

EDEXCEL A LEVEL ECONOMICS

DIAGRAM PRACTICE BOOK



Student Name:

HOW TO USE THIS BOOKLET

This booklet has been **designed by senior examiners** to help you raise your game with diagrams to maximise exam performance. Gone are the days when you could simply provide a memorised diagram in your exam answers. Diagrams score very few marks unless they are used to contribute to analysis. You need to really understand the diagrams (the lines, the areas) and apply them **dynamically** to the context provided. This means that lines on diagrams need to be shifted in response to the given scenarios, new areas shaded, and revised equilibrium points noted. You may also be asked to **interpret unusual or unexpected areas on diagrams** - examiners do not always ask the obvious 'textbook' questions!

This booklet covers **the entire Edexcel specification** in fine detail, with activities to help you revise and practice every possible diagram based on a comprehensive bank of scenario. Simply read each scenario and question carefully, then draw, adapt or explain each requested diagram. **Use this booklet in the crucial final phase of revision at the end of Year 13, or practice your diagrams throughout the entire course - the choice is yours.**

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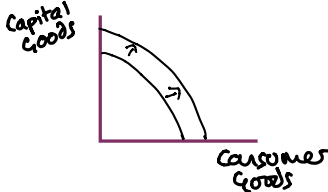
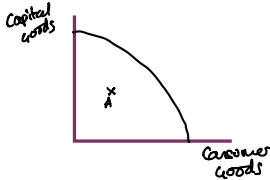
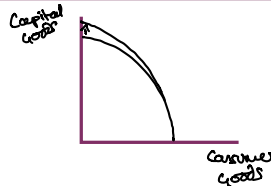
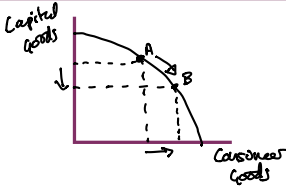
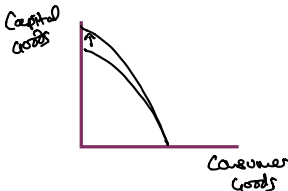
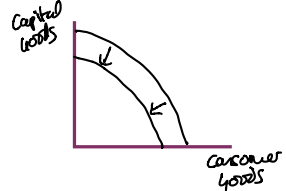
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MACROECONOMICS

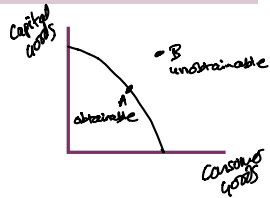
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MICROECONOMICS

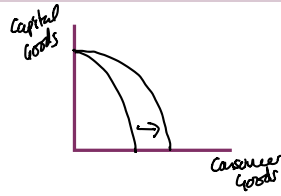
SECTION 1 PPFS, MARKETS AND THE ALLOCATION OF RESOURCES

1 In the boxes below, draw the appropriate and fully labelled production possibility frontier as requested	
A A PPF showing balanced economic growth	B A PPF showing that there are unemployed resources i.e. the allocation of resources is productively inefficient
	
C A PPF showing an increase in production of capital goods but not consumer goods	D A PPF demonstrating a trade off with capital goods as more consumer goods are produced
	
E A PPF showing an increase in productivity in the capital goods industry, but not the consumer goods industry	F A PPF demonstrating the impact of a natural disaster destroying a proportion of all factors of production
	

G A PPF showing an obtainable and an unobtainable allocation of resources in an economy

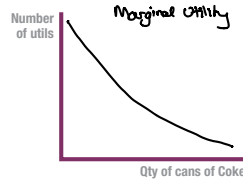
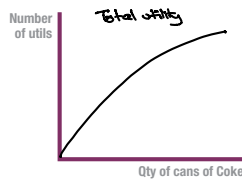


H A PPF demonstrating unbalanced growth in an economy



2 A student decides to drink successive cans of Coke, one after the other

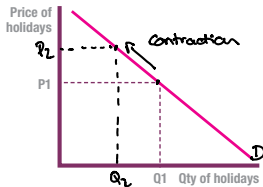
A On the two diagrams below i) in the first diagram, record total utility, and ii) in the second diagram, record marginal utility



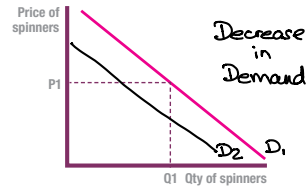
B With reference to your marginal utility diagram, explain the shape of a typical demand curve

3 The boxes below will require demand curves to be drawn. Illustrate in the boxes below what happens when:

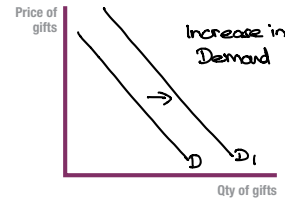
A The price of package holidays to Spain rises



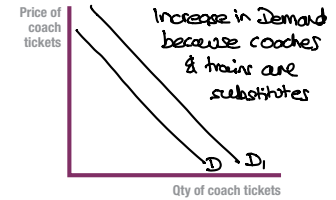
B Fidget spinners go out of fashion



C Retailers launch successful Christmas advertising campaigns for gifts

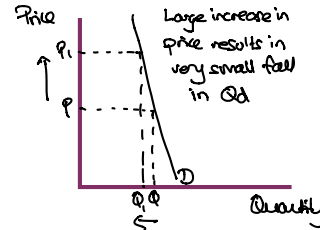


D Rail travel between major towns and cities becomes more expensive

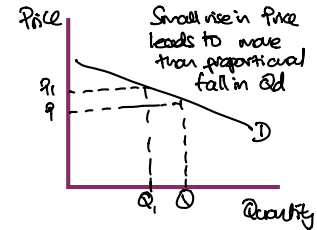


4 In each case below, draw an appropriately shaped demand curve and fully label the diagram

Price Inelastic Product



Price Elastic Product



Give 3 examples of price inelastic goods or services

1 Insulin / medicine

2 Petrol for vehicles

3 Cigarettes

Give 3 examples of price elastic goods or services

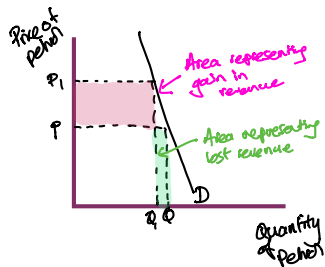
1 Granny Smith apples

2 Supermarket own-brand coffee

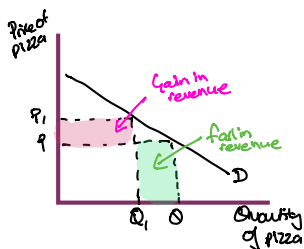
3 Biro pens

- 5 For each of the firms below:
- draw a demand curve
 - indicate what happens when the price rises by 10%, remembering to factor in the likely price elasticity of demand for each product
 - shade in any areas of loss of revenue and any areas of gain in revenue in each case

Petrol retailer

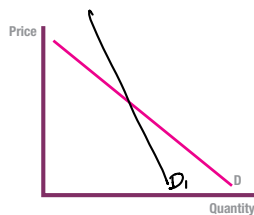


Street pizza retailer

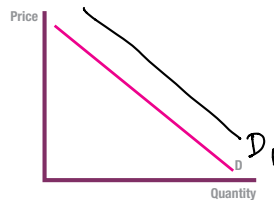


- 6 There are 3 main demand elasticities: price, income and cross. Draw the requested diagram, relating to these elasticities, for each of the scenarios given below

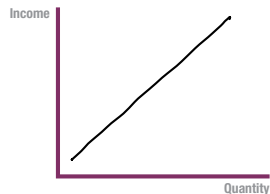
- A Effective advertising for a clothing company leads to demand becoming more price inelastic. Show how the demand curve would change



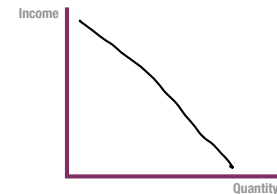
- B Home-delivery pizza is often regarded as an inferior good. Show the impact on demand for home-delivery pizza when real income falls during recession



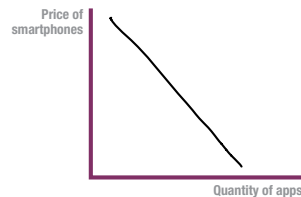
- C Holidays to Disneyworld in the US have a high, positive income elasticity of demand i.e. they are luxury goods. Show the relationship between income and quantity of holidays demanded on the axes below



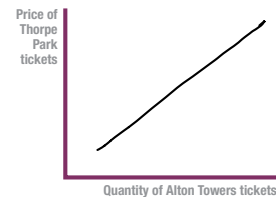
- D The 2008/2009 recession suggested that lipstick (in the UK) is seen as an inferior good. Show the relationship between income and quantity of lipstick demanded on the axes below



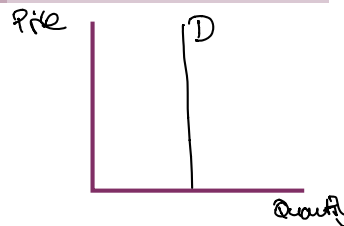
- E Apps and smartphones are complementary goods. Represent this relationship on the axes below



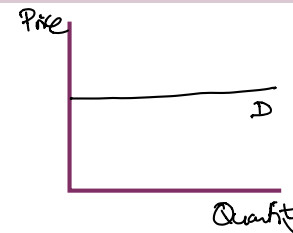
- F The theme parks Thorpe Park and Alton Towers are substitutes. Represent this relationship on the axes below



- G A product such as the essential medicines insulin or epipens, that has perfectly price inelastic demand

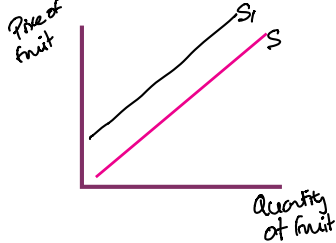


- H A firm in an extremely competitive market that has no choice but to accept the market price, leading to that firm having perfectly price elastic demand

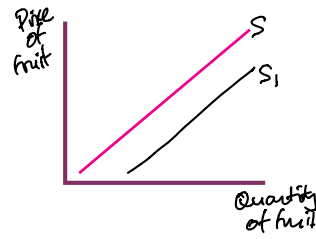


7 The diagrams below represent a fruit grower. Fully label the diagrams, and then amend the supply curves appropriately to illustrate the market changes described

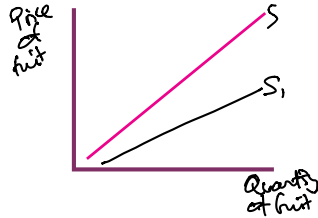
A The labour used in production receives a wage rise



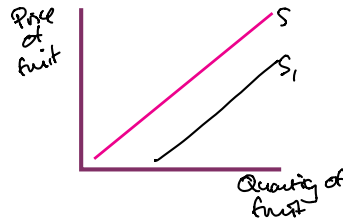
B A bumper harvest is achieved after sunny weather



C Technology improves so that fruit pickers are no longer needed as their jobs can be carried out by machine

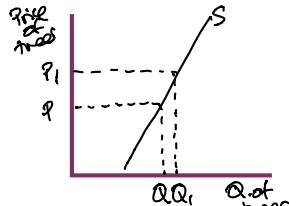


D The government subsidises fruit growing firms in a drive for improved healthy eating in the UK



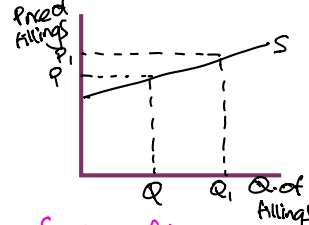
8 Both of the producers in the example below have seen the market price of their output rise by 20% this year. Draw and fully label appropriate supply curve diagrams (thinking about the concept of price elasticity of supply) to demonstrate what would happen in each case

Christmas tree supplier



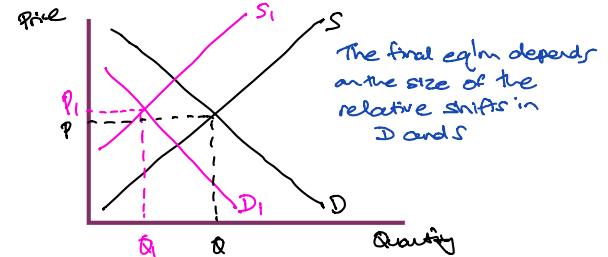
Trees are relatively price inelastic in supply because of the growing period

Sandwich filling supplier



Sandwich fillings are relatively price elastic in supply due to a wide range of raw materials

9 A product is sold at the equilibrium price in a market. However, due to poor publicity about the quality of the product once it is in use, and a rise in the price of the raw materials used, the equilibrium has changed. Demonstrate these changes on the diagram below. Remember to label the axes and curves accurately

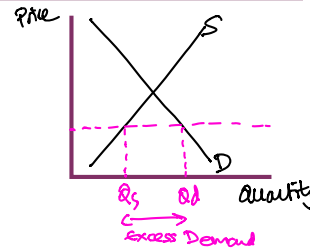


EXPLAIN what has happened here, ensuring that you refer to the price mechanism and the functions of prices

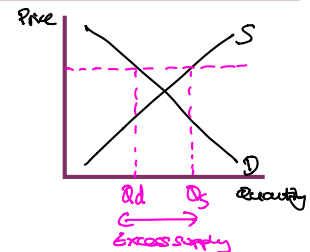
Demand has fallen due to poor publicity and supply has fallen due to the increase in production costs. The initial fall in demand leads to excess supply at the original market price so there is downwards pressure on price. However the decrease in supply clears that excess supply so overall there is little change in the market price.

10 Markets are sometimes not in equilibrium. Draw diagrams to indicate i) excess demand (i.e. a shortage) and ii) excess supply (i.e. a glut)

Excess demand



Excess supply



Give 2 reasons / scenarios in which there may be excess demand in a market

1 Gov't imposes a max. price

2 Demand increases & it takes time for the market to adjust

Explain how the market mechanism operates in order to clear the excess demand

Excess demand implies there is a shortage and it signals to producers that they need to increase the quantity supplied and increase price. As the price rises this rations the good to those willing and able to pay, until a new eq'm is reached.

Give 2 reasons / scenarios in which there may be excess supply in a market

1 Gov't imposes a min'm price

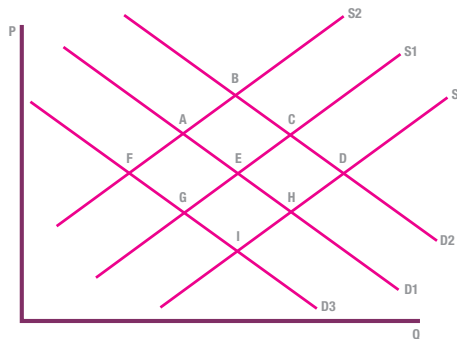
2 Demand falls & it takes time for the market to adjust

Explain how the market mechanism operates to clear the excess supply

Excess supply implies there is a glut; it signals to producers that they need to reduce the quantity supplied and reduce price. As the price falls this means that more consumers are able to buy the good. This continues until a new eq'm is reached.

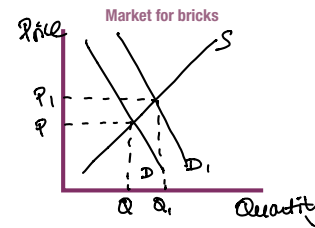
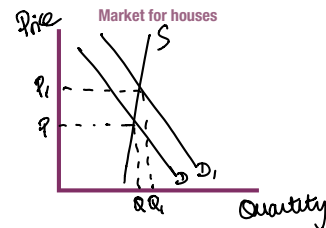
11 The diagram below illustrates the market for fast food, with initial Demand and Supply at D_1S_1 and an initial equilibrium at point E.

- a A rise in the price of meat, an essential ingredient for fast-food burgers A
- b A health conscious movement in the general public. G
- c A 'fat tax' is imposed and a 'healthy eating' campaign launched. F
- d A new form of cooking oil is developed to aid fast cooking of chips H
- e More people now commute for longer periods, and more people are accepting temporary jobs in fast food restaurants as they are 'in between' work D
- f The minimum wage rises and more low-income individuals eat out with their children B

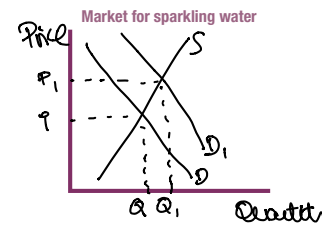
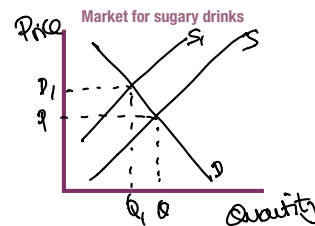


12 Using appropriate diagrams, demonstrate the nature of the interrelationship between these markets

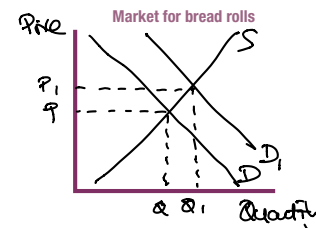
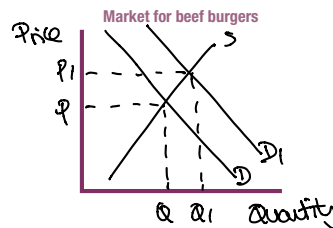
The market for bricks when the demand for housing rises. Relationship = **Derived Demand**



The market for sparkling water after the sugar tax was imposed. Relationship = **Substitutes**

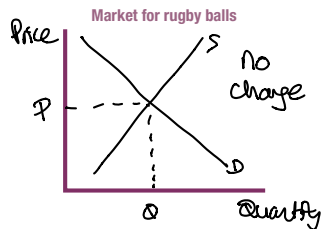
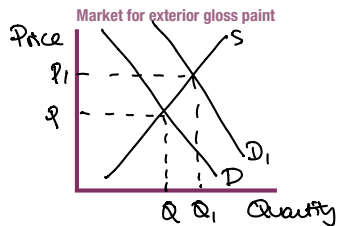


The market for bread rolls during a hot sunny summer when the market for beef burgers experiences a rise in demand. Relationship = **Complements**



The market for rugby balls following an increase in demand for gloss paint for exterior windows.

Relationship = **Unrelated**

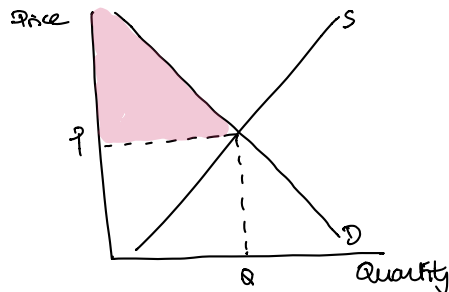


13 Consumer surplus and producer surplus are measures of welfare for each of these economic agents

A Define consumer surplus

The difference between the market price and the maximum price that a consumer is willing to pay.

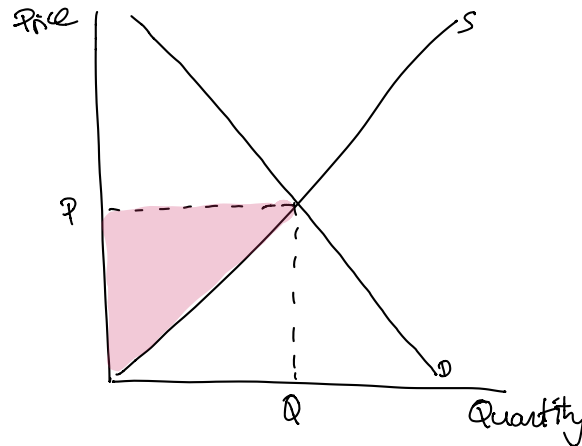
B Draw a demand and supply market diagram to illustrate consumer surplus



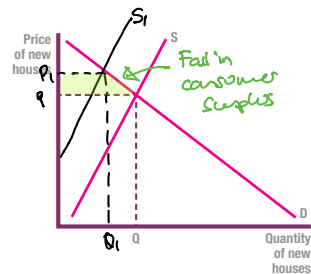
C Define producer surplus

The difference between the market price and the minimum price that producers are willing to accept.

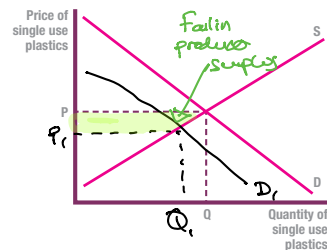
D Draw a demand and supply market diagram to illustrate producer surplus



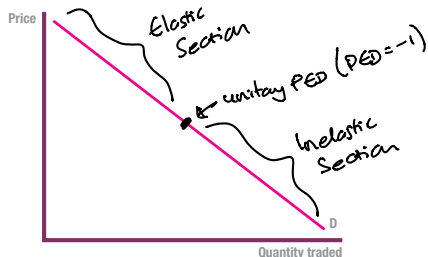
E The diagram below represents the market for new housing in the UK. Suppose that the government reduces planning restrictions on land. Adapt the diagram to illustrate the likely impact on consumer surplus of this change



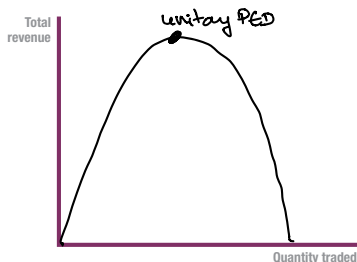
F The diagram below represents the market for single-use plastics, such as straws. Following a high-profile documentary, public opinion turns against the use of such plastic items. Adapt the diagram to illustrate the likely impact on producer surplus of this change



14	The price elasticity of demand varies along a downwards-sloping straight-line demand curve
A	On the diagram below, label i) the price inelastic section, ii) the price elastic section and iii) the point at which demand has unitary price elasticity



B	State what happens to total revenue earned by a business when the good sold is price elastic in demand, and the price is decreased TR rises
C	State what happens to total revenue earned by a business when the good sold is price inelastic in demand, and the price is decreased TR falls
D	State what happens to total revenue earned by a business when the good sold is has unitary price elasticity, and the price is decreased TR is unchanged
E	For the demand curve shown above, sketch the corresponding total revenue curve on the axes below



SECTION 2 MARKET FAILURE

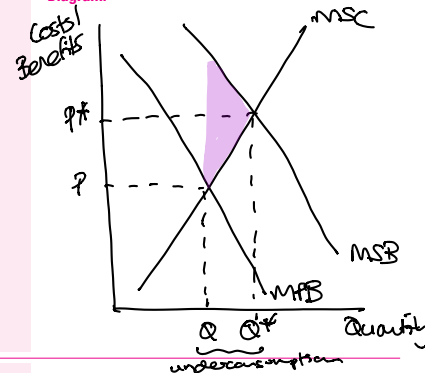
- 1 In each of the spaces in the table below:
- give AT LEAST 4 examples of each externality in the left-hand column
 - in the right-hand column draw an MSC/MSB diagram showing the free market output and price, and the effect of the externality, marking the socially optimum output
 - indicate on your diagram whether the externality leads to over-production, under-production, over-consumption or under-consumption
 - shade the area representing the welfare loss on each diagram

Positive Externalities in Consumption

Examples:

- Vaccinations
- Further Education
- Vegetables
- Gardening Equipment

Diagram:

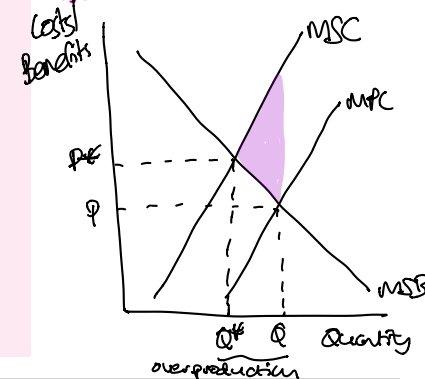


Negative Externalities in Production

Examples:

- Steel production
- Smartphones
- Palm oil
- Petrol

Diagram:

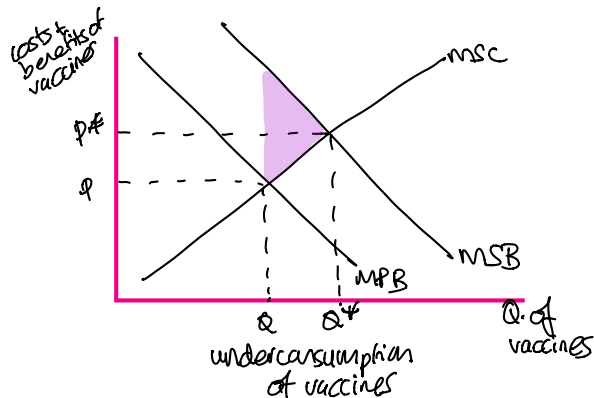


- 2 The MMR vaccine protects children from Measles, Mumps and Rubella - three diseases which are potentially very damaging, even deadly. It is given free-of-charge on the NHS as a single injection to babies, usually within a month of their first birthday. They then have a second injection before starting school, when three years old.

The MMR vaccine has dramatically reduced cases of measles, mumps and rubella and saved about 4,000 deaths from measles, resulting in the UK being declared "measles free" by the World Health Organization last year. However, the number of children receiving the vaccine is falling; in England, it has fallen from over 95% to 87% of children, and in the first nine months of 2018, there have been nearly 1,000 cases of measles.

The UK's Chief Medical Officer blamed "myths peddled about the dangers of vaccines on social media", and urged parents to ignore "fake news", and to get their children vaccinated

Using the axes below, draw a diagram to show the impact of the information gap (i.e. market failure) in the market for the MMR vaccine in the UK

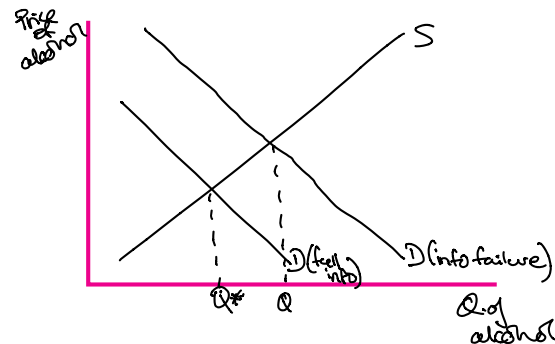


Write an explanation of what is happening in this market

Vaccines generate significant private benefits for those who are vaccinated. They also generate external benefits because people who are not vaccinated are able to benefit due to reduced disease transmission, in this case, measles, mumps and rubella. The data suggests that there is significant underconsumption of the vaccine at the moment as it has fallen to just 87% of babies. There's for babies who have not had the vaccine are more likely to suffer from MMR as a result.

- 3 Alcohol Concern is a pressure group that attempts to raise awareness about alcohol misuse. In 2015 there were 8758 alcohol related deaths, and alcohol misuse is the biggest risk factor for death, ill-health and disability among 15-49 year olds in the UK, and the fifth biggest risk factor across all ages. Alcohol harms are estimated to cost the NHS around the £3.5 billion annually

Using the axes below, draw a diagram to show the impact of the information gap (i.e. market failure) in the alcohol consumption market in the UK

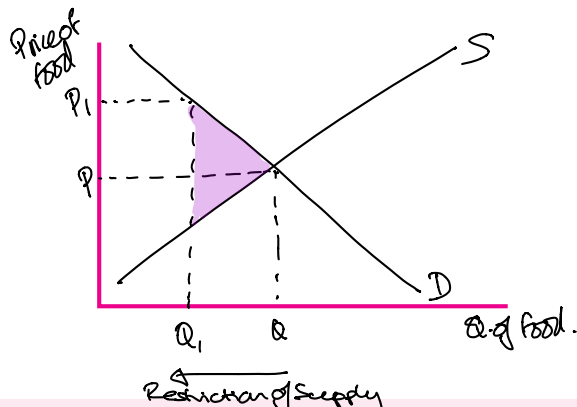


Write an explanation about what is happening in the alcohol consumption market

Because of the addictive nature of alcohol, and the fact that the effects of its consumption can be a long way in the future, there is information failure. This means that demand is higher than it would be with full information, and so there is over consumption of alcohol.

- 4 **EXTENSION TASK:** The proposed merger between Sainsbury and Asda has caused some concern in the food retailing market. This would be a merger between the UK's second and third largest supermarkets and would lead to 463 areas in the UK where it is believed there is a 'realistic prospect of a substantial lessening of competition' (the Competition and Markets Authority (CMA)). If this is the case, shoppers could face higher prices or a worse quality of service

Using the axes below, draw a demand and supply diagram to show this potential market failure in the food retailing market in the UK. Indicate any loss of consumer surplus that might occur on your diagram by shading this area

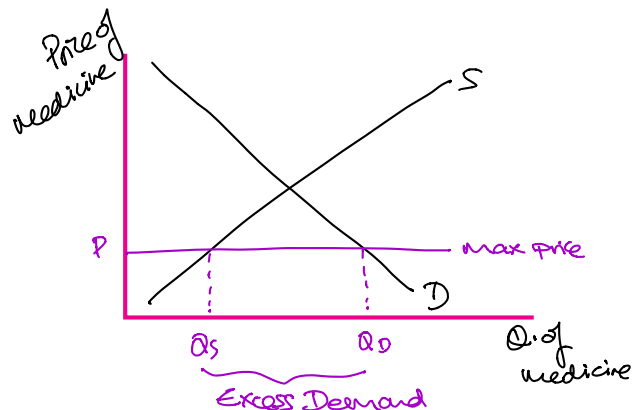


Write an explanation about what is happening in the food retailing market

Competition in the food retailing market is decreasing due to merger activity, and would decrease further if Sainsbury's and Asda merged. This would lead to a lessening of supply and restriction of output, leading to higher prices because of the increased market power of the supermarket companies.

- 5 In the UK, there is a maximum price for the NHS prescription charge of £8.80 for each medicine prescribed

A Using the axes below, show what effect a maximum price in this market has on the equilibrium price and quantity of medicine



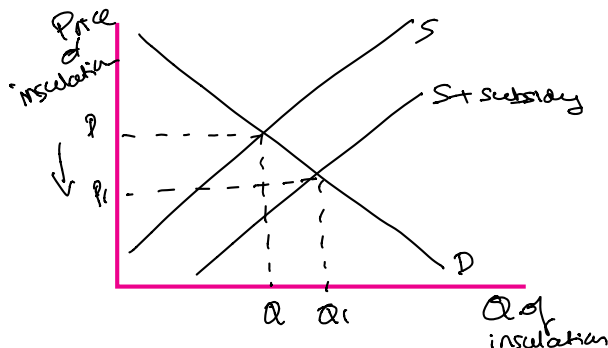
Explain why the government has imposed a maximum price for prescription charges

A maximum price is set below the free market eq'm, usually in order to improve access to essential goods or services for those on low income. This is with the intention of improving living standards. In the case of medicine, the gov't wants everyone regardless of income to be able to buy medicine - many medicines would cost a lot more than £8.80 in a free market. There are positive externalities associated with the use of medicine - people are less likely to transmit diseases and more likely to be able to work productively.

- 6** The Government in the UK leads an Energy Company Obligation Scheme (ECO) which helps families on low incomes and in receipt of government benefits to reduce their energy bills. The big energy companies, such as British Gas, E.ON, Npower and Scottish Power, are required by the government to help such families save money on their heating. One way in which consumers can reduce spending on energy bills is to use better insulation, and government can help by offering subsidies to building firms to reduce the price of insulating materials

A Using the axes below, draw a diagram representing the UK home insulation market

B Apply a government financial subsidy to the equilibrium, and explain what happens to the price and quantity

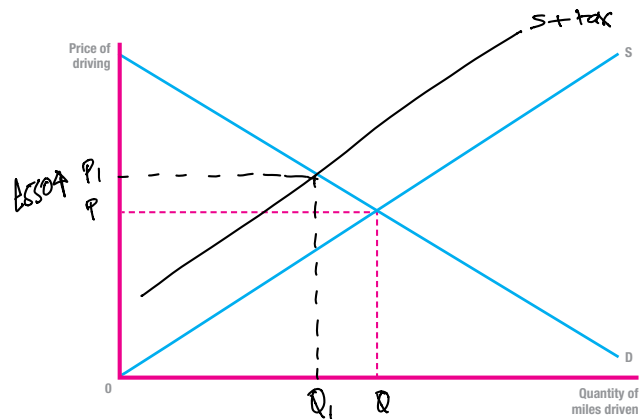


C Explain how this government intervention is an attempt to correct the market failure caused by under-consumption of house insulation by low income families

Home insulation will lead to positive benefits, such as healthier households who are more productive at work, and children who are more able to concentrate and attend school. It may also reduce hospital admissions for people suffering with cold-related illnesses. This has positive impacts on third parties.

A subsidy is a grant given by the government to producers, to lower production costs and therefore increase supply and lower the market price of insulation. This in turn increases the quantity of home insulation demanded, reducing the under consumption and helping to tackle the market failure.

- 7** Cars in the UK have a tax applied to them (Vehicle Excise Duty, VED). Fred owns an old diesel car that is heavily polluting, creating emissions over 255g/km (the most polluting possible). His VED for 2018/19 is £555 for the year. Using the demand and supply diagram below, annotate the diagram fully and show the effect on the initial equilibrium of the VED tax imposed. Explain what is happening in the space that follows the diagram



Explanation

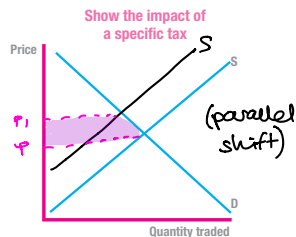
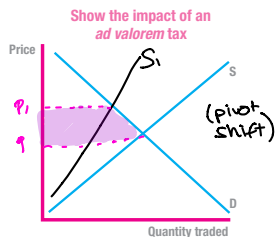
Pollution from old diesel cars leads to negative externalities. The tax (VED) is intended to equal the estimated external costs, thus internalising the externality. In the case of Fred this would be £555 per year. This causes a contraction along the demand curve reducing the number of miles driven, hopefully to the socially optimal level.

- 8 A Distinguish between an ad valorem tax and a specific (unit) tax, ensuring that you give at least one example of each type of indirect tax

Ad Valorem: a % tax (% of the market price)
e.g. VAT

Specific: a set tax per unit sold e.g. sugar tax

- B Adapt the diagrams below, as requested

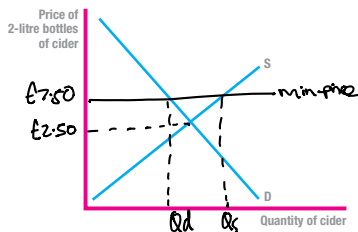


Now indicate the change in consumer surplus and producer surplus on the above diagram

Now indicate the change in consumer surplus and producer surplus on the above diagram

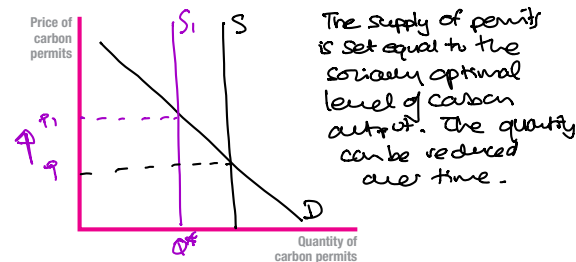
- 9 In May 2018, the Scottish government implemented a new law which set a minimum price on alcohol of 50p per unit. Scottish government ministers said that the minimum price was intended to tackle 'problem drinkers', who typically drink very cheap alcohol. Prior to the introduction of the minimum price, a 2-litre bottle of strong cider (containing 14 units of alcohol) could be bought for just £2.50. The same bottle will now cost consumers £7.50

Show the impact of the new minimum price on the market for 2-litre bottles of cider, by adapting the diagram below



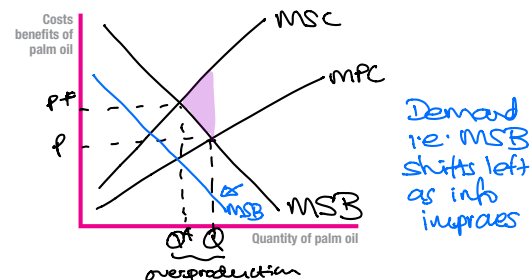
- 10 The EU's Emissions Trading Scheme (EU-ETS) is described by the EU as a "cornerstone of the EU's policy to combat climate change and its key tool for reducing greenhouse gases cost-effectively. It is the world's first major carbon market and remains the biggest one". The market was established in 2005 and operates as a 'cap-and-trade' system. In 2020, carbon emissions will be 21% lower than they were in 2005, and by 2030 they will be 43% lower than in 2005

Using the diagram below, illustrate and explain the mechanism by which reducing the carbon emissions 'cap' and allowing carbon-producing firms to 'trade' their permits reduces market failure



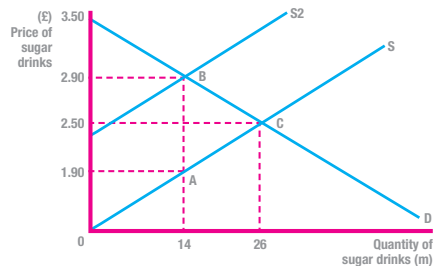
- 11 In November 2018, the food store Iceland said that an advert it had produced, outlining the devastating impact of collecting palm oil on the habitat of orangutans, had been banned by the UK's Advertising Standards Authority for being 'too political'. However, the advert was widely shared on social media and 'went viral', prompting consumers to become much more aware of the impact of palm oil collection. Palm oil is used in many cosmetic products, such as shampoo

- A Using the axes below, draw a diagram to illustrate the negative externalities caused by the production and collection of palm oil

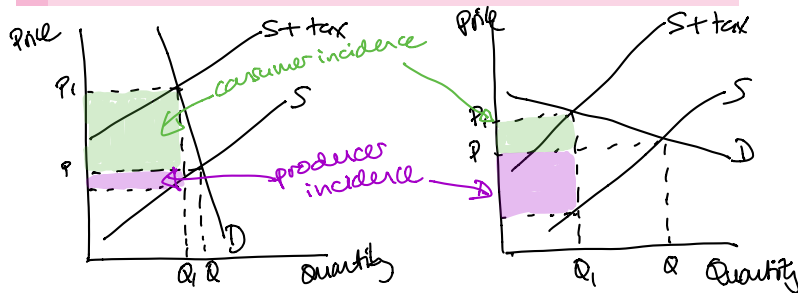


- B Adapt your diagram above to show the impact of improved information. Ensure that you show the new equilibrium point, as well as any changes to welfare loss

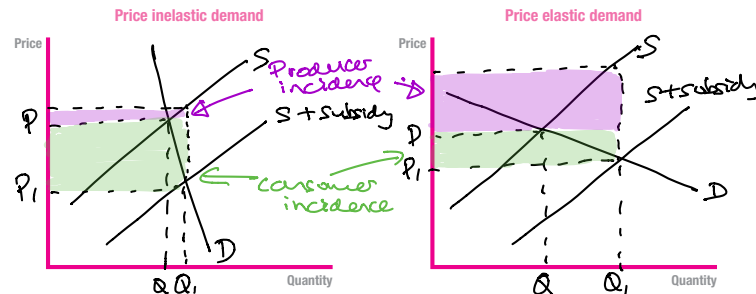
12	The tax on sugary drinks was imposed in 2018 in the UK. Using the information provided on the diagram below, calculate		
A	the consumer surplus before the tax	D	the producer surplus after the tax
	$\frac{(3.50 - 2.50) \times 26\text{m}}{2} = \text{£}3\text{m}$		$\frac{(2.90 - 2.40) \times 14\text{m}}{2} = \text{£}3.5\text{m}$
B	the total producer surplus before the tax	E	the government revenue earned by the tax
	$\frac{2.50 \times 26\text{m}}{2} = \text{£}32.5\text{m}$		$(2.90 - 2.40) \times 14\text{m} = \text{£}7\text{m}$
C	the consumer surplus after the tax		
	$\frac{(3.50 - 2.90) \times 14\text{m}}{2} = \text{£}4.2\text{m}$		



F In the space below, sketch diagrams to show how the incidence of tax between consumers and producers differs, depending on the price elasticity of demand of the good/service that is being taxed



13	This question relates to analysing the impact of a subsidy on both consumers and producers		
A	Complete the diagrams below, to show demand (with the elasticity as requested) and supply, along with the relevant equilibrium point in each case		

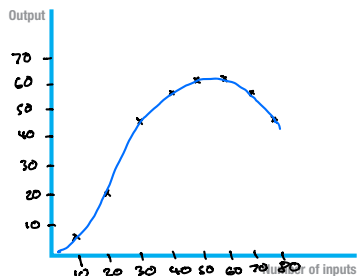


B	On each diagram, show the impact on price and quantity if the government introduces a subsidy		
C	On each diagram, indicate the area that represents the consumer subsidy		
D	On each diagram, indicate the area that represents the producer subsidy		
E	Outline the relationship between PED and the incidence of a subsidy		

When PED is relatively price inelastic, the impact is mostly on the consumer in terms of a significant fall in price. Then producer incidence is minimal. However, when PED is relatively elastic the fall in price is much smaller and so the consumer incidence is much lower than the producer incidence.

SECTION 3 COSTS OF PRODUCTION AND ECONOMIES OF SCALE

- 1 Using the information provided, plot output against input for Firm Y as it increases its number of inputs, labelling your curve appropriately. In the space below, write an explanation of what is happening in your diagram



Inputs	Outputs
10	5
20	20
30	45
40	55
50	60
60	60
70	55
80	45

Explanation (ensure that you use the terms marginal product, average product and total product in your explanation)

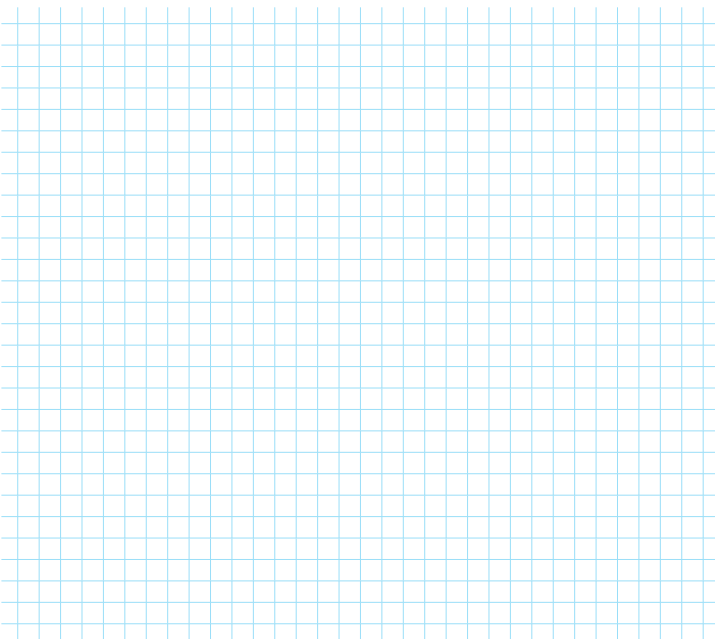
Initially, total product rises very quickly- each new input is highly productive (because, for example, division of labour) and so output rises more quickly than input. Marginal output (represented by the slope of the total product curve) rises very quickly - we can this increasing marginal returns. However, capital becomes increasingly scarce as we add more labour, and so the marginal product of additional factors of production starts to fall i.e. diminishing marginal returns. Eventually, the addition of inputs starts to significantly slow down the production process and total product starts to fall i.e. marginal product becomes negative.

- 2 A Complete the table below which shows cost data in the short term for Widgets Ltd

Output	TFC	TVC	TC
10	25	20	45
20	25	40	65
30	25	60	85
40	25	80	105
50	25	100	125
60	25	120	145

(Assume
VC rises
proportionately
with
output)

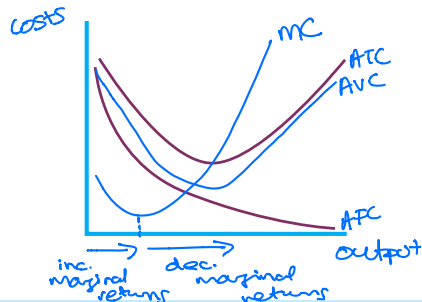
- B Using the data, plot the fixed cost, variable cost and total cost incurred when producing widgets



- C Calculate the total cost at output level 45. Shade the appropriate area on your diagram to show the proportion of total cost that is fixed and the proportion made up of variable costs

3 On the diagram below:

- label the axes
- label the ATC and AFC curves
- draw an appropriate average variable cost curve
- draw the associated marginal cost curve



v) Explain the reason for the shape of the marginal cost curve

The shape of the MC curve is determined by the law of diminishing marginal returns. In the short run, some factors of production are fixed e.g. capital, so output rises as a result of variable factors being added to the production process e.g. labour. To a point, this increases output more quickly than the increase in inputs - the marginal product rises and so marginal cost falls (increasing marginal returns). However, capital quickly becomes more scarce and so labour becomes increasingly less productive than the previous worker - marginal product falls and so marginal cost rises.

vi) Indicate the range of output over which there are increasing marginal returns

vii) Indicate the range of output over which there are diminishing marginal returns

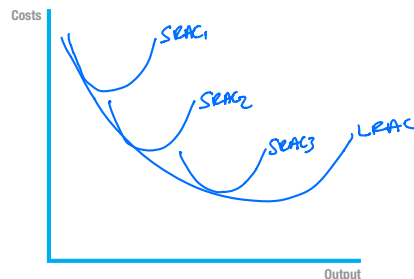
4 A Explain what is meant by the 'short-run' in economics

At least one factor of production is fixed.

B Explain what is meant by the 'long-run' in economics

All factors of production become variable.

C On the axes below, draw a series of short-run average cost curves, and their associated long-run average cost curve (often known as the 'envelope curve')



D Explain your diagram

The series of short run AC curves reflects an addition to capital i.e. a series of short runs. These combine into the long run.

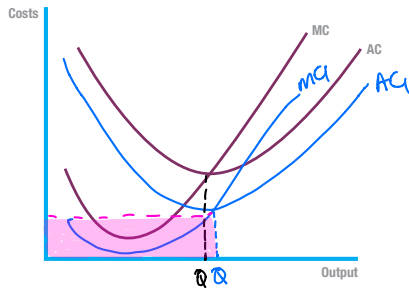
5 Sunny Tomato Sauces Ltd enjoyed the very long hot summer of 2018; their supplier of tomatoes reduced their price as a result of a bumper crop

A Adapt the diagram that follows to show the change in costs *MC + AC shift down*

B If Sunny Tomato Sauces chooses to operate at the level of output where average cost is minimised, what is the change in their average cost per unit as a result of the sunny weather?

AC will fall. The cost of tomatoes is a variable cost so both AC and MC shift downwards

C Shade the area showing new total cost



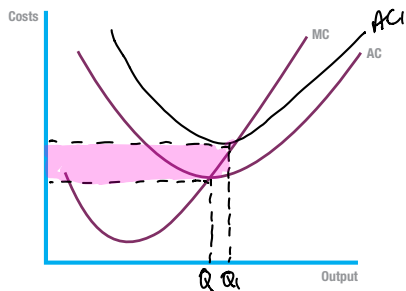
6 As the cost of collecting rubbish from the streets rises, the Town Council in Dilton has decided to raise the rent chargeable on the shops located in Main Street

A Define the terms 'fixed cost' and 'variable cost'

Fixed cost: does not vary proportionately with the level of output i.e. must be paid even when output is zero
Variable: varies directly with the level of output

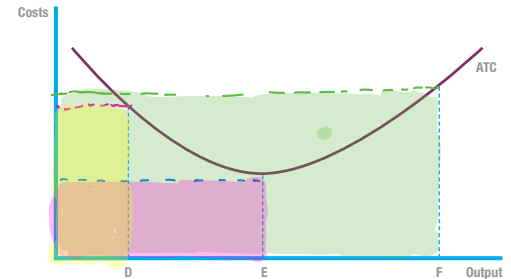
B Adapt the cost curves for hairdresser 'Crowning Glory' appropriately to reflect this change

C Shade the change in total cost if Crowning Glory attempts to minimise its average cost at all times



7 On this short run average cost diagram below, and using different colours / hatchings / shading, show the total cost when

A output is D B output is E C output is F



8 On the diagram below, indicate:

A the range of outputs over which economies of scale are experienced

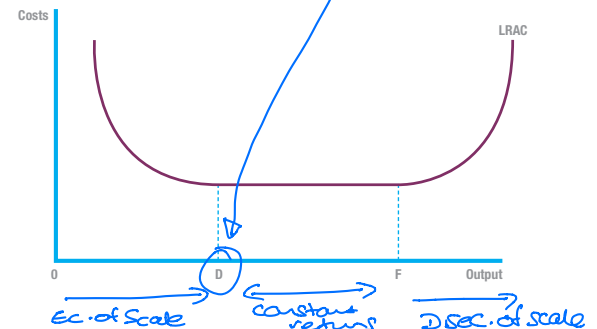
B the range of outputs over which diseconomies of scale are experienced

C the range of outputs over which constant returns to scale are experienced

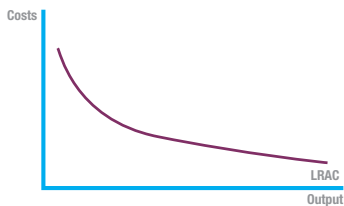
D the smallest amount of output that can be made whilst being productively efficient

E the effect of external economies of scale

↳ shifts the LRAC downwards



- 9 Using the diagram below, explain what is happening for this firm, and give two examples of industries that may experience a long run average cost curve of this shape



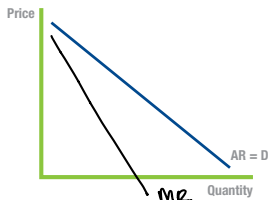
Explanation
Constantly falling LR (natural monopoly) due to very high fixed sunk costs

Example 1
Fast service

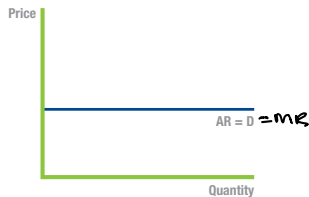
Example 2
Railtrack provision

SECTION 4 REVENUES AND PROFITS & OTHER OBJECTIVES

- 1 For each of the diagrams below, show the position of the marginal revenue curve. Give an example of each market structure depicted



Example Market Structure
Monopoly

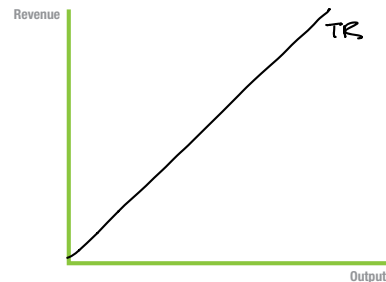
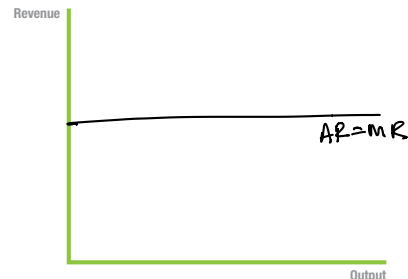


Example Market Structure
Perfect competition

- 2 This question relates to a firm in perfect competition i.e. a price-taking firm

A On the top set of axes, draw the average revenue and marginal revenue curves for a price-taking firm

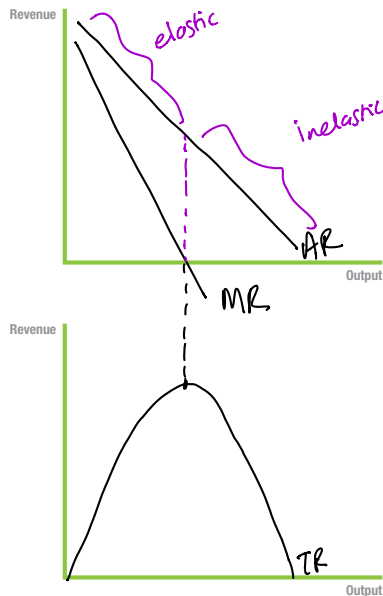
B On the bottom set of axes, draw the associated total revenue curve for a price-taking firm



- C Explain the relationship between the revenue curves shown above

Price is constant for a price-taker therefore $AR = MR$. TR will rise at a constant rate.

3	This question relates to a price-making firm
A	On the top set of axes, draw the average revenue and marginal revenue curves for a price-making firm
B	On the bottom set of axes, draw the associated total revenue curve for a price-making firm

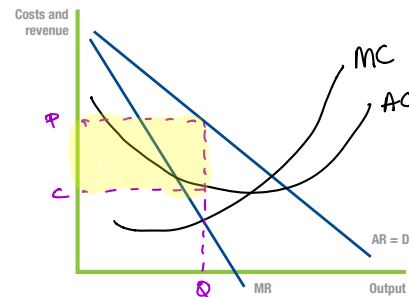


C	Explain the relationship between the revenue curves above
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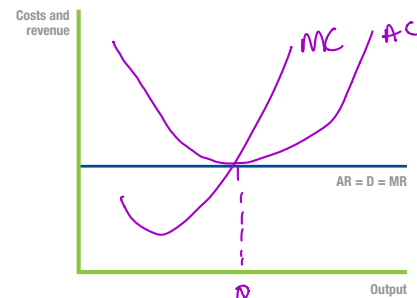
Ensure that you use the concept of price elasticity of demand in your explanation

Initially, demand is price elastic - as the price falls, the Qd rises more than proportionately so TR rises. MR is less than AR because to sell an additional unit, the price of all previous units also need to be reduced. However, in the elastic section, MR is still positive. At unitary PED, MR = 0 i.e. TR is at a maximum. Beyond this point, PED is inelastic so a continued reduction in price causes TR to fall i.e. MR is negative.

4	A Complete the diagram below for a price-making firm (such as in monopoly or oligopoly) that is earning supernormal profits
B	Write down the profit maximising condition $MC = MR$
C	Shade the area representing the abnormal profit

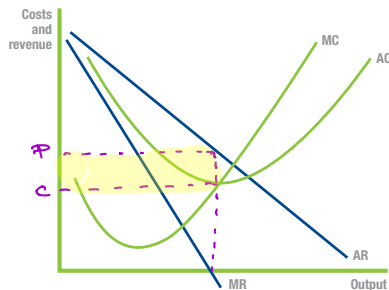


5	Complete the diagram below for a perfectly competitive firm that is making normal profit only at the profit maximising output i.e. a perfectly competitive firm in the long-run
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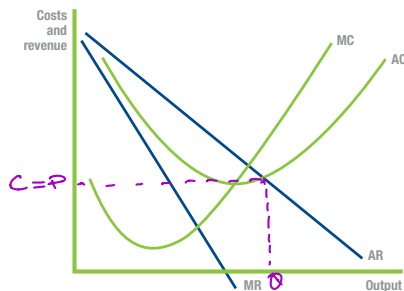


6 Not all firms are profit maximisers

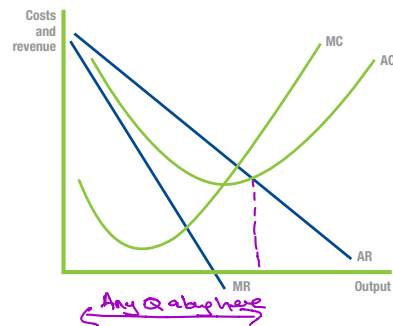
A On the diagram below, indicate the output and price (and any resulting loss or supernormal profit) made by a revenue-maximising firm. Write the revenue-maximising condition here $MR=0$



B On the diagram below, indicate the output and price (and any resulting loss or supernormal profit) made by a firm that aims to maximise sales (i.e. operating at an output level where just normal profit is earned). Write the sales-maximising condition here $AC=AR$



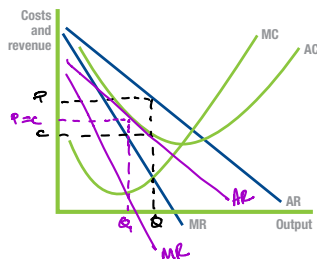
C On the diagram below, indicate the range of output and price (and any resulting loss or supernormal profit) over which a firm is 'satisficing'



D For each of the following objectives, try to give two examples of firms that might follow that objective

	Example 1	Example 2
Revenue Maximising	<i>Students' own examples</i>	
Profit Maximising		
Sales Maximising		
Satisficing		

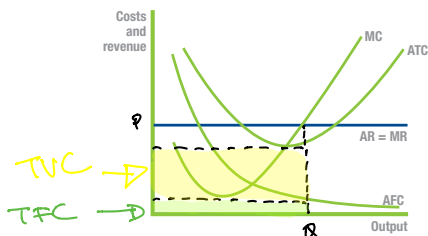
- 7 The diagram below represents a price-making profit-maximising firm. Adapt the diagram to illustrate the impact on i) price ii) output and iii) profit if the firm experiences a fall in demand



In this case
i) price falls
ii) output falls
iii) profit falls

- 8 A hot chocolate vendor at a Christmas market faces significant competition from other hot chocolate vendors. The diagram below represents her profit-maximising business

- Shade the area that corresponds to her total variable costs
- In a different colour, shade the area that corresponds to her total fixed costs



- iii) The cost of renting her hot drinks cart from the manufacturer increases 20%. Draw your own diagram in the space below to show the impact of this change on i) price ii) output and iii) profit

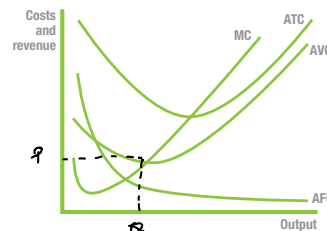
Diagram should show:

→ an increase in fixed costs re. upwards shift in ATC and AFC, but no change in MC
→ no change in price/output, but a fall in profit

- 9 A Write down the condition under which firms will shut down in the short-run

if $Price < TVC$

- B Adapt the diagram below to show the short-run shut down point for a price-taking firm



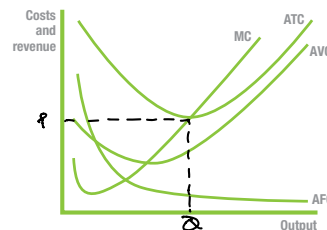
- C Write down the condition under which firms will shut down in the long-run

if $price < TC$

- D Explain why this is a DIFFERENT condition to that in the short-run

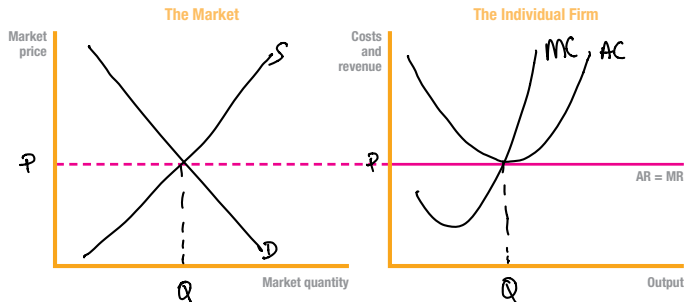
In the LR firms need to be able to cover all of their costs to be able to survive. In the SR, they need to be able to cover their variable costs + contribute towards their fixed costs

- E Adapt the diagram below to show the long-run shut down point for a price-taking firm



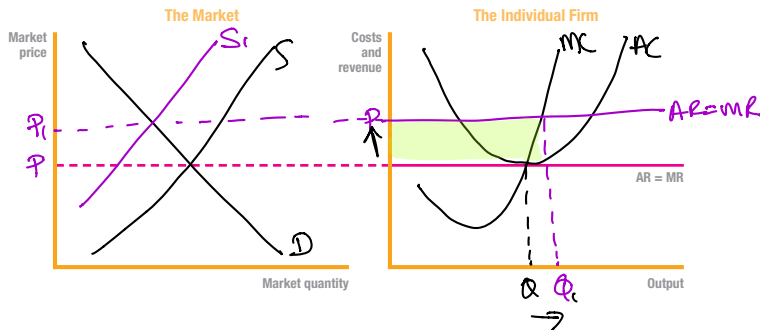
SECTION 5 MARKET STRUCTURES

- 1 In the double diagram below, show the long run equilibrium position for a perfectly competitive firm that has the objective of profit maximising. The diagram has been started for you



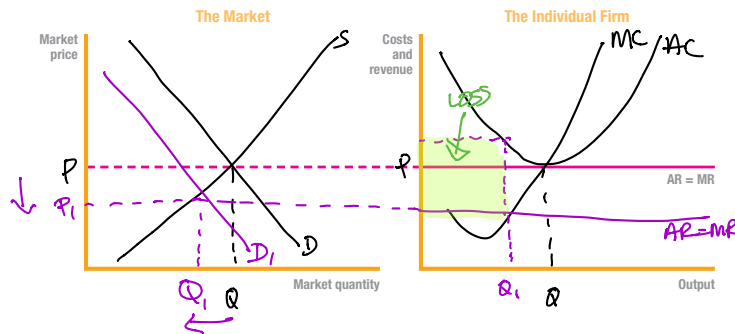
- 2 Using the double diagram below

- A first show a perfectly competitive market, and an individual firm in that market, both in long-run equilibrium, as in question 1 above
- B demonstrate what happens to the individual firm's position when a significant number of firms leave the market
- C shade any areas of loss or supernormal profit



- 3 Using the double diagram below

- A first show a perfectly competitive market, and an individual firm in that market, both in long-run equilibrium, as in questions 1 and 2 on the previous page
- B demonstrate what happens to the individual firm's position when demand for the output falls in the market
- C shade any areas of loss or supernormal profit

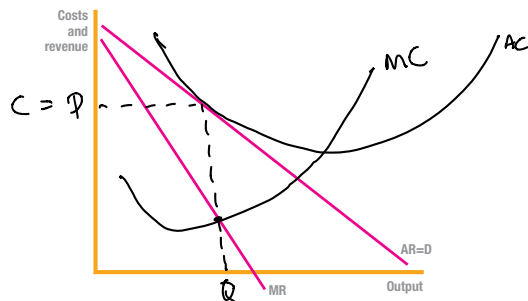


- 4 Walk & Go is a dog-walking service located in Warminster which aims to maximise its profits. Within a 15mile radius there are 6 other similar dog-walking services, each offering slightly different lengths of walks, giving the owners plenty of choice

- A Briefly outline why Walk & Go most likely operates in a monopolistically competitive market

Many firms - slightly differentiated goods/services,
few entry barriers, no dominant firms

B Adapt the diagram below to show the long run equilibrium position for Walk and Go

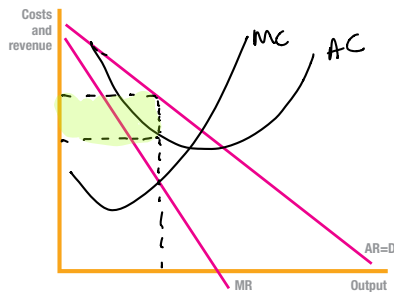


C Walk & Go's owner, James, has bought a new van which is more fuel efficient to use when driving the dogs to their walks

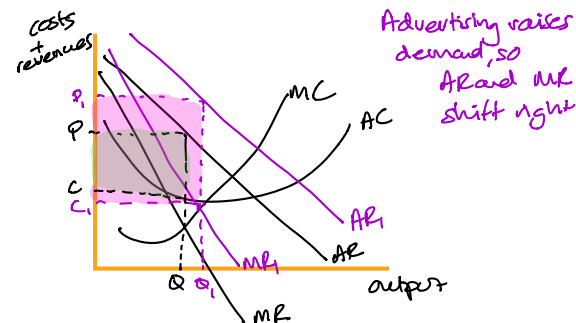
i) Using the diagram below, explain what happens to Walk & Go's equilibrium position as a result of the van purchase

Variable costs will fall, therefore AC and MC shift downwards

ii) Indicate any areas of supernormal profit or losses made as a result of the changes to fuel efficiency



5 Tesco Supermarkets have recently announced a rise in profits due to a successful campaign to win back customers from discount supermarkets such as Aldi and Lidl. Draw an appropriate diagram below to show how Tesco has achieved rising profits. Makes sure that you label the axes, curves, and both the old and new areas of profit

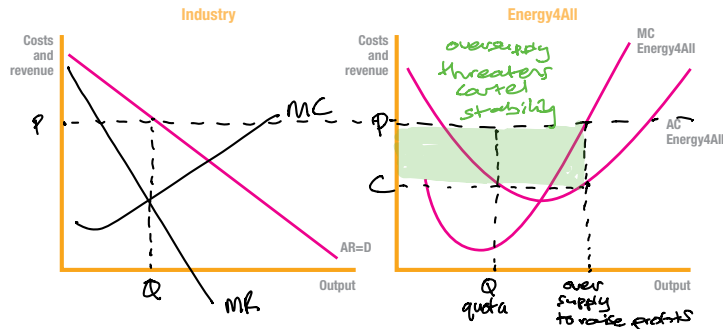


6 **EXTENSION QUESTION:** Energy4All electricity supplier is suspected of colluding with the other five major energy suppliers in the UK. If this was true, Energy4All will have been given a quota to limit the output of electricity it produces for the market. Using the diagram below, illustrate:

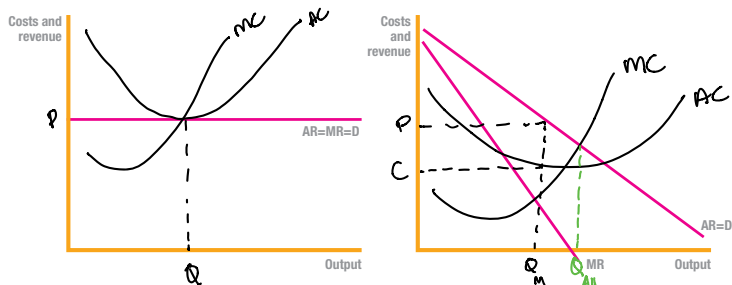
A how the cartel will operate to set a price and limit output by each cartel member

B why Energy4All may have an incentive to cheat on the quota, and

C indicate the gains achievable by Energy4All if it does supply more than its collusive quota



- 7 In economics, the theory of the firm suggests that a monopoly firm which is profit maximising is allocatively inefficient when compared to a perfectly competitive firm. This can lead to a welfare loss for society. Explain this using the diagrams below



Explanation

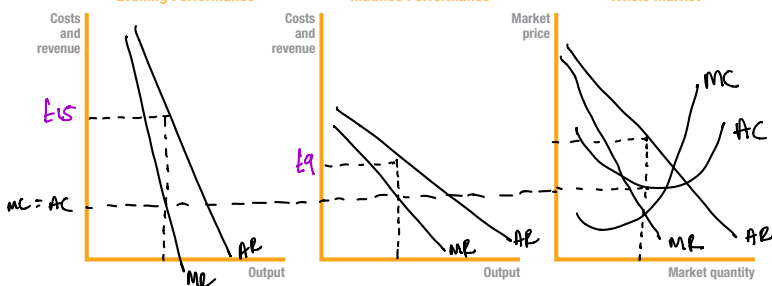
Allocative efficiency occurs when $P = AR = MC$. This will always occur in a perfectly competitive firm that profit maximises. In a monopoly firm, though, the profit max output (where $MC = MR$) is below the level of output at which $AR = MC$ (shown in **GREEN** on the right-hand diagram)

- 8 ABC Cinema charges £9 for a matinee performance of a film, yet charges £15 in the evening for the same film and the same seat. Using the triple diagram below, explain how third-degree price discrimination can occur

Diagram 1:
Evening Performance

Diagram 2:
Matinee Performance

Diagram 3:
Whole Market

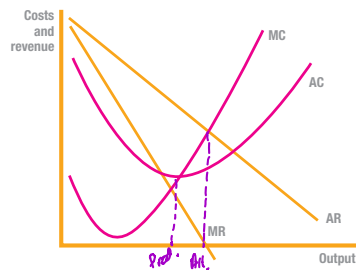


Explanation

Demand for the evening performance will be more price inelastic than the matinee performance (people attending in an evening have less flexibility on timings). The MC is constant for both performances. This leads to higher prices in the evening than afternoon.

- 9 A The diagram below shows a price-making firm. Indicate:

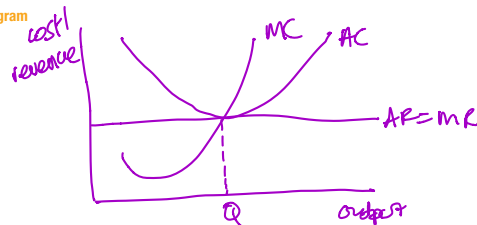
- the productively efficient level of output **lowest AC**
- the allocatively efficient level of output **$MC = AR$**



- B Now draw your own diagram to show a perfectly-competitive firm in the long-run. Again, indicate:

- the productively efficient level of output **Q**
- the allocatively efficient level of output **Q**

Your diagram



10 A Explain what is meant by a firm that has a 'natural monopoly'

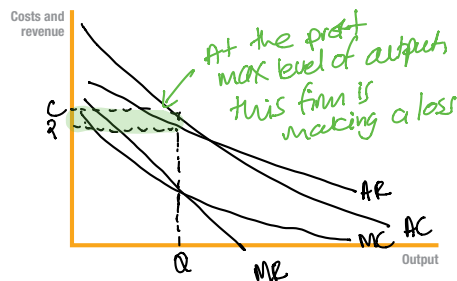
Fixed/sunk costs are so high that AC falls continuously. There is only 'space' for 1 firm to operate with any degree of productive efficiency in this industry.

B Explain why it is difficult for natural monopoly firms to earn supernormal profit

Very hard for AC to be lower than AR, due to the scale required for AC to start to fall.

C Explain why natural monopoly firms may often be operated by the government in the 'national interest', and allowed to operate at the allocatively efficient level of output

The profit max point ($MC=MR$) may be at a relatively low level of output, at which ec of scale have not been fully exploited - this may cause either high prices or sub-normal profits. A gov't may operate at the allocatively efficient point to reduce prices + wider access



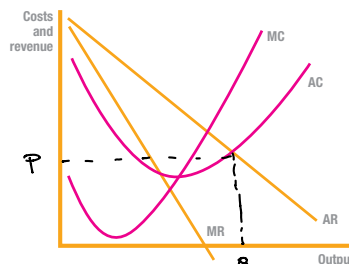
11 A Explain what is meant by a contestable market

A market in which barriers to entry are so low that the threat of potential competition is very high, causing incumbent firms to behave more competitively

B Outline what is meant by 'limit pricing', in relation to firms operating in a contestable market

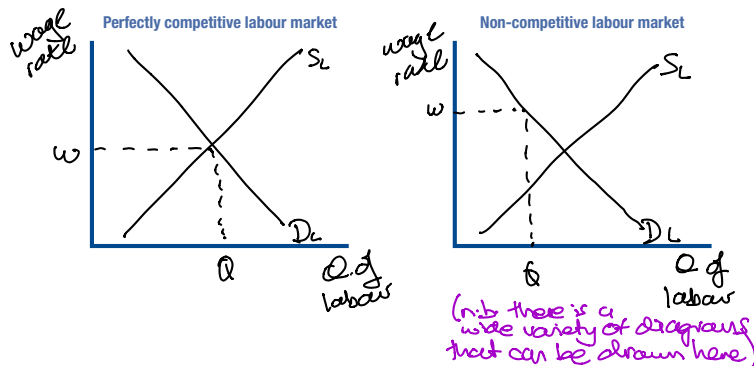
The use of pricing as a barrier to entry; incumbent firms choose to produce at normal profit ($AR=AC$) so as to avoid earning supernormal profit + attracting new entrants. The limit price is the price at which normal profit is earned.

C Indicate the limit price and associated level of output on the diagram below

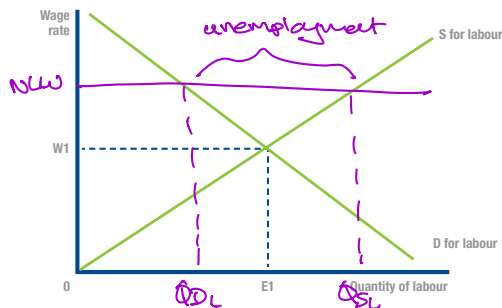


SECTION 6 THE LABOUR MARKET

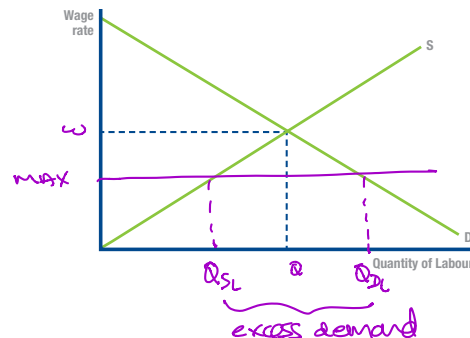
- 1 In the two diagrams below, show how the equilibrium wage rate is established in a perfectly competitive labour market (left hand box) and in a non-competitive labour market (right hand box)



- 2 The National Minimum Wage (NMW) is the lowest wage that employers are allowed to pay to their workers; it is set as an hourly rate and is set by the Chancellor of the Exchequer in his annual Budget speech. The Real Living Wage, calculated by the Living Wage Foundation, is the minimum hourly payment needed by a full-time worker to have a decent standard of living. The government has a target to use this Real Living Wage as the NMW per hour for workers aged 25 and over. Demonstrate the effect of the Real Living Wage on the diagram below. Show the effect the Real Living Wage may have on employment

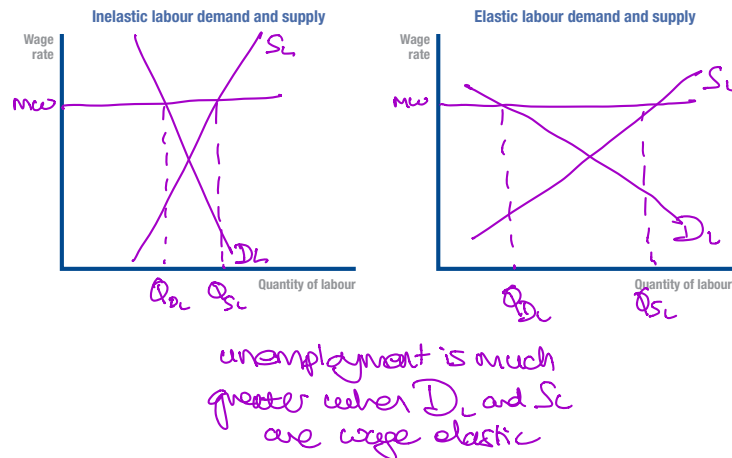


- 3 There has been significant debate in the UK following the Financial Crisis and Great Recession regarding the likely impact of imposing a maximum wage on the earnings of executive board members of large organisations such as banks. Illustrate the effect of imposing a maximum wage for executive pay using the diagram below



- 4 The impact of minimum wages on unemployment levels depends on the wage elasticity of labour demand and supply

- i) On the axes below, demonstrate the different impact of minimum wages in each case:



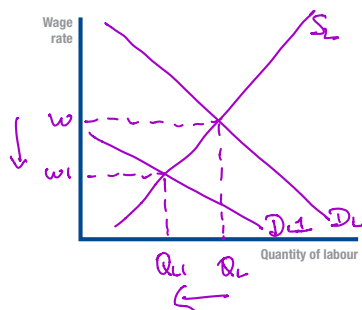
- ii) Give an example of a labour market with relatively wage-inelastic labour demand and supply. Justify your answer

neurosurgeons

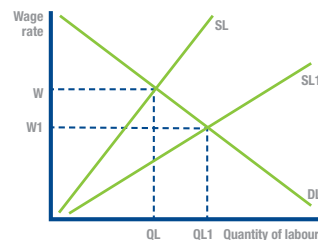
- iii) Give an example of a labour market with relatively wage-elastic labour demand and supply. Justify your answer

supermarket shelf stackers

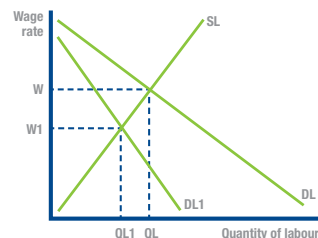
- 6 Companies such as Amazon increasingly use technology and robots in their packaging and distribution warehouses. This is reducing the need for low-skilled labour in these industries. Illustrate the impact of this on the labour market diagram below. (Remember to consider the impact on elasticity of labour demand/supply as well as possible shifts in labour demand/supply)



- 7 For each of the diagrams below, suggest possible reasons for the changes shown:



Possible reasons / scenarios for the change shown:
labour supply has increased + become more elastic i.e. maybe entry requirements have been significantly reduced (cab-driving as a result of apps such as Uber)

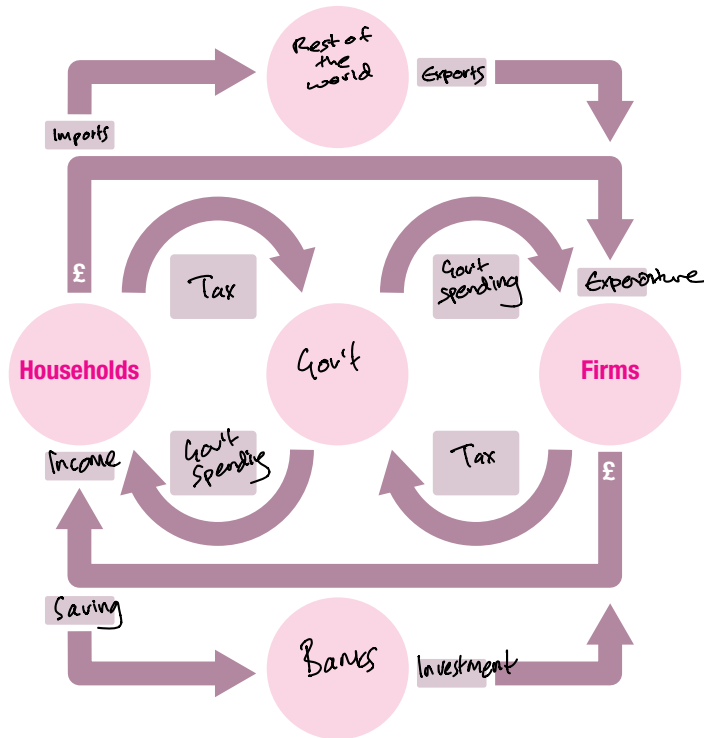


Possible reasons / scenarios for the change shown:
Demand for labour has fallen + become more wage inelastic

MACROECONOMICS

SECTION 1 NATIONAL INCOME AND MACROECONOMIC EQUILIBRIUM

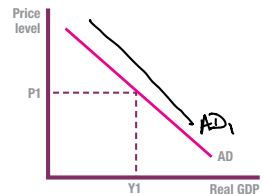
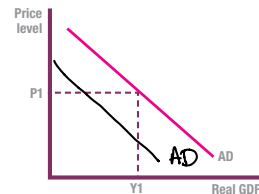
1	The Circular Flow of Income
A	Label this diagram showing the Circular Flow of Income



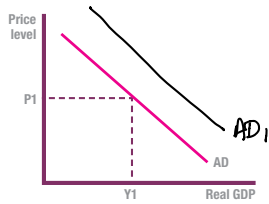
B List 3 injections to the circular flow and 3 withdrawals from the circular flow	
Injections	Withdrawals
Investment	Savings
Gov't Spending	Tax
Exports	Imports

C Use the information below to	
<p>i) calculate the balance of injections and withdrawals</p> <p> $\text{Injections} = 85 + 250 + 73 = 408 \text{bn}$ $\text{Withdrawals} = 56 + 250 + 50 = 356 \text{bn}$ </p> <p> $\left. \begin{array}{l} \text{Injections} = 408 \text{bn} \\ \text{Withdrawals} = 356 \text{bn} \end{array} \right\} \text{GDP will increase}$ </p> <p>ii) state whether the Circular Flow will expand or contract:</p>	
<p>Data:</p> <ul style="list-style-type: none"> Imports £56bn Exports £85bn Total taxation £250bn Savings £50bn Government spending £250bn Business Investment £73bn 	

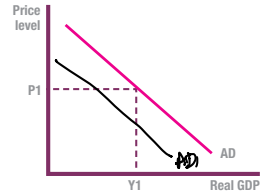
2 Aggregate Demand	
For each of the scenarios given below, add to/adapt the diagram to show the likely impact on the UK's aggregate demand curve	
A An increase in the rate of income tax	B An increase in the amount received by recipients of Job Seeker's Allowance (JSA)



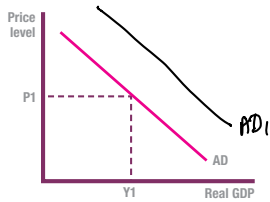
C An increase in business confidence



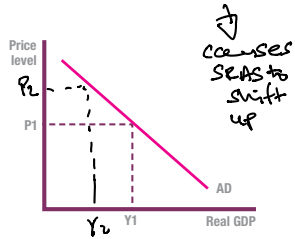
D A fall in average house prices



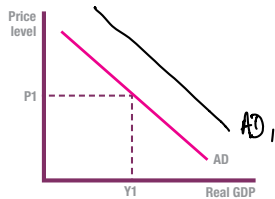
E An increase in the real GDP per capita in the EU and the US



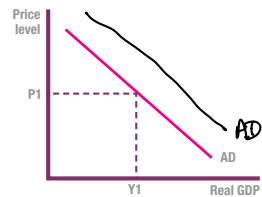
F The government decides to fund more spending on infrastructure by raising the rate of VAT



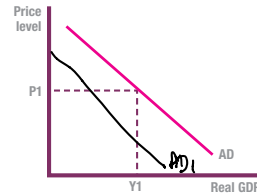
G A weakening of the UK Pound on the foreign exchange markets



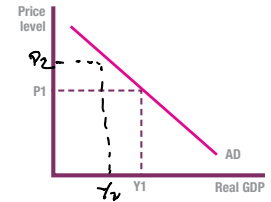
H A fall in the rate of corporation tax levied on business profits



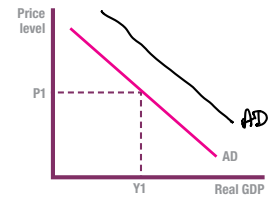
I A rise in the household savings ratio, as workers feel less confident about future job prospects



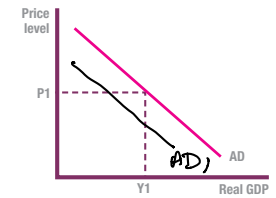
J An increase in the general price level in the economy



K An improvement in the quality of UK exports, resulting in an improvement in net exports



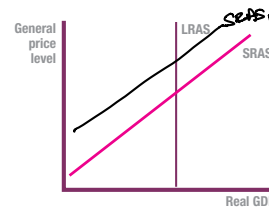
L A fall in access to credit for small businesses



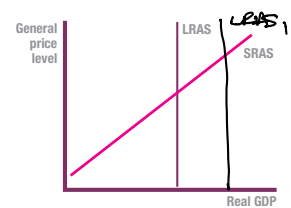
3 Aggregate Supply – the Neoclassical perspective

For each of the scenarios given below, add to/adapt the diagram to show the likely impact on the UK's short-run aggregate supply or long-run aggregate supply curve

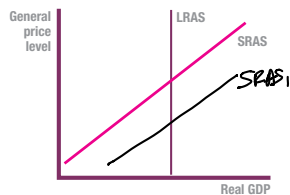
A An increase in the rate of VAT to 22%



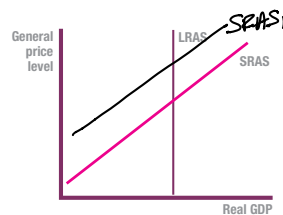
B An improvement in the technology used by UK firms



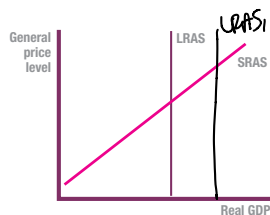
C A significant fall in the price of oil



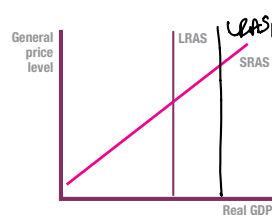
D A weakening of the UK Pound on the foreign exchange markets



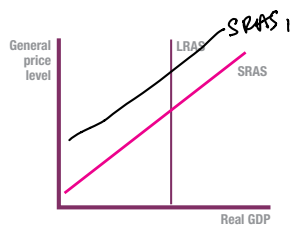
E An announcement in the government's Annual Budget stating that there will be a large increase in the spending on apprenticeships



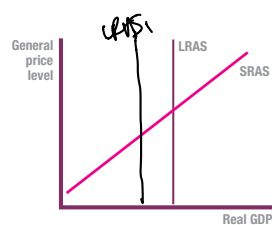
F An increase in inwards FDI



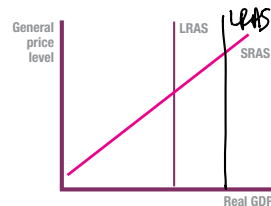
G An increase in the National Living Wage Rate



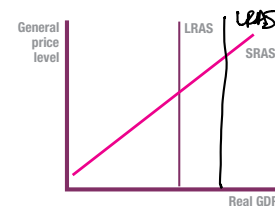
H Negative net migration of skilled labour



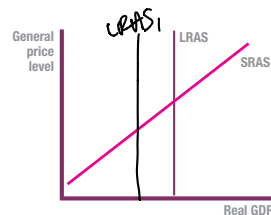
I An improvement in the productivity of the UK's workforce



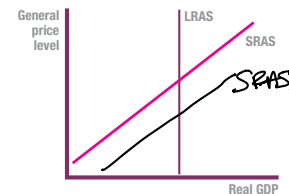
J Greater government support for new businesses, such as reduction in red-tape involved in setting up a business, and lower corporation tax rates for new start-ups



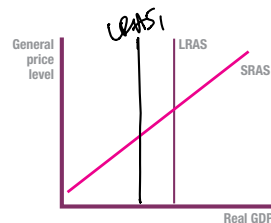
K Reduction in the ready availability of business credit from the UK's banking sector, following profit warnings from many retailers



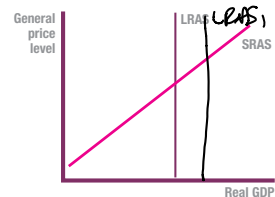
L A reduction in the business rates payable to local councils



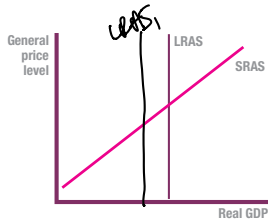
M Widespread flooding in winters and increased drought in summers, due to climate change



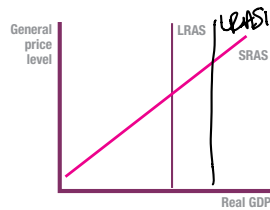
N A narrowing of house prices between UK regions, resulting in improved labour mobility



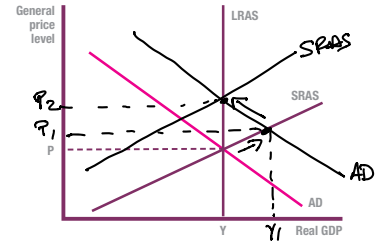
0 An ageing population, causing a shrinking in the population of working age



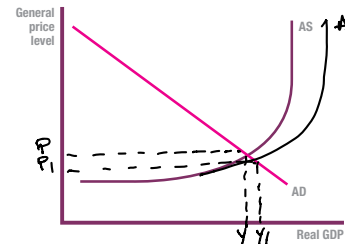
P Introduction of more free-market policies including increased privatisation and further deregulation



Now represent the same scenario on a Neoclassical AD/AS diagram



Using a Keynesian AD/AS diagram, show how net migration might affect the price level and amount of real GDP produced



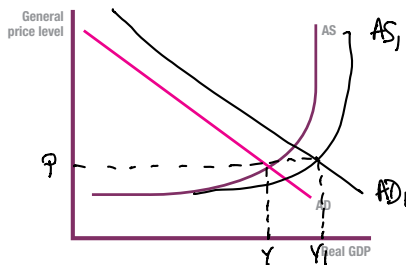
4 Keynesian versus Neoclassical perspectives

Outline 3 key differences between Keynesian and Neoclassical perspectives on the macroeconomy

- 1 (K) markets can fail (N) markets always clear
- 2 (K) wages are sticky downward (N) wages adjust smoothly
- 3 (K) Gov't spending raises AD + causes growth (N) Gov't spending just causes inflation + not ec. growth

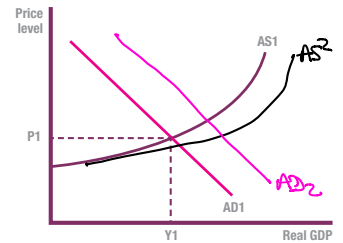
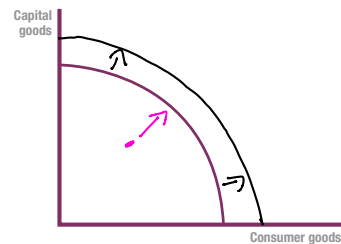
5 Keynesian AS curves

Using a Keynesian AD/AS diagram, show how rising government spending on infrastructure will affect the price level and amount of real GDP produced



6 PPFs and aggregate supply

Here are two diagrams, showing the PPF and the Aggregate Supply for an economy

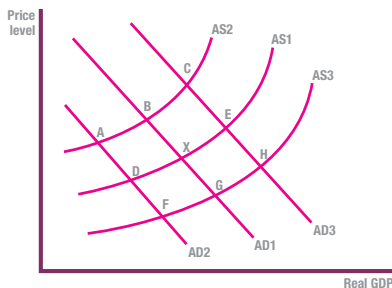


- A** On both diagrams, show an increase in potential long-run GDP growth *in black*
- B** On both diagrams, show increase in actual short-run GDP growth *in pink*
- C** Suppose that the PPF and LRAS have shifted out due to a change in net migration. Explain the nature of that change (i.e. emigration, immigration etc)

Positive net immigration

7 Macroeconomic equilibrium

In this Keynesian AD/AS diagram, the initial macroeconomic equilibrium is at point 'X'. For each of the changes to the economy described below the diagram, select the new equilibrium point. N.b. Each time, you should start from the original equilibrium point X



A reduction in business rates

New equilibrium point: G

A reduction in the value of imports

New equilibrium point: E

A fall in the level of consumer confidence

New equilibrium point: D

A simultaneous increase in the rate of VAT and a reduction in government spending on defence

New equilibrium point: A

Widespread investment in R&D brings new technology into use for the economy

New equilibrium point: E

An increase in the basic rate of income tax, and a fall in the oil price

New equilibrium point: F

8 The Multiplier

A Explain what is meant by the multiplier process:

An injection into the economy leads to a more than proportionate increase in national income

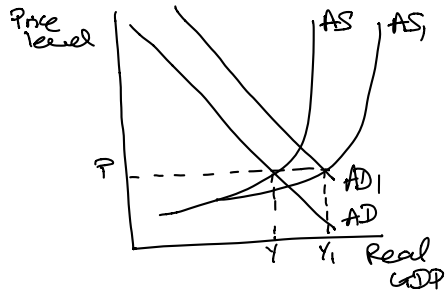
B Give the multiplier formula:

$$\frac{1}{MPW} = \frac{1}{(1-MPC)} = \frac{1}{MPS+MPT+MPM}$$

C Outline factors that would cause the multiplier in an economy to be high

Low interest rates, high confidence, protectionist measures

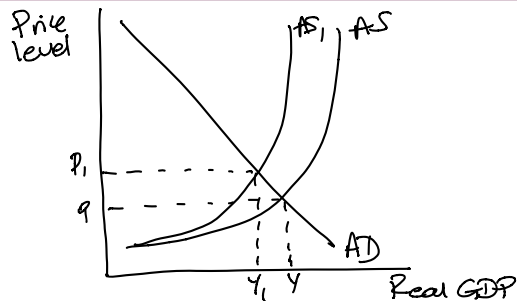
- D** Draw a Keynesian AD/AS diagram to show the effect of an increase in government spending on infrastructure projects such as improved public transport in the North-East of England. Write a short explanation of the changes shown in your diagram in the space provided below



Explanation

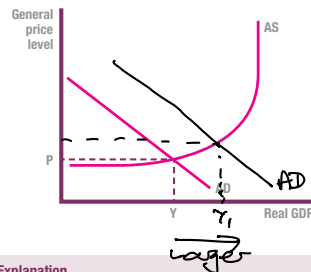
- AD increases because G is a component of AD
- Improved infrastructure increases productive potential therefore AS rises too

- E** Draw a Keynesian AD/AS diagram to show the effect of decrease of inward foreign direct investment in the UK due to concerns about Brexit deal. Write a short explanation of the changes on your diagram in the space provided below



- Explanation** Less inward FDI reduces UK capital i.e. UK productive potential

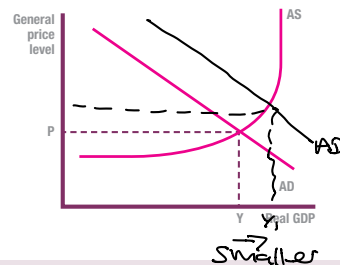
- F** On this AD/AS diagram, show and explain why an increase in AD will lead to a large multiplier effect



Explanation

High spare capacity means that multiplier is likely to be larger as there are many available f.o.p's

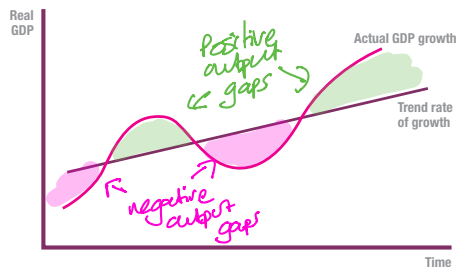
- G** On this AD/AS diagram, show and explain why an increase in AD will lead to a small multiplier effect



Explanation

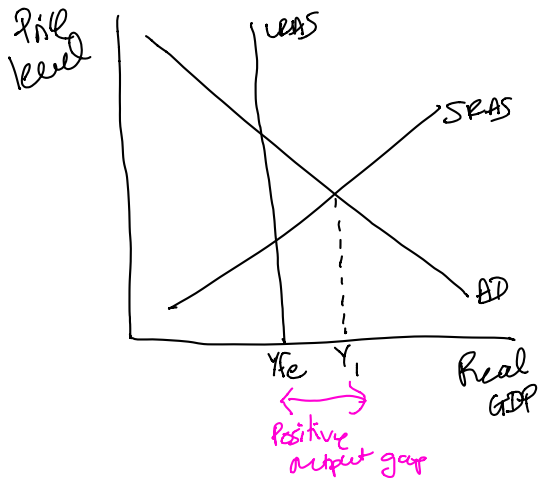
minimal spare capacity reduces the multiplier as output cannot rise easily

On this diagram of the Economic Cycle, label positive and negative output gaps

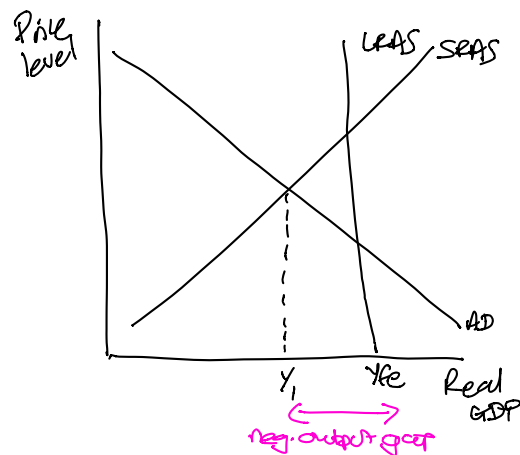


Draw the following diagrams relating to output gaps.

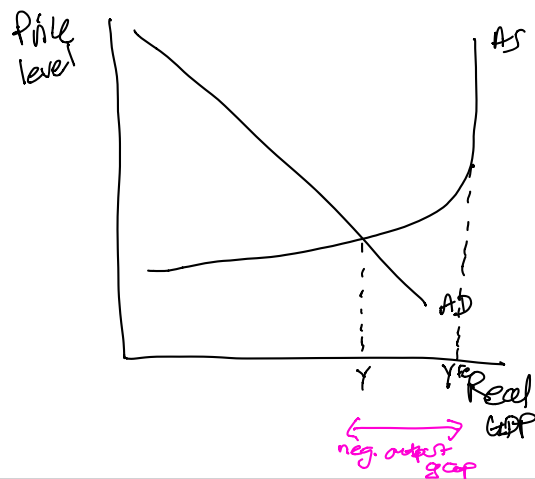
A Neoclassical (monetarist) AD/AS diagram representing a positive output gap:



A Neoclassical (monetarist) AD/AS diagram representing a negative output gap



A Keynesian AD/AS diagram representing a negative output gap



What is the difference between a 'slump' and a 'recession'?

Recession: 2 consecutive quarters of negative economic growth
Slump: more serious + prolonged i.e. a deeper fall in GDP (at least 10%)

What is the difference between a 'recovery' and a 'boom'?

Recovery: rising GDP i.e. positive growth rate although probably still below trend growth rates. A boom suggests growth is above the trend growth rate

Label each of these events A to G on the Economic Cycle diagram below, at the stage that they are most likely to occur:

A Builders decide to delay the construction of new homes

B Reports that the number of job vacancies is rising

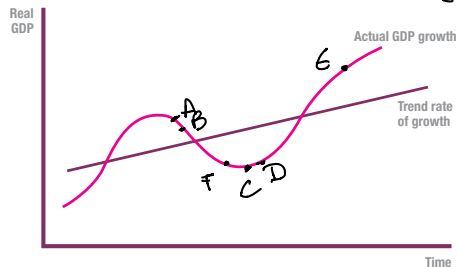
C Home delivered pizza becomes more popular

D The Office for National Statistics announces a fall in size of the trade deficit due to a reduction in imports

E Rising business class air revenues boost profits of leading airlines

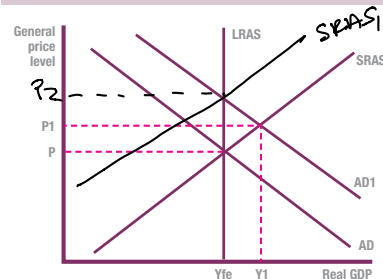
F McDonald's holds prices despite a rise in ingredient costs

(There could easily be debate about these answers!)



10 The Neoclassical automatic adjustment mechanism

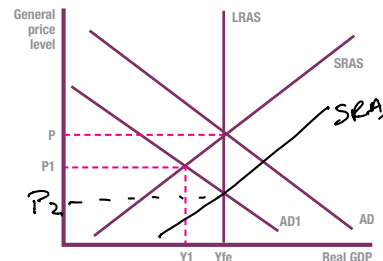
The diagram below shows a Neoclassical (monetarist) AD/AS diagram, following an increase in government spending. Adapt the diagram to show how the economy adjusts back to the full-employment level of output, according to Neoclassical economists. Explain the adjustment process in the space provided



Explanation

At Y1 the economy has a positive output gap. Factors of production e.g. labour have high bargaining power because they are in high demand. This causes a rise in production costs in turn causing a decrease in SRAS.

The diagram below shows a Neoclassical (monetarist) AD/AS diagram, following a decrease in government spending. Adapt the diagram to show how the economy adjusts back to the full-employment level of output, according to Neoclassical economists. Explain the adjustment process in the space provided



Explanation

At Y1 the economy has a negative output gap. Factors of production e.g. labour have low bargaining power because they are in low demand. This causes a fall in production costs in turn causing an increase in SRAS.

Explain why Keynesian economists believe that the economy is NOT self-adjusting:

Keynesians believe that wages are sticky downward i.e. will not adjust automatically. This means that labour markets do not clear or adjust and so unemployment may persist.

SECTION 2 MACROECONOMIC OBJECTIVES

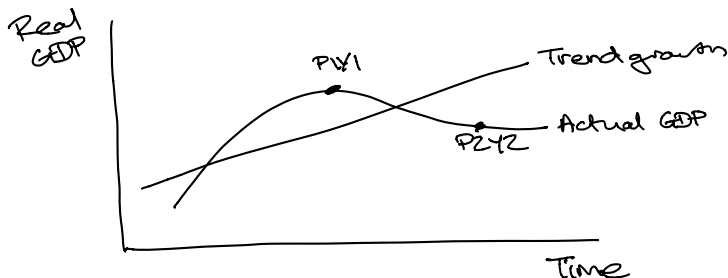
1 Cyclical unemployment



A Explain why the shift in the AD/AS diagram (above left) may result in the shift shown in the labour market diagram (above right)

Demand for labour is derived from demand for goods + services - if demand for output falls (LH diagram) then demand for labour falls too (RH diagram)

B Draw an Economic Cycle (trend) diagram. On your diagram, indicate the position on the cycle that would match the two equilibrium points P1Y1 and P2Y2 on the AD/AS diagram above



C Identify four possible causes of the shift from AD1 to AD2

Increase in income tax rates

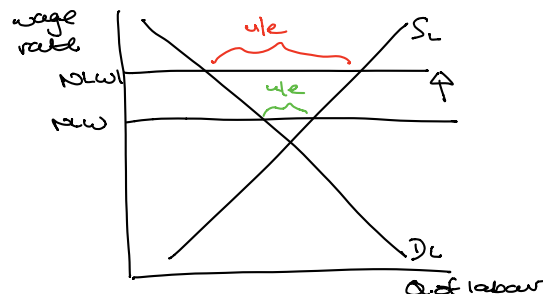
Fall in business confidence

Increase in interest rates

Appreciation of the currency

2 National Minimum Wage causing real wage unemployment

A Draw a labour market diagram to show the impact of an increase in the National Living Wage



B On your diagram above, indicate the increase in real-wage unemployment that results from the higher wage rate

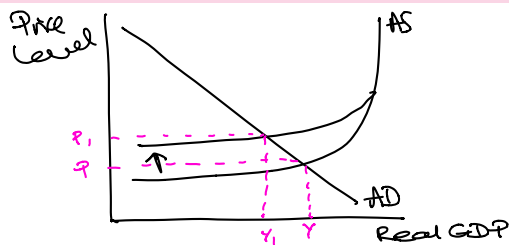
C Explain the possible economic effects on consumers, workers and businesses of an increase in the National Living Wage Rate

Consumers Higher income \therefore possibly more spending + confidence

Workers Those who retain their jobs receive more income so possibly more motivated. But some will become unemployed

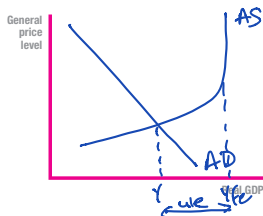
Businesses Rise in production costs \Rightarrow falling profits

- D** Draw an AD/AS diagram to represent the impact of an increase in the National Living Wage rate on the economy

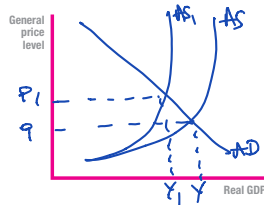


3 Types of unemployment

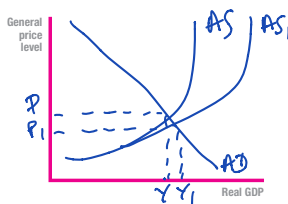
- A** Draw an AD/AS diagram that helps to illustrate cyclical (i.e. demand-deficient) unemployment



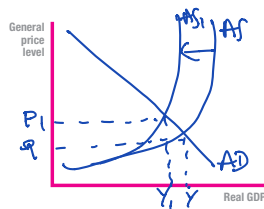
- B** Draw an AD/AS diagram that helps to show the impact of long-term structural unemployment, as the skill-level and motivation of the unemployed decreases



- C** Draw an AD/AS diagram to show the likely impact on the economy of an increase in net immigration of skilled workers



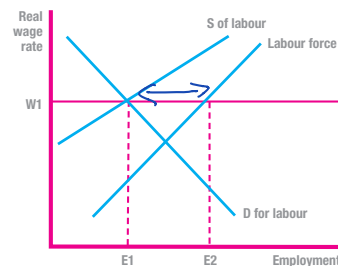
- D** Draw an AD/AS diagram to show the likely impact on the economy of rising economic inactivity rates



- E** Explain what is meant by real-wage inflexibility

Wages, adjusted for inflation, do not adjust freely in the market mechanism

4 The natural rate of unemployment



- A** Indicate the Natural Rate of Unemployment on this diagram

Between E1 and E2

- B** Explain why the people who are potential workers, represented by that gap, would not be included in either the Claimant Count or the Labour Force Survey measures of unemployment

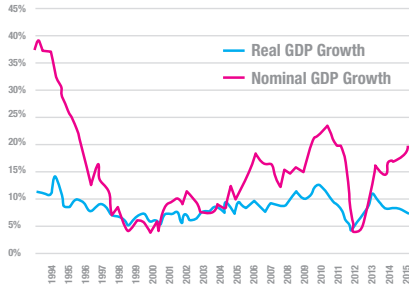
They are choosing voluntarily not to work at that wage rate

C List 5 policies that the government might use to try to narrow this gap

Improved childcare
 Cheaper care for the elderly
 Tax incentives for the 2nd earner in a family
 Improve labour market flexibility e.g. home-working encouraged
 Cheaper transport \rightarrow improved geographical mobility

5 Inflation

Nominal GDP vs Real GDP



According to this diagram, what was the approximate rate of inflation in:

A Early 1997

$$17 - 8 = 9\%$$

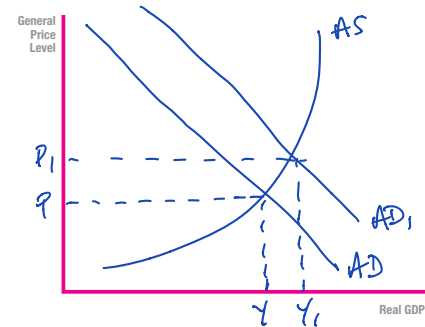
B Late 2009

$$22 - 12\% = 10\%$$

C Distinguish between deflation, disinflation, inflation and accelerating inflation

Deflation - falling average price level i.e. negative inflation
 Disinflation - falling inflation i.e. prices rising but less quickly
 Inflation - rising average price level
 Accelerating inflation - price level is rising increasingly quickly

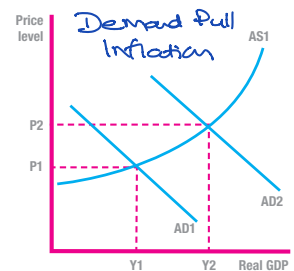
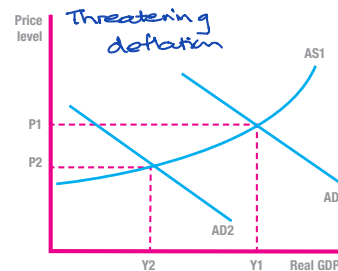
D Draw an AD/AS diagram in the space below, to show the likely impact on the economy of an increase in the money supply

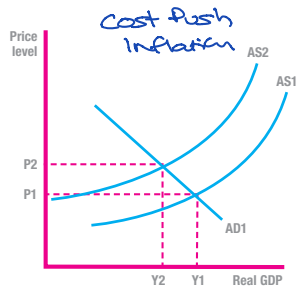
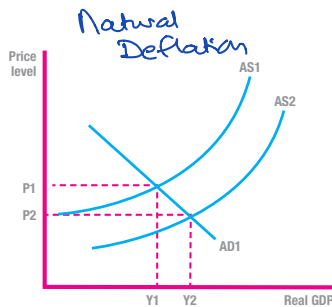


6 Inflation and Deflation

Study the four diagrams below. Then allocate each of them one of the titles from the list below:

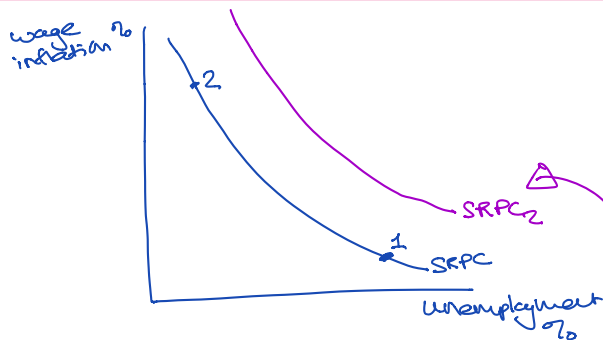
- Demand pull inflation
- Cost push inflation
- Natural ("benign") deflation
- Threatening ("malign") deflation





7 The Short-run Phillips Curves

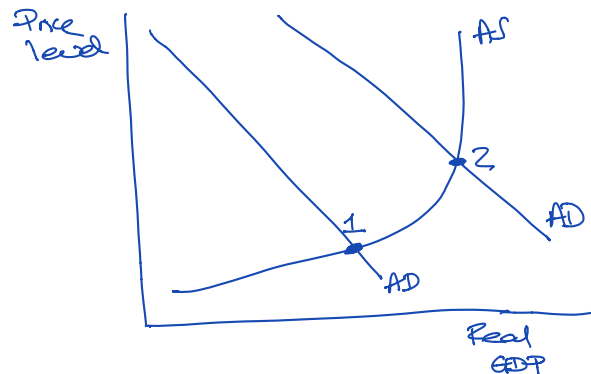
A In the space below, draw a diagram to show the trade-off between inflation and unemployment i.e. a short-run Phillips curve. Remember to show 'Wage Inflation %' on the vertical axis and 'Unemployment %' on the horizontal axis



B On your diagram above, label two positions:

- 1 U1W1 = low wage inflation of 2% and high unemployment at 8%
- 2 U2W2 = high wage inflation of 8% and low unemployment of 2%

C Represent the same trade-off between unemployment and inflation on an AD/AS diagram in the space below:



D How might knowledge of the Phillips curve / the trade-off between unemployment and inflation be used by the government to help decide on macroeconomic policy?

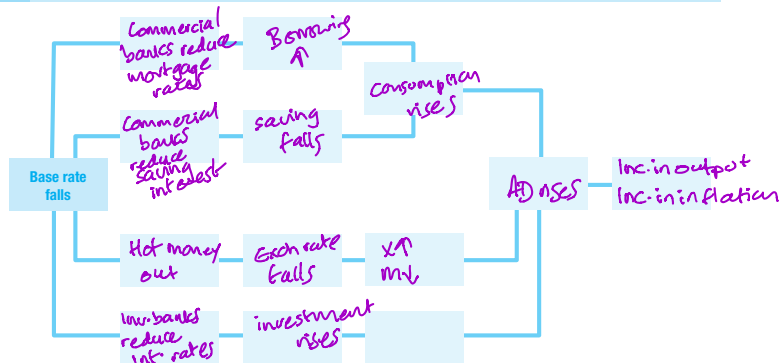
The gov't needs to decide which objective to prioritise, as this theory suggests that they cannot both be achieved at the same time

E EXTENSION QUESTION: Add a second curve (i.e. another short-run Phillips curve) to your original Phillips curve diagram to show what will happen if workers come to expect a higher rate of inflation, as happened in the UK in the mid-1970s

SECTION 3 FINANCIAL MARKETS AND MONETARY POLICY

1 Monetary policy transmission mechanism

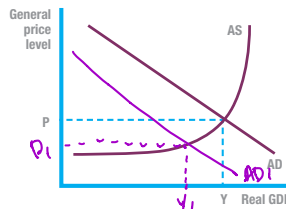
A The monetary policy transmission mechanism can demonstrate the links and relationships between changes in the base rate of interest ("Bank Rate"), and the price level and level of output in an economy. Complete the following transmission mechanism diagram using the terms in the boxes below



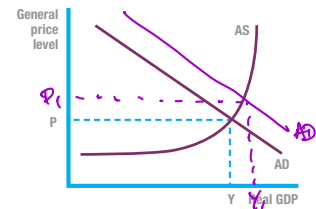
Increase in output Increase in inflation	Commercial banks reduce their savings interest rates	Commercial banks reduce their mortgage rates	Consumption rises
Exports ↑ Imports ↓	Borrowing ↑	Base rate falls	Investment banks reduce their interest rates
ER falls	Savings falls	Hot money flows out	AD rises
	Investment rises	Discretionary income ↑	

B Adapt the AD/AS diagrams below to show the effects of each of the suggested changes to monetary policy

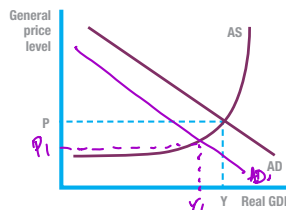
i) An increase in the base rate of interest set by the Central Bank



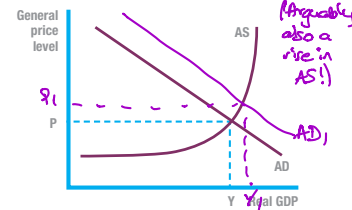
ii) Greater use of asset purchases (Quantitative Easing) by the Central Bank in response to falling confidence



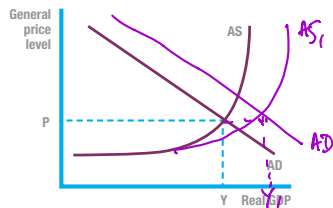
iii) The use of foreign exchange reserves to buy the domestic currency in order to engineer an increase in its value



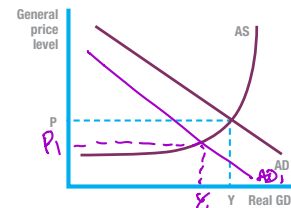
iv) The use of Forward Guidance to indicate to businesses and households that interest rates are unlikely to rise further in the next 12 months



v) The government introduces a Funding for Lending scheme, in which small businesses find it easier to gain access to credit from banks



vi) The government decides to reduce the supply of narrow money in the economy



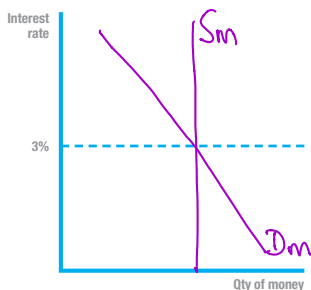
2 EXTENSION QUESTION: Determination of interest rates in money markets

It is assumed in economics that the supply of money is determined exogenously (outside of this model) by the government and therefore when we draw the supply of money against interest rates, it is perfectly interest inelastic. The demand for money follows the normal law of demand: as the 'price' of money (the interest rate) rises, then demand for money falls.

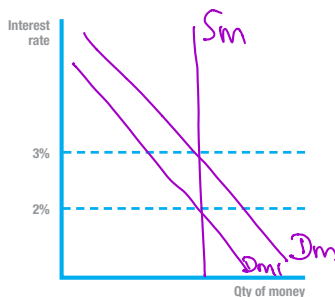
Using the diagrams below:

- Complete and fully label the diagram to show an equilibrium interest rate of 3%
- A decrease in the demand for money amid fears of uncertainty in the economy, causing the equilibrium interest rate to fall to 2%

A An interest rate of 3%



B A decrease in the demand for money amid fears of uncertainty in the economy causing the interest rate to fall to 2%



C Suggest 3 factors that would likely cause the demand for money in an economy to increase

Rising confidence leading to more transactions
 Inflation - households want to spend before prices rise
 Very low returns on assets prompting households to keep more cash

D What will happen to the equilibrium rate of interest if the money supply increases? Explain your answer

The int. rate should fall, ceteris paribus because if it doesn't fall there would be an excess supply of money

E Outline the main factors considered by a Central Bank such as the Bank of England when deciding on its base rate of interest

The focus is often maintaining price inflation target, so they would consider any factors likely to affect inflation e.g. confidence, stock levels, unemployment etc.

F Distinguish between narrow money and broad money

Narrow: very liquid e.g. cash (short term deposits)

Broad: anything that, at some point, could be converted to cash

3 The equity market

A Outline the main roles of financial markets

Facilitate saving
 Lending to businesses + households
 Facilitate exchange of goods + services
 Provide forward markets
 Provide market for equities

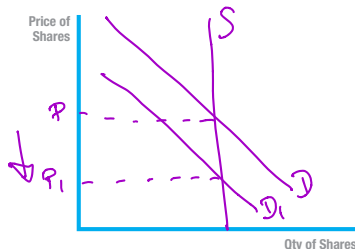
B Explain what is meant by an 'equity market' (i.e. a market for shares)

A financial market (a secondary market) in which shares can be bought + sold. Shares are issued by firms as a way of raising finance.

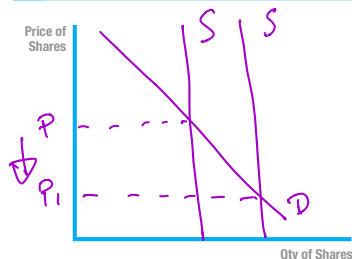
C Outline other possible sources of finance that a business could use in order to fund investment / growth

- Corporate bond issue
- Retain profits
- Bank loan
- Merger

- D Draw a diagram to show the impact on the share prices of a large firm if it announces a profit warning, following lower-than-expected sales in the Christmas period



- E Draw a diagram to show the immediate impact on the share prices of a large firm if it decides to issue more shares in order to fund expansion

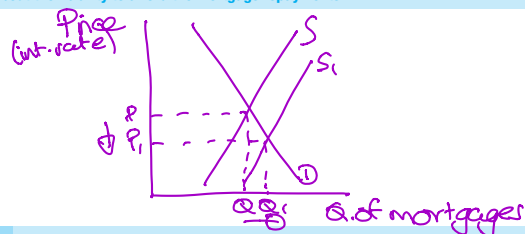


4 Market failure in the financial sector

- 1 A Explain, in the context of financial markets, what is meant by asymmetric information

when one party (eg borrower) has more information regarding the transaction than the other party (eg lender)

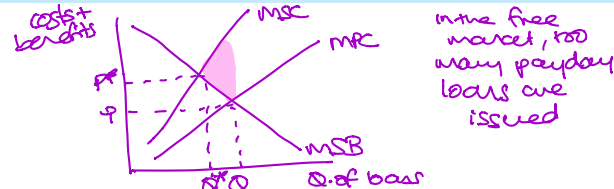
- B Draw a diagram below to represent the market for mortgages in the UK. Illustrate the impact on this market if those wanting to take out mortgages are not completely honest with bank managers about their ability to afford the mortgage repayments



- 2 A Explain, in the context of financial markets, what is meant by a negative externality

Social costs > Private costs
eg. a toxic ban sub-prime debt: not only does the bank/borrower lose out if one borrower cannot repay but it may trigger reduced lending to others

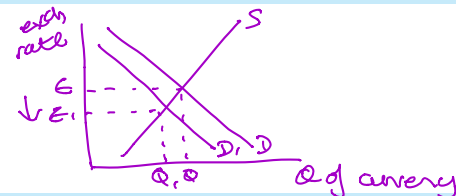
- B Draw a diagram in the space provided below, to show the existence and impact of negative externalities in the market for payday loans, such as those provided by companies such as Wonga



- 3 A Explain what is meant by 'speculation'

Predicting future price changes, prompting buying/selling activities today to take advantage of those price changes for a profit

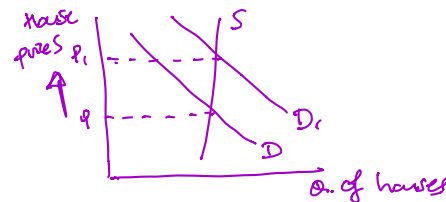
- B On a foreign exchange market diagram, illustrate the impact on the market if currency speculators believe that the currency is likely to fall in value in the near future



- 4 A Explain what is meant by a house-price bubble

House prices rise significantly more quickly than their long term growth rate, often as a result of speculation

- B On a housing market diagram, show how a house-price bubble might occur



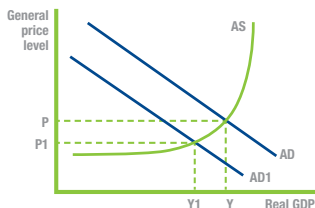
SECTION 4 FISCAL POLICY AND SUPPLY SIDE POLICIES

1 Fiscal policy and AD/AS

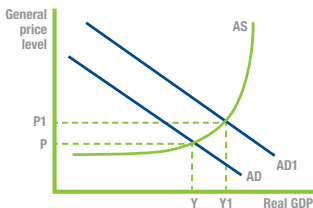
Match the following headings to the most appropriate diagram below. There may be more than one heading for some diagrams!

- A Rise in government spending on computer skills for apprentices
- B Fall in the size of the government budget deficit
- C Fall in National Insurance contributions paid by employees
- D Fall in government spending on infrastructure
- E Increase in the size of the government budget surplus
- F Decrease in the rate of VAT
- G Increase in excise duties charged on fuel
- H A boost to spending on transport due to increased use of public-private partnerships and PFI deals
- I A fall in the rate of corporation tax
- J Increased spending by the government on repaying the national debt to overseas investors
- K The government collects more tax revenue from high-earners and redistributes that amount to low-earners
- L Tax breaks for firms providing inwards foreign direct investment

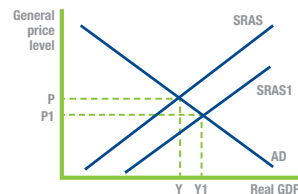
Headings: **B G J**



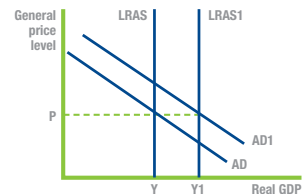
Headings: **K**



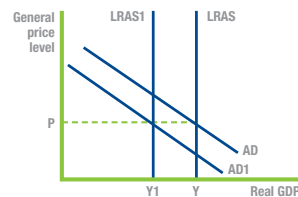
Headings: **F**



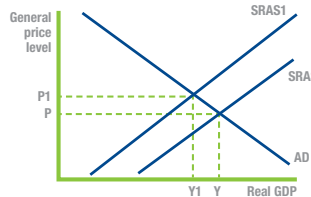
Headings: **C A H I**



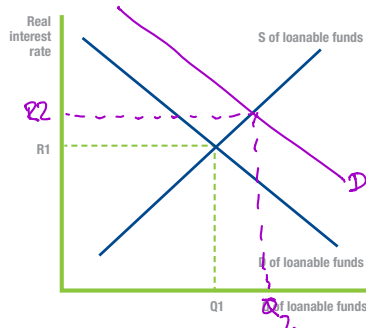
Headings: **D**



Headings: **G**



2 EXTENSION QUESTION: Fiscal Policy and Crowding Out



A Add a second 'Demand for Loanable Funds' curve to this diagram to show what happens if the government decides to increase its budget deficit

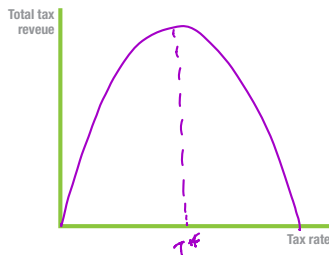
B Explain what is meant by crowding out. Spending by the government presents a problem for the private sector, either because int. rates rise or because there is a scarcity of factors of production

C Explain how this diagram could be used to illustrate why (financial) crowding out might occur

Cost increases D for loans raising int. rates to R2, which raises the cost of borrowing for private firms, reducing borrowing for investment purposes

3 The Laffer Curve

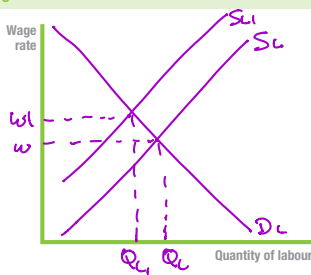
- i) Draw and fully label a Laffer Curve diagram on the axes below. Don't forget to indicate the "optimal tax rate"!



- ii) What effect might an increase in the rate of income tax have on the Supply Curve for Labour?

It may reduce labour supply because the reward for work reduces

- iii) Draw a Labour Market diagram on the axes below to illustrate the effect that you have described above



- iv) Distinguish between regressive taxes, proportional taxes, and progressive taxes

Regressive: take a larger % of income of the poor, whereas progressive taxes take a larger % of income from the rich. Proportional taxes take an identical % of income regardless of income.

- v) To what extent does the Laffer Curve suggest that income tax rates should become more progressive?

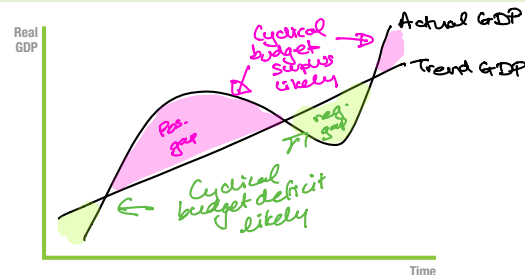
Up to the optimal tax rate T^* then it makes sense for those on higher income to pay a higher rate of tax. However beyond T^* the higher tax rate acts as a disincentive to work, and encourages tax evasion/avoidance, so there is little merit in raising tax beyond this point.

4 Cyclical budget deficits and surpluses

- i) Distinguish between a cyclical budget deficit and a structural budget deficit

A cyclical budget deficit occurs automatically in a recession, because tax revenue automatically declines and government spending automatically rises. The deficit should automatically be corrected when the economy starts to grow. However, a structural budget deficit is a result of discretionary fiscal policy in which the government persistently spends too much no matter the state of the economy.

- ii) Draw a trend diagram to represent the economic cycle, on the axes provided below



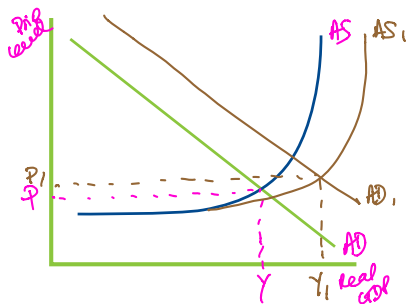
- iii) Indicate the periods in which the economy has a positive output gap and when the economy has a negative output gap

- iv) Indicate the periods in which the government will have a cyclical budget deficit and when the government will have a cyclical budget surplus

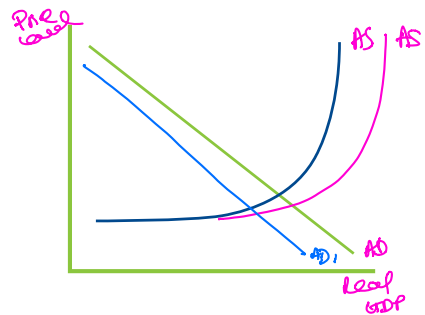
- v) Explain the difference between automatic stabilisers and discretionary fiscal policy

Automatic stabilisers occur automatically with the economic cycle rather than because of deliberate/ specific changes to government policy. Discretionary policy is a deliberate change e.g. change in the tax rate.

5	Supply side policies
A	Distinguish between supply-side policies and supply-side improvements
	A SSP is a deliberate policy/action taken by the government to improve the productive potential of the economy. A SSI is not a deliberate policy, but instead something that occurs intrinsically in the economy to improve the supply side - it can originate in the private sector.
B	Distinguish between free-market supply-side policies and interventionist supply-side policies
	Free market SSPs involve less government intervention e.g. deregulation, increased openness to trade, privatisation etc. They can be inexpensive and can occur quite quickly. Interventionist policies involve more government spending/involvement in the economy.
C	Give 3 examples of free-market supply-side policies
	Deregulation
	Privatisation
	Removal of tariffs/quotas
D	Give 3 examples of interventionist supply-side policies
	Imposition of more non-tariff barriers
	Increased environmental legislation
	Increased labour market regulation

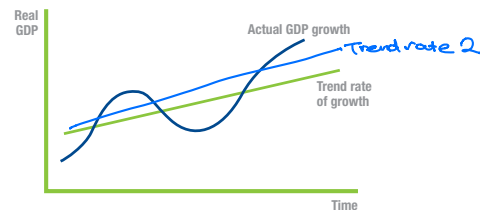


E	Label this diagram to show the macroeconomic equilibrium
F	Illustrate an appropriate shift on the diagram to show what may happen if the government increases its spending on retraining structurally unemployed persons
G	Explain what may happen to the equilibrium price level of output over a period of 10 years Very little change overall



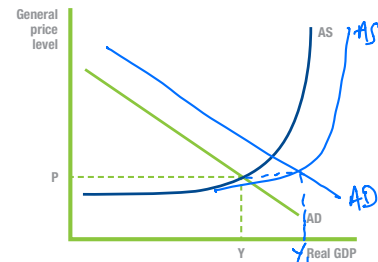
H	Draw and label this diagram to show how an improvement in broadband speeds in rural areas will likely impact the economy Shift right
I	Illustrate an appropriate shift on the diagram to show what may happen if confidence falls significantly in the post-Brexit period Blue shift in AD
J	Explain why not all supply side policies have positive effects on the economy The impact depends on whether AD also rises - there is a risk of simply increasing a negative output gap

K	On the economic cycle diagram below, show how supply side policies might affect the trend rate of growth
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L	Some demand-side fiscal policies also have supply-side effects. Give an example of such a policy, and show the effect of such a policy on the AD/AS diagram to the right
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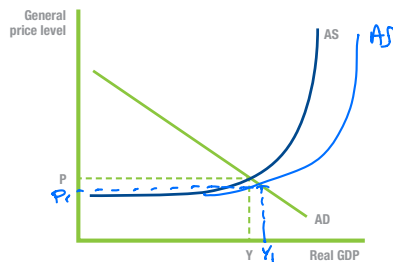
Example:
Reducing the rate of income tax causes C to rise. \therefore AD rises. But it may also encourage the economically inactive into work, so AS rises



- M Some supply-side policies require no government spending. Give an example of such a policy, and show the effect of such a policy on the AD/AS diagram to the right

Example:

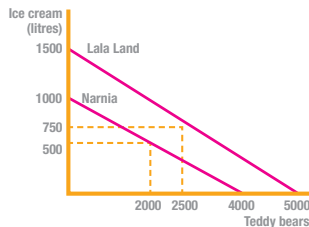
Deregulation of the transport industry



SECTION 5 THE INTERNATIONAL ECONOMY

1 Comparative Advantage and Opportunity Cost

This diagram shows the production possibilities of two countries, Narnia and LaLa Land, each of which uses all available resources to make two products, ice cream or teddy bears



- A Does either country have Absolute Advantage? Explain your answer

LaLa Land can produce more of everything

- B If Narnia chooses to make 1,000 more teddy bears, what is the opportunity cost of that output decision?

250 litres of ice cream

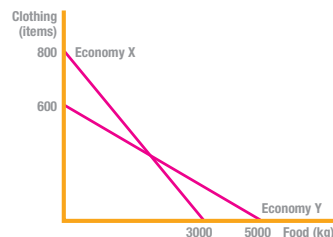
- C If LaLa Land decides to make another 300 litres of ice cream, what is the opportunity cost of that decision?

1000 teddy bears

- D Does either country have a comparative advantage in either product? Explain your answer

Narnia has a lower opp cost in producing ice cream & LaLa Land in teddy bears. Narnia has comp. adv. in ice cream + LaLa Land in teddy bears

The production possibilities diagram below shows the possible combinations of food and clothing that can be produced by Economy X and Economy Y



- E Calculate the opportunity cost in Economy X of i) producing food and ii) producing clothing

i) 3.75kg food

ii) 0.27 items of clothing

- F Calculate the opportunity cost in Economy Y of i) producing food and ii) producing clothing

i) 8.33kg food

ii) 0.12 items of clothing

- G Which country has a comparative advantage in the production of food?

X

- H Which country has a comparative advantage in the production of clothing?

Y

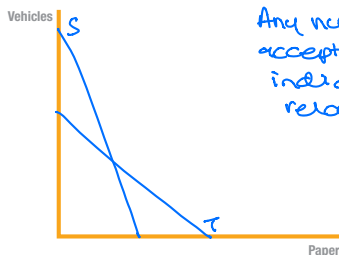
- I Does either country have an absolute advantage?

No

- J EXTENSION QUESTION: what is the range of terms of trade in which these 2 countries will trade with each other?

Anywhere between 3.75kg + 8.33kg of food per item of clothing

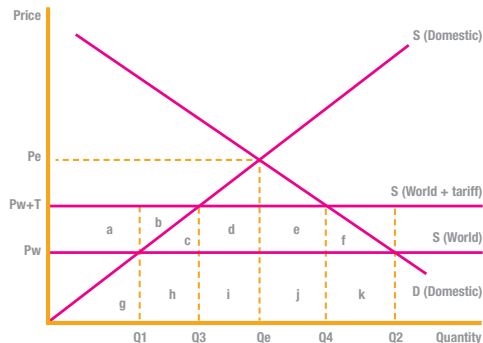
In the space below, draw your own production possibilities diagram to represent two economies. Each economy produces both vehicles and paper. Economy S has a comparative advantage in production of vehicles. Economy T has a comparative advantage in production of paper. Neither country has an absolute advantage. Choose your own numbers to make this scenario work on your diagram!



Any numbers are acceptable that indicate similar relative slopes

2 EXTENSION QUESTION: Trade and Tariffs

The USA has imposed tariffs of 25% on imports of steel from China and the EU. The diagram below shows the impact of that tariff on the market for steel in the US. Study the diagram and then answer the questions that follow



What does each of the following areas on the diagram represent?

1 a + b

Additional domestic producer surplus after the tariff

2 c + f

Deadweight welfare loss after the tariff

3 h + i + j + k

Revenue to overseas producers before the tariff

4 a + b + c + d + e + f

Loss of consumer surplus after the tariff

5 d + e

Revenue to domestic govt post-tariff

6 d + e + i + j

Total amount spent on M after the tariff

7 G

Total cost of domestic production before the tariff

8 $P_e \times Q_e$

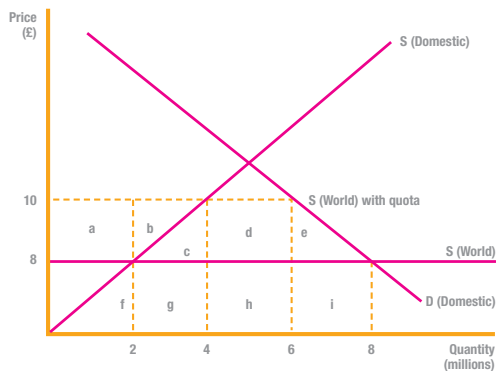
The domestic market eqm with no trade (Total revenue in this case)

9 $P_{w+T} \times Q_4$

Total spending on the good after the tariff

3 EXTENSION QUESTION: Trade and Quotas

This diagram shows the market for sweatshirts, with a quota being imposed to limit imports to 2 million units. Before the imposition of the quota, the equilibrium price was £8; after the quota the equilibrium price rises to £10



Make some detailed notes about the economic effects on each of these stakeholders:

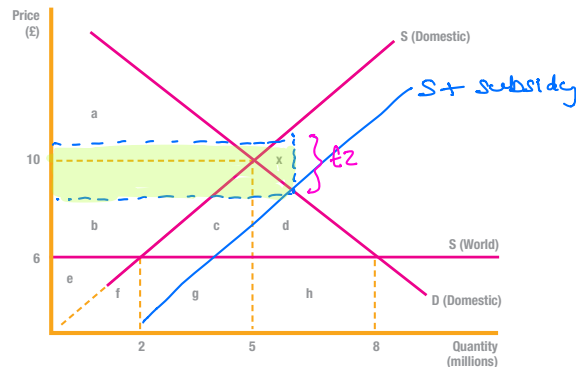
Consumers Price rises £2, consumer surplus falls £14m

Domestic producers Production rises from 2m to 4m, and producer surplus rises by £6m

Global producers (importers)
Initial revenue: $g + h + i$
new revenue: $d + h$

4 EXTENSION QUESTION: Trade and Subsidies

This diagram shows a market in which the product can be produced domestically, but only for £10 each. This domestic price is much higher than the price of imports, at £6 each



A Describe the areas on the diagram that represent

i) domestic consumer surplus

$$a + b + c + d$$

ii) domestic producer surplus

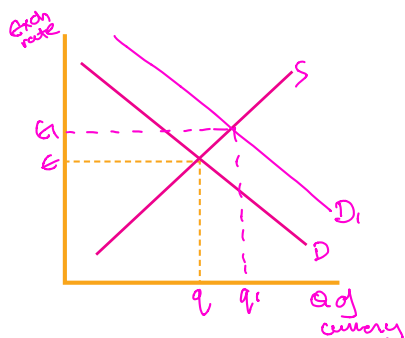
$$e$$

iii) the volume of imports

$$8m - 2m = 6m$$

B Add a new Domestic Supply curve to show the effect of a government subsidy of £2 per unit paid to domestic producers

C On the diagram, shade in the total amount of subsidy that the government will pay to the industry



A Label this diagram to show how a floating exchange rate is determined in the foreign exchange market

B Illustrate an appropriate shift on the diagram to show what may happen if the central bank of the country decides to raise the base rate of interest

C Give 2 other possible factors that could cause the same shift / movement on the diagram

Speculation: belief that the currency will rise in value

Increase in sales of exports

D Distinguish between an appreciation and a depreciation

Appreciation: an increase in the currency's value against others

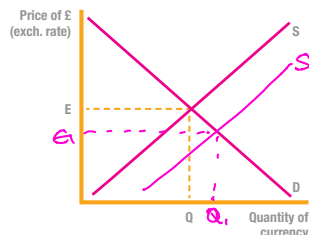
Depreciation: a decrease in the currency's value

E Explain what may happen to the current account of the balance of payments, ceteris paribus, as a result of the change shown

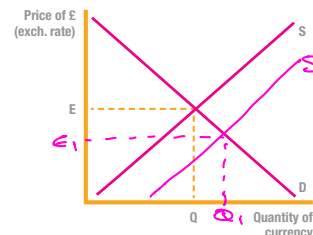
X became more expensive and M relatively cheaper therefore likely decrease in the value of net exports so worsening current account deficit

For each of the scenarios given below, illustrate the effect on the exchange rate diagram.

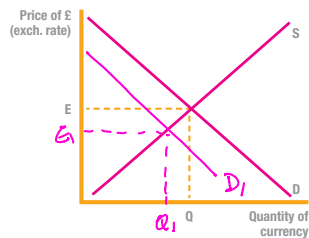
F An increase in interest rates in other, stable economies



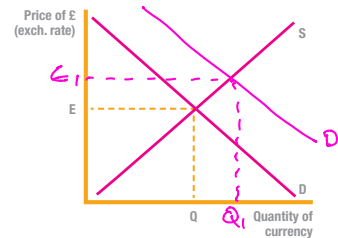
G An increase in speculation AGAINST the £, as currency traders expect the value of the £ to fall



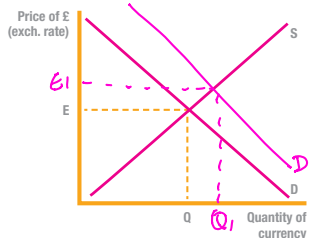
H A worsening of the trade deficit as UK households buy more goods and services from the US and EU



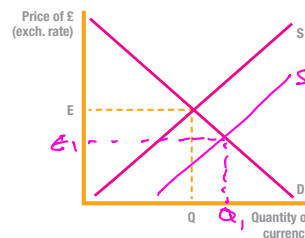
I An increase in inwards FDI (i.e. long-term capital flows) to the UK economy



J A rise in the value of UK exports as the UK government agrees new trade agreements with North American economies

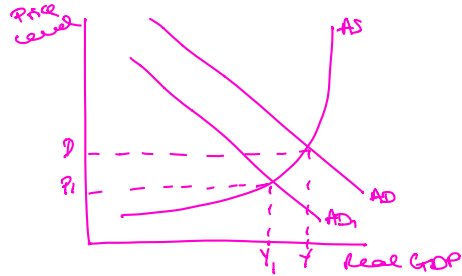


K Currency traders sell £s as they seek to buy the Japanese Yen, which they believe is going to appreciate in the near future



6 The exchange rate and trade

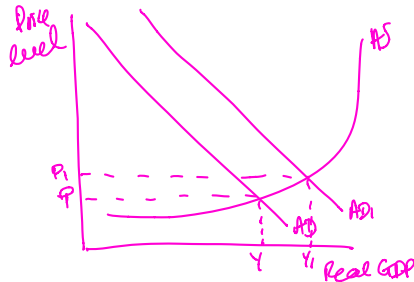
A In the space provided, draw an AD/AS diagram to show how an appreciating exchange rate might affect an economy that has a surplus on its current account of the balance of payments



B Name two economies for which this might be the case

Netherlands China
Germany

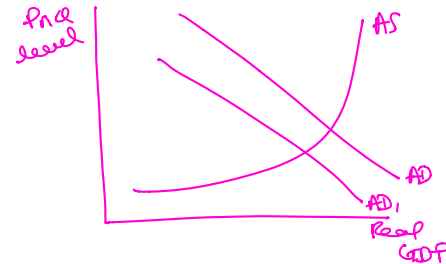
C In the space provided, draw an AD/AS diagram to show how a depreciating exchange rate might affect an economy with a deficit on its current account of the balance of payments



D Name two economies for which this might be the case

UK
USA

E In the space provided, draw an AD/AS diagram that shows the likely impact on an economy that is experiencing an improvement in its terms of trade index

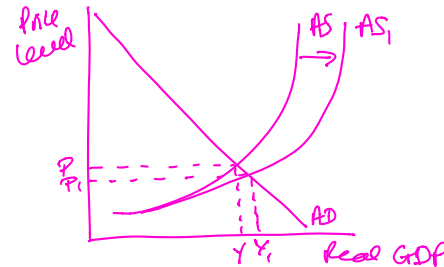


F Give 2 reasons why an economy might experience an improvement in its terms of trade

Rising D for exports
Removal of tariffs

7 National income and the balance of trade

A Draw an AD/AS diagram and show the equilibrium levels of Real National Output and the Price Level

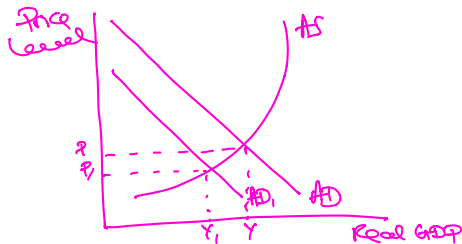


B Add a line or curve to the diagram to show the likely effect of an increase in inwards Foreign Direct Investment

C Which account on the Balance of Payments would be directly affected, following this increase in inward Foreign Direct Investment? Explain your answer

Financial account (long term capital flows)

D Draw an AD/AS diagram and show the equilibrium levels of Real National Output and the Price Level

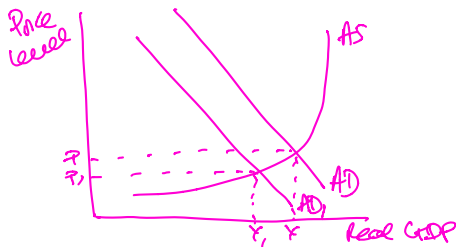


E Add a line or curve to the diagram to show the likely effect of a recession in one of the main export markets for the economy depicted

F Which account on the Balance of Payments would be directly affected, as a result of this recession in one of the economy's main export markets? Explain your answer

Current account (via the Balance of Trade)

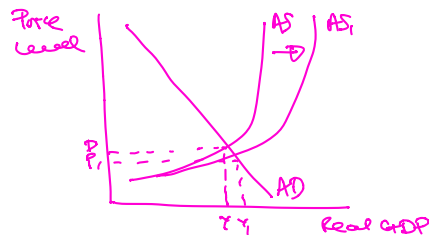
G One method that governments can use to reduce a trade deficit is to implement "expenditure-reducing policies". This type of policy aims to reduce household income, so that households spend less on imports. Draw an AD/AS diagram in the space below to show the effect of an expenditure-reducing policy on the economy



H Governments can also use supply-side policies to reduce a trade deficit. Explain, giving at least one example, how supply-side policies may reduce an economy's trade deficit

Improve transport infrastructure could reduce production costs (of raw materials + finished products) improve international price competitiveness, as well as making it easier for finished products to reach ports (transport hubs)

I Draw an AD/AS diagram in the space below to show the effect of supply-side policies intended to reduce a trade deficit



8 Fixed exchange rates

A Distinguish between fixed exchange rate systems and floating exchange rate systems

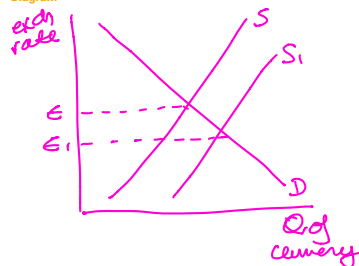
Fixed: value of currency against others fixed at a predetermined rate by the govt - it is maintained by the govt at that rate
Floating: value of the currency determined by D+S in the foreign exchange market

B Suggest possible reasons why a government may want its currency to devalue (i.e. fall) against other currencies

- more price competitive exports, which could stimulate AD

C One way in a government / central bank can cause its currency to be devalued is to increase its purchase of foreign currency. Using an exchange rate diagram, explain how this process works

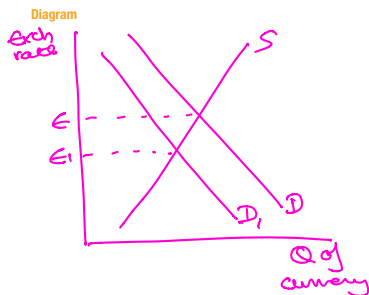
Diagram



Explanation

Buying foreign currency requires supplying domestic currency in return

- D Another way in which a government / central bank can cause its currency to be devalued is to reduce domestic interest rates, in order to attract less hot money. Using an exchange rate diagram, explain how this process works

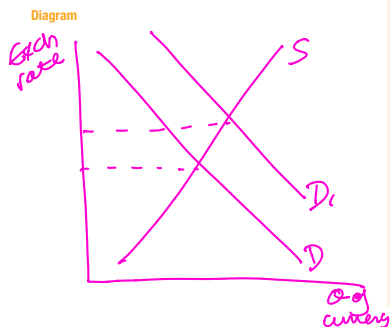


Explanation
 Fewer overseas investors will want to put their money into UK accounts if int. rates are lower, therefore they will not need to buy as much of the currency.

- E Sometimes, a government may want its currency to be stronger relative to other currencies. Outline the reasons why this might be the case

- Causes imports to be relatively cheaper
 - ↳ could be raw materials / capital
 - ↳ could be essential items e.g. food / medicine

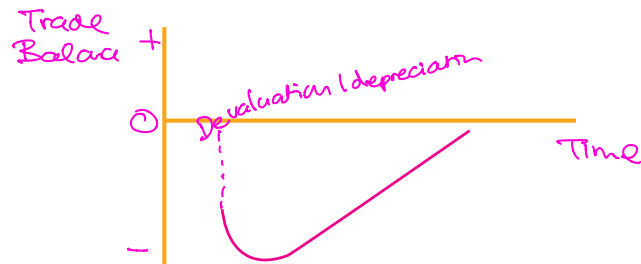
- F One way in which a government / central bank can cause a revaluation of its currency is to sell its foreign currency reserves. Using an exchange rate diagram, explain how this process works



Explanation
 Foreign currency reserves are sold in order to buy domestic currency

9 The J-curve

- A Label this diagram, which shows the possible effects of a change in the exchange rate on the balance of trade, over time



- B According to economic theory, do you think that this country's exchange rate has appreciated or depreciated? Explain your answer

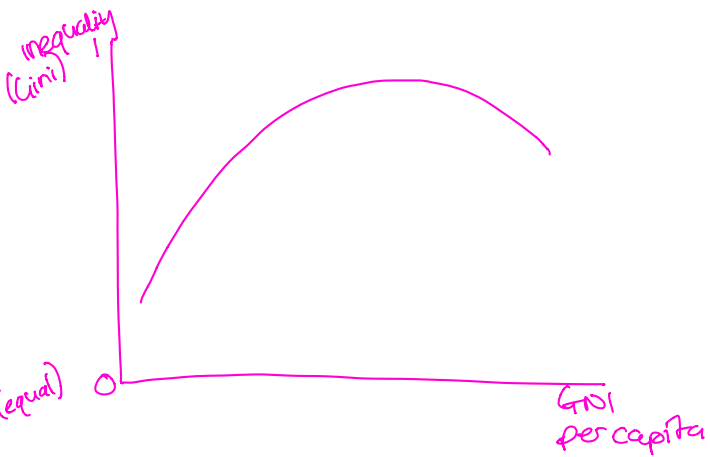
Depreciated - the trade balance ultimately improves, so there are more X and fewer M . There is initially a time lag due to inelastic PED

- C Under what circumstances may the effect shown here not happen?

If Demand for X and M is relatively price elastic even in the short run

SECTION 6 INEQUALITY AND DEVELOPING ECONOMIES

1	EXTENSION QUESTION: Kuznets curve
A	A Kuznets curve plots GNI per capita along the x-axis and inequality (usually using the Gini coefficient) on the y-axis. Draw the relevant axes in the space below:



B	On your axes above, now draw a Kuznets curve. A Kuznets curve suggests that inequality often rises during a phase of rapid industrialisation and urbanisation but there may come a point when increased welfare provision, progressive taxes and more balanced income growth across industries might lead to a fall in overall inequality at higher per capita incomes
C	Carry out research to find a list that ranks countries by their Gini coefficient and find: i) one country in the lowest 10% ii) one country just below the middle of the ranking iii) one country just above the middle of the ranking iv) one country in the highest 10%; and finally v) indicate the likely position of each of those countries on the curve that you have drawn

Students' own research

2The Lorenz Curve

The diagram shows a Lorenz Curve

Cumulative % of Income

100%

0%

Poorest

Richest

Line of Equality

A

Lorenz Curve

B

Households by Income - Quintile Distribution

A

Explain the meaning of the 'Line of Equality' across the middle of the diagram

Perfectly equal distribution of income i.e. everyone has exactly the same income

B

What does the Lorenz curve illustrate?

The distribution of income

C

EXTENSION QUESTION: with reference to the labelling of areas shown on this graph, what is the formula for calculating the Gini Coefficient?

$$\frac{A}{A+B}$$

D

Using a different colour pen or pencil, add a second Lorenz curve to this diagram to show an economy with greater inequality than the one currently shown

Pink line

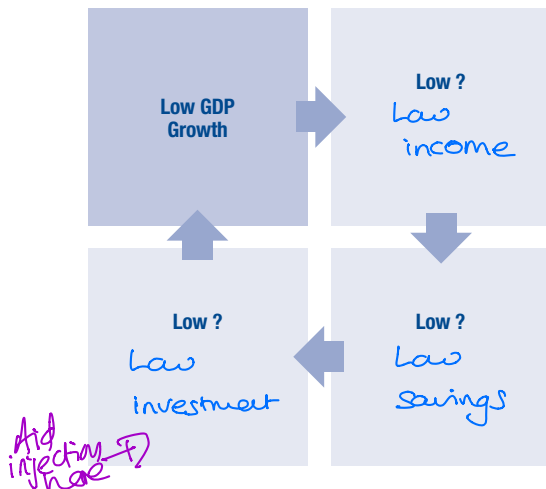
E

Using another different colour pen or pencil, add a third Lorenz curve to this diagram to show the impact of more progressive income tax rates

Blue line

3 The Harrod-Domar model of development

Complete the labelling of this diagram showing the Harrod-Domar model



Which constraints on Growth and Development can be illustrated by using this model?

- Poor financial infrastructure
- Low confidence in financial markets

Add to the diagram to show how an injection of aid may help to overcome this constraint, and explain that effect of that aid on a country such as Honduras or Rwanda.

Explanation:

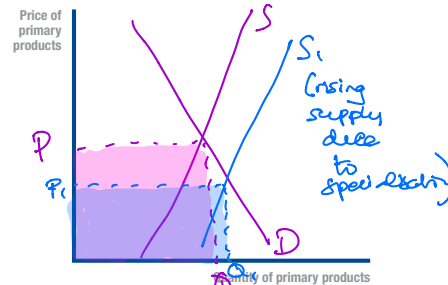
Aid can raise investment i.e. build capital stock

4 Factors influencing growth and development

A Many developing countries are highly dependent on primary products. Using your knowledge of price elasticity of demand and price elasticity of supply, use a demand and supply diagram to show why increasing specialisation in primary products can cause falling revenue in developing countries

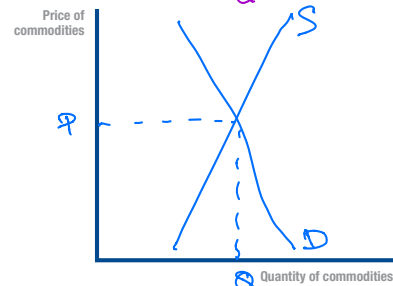
Initial revenue:

new (lower) revenue:



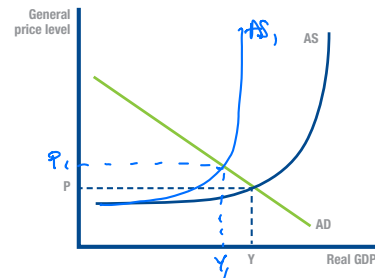
B Using the axes to the right, explain why commodities often have highly volatile prices

S + D are relatively price inelastic, so a change in either S or D leads to a large change in price



C In the space below, explain why capital flight might occur in a developing economy. Then, on the axes to the right, show the effect of this on the economy of a developing economy

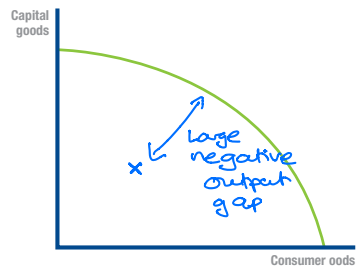
Capital is often described as "footloose" in search of the best return. If tax rates rise in the LDC, or there is more political instability, capital will leave



D

On the PPF, illustrate the effect of poor education and skill levels of the working-age population in a developing economy

The large negative output gap will reduce the amount of capital produced. This could ultimately cause the PPF to shift inwards.



NOTES

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