

MARKER CODE



Student Personal Identification Number

# South Pacific Form Seven Certificate

## ECONOMICS

### 2017

### QUESTION and ANSWER BOOKLET

**Time allowed:** Three hours

*(An extra 10 minutes is allowed for reading this paper.)*

#### **INSTRUCTIONS**

Write your **Student Personal Identification Number (SPIN)** in the space provided on the top right hand corner of this page.

Answer **ALL QUESTIONS**. Write your answers in the spaces provided in this booklet.

If you need more space for answers, ask the Supervisor for extra paper. Write your SPIN on all extra sheets used and clearly number the questions. Attach the extra sheets at the appropriate places in this booklet.

Major Learning Outcomes (Achievement Standards)	Skill Level & Number of Questions				Weight/ Time
	Level 1 <i>Uni- structural</i>	Level 2 <i>Multi- structural</i>	Level 3 <i>Relational</i>	Level 4 <i>Extended Abstract</i>	
<b>Strand 1: Resource Allocation via the Market System</b> Demonstrate understanding of the key ideas about the operation of the market system, and how decisions are made and their outcome in a modern market economy.	8	6	2	1	30% 76 min
<b>Strand 2: Resource Allocation via the Public Sector</b> Demonstrate understanding of resource allocation via the public sector.	4	3	2	1	20% 52 min
<b>Strand 3: Aggregate Economic Activity and Policy</b> Demonstrate understanding of aggregate economic activities and policies.	6	2	2	1	20% 52 min
<b>TOTAL</b>	<b>18</b>	<b>11</b>	<b>6</b>	<b>3</b>	<b>70% 180min</b>

Check that this booklet contains pages 2-13 in the correct order and that none of these pages is blank.

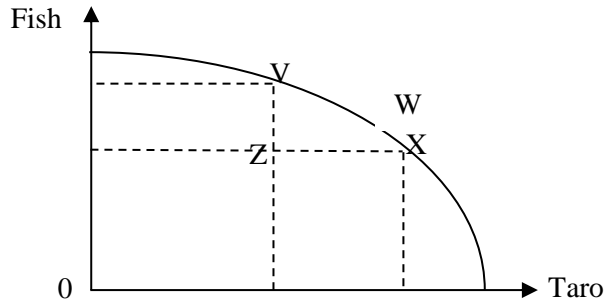
**HAND THIS BOOKLET TO THE SUPERVISOR AT THE END OF THE EXAMINATION.**

**STRAND 1: RESOURCE ALLOCATION VIA THE MARKET SYSTEM**

Answer **ALL** the questions in this section.  
As a guide spend no more than **76 minutes** on this section.

**1.1: Understand the economic problem of scarcity and resource allocation**

**Graph 1. The Production Possibilities Curve for an economy producing fish and taro**



*Assessor's use only*

1.1a	Economists use models in trying to explain economic behavior. State <b>one</b> purpose of the Production Possibilities model.  <hr/> <hr/> <hr/> <hr/> <hr/> <hr/>	<table border="1" style="margin: auto; border-collapse: collapse;"> <tr><th colspan="2">Unistructural</th></tr> <tr><td style="text-align: center;">1</td><td style="width: 20px;"></td></tr> <tr><td style="text-align: center;">0</td><td></td></tr> <tr><td style="text-align: center;">NR</td><td></td></tr> </table>	Unistructural		1		0		NR			
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1.1b	From <b>Graph 1</b> , identify a point that indicates:  (i) Under-utilization of resources: _____	<table border="1" style="margin: auto; border-collapse: collapse;"> <tr><th colspan="2">Unistructural</th></tr> <tr><td style="text-align: center;">1</td><td style="width: 20px;"></td></tr> <tr><td style="text-align: center;">0</td><td></td></tr> <tr><td style="text-align: center;">NR</td><td></td></tr> </table>	Unistructural		1		0		NR			
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1.1c	Describe the shape of the production possibilities curve in <b>Graph 1</b> .  <hr/> <hr/> <hr/> <hr/> <hr/>	<table border="1" style="margin: auto; border-collapse: collapse;"> <tr><th colspan="2">Multistructural</th></tr> <tr><td style="text-align: center;">2</td><td style="width: 20px;"></td></tr> <tr><td style="text-align: center;">1</td><td></td></tr> <tr><td style="text-align: center;">0</td><td></td></tr> <tr><td style="text-align: center;">NR</td><td></td></tr> </table>	Multistructural		2		1		0		NR	
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**1.2: Understand demand and the significance of elasticity of demand to firms**

The information below was supplied by a firm selling two related goods, Good A and Good B.

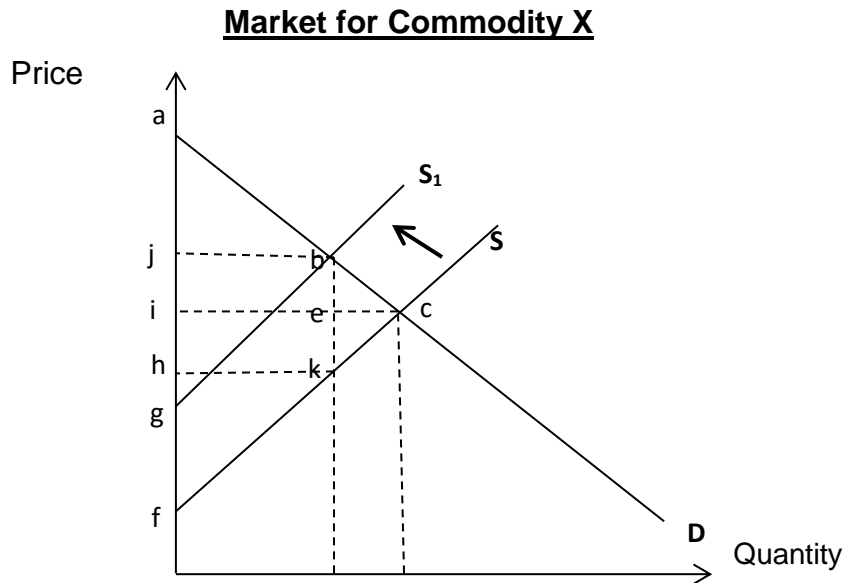
When the price of Good A increased from \$1.00 to \$2.00 the quantity demanded of Good A decreased from 5 units to 3 units and the quantity demanded for Good B increased from 4 units to 6 units.

*Assessor's use only*

1.2a	Define <b>price elasticity</b> of demand.  <hr/> <hr/> <hr/> <hr/>	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <th colspan="2" style="background-color: #cccccc;">Unistructural</th> </tr> <tr> <td style="text-align: center;">1</td> <td style="width: 20px;"></td> </tr> <tr> <td style="text-align: center;">0</td> <td></td> </tr> <tr> <td style="text-align: center;">NR</td> <td></td> </tr> </table>	Unistructural		1		0		NR					
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1.2b	Calculate the <b>cross-elasticity</b> of demand for Goods A and B.  <hr/> <hr/> <hr/> <hr/>	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <th colspan="2" style="background-color: #cccccc;">Multistructural</th> </tr> <tr> <td style="text-align: center;">2</td> <td style="width: 20px;"></td> </tr> <tr> <td style="text-align: center;">1</td> <td></td> </tr> <tr> <td style="text-align: center;">0</td> <td></td> </tr> <tr> <td style="text-align: center;">NR</td> <td></td> </tr> </table>	Multistructural		2		1		0		NR			
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1.2c	Based on your calculation of cross-elasticity of demand above, list factors that affect the relationship between Good A and Good B.  <hr/> <hr/> <hr/> <hr/>	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <th colspan="2" style="background-color: #cccccc;">Multistructural</th> </tr> <tr> <td style="text-align: center;">2</td> <td style="width: 20px;"></td> </tr> <tr> <td style="text-align: center;">1</td> <td></td> </tr> <tr> <td style="text-align: center;">0</td> <td></td> </tr> <tr> <td style="text-align: center;">NR</td> <td></td> </tr> </table>	Multistructural		2		1		0		NR			
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1.2d	Explain how the concept of elasticity will be significant for firms in their pricing decisions.  <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/>	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <th colspan="2" style="background-color: #cccccc;">Relational</th> </tr> <tr> <td style="text-align: center;">3</td> <td style="width: 20px;"></td> </tr> <tr> <td style="text-align: center;">2</td> <td></td> </tr> <tr> <td style="text-align: center;">1</td> <td></td> </tr> <tr> <td style="text-align: center;">0</td> <td></td> </tr> <tr> <td style="text-align: center;">NR</td> <td></td> </tr> </table>	Relational		3		2		1		0		NR	
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### 1.3: Understand the concept of Supply and Market Equilibrium

**Graph 2.** The graph below shows a loss of allocative efficiency due to a decrease in supply of Commodity X.



*Assessor's use only*

- 1.3a The shift in supply will affect equilibrium.  
On **Graph 2** above, use an arrow to show how the shift in supply affects equilibrium price.

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- 1.3b Write the letters that represent the new producer's surplus.

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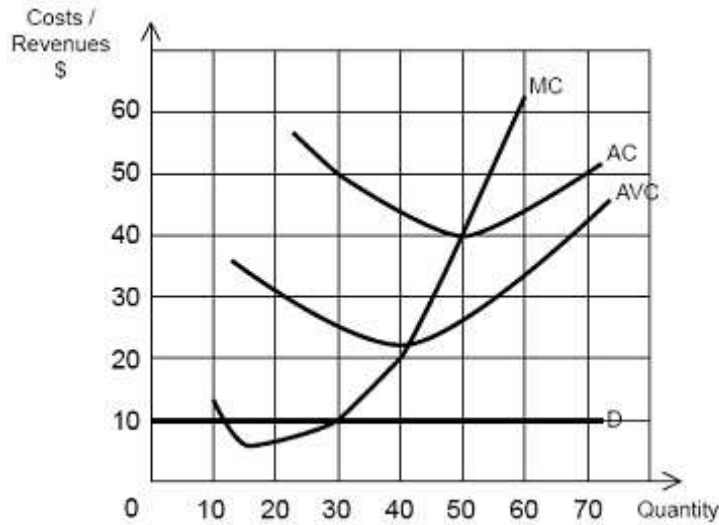
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- 1.3c On **Graph 2** above, shade the area representing the loss of allocative efficiency resulting from the change in market equilibrium.

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1.4: Derive a competitive firm's supply curve

**Graph 3.** The graph below shows the cost curves for a perfectly competitive firm.



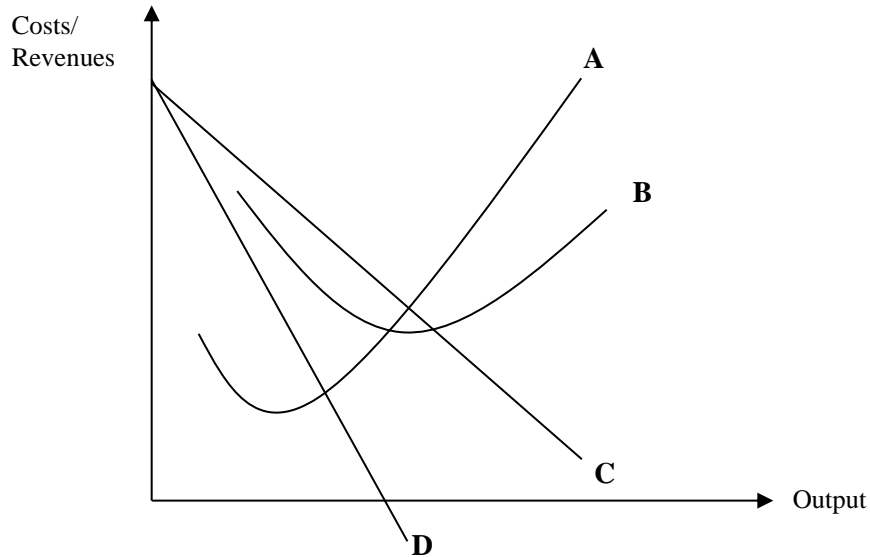
*Assessor's use only*

<p>1.4a</p>	<p>Define <b>marginal cost</b>.</p> <hr/> <hr/> <hr/> <hr/>	<table border="1"> <tr> <th colspan="2">Unistructural</th> </tr> <tr> <td>1</td> <td></td> </tr> <tr> <td>0</td> <td></td> </tr> <tr> <td>NR</td> <td></td> </tr> </table>	Unistructural		1		0		NR			
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<p>1.4b</p>	<p>Describe the link between the firm's supply curve and its marginal cost curve.</p> <hr/> <hr/> <hr/> <hr/>	<table border="1"> <tr> <th colspan="2">Multistructural</th> </tr> <tr> <td>2</td> <td></td> </tr> <tr> <td>1</td> <td></td> </tr> <tr> <td>0</td> <td></td> </tr> <tr> <td>NR</td> <td></td> </tr> </table>	Multistructural		2		1		0		NR	
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<p>1.4c</p>	<p>From the graph above (<b>Graph 3</b>), identify the:</p> <p>(i) level of output at the shutdown point: _____</p> <p>(ii) break-even price: _____</p>	<table border="1"> <tr> <th colspan="2">Unistructural</th> </tr> <tr> <td>1</td> <td></td> </tr> <tr> <td>0</td> <td></td> </tr> <tr> <td>NR</td> <td></td> </tr> </table>	Unistructural		1		0		NR			
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<p>1.4d</p>	<p>A perfectly competitive firm makes normal profit in the long run. Define <b>normal profit</b>.</p> <hr/> <hr/> <hr/>	<table border="1"> <tr> <th colspan="2">Unistructural</th> </tr> <tr> <td>1</td> <td></td> </tr> <tr> <td>0</td> <td></td> </tr> <tr> <td>NR</td> <td></td> </tr> </table>	Unistructural		1		0		NR			
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**1.5: Demonstrate an understanding of the role of firms in a market economy**

For many years, telephone services in a country were provided by a single producer. Because they owned the telephone lines needed to provide the service, and it was uneconomical for other firms to erect new telephone poles and cables, the firm was able to maintain its monopoly position.

**Graph 4. A Monopoly Firm**



*Assessor's use only*

1.5a	From <b>Graph 4</b> above, identify the average revenue curve for the monopolist.  Curve _____	<table border="1" style="width: 100%; border-collapse: collapse; text-align: center;"> <tr style="background-color: #cccccc;"><th colspan="2">Unistructural</th></tr> <tr><td style="width: 20px;">1</td><td style="width: 20px;"></td></tr> <tr><td>0</td><td></td></tr> <tr><td>NR</td><td></td></tr> </table>	Unistructural		1		0		NR							
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1.5b	On <b>Graph 4</b> above identify the monopoly firm's long-run price (label it $P_m$ ) and output (label it $Q_m$ ). Discuss the application of the long-run equilibrium position for the monopolist above.  _____ _____ _____ _____	<table border="1" style="width: 100%; border-collapse: collapse; text-align: center;"> <tr style="background-color: #cccccc;"><th colspan="2">Extended Abstract</th></tr> <tr><td style="width: 20px;">4</td><td style="width: 20px;"></td></tr> <tr><td>3</td><td></td></tr> <tr><td>2</td><td></td></tr> <tr><td>1</td><td></td></tr> <tr><td>0</td><td></td></tr> <tr><td>NR</td><td></td></tr> </table>	Extended Abstract		4		3		2		1		0		NR	
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1.5c	State <b>one</b> feature of a monopoly market.  _____ _____ _____	<table border="1" style="width: 100%; border-collapse: collapse; text-align: center;"> <tr style="background-color: #cccccc;"><th colspan="2">Unistructural</th></tr> <tr><td style="width: 20px;">1</td><td style="width: 20px;"></td></tr> <tr><td>0</td><td></td></tr> <tr><td>NR</td><td></td></tr> </table>	Unistructural		1		0		NR							
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## STRAND 2: RESOURCE ALLOCATION VIA THE PUBLIC SECTOR

Answer **ALL** the questions in this section.  
As a guide spend no more than **52 minutes** on this section.

### 2.1: Explain market failure as a basis for government intervention

Classical economists believed that if left alone, the free market will operate like an **invisible hand** that allocates scarce resources to their most efficient use, hence will maximize society's well-being.  
Many economists have since challenged the classical viewpoint that an economy would work well if there is no government intervention. These economists argued that, in a number of ways, markets fail.

*Assessor's use only*

2.1a	Define <b>market failure</b> .  _____  _____  _____  _____  _____	<table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th colspan="2" style="text-align: center;">Unistructural</th> </tr> </thead> <tbody> <tr> <td style="text-align: center;">1</td> <td style="width: 20px;"></td> </tr> <tr> <td style="text-align: center;">0</td> <td></td> </tr> <tr> <td style="text-align: center;">NR</td> <td></td> </tr> </tbody> </table>	Unistructural		1		0		NR			
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2.1b	Name <b>two</b> factors that can cause market failure. (i) _____  _____  (ii) _____  _____	<table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th colspan="2" style="text-align: center;">Multistructural</th> </tr> </thead> <tbody> <tr> <td style="text-align: center;">2</td> <td style="width: 20px;"></td> </tr> <tr> <td style="text-align: center;">1</td> <td></td> </tr> <tr> <td style="text-align: center;">0</td> <td></td> </tr> <tr> <td style="text-align: center;">NR</td> <td></td> </tr> </tbody> </table>	Multistructural		2		1		0		NR	
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2.1c	List ways in which government can intervene to correct market failure.  _____  _____  _____  _____	<table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th colspan="2" style="text-align: center;">Multistructural</th> </tr> </thead> <tbody> <tr> <td style="text-align: center;">2</td> <td style="width: 20px;"></td> </tr> <tr> <td style="text-align: center;">1</td> <td></td> </tr> <tr> <td style="text-align: center;">0</td> <td></td> </tr> <tr> <td style="text-align: center;">NR</td> <td></td> </tr> </tbody> </table>	Multistructural		2		1		0		NR	
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2.1d	Describe <b>two</b> features of mixed goods. 1. _____  _____  2. _____  _____	<table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th colspan="2" style="text-align: center;">Multistructural</th> </tr> </thead> <tbody> <tr> <td style="text-align: center;">2</td> <td style="width: 20px;"></td> </tr> <tr> <td style="text-align: center;">1</td> <td></td> </tr> <tr> <td style="text-align: center;">0</td> <td></td> </tr> <tr> <td style="text-align: center;">NR</td> <td></td> </tr> </tbody> </table>	Multistructural		2		1		0		NR	
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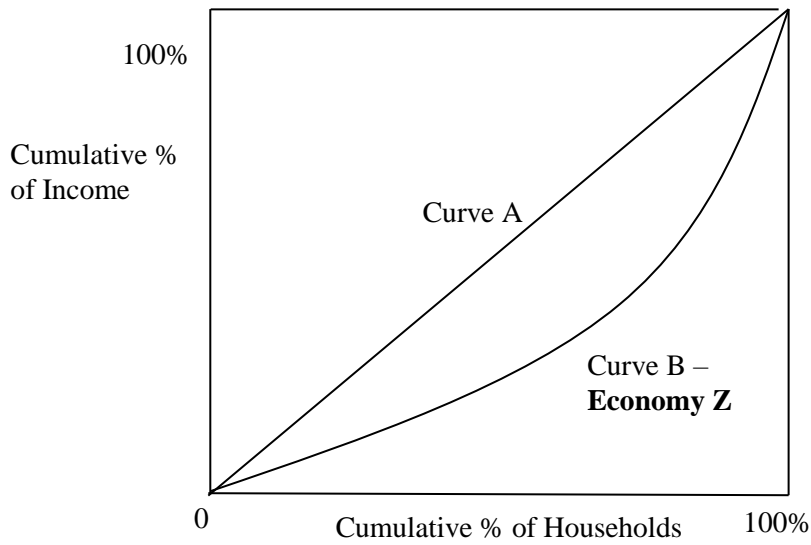
<p>2.1e(i)</p>	<p>The existence of natural monopolies such as the telephone industry may result in market failure.</p> <p>Define <b>natural monopoly</b>.</p> <hr/> <hr/> <hr/> <hr/>	<table border="1"> <tr> <th colspan="2">Unistruclural</th> </tr> <tr> <td>1</td> <td></td> </tr> <tr> <td>0</td> <td></td> </tr> <tr> <td>NR</td> <td></td> </tr> </table>	Unistruclural		1		0		NR							
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<p>2.1e(ii)</p>	<p>Natural monopolies may be regarded as socially undesirable.</p> <p>Discuss the implications of natural monopolies on an economy and evaluate why they may be socially undesirable.</p> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/>	<table border="1"> <tr> <th colspan="2">Extended Abstract</th> </tr> <tr> <td>4</td> <td></td> </tr> <tr> <td>3</td> <td></td> </tr> <tr> <td>2</td> <td></td> </tr> <tr> <td>1</td> <td></td> </tr> <tr> <td>0</td> <td></td> </tr> <tr> <td>NR</td> <td></td> </tr> </table>	Extended Abstract		4		3		2		1		0		NR	
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<p>2.1e(iii)</p>	<p>Natural monopolies can be influenced by government regulations. Explain <b>one</b> appropriate way in which government could intervene in the telephone industry, in order to increase economic efficiency.</p> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/>	<table border="1"> <tr> <th colspan="2">Relational</th> </tr> <tr> <td>3</td> <td></td> </tr> <tr> <td>2</td> <td></td> </tr> <tr> <td>1</td> <td></td> </tr> <tr> <td>0</td> <td></td> </tr> <tr> <td>NR</td> <td></td> </tr> </table>	Relational		3		2		1		0		NR			
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2.2: Explain inequality of wealth using the Lorenz Curve

Graph 5.

Lorenz Curve for Economy Z



Assessor's use only

2.2a

What does the above graph reflect on the distribution of income in Economy Z?

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2.2b

Curve A is known as the Line of Absolute Equality. Define **equality** with reference to income distribution.

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2.2c

Identify **one** way in which the government can achieve greater equality.

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**STRAND 3: AGGREGATE ECONOMIC ACTIVITY AND POLICY**

Answer **ALL** the questions in this section.  
As a guide spend no more than **52 minutes** on this section.

**3.1: Describe the role of the Reserve Bank and the implementation of monetary policy**

3.1a	Define <b>monetary policy</b> .  <hr/> <hr/> <hr/> <hr/> <hr/> <hr/>	<i>Assessor's use only</i>  <table border="1" style="width: 100%; border-collapse: collapse; text-align: center;"> <tr style="background-color: #cccccc;"> <th colspan="2">Unistructural</th> </tr> <tr> <td style="width: 20px;">1</td> <td style="width: 20px;"></td> </tr> <tr> <td>0</td> <td></td> </tr> <tr> <td>NR</td> <td></td> </tr> </table>	Unistructural		1		0		NR	
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3.1b	Describe the function of the Reserve Bank in the implementation of monetary policy.  <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/>	<table border="1" style="width: 100%; border-collapse: collapse; text-align: center;"> <tr style="background-color: #cccccc;"> <th colspan="2">Multistructural</th> </tr> <tr> <td style="width: 20px;">2</td> <td style="width: 20px;"></td> </tr> <tr> <td>1</td> <td></td> </tr> <tr> <td>0</td> <td></td> </tr> <tr> <td>NR</td> <td></td> </tr> </table>	Multistructural		2		1		0		NR	
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The diagram below shows how the definitions of money supply  $M_1$ ,  $M_2$  and  $M_3$ , relate to each other.

**Diagram 1**

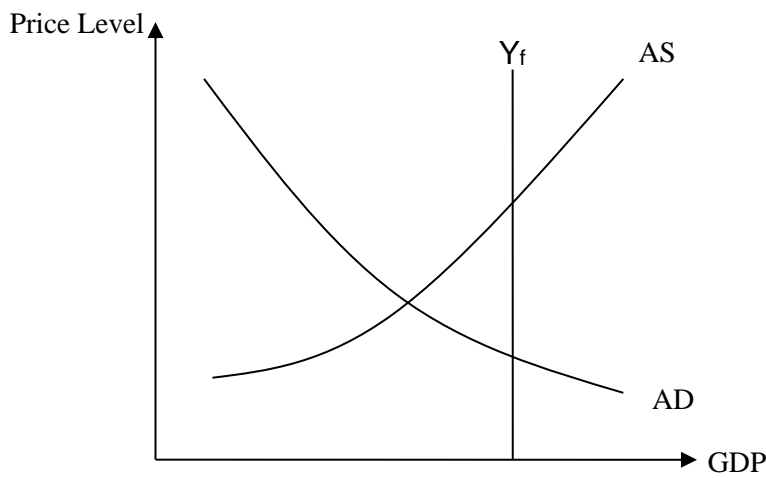
3.1c	Which definition of money supply is also known as the narrow money supply and comprises notes and coins held by the public plus transactions account deposits kept in financial institutions?  <hr/> <hr/> <hr/>	<i>Assessor's use only</i>  <table border="1" style="width: 100%; border-collapse: collapse; text-align: center;"> <tr style="background-color: #cccccc;"> <th colspan="2">Unistructural</th> </tr> <tr> <td style="width: 20px;">1</td> <td style="width: 20px;"></td> </tr> <tr> <td>0</td> <td></td> </tr> <tr> <td>NR</td> <td></td> </tr> </table>	Unistructural		1		0		NR	
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**3.2: Demonstrate understanding of the impact of fiscal policy**

A South Pacific economy, Economy Y had experienced economic depression over the last decade.

Use the Aggregate Demand/Aggregate Supply model below to show the economy in equilibrium below full employment.

**Graph 6. Aggregate Demand and Aggregate Supply curves for Economy Y**



*Assessor's use only*

<p>3.2a</p>	<p>Define <b>aggregate supply</b>.</p> <hr/> <hr/> <hr/> <hr/> <hr/>	<table border="1"> <tr> <th colspan="2">Unstructural</th> </tr> <tr> <td>1</td> <td></td> </tr> <tr> <td>0</td> <td></td> </tr> <tr> <td>NR</td> <td></td> </tr> </table>	Unstructural		1		0		NR	
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<p>3.2b</p>	<p>Define <b>fiscal policy</b>.</p> <hr/> <hr/> <hr/> <hr/>	<table border="1"> <tr> <th colspan="2">Unstructural</th> </tr> <tr> <td>1</td> <td></td> </tr> <tr> <td>0</td> <td></td> </tr> <tr> <td>NR</td> <td></td> </tr> </table>	Unstructural		1		0		NR	
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<p>3.2c</p>	<p>On <b>Graph 6</b> above, identify the equilibrium level of prices (label it <math>P_L</math>) and employment (label it <math>Y_e</math>).</p>	<table border="1"> <tr> <th colspan="2">Unstructural</th> </tr> <tr> <td>1</td> <td></td> </tr> <tr> <td>0</td> <td></td> </tr> <tr> <td>NR</td> <td></td> </tr> </table>	Unstructural		1		0		NR	
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<p>3.2d(i)</p>	<p>Economy Y is experiencing a recessionary gap. Suggest <b>one</b> fiscal policy that can be used by government to eliminate the recessionary gap.</p> <hr/> <hr/> <hr/>	<table border="1"> <thead> <tr> <th colspan="2">Unistructural</th> </tr> </thead> <tbody> <tr> <td>1</td> <td></td> </tr> <tr> <td>0</td> <td></td> </tr> <tr> <td>NR</td> <td></td> </tr> </tbody> </table>	Unistructural		1		0		NR					
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<p>3.2d(ii)</p>	<p>Explain the effect on the price level as a result of the fiscal policy mentioned in <b>Q3.2d(i)</b> above.</p> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/>	<table border="1"> <thead> <tr> <th colspan="2">Relational</th> </tr> </thead> <tbody> <tr> <td>3</td> <td></td> </tr> <tr> <td>2</td> <td></td> </tr> <tr> <td>1</td> <td></td> </tr> <tr> <td>0</td> <td></td> </tr> <tr> <td>NR</td> <td></td> </tr> </tbody> </table>	Relational		3		2		1		0		NR	
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**3.3: Demonstrate understanding of the credit creation process and the role of banks in the process**

A banking system elects to hold 20% of deposits as Reserves. Assume that the Government increases a budget deficit by \$200 million.

*Assessor's use only*

3.3a	Describe the operation of the credit multiplier. <hr/> <hr/> <hr/> <hr/>	<table border="1"> <tr><th colspan="2">Multistructural</th></tr> <tr><td>2</td><td></td></tr> <tr><td>1</td><td></td></tr> <tr><td>0</td><td></td></tr> <tr><td>NR</td><td></td></tr> </table>	Multistructural		2		1		0		NR					
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3.3b	Explain how the credit multiplier works to increase money supply in this banking system. Show working to support your answer. <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/>	<table border="1"> <tr><th colspan="2">Relational</th></tr> <tr><td>3</td><td></td></tr> <tr><td>2</td><td></td></tr> <tr><td>1</td><td></td></tr> <tr><td>0</td><td></td></tr> <tr><td>NR</td><td></td></tr> </table>	Relational		3		2		1		0		NR			
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3.3c	Discuss the role that commercial banks play in the process of credit creation. <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/>	<table border="1"> <tr><th colspan="2">Extended Abstract</th></tr> <tr><td>4</td><td></td></tr> <tr><td>3</td><td></td></tr> <tr><td>2</td><td></td></tr> <tr><td>1</td><td></td></tr> <tr><td>0</td><td></td></tr> <tr><td>NR</td><td></td></tr> </table>	Extended Abstract		4		3		2		1		0		NR	
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