

Worksheet 7: Spotting analysis answers

- 1 A decrease in income reduces the demand for luxury holidays because fewer people are interested in them.
Weak analysis: The second half of the sentence doesn't use a key word and doesn't provide enough steps of analysis.

Example of good analysis: A decrease in income reduces the demand for luxury holidays because fewer individuals are able to afford them at every given price, as the holiday will now take a larger proportion of an individual's income.

- 2 An increase in the number of firms in an industry is caused by a rightward shift of the industry supply curve.
Weak analysis: The statement confuses cause and effect and doesn't provide enough steps of analysis.

Example of good analysis: An increase in the number of firms in an industry causes a rightward shift of the industry supply curve because now there is a larger output produced and a higher quantity is supplied at every given price.

- 3 If a tax on a price elastic product is imposed, government tax revenue increases.
Weak analysis: It doesn't explain why/how the government's tax revenue would increase.

Example of good analysis: If a tax on a price elastic product is imposed, although the quantity traded will fall, the government now receives revenue amounting to Number of units taxed \times Tax per unit.

- 4 Market failure can be caused by demerit goods because they are overconsumed due to information failure and too many scarce resources are allocated to economically undesirable output.
Good analysis

- 5 Secretaries earn less than doctors because they work less.
Weak analysis: It doesn't actually explain why they earn less but makes an ungrounded statement.

Example of good analysis: Secretaries earn less than doctors because they provide a service of lower value compared to doctors, which reduces the derived demand for labour, therefore resulting in lower equilibrium wage for secretaries.

- 6 A decrease in price increases the firm's profit.
Weak analysis: It doesn't justify why a lower price may increase the firm's profit, as the lower price reduces the revenue per unit sold.

Example of good analysis: A decrease in price increases the firm's total revenue if $PED > 1$, which increases the difference between the firm's total revenue and total costs, other things being equal, leading to higher profit.

- 7 An increase in price reduces the quantity demanded of a product because the firm's total revenue decreases.
Weak analysis: It confuses cause and effect and doesn't use PED to explain the effect on TR.

Example of good analysis: An increase in price causes a greater proportionate increase in total revenue than the proportionate decrease the fall in quantity demanded causes if $PED < 1$, therefore increasing the firm's total revenue.

- 8 An increase in government spending on education increases wages, costs of production and inflation.
Weak analysis: The consequences are just listed and not bound together with linking devices in coherent analysis.

Example of good analysis: An increase in government spending on education may increase wages because workers will become more qualified, which could increase firm's costs of production, therefore resulting in a leftward shift in the AS curve, causing cost-push inflation.

- 9 A fall in aggregate demand can reduce economic growth because it leads to a fall in national output, so fewer goods and services are produced.
Good analysis
- 10 Higher spending on education leads to increased taxation.
Weak analysis: It makes a statement without explaining the consequences.
Example of good analysis: Higher spending on education increases government spending, which may cause a budget deficit, which means that the government may have to increase taxes to fund the spending on education by increasing its tax revenue.
- 11 Lower interest rates may not increase spending.
Weak analysis: It makes a statement without justification.
Example of good analysis: Lower interest rates may not increase spending if the economic agents have pessimistic expectations of the future and despite the low interest rates, households and firms do not borrow more, therefore consumption and investment do not increase.
- 12 Effective supply-side policies increase long-run aggregate supply and therefore, the economy's productive capacity increases, leading to reduced inflationary pressure.
Good analysis
- 13 Economic growth can be caused by an advancement in technology.
Weak analysis: It makes a statement without any steps of analysis.
Example of good analysis: Economic growth can be caused by an advancement in technology, which can increase the productive capacity of the economy and enable firms to introduce modern capital equipment and technologies, enabling them to produce more output.
- 14 Demand-pull inflation is caused by higher spending.
Weak analysis: It makes a statement without any steps of analysis.
Example of good analysis: Demand-pull inflation is caused by higher spending triggered by, e.g. increased incomes, which increase consumption, leading to higher aggregate demand, which, if unmatched by an increase in aggregate supply, creates upward pressure on the general price level.
- 15 Higher GDP per head leads to longer life expectancy.
Weak analysis: It makes a statement without any steps of analysis.
Example of good analysis: Higher GDP per head increases average incomes, which enables individuals to access better healthcare, therefore curing diseases more easily and improving their health, which enables them to live longer.
- 16 A decrease in unemployment benefits can reduce poverty, as it increases incentives to work and encourages the unemployed to take up jobs, which increases their earnings.
Good analysis
- 17 An increase in exports leads to a surplus on the current account of the balance of payments.
Weak analysis: It makes a statement without any steps of analysis.
Example of good analysis: An increase in exports may increase export revenue, which increases the inflows to the Balance of Trade in the current account, therefore creating a surplus as total inflows greater than total outflows.