

Worksheet 2: Relationships between economic variables answers

- 1 Scarcity and choice
The existence of the basic economic problem – scarcity, means resources have alternative uses and choices have to be made as to how to employ them to maximise economic welfare.
- 2 Productivity and unemployment
An increase in labour productivity can increase the demand for labour and reduce unemployment, as there would be a higher equilibrium number of workers employed.
- 3 Average incomes and life expectancy
Higher average incomes enable individuals to access basic medications and better healthcare, leading to less diseases and longer life span.
- 4 Technological advancement and productive potential
Greater technological advancement can increase innovation and increase the productivity of capital, expanding an economy's maximum output of goods and services.
- 5 The price mechanism and resource allocation
If the free interaction of demand and supply leads to an increase in equilibrium price in a market this will signal producers to channel more resources to this industry, as the potential profit incentive increases.
- 6 Increase in supply and equilibrium price
Increase in market supply creates a short-run surplus until the market adjusts, which encourages firms to reduce prices to get rid of unsold stock, driving a downward movement along the demand curve until the market clears at a lower equilibrium price.
- 7 External costs and market failure
External costs lead to a divergence between social costs and private costs, resulting in overproduction/overconsumption and more scarce resources tied up in economically undesirable output.
- 8 Inflation and store of wealth as a function of money
Rapid inflation erodes the ability of money to retain its value over time (durability) and reduces the benefits from saving.
- 9 Discrimination and wage differentials
Discrimination based on, e.g. gender, can reduce the demand for women in certain occupations, opening a gap between male and female pay.
- 10 Horizontal integration and economies of scale
Horizontal integration when two competitors merge, increases the scale of operation of the business, resulting in the benefits of economies of scale.
- 11 Increase in output and total costs
An increase in output initially spreads total fixed costs over more units, which outweighs the effect of increasing variable cost per unit, therefore the effect of falling average fixed costs outweighs the effect of rising average variable costs and average total cost falls over the relevant range of output.



- 12** Competitive markets and consumer choice
Competitive markets arise when many firms in the same market offer the same/similar product to the same target customers, which provides variety of options.
- 13** Contractionary fiscal policy and economic growth
A fall in government spending and/or a rise in taxation leads to an overall fall in aggregate demand, which reduces national output and actual economic growth.
- 14** Expansionary monetary policy and inflation
An increase in money supply and/or a decrease in interest rates leads to a rise in consumption and/or investment and an overall rise in aggregate demand, which triggers demand-pull inflation (if AS cannot increase as fast as AD).
- 15** Deregulation and aggregate supply
Deregulation reduces the barriers to entry in a market and increases competition, therefore firms' costs would decrease and more firms would enter the national market, increasing total supply to the economy.
- 16** National output and cyclical unemployment
An increase in national output means firms need to hire more factors of production, including labour, which increases the derived demand for labour and reduces those cyclically unemployed.
- 17** Real GDP per head and living standards
Higher real GDP per head increases average incomes and enables individuals to access better healthcare, increasing their life span, and better education, improving their skills and earning potential, which may improve their quality of life.
- 18** Progressive taxation and poverty
Introducing progressive taxation reduces the poverty gap by redistributing income from the rich to the poor.
- 19** Increase in population and optimum population
An increase in population can reduce underpopulation, which enables more efficient utilisation of resources. This results in higher input per unit of output and therefore maximum output per head, which is the concept of optimum population.
- 20** Specialisation and free trade
In order for economies to obtain the benefits of specialisation, they need to engage in free trade to exchange/export the domestic surpluses for imports of goods and services that are not produced locally based on the advantages of lowest opportunity cost.
- 21** MNCs and unemployment
If an MNC sets up in a host country, it will increase national output and create more job opportunities for local workers, resulting in an increased derived demand for labour and increasing employment.
- 22** PED and export revenue
If the PED for exports is inelastic, an increase in export prices will lead to a smaller proportionate fall in the demand for them by foreign countries, resulting in greater export earnings.
- 23** Current account surplus and GDP
A current account surplus may be caused by a Balance of Trade surplus, where export revenue exceeds import expenditure and an increased demand for exports would encourage exporting industries to expand and produce more output.