Past-paper walk-through

Market failure ▪ 2.9

eXercise

Questions in this set

- 0455/11 N25 Q1 ▪ 1 mark
- 0455/12 N25 Q10 ▪ 1 mark
- 0455/13 N25 Q2 ▪ 1 mark
- 0455/11 J25 Q17 ▪ 1 mark
- 0455/11 J25 Q18 ▪ 1 mark
- 0455/12 J25 Q9 ▪ 1 mark
- 0455/12 M25 Q2 ▪ 1 mark
- 0455/13 N24 Q9 ▪ 1 mark
- 0455/11 J24 Q9 ▪ 1 mark

Question 1

0455/11 N25 ▪ Q1 ▪ 1 mark

1 Consumers and producers face the same problem of satisfying wants.

What is the most likely reason wants cannot be satisfied?

A consumers and producers cannot establish an equilibrium price

B consumers have excess choice when producers oversupply

C consumers have limited income and producers have finite resources

D consumers lack information to buy and producers lack motivation to supply

Solution 1

Answer: **C**

Why

- The economic problem is that wants are unlimited while resources are scarce.
- So wants can never all be satisfied, no matter how much is produced.
- It is the *limited resources* against *unlimited wants* that causes it.

Question 10

0455/12 N25 ▪ Q10 ▪ 1 mark

10 What is **not** a role of the central bank?

A to act as the lender of last resort

B to hold deposits from the general public

C to issue notes and coins

Question 10

D to manage the gold reserves of the country

Solution 10

Answer: **B**

Why

- A central bank is the government's bank and the banks' bank.
- It issues notes and coins, sets interest rates and acts as lender of last resort.
- It does *not* hold deposits from the general public – commercial banks do that.

Question 2

0455/13 N25 ▪ Q2 ▪ 1 mark

2 Which value does opportunity cost measure?

A environmental damage

B next best alternative forgone

C output of labour

Question 2

D price paid

Solution 2

Answer: **B**

Why

- Opportunity cost measures the value of the next best alternative given up.
- It is not the money price and not the output produced.
- Every choice has one, because choosing means forgoing the alternatives.

Question 17

0455/11 J25 ▪ Q17 ▪ 1 mark

17 What is a macroeconomic aim of a government?

A high external costs

B high sales tax

C low unemployment

Question 17

D low wages

Solution 17

Answer: **C**

Why

- Macroeconomic aims cover the whole economy: growth, low unemployment, price stability and a balanced current account.
- Low unemployment is one of the four standard aims.
- High external costs, high taxes and low wages are not aims – they are outcomes or instruments.

Question 18

0455/11 J25 ▪ Q18 ▪ 1 mark

18 What is a principle of taxation?

A equality between social cost and social benefit

B fairness between taxpayers

C profit maximisation by firms

D tax revenue maximisation

Solution 18

Answer: **B**

Why

- The canons of taxation are equity, certainty, convenience and economy.
- Equity means the burden should be fair between taxpayers.
- Profit maximisation is a firm's objective, not a principle of taxation.

Question 9

0455/12 J25 ▪ Q9 ▪ 1 mark

9 What is a characteristic of a demerit good?

A it is more beneficial to the consumer than they realise

B it is overconsumed in the free market

C it is underproduced in the free market

D it provides external benefits

Solution 9

Answer: **B**

Why

- A demerit good is more harmful than the consumer realises, so it is over-consumed.
- The consumer's private benefit is *less* than they think.
- A merit good is the opposite – more beneficial than realised, and under-consumed.

Question 2

0455/12 M25 ▪ Q2 ▪ 1 mark

2 An economics graduate chooses to work in a bank rather than teach economics which was the next best alternative.

Which cost is incurred as a result of this decision?

A external cost

B internal cost

C opportunity cost

D private cost

Solution 2

Answer: **C**

Why

- Opportunity cost is the value of the *next best* alternative given up.
- The graduate gave up teaching economics, which the question names as the next best option.
- So the opportunity cost is the teaching job forgone – not the bank salary earned.

Question 9

0455/13 N24 ▪ Q9 ▪ 1 mark

9 What is external benefit?

A private benefits minus private costs

B private benefits plus social benefits

C social benefits minus private benefits

Question 9

D social benefits plus social costs

Solution 9

Answer: **C**

Why

- External benefit is the benefit received by third parties.
- It is the amount by which social benefit exceeds private benefit.
- So external benefit $=$ social benefit $-$ private benefit.

Question 9

0455/11 J24 ▪ Q9 ▪ 1 mark

9 What is a correct definition of a demerit good?

A a good which generates external benefits

B a good with higher private costs than social costs

C a good which is more harmful to consumers than they realise

D a good which provides no costs to third parties

Solution 9

Answer: **C**

Why

- A demerit good is more harmful than the consumer realises.
- So it is over-consumed in a free market and has external costs.
- A good generating external *benefits* is a merit good – the opposite case.