

X038/701

NATIONAL
QUALIFICATIONS
2011

MONDAY, 23 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*.

Demand and Supply in the Labour Market

Market theory is expected to apply to factor markets in a similar way to its application to product markets. However, there is extensive evidence in the UK economy to suggest that the operation of this theory in the labour market is ineffective.

In market theory the price of labour should adjust to market conditions. However, even
5 during a recession some wages can continue to rise and labour shortages remain despite
high levels of unemployment. Since the demand for labour is a **derived demand** this
would appear to contradict market theory. Many economists blame **inflexibility in
the labour market** for this apparent contradiction. The Organisation for Economic
Co-operation and Development (OECD) has suggested that, whilst money wages may
10 react strongly to price rises, there is little response in money wages to rising levels of
unemployment. In addition, the introduction of a minimum wage in the UK did not lead
to the rapid rise in unemployment anticipated by some people, but it may have distorted
labour market efficiency.

During this recession, unemployment has risen less than anticipated due to improved
15 labour market flexibility such as reduced working hours. The continued existence of a
large pool of long-term unemployed workers, at the same time as shortages persist in some
labour markets, indicates that progress has been limited. The longer individuals are out
of the labour market the harder it becomes to find employment. In recent years inward
migration from newer member states of the European Union (EU) has also had a significant
20 impact on the UK labour market.

It has been suggested that the mismatch between workers and jobs occurs because the
labour force lacks mobility and because there may be a lack of incentive to enter or re-enter
the labour market. The housing market is also a major impediment to labour mobility and
contributes to the large variations in unemployment throughout the UK.

1. Explain what is meant by the following as used in the passage.
 - (a) Derived demand (line 6).
 - (b) Inflexibility in the labour market (lines 7–8). 2

 2. For what reasons might money wages react strongly to price rises, but weakly to rising unemployment? 2

 3. Explain reasons, other than reduced working hours, why unemployment did not rise as much as anticipated during the recent recession. 3

 4. Suggest reasons why those in long-term unemployment might find it hard to re-enter the labour market. 3

 5. Discuss the positive and negative consequences of migration from the rest of the European Union (EU) to the UK on the UK economy. 4

 6. (a) Use a diagram to show how the introduction of a national minimum wage may cause unemployment. 2
 - (b) Explain why, in practice, the introduction of the national minimum wage did not lead to a sharp rise in UK unemployment. 3

 7. Explain why the housing market is an impediment to labour mobility. 2

 8. Changes to the benefits system have been proposed by the UK Government to increase the rate of participation in the labour market. Discuss how these changes could improve the efficiency of the UK economy. 4
- (25)**

[Turn over for Section B]

SECTION B

Attempt TWO of the six questions set.

Each question carries 25 marks.

1. "Oligopolistic markets have become more common and dominant in many UK industries."
 - (a) Explain, using diagrams if appropriate, why oligopoly is often characterised by "price stability". 9
 - (b) Occasionally a "price war" will break out between competing businesses in such markets. Discuss the consequences of a price war for firms and for consumers in such markets. 6
 - (c) Outline the current framework of Competition Policy in the UK and evaluate how effective it has been in recent years. 10

(25)

2. The UK Government's Comprehensive Spending Review announced the biggest cuts in public sector expenditure since the Second World War.
 - (a) Describe the main proposals contained in the Comprehensive Spending Review. 4
 - (b) Explain the Government's reasons for announcing such large-scale cuts in its spending. 6
 - (c) Explore the possible negative consequences for households and for the UK Economy of the Government spending cuts. 8
 - (d) Discuss why the Government has chosen to put most of its policy emphasis on cutting public sector expenditure rather than increasing taxation. 7

(25)

3. Even with inflation expected to remain well above target, the Monetary Policy Committee (MPC) has been persistently split as to whether monetary policy should be tightened or loosened.
 - (a) (i) Explain the arguments which have been made to justify raising interest rates.
 - (ii) Explain the arguments which have been made to justify keeping interest rates low. 9
 - (b) Explain how Quantitative Easing is expected to influence the UK economy. 7
 - (c) Discuss why some economists believe that monetary policy was relatively ineffective in helping the UK economy recover from recession. 9

(25)

4. “Despite different causes, the sovereign debt crises in Greece and Ireland have led to major strains on these economies and the Euro.”
- (a) Identify the causes of the sovereign debt crises in Greece and in Ireland. 10
- (b) Explain why the sovereign debt crisis has imposed strains on the Euro. 6
- (c) Some economists believe that membership of the Euro is the cause of Greece’s and Ireland’s inability to tackle their problems. Discuss this view. 9
- (25)
5. Despite slow growth in much of the developed world, the emerging economies such as China and India have been growing rapidly.
- (a) One of the major causes of China’s high rate of growth is an “undervalued currency”. Explain how this might have contributed to its growth. 6
- (b) Explain, using examples, reasons (other than an undervalued currency) why emerging economies have been enjoying economic success. 9
- (c) Examine the problems facing some developing countries which prevent them from achieving similar growth rates. 10
- (25)
6. At the end of 2010, the UK Government announced that tuition fees are to be raised for students undertaking Higher Education in England. These are to be funded by student loans.
- (a) Explain the economic arguments which can be used to justify graduates contributing to the cost of their higher education. 6
- (b) Many believe that the social benefits of educating students far outweigh the private benefits and therefore government subsidy is justified.
- (i) Discuss the private and social benefits of higher education. 8
- (ii) Draw a diagram to show the divergence between the private and social benefits and show the positive externality of higher education. 5
- (c) A “graduate tax” has been proposed as an alternative to the current system of “student loans”.
- Describe the advantages and disadvantages of these alternatives. 6
- (25)

[END OF QUESTION PAPER]

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