

## ANSWERS

### CHAPTER 1 Ans

1. Zero. If the good is free, nothing has to be sacrificed in order to obtain it.
2. Additional money does not lead to the production of more goods – there is merely likely to be a rise in prices
3. B and d – not wanted; e – not scarce; g – not transferable.
4. Time. This is not a trivial question; the time element is continually entering into economic decisions. Thus people are often prepared to pay extra to have good A now. It follows that 'A in the future' is really a different economic good from 'A now'.
5. 'Money income' is income in terms of money only. Since 1990 the price level has doubled – the value of money has fallen. 'Real income' is income in terms of goods – what money income will actually buy. Because of the rise in prices, my money income will buy only twice as many goods; that is, my real income has doubled.
6. a)

Units of X	0	5	10	15	20
Units of Y	8	6	4	2	0

- b) They lie on a straight line (called the 'budget line'). The budget line defines the possibilities open to the consumer. Points above the line are unattainable.
  - c) 2.5X
  - d) Opportunity cost
  - e) The budget line would not move at all.
  - f) Money income has doubled, but real income is unchanged
  - g) The budget line moves outwards from the origin, parallel to the old one.
  - h) Real income has fallen.
7. a) The various combinations of two goods that can be produced by a country with its resources and given technology
- b) There are unemployed resources and the maximum output is not

being achieved.

- c) Resources are not equally suited to producing both goods, so the opportunity cost of more production of one good increases the more of it that is produced.

8. i) positive; ii), iii), iv) normative  
9. b, a, c, e, d, f.  
10. True: a, b, f, h. False: c, d, e, g.

#### Multiple Choice Questions

11. a; 12. c; 13. a; 14. c; 15. e.

#### CHAPTER 2 Ans

1. Stocks: b, c and e ; flows: a, d and f
2. Micro: a, d and f; macro: b, c and e
3. Households and firms
4. True: b and e; false: a, c, d and f
5. It would be impossible to charge a price because 'free-riders' cannot be excluded.
6. Duplication of research and competitive advertising may waste resources.
7. Prices.
8. Public sector and private sector.
9. The state makes economic decisions through a powerful planning authority.
10. In a command economy.

#### Multiple Choice Questions

11. d; 12. a; 13. a; 14. e; 15. b.

#### CHAPTER 3 Ans

1. Costs of transport for wheat are much smaller in relation to value.  
Wheat is not so perishable.  
Wheat can be classified into standard grades

2. imperfect: b, d, e; approximating to perfect: a, c, f and g
3. Transport difficulties or lack of mobility, eg labour; imperfect knowledge, eg retail paint; some goods are not standardised eg second-hand books and antiques.
4. Prices throughout the market become known more quickly, eg by Telephone or internet and so price differences are eliminated more quickly.
5. Beef is a closer substitute for lamb than it is for fish.
6. The budget speech. Taxes are expected to change, affecting prices.
7. Widespread demand; transportable commodities; small costs of transport (relative to value of commodity); durable commodity.
8. They fall – the supply curve shifts to the right.
9. There is a time-lag in supply of almost everything eg 9-12 months for Houses; 5 years for doctors.
10. Futures dealings enable traders to protect themselves from heavy losses due to price fluctuations – they even out price variations.

#### Multiple Choice Questions

11e; 12a; 13b; 14e; 15d.

#### CHAPTER 4 Ans

1. Rents of council flats are subsidised from taxation and so are less than the market price (private sector rents). Hence demand exceeds supply.
2. Demand exceeds supply and the limited supply can be sold at a high black market price.
3. Cars and DVD recorders (a and c) considerable increase; food, books etc (b and d) slight increase.
4. Price falls. Prices of substitutes move in the same direction.
5. Prices will rise.
6. The price of bricks will rise.
7. a. Fall; price of A falls, so people substitute A for B. Decreased demand for B lowers its price.  
b. Fall; price of A rises, so people buy less A and therefore less B. Decreased demand for B lowers its price.

8. Supply of agricultural products, unlike manufactured goods, varies from season to season and storage can be difficult. As a result the amount of agricultural produce coming onto the market varies considerably, and so prices fluctuate.
9. There will be excess demand. Only some form of rationing can ensure that there is fair distribution. A black market is likely.
10. Decrease demand for road transport by raising its cost (eg heavier duties on fuel and vehicles).

#### Multiple Choice Questions

11a; 12 b; 13 e; 14e; 15e.

#### CHAPTER 5 Ans

1. As long as marginal utility is positive (greater than zero), the purchase of an extra unit must increase total utility.
2. Yes – utility could increase from consumption of one more unit in certain special circumstances, such as a stamp collector completing his collection.
3. For some individuals, margarine may be an inferior good, and when its price falls there is sufficient change in their real income for them to be able to purchase the superior good (butter) instead. However, it is unlikely that the market demand curve will be 'perverse' even over a narrow price range, because:
  - a. there may be only a few people for whom margarine is inferior;
  - b. margarine has many uses and will not be inferior in all of them;
  - c. it is unlikely that margarine will become inferior for all persons concerned at exactly the same price.
4. a. elastic; b. inelastic
5. 90. (% change in price = 20%; % change in quantity = 80%;  $80/20 = 4$ ).
6. Assuming that outlay on agricultural products roughly represents farmers' incomes, then a fall in price would lead to an overall drop in income.
7. More. If demand is inelastic, outlay will increase when price rises.
8. Elastic. More.
9. When a supermarket cuts the price of its goods, it expects a considerable expansion of demand by winning customers from retailers selling at a

higher price.

10. The increase in price might cause such a falling off in demand that the total tax received was less than before.

#### Multiple Choice Questions

11a; 12e; 13d; 14a; 15c.

#### CHAPTER 6 Ans.

1. b,c,e,f,i.
2. Production is not complete until goods are in the hands of the final consumer. Manufacturers find that it pays to carry stocks of all kinds as a buffer against sudden increases in demand. Stocks are, therefore, a factor of production assisting in the process of production.
3. He takes the risk that the book will not sell after going to the cost of having it printed, etc. The author who writes a book in return for a percentage of the selling price on each copy sold is a part-entrepreneur, for his labour could be wasted.
4. Production is defined as any activity which results in the satisfaction of wants. Hence, all of the activities quoted are productive.
5. a. High-gearred  
b. i. profits £50,000 – interest £45,000 = £5000 = 5% or 5p a share  
ii. profits £60,000 – interest £45,000 = £15000 = 15% or 15p a share
6. d
7. b
8. a
9. b
10. Not always. In the short-term it may expand rapidly with a view to future profits. And for small companies, the owners' personal objectives could be followed. Sometimes in larger companies the management may pursue their own objectives, rather than shareholders.

11a; 12b; 13c; 14b; 15c.

#### CHAPTER 7 Ans

1. It facilitates the exchanges implicit in the division of labour.

2. It extends the market and therefore makes a greater degree of division of labour possible.

3. Smith can make 5 tables and 2 chairs in a day;  
Jones can make 2 tables and 5 chairs in a day;  
Without specialisation, total production is 7 tables + 7 chairs  
If Smith specialises in making tables and Jones chairs, total production is 10 tables + 10 chairs.

4. Without specialisation, total production is 9 tables and 6 chairs. If Smith specialises where advantage is greatest (chairs – twice as good as Jones), then total production is 8 tables and 8 chairs, a net increase of one unit.

5. a. external  
b. internal – a technical economy of scale  
c. external  
d. internal – a risk-bearing economy  
e. internal – technical economy as store is using greater division of labour

6. a. horizontal  
b. vertical  
c. horizontal  
d. lateral  
e. vertical

7. a. village store/ shoe repairer  
b. brewers/ timber merchant  
c. personal services/ hobby shops

8. a. small property company limited by lack of capital/ taxation splitting up estates  
b. specialist firms in building eg roofing/ specialist printers  
c. hairdressing/ agriculture/ café proprietor  
d. window cleaner/ plumber

9. Agriculture/ retailing/ professional services/ construction/ personal services.

10.  
a. commercial  
b. technical  
c. external  
d. technical  
e. commercial  
f. financial  
e. risk-bearing

Multiple Choice Questions

11c, 12c, 13a, 14e, 15b.

## CHAPTER 8 Ans

1. a)20,000; b)4,020
2. Economies in distribution; holding stocks; transporting bulky materials; providing credit; giving advice.
3. Stocks a variety of books; situates shop near customer; passes information from customers to publishers.
4. The size of likely demand; time taken to secure replacement stock; perishability; time of year; possibility of future price rises; rate of interest.
5. It is convenient for customers (including dealers) to have all similar shops together to compare products and prices; it also establishes a reputation for the locality, thereby gaining further custom. Other examples are jewellers, art galleries and fashion houses.
6. Fresh vegetables are perishable and it is easier and quicker for greengrocers to go to a central market than for wholesalers to attempt to distribute to them direct.
7. Customers are prepared to make the journey to ensure having fresh eggs; no retailing costs.
8. Economies of bulk buying; economies in carrying stocks through centralised control; management economies; elimination of wholesalers profits; economies of advertising; reputation.
9. Personal management and attention to customers' personal requirements.
10. Wholesalers have declined because:
  - a. of the growth of large stores which can order in bulk;
  - b. faster transport which reduces the necessity for stocks;
  - c. direct links between manufacturers and retailers;
  - d. the practice of branding many products which eliminates many specialised functions.

## Multiple Choice Questions

11. b; 12. a; 13. c; 14. c; 15.d.

## CHAPTER 9 Ans

1. Cotton – South East Lancashire  
Banking – City of London  
Pottery – Staffordshire
2. steel, shipbuilding
3. ice-cream, furniture, beer, potato crisps, plate glass
4. Concentrated urban areas, with traffic congestion, smog etc.  
Dependence on the prosperity of one industry may lead to regional unemployment.
5. Electricity as a source of power freed industries from being on the coalfields so that they could produce near their markets, e.g. London.
6. Land is allocated through competition in the market. Firms prefer a site where receipts less costs (other than rent) are at a maximum. The greater the difference, the higher the rent they can afford to bid the land away from other firms. So the site goes to the user that can make the most profit (and is put to its most efficient use).
7. Governments offer financial incentives to firms to set up plants in Assisted Areas. For example, Nissan was attracted to the Sunderland area partly by the government grants that were available.
8. i. skilled labour  
ii. communications/ transport links  
iii. ancillary industries nearby  
iv. a good reputation for the product in the area eg Sheffield steel
9. For electrical components manufacturers, their raw materials lose little weight in production and the cost of distributing the finished product is only a small proportion of total costs. They are thus indifferent whether they are located near to their raw materials or to their market.
10. There could be problems of pollution and congestion. If there is a decrease in demand for the products of the industry, the whole locality can become depressed leading to regional unemployment.

### Multiple Choice Questions

11.a; 12. b; 13. d; 14.a; 15.b.

## CHAPTER 10 Ans

1. a) 10, 12, 10, 8, 5

b) Third

2. a) 15, 36, 54, 68, 75

b) 15, 21, 18, 14, 7

3. 6, 16, 31, 43, 48

4. Yes; so long as MPP exceeds APP, APP will be pulled upwards. This is true whether MPP is rising or falling. However, as soon as MPP is less than APP, APP will decrease.

5. a) 13 workers

b) 14 workers

c) 14 workers

Workers	10	11	12	13	14	15	16
APP	10	11	12	13	13.5	13	12.5
MPP	21	23	25	20	6	5	

d) No. We only have a technical relationship between a variable factor and a fixed factor. The firm determines its output (and thus employment) from the objective of profit maximisation. Hence two other variables are needed: the price of factors and the price of the product.

6.  $(TPP_n) - (TPP_{n-1})$

7. This means that diminishing returns will lead to falling average product as population increases and more labour (variable factor) is applied to land (fixed factor); as average product falls, average standards of living are likely to fall.

8. An average is the mean of a series of values. If the next or marginal value is lower (because of falling marginal product) then the mean of the series must fall – falling average product.

9. The law of varying proportions.

10. At least two.

## Multiple Choice Questions

6. d; 7. c. (a is too vague; in b, total product need not increase at first); 8. c; 9. a; 10. c.

## CHAPTER 11 Ans

1. Fixed costs: a, d, g, h ; Variable costs: b, c, e, f, i, j.

2. a.

Output	Total cost (£)	Average cost (£)	Marginal cost (£)
0	55		
1	70	70	15
2	82	41	12
3	87	29	5
4	92	23	5
5	120	24	28
6	180	30	60

b. £55

3. a.

Price (£)	Quantity demanded	Total revenue (£)	Marginal revenue (£)	Average revenue (£)
6	10	60		6
5	20	100	4	5
4	30	120	2	4
3	40	120	0	3
2	50	100	-2	2
1	60	60	-4	1

b. Marginal revenue is always less than average revenue because the demand curve slopes downwards left to right. Average revenue equals price and if the demand curve slopes downwards, then the sale of another unit (giving marginal revenue) must always be at a lower price than the sale of the previous unit.

4. £378 = depreciation 90 + opportunity cost 216 + tax and ins 36 + compensation for uncertainty 18 + garage costs 18

5. £108 = 90 petrol and oil + 18 wear and tear

6. £288 = 540 – depreciation 90 – tax and ins 36 – garage 18 – petrol and oil 90 – wear and tear 18

7. £18 (minimum necessary compensation for uncertainty)
8. £54 (receipts – total costs)
9. £108 (must cover variable costs)
10. £486 (must cover total costs)

#### Multiple Choice Questions

11. d (this is equal to its best alternative use)
12. c
13. a
14. d
15. c

#### CHAPTER 12 Ans

1. Rare first edition books; old masters; anything unique.
2. All firms must be in equilibrium – with no incentive to change output; and there must be no incentive for firms to enter or leave the industry – so no supernormal profits or losses are being made.
3. Price elasticity of supply = 1 (10,000/40,000 / 3/12).
4. a. horizontal or perfectly elastic  
b. vertical or perfectly inelastic
5. Elasticity will be higher if stocks can be drawn on
6. Price rises more when supply of workers is inelastic
7. a) Elasticity of supply =  $52/56 / 1/7 = 6.5$   
b) Elasticity of supply =  $20/56 / 1/7 = 2.5$
8. Price rises by the full amount of the tax when supply is perfectly elastic (consumers pay the tax).
9. Price remains the same when supply is perfectly inelastic (producers pay the tax).
10. Demand is often more inelastic for primary products and supply is usually more inelastic, especially in the short-run.

#### Multiple Choice Questions

11. c; 12d; 13b; 14c; 15a.

#### CHAPTER 13 Ans

1. The demand for the factor is derived from consumer demand for the product.
2. Physical productivity and price of product.

3.
  - a. MRP shifts outwards (greater demand for repairs means TV mechanics can charge higher prices)
  - b. MRP shifts outwards (more TV repairs means more income/revenue)
  - c. MRP shifts outwards (higher prices means more income/revenue)
  - d. MRP shifts inwards or down (less expenditure on TV means less income/revenue)
  - e. MRP shifts inwards or down (fewer repairs means less income/revenue)
4.
  - a. 4 workers (MRP = wage rate = £224)
  - b. 5 workers (MRP = wage rate = £160)
5. a. rise; b. fall; c. fall; d. fall; e. rise.
6. a. direct; b. derived; c. derived; d. derived; e. direct
7. The reward of a factor is determined by the interaction of demand and supply
8. £10
9. 95
10. 4

#### Multiple Choice Questions

11. d; 12. a; 13. d; 14. b; 15. d.

#### CHAPTER 14 Ans

1. *Technical efficiency* refers to maximising output from limited resources. *Economic efficiency* relates supply to demand so that limited resources produce that assortment of goods which yields maximum satisfaction.
2. There may be spillover benefits and costs (externalities).
3. It may not be possible to exclude 'free-riders' e.g. street lighting
4. It should aim to ensure that full employment ensures production on the curve; and aim to move the curve outward from the origin through economic growth
5. The distribution of income
6. Since a tax to raise the price of cigarettes is only likely to achieve a small reduction in the demand for cigarettes, the government could try to shift the demand curve to the left by:  
banning promotional advertising; banning smoking in public places;  
publicising the harmful effects of smoking on health

7. Yes, because there are external costs of: passive smoking; health service costs; litter; fire risk etc.
8. 5 million bars
9. 3 million bars
10. £60,000

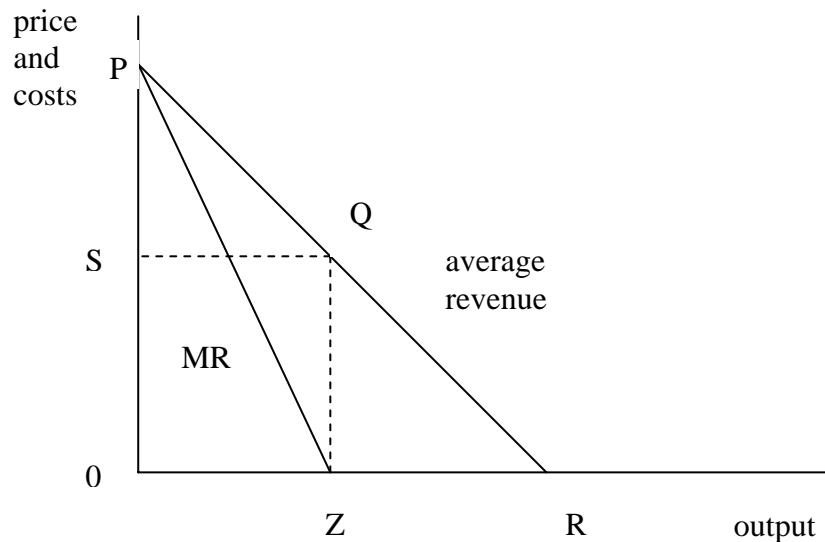
Multiple Choice Questions

- 11.e; 12. b; 13. a; 14. b; 15.c.

CHAPTER 15 Ans

1. By calculating the percentage of total sales controlled by the dominant firm(s) in the industry, or by comparing the rate of profit with that in other industries.
2. A monopoly situation exists, prima facie, when a firm or group is responsible for one quarter of an industry's output.
3. This is not possible because income is limited and so goods compete with one another for this income. To a greater or lesser degree, therefore, all goods are substitutes for one another.
4. a. 2000 litres (MR is zero and so equals MC)  
b. approximately unity

5. OZ see 8.  
below



6. 1 (unity)

7. If there are marginal costs, output must be less than  $OZ$ .
8. Marginal revenue = 0 at equilibrium output  $OZ$ . Therefore elasticity of demand = 1; therefore  $PQ=QR$ . Triangles  $PSQ$  and  $QZR$  are identical, therefore  $OZ=ZR$ .
9. No – the services are not identical, so the product is not homogeneous (the first class letter is 'guaranteed' delivery within 24 hours).
10. i. there must be imperfect competition  
ii. elasticities of demand in the different markets must be different  
iii. the markets must remain separate

#### Multiple Choice Questions

11.a; 12.b; 13.c; 14.a; 15.c.

#### CHAPTER 16 Ans.

1. a. to inform  
b. to expand demand  
c. to persuade
2. Yes. There can be collective advertising, e.g. for eggs or milk.
3. In the long-run, the entry of firms producing close substitutes causes the AR curve to fall.
4. The producer can sell an infinite amount at a given market price in perfect competition, so advertising would be pointless (and consumers are assumed to have perfect knowledge of goods anyway).
5. a. branding or trade marks  
b. advertising  
c. distinctive packaging  
d. free gifts/loyalty points  
e. competitions
6. a. price taker- must accept market price  
b. price maker – can determine its selling price  
c. can decide its price but must take into account likely reactions of competitors
7. There will be excess capacity – output is less than where ATC is at a minimum. Also, there will be non-price competition, advertising, loyalty points etc.
8. Prices tend to be very similar, although this tacit agreement is broken from time to time. Some competition exists through free gifts etc.
9. Wheat and eggs are very difficult for one farmer to differentiate from another – advertising would raise costs but not sales.
10. It shifts to the left and becomes more elastic.

## Multiple Choice Questions

11. b; 12. d; 13. e; 14. e; 15. b.

## CHAPTER 17 Ans.

1. Loss of visual amenity (countryside); noise for nearby residents.
2. a. This may increase the nitrate content in the water supply with health consequences.  
b. Straw burning increases carbon dioxide in the air, may affect nearby residents and reduce visibility on roads.
3. a. It prevents inappropriate development, such as 'ribbon' development or overcrowding.  
b. It is likely to increase the price of land, as supply is limited to that having planning permission.
4. The costs of making such arrangements may be too high, and if a large number of people are affected, agreement may be difficult.
5. MSC includes social costs while MC is only private costs. Where there are negative externalities or social costs of congestion, MSC will be greater than MC.
6. a. OD  
b. OC
7. At traffic levels up to OF there are no external costs of congestion. Only after OF do congestion problems and costs occur.
8. a. Parking meters  
b. Public transport  
c. Parking restrictions such as double yellow lines  
d. Free car parks
9. Cost-Benefit Analysis (C.B.A.).
10. Discounting

## Multiple Choice Questions

11. b; 12. d; 13. b; 14. c; 15. a.

## CHAPTER 18 Ans.

1. a. £210,000 (both goods produced and the clean-up expenditure are included in national income calculations).  
b. £190,000 (value of goods produced less pollution costs).

2. Recycle as much waste as possible.
3.
  - a. to protect water supplies from excessive nitrate content
  - b. the water of some areas does not have excessive nitrates
  - c. it is easy to collect and the revenue raised could be spent on remediation measures.
4. To compensate for reduced net output in order to preserve or improve the landscape of the area.
5.
  - a. the 'congestor' pays; the charge can be adjusted to achieve the flow of traffic desired; revenue raised can be used to subsidise public transport.
  - b. administrative costs and difficulties; the tax is regressive for essential motorists.
6. Full production costs are not paid by the firm and consumers obtain the good at a lower price than if the full cost of resources used were paid.
7. Taxation provides an incentive to the firm to invest in pollution-reducing technology (in order to avoid the tax). Regulation by physical controls sets a limit to pollution which may simply continue at that level.
8. The absence of private property rights over the fishing grounds means there is no incentive for individual fishermen to preserve the asset value of the fishery.
9. Low price-elasticity of demand for private cars means that policies to price them off the road, such as congestion charges, are unlikely to work. High income-elasticity of demand for private cars means that their use will increase as incomes rise.
10. It is unlikely that the external benefits of the preservation of the historic building have been taken into account in the decision to put the site to more profitable use and so this is an example of market failure.

#### Multiple Choice Questions

11. b; 12. c; 13. c; 14. d; 15. d.

#### CHAPTER 19 Ans.

1.
  - i. community goods are indivisible, e.g. defence, motorway lighting and free-riders cannot be excluded (non-excludable).
  - ii. collective goods are similarly indivisible, but charging would mean they are not fully used because marginal cost is zero (non-rivalry) e.g. bridges, and so the state provides them from taxation.
  - iii. merit goods, where external costs arise from inadequate consumption, e.g. vaccination, hospital treatment.

iv. Where a project involves widespread externalities e.g. urban renewal , or requires exceptionally large initial costs e.g. new town development or a new airport.

2. Marginal cost (of another listener) is zero, and it would be very difficult to exclude free-riders.

3. It is a merit good; if all provision was left to the private sector it is felt it would be inadequately consumed and there are external benefits of public provision.

4. Privatisation is claimed to:

- reduce state subsidies
- raise revenue for government
- improve the efficiency of the operation
- improve competition in the market
- encourage wider share-ownership

5. Demand is unrelated to costs of provision and so is likely to be very high. This is likely to be wasteful.

6. Unless everyone can afford expensive insurance, poor people would be denied expensive operations and drugs.

7. By limiting supply through waiting lists.

8. Non-rivalry means that, because MC is zero, maximum benefits can only be enjoyed if no charge is made ( $MC=MR=0$ ), the full cost being met by the state from taxation.

9. Any collaboration between public bodies, such as local authorities or central government, and private companies tends to be referred to a public-private partnership (PPP). In trying to bring the public and private sector together, the government hopes that the management skills and financial acumen of the business community will create better value for money for taxpayers.

10. The Private Finance Initiative (PFI) was a creation of the Conservative government in the early 1990s - but it has been enthusiastically embraced by Labour. Governments and local authorities have always paid private contractors to build roads, schools, prisons and hospitals out of tax money. Under PFI, from 1992, contractors pay for the construction costs and then rent the finished project back to the public sector. This allows the government to get new hospitals, schools and prisons without raising taxes. The contractor, for its part, is allowed to keep any cash left over from the design and construction process, in addition to the 'rent' money.

Multiple Choice Questions

11. c; 12. a; 13. a; 14.e; 15.c.

#### CHAPTER 20 Ans.

1. All increase demand for UK labour.
2. All decrease supply.
3. a. wages in terms of the nominal amount received  
b. wages in terms of their purchasing power of goods and services (i.e. after inflation is taken into account).
4. Inelastic – they have few substitutes; inelastic supply of substitutes (non-union electricians); they are a small fraction of the cost of electricity; there is inelastic demand for electricity.
5. Mainly immobility of labour, both occupational and geographical.
6. Skilled workers have a higher marginal revenue product (MRP) and so demand for them is greater. Also, the supply of them is smaller because of the cost of training and the inherent skills required.
7. a. where there is a monopsony employer, wage rate will be less than MRP.  
b. it cannot be applied to the problem of general unemployment  
c. where there is unemployment, a rise in the MRP may lead to increased employment rather than higher wages  
d. where an employer bargains with a trade union, the influence of bargaining power may be stronger than that of MRP.
8. This can lead to a wages spiral and cost-push inflation; it may also cause disputes when the cost of living is falling.
9. The high level of owner-occupation (68%) means that selling and buying are necessary before a move of area, and this can be difficult; also council housing has waiting lists in areas of high employment, so giving up council housing in one area can be problematic.
10. wages of existing workers could rise from  $w$  to  $w_1$ ; or if there is unemployment, the numbers of labourers employed could rise from  $N$  to  $N_1$ .

#### Multiple Choice Questions

11. e; 12.c; 13. b; 14. a; 15. d.

#### CHAPTER 21 Ans.

1. a) £32410  
b) £500
2. Logically, yes because they yield a series of satisfactions to their owners. Practically there are difficulties – and so only owner-occupied houses are included.
3. c, d, e and f but there would be difficulties in estimating their value.
4. Fixed capital is that capital which can be used many times, e.g. till, factory, plough. Working capital is that capital which is used only once because it is

embodied in the finished product, e.g. stocks of consumer goods, fertiliser, seed.

5. Income is a flow of wealth over time; capital is a stock of wealth existing at a given moment in time.

6. No – titles to capital such as share certificates, represent capital in the form of factories, machines etc. which have already been counted.

7. Postponement of present consumption (some form of sacrifice of current consumption is the opportunity cost).

8. The MRP of capital is the addition to revenue or profit that will arise out of an additional unit of investment (capital).

9. As more units of capital are employed, the returns on successive units will fall because of diminishing returns and because as more of the final product is produced, its price will fall.

10. The rate of interest represents the cost of borrowing capital. As long as the marginal revenue product of capital is greater than the rate of interest, it is profitable to invest. Hence investment is carried to the point where the MRP of investment equals the interest rate.

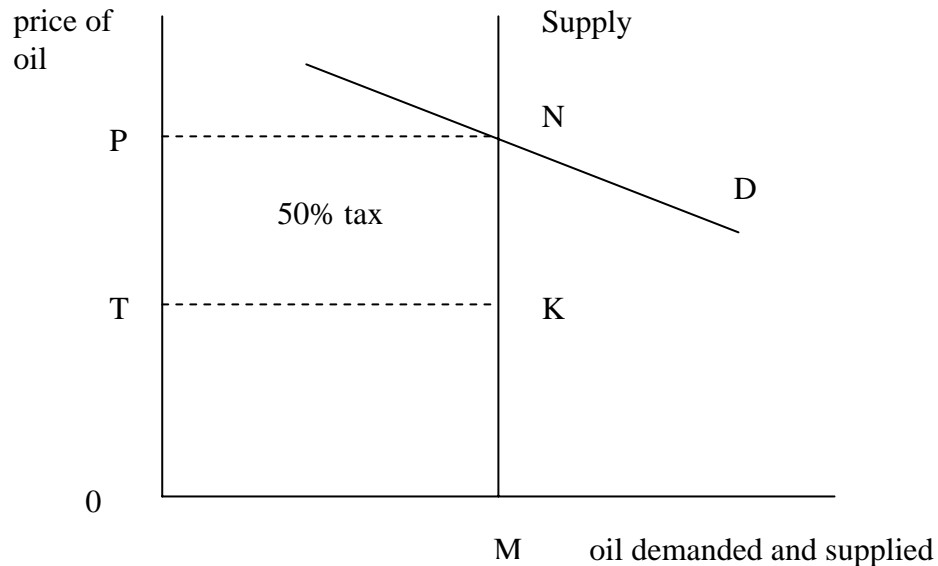
#### Multiple Choice Questions

11. d; 12. a; 13. c; 14.b; 15.e.

#### CHAPTER 22 Ans.

1. Yes – it should (strangely) be classified as land, providing fish, power and a waterway when combined with capital.
2.
  - i. It can be increased with the addition of capital, e.g. fertilising, irrigation, reclamation.
  - ii. It may be decreased by natural causes e.g. flooding, erosion, volcanic eruption.
  - iii. It may be increased by technological discoveries e.g. transport, shorter growing period for wheat.
3.
  - a. £600
  - b. £600
  - c. £480
  - d. If potatoes are £100 per tonne it is £4400; if they are £80 per tonne it is £4520.
4. £99,600
5. Yes – they result from a restriction of supply and are sometimes called 'rent of monopoly'.
6. The tax will not reduce output or supply of that factor.
7. It may be difficult to distinguish how much of the reward is rent and how much is its transfer price.

8. The effect of the tax is simply to reduce the rent received by the owner from OMNP to OMKT. Supply remains unchanged at OM.



9. By building upwards, effectively substituting capital for land.

10. a) BCE  
b) OBEF

#### Multiple Choice Questions

11. d; 12. a; 13. e; 14. c; 15.b.

#### CHAPTER 23 Ans.

1. Any insurable risk.
2. One that can be reduced to a mathematical probability, e.g. a factory may burn down, a cargo may be lost at sea, workers may be injured.
3. One that is due to uncertainties of the market.
4. He/she bears the risk or uncertainty of production.
5. Yes, they are more risky; there is less uncertainty in established industries.
6. Risks are comparatively slight and so rates of profit are low.
7. The rate of expected profit must be high to compensate for the high risk involved.
8. Profit:
  - induces entrepreneurs to accept risks
  - indicates whether an industry should expand or contract
  - encourages firms to increase production

- provides the resources for expansion
  - encourages research, innovation and exploration
  - ensure production is carried out by the most efficient firms
9. Supernormal profits are possible in the long-run in monopoly because competitors can be excluded.
  10. a. Monopoly profits result from deliberate restriction of supply, and represent an economic rent earned at the expense of consumers.  
b. Monopoly profits can stimulate research and allow an industry to expand.

#### Multiple Choice Questions

11. b; 12. a; 13.d; 14. a; 15.c.

#### CHAPTER 24 Ans.

1. Perfect liquidity – it can be spent on anything immediately.
2. The ability to be converted into spending power (cash) quickly and without loss of value.
3. a)7%; b) 2%; c) 5%.
4. There would still be some means of payment, but it would not be cash. In the last resort, debts would be settled by the transfer of bank deposits.
5. No. £960  $[(1000)/12/12.5]$ .
6. a) The difference between the yield on equities and the higher yield on government bonds.  
b) People bid up the price of equities because they have an 'inflation-hedge'.
7. Bank deposits.
8. The desire to hold assets in the form of money rather than in other goods.
9. 'Near money' is any asset which can be converted quickly and easily into money, but which is not counted as part of the money supply e.g. Treasury Bills.
10. The demand for money for speculative purposes will fall because the cost of holding idle balances increases with the rate of interest.

#### Multiple Choice Questions

11. c; 12. a; 13. d; 14. c; 15. b.

#### CHAPTER 25 Ans.

1. Discounting

2. a) rise; b) fall; c) increase.
3. Without such help, Discount Houses could not repay 'call money'. This would undermine the financial system.
4. 'Tap' and 'Tender'.
5. Institutions, such as insurance companies and pension funds, which have funds to purchase bonds and equities.
6. In the inter-bank market, banks borrow and lend large sums of money between themselves. The market serves to smooth out short-term variations in the liquidity positions of different banks.
7. Banks compete to attract funds because these can be on-lent at higher rates of interest than those paid to depositors. The inter-bank market helps to remove surpluses and shortages within the banking system; banks with surpluses lend to banks with shortages.
8. Investment Trusts buy a wide range of securities and so small investors can spread their risk by investing in them.
9. It facilitates borrowing by government and industry; it helps to even-out short-term fluctuations in the price of securities; it advertises security prices; it protects against fraud; it provides a mechanism to raise capital; it reflects economic prospects.
10. The money market deals in short-term loans; the capital market specialises in long-term capital.

#### Multiple Choice Questions

11. e; 12. a; 13. b; 14. e; 15.c.

#### CHAPTER 26 Ans.

1. They can be sent safely through the post; they can be written for any amount; they obviate the need for large sums of money.
2. They permit credit creation when cheques are widely used.
3. Current accounts and deposit accounts.
4. a. A bank deposit is generally acceptable in payment of a debt; hence it acts as money.  
b. An overdraft conveys liquidity and so it is generally acceptable in payment of a debt; hence it acts as money.
5. Treasury Bills are liquid assets; credit creation is now based on liquid assets; a proportion mature each day.
6. Security, profitability and liquidity.
7. Security – they require collateral; profitability – they lend to different types of borrower; liquidity – they lend for different time periods.
8. An asset is liquid to the extent that it can be turned into money a) quickly and b) without loss of value. Securities do not fulfil b), they may have to be sold when the market price has fallen.
9. Funds lent to the Discount Market by the commercial banks at low rates of interest and capable of being 'called back' very quickly e.g. within the hour or by telephone.

10. The shorter the period of a loan, the greater the bank's liquidity, but the less it will earn in interest.

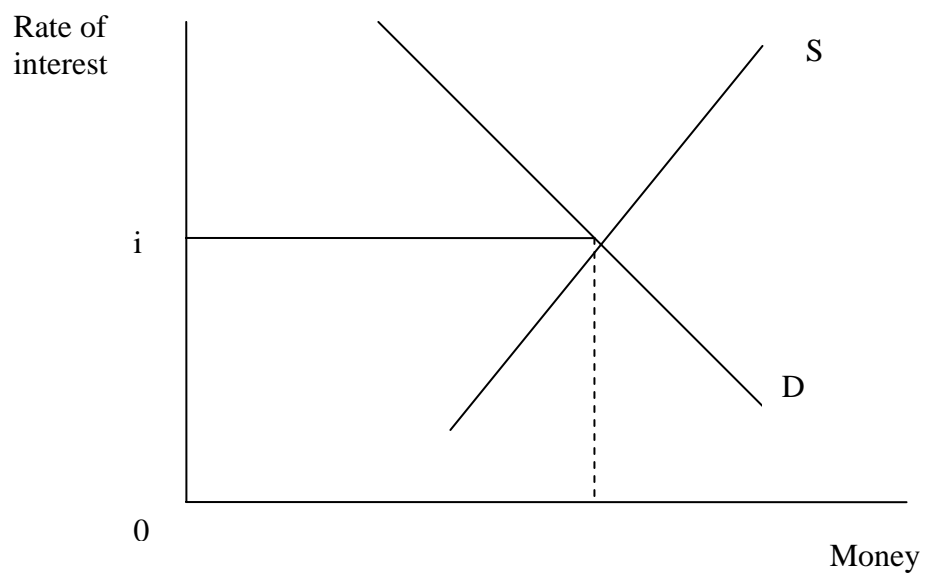
Multiple Choice Questions

11. b; 12. d; 13. a; 14. c; 15. e.

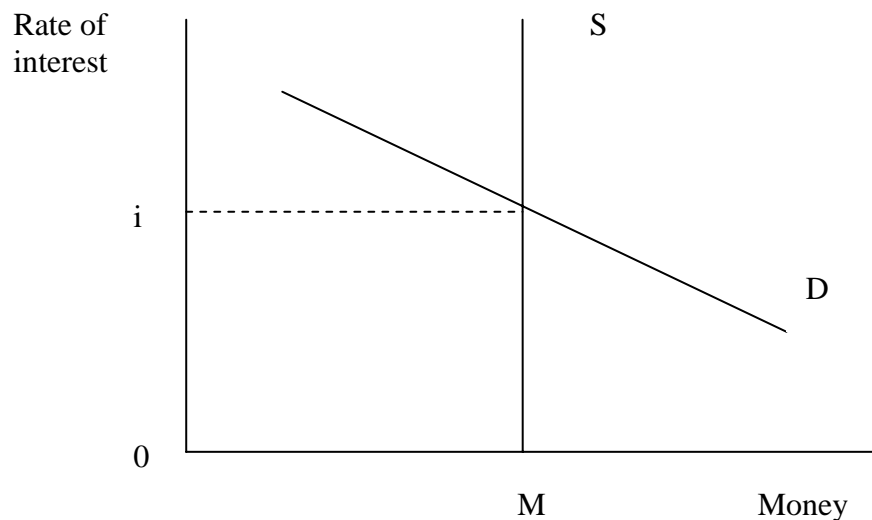
CHAPTER 27 Ans.

1. The institution through which a government operates its monetary policy.
2. To make it more easy or more difficult to borrow money.
3. a. the price of bonds will fall.  
b. the rate of interest will rise.
4. By funding the debt.

5.



6.



7. The rate of interest

8. The Bank of England does the following for the Government:

It keeps the central government accounts;  
It gives overnight 'Ways and Means' advances if the government account goes 'into the red';  
It manages the government's borrowing;  
It advises the government on financial matters.

9. The Bank of England has the following international roles:

It maintains close contact with other central banks and monetary authorities to stabilise international monetary affairs;  
It provides banking services for the central banks of non-sterling countries;  
It participates in the work of certain financial institutions, such as the International Monetary Fund.

10. From May 1997, the Bank of England has had sole operational responsibility for setting interest rates with the specific objective of keeping the rate of inflation within the target set by the government.

Multiple Choice Questions

11. a; 12. b; 13. c; 14. e; 15. b.

CHAPTER 28 Ans.

1. a. +Depreciation (or capital consumption)  
b. +Net property income from abroad  
c. +indirect taxes – subsidies
2.  $b=c-a$ ; or  $c=a+b$
3. a, b, c and e
4. a. £25000m  
b. £23000m
5. a. £2350 m  
b. £2150 m
6. a) 35%  
b) 20%  
c) £1000; £1125  
d) GNP per head increased because the rate of growth of GNP exceeded the rate of growth of population.
7. a) 108  
b) Money GNP rises by 35%, but real GNP rises by only 25%.  
c) GNP per head in real terms rises from £1000 to £1042
8. By reducing investment, or running down capital or by paying for imports with foreign loans.
9. If gross investment is insufficient to cover the depreciation on existing assets, net investment will be negative. In such a case, the country is said to be consuming its capital.
10. Owner-occupied dwellings are classed as part of the nation's stock of productive capital because they produce a flow of services to their owners. The value of these services (i.e. the estimated rent the houses would earn if they were let) must be *imputed* into the national income. A failure to impute a value for these services would create the anomalous situation where the national income would fall if more families bought their own homes.

#### Multiple Choice Questions

11. c; 12. d; 13. a; 14. e; 15.a.

#### CHAPTER 29 Ans.

1. Skills deteriorate; and there are psychological and social effects of not being able to work.
2. Some people are unemployable; there are always people changing jobs; workers can be laid off for a short time when projects are completed.

3. a) decline in shipbuilding and coal;  
b) decline in demand for Lancashire cotton cloth;  
c) decline in demand for ships and coal;  
d) decline in demand for coal.
4. Immobility of labour
- 5.



6. Unemployment is said to occur when persons capable of and willing to work are unable to find suitable paid employment.
7. The real cost of unemployment in economic terms is the lost output that would have been produced if there was no unemployment. All other costs such as benefits and lost taxes are covered by this.
8. There can be a mis-match between skills and vacancies i. e. the unemployed do not have the skills required for the vacant positions.
9. Since the cost of search is often reduced by the payment of unemployment benefit, an appropriate policy response would be to reduce the amount of this payment (the 'replacement ratio') or tighten eligibility criteria. Then the higher cost of search would encourage individuals to accept job offers earlier.
10. The 'replacement ratio' is the ratio between the amount paid in benefit and the previous wage or salary.

Multiple Choice Questions

11. c; 12. c; 13. b; 14. a; 15.a.

#### CHAPTER 30 Ans.

1. a) Stocks of finished goods are depleted  
b) There will be additional investment and employment to increase production.
2. i. When there is full employment  
ii. When the spending is on imports  
iii. When existing machinery can cope with the increased production without additional labour
3. Aggregate demand decreases.
4. NM
5. No MPC is constant (slope of consumption function is constant).
6. Yes
7. No – at low levels of income saving is negative.
8. Saving habits are fairly stable, depending largely on income; investment depends on the volatile expectations of entrepreneurs.
9. £500m
10. Because households may not spend all of their increase in disposable income.

#### Multiple Choice Questions

11. d; 12. a; 13.d; 14. b; 15.e.

#### CHAPTER 31 Ans

1. Other objectives have to be considered e.g. control of inflation.
2. Diminishing returns; bottlenecks in production; accelerating wage increases.
3. Fiscal policy involves budgetary measures, varying government spending and taxation to influence aggregate demand.
4. Monetary policy varies the money supply through the rate of interest or control of liquidity.
5. Features of the economy that slow it down in a boom e.g. income taxes and corporation tax; and that stimulate the economy by boosting demand in a recession e.g. unemployment benefits.

6. Raising funds for government borrowing may involve a higher rate of interest or providing the banks with more liquidity enabling them to expand credit.
7. *Ad valorem* means by value – as the price of goods increases, so does the tax. This means that the tax increases on expensive goods with a high income elasticity of demand. As the economy expands more V.A.T. is paid and so more tax is taken, slowing the expansion.
8. Rational expectations are workers' expectations based on all relevant information – past experience, current statistics, an assessment of the effects of actual or proposed government measures – so that wage adjustments are immediate.
9. Successive boosts to AD eventually led to inflation.
10. i. Market freedom  
ii. Reductions in firms' production costs  
iii. Provide incentives to work and enterprise

#### Multiple Choice Questions

11. a; 12. c; 13. d; 14.e; 15. c.

#### CHAPTER 32 Ans

1. Interest payments are often fixed in money terms; with inflation the real value of those payments declines.
2. Interest payments are reduced in real terms as above, and receipts from taxation increase as money national income rises. This is known as 'fiscal drag'.
3. The yield from the asset is likely to rise in money terms with inflation (its value keeps pace with inflation).
4. a) The balance of payments current account will worsen as exports lose competitiveness and imports gain competitiveness over home-produced goods.  
b) The capital account will worsen as short-term capital moves out as inflation can lead to depreciation/devaluation of the currency.
5. Saving is discouraged because postponing consumption means goods cost more if bought later when prices have risen.
6. If the rate of inflation becomes very high, people refuse to hold money, rushing to spend it before further price increases occur.
7. Interest rates rise, because people require a higher reward for lending money which is falling in value; and because the government is likely to take disinflationary measures such as raising interest rates.
8. In his pre-Budget statement on 10 December 2003, the Chancellor announced that he was switching the definition of the target for UK inflation from the RPIX (retail prices excluding mortgage payments) to the CPI.
9. Although the methodology of the CPI is similar to the RPI there are differences in the way in which it is calculated and the composition of

- the index. For example the CPI excludes housing costs and in particular owner occupiers' costs such as mortgage interest payments.
10. The most serious problems of inflation are: arbitrary redistribution of income, reductions in efficiency and adverse trading conditions.

#### Multiple Choice Questions

11. c; 12. b; 13. a; 14.e; 15. a.

#### CHAPTER 33 Ans

1. When the increased supply of money is matched by an increased supply of goods.
2. When the economy has an AD greater than its full-employment output valued at current prices.
3. From an increase in one of the components of aggregate demand -  
consumer spending  
investment  
government spending
4. Costs are likely to rise if there is full employment because:  
trade unions are in a strong bargaining position  
there are bottlenecks in the supply of factors, especially skilled labour  
less efficient labour is employed  
there is high labour turnover
5. a) The government must take steps to reduce aggregate demand (AD).  
b) It is inappropriate to reduce AD if there is cost-push inflation. This would simply result in unemployment and a reduced rate of growth, while not tackling the real cause of the inflation. The government must therefore analyse the causes of the cost-push. If it comes from wage inflation then policies to address this, such as incomes policy, may be appropriate. If it comes from an increase in import prices, then some deflation of the economy may be appropriate.
6. Demand-pull can lead to cost-push because, as prices rise, workers try to obtain wage increases to compensate for rises in the cost of living. An 'inflationary spiral' may result.
7. A voluntary wage restraint agreement.
8. The rate of inflation (via wage increases) to the rate of unemployment.
9. The rate to which unemployment will tend given the current real wage rate.
10. The real wage rate is higher than that which would clear the labour market when the rest of the economy is in equilibrium. This is because trade unions have obtained a wage increase which exceeds the current rate of inflation.

#### Multiple Choice Questions

11. a; 12. b; 13. c; 14. d; 15.c.

#### CHAPTER 34 Ans

1. Widening: employing more, but similar, capital equipment to maintain the existing capital-labour ratio.

Deepening: occurs when the capital-labour ratio is increased.

2. This occurs because the gains from growth are taken partly in the form of increased leisure – people prefer shorter working hours to increased income.

3. If a constant level of income is redistributed, some people will suffer a loss of income. If there is economic growth, however, a proportionately greater share of the increase in income can be allocated to the lower income groups.

4. The rate of capital accumulation (investment) can only be increased if there is an increase in the rate of saving. The rate of saving can only be increased (in poor countries) if there is an increase in income – but an increase in income requires an increase in investment!

5. With growth, revenue from taxation increases, allowing greater spending on government services without raising *rates* of taxation.

6. As a country develops and standards of living increase, spending switches from agricultural to manufactured goods and later towards services. Since the opportunities for employing more capital and technical improvement are greatest in manufacturing, the growth rate increases as countries industrialise, but slows down later when the economy becomes more service based.

7. Changes in the structure of the economy can lead to some unemployment; environmental costs such as pollution and loss of wildlife habitat; longer working hours and more stress in working life.

8. Technical progress offsets the effects of the law of diminishing returns. By increasing the marginal productivity of capital, technical progress causes the marginal efficiency of capital curve to move upwards.

9. An increase in labour input; development of natural resources; additional investment especially capital deepening.

10. The UK housing market may constrain growth because it reduces mobility of labour. High house prices in growth areas such as the South East mean that moving from areas in relative decline such as South Wales is difficult. Also, because there are waiting lists for council houses in more prosperous areas, the rental sector exacerbates this.

#### Multiple Choice Questions

11. e; 12. b; 13. d; 14. c; 15. a.

## CHAPTER 35 Ans

1. Structural unemployment
2. Immobility of labour
3.
  - i. The particular region's basic industry may be in decline
  - ii. The resources of the region may not be fully developed, usually because of lack of capital
  - iii. The particular region may be endowed with poor natural resources
4. Loss of social capital in the depressed regions; congestion and inflation in the prosperous regions; the multiplier effect worsens these effects.
5. Training in the new skills required by expanding industries and improving entry into certain occupations.
6. Financial assistance toward moving costs, helping with information on opportunities elsewhere, and transport subsidies to work away from home.
7. The government tries to take 'workers to the work' by encouraging labour mobility; and aims to take 'work to the workers' through a variety of schemes including Regional Development Agencies and the New Deal for Communities. In addition the EU operates Assisted Areas schemes providing regional grants.
8. Many fishing areas are badly hit by over-fishing and consequent decline in fishing stocks and unemployment. The Financial Instrument for Fisheries (FIFG) may support projects which modernise the structure of the fisheries sector, and related industries, and encourage diversification of the workforce and fisheries industry into other sectors. It also aims to promote sustainability within the fishing industry by encouraging a balance between fisheries resources and their exploitation.'
9. Yes. The depressed regions of Scotland, Northern Ireland, Southern Italy, Greece etc. are more distant from the expanding heartland of Europe than they are from the centres of their own countries. This EU 'centre' (London, Paris, Bonn, Berlin) forms a concentrated market to which industries are likely to be increasingly attracted, thereby adding to its dominance.
10.
  - i. The *European Regional Development Fund* (ERDF) funds the development and structural adjustment of less-developed regions and declining industrial regions.
  - ii. The *European Social Fund* (ESF) provides funds to organisations running vocational training and job-creation schemes.
  - iii. The *European Agricultural Guidance and Guarantee Fund* (EAGGF) supports farming in less-favoured or environmentally sensitive areas, and the modernisation of infrastructures.

## Multiple Choice Questions

11. e; 12. a; 13.d; 14. c; 15.b.

## CHAPTER 36 Ans

1. a. about 40%  
b. If the government takes more, less is left for private consumption and this can damage incentives to work and enterprise (and the government's chances of re-election).
2. a. A taxation system that is composed of a variety of taxes.  
b. Because different taxes have different attributes and defects.
3. A specific tax is a flat-rate tax; an ad valorem tax is a given proportion of the value of the good/service.
4. a) Proportional  
b) Progressive  
c) Regressive
5. Tobacco, alcohol and motoring.
6. Advantages of direct taxes: high yield; can be made progressive.  
Disadvantages of direct taxes: possible disincentives; encourage avoidance and non-taxable benefits.
7. Advantages of indirect taxes: certain; adjustable to specific policy.  
Disadvantages of indirect taxes: regressive; may dislocate industry.
8. a. mainly the consumer  
b. producer
9. a) income tax  
b) petrol duty  
c) P.A.Y.E. income tax  
d) progressive income tax  
e) inheritance tax  
f) progressive income tax rates on higher incomes
10. If the marginal rate of tax exceeds the average rate, then incentives to work may be affected e.g. working overtime may be discouraged because a higher rate of tax applies.

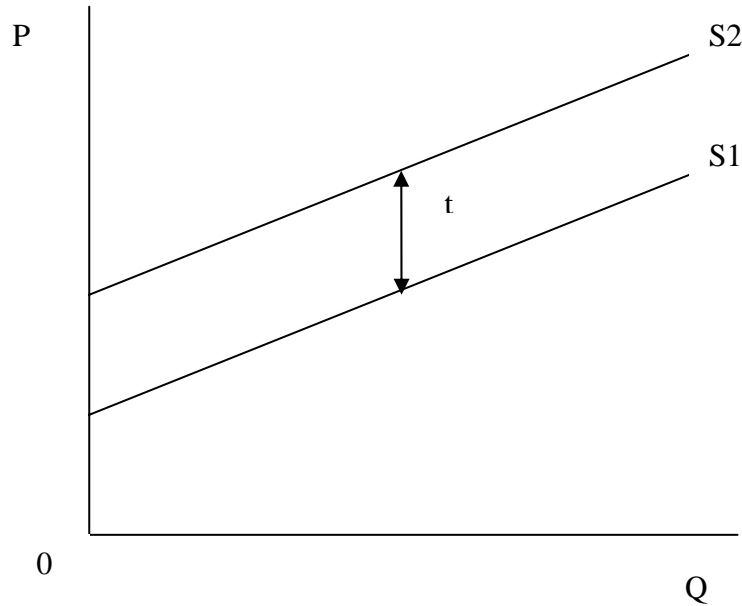
#### Multiple Choice Questions

11. b; 12. a; 13.c; 14.e; 15.d.

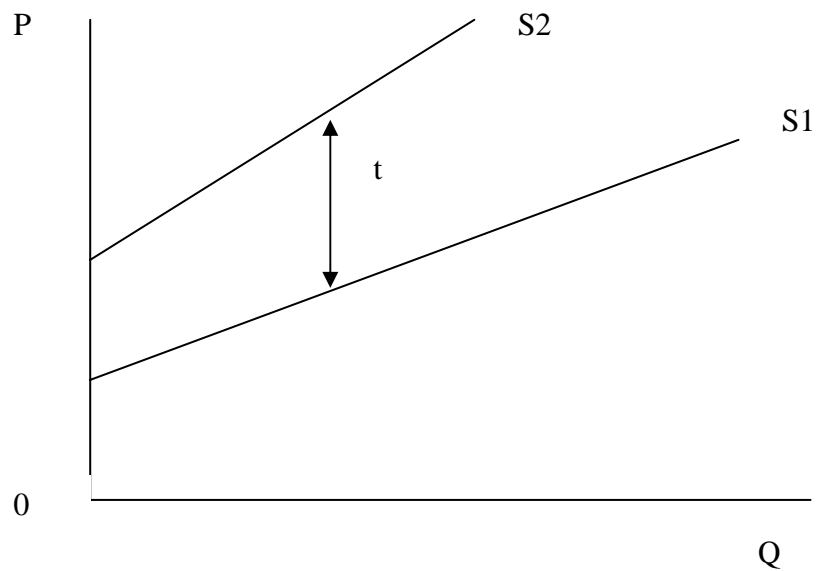
CHAPTER 37 Ans

1. Longer distances involved; currencies usually exchanged; subject to government control; involves crossing frontiers; transport costs and difficulties; differences in languages, weights and measures etc.

2. a)



b)



3. A customs duty is a tax placed on imported goods while similar home goods are untaxed. An excise duty is imposed on home goods and imported

goods alike. Thus a customs duty tends to be protective in nature, while an excise duty is a revenue duty.

4. A quota prevents more than a limited amount e.g. 1000 tonnes of a good, from being imported. The government therefore knows the precise effect on domestic producers who may be affected by the import. If the quota is fixed in value, it can estimate accurately the cost in foreign exchange.

The main arguments against quotas are: i) they interfere with consumer sovereignty, since people cannot purchase the good at all once the quota has been reached, whereas if a tariff is imposed, those who wish to pay the higher price and can afford to, can still buy the good; ii) by the same reasoning, quotas tend to distort the pattern of international trade to a greater extent; iii) other countries retaliate.

5. improve: b,d,e  
worsen: a,c

6. Three main reasons: advantages of trade are lost; retaliation by other countries is likely; protection creates a vested interest and is not easily reversed.

7. They are world wide and multilateral in their operation.

8. If a nation has a high degree of specialisation, it becomes very vulnerable to changes in demand and to technical innovations.

9. If the demand for exports is elastic, total foreign currency earnings will increase (assuming supply of exports is elastic). If the demand for imports is not perfectly inelastic, foreign currency expenditure on imports will fall.

10. The stated aim of the WTO is to promote free trade and stimulate economic growth, but negotiations in recent years have been difficult, frequently failing to reach agreement. Many people argue that free trade does not make ordinary people's lives more prosperous but only results in the rich (both people and countries) becoming richer. WTO treaties have also been accused of a partial and unfair bias toward multinational corporations and wealthy nations.'

#### Multiple Choice Questions

11. c; 12. c; 13. b; 14. e; 15.d.

#### CHAPTER 38 Ans

1. Any payment by a person outside the United Kingdom to a person in the United Kingdom.

2. The terms of trade are the relationship between the price of exports and the price of imports.
3. The balance of trade is the difference between the value of goods exported and the value of goods imported.
4. The balance on current account is the difference between earnings from exports and invisibles and payments for imports and invisibles.
5. The balance of payments is a record of a country's monetary transactions over a period (usually a year) with the rest of the world – it includes both current and capital transactions.
6. a) Balance of payments country X (£million)

#### Current Account

Debit		Credit	
£		£	
Imports	1813	Exports	1529
Invisibles	158	Invisibles	772
Surplus	330		
	<b>£2301</b>		<b>£2301</b>

#### Capital Account

Debit		Credit	
£		£	
Long-term loans	96	Short-term borrowing	97
Investment	131	Investment	146
Aid	40		
Addition to reserves	306		
	<b>£2544</b>		<b>£2544</b>

- b) £284m deficit.
  - c) Surplus £330m.
  - d) Addition £306m.
7. a) Current account has deficit or surplus added to balance each side.  
 b) Overall the balance of payments balances because any differences on current account earning and spending is balanced by capital, including changes in the official reserves.
  8. a) f.o.b. means free on board - i.e. without insurance and freight being

added. It is the cost of the goods when they are placed on the ship or aircraft for transport abroad.

b) c.i.f. – cost, insurance, freight included.

9. a. gain  
b. loss  
c. gain  
d. gain  
e. gain (exports); loss (shipping charge)  
f. loss  
g. loss  
h. gain

10. Private short-term and long-term investment (capital movements); official borrowing from the IMF or foreign central banks; drawing on gold and foreign currency reserves.

#### Multiple Choice Questions

11. a; 12.b; 13.b; 14. c; 15.d.

#### CHAPTER 39 Ans

1. In a highly competitive market, arbitrage operations eliminate any price differences which may temporarily emerge.
2. a, b, d, e, f sterling rises; c, g, h sterling falls.
3. The price of pounds is likely to fall relative to the price of dollars.
4. Rising prices in the UK make her exports less competitive, and increase demand for imports especially of consumer goods. If this leads to a balance of payments deficit, it tends to depreciate the £ sterling, especially if aggravated by speculative capital movements out of sterling. Raising the rate of interest reverses this by a) attracting foreign capital; and b) deflating aggregate demand.
5. a. A reserve currency is one which is widely used as an international liquid asset. Many countries will hold such a currency as an important component of their official reserves.  
b. Normally, the supply of dollars as a reserve currency can only be increased by the USA running balance of payments deficits.
6. a. Special Drawing Rights are an international liquid asset created by the IMF. They are allocated to member countries in proportion to members' quotas.  
b. Supply of SDR's can be increased to by international agreement to keep pace with the growth of world trade. The supply of SDR's is not arbitrary as is the case with a reserve currency.

7. The speculative flows of short-term capital between financial centres. These flows are motivated by a search for higher interest rates and sometimes greater security.
8.
  - i. When interest rates in the country concerned are significantly higher than in other major financial centres;
  - ii. When trade prospects are good, indicating a possible appreciation of the currency;
  - iii. Political and economic uncertainty in other countries.
9. Purchasing Power Parity Theory suggests that in perfectly free markets, the external values of currencies will settle at levels that make the purchasing power of a unit of currency the same wherever it is spent – if £1 = \$2, the £1 in the UK buys the same quantity of goods as \$2 in the US.
10. A capital outflow reduces the foreign currency reserves and enters the balance of payments as a debit item. In future, however, this investment will yield an income as an inflow of foreign currency (a credit in the balance of payments).

#### Multiple Choice Questions

11. d; 12. a; 13. b; 14.c; 15.a.

#### CHAPTER 40 Ans

1. As a sort of 'bank balance' to cover an excess of payments in dollars over receipts.
2.
  - i. Revalue her currency upwards.
  - ii. Liberalise import policy by reducing any protectionist measures.
  - iii. Expand her domestic economy to encourage imports.
  - iv. Lend to the countries with deficits.
3. Unemployment resulting from reduction of home income when deflation is necessary to correct balance of payments deficits.
4.
  - a) no change (in the dollar price)
  - b) they are cheaper because they are priced in pounds which are now cheaper in dollar terms.
5. High home prices encourage imports and discourage exports. This leads to a balance of payments deficit and increased demand for foreign currency relative to home currency.

6. Demand for raw materials to be manufactured into exports is likely to increase.  
Higher home income leads to greater demand for imported goods.
7. a) Elastic demand for imports and exports  
b) No competitive devaluation in retaliation  
c) Elastic supply of exports  
d) Inelastic supply of imports  
e) The depreciation is not thought to be the first of many
8. Corrective action can be expenditure-reducing, which is deflationary and slows down the economy; or expenditure-switching, which attempts to increase the value of exports while reducing the value of imports.
9. a) Raising the short-term rate of interest to reverse the outward flow of short-term capital.  
b) Borrowing from other central banks or the IMF.
10. Buy a) b) d) e) f)  
Sell c) g) h) i).

#### Multiple Choice Questions

11. b; 12. c; 13. a; 14. c; 15e.

#### CHAPTER 41 Ans

1. The EU is a customs union and a common market for its member states. Because the market of the EU is a population of 460 million people, the advantages of specialisation and economies of scale are considerable. The absence of trade barriers within the EU should lead to increased competition and efficiency.
2. Problems associated with the EU include trade diversion away from more efficient suppliers because of the common external tariff, and the enormous cost of the Common Agricultural Policy. There are also claims that political interference by the EU is damaging to individual countries' self-interest.
3. By eliminating customs duties between member countries, it allows trade to flow more freely according to comparative cost advantages.
4. The EU imposes duties against outside countries, thereby hampering trade flows.
5. High prices for agricultural produce are maintained on the home market by imposing duties on cheaper imports from abroad.
6. More wheat has to be bought at the intervention price and stored, and subsequently sold at the lower world market price.
7. Value Added Tax

8. Allocations can be made from the Fund to help Britain's Assisted Areas. Britain should be a major recipient (especially former coalfield areas).
9.
  - a) The target price gives farmers an adequate return.
  - b) The threshold price is used as the basis for assessing the size of import levies.
  - c) The intervention price is the price at which EU agencies buy any output offered by farmers.
10.
  - a) Aircraft, computers, motor vehicles, patent drugs.
  - b) A larger market would enable overheads to be spread over a larger output, thus reducing average cost per unit.

#### Multiple Choice Questions

11.b; 12. a; 13. c; 14. e; 15.c.

#### CHAPTER 42 Ans

1. By increased taxation or borrowing or by creating money.
2.
  - i. less efficient labour is employed
  - ii. decrease in efficiency of plant, management and labour
  - iii. bottlenecks arise
  - iv. trade unions demand higher wages
3. It results in inflationary pressure, a higher rate of interest and a crowding out of private investment.
4.
  - a) By enabling a reduction in the rate of interest consumer demand would be stimulated through lower mortgage repayments and a restoration of confidence in recovery as investment increased.
  - b) Following the devaluation, UK exports are more competitive
5. Imports cost more and this can lead to increased inflationary pressure and an initial deterioration of the balance of payments until exports increase. It could also be that supply of exports could be inelastic because of the UK's reduced manufacturing base.

6. a) Country B has an ageing population
  - b) i. increased dependence of retired persons on workers
  - ii. changing pattern of consumption
  - iii. increasing pressure on social services e.g. hospitals
  - iv. less mobility of labour overall
  - v. a less progressive/dynamic community
7. That food supplies would increase arithmetically (2, 4, 6, 8) while population would increase geometrically (2, 4, 8, 16, 32) and so 'famine, pestilence and war' would result.
8. The 'Dismal Science'.
9. There was greatly increased food supply because of technological developments and imports, and there was a fall in the size of families.
10. a) the UK would be unable to follow an independent economic policy to suit her own domestic conditions.
  - b) directions from the European Central Bank would cover fiscal (taxation) policy as well as monetary.

#### Multiple Choice Questions

- 11.

