

Worksheet 6: Evaluating numbers and change answers

1 Discuss whether or not a 5% increase in the selling price of a product is beneficial.

Beneficial

- Seller receives higher total revenue if $PED < 1$
- Greater tax revenue if an indirect tax is imposed on the selling price
- Product may still be relatively more price competitive if competitors' prices increased more
- May be a demerit good and its consumption falls

Not beneficial

- Reduced affordability
- Product becomes less price competitive
- Seller receives lower total revenue if $PED > 1$
- Black markets may occur if the product becomes too expensive
- May be a merit good, therefore reduces consumption even more
- If unit cost also increased by 5%, profit margin doesn't increase

2 Discuss whether or not an increase of the PES of a product with 0.2 is of overall benefit.

Beneficial

- The producer becomes more responsive to changes in price/more flexible
- The producer can quickly increase quantity supplied to take advantage of higher prices
- The producer can quickly meet new orders/accept new clients
- Output of necessities/staple foods may be increased more easily, so less need for government intervention
- A smaller total subsidy payment would be needed to increase supply

Not beneficial

- PES may still be very low (inelastic)
- Competitors may still have greater elasticity
- Firm may still be unable to meet the whole order/all customers' demand
- Product may be harmful/demerit
- PES may increase in times when demand/prices are falling
- The PES increase may be short-lived
- If PES increases due to higher stocks built, these are subject to obsolescence/damage/warehousing costs

3 Discuss whether or not a 10% increase in public sector employees' earnings is of overall benefit to the economy.

Beneficial

- Higher incomes enable the employees to afford more goods and services
- Better standard of living
- Increased supply of labour to public sector job openings

Not beneficial

- Reduces the wage differential with private sector earnings and may trigger higher wage demands
- May trigger cost-push inflation
- If inflation exceeds 10%, real incomes don't increase
- Public sector wages may still be very low even after the increase
- Greater public expenditure may result in higher budget deficit



- 4 Discuss whether or not an obligatory increase in the time spent in education for doctors with two years is likely to be of overall benefit.

Beneficial

- Doctors may become better trained/qualified and may receive higher wages
- Improved quality of healthcare
- Increased employment in qualification courses for doctors
- Decreased supply of doctors in the short run will increase the wages of already graduated doctors

Not beneficial

- May create/increase shortages of doctors
- Trainee doctors may be unable to pay for extra two years if education is private/may increase government spending if education is public
- Increases the opportunity cost of education to future doctors, so may reduce the supply of doctors
- Additional education of two more years may be poor quality

- 5 Discuss whether or not a firm benefits from a 5% decrease in its costs.

Beneficial

- May increase profits
- The firm becomes more efficient
- If the lower cost is passed on to consumers as a lower price, the firm becomes more price competitive

Not beneficial

- If prices fall by more than 5%, profit margin falls too
- Competitors' costs may fall by more than 5%
- The firm may become complacent in aiming to reduce its costs further/inefficiencies may occur
- The 5% decrease could be in cost(s) that form a very small percentage of total costs, so overall cost reduction is not significant
- May be a one-off/short-lived decrease in costs

- 6 Discuss whether or not a 2% increase in taxes is beneficial.

Beneficial

- Greater tax revenue to enable government spending
- Increase in indirect taxes on demerit goods reduces consumption
- Increase in indirect taxes on goods causing negative externalities reduces overproduction/consumption
- Increase in corporation tax may encourage firms to cut other costs/become more efficient

Not beneficial

- Tax rates may already be very high
- May discourage incentives to work and enterprise
- Higher indirect taxes make them more regressive
- Black markets may appear
- Higher taxes on merit goods cause greater underconsumption
- Necessities may become less affordable
- May lead to tax evasion



7 Discuss whether or not a central bank should increase interest rates with 2%.

Beneficial

- *Contractionary monetary policy may reduce demand-pull inflation*
- *Greater saving may increase future wealth and security of incomes*
- *May attract hot money flows*
- *May reduce indebtedness by discouraging borrowing*
- *A higher cost of borrowing discourages domestic investment*
- *A higher cost of borrowing means households may be unable to borrow to pay for education/healthcare*
- *Increases the burden of debt already borrowed*

Not beneficial

- *Commercial banks may still lend a lot if they have positive expectations*
- *Households and firms may still borrow a lot if they have high consumer and business confidence*
- *Discourages investment*
- *The fall in total demand reduces economic growth*
- *The real interest may still be very low/negative if inflation is very high*
- *Saving may not increase if individuals lack trust in the banking system*
- *Hot money flows may not be attracted if other countries have higher interest rates*

8 Discuss whether or not a government should be concerned about economic growth of 3%.

Beneficial

- *May be considered too slow if the economy is very far away from full capacity*
- *If other economies grow faster, may send a bad signal to investors*
- *The trend may be decreasing*
- *The benefits of growth may be unevenly distributed*

Not beneficial

- *May be non-inflationary if there is enough spare capacity*
- *May be caused by an increase in total supply rather than an increase in total demand*
- *The trend may be upward*
- *Could be sustainable*

9 Discuss whether or not a government should aim to achieve 2% unemployment.

Beneficial

- *Achieves the objective of full employment*
- *Greater economic efficiency, as few idle resources*
- *Increases output and creates economic growth*
- *Increased incomes enable better standard of living*
- *Less government spending on unemployment benefits*
- *Greater tax revenue from income taxes and indirect taxes due to more spending*
- *Reduces poverty*

Not beneficial

- *Higher labour costs for firms as fewer workers are available*
- *Creates inflationary pressure as little spare capacity in the economy left*
- *Greater spending may increase imports, leading to a balance of trade deficit*
- *Trade unions gain more power, which can increase costs to firms*
- *Employment may be very high, but productivity may be low/jobs may be low-paid/with poor working conditions, etc.*



10 Discuss whether or not a government should be concerned about 8% inflation.

Beneficial

- Reduces the value of money
- Makes exports less price competitive
- Investment may be discouraged

Not beneficial

- Real incomes may increase if nominal wages grow more than 8%
- Exports may still be relatively cheaper if other countries experience more than 8% inflation
- The trend of inflation may be downward, e.g. if last year inflation was 10%

11 Discuss whether or not a 4% increase in average incomes in a country is likely to end poverty.

Beneficial

- Higher average incomes enable citizens to afford more goods and services/necessities, therefore ending absolute poverty
- Higher average incomes enable families to afford better education for their children, ending inter-generational poverty
- Income tax revenue may increase, enabling the government to spend more on measures to reduce poverty

Not beneficial

- Average incomes may still be very low despite the 4% increase
- Average incomes may increase but income distribution may worsen
- Relative poverty may still exist
- Inflation may be very high, so real incomes may fall/necessities may still be unaffordable
- The increase may be one-off and/or over a very long time period, insufficient to end poverty
- Poverty may still persist in other countries/parts of the world

12 Discuss whether or not an increase in all import tariffs with 2% is likely to benefit an economy.

Beneficial

- Greater tax revenue
- Increases the relative competitiveness of domestic output
- Increases domestic employment, as demand switches away from imports towards domestic substitutes
- Reduces demand for imports, therefore reducing a balance of trade deficit
- Protects infant and/or declining industries
- May discourage the consumption of imported demerit goods

Not beneficial

- Imports with price inelastic demand would increase import expenditure
- Higher prices and more limited choice reduce the welfare of local consumers
- 2% may be too insignificant an increase to solve a balance of trade deficit
- The other countries may retaliate
- Import-reliant industries would experience an increase in raw material costs, leading to imported inflation
- Some tariffs may already be very high
- Domestic substitutes may still be more expensive/of poor quality/there may be no domestic substitutes to some imports
- May encourage smuggling



13 Discuss whether or not a 5% increase in a country's exchange rate is beneficial.

Beneficial

- Lower price of imports may reduce cost of production for import-reliant industries
- Improved current account balance if the PED exports are less than 1, as export revenue would increase following an increase in export prices
- If PED of exports and imports is elastic, net exports fall, total demand falls and there's less demand-pull inflation

Not beneficial

- Domestically produced goods and services may appear less price competitive than imports, so lower demand for domestic goods, increasing unemployment
- Export price increases, making exports less price competitive
- If the PED of exports and imports is inelastic, net exports increase and demand-pull inflation may occur