CARIBBEAN EXAMINATIONS COUNCIL
ADVANCED PROFICIENCY EXAMINATION

ECONOMICS

UNIT 1 – Paper 02

2 hours 30 minutes

(**21 MAY 2012 (a.m.)**)

READ THE FOLLOWING INSTRUCTIONS CAREFULLY.

1. This paper consists of **THREE** sections.

2. There are **TWO** questions in each section. Candidates **MUST** answer **THREE** questions, **ONE** from **EACH** section.

3. Answers for **ALL** questions must be written in the answer booklet provided.

4. Begin **EACH** question on a separate page.

5. Candidates may use silent, non-programmable calculators.

DO NOT TURN THIS PAGE UNTIL YOU ARE TOLD TO DO SO.

SECTION I

Answer ONE question from this section.

Draw ALL diagrams neatly and carefully and clearly label ALL axes and curves.

1. A consumer is consuming a combination of *Good X* and *Good Y* at equilibrium *A*. The price of *Good X* falls. The consumer therefore moves to another equilibrium, *B*.

    (a) (i) a) Define the terms 'indifference curve' and 'budget line'. **[2 marks]**

            b) Draw a diagram showing an indifference curve and a budget line, and use the diagram to explain consumer equilibrium. **[8 marks]**

        (ii) Using the diagram in (a) (i) b) above, explain how a decrease in the price of *Good X* moves the consumer to equilibrium *B*. **[5 marks]**

    (b) (i) The change from equilibrium *A* to equilibrium *B* is the total change.

            Explain what is meant by EACH of the following terms:

            a) 'Substitution effect' **[2 marks]**

            b) 'Income effect' **[2 marks]**

        (ii) With the aid of a diagram, explain the income and substitution effects using EITHER the Hicksian approach OR the Slutskian approach. **[6 marks]**

                                    Total 25 marks

2. A perfectly competitive firm producing microchips has recorded its fixed cost as $128. Its output levels and variable costs are shown in the table below.

Output Level	Variable Cost $	Total Cost $	Marginal Cost $	Average Fixed Cost $	Average Total Cost $
0	0	128	–	–	–
1	56				
2	90				
3	108				
4	116				

(a) (i) Write the formula for EACH of the following costs:

      a) Total cost

      b) Marginal cost

      c) Average fixed cost

      d) Average total cost

      e) Variable cost

[5 marks]

    (ii) Copy and complete the table to show the FOUR costs for EACH level of output. **[8 marks]**

(b) With the aid of a diagram, explain the relationship between the 'marginal cost' and the 'average total cost'. **[6 marks]**

(c) With the aid of a diagram, explain the relationship among the 'marginal cost curve', the 'supply curve' and the 'average variable cost curve'. **[6 marks]**

Total 25 marks

SECTION II

Answer ONE question from this section.

3. (a) (i) State the difference between 'normal profit' and 'positive economic profit' (abnormal profit). **[3 marks]**

    (ii) Explain the concept of 'market structure'. **[2 marks]**

    (b) Use the following characteristics to distinguish among the FOUR MAJOR market structures: (A table may be a helpful device in organizing your response.)

    (i) The number of firms in the industry

    (ii) The product

    (iii) Barriers to entry

    (iv) Control over price **[8 marks]**

    (c) An industry comprises 10 firms which recorded the following sales:

    ABC Corporation $1 650
    FBN Corporation $1 400
    ATT Corporation $1 350
    GNC Corporation $1 200

    The other six firms recorded sales of $500 EACH.

    (i) Calculate, for the industry

    a) the Four-Firm Concentration Ratio **[4 marks]**

    b) the Herfindahl-Hirschman Index. **[4 marks]**

    (ii) Interpret the TWO measures of industrial concentration in relation to market structures. **[4 marks]**

    Total 25 marks

4. (a) Define EACH of the following concepts:

    (i) 'Economic efficiency' **[2 marks]**

    (ii) 'Market failure' **[2 marks]**

  (b) (i) Distinguish between 'private benefits' and 'social benefits'. **[4 marks]**

    (ii) Explain how divergence between private benefits and social benefits causes market failure. **[1 mark]**

  (c) (i) Compare the characteristics of a 'public good' with those of a 'private good'. **[4 marks]**

    (ii) Explain how a public good may cause market failure. **[2 marks]**

    (iii) Explain how government may respond to the problem caused by public goods and externalities. **[2 marks]**

  (d) Draw a diagram to illustrate 'deadweight loss' and use the diagram to explain how a monopoly may cause market failure. **[8 marks]**

Total 25 marks

SECTION III

Answer ONE question from this section.

5. (a) (i) Identify TWO factors of production and their rewards. **[2 marks]**

    (ii) Explain why the demand for a factor of production is a derived demand. **[2 marks]**

  (b) (i) Outline the 'marginal productivity theory'. **[2 marks]**

    (ii) Explain how the marginal productivity theory is related to the demand for labour. **[3 marks]**

  (c) (i) With the aid of a diagram, distinguish between 'transfer earnings' and 'rent'. **[6 marks]**

    (ii) Assuming that the supply curve of the factor is vertical, state the values of rent and transfer earnings. **[2 marks]**

  (d) Discuss the effect of a monopsony on the labour market. **[4 marks]**

  (e) A computer has a two-year life span and generates marginal revenue product (MRP) of $3 000 at the end of the first and second years of its life. The interest rate is 5%.

    Apply the marginal productivity theory of the demand for capital to determine the highest price that should be paid for the computer. **[4 marks]**

Total 25 marks

6. (a) (i) Define the term 'wage differentials'. **[2 marks]**

    (ii) Outline TWO factors that give rise to wage differentials. **[4 marks]**

    (b) With the aid of a diagram, compare the level of wages in EACH of the following situations:

        (i) When the buyer has monopoly power in the production market **[5 marks]**

        (ii) When there is perfect competition in the labour market **[4 marks]**

    (c) (i) Explain TWO types of labour mobility. **[6 marks]**

        (ii) The CARICOM Single Market and Economy (CSME) permits labour mobility among CARICOM member states. Discuss the expected effect of this mobility on the labour market of CARICOM member states. **[4 marks]**

Total 25 marks

END OF TEST

IF YOU FINISH BEFORE TIME IS CALLED, CHECK YOUR WORK ON THIS TEST.