

**Economics Unit 1 Exam Semester 1 2020**

**Marking Guide**

**Section 1 (24 marks)**

1 D

2 A

3 D

4 B

5 A

6 B

7 C

8 B

9 A

10 D

11 C

12 D

13 A

14 D

15 C

16 C

17 B

18 A

19 B

20 C

21 A

22 C

23 D

24 B

**Section 2 (36 marks)**

**Question 25 (12 marks)**

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| a. There will be an increase in Demand – draw a new D curve to the right  At the initial price there will now be a shortage: Qd > Qs (see diagram below) | 1 mark  1-2 marks |
| b. A shortage will cause the price to rise  As price rises, qty demanded will fall while qty supplied will rise (move up along both the S curve & the new D curve) | 1 mark  1 mark |
| c. A rise in the expected future price will cause an increase in demand – D curve shifts to the right – causing the price to rise. | 1-2 marks |
| d. The govt would introduce a subsidy  Diagram – 2 marks: show an increase in supply – S curve shifts to the right causing equil. P to decrease & equil. Qty to increase  Yes it would improve equity by lowering price making them more affordable  This is more difficult – normally a subsidy decreases efficiency because the cost exceeds the increase in CS + PS. However a subsidy can increase efficiency in this case because of the external benefit of the face masks | 1 mark  1-2 marks  1 mark  1 mark |

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**Question 26 (12 marks)**

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| a. Price elasticity of demand measures the responsiveness of qty demanded to a change in price | 1 mark |
| b. Outline Any ONE factor – relate to sneakers  1) Availability of substitutes – if close substitutes are available then demand for sneakers will be relatively elastic  2) How necessary – if sneakers are viewed as essential then demand will be relatively inelastic  3) Proportion of income spent – expensive sneakers will be more elastic, while budget, no frills sneakers will be less elastic | 1 mark to identify factor  1 mark for brief explanation |
| c. Men’s sneakers: 8% fall in Qd; decrease in TR  Women’s sneakers: 4% fall in Qd; increase in TR | 1-2 marks  1-2 marks |
| d. Women would be willing to pay full price  Men would be more influenced by a discount sale  Reason: women’s demand is inelastic so sneakers must be more desirable/necessary than for men | 1 mark  1 mark  1 mark |
| e. Income elasticity measures the responsiveness of demand to a change in income  Income elasticity of demand for sneakers would be **positive**.  An increase in consumer income is likely to lead to an increase in demand for sneakers because they are a normal (or superior) good. | 1 mark  1 mark  1 mark |

**Question 27 (12 marks)**

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| a. Draw new supply curve shifting up by $20  Price buyers pay = $50  Price sellers receive = $30  Equil. Qty after the tax = 40,000 | 1 mark  1 mark  1 mark  1 mark |
| b. Tax revenue = $ tax x qty = $20 x 40,000 = $800,000/week  Annual revenue = 52 x $800,000 = $41.6 million | 1 mark  1 mark |
| c. The tax incidence would be shared equally  Incidence on buyers is $10; Incidence on sellers is $10 | 1 mark  1 mark |
| d. The tax will decrease consumer surplus – consumers purchase less rides at a higher price  The tax will decrease producer surplus – producers sell less quantity at a lower price  But the tax raises revenue which can be spent in the economy – in this case given to the taxi industry  However the tax revenue is less than the loss of CS & PS resulting in a deadweight loss. | 1 mark  1 mark  1 mark  1 mark |

**SECTION 3 (40 marks) – Answer TWO questions**

**Question 28** **(20 marks)**

(a) Illustrate and explain how each of the following would affect the market supply of a good:

* an increase in the price of the good
* an increase in input prices
* an improvement in technology
* an increase in expected future price of the good (12 marks)

(b) Define price elasticity of supply and discuss three determinants of price elasticity of supply.

(8 marks)

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| a. 3 marks x FOUR factors (2 for explanation; 1 for diagram)  1) An increase in price will cause a MOVEMENT up along the supply curve – an increase in price will cause qty supplied to increase (some may refer to this as an expansion in supply). Diagram showing movement along the S curve  2) An increase in input prices will increase production costs causing a decrease in supply – this will SHIFT the S curve to the left. Diagram showing shift of the S curve to the left  3) An improvement in technology will cause an increase in supply – this will SHIFT the S curve to the right. Diagram showing shift of the S curve to the right.  4) An increase in the expected future price will cause a decrease in supply now – this will SHIFT the S curve to the left. Producers will want to decrease supply now to take advantage of higher prices in the future. Diagram showing shift of the S curve to the left. | 1-2 marks  1 mark  1-2 marks  1 mark  1-2 marks  1 mark  1-2 marks  1 mark |
| b. 1 mark for defn + 1 mark for elaboration  Price elasticity of S is a measure of the responsiveness of supply (or qty supplied) to a change in price; e.g. If qty supplied increases by 2% after a 1% increase in price, then supply is said to be elastic.  2 marks x THREE determinants  1) Time: how much time producers have to respond to a change in price. In the short run S tends to be relatively inelastic; in the long run S becomes more elastic  2) Nature of production: manufactured goods tend to have more elastic supply since producers can respond to a price change more readily; agricultural products tend to be relatively inelastic.  3) Ability to store: if a producer can hold inventories in a warehouse then S will be relatively elastic e.g. non-perishable goods; perishable goods that cannot be stored for long will be inelastic | 1 mark  1 mark  1-2 marks  1-2 marks  1-2 marks |

**Question 29** **(20 marks)**

(a) Use a demand/supply model and the concepts of consumer and producer surplus to explain the benefits to both buyers and sellers from participating in a market. (8 marks)

(b) Price floors are often used in agricultural markets. Explain the purpose of a price floor and with the aid of a model analyse its effects on consumers, producers and market efficiency.. (12 marks)

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| a. 4 marks for consumer surplus (3 for explanation; 2 for diagram)  Explain consumer surplus: CS represents the net benefit to a consumer from entering a market – it is the difference between what a consumer is willing to pay & what they actually pay. The total benefits a consumer gets from entering a market is the area under the D curve – this comprises what they spend plus their CS.  Correctly labelled diagram to show CS *(see p. 82 P&K 6th ed)*  4 marks for producer surplus  Explain producer surplus: PS represents the net benefit to a producer from entering a market – it is the difference between what a producer is willing to receive & what they actually receive. The total benefits a producer gets from entering a market is the area under the S curve – this comprises their costs of production plus their PS.  Correctly labelled diagram to show PS *(see p. 84 P&K 6th ed)* | 1-2 marks  1-2 marks  1-2 marks  1-2 marks |
| b. Meaning of price floor – a minimum price set above the equilibrium price. It causes qty demanded to decrease & qty supplied to increase, resulting in a surplus.  Purpose – to raise incomes for agricultural producers &/or help stabilise prices  Correctly labelled diagram of a price floor *(see p. 91 P&K 6th ed)*  Effects on CS – will decrease because consumers have to pay a higher price & they consume less  Effects on PS – normally increases as long as producers income (TR) increases. However the price floor causes qty sold to decrease so effect may be uncertain It depends on P.E.D).  Effect on market efficiency – the price floor reduces market efficiency because it causes a deadweight loss (DWL) – a decrease in total surplus. | 1-2 marks  1 mark  1-3 marks  1-2 marks  1-2 marks  1-2 marks |

**Question 30** **(20 marks)**

Explain how each of the following is an example of market failure. Where appropriate use a model to support your answer.

* Market power
* Negative externality
* Common resource
* Public good

For each example discuss a policy option that could be used to overcome the market failure.

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| 5 marks x FOUR types of market failure  1) Market power – 2 marks explanation; 2 marks model; 1 mark policy  Occurs when firms restrict competition in a market in order to increase price & profits (monopoly behaviour). It causes market failure because it harms consumers & causes a decrease in total surplus (DWL)  Correctly labelled diagram showing market power *(see p. 108 P&K 6th ed)*  Policy option – govt could use price regulation on monopoly firms or could use legislation to prevent anti-competitive behaviour  2) Negative externality – when the act of consuming or producing a good creates an external cost on other people, e.g. a factory that pollutes the atmosphere may adversely affect people’s health – social costs > private costs. The market fails because there is overproduction resulting in a DWL. Most students will discuss negative production externality but if some do a negative consumption externality that is fine  Correctly labelled diagram showing negative externality *(see p. 112 P&K 6th ed)*  Policy option – govt could tax firms that pollute to reduce the external costs  3) Common resource – a good that is rival but non-excludable; e.g. fish in the ocean or endangered species. Rival means that consumption by one person affects the consumption of others while non-excludable means that these goods have no price – it is not possible to exclude non-payers. This results in the tragedy of the commons – the common resource is used up.  Policy option – govt need to restrict access /consumption of the common resource by issuing quotas or licences e.g. fishing  4) Public good – a good that is non-rival and non-excludable; e.g. national park, national defence. This means that everyone can consume the good/service at the same time but it is not possible to exclude non-payers or free riders. The market fails because these goods will not be provided by the market because they have no price.  Policy option – the govt needs to supply these goods and cover their cost from general taxation. | 1-2 marks  1-2 marks  1 mark  1-2 marks  1-2 marks  1 mark  1-4 marks  1 mark  1-4 marks  1 mark |