

Coimisiún na Scrúduithe Stáit
State Examinations Commission

Leaving Certificate 2014

Marking Scheme

Economics

Higher Level

Note to teachers and students on the use of published marking schemes

Marking schemes published by the State Examinations Commission are not intended to be standalone documents. They are an essential resource for examiners who receive training in the correct interpretation and application of the scheme. This training involves, among other things, marking samples of student work and discussing the marks awarded, so as to clarify the correct application of the scheme. The work of examiners is subsequently monitored by Advising Examiners to ensure consistent and accurate application of the marking scheme. This process is overseen by the Chief Examiner, usually assisted by a Chief Advising Examiner. The Chief Examiner is the final authority regarding whether or not the marking scheme has been correctly applied to any piece of candidate work.

Marking schemes are working documents. While a draft marking scheme is prepared in advance of the examination, the scheme is not finalised until examiners have applied it to candidates' work and the feedback from all examiners has been collated and considered in light of the full range of responses of candidates, the overall level of difficulty of the examination and the need to maintain consistency in standards from year to year. This published document contains the finalised scheme, as it was applied to all candidates' work.

In the case of marking schemes that include model solutions or answers, it should be noted that these are not intended to be exhaustive. Variations and alternatives may also be acceptable. Examiners must consider all answers on their merits, and will have consulted with their Advising Examiners when in doubt.

Future Marking Schemes

Assumptions about future marking schemes on the basis of past schemes should be avoided. While the underlying assessment principles remain the same, the details of the marking of a particular type of question may change in the context of the contribution of that question to the overall examination in a given year. The Chief Examiner in any given year has the responsibility to determine how best to ensure the fair and accurate assessment of candidates' work and to ensure consistency in the standard of the assessment from year to year. Accordingly, aspects of the structure, detail and application of the marking scheme for a particular examination are subject to change from one year to the next without notice.



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State Examinations Commission

LEAVING CERTIFICATE 2014

MARKING SCHEME

ECONOMICS

HIGHER LEVEL

Marking Scheme and Support Notes for use with the Marking Scheme

In considering the marking scheme and the support notes the following points should be noted:

- The support notes presented are neither exclusive nor complete.
- They are **not** model answers but rather a sample of possible responses.
- The support notes in many cases may contain key phrases which must appear in the candidate's answer in order to merit the assigned marks.
- **Further relevant points of information presented by candidates are marked and rewarded on their merits.**
- The detail required in any answer is determined by the context and the manner in which the question is asked and by the number of marks assigned to the answer in the examination paper. Requirements may therefore vary from year to year.
- Words, expressions or phrases must be correctly used in context and not contradicted, and where there is evidence of incorrect use or contradictions the marks may not be awarded.

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SECTION A

1. Define the term ‘**opportunity cost**’.

State **one** example of an opportunity cost facing the Irish Government.

Opportunity cost is the cost of forgone alternatives involved in making a choice / the cost of something in terms of the next best alternative.

State **one** example of an opportunity cost facing the Irish Government.

Sample responses include the following:

- Spending on a new hospital the opportunity cost is the infrastructural project which must be deferred.
- Cuts in taxes next year implies less money to spend on other projects.
- The interest on government debt involves a sacrifice of government services such as education.

Definition: 8 marks / Example: 8 marks

2. If the marginal cost (MC) is **less than** average cost (AC), then AC must be **falling** when output increases.

(i) Is this statement true?

Circle the correct answer.

YES

NO

(ii) Explain the reason for your answer:

If the additional cost of producing one extra unit is less than the average total cost then producing that extra unit lowers the average total cost.

Circle correct answer: 1 mark / Explanation: 15 marks

3. Define the term ‘**structural unemployment**’ and outline **one** policy response that the Irish Government could take to reduce it.

Definition:

Structural unemployment arises from a change in the structure in an industry brought about by the changing pattern of demand in the economy / or increasing mechanisation (technical progress).

One policy response that the Irish Government could take to reduce it:

- A retraining scheme so that long-term unemployed workers can be upskilled for the jobs available and then rejoin the workforce e.g. the Momentum Programme
- Governments ‘Springboard’ programme: Third level courses aimed at increasing graduates in areas where job vacancies exist.

Definition: 10 marks / One policy measure: 6 marks

4. Explain the meaning of the term ‘**complementary goods**’ (i.e. joint demand). State **one** example.

Complementary goods: Goods which are consumed together / are used in conjunction with one another / a rise in the price of one good will lead to a decrease in the demand for another good.

Example: Computer consoles and software/games; cars and petrol.

Explanation: 12 marks / Example: 4 marks

5. State **three** assumptions/characteristics underlying the theory of monopoly.

- There is only one firm in the industry / the firm is the industry.
- The firm controls price *or* output / the firm is a price maker.
- The firm aims to maximize profits / it produces where $MC = MR$.
- Barriers to entry exist in the industry.
- A unique product is sold / there are no close substitutes.

3 assumptions: 6 marks + 5 marks + 5 marks
1st correct answer: 6 marks

6. Outline two possible economic effects for the Irish Economy of the **euro** (€) appreciating in value against the **US dollar** (\$).

Import prices are cheaper

Price of imports from the US are likely to decrease. This results in a lower import bill for Irish producers / increase in imports from the US.

Export Prices Dearer

Price of exports from Ireland to US are likely to increase and therefore become less competitive. This may result in reduced exports to the US.

Falling Employment

With a reduction in exports, employment in those industries which depend on Irish exports to the US will fall.

Effect on tourism revenue in Ireland

There is likely to be a drop in tourism from the US as it will now be more expensive in dollar terms to holiday in Ireland. More Irish people may holiday in the US.

Foreign Direct Investment / Irish investment in US

FDI from the US may be discouraged as it will now be costlier in dollar terms to invest in Ireland. Investment by Irish companies in the US may be encouraged as it is cheaper in Euro terms.

1st correct answer: 10 marks / 2nd correct answer: 7 marks

7. Outline **two** ways in which the return to the factor of production **enterprise** differs from the return to other factors of production.

It can earn a loss

It is the only factor that can earn a loss due to fall in demand or excessive production costs.

Returns can vary

The returns can vary enormously from supernormal profits to losses.

Return is residual

Enterprise receives its return only after the other factors have been paid for. It is different from the other factors since their payments are agreed in advance. The returns to the other factors are contractual.

1st correct response: 10 marks / 2nd correct response: 7 marks

8. Ireland recently emerged from the EU/IMF/ECB '**Troika Bailout Programme**'. (December 15th 2013)
Outline **two** possible economic implications for the Irish economy of having exited this programme.

Increased consumer confidence

Consumers may feel more confident about the Irish economy which may lead to increased spending, leading to employment and increased tax revenue for the government.

Increased economic sovereignty

The Irish Government may have more scope to make taxation and expenditure decisions / may regain a greater degree of control over the national budget.

More difficult for government to maintain fiscal discipline

- It may be more difficult for the Irish Government to maintain fiscal discipline as they are no longer under direct supervision of the Troika.
- Due to less direct supervision the Irish Government may undertake inappropriate fiscal policies.

Increased governance by outside agencies

Annual budget will be scrutinised each year in Brussels / new EU rules and warning systems have been put in place to avoid public finance crises etc.

Improved global perception of Irish economy

- Exiting the bailout programme may send a positive signal to bond markets and to international investors leading to possible reductions in the interest rate on government debt.
- Triple 'A' credit rating restored / our improved global image may attract more FDI.

1st correct response: 11 marks / 2nd correct response: 6 marks

The expected responses given are not exhaustive.

9. Outline **two** possible social costs and **two** possible social benefits of an investment by ‘EirGrid’ in upgrading Ireland's electricity network by erecting high-voltage power lines (pylons).

Social Costs could include:

Visual intrusion on the landscape

This may have a consequent negative impact on the tourism sector. Loss of visual amenity to local people.

Possible health implications

The electromagnetic fields may have a negative impact on health / the noise pollution.

Potential damage to wildlife habitats / agriculture / equine industry

The construction and maintenance of the new power lines through rural areas may damage local wildlife habitat / local farms and the horse-breeding industry.

Decline in land and house prices in areas close to pylons.

Social Benefits could include:

Improved infrastructure / secure supply of electricity

The improvement in the infrastructure may secure our supply of electricity and thereby may encourage FDI.

Opportunities within the renewable energy sector

Some entrepreneurs may invest in this sector resulting in increased employment within this sector.

Increased capacity of renewable energy

This would reduce our carbon emissions, reduce our dependence on imports and reduce the amount of money leaving the country to pay for these imports (roughly 85% of Ireland's energy needs are imported).

1st correct response: 5 marks / 2nd, 3rd & 4th correct responses: 4 marks each

Q1 Utility / Supply and Markets

(a)

No of Units Consumed	1	2	3	4	5
Total Utility in <i>Units/Utils</i>	20	45	60	70	75
Marginal Utility in <i>Units/Utils</i>	20	25	15	10	5

- (i) State and explain the law illustrated in the above table.
(ii) Outline **two** assumptions underlying this law.

(25)

(i)

Statement:

This table illustrates the **Law of Diminishing Marginal Utility**.

Explanation:

This law states that as a consumer consumes more units of a good the extra satisfaction or marginal utility derived from each additional unit consumed will eventually decline. After the consumption of the second unit of the good in the above example, the marginal utility of the third unit consumed is 15 utils of satisfaction compared to a marginal utility of 25 utils for the second unit consumed.

Statement: 4 marks/Explanation: 9 marks = 13 marks

- (ii) Outline **two** assumptions underlying this law.

Applies after ‘the origin’

The law only applies after a certain minimum quantity of the item has been consumed e.g. A full orange consumed equals ‘the origin’ rather than segments of it.

Consumer tastes do not change

It is assumed that consumers’ tastes remain the same, thus utility means the same thing for the commodity in question.

Consumer incomes do not change

It is assumed that consumers’ incomes do not change in the time period being examined, which would affect consumption patterns.

No time lapse between the consumption of successive units which permits a change in taste

It is assumed that there is a relatively short time period between consumption points.

2 Assumptions: 6 marks each = 12 marks

- (b) (i) State the 'Law of Supply', and illustrate with a labelled diagram.
(ii) Explain how technical progress affects the supply curve.
(iii) Outline, with the aid of labelled diagrams, **two** other factors that would cause a shift in the supply curve. (30)

- (i) State the 'Law of Supply', and illustrate with a labelled diagram.

The law of supply states that there is a positive relationship between the price of a good and the quantity supplied of that good i.e. if the price rises / quantity supplied rises and if price falls quantity supplied falls, ceteris paribus (all other things being equal).

Statement: 4 marks

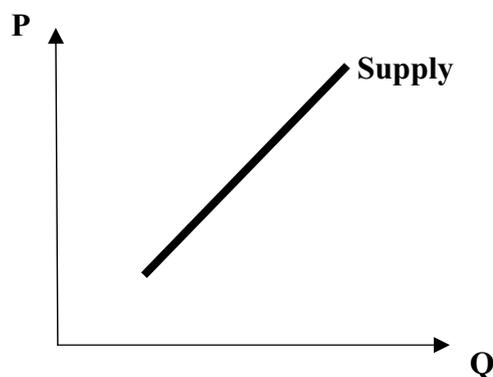


Diagram: 4 marks

- (ii) Explain how technical progress affects the supply curve.

Technical progress, such as the introduction of a labour saving device:

Will reduce production costs / increase the productivity of the firm (more output per worker)

The supply curve shifts out to the right (at each level of price there will be an increase in the supply).

Explanation: 6 marks

- (iii) Outline, with the aid of labelled diagrams, **two** other factors that would cause a shift in the supply curve.
- Costs of inputs/factors of production
 - Number of sellers/suppliers in the market
 - Changes in taxation/subsidies
 - Price of related goods in production
 - Changes in expectations about future price of the good
 - Changes in unplanned factors.

Cost of inputs

If there is an increase in input prices that a firm uses in the production of its good, then it will be more costly to produce the good. They will not continue to supply the same quantity of the good at the old prices, there will be a reduction in supply. The supply curve will shift to the left.

Number of sellers in the market

If the number of firms in the industry decreased e.g. due to rationalisation, then the overall quantity supplied will decrease, with a leftward shift in the supply curve.

Changes in Taxation/Subsidy

A subsidy will shift the supply curve to the right by the amount of the subsidy. Taxes on goods cause price increases and this affects the quantities firms may or may not be willing to supply.

Changes in the price of related goods in production

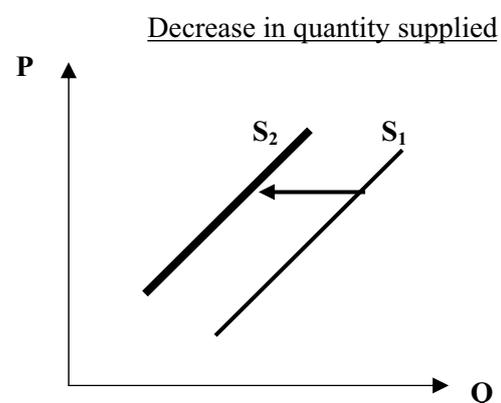
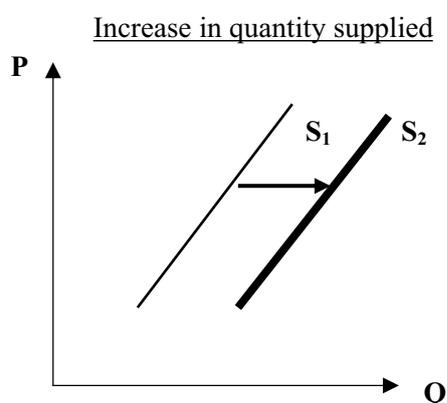
When a producer sells several products the quantity of any one good it is willing to supply at any given price depends on the prices of its other co-produced goods. Example: Oil refinery produces gasoline from crude oil but it also produces heating oil and other products from the same raw material. If the price of gasoline increases relative to heating oil, then the supply of gasoline will increase.

Changes in expectations

When suppliers have some choice about when they put their goods up for sale, changes in the expected future price of the good can lead a supplier to supply less or more of the good today.

Changes in unplanned factors

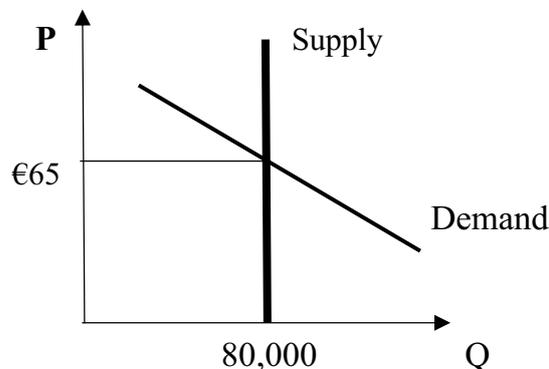
If the weather improves unexpectedly then the supply of agricultural products may increase and supply curve may shift to the right.



2 factors stated, explained with correctly labelled diagram: 8 marks each = 16 marks

- (c) Macklemore announces a concert in Ireland at a venue with a maximum capacity of 80,000 people. The tickets are priced at €65 and the concert sells out in hours.
- Draw **one** labelled diagram, showing a market demand curve and a market supply curve that would be consistent with the above information. Explain your answer.
 - Explain, using the concept of **Consumer Surplus**, why it might make sense for the concert promoters to have different ticket prices (e.g. VIP section, seating section and standing section) for this concert. (20)

(i)



- Supply of Macklemore tickets is fixed, therefore the supply curve is vertical or perfectly inelastic.
- The equilibrium quantity is 80,000.
- and the equilibrium price is €65.

Correct diagram: 8 marks/Explanation: 4 marks = 12 marks

(ii)

Consumer surplus

Consumer surplus is the difference between what a consumer actually pays for a product i.e. the market price and what s/he would have paid rather than go without the product.

Some concert goers are likely to be bigger fans than others and so would be willing to pay more than €65 to go to the concert.

The concert promoter can extract consumer surplus by offering something extra

To extract this consumer surplus the concert promoter may charge these concert goers a higher price for tickets closer to the stage, for seated tickets or for advance ticket purchase for fan club members. The VIP tickets could allow fans meet with band members plus other perks etc.

Example

For example the promoter could charge €100 for front row seats tickets. Those who pay this will forgo a consumer surplus of €35; those who pay €85 for seated tickets will forgo €20 of consumer surplus.

In this way the sales revenue of the promoter will increase as these consumers have been charged what they are willing to pay and will therefore buy the tickets. A person who faces a price for a ticket higher than what s/he is willing to pay will not buy a ticket.

2 points of explanation: 4 marks each = 8 marks

Q2 Imperfect Competition and Irish grocery market

- (a) (i) State and explain **three** assumptions underlying the theory of imperfect competition.
(ii) Explain why a firm's demand curve under imperfect competition differs from a firm's demand curve under perfect competition. (25)
- (i) State and explain **three** assumptions underlying the theory of imperfect competition.

There are many buyers

An individual buyer, by his/her own actions, can not influence the market price of the goods.

There are many sellers in the industry

An individual seller can influence the quantity sold by the price it charges for its output.

Product differentiation exists

The goods supplied by the firm are not homogenous but are close substitutes.

Firms use branding to distinguish their products from one another.

Freedom of entry and exit

No barriers to entry exist within the industry.

It is possible for firms to enter/leave the industry as they wish.

Reasonable knowledge

Within the industry each firm has reasonable knowledge of profits made by other firms.

Consumers have a reasonable knowledge of the prices being charged for different products.

Each firm attempts to maximise profits

Firms produce where $MC = MR$.

Each firm will attempt to minimise costs of production.

3 Assumptions: 5 marks + 4 marks + 4 marks

1st correct answer: 5 marks

- (ii) Explain why a firm's demand curve under imperfect competition differs from a firm's demand curve under perfect competition.

Perfect competition

The demand curve facing a perfectly competitive firm is horizontal or perfectly elastic ($D=AR=MR$).

This is because each firm is selling an identical (i.e. homogeneous) product and each firm's quantity sold is small relative to the total market size. Any attempt to undercut the market price will result in complete switching to identical products of competitors.

6 marks

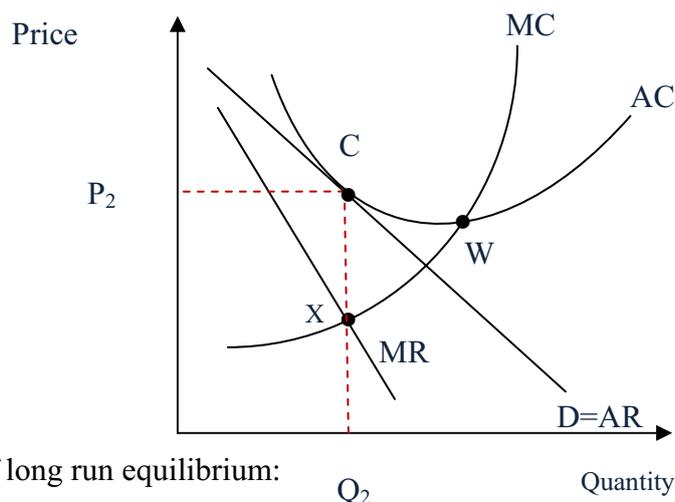
Imperfect competition

The demand curve facing a firm in imperfect competition is downward-sloping. This is because each firm sells a differentiated product, which creates scope for brand loyalty. Each firm has a product that consumers view as somewhat distinct from the products of competing firms.

If the firm increases the product price there will be a reduction in demand as some consumers will switch to rival firms' goods (close substitutes) that have become relatively cheaper.

6 marks

- (b) (i) Explain, with the aid of a diagram, the long run equilibrium of a firm in imperfect competition.



Explanation of long run equilibrium:

- Equilibrium / profit maximisation occurs (at point X) where $MC = MR$ (*MC is rising and cuts MR from below*).
- The level of output produced is Q_2 and the price the firm sells this output at is P_2 .
- The average cost of production is shown at point C / not producing at lowest point of AC.
- This firm is earning normal profits because $AR = AC$.

Correct Diagram: 10 marks/ Explanation: 8 marks = 18 marks

- (ii) With reference to your diagram in (b) (i) explain why the firm is not making socially efficient use of scarce resources.

Possible response

An imperfectly competitive firm does not produce at the socially efficient lowest point on its AC curve, point W.

They are not producing at the lowest point of AC due to product differentiation. Product differentiation makes a firm's product appear different through additional costs such as advertising and branding.

Price exceeds the marginal cost of production. The extent of the difference between P and MC represents the degree of monopoly power the firm is able to exert in the market for its differentiated product.

Because it is not producing at the lowest point of the average cost curve, there is spare/excess capacity in its operations and society does not benefit from maximum utilisation of resources. Consumers gain variety at the expense of social efficiency.

3 points of information: 4 marks each = 12 marks

- (c) “A few large retailers (e.g. Tesco, SuperValu, Dunnes Stores, Aldi, Lidl) dominate the Irish grocery market at present.”
Suggest a market structure which most closely reflects this situation. Explain your answer. (20)

Market Structure: **Oligopoly**

Explanation:

The Irish grocery market is dominated by a few large sellers

The industry is dominated by a few large retailers, who hold a major share of the market / high concentration ratio. The large multiples dominate the grocery trade in Ireland. While Tesco’s dominant market share is falling the share of the market held by Lidl and Aldi is expanding. The Musgrave Group is also a large player which owns Centra and SuperValu.

Barriers to entry exist

New firms may find it difficult to enter due to high barriers to entry such as economies of scale, brand proliferation and control by existing firms of the channels of distribution. Limit Pricing may also be used by the existing firms, so future entrants to the market are discouraged. Apart from the entry of Aldi and Lidl no new firms have entered the Irish grocery trade in recent years.

Mutual interdependence between the large retailers

Firms interact by taking account of each other’s marketing/pricing strategies. They are concerned with maintaining or increasing their share of the total market e.g. the current wave of below cost selling/loss leaders, which has become part of the pricing strategy of Dunnes Stores, Aldi, Lidl etc.

The products sold are close substitutes / product differentiation

Competitive advertising is very important as is heavy ‘product loyalty’ promotions in-store e.g. loyalty cards etc. Large multiples also use ‘brand names’ to maintain consumer loyalty. The multiple may also use advertising and marketing campaigns to create differentiation in the mind of consumers, even though its product is more or less identical to the products of rivals/ positioning strategies attempt to increase brand recognition and loyalty. The multiples engage in extensive advertising on TV and newspapers.

Non price competition

The large retailers that have a tacit understanding not to compete on price often engage in intense non-price competition using advertising and other means to try and increase their sales. There may be short-lived price wars or price competition based around a few well-known products as happened with the multiples before the Christmas period. Price wars occur when tacit collusion breaks down and prices collapse.

Choice of market structure: 1 mark

Explanation: 4 responses: 5 marks + 5 marks + 5 marks + 4 marks

Reference must be made to the Irish grocery market

Q3 Elasticity

- (a) (i) Define the categories of Price Elasticity of Demand (PED): elastic, inelastic and unit elastic.
(ii) State **three** factors that affect PED **and** explain how each factor affects it. (30)
- (i) Define the categories of Price Elasticity of Demand (PED): elastic, inelastic and unit elastic.

Elastic demand

The percentage / proportionate change in the price of the good causes a greater than percentage / proportionate change in quantity demanded of the good.

Inelastic Demand

The percentage / proportionate change in price of the good causes a lesser percentage/proportionate change in the quantity demanded of the good.

Unitary Elastic Demand

The percentage / proportionate change in the price of the good is equal to the percentage / proportionate change in the quantity demanded of the good.

Each definition: 5 marks each

- (ii) State **three** factors that affect PED **and** explain how each factor affects it.

The amount and availability of close substitutes

When a good has a close substitute and its price is increased the demand for the good will be elastic because people will switch to the cheaper substitute. Where a good has no substitutes and its price is increased there is no substitute to switch to and so it will be inelastic.

The proportion of income which is spent on the good

In general the greater the proportion of income which is spent on a good, the more elastic the demand this good is likely to be in response to a change in its own price. An increase of 50% in the price of a box of matches is unlikely to have a significant effect on the demand for it as it constitutes only a small % of income.

The length of time allowed for adjustment to price changes

The longer any price change persists, the greater will be the PED. If the price of electricity rose by 80% a consumer may economise on the use of various electrical appliances in the short term. In the long term the consumer will have to consider substituting other forms of energy. The longer the time period available to figure out possible changes, the more electricity will be saved. The demand will at first be highly inelastic but as time goes on will become more elastic.

The durability of the good

The more durable the good, the more elastic is the demand for it likely to be in response to a change in its own price. In the case of products such as cars if there is an increase in price, it is likely that the public will extend the life of their existing car and postpone the purchase of a replacement.

Number of alternative uses the good has

A good which has a large number of alternative uses will usually have an elastic demand. For example sugar is used in direct consumption, for sweetening purposes, baking, food processing etc. Any increase in the price of sugar may only result in a small fall in demand in each of these markets but the overall total fall may be significant and so will be price elastic.

3 factors: 5 marks each = 15 marks

- (b) A consumer/motorist buys 20 litres of petrol when the price is €1.60 per litre. When the price increases to €1.70, as a result of an increase in carbon tax, the consumer buys 19 litres. Calculate the consumer's Price Elasticity of Demand (PED). **(Show all your workings.)** Is this demand for petrol price elastic or price inelastic? Outline the implication of your answer for government revenue. (20)

Calculate the consumer's Price Elasticity of Demand (PED)

$$\frac{-1}{10c} \times \frac{\underline{\underline{\text{€}1.60 + \text{€}1.70 (\text{€}3.30)}}}{20 + 19} = -0.846 (-0.85) \quad (39)$$

10 marks

Is this demand for petrol price elastic or price inelastic? **Demand for petrol is inelastic. 2 marks**

Outline the implication of your answer for government revenue.

An increase in the price of petrol will yield an increase in revenue for the government, because the percentage increase in price will be greater than the percentage decrease in quantity demanded, resulting in increased tax revenue for the government.

8 marks

- (c) A firm is considering a change to its product's price. It conducts market research which reveals that the Price Elasticity of Demand (PED) for the product is - 2.5. Use this information to answer the following question:

- (i) If the firm wishes to maximise total sales revenue, should it lower or raise the price of the product? Explain your answer.

The market research also reveals Income Elasticity of Demand (YED) for the product is + 4.5.

Use this information to answer the following question:

- (ii) In the case of an economy which is expected to remain in recession for the next five years, what, if any, will be the likely impact on the demand for the product? Explain your answer. (25)

- (i) Price Elasticity of Demand (PED) for the product is - 2.5.

This good is a price elastic good because its absolute value is greater than 1 (a 1% reduction in price will cause a 2.5% increase in quantity demanded).

To increase total sales revenue the firm should reduce price.

This is because the percentage increase in quantity demanded is greater than the percentage decrease in price.

12 marks

- (ii) Income Elasticity of Demand (YED) for the product is + 4.5.

This good could be considered by consumers to be a luxury good because its YED is greater than 1 (a 1% reduction in income will cause a 4.5% reduction in quantity demanded).

So as incomes fall in a recession / quantity demanded should fall by a larger percentage than the percentage fall in income.

13 marks

Other acceptable answers marked on their merits

Q4 Economic terms / Location of a firm / residential property and mortgage arrears

- (a) Explain, with the aid of an example, **each** of the following terms:
Derived Demand / Transfer Earnings / Supply Price / Economic Rent. (20)

Derived demand

Is where a factor of production is demanded not for its own sake but for its contribution to the production process.

An example of derived demand is the demand for land around Dublin and other large cities, which existed during the boom as a consequence of the demand for housing.

Transfer Earnings

Can be defined as the earnings of a factor in the next best alternative employment.

Appropriate example.

Supply Price

Is the minimum payment necessary to bring a factor into use and maintain it in that particular use.

Appropriate example.

Economic Rent

This is any payment to a factor of production above the necessary supply price of a factor.

Appropriate example.

Explanation: 3 marks each/example: 2 marks each = 20 marks

- (b) (i) Outline **two** economic characteristics of 'land'.
(ii) Discuss **three** economic factors which influence a firm's decision on where to locate its operations within Ireland. (25)
- (i) Outline **two** economic characteristics of 'land'

Land is fixed in supply

An increase in price being offered for land will not bring about an increased supply.

The supply curve for land is a vertical straight line.

Quantities of land can be reclaimed and soil erosion may take place but these have little effect on total supply.

Land has no cost of production to society as a whole

As land is a gift provided by nature it has no cost of production to society as a whole.

Any payment to land is above its supply price of zero and this is termed economic rent.

Land is a non-specific factor

Land can be used for various purposes. It can be switched from agricultural use to industrial / residential use.

2 characteristics: 5 marks each = 10 marks

- (ii) Discuss **three** economic factors which influence a firm's decision on where to locate its operations **within Ireland**.

Possible responses include:

Closeness to similar firms

Many IT/ Tech companies (Google, LinkedIn, Facebook) have now located within the same area in Dublin (known as the "Silicon valley" of Dublin). The essential support services are available close by.

Availability of a skilled workforce

Firms need a workforce with diverse language skills / engineering skills / IT Specialists so that they can commence operations and do so with minimum training costs.

Proximity to market / raw materials

A firm which relies on a steady flow of consumers must locate close to the market i.e. a boutique.

A firm which relies on the usage of large amount of raw materials must locate close to the availability of these e.g. a power generating station.

Well developed infrastructure

Having a well developed infrastructure is crucial when firms are deciding where to locate. This includes road, rail and air transport network etc. The availability of high speed broadband is also critical in this regard.

Government Incentives

Availability of Advance Factories together with attractive grants are another consideration to take into account when deciding where to locate. The IDA and Enterprise Ireland provide supports.

Commercial Property Prices

With the downturn in the economy and the property crash, commercial property prices together with commercial rents have significantly reduced. This has made Ireland a more attractive place to locate industry. Google has purchased commercial property recently in Barrow Street, Dublin.

Social Infrastructure

Firms will consider the availability of schools, hospitals, parks etc so that their workforce can have a good lifestyle.

Planning Laws

Irish planning laws are flexible enough to facilitate large multinationals who wish to set up here. Such laws facilitated the construction of the Swedish Ikea outlet close to Dublin, which led to the largest retail outlet in the history of the state, being built.

3 factors: 5 marks each = 15 marks

- (c) (i) State and explain **three** factors that caused the price of residential property to fall considerably in Ireland in the years following 2007.
- (ii) Mortgage arrears (i.e. the inability to meet mortgage loan obligations) is the biggest single personal debt issue for many households.

Discuss **one** possible economic impact of **mortgage arrears** on **each** of following:

- the household
- the banking sector
- the Irish Government.

(30)

- (i) State and explain **three** factors that caused the price of residential property to fall considerably in Ireland in the years following 2007.

Possible responses include:

Property market collapse

As a result of more and more land being rezoned and the construction boom, the supply of property exceeded the demand for it, except in the larger cities (Dublin). Many parts of the country now have ghost housing estates, particularly in areas in the West of Ireland.

The Banking Crisis

Due to a change in lending guidelines and greater credit controls following the banking collapse, many banks now are unable to lend out money as the criteria to secure loans makes it almost impossible for them to do so. There are also fewer banks operating in the Irish economy now.

Economic recession / Weaker demand in housing market

With the downturn in the economy and the accompanying drop in economic growth, there has been a decrease in the demand for housing. Increases in taxation have resulted in lower disposable incomes leading to reduced demand and prices. Economic uncertainty resulted in some people not trading up to larger houses.

Emigration

With the downturn in the economy and lack of job opportunities, many young people have been forced to leave the country, with a consequent drop in demand for residential property.

Speculation in housing

During the boom, increases in property prices fuelled speculative demand with more people seeking investment opportunities. With the onset of the recession, fewer people were willing to invest in property as it is deemed a very unstable investment.

3 factors: 5 marks each = 15 marks

- (ii) Mortgage arrears (i.e. the inability to meet mortgage loan obligations) is the biggest single personal debt issue for many households.

Discuss **one** possible economic impact of **mortgage arrears** on **each** of following:
the household / the banking sector / the Irish Government.

Possible responses include:

Households

Lack of consumer confidence

Increasing debt leading to less spending in the economy and less aggregate demand. Consumers are deleveraging rather than consuming. Mortgage arrears can therefore decrease consumer confidence and hence consumer spending. This can have a negative impact on the economy and society as a whole resulting in reduced spending and a reduction in aggregate demand.

Reduced creditworthiness

Mortgage arrears may mean that households' creditworthiness could be adversely affected thus limiting their ability to borrow.

Less houses for sale / depressed property market

People may be less willing to sell their homes because they will realise losses. This may also have implications on the 'mobility of labour' and the flexibility needed to move to areas where employment opportunities arise. There is little movement in the property market.

Social housing requirement

When people fall into arrears and their house is eventually repossessed, those people then end up on the social housing list, thus leading to an even longer waiting list. The burden on the tax payer becomes even greater.

The banking sector

Debt write-down deals

Banks may suffer loss of profits due to non-repayment of loans. They must develop strategies to deal with outstanding debt- the forced restructuring of loans into interest only, split mortgages and the extra cost of debt collection. This will have an impact on the banks' ability to lend and on its own indebtedness.

Subject to more regulation and legislation

Banks may be subject to more regulation on debt write-off /restructuring / insolvency legislation where it has to agree as a creditor to a solution. Their ability to meet the stress tests being carried out by ECB may also be affected.

Unemployment in the Banking Sector

Irish banks together with some foreign banks operating here, have pursued a policy of rationalisation, thus radically reducing the number of employees in the sector. The major banks have both pursued the policy of reducing staffing numbers in an effort to cut costs.

Collapse in share prices of bank stocks

Investors have lost confidence in the banks and so their share prices have fallen resulting in reduction in profits, reduction in the capital value of the banks, increase in bank debt and the nationalisation of some banks.

Reduced Tax Revenue for Government

Since many people have been unable to sell their property due to slowdown in property sales, there is a consequent loss of revenue from property transactions including stamp duty for the government etc. Also as people are not buying there is a loss of transaction taxes for the government. Consumers because they have reduced disposable incomes are not spending and so tax revenue to the government may be affected.

More debt write-offs / Guarantor for the Irish banks

The government have *de facto* become guarantor for the Irish banks. Bank losses are ultimately pushed onto the Irish taxpayers/ Recapitalisation of the banking sector due to non-repayment of capital. Thus, the government may be on the line for future bank liabilities (capital injections).

Increased demand for Social and Affordable Housing

As a consequence of debt default repossessions and the fact that consumers are finding it more difficult to secure a mortgage, a greater proportion of people are being forced to look to the government to provide social housing. In the greater Dublin area, the housing waiting list has increased dramatically.

New measures introduced by government to deal with banking/housing crisis

The government has had to introduce new legislation, increase regulation of the banking sector and try to help households to cope with mortgage arrears.

Measures include: a new Insolvency Act to aid banks to write down debt following bankruptcy /

More regulation of banks to deal with arrears / new codes of behaviour for debt collection / A national mortgage-to-rent scheme allows people in mortgage difficulties to switch from owning their home to renting it as a social tenant. People who take up this option no longer own their own home.

One possible economic impact per category: 5 marks each = 15 marks

Q5 National Income

- (a) The following table shows the level of National Income (Y), Consumption (C), Investment (I), Government Spending (G), Exports (X) and Imports (M) for 2013 and 2014.

	Y	C	I	G	X	M
2013	€80,000	€?	€10,000	€40,000	€100,000	€120,000
2014	€90,000	€56,000	€15,000	€34,000	€110,000	€?

Use this data to calculate the following: **(Show all your workings.)**

- (i) The level of Consumption in 2013
(ii) The Marginal Propensity to Consume (MPC)
(iii) The level of Imports in 2014
(iv) The Marginal Propensity to Import (MPM).

(20)

(i) Consumption in 2013

$$\begin{aligned} Y &= C + I + G + X - M \\ 80,000 &= C + 10,000 + 40,000 + 100,000 - 120,000 \\ 80,000 &= C + 30,000 \\ 80,000 - 30,000 &= C \\ C &= 50,000 \end{aligned}$$

5 marks

(ii) Marginal Propensity to Consume

$$\begin{aligned} \text{MPC} &= \frac{\Delta C}{\Delta Y} \\ \text{MPC} &= \frac{6,000}{10,000} = 0.6 \text{ (60\%)} \end{aligned}$$

5 marks

(iii) Imports in 2014

$$\begin{aligned} Y &= C + I + G + X - M \\ 90,000 &= 56,000 + 15,000 + 34,000 + 110,000 - M \\ 90,000 &= 215,000 - M \\ M &= 125,000 \end{aligned}$$

5 marks

(iv) Marginal Propensity to Import

$$\begin{aligned} \text{MPM} &= \frac{\Delta M}{\Delta Y} \\ \text{MPM} &= \frac{5,000}{10,000} = 0.5 \text{ (50\%)} \end{aligned}$$

5 marks

- (b) "Ireland heads Forbes' list of the best countries for business." (*Forbes Magazine* Dec 4 2013). Discuss the economic benefits Multinational Companies (MNCs) can bring to a small economy such as Ireland. (20)

Possible responses include:

Employment / improved standard of living / economic growth

Multinational companies employ many people here in Ireland particularly in the technology, pharmaceutical and medical devices, chemical industries. Employment boosts income and spending within localities. Employment will also be created in support industries.

Balance of Payments Benefits

Multinational companies have a major impact on the Balance of Payments by boosting the level of exports from Ireland and earning much needed revenue for the economy.

Investment in Research & Development and Education

The level of investment directed towards universities and other third level institutions that are involved in research and development, has increased dramatically. This in turn has meant that Ireland can continue to be to the forefront of technological advancement / new technology and management techniques leading to increased production capacity into the future.

Increased Government Revenue for the economy

As more and more multinational companies set up here, there is a greater contribution being made by these companies towards the exchequer in the form of corporation tax and both direct and indirect taxes.

Increased demand for Commercial Property

As Google, Facebook, LinkedIn etc. have decided to locate here, there has been an increase in the demand for both office space and commercial property, particularly in Dublin.

Promotes regional development

Many multinational companies have located in the West of Ireland and other peripheral locations, due to the existence of grants and advance factories thus greatly aiding the government's aim of balanced regional development.

New technology introduced

The introduction of new technology increases the skill base of Irish workers which improves employee mobility and expertise.

Benefits to indigenous companies

With the presence of more multinational companies, there is a knock on effect for indigenous companies e.g. transport/logistics companies involved in the distribution of products together with packaging companies etc.

Improved reputation for future FDI

As more and more international / multinational firms choose to locate here, Ireland's reputation as a location to transact business improves.

Indigenous MNCs encourage more FDI

Ireland's reputation for doing large scale business here increases FDI confidence in Ireland. MNCs such as CRH, the Kerry Group, Glanbia, Paddy Power etc. encourage more inward investment.

Development of a "silicon valley" (clusters of MNCs with core competencies)

Inflow of high-tech firms in clusters. New technology firms are attracted to areas where technology firms have already located.

4 points of information: 5 marks each = 20 marks

- (c) Economists use Gross Domestic Product (GDP) and Gross National Product (GNP) as measures of economic activity.
- (i) Define **each** of the underlined terms.
 - (ii) Which of these terms do you consider to be a more useful measure of economic activity for Ireland? Explain your answer.
 - (iii) Discuss **three** limitations of national income statistics. (35)

- (i) Define **each** of the underlined terms.

Gross Domestic Product can be defined as the total output produced by the factors of production in the domestic economy irrespective of whether the factors are owned by Irish nationals or foreigners.

6 marks

Gross National Product is defined as the total output produced (value of goods and services) by Irish owned factors of production in Ireland and elsewhere. It is a measure of the income accruing to a country's residents.

6 marks

- (ii) Which of these terms do you consider to be a more useful measure of economic activity for Ireland? Explain your answer.

A possible response:

- $GNP = GDP + \text{Net Factor Income from Abroad (NFIA)}$
- GDP measures the value of all goods and services produced in the country in the period. It is the fundamental measure of economic activity.
- The difference between GDP and GNP is significant in Ireland as NFIA is a relatively large negative in Ireland's case.
- NFIA is negative because the profits earned by MNCs and repatriated back to their home countries exceed the profits earned by Irish MNCs located abroad and returned to Ireland and the interest payments on Irish debt held by non-residents also cause the 'Net Factor Income from Abroad' figure to be negative.
- The net repatriation of profits and the interest repayments on the national debt to non-residents are both outflows hence GDP is consistently and considerably larger than GNP in Ireland.
- Although GDP is used for comparison with other EU countries, GNP is probably a better measure of Irish economic activity as GNP reflects only the part of economic activity that is produced and shared by Irish nationals.

8 marks

(iii) Discuss **three** limitations of national income statistics.

Possible responses include:

Population distortions

Population changes must be considered with changes in national income when assessing a country's economic performance. If national income grows at a slower rate than population, then average income per head may decrease and the average standard of living may fall. Per capita income may be a more meaningful measure of living standards than national income.

Constant prices and current prices / Inflation

An increase in prices will increase national income but the standard of living may fall. So changes in national income must be compared with changes in prices to consider the impact on standard of living / economic performance. GDP calculated at constant prices is a better reflection of economic growth than GDP at market prices.

Hidden social costs attached to increases in national income / externalities involved

If a firm increases output national income increases. However, a hidden cost may be increased pollution etc. Positive and negative externalities such as congestion, waste disposal and attractiveness of areas are excluded.

Distribution of national income and poverty

National Income statistics give headline figures as to the overall economic performance. Further research needs to be undertaken to find how income is distributed. e.g., two countries might have the same level of GNP. However, the income distribution might be very different in both countries with consequences for the welfare of its citizens.

Shadow economy transactions not measured

The black economy is excluded from the calculation of national income. The value of unreported transactions is difficult to ascertain thus underestimating the level of national income.

Nature of the goods produced

A country which spends a small amount on military equipment and a larger amount on health, education etc. will have a better standard of living than one where the reverse is the case i.e. much of its wealth is on armaments. There is a large difference in terms of relative economic well-being between the two countries yet the National Income data doesn't reflect this difference.

3 points of information: 5 marks each = 15 marks

Other acceptable answers marked on their merits

Q6 Economic Aims / Privatisation / Austerity

- (a) (i) State and explain **four** current economic aims/objectives of the Irish Government. (30)
(ii) Outline **two** possible conflicts that could arise between some of these Government aims/objectives.
- (i) State and explain **four** current economic aims/objectives of the Irish Government.

Possible responses include:

To reduce unemployment

Unemployment currently stands at 11.8%. The government have introduced a number of initiatives to improve employment prospects e.g. Job Bridge for the long term unemployed/provision of SOLAS courses. The government aims to reduce unemployment to 10% by 2016.

To reduce the national debt/sustainable public finances

Irish debt currently stands at 124% of GDP and the government must aim to reduce this. Although we have exited from the bailout, we are still under the direction of the Troika and they will continue to monitor our national debt reduction efforts. The funds from the sale of state assets may be used to reduce the debt. Restraint and discipline is required. The Government aim is to bring the fiscal deficit to 3% of GDP by 2015.

Achievement of economic growth

By economic growth we mean an increase in output per person in the economy (expansion of the productive capacity of the economy). Thus an increase in output per person implies an increase in income per person. We are under the direction of the Troika to return economic growth to the Irish Economy.

Boost exports / improve competitiveness / attracting investment

By taking steps to improve competitiveness, the government hopes that Irish exports will continue to grow and so help create jobs. They also aim to reduce cost of utilities. This may make Ireland more attractive for FDI. Trade missions by the IDA and Enterprise Ireland to China etc. to encourage FDI.

Broaden the tax base / greater tax revenue certainty

The government has introduced the local property tax, septic tank tax inspection charge and plans to introduce a water tax. These taxes will provide stability and increased certainty for the collection of government revenue.

Sustainable economic development

The government aims to increase investment in renewable energy so as to reduce carbon emissions and allow Ireland to be more sustainable. Measures include availability of grants for home insulation etc.

Balanced regional development

The IDA has had advance factories built outside of the Dublin region. It is hoped that employment will be created in the regions so as to boost economic activity.

4 points of information: 5 marks each = 20 marks

(ii) Outline **two** possible conflicts that could arise between some of these Government aims/objectives.

Possible responses include:

Sustainable government finances vs. economic growth/employment growth

Government policies to increase employment may cause an increase in government spending and a resultant budget deficit. This may be short term though as an increase in employment will lead to a higher level of tax revenue in the future thus reducing the deficit.

Sustainable government finances vs. regional development

Huge capital expenditure required (broadband and services such as hospitals and schools) to develop regionally, adversely affecting the budget deficit.

Full employment vs. equality

Achieving equality means that the government has to divert resources from one section of society to another. The gains made towards equality may be made at the expense of reduced efficiency and lower employment. e.g., a tax on employers may result in fewer workers being employed.

Economic Growth vs. just social policy.....etc.

2 conflicts: 5 marks each = 10 marks

Other acceptable answers marked on their merits.

(b) Discuss arguments for **and** against the privatisation of state assets.

(20)

Possible responses include:

Arguments in favour of privatisation:

Revenue for government

The government could use the revenue from the sale of the asset to reduce its level of borrowings into the future. This is one of the recommendations from the Troika during the recent 'bailout' programme.

More competition

Competition in the industry could improve services offered to customers and lead to more competitive prices on goods and services e.g. air travel in Ireland. Rationalisation ensures maximum efficiency from available resources.

Enterprise culture

Increased share ownership may lead to growth in an enterprise culture within the country and so help employment.

Access to finance

Through the sale of additional shares on the stock exchange, private companies have access to extra finance.

Greater incentives for innovation

Employees may have a greater incentive to innovate and improve productivity as they may reap greater rewards for their innovations within the privatised sector e.g. higher bonuses.

Shedding of loss making companies

By selling off loss making companies the burden on the state is removed and so the burden on taxpayers should be reduced.

2 arguments for: 5 marks each = 10 marks

Arguments against privatisation:

Increased Prices/ falling standards of service

The quality of services provided by the new company may deteriorate in an effort to cut costs. Prices may be increased to increase revenues.

Loss of jobs and reduced job security

Jobs may be lost through rationalisation of services and this may lead to higher social welfare costs.

Loss of a State Resource / loss of annual profits

Taxpayers lose critical infrastructure, which was once owned by the state. The state will lose profits made by profitable state firms.

Foreign Ownership

With the sale of a state owned asset, overseas buyers may become the owners of an Irish company and so control of the asset may go outside the state.

Loss of essential public services

The newly privatised company may cut those services which are non-profit making and this may affect lower income groups in particular.

2 arguments against: 5 marks each = 10 marks

- (c) In *The Irish Times* (November 2013) the economist Joseph Stiglitz predicted a "lost decade" for the Irish economy, due to the extended period of austerity.
(Austerity refers to government measures introduced to reduce a Budget Deficit.)
Outline **four** possible economic consequences for the Irish economy arising from the austerity measures introduced in recent Irish Government budgets. (25)

Possible responses include:

Increased unemployment / emigration

Reduced state services leads to less disposable income, which leads to less businesses (fall in production, reduction of the workforce, possible closure) leading to unemployment. The unemployment rate has grown as a result of these austerity measures. Some people have been forced to emigrate, having being made redundant here.

Loss of business confidence / lack of investment

With increased austerity and less disposable income available, loss of confidence in the Irish economy has led to entrepreneurs looking abroad seeking investment opportunities. Return on investment is viewed as being less reliable.

Reduction in aggregate demand / spending / lack of economic growth

As a direct result of government cuts in social welfare payments etc. there is less disposable income available for consumption, so aggregate demand decreases leading to reduction in economic growth.

Fall in living standards / increased Taxation / cuts in benefits and welfare service / greater inequality

With the austerity measures which were introduced by the government, there has been an increase in stealth taxes (regressive) and new forms of taxation such as the local property tax, household charge etc. The above have resulted in a fall in living standards.

Increased indebtedness

Within the economy, the increase in stealth taxes may lead to increased indebtedness. The high levels of personal debt is now having a negative impact on banks, credit unions etc. A credit squeeze may result.

Role of the government increases

The role of the government becomes much more strategic in a time of protracted austerity e.g. if people cannot afford health insurance etc., then the government may have to step in and provide medical cards. There may also be a need for further investment in rent allowance schemes, social and affordable housing etc.

More regional inequality

Peripheral areas of the country have suffered to a much greater degree during this period of prolonged austerity. Some Business closures with a consequent loss of jobs has been a feature of these regions.

1st correct response: 7 marks
2nd/3rd/4th correct responses: 6 marks

Q7 Economics of population / Economic growth and development

- (a) (i) Distinguish between the terms 'economic development' and 'economic growth' with reference to Less Developed Countries (LDCs).
(ii) Outline **three** characteristics of LDCs. (25)

- (i) Distinguish between the terms 'economic development' and 'economic growth' with reference to LDCs.

Economic Development

Occurs where an increase in the level of income / standard of living/output/GNP per person in a country, accompanied by a change in the structure of society.

5 marks

Economic Growth

It can be defined as an increase in GNP per head without any changes in the structure of society.

5 marks

- (ii) Outline **three** characteristics of LDCs.

High population growth rates in LDCs

Famine in LDCs / low life expectancy

High foreign debts / lack of capital

High percentage of the population engaged in extractive / primary industries in LDCs

Poor infrastructure in LDCs

Poor levels of education / literacy in LDCs

Exploitation by multinationals, individuals within the country and foreign countries

Political corruption / less stable political institutions

3 points of information: 5 marks each = 15 marks

Other acceptable answers marked on their merits

- (b) (i) Describe **three** types of foreign aid available to LDCs.
(ii) Discuss why foreign aid may not always result in economic growth in LDCs. (25)
- (i) Describe **three** types of foreign aid available to LDCs.

Direct financial aid by governments

This is also known as official development assistance, grants and loans. Governments may provide aid to help in emergency situations. They can also assist with the development of infrastructure and the provision of education, health programmes etc.

Financial aid through voluntary agencies

Various international voluntary agencies provide direct aid to LDCs on a permanent basis or in times of emergency.

Aid (other than financial aid) by foreign citizens

Foreign citizens could work in LDCs and provide a necessary service e.g. teach, build or provide healthcare etc. Foreign citizens can help by buying 'fair trade' products which ensure higher prices for producers and hence a better standard of living for citizens in LDCs.

Foreign citizens could donate food, clothes, livestock etc so as to improve the standard of living of citizens in LDCs.

Restructuring of national debts

If national debts of LDCs are cancelled or re-structured more funds would become available for the LDCs to use for economic development in their countries.

Multinationals setting up in LDCs

Multinationals, by providing employment opportunities, provide workers with skills. The fair wages received could help boost domestic demand, provide tax revenue for the state and boost employment.

Improve trade terms with LDCs

Most LDCs suffer from unfavourable terms of trade. If access to markets in the developed world was improved and /or the terms of trade available were more favourable then LDCs could increase exports and/or obtain higher prices for their exports boosting their national incomes.

Assist LDCs with skills and technologies

Governments or voluntary agencies could provide skills and technologies to the LDCs so that living standards could improve and this could boost their productive capacity.

3 points of information: 5 marks each = 15 marks

- (ii) Discuss why foreign aid may not always result in economic growth in LDCs.

Unfair distribution of benefits / Widening poverty gap / trickle down effects

The increased wealth may not trickle down to the people who most need it and economic growth may not result. Any wealth that exists in the poorest countries is often concentrated in the hands of a small ruling elite. In many cases military dictatorships are the norm and they wish to maintain the status quo. The money may be used for the purchase of armaments and other non-essential projects.

Costs to the environment

Increased pollution, disfigurement of the landscape/environment, large scale urban sprawl may negate any positive effects from the foreign aid.

Rapid population growth / standard of living

In LDCs there are rapidly rising populations and the implications of such population growth is that any economic growth is completely outweighed by an increase in population. The impact of the foreign aid may be hard to discern as it may not improve the standard of living.

Culture of dependency rather than improvement of local economy

In some LDCs, a culture of dependency may exist and this may prove to be a major barrier to promoting economic growth and development. Entrepreneurship demands ingenuity and inventiveness. A culture of dependency reduces the desire for risk taking ventures and ultimately profit making.

Food aid dependency/ reduced incentive for production / growth

In order for economic growth to be sustained, economic projects must be undertaken and the focus on provision of food aid exclusively must be reduced. The whole notion of subsistence must be replaced by a desire for excess production and a move away from the primary production area. Secondary and tertiary sectors should be encouraged.

High profile projects

In some LDCs, the provision of adequate infrastructure together with land drainage and irrigation schemes, roads, housing, factories and communication facilities are bypassed in favour of 'high profile' projects. Governments need to prioritise those projects which will ultimately lead to economic self-sufficiency and increase the productive capacity of LDCs. The provision of skills and technologies will ultimately help with improving standards of living and increasing productive capacity.

2 points of information: 5 marks each = 10 marks

- (c) “The World Trade Organisation (WTO) is the only international organisation dealing with the global rules of trade between nations.”
- (i) Outline **two** economic benefits claimed for ‘free trade’.
 - (ii) Outline **three** reasons why countries might choose to impose barriers to free trade. (25)
- (i) **Two** economic benefits claimed for ‘free trade’.

Greater choice of commodities / higher standard of living

Trade allows us benefit from a greater variety of goods and services, than would be available without trade. We lack some essential raw materials for production and thus must import these. Trade increases our standard of living.

More competitive prices of goods and services

Trade results in greater competition on the market which should lead to more competitive prices for consumers.

Strengthens home economy / boosts employment / investment opportunities

Employment will be created in those industries which are expanding due to the benefits of trade. A healthy trading economy generates confidence in the economy and investment is thus encouraged. GDP is boosted and an incentive to grow may develop.

Companies benefit from economies of large scale production

With trade, specialisation will take place. Companies will increase production and may benefit from economies of scale. Domestic firms may become more competitive and more efficient.

2 economic benefits: 5 marks each = 10 marks

- (ii) **Three** reasons why countries impose barriers to free trade.

Protect infant industry

Small firms need to be protected to give them time to expand and gain economies of scale, which will allow them compete on an international basis.

Prevent dumping

A country may ban dumping of foreign goods on its home market if the government sees such dumping as a threat to domestic producers.

Protect employment on the domestic / home market

A country may impose restrictions on imports to protect goods which can be produced at home, thus protecting job opportunities in the home market.

Encourage the domestic production of vital goods / national security

A country may impose restrictions on the import of certain goods to reduce its dependence on foreign supplies of such goods. Governments do not want to be exclusively dependent on foreign markets for supplies of strategically important goods such as food, fuel etc. Free trade may result in the spread of animal diseases. During such crises governments may ban the importation of cattle to protect this vital industry.

3 reasons: 5 marks each = 15 marks

Other acceptable answers marked on their merits

Q8 Economics terms and Taxation

- (a) Explain the relationship between a government Budget Deficit and the National Debt. (20)

A government budget deficit exists when total government expenditure exceeds total government revenue. A budget deficit is financed by increased government borrowing.

10 marks

National debt is the total amount (cumulative) of government borrowing which is outstanding (due / owed). A budget deficit will result in an increased national debt in absolute terms and a higher cost of servicing the national debt.

10 marks

- (b) “The Irish Tax system has evolved over time to reflect changing economic and social conditions and will need to be equally responsive to new developments in the future.” (35)
(*Commission on Taxation Report, 2009*)
- (i) Discuss Adam Smiths' **four** Canons of Taxation in his book, *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776).
- (ii) Outline **two** other principles which could be considered in a modern tax system. Justify answers.
- (i) Discuss Adam Smiths' **four** Canons of Taxation.

Equity

The ability-to-pay principle/Taking a higher proportion of income in tax as income rises. The better able should bear a greater burden of taxation, whether or not they benefit. The idea of this canon is that taxes should be progressive and so income tax in Ireland is equitable as those on higher incomes pay a greater proportion in taxation.

Economy

The costs of collecting taxes should be as low as possible. The income collected should be greater than the cost of collection. The raising of revenue for government is the main aim of taxation. If the taxes imposed are difficult to administer it may result in costs of collection being high relative to the yield from the taxation. The majority of the tax take should be available for the welfare of the economy. The local property tax is economic as it can be collected on-line.

Certainty

The amount paid should be certain and clear/ A taxpayer should know when they are paying tax and how much tax they are paying.

Similarly the government should know how much they are collecting and when they will receive it.

Various taxes such as VAT receipts must be forwarded to the Revenue Commission at certain specified times.

Convenience

The tax should be collected in a way and at a time which is convenient for the taxpayer.

It is more convenient to have tax deducted at source e.g. PAYE rather to receive a bill for the total amount due in a single payment after the income has been spent. VAT is collected at the time of purchase and so is convenient for the taxpayer.

4 points of information: 6 marks each = 24 marks

- (ii) Outline **two** other principles which could be considered in a modern tax system. Justify your answers.

Possible responses include:

A tax system should have a limited disincentive effect on work / saving

If the rate of personal income tax is considered too high (Ireland's effective highest rate is 51%) and a large proportion of additional income is taxed away this may discourage people from supplying additional effort or labour. Plans for a higher rate of income tax to be charged on people earning over €100,000 may deter foreigners from working in Ireland. The current rate of DIRT of 41% may deter people from saving.

A tax system should have a limited disincentive effect on investing

The current rate of CPT 12.5% is a factor in attracting FDI. If this rate of tax were to increase it may deter MNCs from locating in Ireland and it may mean that some companies re-locate their operations.

Taxes should have a stabilising impact on the economy thus developing into automatic stabilisers

A tax system should prevent the level of economic activity rising too fast as it would otherwise during a period of economic growth. Similarly in a recession, the amount collected in taxes falls, so the decrease in demand is not as great as it would otherwise be.

Tax rates should be consistent with national economic objectives

The taxes levied should help the government achieve other economic/social objectives e.g. raising excise, VAT rates on alcohol may discourage consumption; the introduction of a 'sugar tax' may help reduce Irish obesity levels; the 'carbon taxes' may help reduce our carbon emissions.

Tax evasion should not be possible.....etc.

1st correct response: 6 marks

2nd correct response: 5 marks

Other acceptable answers marked on their merits

- (c) Outline possible economic consequences of the Irish Government shifting the burden of taxation from direct taxation to indirect taxation. (20)

Possible responses include:

Encourages enterprise, investment, employment and employment promotion

Lower rates of direct tax may incentivise workers and companies as direct taxes tend to be progressive. More take-home pay will increase the incentive to work. Rewards for risk taking encourages effort. Lower rates of direct taxes may lead to increased FDI.

Moving from direct to indirect can make the tax system more regressive

Indirect taxes tend to be regressive. Lower income groupings may end up paying a greater proportion of their income in this form of tax because they spend a greater portion of their income. In 2010 a carbon tax was introduced in Ireland resulting in higher costs of purchase. Indirect taxes do not take account of ability to pay.

Evasion is more difficult with indirect tax

Since the indirect tax e.g. VAT is included in the selling price of the good or service, it is impossible to evade. If you buy a good, then you must pay the tax on that good.

Revenue collected is not as certain with indirect tax

The revenue collected is not as predictable as that from direct taxation. This may hinder the government's financial planning. Indirect taxes can distort demand patterns thus making it more difficult to predict the amount of revenue that will be collected.

Indirect taxes can be inflationary

A rise in VAT / Excise duties will increase the CPI in the short term. This may cause consumers to possibly decrease their spending and /or defer their spending.

May lead to a growth in the 'shadow economy'

An increase in the rates of indirect taxation may cause some consumers to switch to the shadow economy as they seek lower prices for some goods and services.

4 points of information: 5 marks each = 20 marks

Other acceptable answers marked on their merits

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