Demand

Measures the percentage change in/responsiveness of the demand for one good caused by the percentage change in the price of other goods.

2 definitions: 8 + 7 marks graded

(b) (i)

YED is usually positive

5 marks graded

- This means that as income increases, quantity demanded rises
- These goods are normal goods.
- e.g. YED for foreign holidays is positive.

YED is sometimes negative

5 marks graded

- This means that as income rises, quantity demanded falls
- These goods are inferior goods.
- e.g. YED for potatoes is negative.

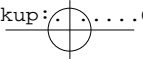
(b) (ii)

10 marks graded

- This good is a normal good
- Let the consumer's income = €100. S/he spends €40 on the good.
The consumer's income is doubled. S/he now spends €60 on the good

(c) 3 x 10 marks graded = 30 marks

Category	Answer	Explanation
YED for potatoes	- 0.1	- Potatoes are an inferior good – so they have a negative YED - Potatoes are a necessity – so they are inelastic .
YED for designer clothes	+2.5	- Designer clothes are a normal good - so they have a positive YED - Designer clothes are a luxury – so they are income elastic .
PED for airline seats	- 2.8	- Airline seats are a normal good so they have a negative PED - Demand for airline tickets is responsive to price changes – so they are price elastic .



(d) YED = +1.8 and Sales in Year 1 = 20,000 units. Consumers income rises by 5%

- For the 5% rise in income, sales will rise by $1.8 \times 5 = \underline{9\%}$.
- Sales will rise by $\underline{9\% \times 20,000 \text{ units} = 1,800 \text{ units}}$.
- Thus sales in Year 2 = $20,000 + 1,800 = \underline{21,800 \text{ units}}$.

10marks graded

Q4 Factor Market

7+7+6 graded

(a)

(i) Capital

Anything man made which is used to produce goods and services

(ii) The Marginal Efficiency of Capital

- This is the extra profit earned as a result of employing one extra unit of capital.
- It is the Marginal Revenue Productivity of additional capital goods minus their cost

(iii) Investment

- Involves the production of capital goods
- any addition to capital stock in the economy.

(b) (i) 2 reasons why investment is important for the Irish economy.

10 marks

1. Increased productive capacity:

Greater investment allows the country to produce more output / It replaces worn-out capital resources.

2. Increased labour productivity:

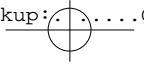
More investment allows labour become more efficient. Investment allows workers to use more up-to-date capital goods, making them more efficient.

3. Increased employment.

Extra investment increases aggregate demand resulting in the demand for more employees to meet this additional demand for goods & services.

4. Increased GNP.

Increased investment leads to higher GNP, greater demand, increased spending and a higher standard of living.



5. Investment generates future wealth for the economy.

Investment into the economy safeguards the future wealth creating capacity of the country by ensuring that capital goods exist in the future.

6. Increased Government Revenues.

An increase in investment will increase economic activity. This will generate additional revenues for the government for use within society.

2 points x 5 marks graded.

(ii) State and explain FOUR factors that influence the level of investment in the Irish economy at present.

20 marks

1. Rates of interest / Cost of borrowing

The higher the rate of interest - the higher the cost of borrowing.
Hence investment may fall / MEC may fall.

2. Business people's expectations about the economic future.

If business people are optimistic about the economy or the sector they are more likely to invest.

3. The cost of capital goods.

The greater the cost of capital goods, the lower the profitability of the investment, hence investment tends to fall.

4. Government policy.

If government policy is favourable towards investment then investment will tend to rise.
Examples of favourable policies include: attractive state grants; reduction in corporation tax; development of infrastructure etc.

5. The international economic climate.

Ireland is an open economy. It relies on foreign investment.
If the international economic climate is booming then this may result in a growth in demand benefiting Irish business.

6. Industrial Relations Climate.

Due to the existence of the partnership model, Ireland has a relatively peaceful industrial climate.
This ensures uninterrupted production which impacts positively on investment.

7. The capital Stock in the economy.

In the long-term, the greater the stock of capital goods the lower will be the MEC and thus the lower the level of investment.

4 factors x 5 marks graded



(c) J.M. Keynes identified three reasons (motives) for holding money.

Explain the THREE reasons and outline ONE main influence on each reason. 25 marks

Transactionary	Precautionary	Speculative
Money demanded for day-to-day expenses	Money demanded for emergencies e.g. illness, house repairs.	Money demanded for any possible profitable investment opportunity
<u>Level of Income</u> higher incomes ⇒ the greater our daily expenditure.	<u>Level of Income</u> People are aware that emergencies will arise and it will be necessary to have money available to meet these emergencies.	<u>Interest Rates</u> As interest rates rise people prefer to hold their cash in liquid form rather than invest in bonds.
<u>OR</u>		
No.of transactions / level of expenditure	<u>Interest Rates</u>	Market value of bonds
	As interest rates rise it is more costly to hold money for this purpose so less cash will be held.	

8+8+9 graded

Question 5 Credit creation and interest rates

(a) (i) Explain how it is possible for banks to create credit. 18 marks graded

Accept deposits + Use of Cheques + Create Credit in excess of Deposits

- Commercial banks accept cash deposits from their customers e.g. say €100, for safekeeping.
- These banks know from experience that their customers will only demand back a small amount of these deposits in cash - say 10% because of their use of cheques as an acceptable method of payment.
- So they now have surplus cash with which to give loans - €90.
The amount of loans they give is related to, but in excess of their cash deposits and based on their reserve ratio.

or

The amount it can create is calculated as follows:

$$\text{Increase in credit} = \text{Increase in Cash Deposits} \times \frac{1}{\text{Banks Reserve Ratio}}$$

Or

Balance Sheet of a Bank

<u>Assets</u>		<u>Liabilities</u>	
Cash lodged by X	€100	X's deposit	€100
Total Assets	€100	Total Liabilities	€100

Balance Sheet of a Bank

<u>Assets</u>		<u>Liabilities</u>	
Cash lodged by X	€100	Deposits	€100
Loan	€900	New Deposits	€900
Total Assets	€1000	Total Liabilities	€1000

Plus explanation:

1. Mr. X lodges €100 into the bank .
2. It knows that only 10% is demanded in cash.
3. It has enough cash to support total deposits of €1,000. The bank can create another €900 in deposits. It does this by giving out loans of €900.
4. Only 10% of its total deposits will be demanded in cash. So €100 cash is sufficient for this purpose. This is shown in the new balance sheet.

(ii) THREE limitations on banks' power to create credit.

12 marks graded

1. Availability of creditworthy customers / Need for collateral.

Loans can only be given to those people who are in a position to repay them.

2. Availability of Cash Deposits

A bank can only give loans provided that it can attract cash deposits.

3. Customers' Demands for Cash

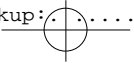
The bank must keep sufficient cash to be able to meet the demands of its customers for cash

4. European Central Bank guidelines

Commercial banks must note the guidelines of the Central Bank.

5. Demand for loans by customers.

A bank is limited in the amount of loans it creates by the demand for loans. In a recessionary period the demand for loans will fall.



(b) Explain how an increase in the use of ‘plastic money’ (credit cards, etc) by customers affects the ability of the banks to create credit **15 marks graded**

- Banks will be able to increase the amount of credit they can create
- Therefore banks now have the use of an increased amount of their depositors’ cash with which to extend the amount of credit created.

Or

$$\text{Increase in credit} = \text{Increase in Cash Deposits} \times \frac{1}{\text{Banks Reserve Ratio}}$$

If customers use more plastic money, the banks can now decrease their banks reserve ratio and hence increase the amount of credit created

Q5 (c) (i)

Monetary Policy

Those actions, which influence the money supply, interest rates or the availability of credit.

Inflation

- This is the continuous rise in the general price level.
- This is the fall in the value / purchasing power of money

2 points at 5 marks graded

Q5 (c) (ii)

Effects of a reduction in interest rates on the Irish economy.

20 marks graded

1. Borrowing encouraged

Borrowing is now cheaper resulting in lower loan repayments ⇒ increased spending power ⇒ increased inflation ⇒ increased demand for imports ⇒ higher standard of living.

2. Savings discouraged

With lower rate of returns people may find it less attractive to save ⇒ higher spending.

3. Reduced mortgage repayments / Pressure on house prices to rise.

The cost of monthly repayments decreases resulting in higher standards of living.

4. Cost of Servicing the National Debt.

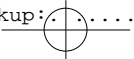
With lower domestic interest rates the cost of repaying the euro-zone portion of the national debt falls.

5. Costs of Production / Improved Competitiveness.

Costs will fall resulting in possible lower prices & / or an increase in the numbers employed.

6. Incentive to Invest.

The MEC will rise resulting in higher profits / investment encouraged/ it becomes cheaper for businesses to borrow and so businesses may invest.



7. Economic Growth - encouraged.

With possibly higher investment, future economic growth in Ireland may be increased.

8. Revenue received from DIRT

With less savings the government may receive less revenue through DIRT.

9. Shift in emphasis in Government Policy

With lower interest rates the government could shift its emphasis from tax revenues more toward borrowing, as it is now cheaper for the government to borrow/ Introduction of government special savings scheme.

Q6 Trade

(a) (i) State the Law of Comparative Advantage :

10 marks graded

The law states that a country should **specialise** in the production of those goods and services **in which it is relatively most efficient**

or

that particular good in which it has the lowest opportunity cost relative to another country's production of the good

and

trade for the remainder of its requirements.

(a) (ii) State and explain the assumptions underlying this law.

5x 4 marks graded

1. Transport costs do not exist

The LOCA assumes that transport costs do not exist. However for an island nation like Ireland, transport costs can be a major cost factor and can act as a barrier to trade. A firm's costs efficiencies may be eliminated by the transport costs involved.

2. The law of diminishing marginal returns does not apply / Constant Returns to Scale.

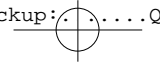
The LOCA assumes that the LDMR does not apply, but this law does apply. In the example used each extra person employed will not continue to produce the same amount as the original person. A point will eventually be reached when an extra person employed will produce less additional output.

3. Free trade takes place

The LOCA assumes that free trade takes place. While this may be true within the EU, free trade is often limited as countries impose barriers to trade for economic, social or cultural, and moral reasons.

4. The complete mobility of labour/factors of production exists

In the example used we assume that the person who becomes unemployed in each country, as a result of specialisation occurring, can switch to an alternative job and that there are no barriers to mobility. This is not always the case as there are barriers to the complete mobility of labour.



5. Alternative employment is available

It is assumed that people who become unemployed in one sector arising from specialisation can find alternative employment. This may not be the case. Consider countries during a recession, employment may not be available.

6. An equal distribution of benefits occurs

When we calculate the terms of trade we assume that both countries benefit from trade. Consider a developing country – sometimes the terms of trade may not be to their advantage. They may get very low export prices and have to pay high import prices, hence their bargaining position is weak and they may not benefit from trade as much as developed, powerful countries.

(b) The table below illustrates the Law of Comparative Advantage.

<u>COUNTRY</u>	<u>COMMODITY</u> <i>(HOURLY PRODUCTION PER PERSON)</i>	
	FOOD	MACHINERY
Country X	5 tonnes	10 units
Country Y	20 tonnes	30 units
Total Output	25 tonnes	40 units

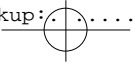
(i) Use the above example to show how both countries benefit from international trade.

(In world terms 1 ton of food = $(40/25)$ 1.6 units of a machine)

- With specialisation the output of machinery has decreased by 20 units or **50%**.
- For the world to be better off with trade the output of food must rise by a minimum of $(20/1.6)$ 12½ tonnes of food.
- The output of food has risen by 15 tonnes **(60%)**
- Therefore since the ↑ of 60% is greater than the ↓ of 50%, the world is better off.

8 marks graded

(Note: Correctly answered alternatives for b(i) were accepted and marked accordingly)



(ii) Calculate the terms of trade for both commodities

12 marks

Country X

1 ton of food is the equivalent of 2 machines.
1 machine is the equivalent of ½ ton of food.

Country Y

1 ton of food is the equivalent of 1½ machines.
1 machine is the equivalent of 2/3 tonnes of food.

So the possible terms of trade for

FOOD : lie between 1½ machines and 2 machines.
MACHINERY : lie between ½ ton of food and 2/3 tonnes of food.

(c) Discuss the factors, which affect the competitiveness of Irish-based firms in international trade.

25 marks

1. Irish inflation rates v. that of competitors.

If the level of inflation is higher in Ireland than in the firm's export markets, then the firm's goods are at a price disadvantage.

2. Value of the euro v. that of other currencies e.g. sterling, dollar.

If the value of the euro rises against that of other currencies then the price of that firm's exports will rise.

3. Transport costs.

These costs can be significant when exporting goods from Ireland and must be incorporated into the final price.

4. Labour costs – wage rates, PRSI etc.

If labour costs in Ireland rise above that in export markets, then these additional costs must be borne by the final consumer and this increases the price of the exports. Immigration into Ireland has helped stabilise wage inflation.

5. Infrastructure costs – costs of housing / delays in transport.

Pressure exists on the country's resources and constraints exist on our productive capacity – these are putting pressure on prices to rise within the country.

6. Government policies, which affect a firm's cost structure

Indirect taxes / corporations tax / health and safety legislation.

VAT has risen recently and this automatically increases prices. Actions by the government or EU imposing further requirements on industry, that have cost implications for firms, will have the effect of making exports less competitive.

7. Insurance costs –have risen sharply since Sept.11th.

Many firms have voiced concerns about the rise in insurance premiums since 11th Sept. These cost increases must make exports less competitive.

8. Social Partnership – has ensured industrial peace, resulting in less unrest.

Due to the existence of social partnership, Irish industry has enjoyed a relatively peaceful industrial climate. If this did not exist, and industrial disputes did occur, then this would increase the costs for Irish industry. Social partnership has helped stabilise price increases within the economy.

4 points : 7 + 6 + 6 + 6 marks graded.

Q.7 The Economy

(a) Outline, using appropriate figures, how the Irish economy performed in the past twelve months in each of the following areas:

- (i) inflation;**
- (ii) the national debt;**
- (iii) economic growth;**
- (iv) employment.**

20 marks graded

Inflation

- 4.7% in May 2002.
- Irish inflation is the highest within the euro-zone at 2%
- Since the budget, inflation rose due to higher electricity costs and cigarette, cider and petrol prices.
- In the year ended Dec.2001 inflation had fallen to its lowest level in 2 years – resulting from falling mortgage rates and cheaper energy costs.

The National Debt

- At the end of March 2002 our national debt was €33.5 billion.
- The debt/GDP ratio has fallen from over 90% in the 1990's to 34% at the end of 2001.
- A further decline in this ratio is expected by the end of 2002.

Economic growth

- G.D.P grew by 5.9 per cent for the year 2001.
- This compares with an annual growth rate of 11.5% for 2000 and 10.8% in 1999.
- Since Sept.11, 2001 there has been a slow down in the rate of economic growth in Ireland.



Employment

- 154,944 persons were recorded on the live register in May 2002.
- Represents 4.2% of the labour force –April 2002.
- The rate of unemployment has increased in the past year.

(b) Economic consequences of a Current Budget Surplus – Minimum 2 positives/negatives		5x5marks graded
Positive	Negative	
<p><u>1.Reduced inflationary pressures.</u> The government is taking more money out of the economy than it is putting in→ this tends to have a deflationary effect in the economy.</p>	<p><u>1. Rise in conflicting expectations.</u> Citizens, when they observe the surplus, may demand an improvement in state services e.g. health services, education provision.</p>	
<p><u>2.Improved government finances.</u> The existence of a CBS means that government does not have difficulty in controlling its finances.</p>	<p><u>2. Public Sector pay.</u> Public sector workers may demand pay increases as they see the government’s improved ability to pay.</p>	
<p><u>3.Meeting agreed EU guidelines.</u> The fact that a surplus exists indicates that the country is meeting the EU agreed guidelines without difficulty.</p>	<p><u>3. Tax reductions.</u> Taxpayers may demand reductions in their tax / improved equity in the tax system.</p>	
<p><u>4.Scope for taxation reforms.</u> The fact that a surplus exists indicates that scope exists for reform in the taxation system in the country.</p>	<p><u>4. Discontinuity of Social Partnership.</u> The existence of the surplus may cause discontent within society leading to conflicting demands from various sectors.</p>	
<p><u>5.Uses of this increased govt. revenue.</u> With increased revenue flowing into the government, it now has the ability to make use of this additional revenue.</p>	<p><u>5. Government financial planning.</u> The surplus may indicate that the planning by the government was not sufficiently accurate at budget preparation time / or that economic circumstances have changed.</p>	

(c) (i) Outline, giving examples, TWO reasons why Irish semi-state companies are facing increasing competition. 2 x 5 marks graded

1. EU / Irish Competition Policy.

This is the one of the principal factors forcing competition within all semi-state firms e.g. ESB. The aim is to reduce monopoly power and provide consumers with greater choice.

2. Restrictions on additional capital

The government has not been forthcoming in providing finance to semi-state bodies, forcing these companies to compete with market forces for additional capital e.g. Aer Lingus.

3. Drive towards market forces.

The government’s policy to privatise semi-state bodies, supported by the electorate, is forcing these firms to change their outlook and realise that state protection is being reduced and increased competition will result e.g. RTE



4. Consumer demand

Consumers are demanding greater choice in the provision of services / improvement in the quality of these services and more competition in relation to price. e.g. Aer Lingus

5. Entrepreneurial culture supported

With an improved tax regime / greater rewards possible for entrepreneurs, more companies/individuals are willing to provide services which state bodies had the monopoly on e.g. Ryanair and its offer to fly transatlantic.

c. (ii) Discuss ONE advantage and ONE disadvantage of this development for:

CONSUMERS

ADVANTAGES	DISADVANTAGES
1 x 5 marks graded	1 x 5 marks graded
<p><u>1. Quality of services.</u> The competition may force the semi-state companies to improve the quality/efficiency of the service provided.</p>	<p><u>1. Loss of non-profit making services.</u> The semi-state company may discontinue non-profit making services in an effort to reduce costs.</p>
<p><u>2. More competitive prices.</u> Increased competition may force the firms to offer consumers more competitive prices.</p>	<p><u>2. Possible reduction in safety standards.</u> In the drive towards increased efficiency shortcuts may be taken resulting in a decline in safety.</p>
<p><u>3. Increased choice / availability of services.</u> Consumers may now be able to avail of a wider choice of services.</p>	<p><u>3. Decline in standards of service.</u> The quality service provided by the semi-state company may deteriorate in an effort to save costs.</p>
	<p><u>4. Possibility of future price increase</u> The firm may have to increase prices in order to survive this competition and remain operating.</p>

EMPLOYEES OF SEMI-STATE FIRMS

ADVANTAGES	DISADVANTAGES
1 x 5 marks graded	1 x 5 marks graded
<p><u>1. More motivated workforce.</u> Increased competition may allow the workforce to become more innovative in their jobs.</p>	<p><u>1. Loss of job / reduced job security.</u> The biggest risk is the loss of their job through rationalisation of services.</p>
<p><u>2. Reward/Incentive for innovation.</u> If the semi-state firm can meet the challenges of competition, employees may reap more rewards for their innovation i.e. higher bonuses.</p>	<p><u>2. Changes in conditions of employment / loss of benefits</u> The firm may change the conditions of employment for its employees resulting in a worsening of these for the employee</p>
<p><u>3. Provision of extra services.</u> It may now be possible for the company to aggressively pursue its share of the market, without state restrictions, ensuring a growth in employment / additional job security.</p>	<p><u>3. Curtailment in Pay / Pensions Increases</u> The firm may limit the pay / pension increases due to its employees.</p>

Question 8 Employment

- (a) (i) 1. **Quarterly National Household Survey**
(formerly the **Labour Force Survey**)
2. **The Live Register.**
3. **Census** (of population)

2 x 3 marks

- (ii) **The National Household Survey-**
Provides a more accurate measurement of Irish unemployment.

2 marks

Because:

1. People who are 'signing on' the Live Register do not describe their status as unemployed when questioned in the NHS.
2. A high percentage of those surveyed in the NHS indicated that they had full-time jobs.
3. Some, in the sample, are working part-time.
4. More on the Live Register indicated that they were neither looking for work or wanted work.

12 marks graded

OR

The candidate may answer the question, by stating why the Live Register is inaccurate:

The Live Register provides inaccurate data because it includes:

1. People 'signing on' who are actually working.
2. Part-time (working up to 3 days per week), seasonal workers and casual workers who are entitled to Unemployment Benefit. / Unemployment Assistance if they meet the statutory requirements.
3. People who are signing on for credited Social welfare contributions who are not receiving the 'dole'.
4. Some claiming UA / UB are not seeking work are or are not available for work.
5. People who are unemployed, but for many reasons, may not draw the dole and do not sign on.

12 marks graded

(b) (i) Full Employment is defined as :

All those seeking work are working at existing wage rates

10 marks graded

(b)(ii) Economic consequences of very high employment in the Irish economy.	
4 x 5 marks graded	
<u>Positive</u>	<u>Negative</u>
<p><u>1. Increased standard of living.</u> Higher incomes will allow a greater quantity of goods and services to be purchased.</p>	<p><u>1. Possible labour shortages.</u> These may occur causing difficulties for employers in meeting production targets. Need for recruitment from overseas / relaxed immigration rules.</p>
<p><u>2. Increased government tax revenues.</u> With high employment the government will collect more direct and indirect tax revenue.</p>	<p><u>2. Inflationary pressures.</u> Rising incomes and spending tend to fuel inflation within the economy.</p>
<p><u>3. Reduced social welfare bill.</u> The government will be paying out less in social welfare.</p>	<p><u>3. Pressure on the state's infrastructure.</u> Difficulties/shortages may occur with housing, roads, child minding services, public services etc.</p>
<p><u>4. Increased aggregate demand within the economy.</u> High employment will increase aggregate demand within the economy and this will further increase GNP.</p>	<p><u>4. Wage Demands.</u> Where shortages of labour occur, employers may be forced to increase wage rates in order to retain their workforce.</p>
<p><u>5. Increased investment.</u> A buoyant economy encourages further investment, as demand is rising expectations</p>	<p><u>5. Deterioration / Loss of services.</u> In those sectors with low wage rates it may be difficult to attract workers and the quality of</p>

about the future are positive.	service may deteriorate or the service discontinue.
6. Economic growth. Rising demand, rising tax revenues, and increased investment all will have a positive effect on <u>future</u> economic growth.	6. Increased demand for imports. With higher spending within the economy, the demand for imports may increase due to our high MPM.

(c) In 2001 the Irish economy began to experience a downturn in the level of economic activity. Discuss the reasons for this development in the Irish economy. 25 marks

1. Loss of competitiveness

The Irish inflation rate has been higher than our EU trading partners. This has placed our goods at a price disadvantage in our main export markets, resulting in a drop in exports.

2. Resource and capacity constraints within the economy.

The Irish economy has achieved major growth in recent years. However with unemployment falling to 3.7% in the early part of 2001, the economy experienced certain shortages of labour. This, accompanied with inadequacies in our infrastructure, meant that the economy could not continue to grow at the same rate.

3. Loss of business confidence.

Fears about Government finances / fears about wage demands are affecting business confidence. This has had the effect of reducing investment and contributed to the slowdown in economic activity.

4. Contraction in the Information Communications Technology (ICT) sector.

This sector has seen a major worldwide contraction, and Ireland which has a high dependence on this sector has not been immune to this.

5. Foot & Mouth.

Measures deemed necessary to limit the risk of foot-and-mouth disease had a significant effect on the economy and resulted in a downturn in major sectors of the economy.

6. International economic climate.

Export volumes were severely affected by the deterioration in the international environment, in particular by much weaker demand growth in our country's main trading partners.

7. Decline in Irish tourism sector.

Since 11th Sept. and the advent of the measures to control F&M, the number of tourists visiting Ireland has declined. This sector has seen a significant slowdown since these events.

8. Recession in the US economy.

The US experienced a major decline in economic activity, which resulted in many US companies rationalising their operations. This led to some closure / cutbacks in employment in these companies here in Ireland.

4 points: 7 + 6 + 6 + 6 graded