



## Worksheet 9: Critical judgement answers

- 1 An increase in the profitability of a product is likely to attract more firms to the industry and increase market supply.

Reason(s) why an increase in the profitability of a product may not increase market supply:

- A greater proportionate increase in the profitability of other products may attract firms to those markets
- The industry may already be highly competitive and new firms may perceive the market as too saturated
- The barriers to entry in the industry may be too high
- Firms may expect the increase in profits to be short term only
- The number of firms in the industry may be restricted by government regulation

- 2 A worker is likely to choose a job with a higher wage.

Reason(s) why the worker may not choose the job despite the higher wage:

- Other occupations may experience a greater wage rise
- The job may have poor working conditions/be far away from family/unsociable working hours/no perspectives for promotion/long commute time, etc.
- The worker may not have the skills/qualifications required for the job

- 3 Government's attempts to address market failure are likely to improve consumers' living standards.

Reason(s) why fixing market failure may not improve living standards:

- Decreasing the consumption of demerit goods may require an increase in indirect taxes, which are regressive
- Breaking up a monopoly/introducing competition may forgo the benefits of economies of scale that might have resulted in lower prices
- Mandating the consumption of a merit good, if it is not provided/subsidised by the government, could mean it is unaffordable for low-income families
- Direct provision of poor quality, e.g. housing/education
- Reducing the overproduction in markets generating negative externalities in production means there would be a lower quantity traded available for consumers
- Taxation may have to be increased to fund the provision of public goods
- Increased government spending on the provision of public/merit goods creates opportunity cost and could mean lower government spending in other areas that would have improved living standards more

- 4 A decrease in costs is likely to increase a firm's profit.

Reason(s) why a decrease in costs may not increase the firm's profits:

- Selling price may have fallen by the same/greater proportion, leaving profit margins unchanged/lower
- Fixed costs, e.g. rent, may have decreased but there may be a greater simultaneous increase in raw material costs
- The firm may incur diseconomies of scale, increasing its average costs
- Corporation tax/dividends paid may increase, therefore reducing the firm's retained profit



5 An increase in interest rates is likely to increase saving.

Reason(s) why increased interest rates may not increase saving:

- Average incomes may fall, reducing households' ability to save
- High inflation could make real interest rates negative
- Individuals may lack trust in banking/saving institutions
- Other countries' interest rates may have increased by a greater proportion, attracting saving abroad
- There may be lack of suitable saving facilities/products in banks
- Other investment opportunities may appear more profitable
- Expectations the increase may be short-lived and interest rates may soon fall again
- Optimistic expectations may encourage greater spending
- An increase in birth rates may necessitate households to spend more

6 An increase in taxes is likely to increase government tax revenue.

Reason(s) why higher taxes may not increase government tax revenue:

- A simultaneous increase in unemployment could mean the tax base decreases
- The higher taxes may encourage tax avoidance and/or tax evasion/greater share of the grey sector
- An increase in indirect taxes may result in a greater proportionate fall in quantity demanded if  $PED > 1$
- Ineffective mechanisms for enforcement/administration/collecting taxes may reduce collection rates
- A significant increase in corporation tax/profit repatriation tax may force MNCs out of the country

7 An increase in government spending is likely to decrease unemployment.

Reason(s) why higher government spending may not decrease unemployment:

- Government may spend on training workers in the wrong skills which are not in high demand
- Government may spend on imports, which do not increase domestic output and employment
- Government may spend on short-term projects that do not provide long-lasting jobs and unemployment does not increase in the long run

8 Higher economic growth is likely to improve standards of living.

Reason(s) why higher economic growth may not improve standards of living:

- The higher average incomes resulting from economic growth may be accompanied with worsened income distribution
- Economic growth from industrial activities can increase pollution, worsening health
- Economic growth resulting from low-quality/low-skilled jobs may worsen workers' physical health
- Unsustainable economic growth may lead to depletion of a key resource, therefore making standards of living worse for future generations
- Economic growth may result from workers doing overtime, less free time and more stress
- The additional incomes earned may be spent on imports/demerit goods/consumer rather than capital goods
- Economic growth may come from more military goods produced/more police services provided due to more crime
- Despite economic growth the national output may be of poor quality/uncompetitive



- 9 A fall in a country's exchange rate is likely to increase its exports.

Reason(s) why a fall in the exchange rate may not succeed in increasing exports:

- *Other factors may cause export prices to increase by a greater degree, e.g. domestic inflation; fall in domestic productivity*
- *Exports may lose competitiveness, e.g. due to worsened quality*
- *A global recession decreasing incomes abroad and therefore the demand for exports*
- *An increase in the country's population may redirect some of the exports towards the local market to meet domestic demand*
- *Other countries may impose trade restrictions on the country's exports*
- *Artificial substitutes for the country's exports may develop, decreasing the demand for exports*
- *Depletion of a key resource used to produce the exports may reduce the export industries' output*
- *Lack of skilled labour required by the export industries may reduce their capacity*

- 10 An increase in import tariffs is likely to reduce a country's current account deficit.

Reason(s) why higher tariffs may not reduce a country's current account deficit:

- *Imports may have price inelastic demand due to, e.g. lack of local substitutes, increasing import expenditure*
- *A simultaneous increase in domestic incomes may increase residents' ability to spend on imports*
- *Local shortages of the imported products could make import demand price inelastic, increasing import expenditure*
- *A decrease in exports may lead to a greater proportionate fall in export revenue, leaving the Balance of Trade in deficit*
- *Trade retaliation may lead to a greater decrease in exports/export revenue*
- *Imports may still be more price competitive than local substitutes despite the tariff*
- *The tariff may force importers to become more cost competitive to maintain low prices*
- *The Primary and Secondary income balances may be of greater deficits than the Balance of Trade surplus*