

X038/701

NATIONAL
QUALIFICATIONS
2009

TUESDAY, 26 MAY
9.00 AM – 11.15 AM

ECONOMICS
ADVANCED HIGHER

You should answer Section A and **two** questions from Section B.

The marks for each question are shown in the margin.



SECTION A

Read the following passage, and then answer the questions which follow on *Page three*.

The weakness of sterling

The foreign exchange value of a nation's currency is an indicator of the health of its economy. In November 2008, the pound fell to its lowest level against the US dollar for 6 years. Further, its **trade weighted index at 80·6** was at its lowest level for 13 years.

- 5 It seemed that international investors were passing judgement on the UK economy. The decision made by the Bank of England to cut interest rates from 4·5% to 3% and the sharp rise in UK government borrowing triggered movements of “**hot money**”.

- 10 The fall in sterling's value also stemmed from a structural weakness in the UK's trading position. The UK has had a persistent current account deficit for many years.

- A fall in sterling's value may be good news for some parts of the UK economy. Competitiveness should improve, provided that firms do not take the opportunity to improve profit margins. It is thought that a 4% fall in the exchange rate has a
15 similar effect to a 1% cut in interest rates. Some commentators believe that a falling pound is the best way to revive an economy during a recession.

- Private individuals may view the fall in sterling's value with mixed feelings. Jobs might be safer, but they may face a decline in living standards. When a continued fall in sterling's value leads to “**a run on the pound**”, the deflationary effects of
20 the recession may be negated. Some firms may face difficulty meeting overseas orders because of capacity limits and problems in securing investment funding.

Whilst a rising or a falling pound is not necessarily good or bad for the economy, instability will undermine already fragile business confidence.

The information in the passage reflects the economic position in November 2008.

	<i>Marks</i>
1. Explain what is meant by the following terms as used in the passage.	
(a) Trade weighted index at 80·6.	2
(b) “A run on the pound”.	1
2. (a) Describe what is meant by the term “hot money”.	1
(b) Explain why movements of “hot money” might be triggered by cuts in UK interest rates and increases in government borrowing.	2
3. (a) Outline the structural weakness in the UK trading position.	2
(b) Explain how it is possible to run a persistent current account deficit.	3
4. (a) Explain the possible benefits to the UK economy of a fall in the value of sterling during a recession.	3
(b) Explain how a 4% fall in the exchange rate has a similar effect to a 1% cut in interest rates for the UK economy.	2
(c) Describe how a UK firm might improve its profit margin when sterling is falling in value.	2
5. Explain how UK living standards might be affected by a fall in sterling’s value.	3
6. Explain why a fall in sterling’s value might not result in improvements in the UK’s trading position and economic performance.	4
	(25)

[Turn over for Section B

SECTION B

Attempt TWO of the six questions set.

Each question carries 25 marks.

1. In recent years, the BRIC countries (Brazil, Russia, India and China) have experienced very rapid rates of economic growth.
 - (a) Discuss reasons for the economic success of the BRIC countries. **10**
 - (b) Examine the problems of other developing countries which prevent them from achieving the economic success of the BRIC countries. **8**
 - (c) Explain how current global economic problems may limit the economic prospects of all developing countries in the next 2 years. **7**

2. In 2008, because of “the credit crunch”, the world appeared to be facing its most severe economic crisis for over 50 years.
 - (a) Outline the causes of “the credit crunch”. **8**
 - (b) Describe the measures that have been taken in the UK and elsewhere to address “the credit crunch”. **10**
 - (c) Discuss the effectiveness of these measures in overcoming “the credit crunch”. **7**

3. Climate change represents “the greatest and widest ranging market failure ever seen”. (The Stern Review, The Economic of Climate Change, October 2006).
 - (a) Explain, with the aid of a diagram, why the external costs from climate change lead to market failure. **8**
 - (b) Discuss ways in which this type of market failure can be addressed. **9**
 - (c) Evaluate the problems encountered when attempting to make markets more responsive to the consequences of climate change. **8**

4. The current recession in the UK economy is the first in over 15 years.
 - (a) Discuss the reasons why the UK economy moved into recession in 2008. **7**
 - (b) Explain how monetary, fiscal and supply side policies can be used to overcome a recession. **12**
 - (c) Discuss factors that limit the effectiveness of these policies. **6**

5. Monopoly and oligopoly firms are often considered to be inefficient in their use of economic resources.
- (a) Explain why monopoly can be inefficient both in technical (productive) and allocative terms. (Diagrams must be used to support your answer.) **7**
 - (b) Discuss how monopoly may result in an efficient use of economic resources. **6**
 - (c) Describe the policies that have been used by the UK and the EU to limit monopoly and oligopoly abuse of power. **6**
 - (d) Assess the effectiveness of the measures taken to limit monopoly and oligopoly abuse of power. **6**
6. The UK has had a growing public sector deficit in recent years.
- (a) Describe the circumstances in which it can be considered acceptable to run a budget deficit. **8**
 - (b) Discuss the possible harmful consequences for the UK of a growing public sector deficit. **10**
 - (c) Compare the UK's public sector deficit and national debt with those of other developed countries. **7**

[END OF QUESTION PAPER]

ACKNOWLEDGEMENTS

Section B Question 3—Quote is taken from *The Stern Review, The Economic of Climate Change, October 2006*. © Crown Copyright.

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