# SCHOOL OF ARTS, SOCIAL SCIENCES AND MANAGEMENT

# DIVISION OF BUSINESS, ENTERPRISE AND MANAGEMENT

# LEVEL 1 DIET 1

# MODULE CODE: B1074

# MODULE TITLE: Business Economics

| **DATE:** (Click here to select) | **TIME:** |
|---|---|
| **WRITING TIME: 2 hours** | **READING TIME: 5 minutes** |

## INSTRUCTIONS:

This examination is in FOUR sections. **Answer all sections as detailed below.**

SECTION A –    Consists of multiple choice questions. Each question is worth 1.5 marks. No marks are deducted for a wrong answer. Attempt **all 20 questions**. **Total 30 Marks**

On the first page please list q1-20 and indicate your answer as A, B, C or D. If you wish to change your answer make sure to **completely score out** your original answer and clearly write your alternative answer. **Where more than one answer is given no marks will be awarded**. **No explanation is required**. You should attempt **all questions**.

SECTION B –    Answer **any two** of the three questions in this section**.** Each question is worth 15 marks. **Total 30 Marks**

SECTION C –    Answer **any two** of the three questions in this section**.** Each question is worth 15 marks. **Total 30 Marks**

SECTION D –    Answer **any one** of the two questions in this section. Both questions are worth 10 marks. **Total 10 Marks**

Please write your answers within an answer booklet(s). You may allocate your time as you see fit.

**PAPER SETTER: Dr Gemma Blackledge-Foughali**

**SECTION B (30 marks)**

Answer **two** questions **from three** in this section.  Each question carries 15 marks.

B1

(a)  Given the following scenarios, explain whether consumer demand is likely to be relatively price elastic or price inelastic:

(i)      A family with school age children looking to book a week long holiday to Tenerife during the school half term break.
(ii)     A student looking to purchase a cup of tea in a city centre.
(iii)    A parent looking to buy a red school jumper for their child for the start of the new school year.
(iv)    A tax accountant who works from home who needs a replacement ink cartridge for their printer today.

(8 marks)

(b)  Calculate the price elasticity of demand when the price of good x falls from £12 to £10, and the quantity demanded increases from 450 units to 500 units.

(3 marks)

(c)  Describe two factors which influence the price elasticity of demand for a good/service.

(4 marks)

**Total 15 marks**

B2

(a)   Explain the relationship that exists between scarcity and choice in economics.

(3 marks)

(b)  For each of the examples below indicate whether the scenario represents a factor of production for a local house building firm.

(i)       Callum, a bricklayer for a local house building firm.
(ii)      The homes that Callum helps construct.
(iii)     The bricks that Callum uses.
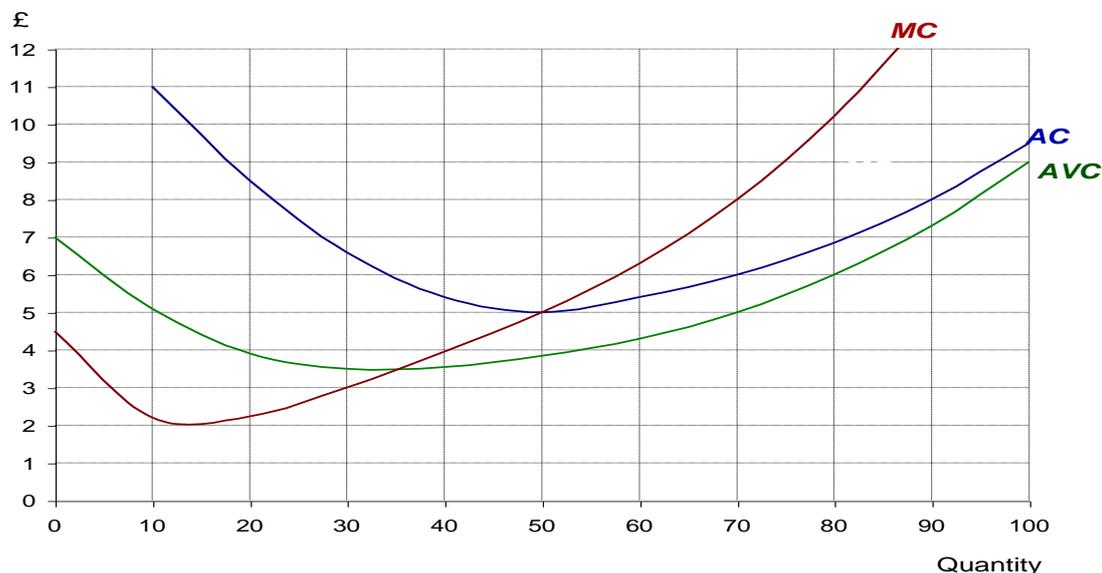(iv)     The wage Callum gets paid at the end of the month.

(8  marks)

(c)  Compare and contrast the characteristics of a planned economy with a free market.

(4 marks)

**Total 15 marks**

B3

(a) Use the diagram below to answer parts (i)-(v), which represents the cost curves of a firm operating under perfect competition.



(i) State how much the firm will produce, in order to maximise profits at a price of £8 per unit.

(ii) State the <u>total cost</u> of production at the profit maximising level of output which you have identified in part (a).

(iii) State the level of profit/loss at the level of output you have identified in part (a).

(iv) State how much the firm produce in order to maximise profits at a price of £5 per unit.

(v) State the level of profit/loss at the level of output you have identified in part (d).

(5 marks)

(b) Discuss <u>two</u> characteristics of monopolistic competition.

(4 marks)

(c) We tend to think of monopolies as undesirable. Describe <u>two</u> arguments in favour of monopolies.

(4 marks)

(d) Explain why firms operating under oligopoly tend to have relatively stable prices. You may use an example to support your discussion.

(2 marks)

**Total 15 marks**

**SECTION C (30 marks)**

Answer **two** questions **from three** in this section.  Each question carries 15 marks.

C1

(a) Define and discuss cyclical (demand-deficient) and frictional unemployment.

(4 marks)

(b) Outline ONE demand side policy that may be available to government in an attempt to reduce the level of unemployment.

(2 marks)

(c) Outline ONE supply side policy that may be available to government in an attempt to reduce the level of unemployment.

(2 marks)

(d) Explain the difference between voluntary and involuntary unemployment.

(3 marks)

(e) Identify <u>two</u> possible costs of unemployment.

(4 marks)

**Total 15 marks**

C2

(a) Discuss <u>two</u> factors which influence the supply of labour to the economy.

(4 marks)

(b) Discuss <u>two </u>factors which influence the demand for labour in the economy.

(4 marks)

(c) Explain with the use of diagrams why we observe more than one wage in the labour market.

(3 marks)

(d) Propose some of the reasons why women tend to earn less than men in the labour market.

(4 marks)

**Total 15 marks**

C3

(a) Explain the difference between fixed and floating exchange rates.

(3 marks)

(b) Outline <u>two</u> factors which determine the demand for a currency.

(4 marks)

(c) Outline <u>two</u> factors which determine the supply of a currency.

(4 marks)

(d) State two advantages and two disadvantages of a floating exchange rate.

(4 marks)

**Total 15 marks**

**SECTION D (10 marks)**

Answer **one** question **from the choice of two** in this section.  Both questions carry 10 marks.

D1

The table below represents the supply and demand curves for organic apples.

| Price per tonne euros (€) | Quantity supplied | Quantity demanded |
|---|---|---|
| 140 | 260 | 680 |
| 180 | 320 | 610 |
| 220 | 400 | 550 |
| 260 | 500 | 500 |
| 300 | 640 | 460 |
| 340 | 880 | 400 |

(a)  Plot the supply and demand curves for organic apples given the information in the table.

(3 marks)

(b)  State whether a price of 140 euros, is there a shortage or a surplus and the size of this shortage or surplus.

(2 marks)

(c)  What is the equilibrium price and quantity?

(1 mark)

(d)  Now assume there is an increase in the wage rate for fruit pickers. State what the effect will be on the market equilibrium price and quantity.

(2 marks)

(e)  State <u>two</u> factors which would shift the demand curve for organic apples to the right.

(2 marks)

**Total 10 marks**

# OR

D2

(a)  Explain the difference between actual and potential growth.

(2 marks)

(b)  Draw a fully labelled diagram to demonstrate the stages of the economic cycle.

(2 marks)

(c)  Outline each of the stages of the economic cycle from your diagram in part (b).

(d)   State <u>one</u> cost and <u>one</u> benefit of economic growth.

## END OF PAPER

## Sample paper indicative marking scheme

**This is a guideline. It is not a definitive document and nor would you be required to make every point given in the indicative answers below.**

This document is purely to give you an indication of what sort of answers I would be looking for on such a paper. Most commonly the first mark or ½ mark is quite easy to obtain, you just need to provide me with a correct answer. The more difficult part is the detail but to achieve full marks for discuss/describe type questions you need to add some additional discussion to show me that you have understood things. If you struggle to explain something then can you explain it with an example? It's often a really good way of telling me what you mean.

Make sure you show working as otherwise I cannot award any credit if you give me an incorrect answer. If you have the correct answer then working obviously doesn't matter – you get the full mark.

Have a look over the examination phrases on Hub for additional guidance.

**SECTION B**

B1. 1 mark for stating the degree of elasticity and 1 further mark for explaining each case.

(a) Inelastic (1 mark) as parents can only book a half term holiday in a specific and restricted time period. They do however have some choice of location so whilst Tenerife may be a first choice, there are plenty of alternative/substitute holiday destinations. If the family were able to consider such alternatives then we would expect to see greater price elasticity (1 mark).

(b) Elastic (1 mark). Tea is a generic product and as such there are many alternative providers; small cafes to the likes of the large chains. However, one could argue that tea is a relatively inexpensive product and would therefore be fairly price inelastic. A student however may feel that a cup of tea would be a reasonable portion of their disposable income and would therefore be more price elastic than the general population (1 mark).

(c) Elastic (1 mark). A plain red jumper will be very easy to purchase in the run up to a new school term as all the shops will have schoolwear in. The fact that it must be red makes it a more specific product but relatively speaking there should be plenty of substitutes across different retailers. If it were the day before/morning that school starts one could argue that a parent would be relatively price inelastic as they would wish to ensure that their child was in the correct uniform (1 mark).

(d) Inelastic (1 mark). If you need a replacement ink cartridge that day you do not have the option to mail order and instead must visit a local shop. Given the effective short time horizon you would be relatively price inelastic ( 1 mark).

(b) % Δ in Qd/% Δ in P

% Δ in Qd = [500-450/450]*100 = 50/450*100 = 11.1% (1 mark)
% Δ in P = [10-12/12]*100 = -2/12 = -16.7% (1 mark)
= 11.1/-16.7 = -0.66 (1 mark)

All 3 marks to be awarded if correct answer given even if no working shown.

(c) Can pick any two from the list, 1 mark for stating the factor and 1 mark for further explaining it, may use examples to illustrate understanding.

(i) How differentiated the product is
(ii) The time period involved
(iii) Whether the firm has built a relationship with its customers
(iv) The breadth of the product category being considered
(v) Who is paying
(vi) The awareness and availability of substitutes
(vii) The percentage of income spent on the product
(viii) The nature of the product

**Total 15 marks**

B2.

(a)  Scarcity arises as a result of unlimited wants and limited resources (1 mark). The resources each country has will be varied, scarcity is not limited to less developed countries; it can occur anywhere. Effectively limited resources act as a constraint; we cannot do everything we want to (1 mark). As a result of this we need to make choices; pick one option over another. We refer to this as opportunity cost within economics (1 mark). Examples may be given to illustrate understanding. May also refer to price rises being insufficient in terms of resolving the problem of scarcity. May also refer to different types of individuals and the scarcity that they may face.

(b)  (i) Callum is a worker/employee and therefore represents labour or human capital. He is therefore a factor of production as his input leads to an output.

(ii) The homes that Callum constructs are not a factor of production as they are not an input, they are an output of the activity undertaken.

(iii) The bricks that Callum uses are classed as a factor of production as they are an input into the production of homes as they are a raw material.

(iv) Wages are not a factor of production as they do not represent an input.

1 mark for identifying whether it is a factor of production or not and 1 additional mark for explaining why it is/isn't in each case.

(c)  A discussion of the two types of economy should be discussed. A planned economy is one controlled by the government and they take full responsibility for all activities including the economy and the allocation of resources (1 mark). Examples may be given to explain how and possibly some countries that are very close to planned economies.

A free market economy is the opposite end of the spectrum where all activity is completely determined by the market forces of supply and demand. The government does not intervene in this market (1 mark). Examples may be given to explain how and possibly some countries that are very close to planned economies.

2 marks for indicating how they differ – this may include a comparison of some pros/cons as per p10 table 1.1.

**Total 15 marks**

B3.  (a)

  (i)  70 units (1 mark)
  (ii)  6*70 = 420 (1 mark) -  can be awarded as ½ marks for method and correct calculation
  (iii)  (8*70) – (6*70) = 140 ( 1 mark) -  can be awarded as ½ marks for method and correct calculation as it's TR – TC = profit/loss
  (iv)  50 units ( 1 mark)
  (v)  No profit or loss, firm will break even (1 mark)

(b) Characteristics include:

Many firms selling differentiated products (1 mark). An example could be a restaurant. The menu, uniform and/or décor in a restaurant can be different in some way or another making each restaurant different from another (1 mark).

Low barriers to entry and exit (1 mark), this means that new firms can find it relatively easy to enter into the industry. As new firms enter the existing pool of customers is shared between the firms so each serves fewer customers. Equally, firms can leave the industry with relative ease (1 mark).

Supernormal profits are only possible in the short run (1 mark). Due to low barriers to entry and exit we would expect supernormal/abnormal profits to encourage new firms to enter. This additional profit would be shared out until there is no further incentive to enter an industry (1 mark).

Some control over market price as shown by downward sloping demand curve and marginal revenue curve (1 mark). Due to differentiation there is some degree of control over price (although not to the same degree as seen in oligopoly or monopoly). To sell more units the price must fall on each and every unit (1 mark).

(c) Possible arguments in favour of monopoly include:

Encouraging others to innovate (1 mark) due to the attractiveness of supernormal profits. Firms may seek to innovate their product/service rather than becoming stagnant. Other firms may see this as an example to follow – monopolies don't get to be where they are by carrying on their normal day-to-day activities, they need to push themselves. This is also known as the Schumpeter effect (1 mark).

Benefit from internal economies of scale (1 mark). Lower unit costs may enable such firms to lower their prices and increase output beyond what would be observed in a competitive market. This could be very important for high cost industries to make firms competitive in the global market (1 mark).

Funds for investment (1 mark). Monopolies generate supernormal profits which may then be invested into further research and development. As they have such funds they can pursue risks and opportunities that other firms may not be able to. Such investment can lead to long term efficiency and potentially greater choice for consumers (1 mark).

Benefits of efficiency that would be lost from breaking it up (1 mark). A monopoly may have been created due to investment in patents and other activities. Such activities need to be protected by the government to ensure that firms have incentives to continue. If we remove the reward to innovation by removing patent/copyright laws then there is little/no incentive for firms – this would be against the public interest (1 mark).

Profits may be distributed as dividends or investment in other firms (1 mark). As such there is a redistribution of the profits to society (1 mark).

Prevent duplication (1 mark). In the utilities market this is particularly common and as such we may use the term of natural monopoly in such cases. It doesn't make sense to have multiple networks of cables/pipes etc. This is unnecessary duplication of infrastructure and is a waste of resources (1 mark).

The product/service may make life easier for others (1 mark). A good example of this is Microsoft as a large number of firms then design products to work with a particular product/service which is the market leader rather than having to account for lots of different systems which would make things more costly due to compatibility issues (1 mark).

(d) We tend to observe stable prices in oligopoly as there is no incentive to deviate from the market price that has been set. A feature of this market structure is interdependence; the behaviour of one firm influences the behaviour of others (1 mark). The kinked demand model shows that an increase in price will not be followed by other firms. As a result of this, the firm would lose customers to its competitors and total revenue would fall. Equally, if the firm lowers its price, all firms will follow. This may attract additional demand but the fall in price will exceed the increase in customers (quantity demanded). As a result total revenue will fall (1 mark). In both cases, total revenue falls and therefore there is no incentive to change price; they remain stable.

**END OF SECTION B**

**SECTION C**

C1

(a) Cyclical unemployment occurs when demand is low in the economy (1 mark). This form of unemployment will be high when the economy is in a decline/recession. Labour is derived demand and if firms have relatively low demand for their goods/services then they may lay some people off/reduce the number of individuals being hired (1 mark).

Frictional unemployment is also known as search unemployment and arises when people are moving between jobs (1 mark). For example you could have left your current job and be looking for a new job. Provided people can find work relatively easily this is not a major concern. However, if the gap between jobs becomes greater it can become problematic (1mark).

(b) The government could seek to reduce interest rates (½ mark). Reducing interest rates would potentially make saving less attractive and borrowing more attractive (½ mark) Firms and individuals may decide to undertake more investment and consumption – these are two key components of aggregate demand ($Y = C + I + G + X - M$) (½ mark). The resultant increase in demand would encourage firms to employ more people and hence reduce the number of people unemployed (½ mark).

Alternatives would include a reduction in taxation and/or an increase in government spending with an appropriate discussion of how the policy would work as per the level of detail given in the above example.

(c) The government could provide training to individuals who are out of work (1 mark). This is a particularly appropriate measure for those who are unemployed as a result of a decline in their industry who then find themselves structurally unemployed. By giving people relevant skills, they become more employable (1 mark).

Alternatives would include changes to the benefit and taxation system to encourage people to move into jobs. Reducing the tax wedge and ensuring people have information are also other appropriate initiative. As above, some additional discussion would be required for such a case to achieve full marks.

(d) Voluntary unemployment refers to those who are in the labour force and looking for work but are not yet willing or able to accept a job at the given real wage (1 mark). Involuntary unemployment measures the number of people who are willing and able to work at the given real wage rate but who are not employed (1 mark). Effectively those who are voluntarily unemployed are choosing not to

work whilst those who are involuntarily unemployed are unable to find a job due to a lack of demand in the economy (1 mark).

(e) Possible costs of unemployment include:

Less income in a region as fewer people are working (1 mark) and therefore less spending in the local economy which can create further unemployment (1 mark).

Social problems (1 mark). Some people without work may find that they use the additional free time in an unproductive manner for crime and other antisocial activity (1 mark).

Increased spending on unemployment related benefits (1 mark) which is often coupled with less tax revenue and therefore is likely to lead to a higher government budget deficit (1 mark).

Less taxation revenue (1 mark). Both direct and indirect taxes will fall as fewer people are in work and people may also undertake less expenditure on goods and services resulting in a fall in indirect tax revenue (1 mark).

Less investment (1 mark). If firms have fewer sales due to reduced confidence in the economy, they may hold off on investment activities. This results in even lower aggregate demand (1 mark).

Less consumption (1 mark). If people have lost their jobs or are worried about the risk of losing their job they will reduce their level of spending and potentially increase saving where possible. Further falls in demand may further reinforce the downturn in the economy (1 mark).

**Total 15 marks**

C2

(a) 1 mark per answer, answer may vary slightly due to rounding and number of decimal places.

| Year | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|
| Price index | 105.6 | 106.9 | 108.3 | 109.8 | 111.2 |
| Rate of inflation | 0.8 | 1.2 | 1.3 | 1.4 | 1.3 |

(b) Inflation can be defined as a sustained increase in the general price level over a given period.

Key words for the marks are sustained increase (½ mark), general (½ mark) price level (½ mark) and a given period (½ mark) – if say a year then accept this as well, as long as the comment indicates some time dimension.

(c) 2 marks per answer

May damage business confidence as firms will be unsure about the future cost of activities (1 mark). As a result firms may not undertake investment as they will struggle to estimate future profits, this has a negative impact on economic growth (1 mark).

Changing costs lead firms to have to change their promotional material (1 mark). This means that brochures and price lists must also be changed. This is known as "menu costs" (1 mark).

Increased search (1 mark). If prices are increasing then people will spend longer looking for the best deals. This additional search is known as "shoe leather costs" (1 mark).

Differences in bargaining power (1 mark). If wages do not grow at the same level as prices then real wages fall; people have less purchasing power. Some people can renegotiate their wage whilst others can't so easily (1 mark). May also discuss redistribution between borrowers and savers or government and employees as alternatives.

Reduce international competitiveness (1 mark). If prices are rising in a country then goods become relatively more expensive and are less desirable than those produced overseas. This would have a negative impact on our export levels (1 mark).

(d) 1 mark per answer.

- higher wages which are not associated with increased productivity
- higher import prices
- monopoly suppliers pushing prices up
- increased raw material costs (oil is a common example)


(e) 1.5 marks per answer

Reduce aggregate demand ½ mark plus up to an additional mark for explaining how this would be undertaken in practice – discussion of increased taxes or reduced government spending or an increase in interest rates ½ mark for giving one of these as an example and then the final ½ mark for explaining how it works.

Reducing costs ½ mark plus up to an additional mark for explaining how this would be undertaken in practice – examples may include wage restraints (incomes policy), setting the exchange rate so that the currency is stronger to reduce import prices ½ mark for an example and then the final ½ mark for explaining how it works.

Other methods may include the setting of inflation targets and/or supply side policies – marks to be awarded in a similar way to those outlined above. ½ mark for stating approach, ½ mark for saying how and then ½ for the practical implementation/effect.

**Total 15 marks**

C3.

(a)  1.5 marks for each

A fixed exchange rate is one in which the government must intervene (½ mark) to maintain the value of the currency at a fixed value or within a given range (½ mark). To maintain the rate, it can buy and sell currency (½ mark). May also indicate other forms of intervention such as a change in the interest rate or use of inflationary/deflationary policy for the final ½ mark.

A floating exchange rate is determined purely by market forces (½ mark) and governments do not intervene in the market (½ mark). This exchange rate may appreciate, following an increase in demand

or fall in supply of the currency or depreciate following a decrease in demand or increase in supply of the currency (½ mark).

(b) 1 mark in each case for stating a point and then up to an additional mark for providing some additional detail.
Demand for UK goods and services from abroad
Relative interest rates
Relative inflation rates
Expectations
(c) 1 mark in each case for stating a point and then up to an additional mark for providing some additional detail.
Demand for foreign goods and services by UK households and businesses
Interest rates overseas
Speculation

(d) 1 mark per answer (need 2 advantages and 2 disadvantages, accept other relevant alternatives).

Exchange rate adjusts to reflect market conditions
No costs of intervention
Value of the currency will adjust regularly
Encouraged speculation
Changes may be insufficient to restore equilibrium

**Total 15 marks**

**END OF SECTION C**

D1

(a) An accurate diagram is required. 1 mark for supply curve, 1 mark for the demand curve, ½ mark for vertical axis label (price) and ½ mark for the horizontal axis label (quantity).

(b) Shortage (1 mark), 420 units (1 mark)

(c) 260 euros (½ mark) and 500 tonnes (½ mark).

(d) Increase in cost of production, leftward shift in supply (½ mark). At the original market price there will be excess demand so price will need to rise to restore equilibrium (1 mark) leading to a lower quantity traded and a higher equilibrium price (½ mark).

(e) Can select any two from the list below, 1 mark for each appropriate suggestion.

An increase in consumer income, increased advertising/marketing to entice consumers, an increase in the number of buyers, an increase in the price of substitute goods, a fall in the price of complements – accept other reasonable alternatives.

**Total 10 marks**

D2.

(a) Actual growth is the rate at which the economy is actually growing over a given period (1 mark). Potential growth differs as it refers to how the economy would grow if all the resources were fully employed (1 mark).

(b) Both axes labelled (time on the horizontal and gdp growth on the vertical or an appropriate equivalent) ½ mark. Should then show a cycle with each phase appropriately labelled ½ mark. Final mark is allocated across the diagram for the correct labelling of the cycle ½ mark for two correctly labelled parts. May use different but appropriate terminology.

boom (top of the cycle)
recession (downward part of the cycle)
recovery (upward part of the cycle)
slump (bottom part of cycle)

(c) 1 mark for each

Boom – increase in GDP growth and low levels of unemployment, possible rising prices due to increases in demand.

Recession – two quarters of negative economic growth, the economy is shrinking and is usually characterised by increases in unemployment and underused capacity, lower income, more business closures and a fall in tax revenue and increase in benefit payments.

Recovery – demand starts to grow and employment levels begin to improve. Prices and wages may start to rise and firms start to replace machinery as they gain business confidence.

Slump – economic growth is slow and unemployment is high.

(d) Only need to give one example for each case.

Improved standards of living, more choice, higher incomes and other appropriate alternatives (1 mark). Environmental damage, depletion of resources, greater inequality and other appropriate alternatives (1 mark).

**END OF SECTION D**