



Coimisiún na Scrúduithe Stáit
State Examinations Commission

LEAVING CERTIFICATE 2009

MARKING SCHEME

ECONOMICS

HIGHER LEVEL



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Marking Scheme and Support Notes

- There is no suggestion that the enclosed notes are exhaustive or complete.
- Further relevant information presented by candidates will be marked and rewarded on their merits.
- The detail required in any answer is determined by the context and the manner in which the question is asked and by the number of marks assigned to the answer in the examination paper. Requirements may therefore vary from year to year.

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SECTION A (100 marks)

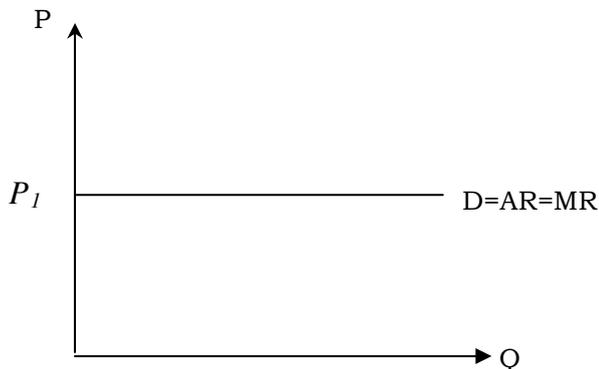
1. Outline **two** non-insurable risks faced by entrepreneurs.

- Loss of profits due to falling demand
- Poor decision-making / poor management.
- Industrial relations disputes.
- Changes in consumers taste or fashion.
- Entry of competition into the industry.
- Changes in competitive conditions e.g. new legislation.

2 points @ 8 marks each for development

(16 marks)

2. The diagram below represents the demand curve facing a firm in Perfect Competition.



This demand curve is;

(✓ correct answer)

- Unitary Elastic
- Perfectly Inelastic
- **Perfectly Elastic**

State the reason for your choice:

- Any deviation in price from P_1 will result in quantity demand falling to zero.

Perfectly elastic: **4 marks** and bulleted point above: **12 marks**

(16 marks)

3. Ireland has a mixed economy. What do you understand by the underlined term? State **one** economic advantage, and **one** economic disadvantage of this economic system.

Explanation:

An economy that incorporates elements of both central planning (government involvement) and private enterprise in its economic system.

Advantage:

- Benefit from efficiency encouraged by free enterprise with regulation from central government.
- Entrepreneurial talent is encouraged.
- Ensures a fairer distribution of wealth within the country.
- Regulation by the government is essential to limit possible abuses of the market.
- Provision of essential services may be provided by government.

Disadvantage:

- The government may be forced to financially support unsuccessful enterprises in the short-term which will cost the public in the long-term.
- A large public sector and private sector may be politically divisive which could affect how economic problems are solved.
- State intervention may result in higher taxes / bureaucracy / inefficiencies.
-

**Explanation: 8 marks. one advantage @ 4 marks and one disadvantage @ 4 marks
(16 marks)**

4. Define cost-push inflation. Identify **two** sources of this form of inflation in the Irish economy.

Definition:

Any increase in the general level of prices due to an increase in the costs of production/costs of inputs faced by the producer.

Sources:

- Increased wage demands due to minimum wage or social partnership agreements.
- Indirect taxes imposed on business such as VAT and excise duties on goods.
- Increased prices for raw materials e.g. oil.
- Increased costs of production e.g. utility charges; costs of rent; insurances etc.

Definition: 8 marks. two sources @ 4 marks each.

(16 marks)

5. The demand for land is derived demand. Explain what is meant by the underlined term with reference to land.
- Where a factor of production is demanded for its contribution to the production process.
 - The demand for land will decrease if there is a decrease in the demand for housing.

Explanation: 16 marks graded

(16 marks)

6. Outline **two** possible economic effects of UK Sterling (£) falling in value relative to the euro (€) for the Irish economy.
- **Import Prices Cheaper**
Price of imports from UK has decreased. This has resulted in a lower import bill for Irish producers / increase in imports from the UK / more Irish people holidaying in the UK.
 - **Exports Prices Dearer**
Price of exports from Ireland to UK has increased and therefore have become less competitive. This has resulted in reduced exports to the UK / less UK visitors holidaying in Ireland.
 - **Employment**
With a reduction in exports, employment in those industries which depend on Irish exports to the UK will fall e.g. food production such as pork products.
 - **Slowdown in rate of economic growth**
With the loss of jobs, spending within the economy falls. Expenditure by the government on social welfare increases. Combined, these will negatively impact on the rate of economic growth.
 - **UK Investment in Ireland discouraged**
It will be more costly for UK firms to purchase capital goods/invest in Ireland.

2 points: 17 marks graded.

(17 marks)

7. (a) State the **Law of Diminishing Marginal Utility**.

This law states that as a consumer consumes additional units of a good the marginal utility/ extra satisfaction derived from each additional unit consumed will eventually decline.

Definition @ 9 marks

(b) The table below illustrates the Law of Diminishing Marginal Utility.

Number of units consumed	1	2	3	4	5	6
Total Utility in units	30	65	85	100	110	115
Marginal Utility in units	30	35	20	15	10	5

5 figures @ 1mark each= 5 marks

Complete the table and state the point after which diminishing utility set in.

Diminishing utility sets in after the consumption of the 2nd unit/when the 3rd unit is consumed.

3 marks

(17 marks)

8. Define 'economic development'. Explain **two social costs** of economic development.

Definition:

An increase in GNP per head of population, which is accompanied by a fundamental change in the structure of society.

Explain two social costs:

- Pollution of air/water e.g. water pollution in Galway.
- Disfigurement of the landscape e.g. construction of roads disfigures the landscape.
- Possible loss of cultural heritage e.g. the construction of M3 through Hill of Tara.
- Traffic congestion in cities and towns with resulting problems.
- Global warming: increased carbon emissions will affect global weather patterns.
- Reduction in public amenities / urban sprawl/communities have less public spaces.

Definition: 8 marks.

2 Social Costs: 5 marks + 4 marks.

(17 marks)

9. Economists have commented on Ireland's 'greying population', i.e. the structure of Ireland's population is getting older. Outline **two** economic effects of this development for the Irish economy.

- The participation rate falls: as more people reach retirement age, the supply of labour may be affected. Some may wish to work part-time. Some may retire.
- Reduced mobility of labour: as people get older they are less likely to move to a different location seeking work.
- Possible increased tax burden: with larger numbers of people over 65 the dependency ratio may increase, resulting in the need for higher taxes in the working population.
- Increased government expenditure: the government may spend a greater proportion of its revenue on the provision of services for the elderly such as medical care, free transport etc.
- Pressure on provision of state pensions: the government may encourage individuals, through tax incentives, to avail of private pensions in order to reduce the pressure on the government to provide state pensions.
- Changing pattern of demand: demand for certain goods and services required by older people will increase e.g. nursing homes; medication etc.

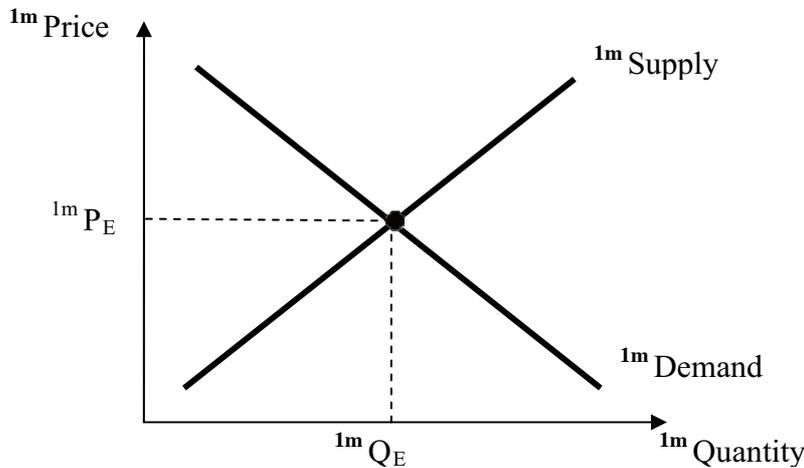
2 points @ 17 marks graded

(17 marks)

Question 1 Demand, Supply & Elasticity

- (a) (i) Show, by means of a labelled diagram, the market demand and supply curves for games consoles e.g. Xbox, PlayStation, Nintendo DS. Identify and explain the market equilibrium position.

Labelled Diagram: 6 marks



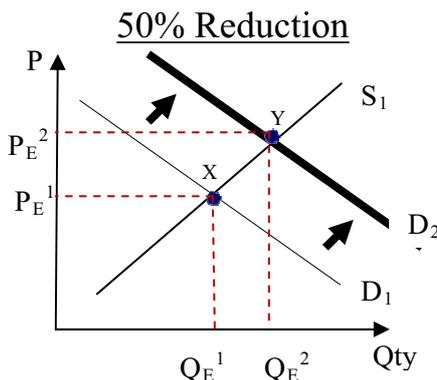
Marking Diagram	
Price:	1m
Quantity:	1m
Supply Curve:	1m
Demand Curve:	1m
PE:	1m
QE:	1m

Explanation: 3 marks

The firm is in equilibrium where the market demand curve equals the market supply curve and there is no tendency for the price to change.

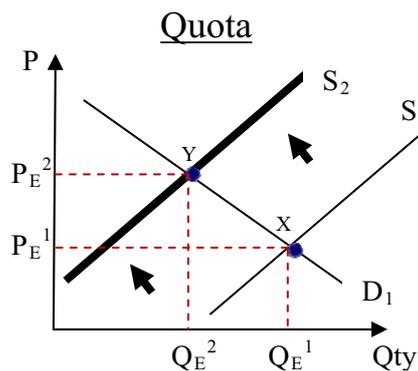
- (ii) Explain, with the aid of a separate diagram in **each** case, the effects which **each** of the following is most likely to have on the above equilibrium position:

- 50% reduction in the price of computer games used with the games console;
- Quota placed on the quantity of games consoles entering Ireland;
- Government introduce a 2% levy (tax) on all income earned.



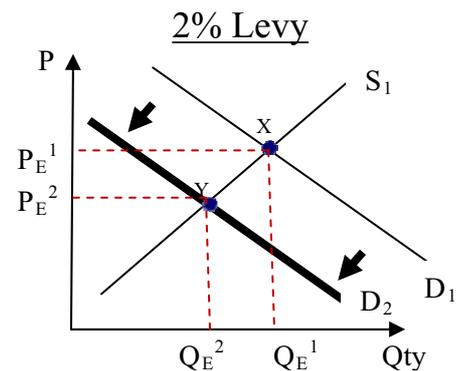
- D/C shifts to the right (D_2)
- Explanation:
- Because the complementary good is now cheaper
- New **higher** P_E^2
- New **higher** Q_E^2

7 marks graded



- S/C shifts to the left (S_2)
- Explanation:
- Because less Consoles can be imported
- New **higher** P_E^2
- New **lower** Q_E^2

7 marks graded



- D/C shifts to the left (D_2)
- Explanation:
- Because consumer income has fallen
- New **lower** P_E^2
- New **lower** Q_E^2

7 marks graded

(b) (i) Define income elasticity of demand **and** price elasticity of demand. **6 marks**

Income Elasticity of Demand measures

The percentage / proportionate change in the demand for a good caused by the percentage / proportionate change in income.

Price Elasticity of Demand measures

The percentage / proportionate change in the demand for a good caused by the percentage / proportionate change in the price of that good.

(ii) Which figure stated below is most likely to represent each of the following:

- **Income** elasticity of demand for low price cuts of meat;
- **Income** elasticity of demand for Apple iPhones;
- **Price** elasticity of demand for Petrol.

- 1.6 - 0.1 + 4.3

Give reasons for your choice in **each** case.

Category	Answer	Reason
Income elasticity of demand for low price cuts of meat	- 1.6	<ul style="list-style-type: none"> • low price cuts of meat is an inferior good so it has a negative YED. • low price cuts of meat is not a necessity so it is income elastic (>1)
Income elasticity of demand for Apple iPhones	+4.3	<ul style="list-style-type: none"> • Apple iPhones are a normal good so they have a positive YED. • Apple iPhones are a luxury so they are income elastic (>1).
Price elasticity of demand for Petrol	- 0.1	<ul style="list-style-type: none"> • Petrol is a normal good so it has a negative PED. • Petrol is a necessity so it is price inelastic (<1).

3 answers @ 8 marks each = 24 marks

(b) Assume **Income** elasticity of demand for games consoles is **+ 2.5** and total sales in 2008 were 100,000 units. Calculate the expected total sales for the year if consumers' incomes are expected to fall by 8% in 2009. Show your workings.

- If income decreases by 8% then sales will decrease by $(8\% \times 2.5) = 20\%$.
- Sales will fall by 20% of 100,000 units = 20,000 units.
- Sales in 2009 will equal $100,000 - 20,000 = 80,000$ units.

15 marks graded

Question 2 Imperfect Competition

(a) (i) State and explain the assumptions underlying the theory of **imperfect competition**.

1. There are many buyers in the industry.

- An individual buyer, by his/her own actions, can't influence the market price of the goods.

2. There are many sellers in the industry.

- An individual seller can influence the quantity sold by the price it charges for its output.

3. Product differentiation exists.

- The goods, supplied by the producer, are not homogenous but are close substitutes.
- Firms use branding to distinguish their products from one another.

4. Freedom of entry and exit.

- No barriers to entry exist within the industry.
- It is possible for firms to enter/leave the industry as they wish.

5. Reasonable knowledge.

- Within the industry each firm has reasonable knowledge of profits made by other firms.
- Consumers have a reasonable knowledge of the prices being charged for different products.

6. Each firm attempts to maximise profits.

- Firms produce where $MC = MR$
- Each firm will attempt to minimise costs of production.

5 points @ 4 marks each graded

(ii) Outline the advantages imperfect competition may offer to consumers.

- **Greater choice**

Goods are not homogenous, but are close substitutes, therefore consumers have a greater choice of goods/services.

- **Normal Profit**

In the long-run consumers are not being exploited as the firm is earning normal profits.

- **Lower prices**

Competition between firms in the industry will help lower prices and make them more competitive for consumers.

Some items such as newspapers, magazines, sporting and music events may be cheaper due to the revenues earned by the supplier from competitive advertising.

- **Innovative goods/services**

Innovation is encouraged as firms will constantly strive to gain a competitive edge over their rivals, hence, consumers get the benefit of modern up-to-date goods/services.

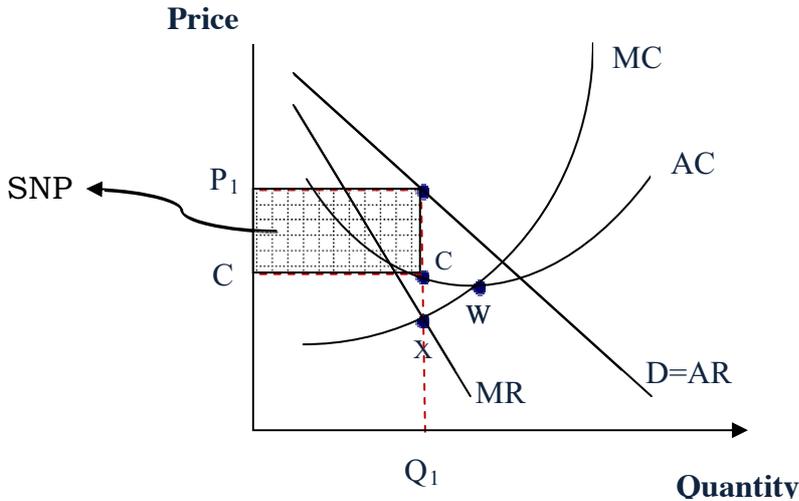
- **Access to information**

Consumers may have more information available to them because of the extensive competitive advertising used within the industry.

2 points @ 5 marks each graded

(b) Explain with the aid of a diagram in each case the conditions for a profit maximising firm to be in equilibrium under imperfect competition:

(i) **In the short run**



Marking of Diagrams

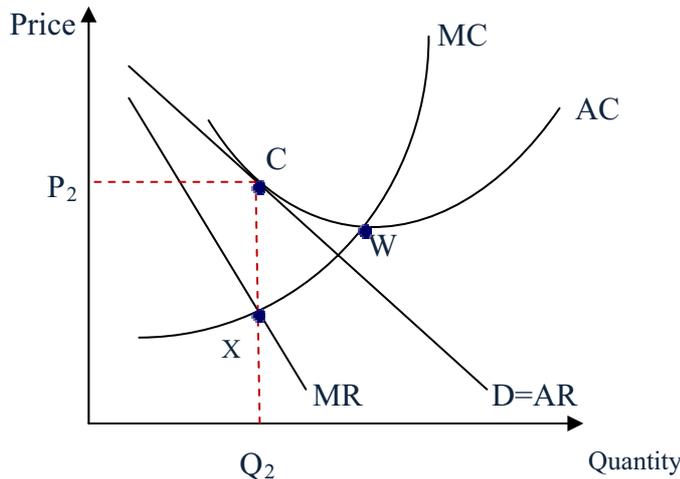
Short Run	Long Run
P & Q	
MR	
D=AR	AC = AR:
AC	Correct equilibrium:
MC	Lowest point of AC
Correct equilibrium	
7 marks	5 marks

Explanation of short run equilibrium:

- Equilibrium/ Profit maximisation occurs at point X where $MC = MR$ (*MC is rising and cuts MR from below*).
- The level of output produced is Q_1 and the price the firm sells this output at is P_1
- The average cost of production is shown at point C / not producing at lowest point of AC.
- This firm is earning super normal profits because $AR > AC$.

4 points @ 2 marks each = 8 marks

(ii) **In the long run.**



Explanation of long run equilibrium:

- Equilibrium / profit maximisation occurs at point X where $MC = MR$ (*MC is rising and cuts MR from below*).
- The level of output produced is Q_2 and the price the firm sells this output at is P_2 .
- The average cost of production is shown at point C.
- This firm is earning normal profits because $AR = AC$.
- The firm is not producing at the lowest point of AC / this indicates that the firm is wasting scarce resources.

5 points @ 2 marks each = 10 marks

- (c) 'Major food retailers in the Irish market, such as Aldi, Dunnes, SuperValu and Tesco, operate under conditions of Imperfect Competition'.

Do you agree with this statement?

Give reasons for your answer, referring to major food retailers in the Irish market mentioned above.

No, I do not agree with this statement. It is an **oligopolistic market** because:

1. The industry is dominated by a few large retailers/multiples, who hold a major share of the market such as Tesco, Dunnes Stores, Superquinn etc.
2. New firms may find it difficult to enter due to barriers to entry such as economies of scale, brand proliferation and control by existing firms of the channels of distribution.
3. Mutual interdependence between the firms: Firms interact by taking account of each others marketing / pricing strategies. They are concerned with maintaining or increasing their share of the total market e.g. the current Tesco and Dunnes Stores advertising / pricing campaigns.
4. The products sold are close substitutes: Competitive advertising is important as is heavy 'product loyalty' promotion. Various gimmicks are used to attract customers. Sellers also use 'brand names' extensively to maintain consumer loyalty.

2 reasons @15 marks graded

(Development must refer to the food retailers in the Irish market)

Note:

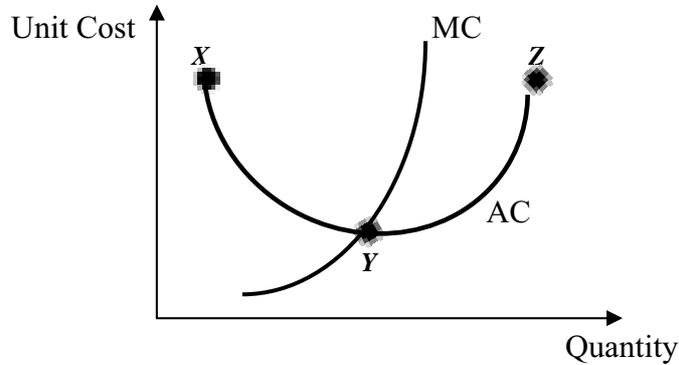
Arguments for imperfect competition from a local market point of view were also accepted

Question 3 Costs of Production

(a) The Short Run Average Cost (AC) of a firm is usually shown as a U-shaped curve.

(i) State and explain the reason(s) for the shape of the AC curve below:

- From point X to Y;
- From point Y to Z.



Downward sloping from X to Y	Upward Sloping from Y to Z
<ul style="list-style-type: none"> • Specialisation: Specialists may be employed or existing workers become more efficient resulting in lower unit costs. • Fixed Costs spread over larger output: As the number of units produced increases the unit cost falls. 	<ul style="list-style-type: none"> • The Law of Diminishing Marginal Returns. This law will apply after a certain point resulting in an increase in the amount of variable factors used per unit produced, resulting in higher unit costs. <i>or</i> Example to illustrate why costs increase.
ONE point @ 7 marks graded	ONE point @ 6 marks graded

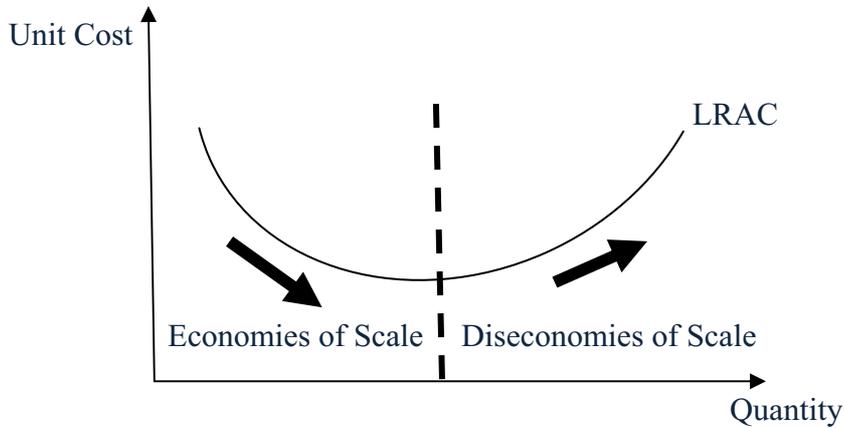
(ii) Explain the relationship between the Marginal Cost (MC) and Average Cost (AC) curves as shown above

- When MC is greater than AC then AC is rising.
- When MC is less than AC then AC is falling.
- When MC is equal to AC the AC is at its minimum point/constant.

3 points @ 4 marks each graded

(b) 'The shape of a Long Run Average Cost (LRAC) curve is determined by economies and diseconomies of scale'.

(i) Explain this statement, with the aid of a clearly labelled diagram.



- LRAC slopes downwards due to increasing returns to scale;
- LRAC slopes downwards because economies of scale are dominant over this range of output.
- LRAC slopes upwards due to decreasing returns to scale;
- LRAC slopes upwards because diseconomies of scale are dominant over this range of output.

6 marks graded

(ii) Define **Internal Economies of Scale** and **External Economies of Scale**.

Internal Economies of scale:

These are forces **within** a firm which cause the average / unit costs of that firm to decline as the firm grows in size.

External Economies of scale:

These are forces **outside** a firm which cause the average / unit costs of that firm to decline as the industry grows in size.

2 @ 6 marks each graded

(iii) State and explain **two** examples of **each** economy.

INTERNAL	EXTERNAL
<p>1. Increased use of specialised machinery A firm may be able to buy/use more specialised equipment/machinery resulting in a reduction in unit costs/machinery fully utilised</p>	<p>1. Better infrastructure. As roads / communications etc. improve they will benefit all firms.</p>
<p>2. Labour economies / Greater specialisation of workers If a particular job can be separated into separate and distinct components it may result in a reduction in costs.</p>	<p>2. Bulk purchasing of raw materials by the industry. As an industry expands firms require more materials / components. These may become cheaper as suppliers expand to meet increased demand.</p>
<p>3. Construction economies Large plants cost less per cubic foot than smaller ones.</p>	<p>3. Development of specialist firms Some of the jobs, which a firm once performed may be contracted out to specialist firms at reduced costs e.g. the supply of linen to hotels.</p>
<p>4. Buying economies Larger quantities bought may result in bigger discounts.</p>	<p>4. Development of separate R & D units As industry becomes very large, R&D agencies may set up to provide facilities for individual firms / the costs of research may be shared between firms <i>or</i> with a public body like Teagasc.</p>
<p>5. Economies in distribution Lower unit cost of delivery.</p>	<p>5. Suppliers of Machinery Manufacturers of machinery will be encouraged to design, develop and produce machines for expanding industry. These advanced machines will help reduce costs.</p>
<p>6. Financial economies Larger firms may avail of lower interest rates/larger firms better chance of acquiring a loan</p>	<p>6. Development of Training Courses Workers in expanding industries may be provided with training courses by VECs, FÁS thereby helping them become more efficient.</p>
<p>7. Managerial economies As a firm grows, management costs may not grow in proportion to the growth in the firm.</p>	<p>7. Supports from Public Bodies. Some public bodies help particular industries e.g. Failte Ireland / FAS may help firms in the tourism industry.</p>
<p>8. Production Process economies. A large firm may be able to run one process into the next without costly discontinuities</p>	<p>8. Subsidiary Trades may develop As an industry grows subsidiary trades may develop to service the expanding industry e.g Hotels, B&B's located close to airports etc.</p>
<p>9. Indivisibility problem reduced. If the volume of production increases, the unit cost may be lower e.g. glass-making furnaces may operate around the clock to save costs of cooling and re-heating/ full capacity used</p>	<p style="text-align: center;">Internal 2 @ 3 marks each.</p> <p style="text-align: center;">External 2 @ 3 marks each.</p>
<p>10. Marketing economies Savings in the cost of advertising e.g. NIKE advertising globally/ bigger firms bigger advertising campaigns.</p>	

- (c) ‘The Irish government should encourage initiatives that will prevent further cost increases and in turn sustain employment in small firms’.
Suggest with reasons **two** actions the government could take to improve the competitiveness of small firms.

- **Reduce the minimum wage / wage restraint.**

Employers would be able to get cheaper labour and therefore reduce costs.

By negotiations for example through lowering direct taxes, the government could reach agreement with the social partners to limit pay rises

- **Reduce utility charges.**

A reduction in costs for electricity, gas, postage, waste charges etc. or any state service provided for small businesses would help reduce costs of production.

- **Reduce taxation.**

A decrease in indirect taxes e.g. VAT or excise duty on fuel or raw materials would reduce costs to small business.

A decrease in direct taxes e.g. CPT would help firms reduce their costs.

A reduction in income tax may encourage wage moderation thus helping firms to lower their costs.

- **Reduce bureaucracy.**

Eliminate restrictions and excessive paperwork, thereby reducing administrative costs.

- **Subsidies to firms.**

By reducing the rate of employer’s PRSI it becomes cheaper to employ labour.

By subsidising training costs / export credit insurance a firm’s costs may decrease making them more competitive.

- **Develop infrastructure.**

Traffic gridlock/lack of broadband and poor infrastructure generally increase costs for small business. By improving the infrastructure it should become more efficient and therefore less expensive to move goods and services around the country.

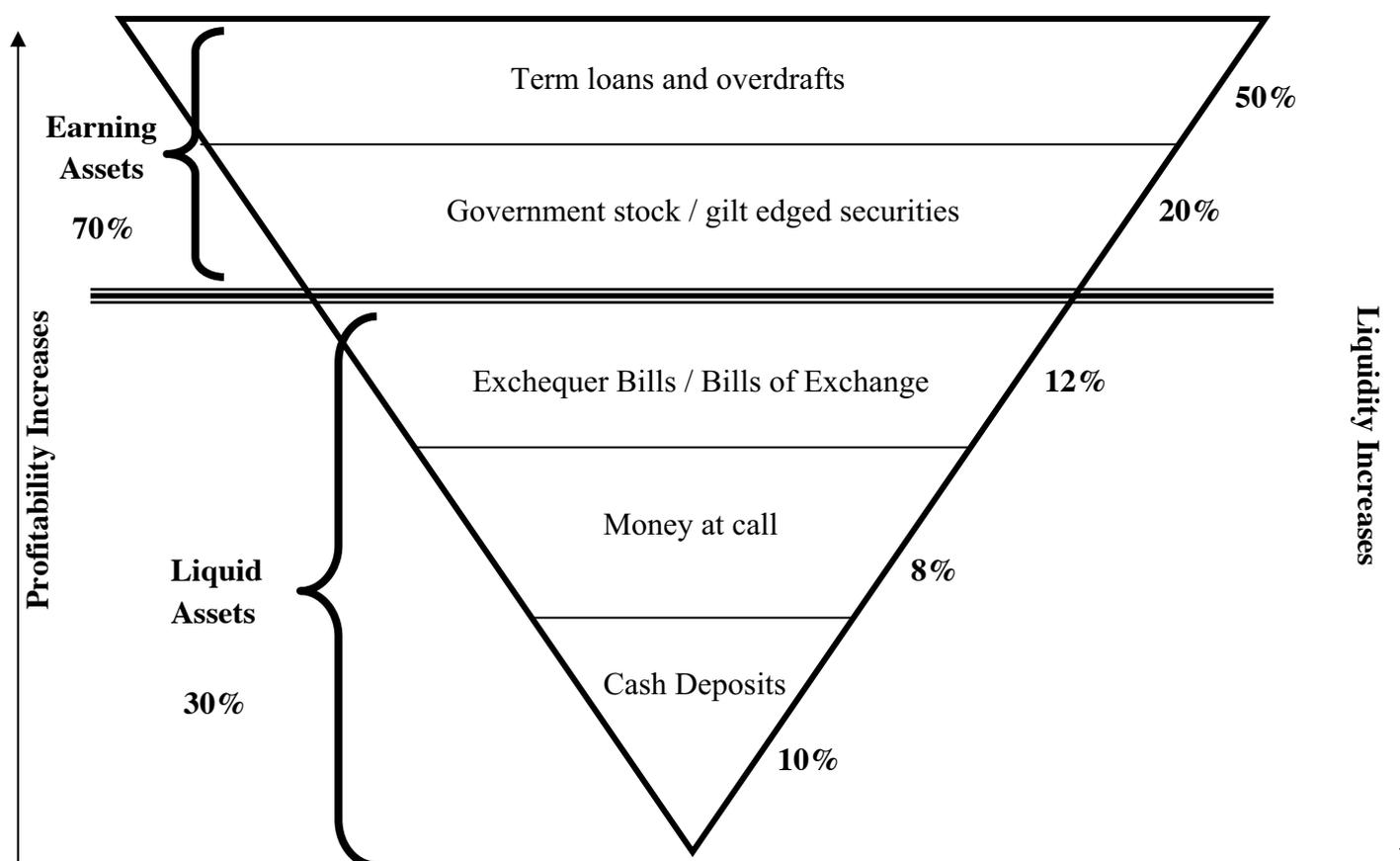
2 points @ 10 marks each graded

Question 4 Money & Banking, Capital

- (a) 'Banks may fail by overextending their loan book'.
Explain this statement within the context of a bank's twin requirements of liquidity and profitability.

A bank has twin requirements:

- **Profitability:** refers to the need for a bank to make as much profits as possible from its assets to satisfy its shareholders. The more profitable the asset is the less liquid it is.
- **Liquidity:** refers to the need by a bank to have liquid assets in order to meet the demand for cash by its customers. The more liquid the asset is the less profitable it is.
- Banks must strike a balance between the twin requirements of profitability and liquidity. As a result banks structure their holding of assets along the following lines:



- By focusing on profitability (extending credit) at the expense of liquidity a bank may give loans to high risk ventures e.g. commercial property development loans. Property loans are highly illiquid but can be very profitable. A bank may run the risk of increasing bad debts, falling share prices, a lack of capital and possible bank failure.
- By ignoring liquidity requirements, banks may not have enough cash to meet the demand of their depositors and this could result in a 'run' on the banks and result in bank failure.

25 marks graded

(b) Keynes' concept of 'Liquidity Preference' is based on three reasons why people desire to hold wealth in money form.

(i) State and explain **each** of these reasons.

Transactionary motive	Precautionary motive	Speculative motive
People desire to hold money for day-to-day expenses e.g. buying goods & services	People desire to hold money for emergencies/rainy day e.g. illness, house repairs.	People desire to hold money for any possible profitable future investment opportunities.

3 reasons (stated and explained) @ 6 marks each graded

(ii) Discuss the effect, if any, a fall in interest rates is generally expected to have on **each** of these reasons.

Motive	Effect of fall in interest rates	Marks
Transactionary	The demand for money for transactionary reasons is not affected by the fall in the rate of interest. Why? People need to have cash for day-to-day spending and this, allied to their level of income, not rates of interest determines the motive.	4 marks graded
Precautionary	The demand for money for precautionary reasons is affected slightly (negatively) by the rate of interest. Why? As interest rates fall slightly more money will be held for precautionary purposes, due to the opportunity cost of lower rates of interest.	4 marks graded
Speculative	The demand for money for speculative reasons is greatly affected (negatively) by the rate of interest. Why? As interest rates fall more money will be held for speculative purposes as people will hold more wealth in cash form to profit from future higher rates of interest.	4 marks graded

(c) Outline how the recent tightening (reduction) in the availability of credit may affect:

(i) The Irish Motor Industry:

- **Decreased demand for cars.**

It is more difficult for customers to avail of credit in order to purchase cars. This has led to a fall in the demand for both new and second-hand cars.

- **Increased redundancies**

With less demand for cars the numbers of people employed in the sale of cars has declined.

- **Business Closures/Consolidations**

Many small independent car dealerships can not survive and close.

Inability to get credit may result in cash flow problems for the firms, inability to pay suppliers and possible closure.

(ii) Inflation:

- **Inflation will decrease**

The supply of money/credit will fall causing a decrease in the spending power of individuals. This fall will lead to a reduction in demand-pull inflation.

- **Deflation**

The price of goods and services will fall due to falling demand and costs of production.

(iii) Ireland's Balance of Payments:

- **Imports decrease**

If there is a reduction in the demand for goods and services then we can assume that there will be an automatic fall in the demand for imports.

OR

- **Imports Increase**

Consumers with a lower spending power may switch consumption to cheaper imported substitute goods.

OR

- **Exports Decrease**

Business will not be able to avail of credit in order to expand their business. This fall in investment may lead to a decrease in exports.

The credit crunch on international markets may reduce aggregate demand resulting in reduced demand for goods produced in Ireland on export markets.

20 marks graded

Question 5 National Income

- (a) The following table shows the level of National Income, its Consumption, Investment and Export components at the end of periods 1 and 2, and the level of Imports at the end of period 1. (For the purpose of this question you may ignore the government sector.)

	National Income	Consumption	Investment	Exports	Imports
Period 1	€40,000	€30,000	€15,000	€15,000	€20,000
Period 2	€50,000	€39,000	€18,000	€21,000	?

Calculate the following, showing all your workings:

- (i) The level of imports at the end of period 2;
- (ii) The level of savings at the end of period 2;
- (iii) The Marginal Propensity to Consume;
- (iv) The size of the Multiplier.

(i) Imports at the end of period 2

$$\begin{aligned} \text{GNP} &= C + I + X - M \\ 50,000 &= 39,000 + 18,000 + 21,000 - M \\ 50,000 - 39,000 - 18,000 - 21,000 &= -M \\ 50,000 - 78,000 &= -M \\ -28,000 &= -M \\ M &= 28,000 \end{aligned}$$

(ii) Savings at the end of period 2

$$\begin{aligned} \text{GNP} - C &= S \\ 50,000 - 39,000 &= S \\ S &= 11,000 \end{aligned}$$

(iii) Marginal Propensity to Consume

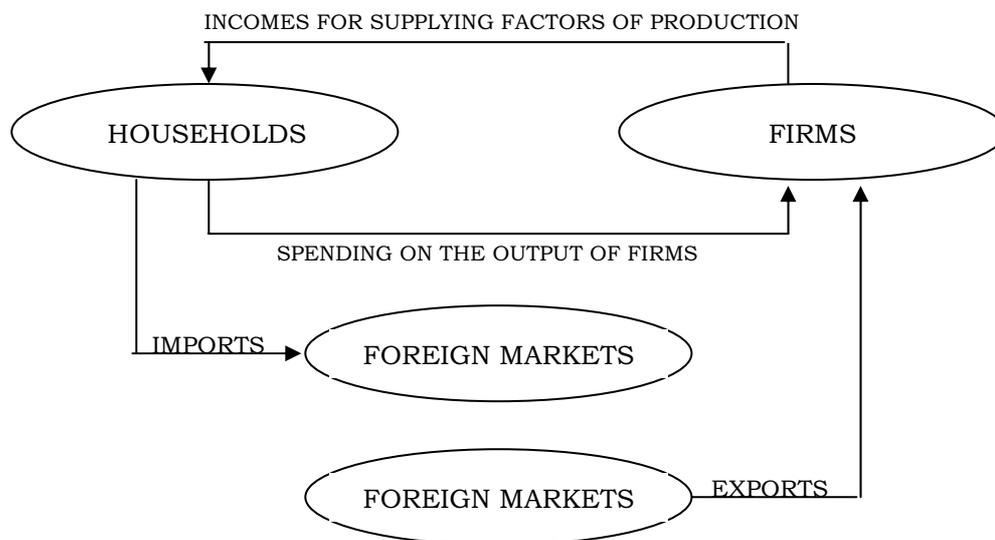
$$\begin{aligned} \text{MPC} &= \frac{\Delta C}{\Delta \text{GNP}} \\ \text{MPC} &= \frac{9,000}{10,000} \\ \text{MPC} &= 0.9 \end{aligned}$$

(iv) Size of the Multiplier

$$\begin{aligned} &\frac{1}{1 - (\text{MPC} - \text{MPM})} \\ &\frac{1}{1 - (0.9 - 0.8)} \\ &\frac{1}{1 - 0.1} = \frac{1}{0.9} = 1.11 \end{aligned}$$

$$\begin{aligned} \text{MPM} &= \frac{\Delta M}{\Delta \text{GNP}} \\ \text{MPM} &= \frac{8,000}{10,000} \\ \text{MPM} &= 0.8 \end{aligned}$$

- (b) 'Ireland is described as a small open economy and this affects the government's ability to influence the level of aggregate demand in the country'.
Explain this statement using the Circular Flow of Income to support your answer.



Circular Flow Diagram – 14 marks graded.

1. As an open economy, Ireland is heavily dependent on imports and exports to achieve economic growth.

Imports are a leakage.

2. If the government injects money (through C, I or G) into the circular flow, some of it will leave the economy due to the MPM and reduce the circular flow of income. Thus aggregate demand will not grow by the anticipated amount / aggregate demand will fall.

Exports are an injection.

3. The government has little direct control/influence over exports except through offering tax incentives to exporters. If demand for Irish exports increases then this will increase the circular flow of income. This will lead to extra income in Ireland and an increase in aggregate demand.
4. The ability of the government to influence aggregate demand is hindered by the extent of foreign trade, particularly imports. If imports exceed exports aggregate demand will fall. If exports exceed imports aggregate demand will increase.

Explanation: 16 marks graded.

- (c) Outline the limitations of Gross National Product at Current Market Prices when comparing the average standard of living between two different years.
- **Population changes**
If GNP grows at a slower rate than population, then GNP per head decreases and the average standard of living will fall.
 - **Inflation**
An increase in prices will automatically increase GNP at current market prices. Therefore it is better to consider GNP at constant market prices.
 - **Employment / Unemployment**
If a person is unemployed rising GNP per head will not necessarily mean that this person's average standard of living is rising.
 - **Levels of taxation**
When considering a person's standard of living one should take into account rates of income tax and levels of indirect tax within the country. An increase in either of these may result in a drop in a person's standard of living.
 - **Levels of social welfare**
For a person who is unemployed the rates of social welfare payable is of more relevance than the average standard of living in the country.
 - **Measures flow of wealth not welfare**
Rising GNP may be accompanied by changing working or living conditions which may cause a loss of welfare e.g. traffic congestion.
 - **Hidden social costs attached to increases in GNP**
If a firm increases output GNP increases. However, a hidden cost may be increased pollution etc.
 - **Distribution of GNP**
If increases in GNP make their way into the pockets of a small minority, there may be no improvement in the standard of living of the general community.
 - **Exclusion of important activities from calculation of GNP**
The black economy is excluded from the calculation of national income. The work of housewives & voluntary activities is also excluded. Such activities are important to the welfare of its citizens.
 - **Nature of the goods produced**
A country which spends a small amount on military equipment and a large amount on health, education etc. will have a better standard of living than one where the reverse is the case.
 - **Government services at cost price.**
Government services are included at cost while private services are included at selling price. A country where the government provides many services will record a lower GDP.

5 points @ 5 marks each graded

Question 6 Government in the economy

- (a) Define **each** of the following terms:
- (i) Current Budget Deficit;
 - (ii) Exchequer Borrowing Requirement;
 - (iii) Public Sector Borrowing Requirement;
 - (iv) National Debt.

(i) Current Budget Deficit

Current government expenditure exceeds current government revenue/ Current (Day-to-day revenue and expenditure).

(ii) Exchequer Borrowing Requirement

The amount borrowed by the government to fund a current budget deficit and any borrowing for capital purposes/current budget deficit plus borrowing for capital purposes.

(iii) Public Sector Borrowing Requirement

The exchequer borrowing requirement plus borrowing for semi-state/state sponsored bodies and local authorities.

(iv) National Debt

This is the total amount /accumulated total of outstanding borrowing by the government.

4 definitions @ 5marks each graded

- (b) Irelands National Debt grew from €36bn at end of 2006 to €50.4bn at end of 2008.

- (i) Outline the major reasons for the increase in National Debt.

1. Increased Current Budget deficits

The government have decided to operate a deficit budget in order to continue with the provision of public services / not to further reduce aggregate demand. Any borrowing to finance this current expenditure will increase the size of the deficit. This money must be borrowed thereby increasing the national debt.

2. Borrowing for capital purposes/Self-Liquidating Debt

The government continues to borrow to invest in infrastructure and other capital projects, which will eventually generate income and yield tax revenues to meet costs of repaying the money borrowed This also increases the national debt.

3. Social Investment

The government borrowed to invest in socially desirable projects which may not yield any tax revenue such as hospitals, schools, public amenities.

2 reasons @ 5 marks each graded

(ii) Describe the economic consequences (positive and negative) of the increase in National Debt in recent years.

Positive Consequences	Negative Consequences
<ul style="list-style-type: none"> • Improved Public services. If the increased debt is caused by an increase in current borrowing the government may continue to spend on public services resulting in a continuation of these services. • Increased spending on infrastructure. If the increased debt is caused by an increase in capital borrowing then there may be greater spending on the state's infrastructure which may assist the future growth of the economy. • Future Economic Growth. Increased National Debt may boost aggregate demand and may provide opportunities for further economic growth. • Employment Rising aggregate demand should lead to increased demand for labour resulting in lower unemployment. • Self-Liquidating debt. If the return on the borrowings is able to meet the cost of repayments then the borrowing has been self-liquidating. 	<ul style="list-style-type: none"> • Opportunity costs involved. With more funds being used to meet our annual interest repayments the government has less funds available for other purposes. • Increased burden on taxpayers. The increase will mean that the government will have to consider increasing future taxes on future taxpayers. • Increased annual interest repayments. An increasing national debt means that the annual cost of repaying our national debt is rising. • Diminished international credit-rating. The fact that Ireland is seen to have an increasing national debt may mean that our credit-rating worsens. • Outside Euro stability pact requirements. Ireland has difficulty in meeting the conditions of the stability pact and hence corrective action will need to be taken in economic policy matters. • Poor Govt. management of economy. Citizens may become aware of the government's poor management of the economy and this may diminish citizen's confidence in the government. • Risk in Provision of Public Services Due to an increase in the national debt the government may cut back spending on public services, resulting in a deterioration in provision of services e.g. the health service

5 points @ 5 marks each graded
Must have a minimum of two points under one heading.

(c) The Irish economy will experience a substantial Current Budget Deficit for 2009.

You have been employed as an Economic Advisor to the Minister for Finance.

(i) State and explain **two** specific courses of action (one on the revenue side and one on the expenditure side) you would advise the Minister to take in order to reduce significantly the Current Budget Deficit.

(ii) Outline the possible economic effect(s) of **each** course of action you have chosen.

Revenue	Expenditure
<ul style="list-style-type: none"> • <u>Increase Indirect Tax or example</u> By increasing taxes such as VAT and excise duties the government would aim to increase tax revenue from consumption. <i>Effect</i> <ul style="list-style-type: none"> ○ Increased smuggling in order to evade tax. ○ Increased inflation as the increase is automatically built into the price. ○ Reduction in aggregate demand as prices have increased. • <u>Increase Direct Tax / Pension levy</u> By increasing taxes such as PAYE, CGT or the pension levy the government would aim to increase their tax revenue from wealth and incomes. <i>Effect</i> <ul style="list-style-type: none"> ○ Increased numbers working in the ‘black economy’ in order to evade tax. ○ Decrease in employment as the cost of wages will increase / decreased incentive to work. ○ Increase wage demands which may lead to industrial disputes. ○ Decrease in aggregate demand as real incomes and spending power falls. 	<ul style="list-style-type: none"> • <u>Decrease numbers employed in the public sector.</u> Offer redundancy packages to those working in the public sector. <i>Effect</i> <ul style="list-style-type: none"> ○ Increase in short-term costs in meeting redundancy payments. ○ May lead to increase in long term unemployment if no work is available in the private sector. ○ Reduction in aggregate demand as real incomes and spending power have decreased. ○ Deterioration in public services. • <u>Decrease wages in the public sector.</u> Introduce a pay freeze where workers wages will not increase over a period of time. <i>Effect</i> <ul style="list-style-type: none"> ○ May lead to industrial disputes. ○ Skilled workers may leave for the private sector or emigrate. ○ Discourage effort and motivation in the sector, reducing efficiency in the long-term. • <u>Reduce / cut back on state services / raise charges on state services.</u> Cut services such as medical card / cervical cancer vaccine / book grants etc in each government department. <i>Effect</i> <ul style="list-style-type: none"> ○ Those on lower incomes may suffer a dramatic fall in standard of living. ○ May increase costs in the long run in order to reintroduce services. ○ May lead to industrial disputes and public protests by affected citizens. • <u>Reduce social welfare</u> This will reduce current expenditure and reduce the budget deficit. <i>Effect</i> <ul style="list-style-type: none"> ○ Those on lower incomes may suffer a dramatic fall in their standard of living. ○ May increase the incentive to find work.
<p>Revenue course of action: 5 marks graded Economic Effect of action: 5 marks graded</p>	<p>Expenditure action: 5 marks graded Economic Effect of action: 5 marks graded</p>

Question 7 International Trade, History of Economic Thought

(a) The Law of Comparative Advantage suggests that specialisation will increase world output.

(i) Explain the meaning of the underlined term in the context of international trade.

Where one country is more efficient than another in the production of a particular commodity it should produce that commodity, as this will be to the benefit of the country itself and overall world output

Explanation @ 6 marks graded

(ii) Identify the main assumptions underlying this law.

1. Transport costs do not exist

The LOCA assumes that transport costs do not exist. However, for an island nation like Ireland, transport costs can be a major cost factor and can act as a major barrier to trade. A firm's cost efficiencies may be eliminated by the transport costs involved.

2. The law of diminishing marginal returns (LDMR) does not apply

The LOCA assumes that the LDMR does not apply/assumes constant returns to scale. But this law does apply. Each extra person employed will not continue to produce the same amount as the original person. A point will eventually be reached when an extra person employed will produce less additional output.

3. Free trade takes place

The LOCA assumes that free trade takes place. While this may be true within the EU, free trade is often limited where countries impose barriers to trade for economic, social or cultural, moral reasons.

4. The complete mobility of labour/factors of production exists

We have assumed that the person who becomes unemployed in each country as a result of specialisation occurring can switch to an alternative job and that there are no barriers to mobility. This is not always the case as there are barriers to the complete mobility of labour.

5. Alternative employment is available

It is assumed that people who become unemployed in one sector arising from specialisation can find alternative employment. This may not be the case. Consider countries during a recession the availability of employment is very difficult/ huge adjustment costs in the transition.

6. An equal distribution of benefits occurs

When we calculate the terms of trade we assume that both countries benefit from trade. Consider a developing country – sometimes the terms of trade may not be to its advantage. It may receive very low export prices and have to pay high import prices. Hence, their bargaining position is weak and they may not benefit from trade to the extent that developed more powerful countries do.

4 points @ 4 marks each graded

(iii) Identify **two** sources of comparative advantage for the Irish economy.

1. **Climate:** our climate is suitable for the production of crops like potatoes, grazing for livestock.
2. **Raw Materials:** for example Moss Peat, blanket bogs provide the raw material which is scarce in other countries.
3. **Educated and skilled workforce:** companies locate here without incurring exorbitant training costs. the workforce has developed specific skills in production/services over a period of time e.g. ICT, food production, pharmaceutical companies
4. **Low rate of CPT:** this means that the costs of operation may be more competitive in Ireland than in other countries.

2 sources @ 4 marks each graded

(b) Ireland is a small open economy which relies very heavily on international trade.

(i) Discuss the importance of international trade to the Irish economy.

1. **Greater standard of living / increased wealth.**

Trade increases wealth / GNP and this allows the purchase of a greater quantity of goods and services.

2. **Greater choice of commodities / Commodities not produced in Ireland.**

Trade allows us benefit from a greater variety of goods and services, than would be available without trade. We lack some essential raw materials for production and thus must import these.

3. **More competitive prices of goods and services.**

Trade results in greater competition on the market which should lead to more competitive prices for consumers.

4. **Employment / Investment opportunities.**

Efficient production means that employment in these industries is more secure. Employment will be created in those industries which are expanding due to the benefits of trade. A healthy trading economy generates confidence in the economy and investment is thus encouraged.

5. **Companies benefit from economies of large scale production**

With trade, specialisation can take place. Companies will increase production and thus may benefit from economies of scale. These savings may be passed onto the consumers in the form of lower prices and/or greater innovation.

6. **Allows for the sale of surplus/ excess domestic output.**

If a company is competitive then it has the opportunity to sell on the international market that output which it doesn't/can't sell domestically. The Irish domestic market is small.

7. **More efficient use of scarce world resources.**

By specialising in production countries maximise their combined outputs and thus resources are allocated more efficiently, resulting in less wastage.

3 points @ 5 marks each graded

(ii) Are there any economic justification for a government intervening in order to restrict international trade? Outline reasons for your answer.

1. To create/protect employment.

By discouraging competitive imports the government can help stimulate domestic employment.

2. Protect infant industry.

New business may find it difficult to compete against foreign competition in their early years. These industries can be protected until they are capable of competing with foreign firms.

3. Strategic purposes.

An entire industry such as beef production may need to be protected, otherwise it would be unable to compete with cheap foreign competition. Protection may also ensure continuity of supply.

4. To increase government revenue.

Increased revenue may be raised from tariffs to help fund state services.

5. Protect against low wage competition.

High wage economies may introduce protective measures in order to protect their producers from what is deemed unfair low wage economies.

6. Retain wealth within the country / protect the Balance of Payments.

By reducing the amount spent on imports the government could reduce the level of wealth leaving the country/ protection against recurring BoP deficits.

7. Prevent 'dumping'.

Barriers will stop other firms from 'dumping' and so stop their ability to undermine domestic firms, which may result in their closure.

8. Protect the country.

In the past it was necessary for Ireland to impose strict regulations governing the importation of agricultural commodities so as to protect the country from foot and mouth disease and so protect this vital industry.

3 points @ 5 marks each graded

(c) Write a brief note on David Ricardo's contribution to economic thought.

Law of Comparative Costs

Ricardo supported the idea of free trade and developed the law of comparative costs which states that a country should specialise in the production of those commodities in which it is relatively most efficient and trade for the remainder of its requirements.

Theory of Economic Rent

If population increased it was necessary to use inferior / more remote land. For use of this land rent was paid. As a result the price of food rose. Cost of producing on the best land was lower therefore food produced on this land earned a surplus over that produced on inferior land. This surplus led to an increase in rent payable for the use of good land.

Accepted the Subsistence Wages Theory

He believed that any increase in wages above the subsistence level would cause an increase in population which would in turn cause wage levels to fall.

15 marks graded

Question 8 Unemployment

(a) Discuss the factors that influence the size of the Irish labour force.

1. Wage levels within the economy.

Higher wage levels in recent years act as an incentive for more people to supply labour. However, recent wage restraint may see a fall in this figure.

2. Structure of population/ Size.

Ireland's population has increased with more citizens within the working-age bracket. The size of the labour force increases, e.g. Ireland has a smaller population than France resulting in a smaller labour force.

3. Participation Rate.

The number of people willing to work within the 16-65 age groups has increased. More women working/people who once retired are willing to take up part-time employment.

4. Rates of income tax within the economy.

In the past a reduction in income tax rates acted as an incentive for people to join the workforce. In the 2009 budget the new 'Income Levy' could now act as a disincentive to work and negatively affect the size of the labour force.

5. Labour mobility.

The workforce in Ireland has become more occupationally mobile: there are less barriers in place preventing the movement of workers. With EU enlargement, the free movement of labour is increasing. The recent down turn in the Irish economy may see many immigrants moving home and an increase in emigration of Irish citizens.

6. Government Policies.

The government has moved to ease restrictions on the entry of immigrants to Ireland aiming to liberalise entry requirements into certain occupations e.g. pharmacies; hospital consultants.

3 points @ 8 marks + 6 marks + 6 marks graded

(b) According to the Quarterly National Household Survey (QNHS) the rate of unemployment was 7.7% in December 2008.

(i) Name one source, other than QNHS, for unemployment statistics in Ireland.

- Live Register
- Census (of Population)

Source: 4 marks

(ii) State, with reasons, which of the measurements of unemployment used by each of these sources gives the most accurate estimate of Irish unemployment.

The Quarterly National Household Survey – 3 marks

Provides a more accurate measurement of Irish unemployment because it excludes:

1. People 'signing on' who are actually working.
2. People who work Part-time (working up to 3 days per week), seasonal workers and casual workers (who are entitled to Unemployment Benefit / Unemployment Assistance if they meet the statutory requirements).
3. People who claim UA / UB who are not seeking work /or are not available for work.
4. The QNHS includes those people who are unemployed, but for many reasons, may not draw the dole and do not sign on.

2 reasons @ 4 marks each graded

(c) (i) Outline the main causes of the recent increases in unemployment in the Irish economy.

1. Economic recession / cyclical unemployment.

The current worldwide recession has resulted in a reduction in aggregate demand resulting in the closure of businesses and hence the lay-off of workers. This is not confined solely to Ireland as many firms worldwide have reduced their workforces.

2. Re-location of industry.

Businesses that need to reduce their costs and wish to survive have moved to lower cost locations e.g. Dell manufacturing moved to Poland resulting in job losses in Limerick. The loss of income results in a further job losses and jobs lost in firms who supply to these firms.

3. Irish companies exporting to US and UK.

The rise in the value of the euro against the UK pound sterling and US dollar resulted in a reduction in demand for their output and this resulted in job losses in export oriented industries e.g. Waterford Glass; loss of jobs in the hotel and catering industry.

4. Banking crisis.

The crisis in the banking sector has resulted in a major reduction in the availability of credit for businesses. This has meant that businesses are being forced to close with the resulting loss of jobs e.g. the closure of various restaurants in Dublin. Some banks may cause closures by foreclosing on those firms who are having difficulty repaying their loans.

5. Uncertainty for the future.

With the downturn in economic activity and the severity of the recession people are fearful for the future. Many are reducing their spending and some are deferring spending. This further reduces demand and results in job losses e.g. the closure of firms in the retail sector and consequent job losses.

6. Reliance on construction sector / structural unemployment.

Much of Ireland's economic growth relied on the development of this sector. With the downturn the immediate effect was the major loss of jobs in this sector with the accompanying loss of jobs in all allied trades / industries. This change resulted in significant job losses.

4 points @ 5 marks graded

- (ii) Discuss economic policies which the Irish government might pursue in order to reduce the level of unemployment.

1. Reduce taxation.

If the government reduced rates of VAT this would remove the divergence between rates of VAT in the Republic and those in Northern Ireland. It would also help reduce prices. This may encourage people to spend, thereby increasing demand and leading to an increased demand for labour.

2. Subsidise additional labour employed.

If the government reduced the rates of PRSI on additional labour hired it would help reduce the cost of labour and may encourage employers to hire additional labour.

3. Reduce costs for business.

The government could, through regulation, force those firms supplying utilities to reduce their prices. This could reduce the costs for businesses, which may lead to a reduction in prices. Demand may increase resulting in an increased demand for labour. This may help decrease export prices thereby increasing aggregate demand, resulting in employment.

4. Prudent management of the economy / improved regulatory framework.

Many economic commentators suggest that the government needs to restore confidence in the public. If confidence is restored then people will start to spend, resulting in increased aggregate demand and boost employment. Thus prudent economic management of the economy is essential to restore confidence.

5. Infrastructural development.

Funding of improvements in the capital and social infrastructure directly leads to employment in the construction industry and, through the multiplier effect, leads to increasing spending and growth in employment.

6. Maintain a low corporation profits tax base / attract high value added FDI.

The low rate of CPT is seen as an essential element for Ireland to continue to attract mobile foreign direct investment. This can be used as part of the package used to attract companies to Ireland and so increase employment.

7. Investment in education / training.

One of the factors which attracts companies to set up in Ireland is the availability of an educated, skilled workforce. To maintain this advantage the government must continue to invest in education and training. Investment will allow workers to up-skill and so acquire those skills in demand currently. Possible availability of EU funding for training and up-skilling workers.

4 points @ 5 marks each graded



Coimisiún na Scrúduithe Stáit

Marcanna Breise as ucht freagairt trí Ghaeilge

Léiríonn an tábla thíos an méid marcanna breise ba chóir a bhronnadh ar iarrthóirí a ghnóthaíonn níos mó ná 75% d'iomlán na marcanna.

N.B. Ba chóir marcanna de réir an ghnáthráta a bhronnadh ar iarrthóirí nach ghnóthaíonn níos mó ná 75% d'iomlán na marcanna don scrúdú. Ba chóir freisin an marc bónais sin a **shlánú síos**.

Tábla 400 @ 10%

Bain úsáid as an tábla seo i gcás na n-ábhar a bhfuil 400 marc san iomlán ag gabháil leo agus inarb é 10% gnáthráta an bhónais.

Bain úsáid as an ghnáthráta i gcás 300 marc agus faoina bhun sin. Os cionn an mharc sin, féach an tábla thíos.

Bunmharc	Marc Bónais
301 - 303	29
304 - 306	28
307 - 310	27
311 - 313	26
314 - 316	25
317 - 320	24
321 - 323	23
324 - 326	22
327 - 330	21
331 - 333	20
334 - 336	19
337 - 340	18
341 - 343	17
344 - 346	16
347 - 350	15

Bunmharc	Marc Bónais
351 - 353	14
354 - 356	13
357 - 360	12
361 - 363	11
364 - 366	10
367 - 370	9
371 - 373	8
374 - 376	7
377 - 380	6
381 - 383	5
384 - 386	4
387 - 390	3
391 - 393	2
394 - 396	1
397 - 400	0

