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About O Level

ECONOMICS

(TOPICAL)

About Thinking Process

When solving problems, we first analyse the questions and then gather relevant information until we are able to determine the answers. But for presentation reason, we need to organise, rearrange and then present ONLY the required workings and solutions.

Thinking process reveals the extra but relevant information which is not required as part of the solutions.

About MCQ with HELPs

Explanations are given so that students know exactly why the answer is the right one.

period	2013 to 2024
contents	June & November, Paper 1 & 2, Worked Solutions
form	Topic By Topic
compiled for	O Levels
special features	Thinking Process, MCQ with HELPs

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REVISION

June / November **2021** Paper 1 & 2
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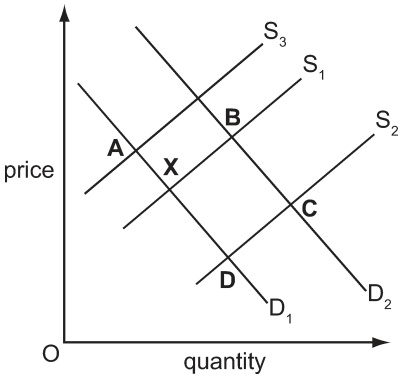
TOPIC 2.2

Demand, Supply and Equilibrium

PAPER 1
Multiple Choice Questions

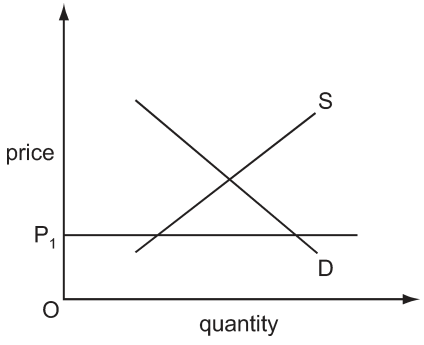
1. The diagram shows the market for fresh fish in the Caribbean with equilibrium point **X**. New, more efficient boats with lower running costs are then used.

Which point represents the new equilibrium?



[J10/P1/Q7]

2. The diagram shows the demand for and the supply of bread.



A maximum price P_1 is fixed by the government.

What is likely to be the immediate result of this?

A a movement of the demand curve to the right

B a movement of the supply curve to the right

C a shortage of bread

D a surplus of bread

[J10/P1/Q8]

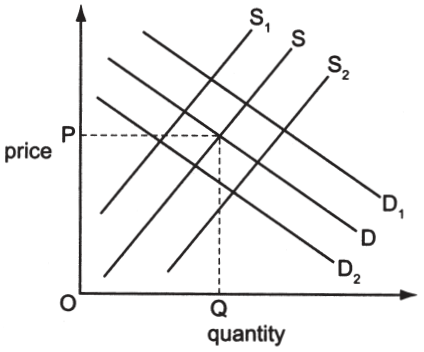
3. South African companies are planning to undertake major investment in Zimbabwe in order to mine platinum.

If this investment occurs, what would happen in the short term to the supply of platinum, the price of platinum and the profits of the companies?

	supply curve	price of platinum	profits of the companies
A	no change	rise	rise
B	shift to left	no change	fall
C	shift to right	rise	rise
D	shift to right	fall	uncertain

[J10/P1/Q21]

4. The diagram shows demand and supply curves for a product at its equilibrium price P.



How would the introduction of a subsidy be shown?

A Demand would shift to D_1.

B Demand would shift to D_2.

C Supply would shift to S_1.

D Supply would shift to S_2.

[N10/P1/Q9]

1. D New, more efficient boats with lower running costs would reduce the cost of production causing an increase in supply from S_1 and S_2 with demand unchanged at D, shifting the equilibrium from point X to point D.

2. C At maximum price P_1, demand would exceed the supply of bread, resulting in a shortage of bread.

3. D A major investment to mine platinum would increase the supply of platinum causing the supply curve to shift to the right and price to fall. However, since costs are unknown, profits are uncertain.

4. D The introduction of a subsidy would reduce the cost of production causing an increase in supply shown by a shift from S to S_2.

5. B New production techniques would increase the demand for substitutes of rubber causing a decrease in the demand for natural rubber Option **A** would increase the demand for natural rubber while Options **C** and **D** would increase the supply of natural rubber.

5. Which statement could explain a decrease in the demand for natural rubber?

A Demand for car tyres has increased.

B New techniques of producing substitutes for rubber have been introduced.

C Productivity of rubber plantations has increased.

D The area of land on which rubber is grown has increased.

[N10/P1/Q10]

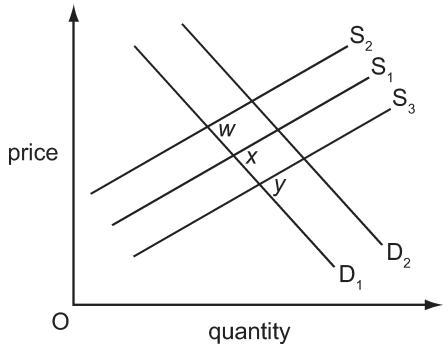
6. The table shows the changes in two influences on the demand for and supply of televisions.

If these two changes occurred at the same time, in which case is it impossible for the price of televisions to rise?

	consumers' incomes	costs of production
A	fall	fall
B	fall	rise
C	rise	fall
D	rise	rise

[J11/P1/Q6]

7. Due to changes in the costs of production, an industry's supply curve shifted at various times from S_1 to either S_2 or S_3.



If a shift in supply was due to a seasonal increase in the cost of raw materials, what would have been the effect on demand?

A The demand curve would move from D_1 to D_2.

B The quantity demanded would move from x to w.

C The quantity demanded would move from x to y.

D The quantity demanded would remain the same at x.

[J11/P1/Q10]

8. Wet weather in 2009 led to a fall in the sales of summer clothes. To support businesses the government reduced the sales tax (VAT).

How would these events be shown on a demand and supply diagram for summer clothes?

	demand curve	supply curve
A	move to the left	move to the right
B	move to the left	no change
C	move to the right	move to the left
D	no change	move to the right

[N11/P1/Q8]

9. Drought in African countries often results in poor harvests. Other countries then help by sending quantities of food.

What are the likely results of these events for the price of food in the drought-affected countries?

A It will fall and then rise.

B It will rise and continue to rise.

C It will rise and remain at this higher level.

D It will rise and then fall.

[N11/P1/Q9]

10. What is **not** held constant in constructing a demand schedule?

A the incomes of consumers

B the prices of complementary goods

C the price of the good itself

D the tastes of consumers

[J12/P1/Q6]

11. The diagram shows the demand and supply curves for digital cameras. The original equilibrium point is X.

What will be the new equilibrium point if these cameras become more fashionable and the rate of sales tax rises?

MCQ Answers

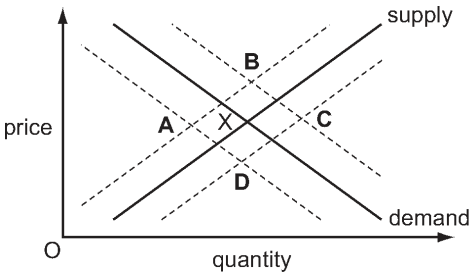
6. A If television prices fall, consumers might think that they are better off. However, this fall in price is accompanied by a fall in consumer's income, thus prices will remain constant. Note: Fall in television prices have to be matched by a fall in income.

7. B The original equilibrium is at x where ($D_1 = S_1$). However, an increase in cost of raw materials shifts the supply curve backward from S_1 to S_2. It does not affect the demand curve at all. Hence the new equilibrium is at 'w' where ($D_1 = S_2$).

8. A Wet weather in 2009 led to a fall in demand for summer clothes. This is shown by a leftward shift in the demand curve. However, at the same time, the government reduced sales tax, which shifted the supply curve to the right.

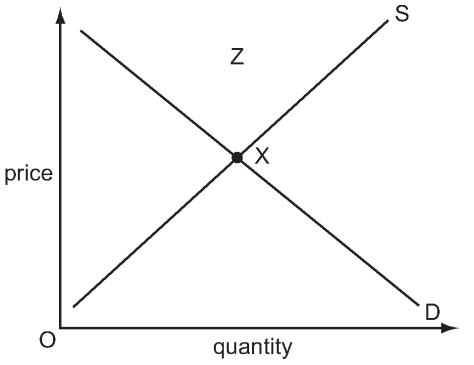
9. D Drought in African countries lead to poor harvests. The immediate effect will be a shortage of supply (supply curve shifts to the left) causing an increase in prices. Then, other countries contributed by sending food that increased the supply (supply curve shifts to the right) leading to a fall in prices. Thus price will rise first and then fall.

10. C When constructing a demand schedule, the price and quantity of the good are required. Options **A**, **B**, **D** are all held constant.



[J12/P1/Q7]

12. What changes would move the equilibrium in the diagram from point X to a new point within area Z?



A a decrease in demand with a decrease in supply

B a decrease in demand with an increase in supply

C an increase in demand with a decrease in supply

D an increase in demand with an increase in supply

[J12/P1/Q10]

13. A supply curve for a commodity is drawn to show how quantity supplied varies with

A government taxes.

B income.

C tastes.

D the price of the commodity.

[N12/P1/Q6]

14. In 2010, floods caused severe damage to wheat production.

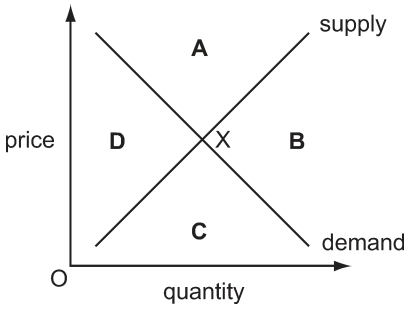
How would this be shown on a market demand and supply diagram for wheat?

	supply curve	demand curve
A	no change	shift to the right
B	shift to the left	no change
C	shift to the left	shift to the left
D	shift to the right	shift to the left

[N12/P1/Q7]

15. The market for a normal good is in equilibrium at point X. Consumers' incomes fall and the cost of producing the good rises.

In which area of the diagram will the new equilibrium be?



[N12/P1/Q10]

16. Many countries buy oil from Saudi Arabia.

Which change is most likely to lead to a fall in the price of a barrel of oil?

A an increase in demand of 10% with no change in supply

B an increase in demand of 10% with an increase in supply of 10%

C no change in demand with a 10% decrease in supply

D no change in demand with a 10% increase in supply

[J13/P1/Q6]

17. In the 2016 Olympics in Brazil, the opening ceremony will take place in the Maracana Stadium, which can seat 82 000 spectators. It is expected that all tickets for the ceremony will be sold quickly, leaving many people dissatisfied.

What can be concluded from this?

A Price elasticity of demand for tickets will be perfectly elastic.

B Some people will be able to resell their tickets at a higher price than they paid for them.

MCQ Answers

11. B There are two shifts occurring in this example. When cameras become more fashionable, their demand increases and the curve shifts right. An increase in sales tax will shift the supply curve to the left. The new equilibrium occurs at B.

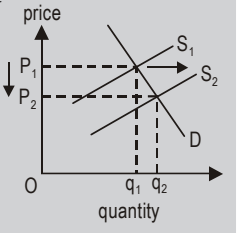
12. C In order to move to the area Z both demand and supply curves need to shift. The demand curve will need to shift right (increase) and the supply curve to left (decrease).

13. D A supply curve shows how the quantity supplied of a commodity changes due to changes in its price. Options **A**, **B**, **C** shift the supply curve to the right/left.

14. B Wheat production suffered / decreased means that the supply curve shifted to the left, whereas the demand curve was unaffected.

15 D Falling consumers' income means that demand decreases and shifts to the left. Simultaneously, an increase in the cost of production shifts the supply curve to the left. Thus, the new equilibrium occurs in the region **D**.

16. D Options **A** & **C** would increase price while **B** would not change the oil price.

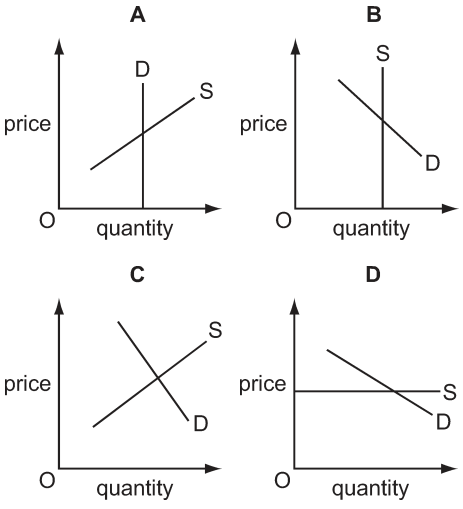


C The Olympic authority will make more tickets available for sale.

D This will be an example of market failure.

[N13/P1/Q4]

18. The diagrams show different conditions of demand and supply for a product.
In which diagram would market price remain unchanged if consumers' incomes fell?



[N13/P1/Q5]

19. In 2011, a company selling milk in glass bottles replaced them with new plastic bottles. When they were introduced, the equilibrium quantity on the market fell.

What could be a reason for this fall?

A Consumers preferred the new bottle because it was lighter to carry.

B Milk from the farms used to fill the bottle cost more.

C The bottle was cheaper than the existing glass bottle to produce.

D The new bottle was introduced with a successful advertising campaign.

[N13/P1/Q6]

20. Which will encourage domestic producers to grow more maize?

A granting subsidies to maize producers

B increasing the sales tax on maize

C removing guaranteed minimum prices for maize

D removing quotas on imported maize

[N13/P1/Q9]

21. A supply curve shows the link between the quantity supplied and

A demand.

B equilibrium output.

C the price of the product.

D the scale of production.

[J14/P1/Q4]

22. In 2011 the US Government declared that the country must increase the manufacture of fuel from crops such as corn that have previously only been used for food.

What is likely to happen in the market for corn?

A a movement along the demand curve for corn

B a movement along the supply curve for corn

C a shift to the left in the demand curve for corn

D a shift to the left in the supply curve for corn

[J14/P1/Q7]

23. What is meant by the equilibrium quantity in the market for a product?

A the average quantity produced over the year

B the average quantity sold over the year

C the quantity at which profit occurs

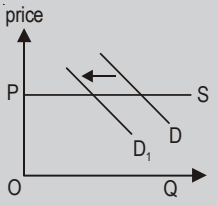
D the quantity at which the demand and supply curves intersect

[N14/P1/Q5]

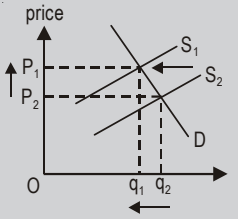
MCQ Answers

17. B A higher demand, compared to the limited number of seats, suggests that some people will be willing to buy tickets even at a higher price that gives a chance to the ticket holders to sell their tickets at a higher price.

18. D Following a fall in consumers' incomes demand also fell, leaving equilibrium price unchanged.



19. B Switch from glass to plastic bottles results in an increase in costs leading to a fall in S and a rise in P leading to a fall in equilibrium quantity.



20. A A subsidy encourages producers to increases supply.

21. C A supply curve shows the positive relationship between quantity supplied and the price of the product, keeping all other factors constant.

TOPIC 2.2

Demand, Supply and Equilibrium

PAPER 2
Structured Questions

Question 1

(a) (i) Using a demand diagram, show an increase in demand for a product. [2]

(ii) Identify **two** causes of such an increase in demand. [2]

[J10/P2/Q2(a)]

Suggested Solution

(a) (i) The Fig 2.1 shows a demand curve D_1 with original price and quantity demanded being at OP_1 and OQ_1 respectively. An increase in demand is shown by a rightward shift in the demand curve from D_1 to D_2 causing both price and quantity demanded to rise to OP_2 and OQ_2 respectively.

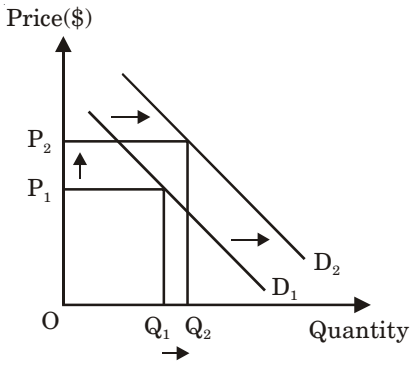


Fig. 2.1

(ii) The two possible causes of such an increase in demand could be a rise in consumers incomes or a successful advertising campaign.

COMMENT on **ANSWER**

"**(a) (ii)** This part of the question only requires you to identify two causes so do not waste time and effort on providing long explanations."

Question 2

Money, in terms of how we earn it, spend it and save it, is of fundamental importance to everybody.

Analyse, with the aid of a demand and supply diagram, the effect of an increase in demand for air travel on the wages of pilots. [6]

[N10/P2/Q3(b)]

Suggested Solution

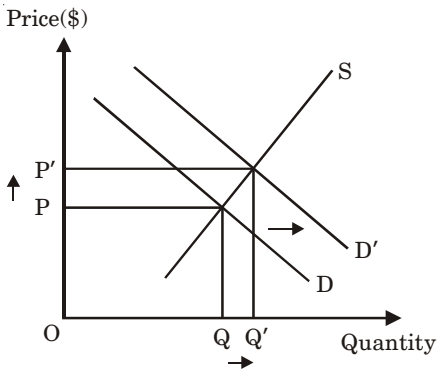


Fig. 3.1 Market for airtravel

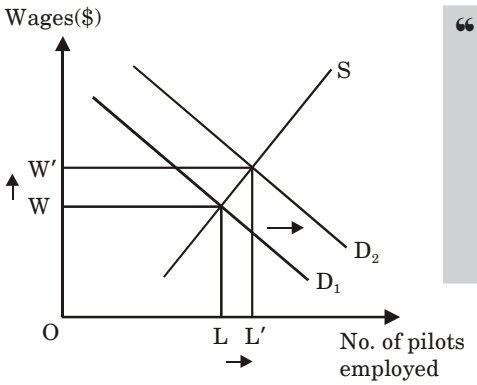


Fig. 3.2 Market for Pilots

As shown in **Fig. 3.1** an increase in demand for air travel from D to D′ is likely to increase the amount of air travel from Q to Q′ while the price of air travel (tickets) is likely to rise from P to P′. This is likely to increase the revenues of air travel companies providing them an incentive to increase the supply of air travel. As a result air travel companies would demand more of the factors of production (including labour such as pilots) involved in the provision of air travel, thus "derived demand". **Fig. 3.2** shows an increase in the demand for pilots from D_1 to D_2, which is likely to cause an increase in the wages of pilots from W to W′.

COMMENT on **ANSWER**

"**(b)** Be careful to label your diagram properly which includes the axes, curves and shifts because half of the marks are for the diagram and half for the analysis. "

Question 3

One feature of many mixed economies is that governments may intervene by giving subsidies to some producers.

(a) What is meant by a subsidy? [3]

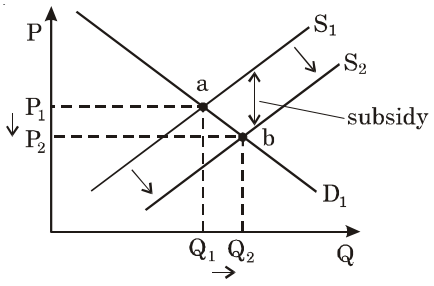
(b) Explain, using a demand and supply diagram, how a subsidy can affect the equilibrium price and equilibrium quantity in a market. [6]

[J11/P2/Q2(a,b)]

Suggested Solution

(a) A subsidy is a payment made by the government to a producer to help reduce their cost of production. Hence, the producers have an incentive to increase supply at every given price.

(b)



The initial equilibrium is at 'a' where $D_1 = S_1$. However, with the imposition of the subsidy, the supply curve will shift to the right from S_1 to S_2. The new equilibrium is now at 'b' where $D_1 = S_2$. As seen by the diagram, equilibrium price will decrease and quantity will increase.

COMMENT on **ANSWER**

"**(b)** 3 marks for the diagram.
- — Correctly labelled axes.
- — Correctly labelled demand / supply.
- — Shift in the supply curve.
- — Equilibrium price falls & quantity rises.

Explanation of the diagram carries 3 marks. "

Question 4

Firms are keen to know what influences consumers in their buying decisions. Publishing firms in India have researched why people buy particular magazines and have found that the price elasticity of demand for different magazines varies.

Describe the factors that can affect the demand for a product. [6]

[J11/P2/Q3(a)]

Suggested Solution

There are numerous factors that affect the demand of a product. The most important factor is the price of the product itself. However, this will only cause a movement along the demand curve. If price goes up, quality demanded goes down and vice versa. However, there are other factors that will cause a shift in the demand curve and affect the quantity at every given price. Firstly, the price of a substitute good has an important role to play. If the price of a substitute good X goes up then the demand of good Y will increase as people are willing to substitute good Y for X. Secondly, the price of complementary good will affect the demand of a product. If the price of a complement X goes up then the demand of good Y will also decrease as these goods are bought together. Thirdly, change in income of an individual also has a role to play. If the income of an individual increases, then it is likely to increase the demand (For normal goods). Fourthly, change in tastes & preference of consumer affect the demand for a product. And fifthly, advertising campaigns are also likely to affect the demand for the good.

COMMENT on **ANSWER**

❝ A list-like approach can get 3 marks at maximum. ❞

Question 5

Both the private sector and the public sector are involved in building houses. In one country a private firm has built an extra 100 000 houses but, at the same time, its government has increased income tax significantly.

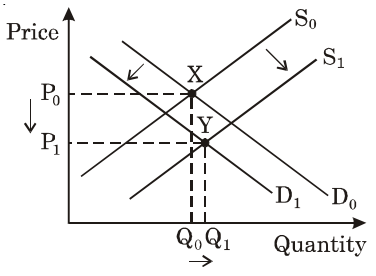
(a) Explain, using a demand and supply diagram, how these two actions would have affected the equilibrium price and the equilibrium quantity of houses. [6]

(b) Explain what determines the demand for houses. [6]

[J12/P2/Q3(a,b)]

Suggested Solution

(a)



The initial equilibrium occurs at 'X' (where $D_0 = S_0$) and P_0 and Q_0 are initial equilibrium price and quantity. Since the private sector has built 10,000 extra houses, there will be increased supply as indicated by the shift from S_0 to S_1. At the same time, the government has increased income tax which means people have less income. Due to reduced income, the demand for houses will decrease as indicated by the shift from D_0 to D_1. The new equilibrium is

COMMENT on **ANSWER**

❝ **(a)** 4 marks for the diagram
— Labels (price, quantity, demand, supply)
— Shift of demand / supply curve
— Change in equilibrium and explanation of the diagram. ❞

shown at 'Y' where ($D_1 = S_1$) and P_1 & Q_1 are the new equilibrium price and quantity. One can see that the equilibrium price has been lowered but the quantity has increased.

(b) There are many factors that influence the demand for houses. The most important factor is the price of the house itself. The higher the price of the house, the lower is its quantity demanded & vice versa. However, the change in price of the house will only cause a movement along the demand curve.

The level of disposable income of an individual has an effect on the demand for houses. Disposable income is the income left after taxes have been deducted. Thus tax also has an effect on the demand for houses. The higher the disposable income / lower the tax, the higher is the demand for houses & vise versa. This will shift the demand curve to the right or left.

The location of the house may influence demand. If the house is located in a very clean / safe / residential area, the demand will increase and shift to the right & vice versa.

The condition of the house will also effect demand. If the house is well built & kept, the demand will increase and shift rightwards & vice versa

Lastly, advertising of the houses will also influence the demand positively and shift it to the right.

COMMENT on **ANSWER**

"**(b)** A list like answer will only get half credit. Explanation of the factors is required. "

Question 6

The demand for flat screen televisions has increased enormously in many countries and this has had an effect on the market.

(a) Describe what can influence the demand for flat screen televisions. [4]

(b) Using a demand and supply diagram, analyse how an increase in income can affect the equilibrium price and equilibrium quantity of flat screen televisions. [6]

[J13 / P2 / Q3(a,b)]

Suggested Solution

(a) The demand for flat screen TVs is influenced by two sorts of factors They are price and non-price factors.

Price influences the demand of flat screen televisions in contrast with the price elasticity concept. If the price of flat screen televisions is raised, the demand might be low. In the same way, if the price is lowered, the demand might rise.

Furthermore, the price of complements also matter since if the price of complementary goods such as electricity increases, the demand for flat screen televisions will decrease and vice versa.

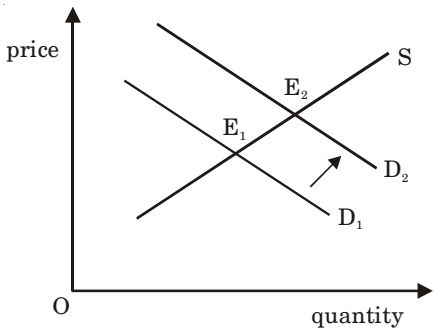
The income of consumers if increasing will cause the demand to increase simultaneously, and vice versa.

COMMENT on **ANSWER**

"**(a)** Other factors such as quality, indirect taxation, advertisement, etc. can also be written.

(b) The correct axes must be labeled, new equilibrium positions with regard to price, quantity and the shift outwards must be clearly shown. "

(b)



Income is undoubtedly amongst the most influential determinants of demand and an increase in income is highly likely to cause an increase in demand for flat screen televisions as they are positively related. An increase in demand will bring an outward shift in the demand curve causing the equilibrium to be set at a higher position hence, increasing the price and the quantity of flat screen televisions because of this generated demand.

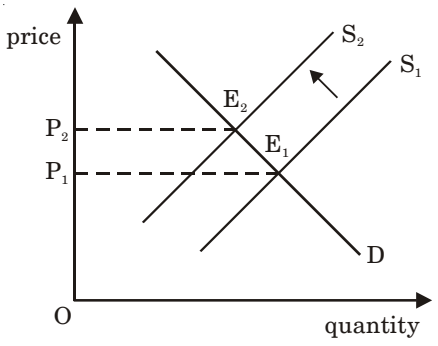
Question 7

There are usually many different taxes in an economy and they can be divided into direct and indirect taxes.

Using a demand and supply diagram, analyse how an increase in tax on fuel can affect the equilibrium price and equilibrium quantity of fuel. [6]

[N13/P2/Q5(b)]

Suggested Solution



The firm's cost of production increases due to an increase in an indirect tax. This results in a rise in the equilibrium price and a fall in the equilibrium quantity and a change in the equilibrium position.

Question 8

Despite more cars being sold, world demand for bicycles is increasing. It has been estimated that the world price elasticity of demand for bicycles is –0.18 but this does vary between countries. The indirect taxes imposed on bicycles also differ between countries.

(a) Define 'demand'. [2]

(b) Explain **three** likely causes of an increase in demand for bicycles. [6]

[J14/P2/Q3(a,b)]

COMMENT on **ANSWER**

"**(b)** A general answer with no reference to bicycles would lead to a reduction in marks. You have to relate the causes of changes in demand to the example of bicycles in the question. "

Suggested Solution

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

(b) There are several factors that may cause an increase in the demand for bicycles.

If bicycle is a normal good, an increase in income will increase the demand for bicycles.

Similarly, if there is an increase in the price of a substitute e.g. fares of buses; people would switch their demand to bi-cycles leading to a shift of the demand curves to the right as shown below.

TOPIC 5.1

Aims of Government and its Role as Producers and Employers

PAPER 1
Multiple Choice Questions

1. The directors of a firm have to discuss the following topics.

Which topic is **least** likely to be directly affected by the government's influence on the firm?

A health and safety laws

B the interest it pays on borrowed money

C the minimum wage it must pay its workers

D the replacement of the director of finance

[J10/P1/Q23]

2. A government achieves a high rate of economic growth.

How may this conflict with other government aims?

A It may increase government income.

B It may increase incomes for the lower paid.

C It may increase the supply of exports.

D It may increase the volume of imports.

[J10/P1/Q26]

3. What is **not** usually an aim of a government?

A economic growth

B full employment

C inequality of incomes

D price stability

[J10/P1/Q30]

4. Which government policy would most likely lead to a redistribution of income?

A a change in the rate of exchange

B control of commercial bank lending

C control of interest rates

D expenditure on unemployment benefits

[N10/P1/Q26]

5. During 2009 some governments adopted policies to try to end the recession in their country and increase economic growth.

Which combination of policies is most likely to achieve this?

A Lower taxes and decrease government spending.

B Lower taxes and increase government spending.

C Raise taxes and decrease government spending.

D Raise taxes and increase government spending.

[J11/P1/Q27]

6. The central bank of Mexico set its rate of interest to try to keep the rise in the price level to only 3 %.

Which government aim was it directly trying to achieve?

A Balance of payments equilibrium.

B Economic growth.

C Full employment.

D Low inflation.

[J11/P1/Q28]

7. In 2009, the Chinese Government tried to increase household spending.

Which policy measure would have been **most** likely to achieve this objective?

A an increase in both direct and indirect taxes

B a reduction in subsidies given to manufacturers

1. D The hiring decisions within the firm are an internal matter of the firm, which is least likely to be directly affected by the government.

2. D A high rate of economic growth would increase incomes which is likely to increase imports, adversely affecting the current account balance. All other options complement other government aims.

3. C The main aims of a government are economic growth (so not option **A**), full employment (so not option **B**), price stability (so not option **D**) and income equality (so option **C**).

4. D Unemployment benefits are an example of social security benefits / transfer payments which can help to redistribute income from the rich to the poor.

5. B In order to end the recession, the government needs to increase aggregate demand. For that, they will use expansionary fiscal / monetary policy. The options available are tools of fiscal policy, where expansionary fiscal policy means lower taxes and increased government spending.

C a requirement for commercial banks to reduce their lending

D a switch from public to private sector provision of health care and pensions

[N11/P1/Q12]

8. Between December 2008 and August 2009, the Central Bank of South Africa cut the rate of interest from 12.5% to 7%.

What effect would this action be expected to have on economic growth and unemployment?

	economic growth	unemployment
A	decrease	decrease
B	decrease	increase
C	increase	decrease
D	increase	increase

[N11/P1/Q24]

9. Which government policy would be likely to help local companies expand?

A encouraging investment by foreign companies

B increasing income tax

C providing a subsidy

D raising interest rates

[N11/P1/Q25]

10. A government decides to subsidise a major industry that is making a loss and also reduce sales tax (VAT) to increase consumer demand.

Which aim would these policies be likely to help and which aim would they be likely to hinder?

	aim policies would help	aim policies would hinder
A	balance of payments surplus	economic growth
B	economic growth	full employment
C	full employment	stable prices
D	stable prices	economic growth

[N11/P1/Q27]

11. Which statement about the meaning of government economic aims is correct?

A Economic growth means that a country's real output must rise over time.

B Full employment means that no-one must be unemployed.

C Price stability means that the price of all goods and services must remain unchanged.

D Redistribution of income means that everyone must have equal incomes.

[J12/P1/Q24]

12. Which combination of government policies would **most** likely increase the rate of growth of domestic production in an economy?

A an increase in expenditure on infrastructure and an increase in income tax

B an increase in interest rates and an increase in quotas on imported goods

C an increase in subsidies to domestic industry and an increase in tariffs

D an increase in value added tax (goods and services tax) and an increase in education expenditure

[J12/P1/Q25]

13. In 2010, the Brazilian Government stated it was concentrating on making the country the world's fifth biggest economy by 2025, and on narrowing the gap between the rich and the poor in the country.

What does the statement indicate were the main aims of the Brazilian Government?

A balance of payments stability and price stability

B economic growth and redistribution of income

C price stability and economic growth

D redistribution of income and balance of payments stability

[N12/P1/Q24]

MCQ Answers

6. D The price level has been fixed at 3%. Thus corresponding to the goal of controlling inflation.

7. D Options **A, B** & **C** are likely to reduce government spending. If health care/pensions become the duty of the private sector as opposed to the public sector, households would spend on these for their old age/retirement.

8. C Lower interest rates imply that people borrow more which increases aggregate demand. Thus increasing output, economic growth and employment.

9. C Local companies can expand when the government provides a subsidy. Option **A** is referring to foreign companies and thus incorrect. Option **B** will hinder domestic companies to expand. Option **D** will again lead to an inflow of capital from foreign as opposed to local companies.

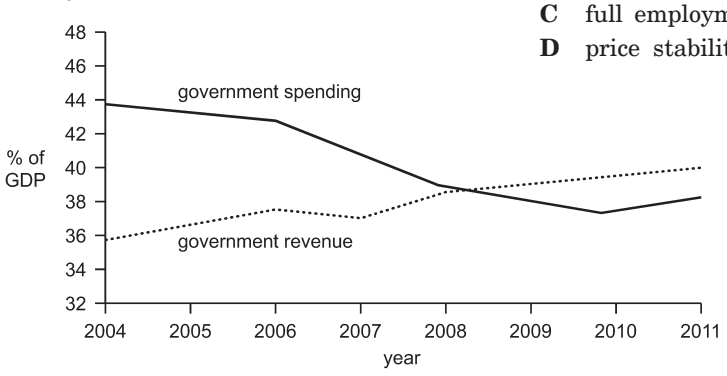
10. C If a government subsidizes an industry that means it's paying for part of their production costs, thereby increasing aggregate supply and reducing tax will increase aggregate demand. This will increase output, economic growth employment. However, an increase in aggregate demand will increase prices, which will hinder government's aim of controlling inflation.

14. A government wishes to stimulate economic recovery.
Which action will assist this?

A decreasing government investment
B decreasing income tax
C increasing indirect taxation
D increasing interest rates

[N12/P1/Q25]

15. The graph shows government revenue and spending in a country, as a percentage of GDP, between 2004 and 2011.



What can be concluded from the graph?

A The balance of payments position improved.
B The borrowing of the government increased.
C The economy went into recession (economic downturn).
D The government budget moved from deficit to surplus.

[N12/P1/Q27]

16. A government reduces the interest rate to encourage economic growth.
Which other aim of government policy might now become more difficult to achieve?

A reducing a balance of trade in goods surplus
B reducing a government budget deficit
C reducing the level of unemployment
D reducing the rate of inflation

[J13/P1/Q26]

17. In an economic recession, which policy might be adopted to reduce unemployment?

A an increase in foreign exchange rates
B an increase in interest rates
C a reduction in import duty
D a reduction in tax rates

[J13/P1/Q29]

18. Which aim of government policy is most likely to be achieved by an increase in interest rates?

A economic growth
B greater equality of income
C full employment
D price stability

[N13/P1/Q24]

19. Which combination of government policies is most likely to be successful at reducing unemployment?

A budgeting for a surplus and lowering interest rates
B budgeting for a deficit and raising interest rates
C budgeting for a surplus and raising interest rates
D budgeting for a deficit and lowering interest rates

[N13/P1/Q26]

20. A government wishes to raise the general standard of living in its country.

In the short run, which policy would be the most likely to achieve this aim?

A preventing the merger of two companies into a monopoly
B raising taxation to repay government debts

MCQ Answers

11. A Economic growth means an increase in the country's real output over a period of time. Option **B** is incorrect as full employment means there will be some people unemployed. Option **C** is incorrect as price stability means there will still be a low level of inflation. Option **D** is incorrect as redistribution of income means taking a certain percentage of income from the rich and providing the poor.

12. C Subsidies are payments made by the government to the producers to help reduce their cost of production, due to which domestic production increases. Simultaneously, tariffs-taxes on the price of imported goods makes import expensive and increases the demand and supply of domestic goods.

13. B In order to make Brazil the fifth biggest economy, economic growth is required. And to narrow the gap between rich and poor, redistribution of income from rich to poor is required.

14. B Decreasing income tax will increase the disposable income and aggregate demand. This, in turn, will increase the output and stimulate economic recovery.

15. D Government Budget = Government revenue (GR) – Government spending (GS)

If GR > GS, it is surplus and if GS > GR it is deficit.

Initially, there's deficit (2004 – 2008) but post 2008 there's surplus.

TOPIC 5.1

Aims of Government and its Role as Producers and Employers

PAPER 2
Structured Questions

Question 1

The Government of Nigeria has a number of economic aims. One of these is to increase the rate of economic growth in the country. It recognises, however, that this aim could conflict with some of its other aims.

(a) Describe what is meant by economic growth. [2]

(b) State **four** economic aims a government may have, other than economic growth. [4]

(c) Describe the policies that a government might adopt to increase the rate of economic growth in its country. [6]

(d) Discuss whether economic growth conflicts with the achievement of the other government economic aims. [8]

[N11/P2/Q5]

Suggested Solution

(a) Economic growth refers to an increase in the real output of an economy over a period of time leading to an increase in the economy's productive capacity (potential) in the long term. It is measured by an increase in GDP over a period of time.

(b) – To control prices.
– To control unemployment.
– Favourable Balance of payment.
– Equal distribution of income.

(c) There are various policies that the government might adopt to increase the rate of economic growth in its country.

Firstly, the government can use demand side policies to influence economic growth via aggregate demand. Both fiscal / monetary policy can be used to impact aggregate demand. Since the government wishes to increase economic growth, it will use expansionary fiscal / monetary policy.

Secondly, the government can use various supply side policies to affect economic growth via aggregate supply. Educational / technical reforms can be used to improve the quality of human resources by empowering them with skills and making them more productive. Also, the government can provide tax / subsidy incentives e.g. tax holidays and subsidies to encourage new businesses to set up and invest in research & development.

(d) There are six aims of the government; economic growth, price stability, controlling unemployment, favourable balance of payments, equal distribution of income and protection of environment.

The aim of economic growth may conflict with a few other aims of the government.

COMMENT on **ANSWER**

"**(c)** Any 3 demands / supply side policies for increasing economic growth can be explained."

Firstly, it may conflict with price stability. If aggregate demand is more than supply, prices rise thus, causing price instability.

Secondly, BOP stability may conflict with economic growth. If incomes rise due to economic growth, this may lead to a large increase in demand for imports relative to exports, causing BOP deficit.

Thirdly, it may conflict with equal distribution of income. If economic growth is only going to benefit a handful of (rich) people, then the distribution of income is unequal.

Fourthly, economic growth is sometimes achieved at the expense of environmental degradation and natural resource exploitation.

However, conflict is less likely with the aim of lowering unemployment because economic growth is likely to increase the demand for labour and lower unemployment.

COMMENT on ANSWER

"**(d)** The key word is "discuss" therefore both sides of the argument need to be discussed.

Economic growth may / may not conflict with other government aims.

One-sided answer can only gain 5 marks."

Question 2

Low inflation, low unemployment and high economic growth are all government economic aims.

Discuss whether it is always possible for a government to achieve a high rate of economic growth. [10]

[J12/P2/Q6(c)]

Suggested Solution

COMMENT on ANSWER

" The keyword is 'always possible' therefore both sides of the argument need to be presented. Possible factors influencing and inhibiting economic growth need to be mentioned.

One sided answer can get a maximum of 6 marks."

Economic growth refers to an increase in the real output of an economy over a period of time. There are many possible factors that influence the economic growth of a country.

The economy might not be using all its resources to the full capacity. This means the economy is producing inside the production possibility curve. So by utilizing their existing capacity or by becoming efficient they can achieve actual economic growth. This is shown in Fig. 6.1 by a movement from point 'X' to 'Y'.

Moreover, the economy's potential capacity can be increased in the long run by increasing the quantity / quality of resources or by the application of new technology. This will cause the production possibility curve to shift outwards as shown in Fig. 6.2

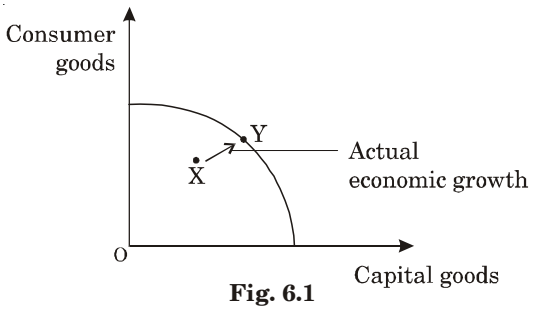


Fig. 6.1

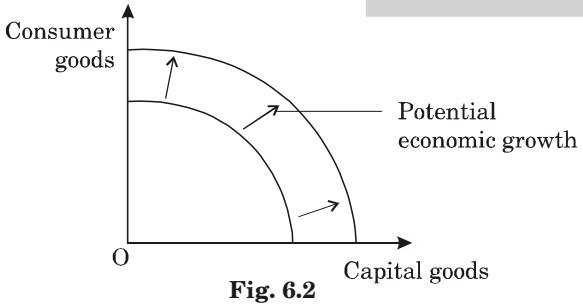


Fig. 6.2

Economic growth will result in an improvement in the standard of living, welfare and the quality of life in the economy.

A government might affect economic growth in a country by its various macroeconomic policies aimed to increase aggregate demand and/or aggregate supply in the economy. A government might use an expansionary fiscal policy involving a reduction in taxes and/or an increase in government spending to stimulate aggregate demand in the economy. Similarly, the government might employ an expansionary monetary policy involving lower interest rates to stimulate investment and consumer spending to increase demand. As shown in Fig. 6.3, the increase in aggregate demand from AD to AD' will encourage firms to produce more and thus output will expand from Q to Q' implying actual economic growth.

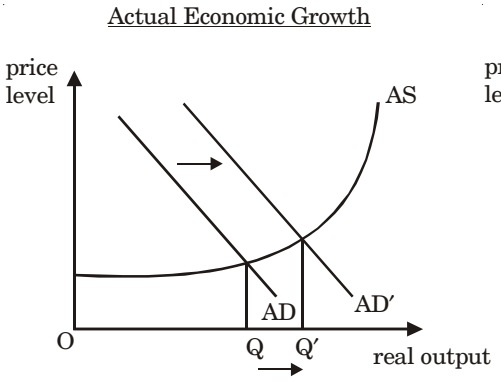


Fig. 6.3

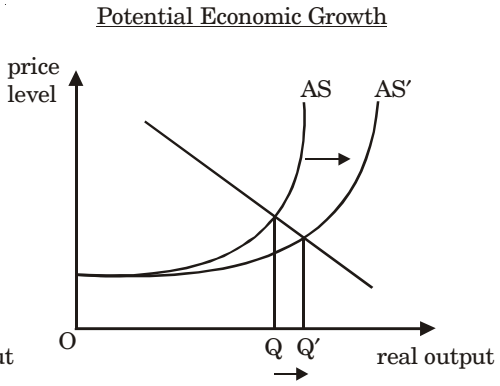


Fig. 6.4

A government might also influence economic growth by its various supply side policies which will increase the productive potential of the economy (in the long run). Such policies seek to increase the quantity and quality of resources and raise the efficiency of the markets which encourages an increase in potential output. These policies include improving education and training of the work force which will help boost labour productivity. Moreover, cutting direct taxes and benefits will provide greater work incentives and thus encourage more people to work and produce more goods and services. Labour market reforms, such as reducing power of trade unions, would also help to improve efficiency in the labour market resulting in greater output. A government might also resort to privatisation and deregulation to encourage greater business activity. In addition, a government might encourage new research and development, attract foreign direct investment, boost investor confidence, undertake infrastructural development to stimulate economic growth in the country. The effect of these policies can be seen in Fig. 6.4 where an increase in aggregate supply from AS to AS' causes output to expand from Q to Q'.

However it is not always possible for a government to achieve economic growth as a number of factors might inhibit it.

The aggregate demand of the economy might fall (due to a number of reasons) which will cause the GDP to fall and prevent economic growth.

A higher rate of taxation (which will reduce the disposable income of people) or discouraging foreign investment will cause a fall in aggregate demand, reducing output and hindering economic growth.

Furthermore, the supply side policies might not be effective in increasing the aggregate supply and causing growth. For example, the government might provide education / training to improve the quality / skills of the workforce but there might not be any significant improvement in the quality of labour force and aggregate supply may not increase & enable growth.

In conclusion, it may / may not be possible for a government to achieve economic growth.

Question 3

Governments usually aim to have a low rate of inflation and a high rate of employment, but these two aims can sometimes conflict.

Discuss to what extent the aims of a low rate of inflation and a high rate of employment are likely to conflict. [8]

[N12 / P2 / Q6(c)]

Suggested Solution

Low rate of inflation and a high rate of employment are both aims of a government. Both these aims may or may not conflict depending on the kind of policy adopted and their consequences. (The two aims may conflict due to a number of reasons). Firstly, if high employment is a core aim of the government and the government manages to achieve a high rate of employment, then the income / GDP of the economy will increase. This increase in the income level will trigger higher spending and hence aggregate demand in the economy causing "demand-pull inflation". This happens when the supply is not enough to meet the increased demand, as a result prices rise and lead to inflation.

Secondly, if the government achieves a high rate of employment, this may result in a shortage of workers. The shortage of workers will cause wages to be pushed up as firms demand more workers or trade unions enjoy greater bargaining power, leading to 'cost-push' inflation. Cost push inflation occurs when the cost of production increases (in this case due to higher wages) reducing supply and increasing prices and causing inflation. These increased prices of goods / services will further give an incentive for workers to demand higher wages leading to a wage-price spiral.

Thirdly, higher employment will increase the incomes of people in the economy and consequently aggregate demand. This raised demand will also increase the demand for imports and increase their prices, causing 'imported inflation'.

Fourthly, the aim of the government might be to reduce inflation-or keep a low-level of inflation. A government may seek to reduce inflation via demand-side policy i.e. by reducing aggregate demand. This may be achieved via increased taxes or interest rates. The reduced / lower aggregate demand will reduce output and consequently firm employ less workers, thus causing, 'cyclical-unemployment' / 'demand-deficient unemployment'.

However, the two aims may be possible to achieve. Firstly, if supply-side policies are used, the two aims may be achieved simultaneously. For example, if education / training is provided to make labour more skillful / mobile, it will reduce costs and hence lower "cost-push inflation".

Secondly, if low inflation is the aim and the government manages to control inflation, this means that prices are low. Low prices will make goods internationally competitive and increase the demand for exports. This higher demand means a higher output is required which is achieved via raised employment, lowering cyclical unemployment / demand-deficient unemployment.

To conclude, the two aims of higher employment and low inflation may conflict with each other. However, these two aims may also be achieved simultaneously. It depends on the policies the government employs along with consequences that may result from it.

COMMENT on **ANSWER**

"The keyword is 'discuss' therefore explain when and why the two aims may/may not conflict."

Question 4

Governments can use a range of different policies to encourage economic growth.

(a) Describe how economic growth is measured. [4]

(b) Explain how fiscal policy can be used to encourage economic growth. [6]

(c) Discuss to what extent supply-side policies are likely to be more effective than monetary policies in stimulating economic growth. [10]

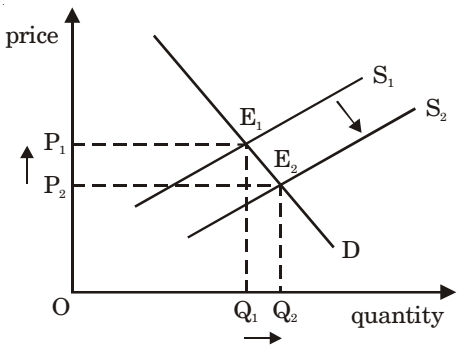
[J13/P2/Q5]

Suggested Solution

(a) The rate of economic growth can be measured through the change in output or real output. It can also be measured through analyzing changes in GDP, real GDP and/or GDP per head. This means that an outward shift from the production possibility curve is made indicating an increase in the productive potential of a country.

(b) The government spending could be increased for instance, more amount spent on infrastructure and facilities such as education and health. The burden of direct taxation could be lowered by for instance the corporation tax on firms and the income tax on workers which would help protect them from large amounts going as tax. Moreover, indirect taxation too could be lowered for example taxes like VAT or GST to stimulate demand. The imposition of tariffs on imported good to protect domestic producers from failing against pressure from imported firms is another stimulator of economic growth acting under the fiscal policy.

(c)



Very fundamentally, the examples of supply-side policies include improvements in education and training. Supply side policies also include the reformation of trade unions in attempt to reduce their power and work towards making the labor more productive. It also accounts to the privatization of industry in attempt to increase their productivity and efficiency. The use of subsidies could help to reduce supply costs hence encouraging production. There would be cuts in direct taxes under these policies to act as an incentive to enterprise and effort. Moreover, there would be cuts in welfare payments where the major aim is to provide them an incentive to work.

On the other hand, monetary policies are also effective. Under the umbrella of monetary policies comes the price of money that is the interest rate which can be adjusted and set lower to stimulate demand. The quantity of money for instance the money stalk can also appeal people hence stimulating a demand. To a great extent, on the exchange rate, the value is often reduced to keep the element of competitiveness in the market.