

FORM TP 2008179



TEST CODE **02116020**

MAY/JUNE 2008

CARIBBEAN EXAMINATIONS COUNCIL
ADVANCED PROFICIENCY EXAMINATION

ECONOMICS

UNIT 1 – PAPER 02

2 $\frac{1}{2}$ hours

22 MAY 2008 (a.m.)

INSTRUCTIONS TO CANDIDATES

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. Candidates may use silent non-programmable calculators.

SECTION I

Answer ONE question from this section.

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

1. (a) Define ANY THREE of the following terms:

- (i) Scarcity
- (ii) Production possibilities frontier
- (iii) Opportunity cost
- (iv) Production function
- (v) Price elasticity of demand

[6 marks]

- (b) The mythical country Caricombia can produce the following combinations of food and capital goods given its resource endowment:

Possibilities	a	b	c	d	e	f
Food:	0	1	2	3	4	5
Capital goods:	30	28	24	18	10	0

Draw a graph in which you plot Caricombia's production possibilities frontier (PPF) with food on the horizontal axis.

[9 marks]

- (c) (i) Show on the diagram you plotted in (b) above, ONE point that is attainable and ONE point that is unattainable and explain why you chose those points.

[4 marks]

- (ii) Show on the diagram ONE point that is efficient and ONE point that is inefficient and explain why you chose these points.

[4 marks]

- (d) (i) Discuss the assumption that you have made about Caricombia's technology in drawing your diagram.

[3 marks]

- (ii) Explain the effects of an improvement in Caricombia's food technology on its PPF. Show this on your diagram.

[5 marks]

- (iii) Explain the effect of an increase in all of Caricombia's resources on its PPF. Show this on your diagram.

[5 marks]

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- (e) (i) Calculate the opportunity cost of increasing food production from '3' to '4' ('d' to 'e'). [5 marks]
- (ii) Explain how the cost of producing food changes as more food is produced. In your explanation indicate what is responsible for the changes in the cost of food. [4 marks]
- (iii) Explain how Caricom's PPF will be affected in the future if it chooses to produce at point 'e' rather than point 'c'. [5 marks]

Total 50 marks

2. An increase in the relative price of chicken during the Christmas season will have both a substitution effect and an income effect.

- (a) Explain how an increase in the relative price of chicken will have BOTH a substitution effect AND an income effect and say what the net effect is likely to be. [6 marks]
- (b) List TWO major factors that can shift **the demand curve** of chicken to the right and discuss the relationship of EACH factor to the demand for chicken. [6 marks]
- (c) List TWO major factors that can shift **the supply curve** of chicken to the left and discuss the relationship of EACH factor to the demand for chicken. [6 marks]
- (d) ~~A 5% rise~~ in the price of beef decreases the quantity of beef demanded by 10% and increases the quantity of chicken demanded by 15%. A 10% increase in income increases the quantity of chicken demanded by 8%.
- (i) Write the formula for calculating the cross-elasticity of demand and calculate the cross-elasticity of demand between beef and chicken. [4 marks]
- (ii) Explain how a consumer can determine whether a good is a normal good or an inferior good. [4 marks]
- (e) (i) Explain THREE determinants of price elasticity of demand, OTHER THAN time. [6 marks]
- (ii) Draw the graphs illustrating a) perfect elasticity and b) perfect inelasticity. [4 marks]
- (iii) Show, using a graph, how elasticity can change along a straight-line downward sloping demand curve. [8 marks]
- (f) Discuss TWO ways that time impacts on price elasticity of demand for a product. [6 marks]

Total 50 marks

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SECTION II

Answer ONE question from this section.

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

3. (a) Define the term “market structure”. [2 marks]
- (b) Outline THREE similarities and TWO differences between perfect competition and monopolistic competition. [10 marks]
- (c) (i) Outline TWO similarities and THREE differences between monopolistic competition and monopoly. [10 marks]
- (ii) Name ONE monopoly and ONE firm in monopolistic competition in your country and justify your choices. [4 marks]
- (d) List FOUR barriers to entry that protect monopolies. [4 marks]
- (e) Firms in monopolistic competition are making positive economic profit.
- (i) Differentiate between “normal profit” and “economic profit”. [4 marks]
- (ii) Draw a diagram showing a firm in monopolistic competition making economic profit. Label the axes, the cost curves and revenue curves and shade the area showing the profit made by the firm. Show the price and output. [12 marks]
- (iii) Explain the long term effect of the situation in (e) (ii) above, on
- profit
 - the number of firms in the industry. [4 marks]

Total 50 marks

4. (a) Define the following terms:
- (i) Market failure
 - (ii) Private cost
 - (iii) Social benefit
 - (iv) Pareto efficiency [8 marks]
- (b) (i) State TWO characteristics of pure public goods. [2 marks]
- (ii) List TWO examples of public goods. [2 marks]
- (iii) Explain why the free rider problem leads to market failure. [3 marks]
- (c) (i) Define the term “externality”. [2 marks]
- (ii) Differentiate between a “positive externality” and a “negative externality”. [4 marks]
- (iii) Explain the effects of externalities on private and social costs and benefits. [8 marks]
- (iv) Explain how externalities affect the level of output of goods and services. [4 marks]
- (d) Identify TWO sources of market failure OTHER THAN public goods and externality. [2 marks]
- (e) Explain, using examples, how government can use EACH of taxation, subsidies and legislation to deal with market failure caused by externalities. [15 marks]

Total 50 marks