

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	Not beneficial
<ul style="list-style-type: none"> • 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 	<ul style="list-style-type: none"> • 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	Not beneficial
<ul style="list-style-type: none"> • 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 	<ul style="list-style-type: none"> • 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	Not beneficial
<ul style="list-style-type: none"> • Higher incomes enable the employees to afford more goods and services • Better standard of living • Increased supply of labour to public sector job openings 	<ul style="list-style-type: none"> • 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	Not beneficial
<ul style="list-style-type: none">Doctors may become better trained/qualified and may receive higher wagesImproved quality of healthcareIncreased employment in qualification courses for doctorsDecreased supply of doctors in the short run will increase the wages of already graduated doctors	<ul style="list-style-type: none">May create/increase shortages of doctorsTrainee doctors may be unable to pay for extra two years if education is private/may increase government spending if education is publicIncreases the opportunity cost of education to future doctors, so may reduce the supply of doctorsAdditional 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	Not beneficial
<ul style="list-style-type: none">May increase profitsThe firm becomes more efficientIf the lower cost is passed on to consumers as a lower price, the firm becomes more price competitive	<ul style="list-style-type: none">If prices fall by more than 5%, profit margin falls tooCompetitors' costs may fall by more than 5%The firm may become complacent in aiming to reduce its costs further/inefficiencies may occurThe 5% decrease could be in cost(s) that form a very small percentage of total costs, so overall cost reduction is not significantMay be a one-off/short-lived decrease in costs

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

Beneficial	Not beneficial
<ul style="list-style-type: none">Greater tax revenue to enable government spendingIncrease in indirect taxes on demerit goods reduces consumptionIncrease in indirect taxes on goods causing negative externalities reduces overproduction/consumptionIncrease in corporation tax may encourage firms to cut other costs/become more efficient	<ul style="list-style-type: none">Tax rates may already be very highMay discourage incentives to work and enterpriseHigher indirect taxes make them more regressiveBlack markets may appearHigher taxes on merit goods cause greater underconsumptionNecessities may become less affordableMay lead to tax evasion



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

Beneficial	Not beneficial
<ul style="list-style-type: none">• 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	<ul style="list-style-type: none">• 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	Not beneficial
<ul style="list-style-type: none">• 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	<ul style="list-style-type: none">• 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	Not beneficial
<ul style="list-style-type: none">• 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	<ul style="list-style-type: none">• 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	Not beneficial
<ul style="list-style-type: none">• Reduces the value of money• Makes exports less price competitive• Investment may be discouraged	<ul style="list-style-type: none">• 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	Not beneficial
<ul style="list-style-type: none">• 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	<ul style="list-style-type: none">• 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	Not beneficial
<ul style="list-style-type: none">• 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	<ul style="list-style-type: none">• 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