

The following are past-year H2 Economics CSQ lower-order thinking questions and their suggested answers. The context may change, but the explanations are generally in the same format :')

1. Microeconomics

1.1 The Market Economy

Explain whether an agreed minimum price for solar panels will always result in a 'new market equilibrium at a sustainable price' [4m]

- A minimum price is effective when it is set above the market equilibrium price
- At the minimum price P_{\min} , a surplus arises. Producers are not able to sell all the units of solar panels they have produced.
- However, the new market equilibrium at a sustainable price will not be achieved if producers seek to sell of their surplus solar panels in the black market.
- Black market is illegal and unmonitored → producers sell solar panels at a lower price → consumers diverting demand to the black market in search of cheaper solar panels.
- Prices in black market < minimum price → not sustainable

Using the information in Extract 2, calculate and interpret the cross-elasticity of demand in Japan between Australian chilled beef and (i) US chilled beef and (ii) chilled beef from the rest of the world.

$$XED = \frac{\frac{\Delta Q^d_A}{Q^d_A} \times 100\%}{\frac{\Delta P_B}{P_B} \times 100\%} = \text{(i) } 0.74, \text{ (ii) } 1.34$$

Given that the XED values > 0, both Australian chilled beef and beef from the rest of the world are substitutes to US chilled beef.

And with XED value in (ii) > in part (i), a 1% increase in the price of Australian beef will lead to a greater increase in quantity demanded in DD for beef from the rest of the world. As such, beef from the rest of the world is considered to be a stronger substitute in comparison to beef from Australia.

How could the difference in price of oil relative to price of natural gas in 2012 and 1993 be explained given the increase in production of both commodities?

- The increase in production in both commodities would have caused an increase in supply and a subsequent decrease in equilibrium price of both commodities
- However, the supply of natural gas had increased more significantly as compared to the supply of oil, leading to the relative price of oil to increase because the actual price of oil falls less than the actual price of natural gas OR
- The demand for oil may have increased more than the demand for gas, causing the relative price of oil to rise.

1.2 Market Failure

With reference to Extract 1, identify and explain one negative externality arising from the 'diet Westernization' in Japan [2m]

'Diet westernization' contributes to obesity. As one who is obese is likely to seek treatment and absent himself more frequently, this affects the productivity of his *co-workers* (third parties).

1.3 Market Structures

Explain the likely impact on the OPEC cartel and its individual members following the increased production of oil as a result of the fracking boom [5m]

- $\uparrow SS_{\text{oil}}$

Impact on OPEC cartel:

- $\downarrow DD_{\text{OPEC oil}}$ and demand becomes more price elastic → charge lower price given the profit-maximizing condition of $MC = MR$ and produce at a lower level of output. (monopoly diagram) → \downarrow Profits for OPEC cartel.

Impact on individual members

- For OPEC members who rely on oil as a key export, $\downarrow P$ and $\downarrow Q$ will affect NY, employment and BOP
- $\downarrow X \rightarrow \downarrow AD \rightarrow \downarrow NY \rightarrow \downarrow$ employment
- $\downarrow X \rightarrow$ worsen current account position

Compare the likely BTE facing potential entrants to guar farming with those to oil production by fracking [3m]

BTE are obstacles that make it difficult for firms to enter a market. In the industry of guar farming, the likely BTE facing potential entrants would be lower than those to oil production by fracking.

- To enter guar farming, a potential entrant would only need to have some land and guar seeds and the materials to grow the crop.
- In contrast, oil production by fracking requires specialized technology and skilled labour to find the trapped shale oil, build the oil rig, use hydraulic blasting to release the oil and finally drilling to extract the oil. These all require 'high capital expenditure' and it is higher as compared to guar farming.

2. Macroeconomics

2.1 International Trade

Explain what is meant by the term 'protectionism' [2m]

Protectionism occurs when a country implements policies which distort market forces in order to give a competitive advantage to the domestic industries of its economy.

Protectionism can take the form of e.g. import tariffs which make imports more expensive, or export subsidies that make exports cheaper in the world market and therefore more price competitive.

Suggest 2 ways in which changes in the price of exports and imports might lead to the change in India's terms of trade in 2013 compared to 2005 [2m]

The terms of trade refer to the number of units of imports that can be obtained with one unit of exports. It is expressed as the ratio of the price of exports to the price of imports.

India's TOT increased from 2005 to 2013 due to:

- $\uparrow P_X$ while P_M unchanged
- $\downarrow P_M$ while P_X unchanged

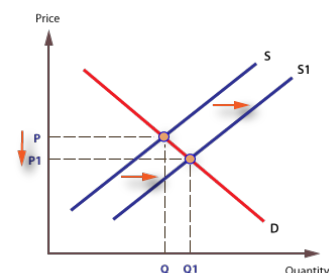
Explain how a rise in terms of trade can be consistent with a strong rise in the value of India's net exports of agricultural products [4m]

- Assume India's \uparrow TOT is due to $\uparrow P_X$ of agricultural products
- $PED < 1$ for agricultural products as staple food e.g. wheat, rice, sugar are basic necessities
- $\uparrow P_X \rightarrow$ less than proportionate $\downarrow Q_d \rightarrow \uparrow X$
- Assume India's \uparrow TOT is due to $\downarrow P_M$ of agricultural products
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- $\downarrow P_M \rightarrow$ less than proportionate $\uparrow Q_d \rightarrow \downarrow M$

Since the value of India's net exports is $P_X Q_X - P_M Q_M$, there is a strong rise in value of India's net exports of agricultural products.

With the help of a diagram, explain how it could be claimed that subsidies allow the Chinese to dump solar panels in the EU [4m]

- Dumping occurs when a country sells its exports in another country at a price lower than the marginal cost of producing the good.
- Subsidies $\rightarrow \uparrow SS_{\text{solar panels}} \rightarrow \downarrow P + \uparrow Q$
- Without subsidies, price of Chinese solar panels would be higher at P_0 and quantity produced lower at Q_0
- The subsidies have allowed China to sell large quantities of solar panels in the EU at very low prices which are likely lower than their actual MC had they not been subsidised.



2.2 Introduction to Macroeconomics

Explain how the opening of the new potash mine in North Yorkshire would create 'indirect jobs' [2m]

- Owners of new potash mine undertake investment by spending on fixed capital formation → $\uparrow DD$ for capital goods such as construction and industrial equipment produced by other firms in related industries. To meet the $\uparrow DD$, firms supplying these materials will hire more workers.
- \uparrow Household income → \uparrow 'C' in other industries such as recreation, food, beverage etc. This will further lead to indirect job creation through the multiplier effect.

2.3 National Income Accounting

Explain how productivity and living standards are related [2m]

- As productivity increases, more output can be produced using the same amount of input. As such, more goods and services could be consumed, and this increases the material aspect of SOL
- OR as productivity increases, more output can be produced using the same amount of input, increasing the rate of return of investment, which helps to drive economic growth as more investment takes place. This secures the employment of workers and allow workers to command higher wages, increasing their purchasing power and translating to a higher level of material well-being.
- OR as productivity increases, more output can be generated with the same man hours. As such, workers could spend less time on work and have more time for leisure, thereby increasing the non-material SOL

2.4 Exchange Rate

With the help of a diagram, explain why the collapse of the potash cartel could erode the value of the Canadian dollar [4m]

- Collapse of potash cartel → potential customers delay their purchase due to expectation that prices will drop in future.
- Potash account for 1.3% of Canada's total export → $\downarrow DD_{\text{potash}}$ leads to $\downarrow X$ → $\downarrow DD$ for C\$ → depreciation.

Explain why the change in price of a barrel of crude oil has caused a fall in Saudi Arabia's foreign currency reserves [4m]

- Fall in oil prices → \downarrow price of oil exports of Saudi Arabia. PED for oil (in general) < 1 as there are few substitutes which can replace the usage of oil in the production processes of many finished goods. → $\downarrow Qd$ less than proportionately → $\downarrow X$
- $\downarrow X$ → $\downarrow DD_{\text{riyal}}$ → depreciation of the riyal
- According to extract, since the Saudis peg the riyal to the USD, the government has to artificially $\uparrow DD_{\text{riyal}}$ by using foreign currency reserves to buy more riyal in the foreign exchange market in order to maintain the peg. → depletion of Saudi Arabia's foreign currency reserves.

2.5 Unemployment

What is the opportunity cost to the Saudi Arabian economy of women not participating in the labour market?

The opportunity cost to the Saudi Arabian economy is the increase in productive capacity / lower wages / productivity as a result of women participating in the labour market.

2.6 Balance of Payments

Explain whether you would expect the UK trade balance improving to lead to a slump in the value of the pound [2m]

- No. The improvement in trade position, possibly due to an increase in export revenue, would cause DD_{pound} to increase, and hence an appreciation of the pound.

OR

- No. The improvement in trade position, possibly due to a fall in import expenditure, would cause SS_{pound} to fall, and hence an appreciation of the pound.

State how the remittances by foreign workers are included in Saudi Arabia's balance of payments [2m]

Factor income earned by foreigners who work in Saudi Arabia remitted back to their source country are included under the Net Income Flows in the Current Account under Saudi Arabia's BOP and constitute a debit item.